Hogan Lovells

Marketing funds to EU investors after 22 July 2014

Are you prepared?

July 2014

The Alternative Investment Fund Managers Directive

If you are a fund manager based outside the EU, are you prepared?

Summary

The Alternative Investment Fund Managers Directive (the "Directive") is part of a new suite of complex rules that will apply to any fund manager that manages funds in the EU[1] or markets funds in the EU[2].

The Directive came into force on 22 July 2013 but non-EU fund managers have been able to rely upon transitional provisions in certain EU member states for the last 12 months to allow them to continue marketing without complying with the Directive.

These transitional provisions fall away as of 22 July 2014, and now non-EU fund managers who wish to market any fund to investors based in the EU must comply with the fundamentally revised legal regime under the Directive.

Penalties for a failure to comply can be severe but vary from EU member state to EU member state – for example, in the UK "unlawful marketing" may amount to a criminal offence and investors may reclaim their invested money as well as compensation for any losses sustained - so it is critical that non-EU managers understand and adhere to these new rules.

This booklet sets out a brief overview of the new rules, together with details of how Hogan Lovells can help ensure that non-EU managers are able to comply with them.

Objective

The Directive establishes a common EU regulatory approach to the oversight of managers of "alternative investment funds", such as debt, private equity, venture capital, real estate, hedge and infrastructure funds and investment companies (and the like).

The purpose of the Directive is to subject all managers ("AIFMs" or "managers") of alternative investment funds ("AIFs" or "funds") to much more stringent legislation if they:

- manage an AIF (wherever domiciled) in the EU; and/or
- market an AIF (wherever domiciled) in the EU or to any person domiciled or with a registered office in the EU ("EU investors").

Strictly speaking, the Directive applies to the AIFMs and not to the AIFs themselves. However, many of the requirements will in practice impact materially on the AIFs.

Scope

An AIF is defined as:

- a collective investment undertaking that
- raises capital from a number of investors
- with a view to investing that capital in accordance with a defined investment policy for the benefit of those investors.

There are only a very limited number of *de minimis* and other exemptions, meaning that a very wide range of fund managers will be caught.

While managed accounts for one investor only, family offices and joint ventures are excluded, most traditional pooled investment vehicles will be treated as AIFs.

[1] For ease of reference, the term "EU" as used in this memorandum includes Norway, Iceland and Liechtenstein, which together with the 28 member states of the European Union, form the European Economic Area.

[2] With the exception of EU retail mutual funds established under the UCITS Directives, as these funds are not caught by the Directive.

From 22 July 2014, all non-EU managers must comply with the new rules to market their funds to EU investors, as the transitional provisions that managers may have been relying upon fall away

Impact

Even managers and funds that are both based outside the EU will be caught by the Directive if the fund is "marketed" in the EU or to EU investors.

Under the Directive these funds will only be capable of being marketed to EU investors in an EU member state where the following requirements are met:

1. The relevant EU member state allows private placement to investors in their territory and the marketing activity in that EU member state complies with relevant private placement laws in that state (i.e. the continued marketing of funds will subject to the local laws of each EU member state).

2. Neither the non-EU country where the fund is domiciled, nor (if different) the non-EU country where the manager is established, must be on the FATF's "blacklist" of non-cooperative countries. (The United States is not on that blacklist.)

3. There must be a supervisory cooperation agreement in place between the regulator of the home EU member state(s) of each investor and the regulator(s) of the non-EU country in which the fund (and, if different, the manager) is located. (To date, the United States has concluded agreements with 29 of the 31 regulators, i.e. all except Croatia and Slovenia.)

4. The manager must comply with "operational" rules in certain of the key areas covered by the Directive. These are:

- initial and on-going reporting and notification obligations to regulators in each EU member state where the relevant AIF is marketed;
- transparency and investor disclosure rules (annual reports, initial and on-going investor disclosures); and
- private equity rules (notification of control of certain unlisted EU companies and rules preventing asset stripping).

If any of these requirements are not met, the relevant fund will only be able to be accessed by EU investors by way of "reverse solicitation" (and then only subject to any relevant reverse solicitation rules in the EU member state concerned).

Reverse solicitation

While the Directive seeks to regulate the marketing of funds in the EU, it does not prevent reverse enquiries – that is to say, promoting a fund at the initiative of the potential investor is not considered as "marketing" for the purpose of the Directive. This was a hard-won concession that is designed to help the larger, more sophisticated EU investors to continue to access "best in breed" funds globally.

Where a manager is unable to use private placement as its route to market – e.g. because a relevant target EU member state has prohibited private placement, or because the manager is unwilling or unable to comply with the operational rules referred to above – reverse solicitation may be the only lawful method of accessing capital from EU investors.

What do non-EU managers need to do?

While non-EU managers have no control over each EU member state's private placement rules, there are three key steps that they should take as a matter of urgency if they intend to market funds in the EU or to EU investors (and they should cease all EU marketing activities prior to obtaining the necessary advice):

- review carefully the details of the operational rules they will have to comply with (noted above) to assess if there are any rules that pose a particular problem (e.g. many non-EU managers are concerned regarding the requirement to disclose the remuneration and, where relevant, carried interest paid to senior management and relevant staff members);
- review the new private placement laws with respect to each EU member state in which they intend to market their fund and explore whether the *de minimis* provisions will apply; and
- notify/register the fund with the regulator in each such EU member state in accordance with local law requirements (which will vary depending on whether the *de minimis* provisions apply and may take several months in certain cases) prior to commencing marketing.

Caution should be taken regarding what activities constitute "marketing" a specific fund in an EU member state under the Directive (as distinct from undertaking general promotional activities) given that different EU member states have adopted varying interpretations of this term. Since a number of requirements become applicable upon commencement of "marketing", non-EU managers should seek advice prior to commencing any dialogue with potential investors as this could constitute (unlawful) marketing.

Future development

The Directive put in place a framework to extend the marketing passport that currently allows EU managers with EU funds to market freely throughout the EU to non-EU funds and non-EU managers approximately two years after implementation (i.e. in mid-2015). Following this, the Directive contemplates that the passport and private placement regimes will co-exist for three years (i.e. until mid-2018) and thereafter the private placement regimes are intended to be phased out and be replaced by the passport alone. However, both the adoption of the passport and the phasing out of national private placement regimes are dependent on certain conditions being satisfied, including the European Securities and Markets Authority issuing an opinion on the functioning of the marketing passport for EU managers and an assessment of the private placement regimes.

How can Hogan Lovells help?

All non-EU managers who wish to market funds in the EU or to EU investors need to take legal advice promptly in order to ensure that they understand the new regulatory reporting and investor disclosure requirements and do not breach the new rules.

Hogan Lovells has a leading global investment funds team, with EU based funds practitioners in France, Germany, Italy, Luxembourg, Netherlands, Poland, Spain and the UK. We are therefore extremely well placed to advise non-EU managers on compliance with these new rules, and to help managers to assess the implications for their businesses and make any necessary regulatory filings. Contact details are set out overleaf.

Key points

- The Directive will have a material impact on alternative investment funds marketed in the EU or to EU investors even if both the manager and the fund are established outside the EU.
- Under the Directive, non-EU funds can be marketed in the EU or to EU investors on a private placement basis, but only to the extent this is permitted by the EU investor's home member state and only if all conditions for private placement are satisfied. Even so, the regulatory reporting, investor transparency and various private equity provisions in the Directive will also apply.
- If the conditions for private placement are not fulfilled, EU investors can only invest in non-EU domiciled/managed funds on a reverse solicitation basis (at the investors' initiative) and then only in compliance with the laws of their home member state.

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