Revised proposals for new AIFMD marketing rules: how might they impact non-EU funds and their managers?

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Back in March 2018 the European Commission announced a proposal for a supplementary Alternative Investment Fund Managers Directive (AIFMD) focussed on the subject of so-called "pre-marketing" of private equity and other alternative investment funds to European professional investors. (See our previous newsflash here.)

By way of reminder:

- Currently, AIFMD only regulates “marketing” to such investors, and not “pre-marketing”.
- The boundary between the two concepts is extremely important, because many EU countries have imposed additional barriers in relation to “marketing” and managers don’t want to have to comply with the relevant requirements unless they have a reasonably good prospect of securing a commitment from an investor located in the relevant country.
- The 'catch', of course, is that the only way a manager can assess how good its chances are is by testing the market beforehand - so the ability to “pre-market” is essential to avoid significant wasted time and expense.
- The boundaries in relation to pre-marketing are set unilaterally by each country in relation to its own territory. However, in many cases there is very little guidance and so the position is uncertain (and how far to push things becomes a risk-based judgment for each manager).
- In other cases there is some formal guidance on pre-marketing but it is so restrictive that managers have tended simply to cut the relevant jurisdiction out of their marketing plans. This is bad for investors in the more conservative jurisdictions as they are currently being denied access to many high-performing funds.

The Commission’s proposal introduces a uniform definition of pre-marketing across the whole of the EU. However, in its original version it was based on the approach that has evolved in member states such as Germany, which is more restrictive and less pragmatic than what is currently permitted in countries such as the UK. However, the proposal has now been revised, and is now much closer to the current UK position such that, for example, draft documents could be provided and detailed fund terms discussed.

On the face of it, this is excellent news. However, a closer read reveals several potential bumps in the road that managers need to be very alive to when planning their next fundraise:
• Under the proposal, any "communication...on investment strategies or investment ideas...in order to test [the investors’] interest in a [fund] which is not yet established" would be expressly caught within the scope of pre-marketing. In view of the new requirements that will apply to pre-marketing in future (see below), it will be essential to adopt a pragmatic and common sense approach here, so that this only captures overtly promotional activity, that is specifically in relation to a particular proposed fund (and not, for example, more general discussions about markets and possible fund strategies that managers would typically have with their clients as part of any normal relationship meeting).

• Strictly speaking, the proposed new rules only apply to EU managers promoting EU funds. Ever since AIFMD first went live, there has been only modest harmonisation of the rules in relation to non-EU managers. EU member states have always had (and many have utilised) the ability to impose additional requirements of their own on top of the baseline requirements set out in Article 42 of AIFMD. Unsurprisingly, there is no overt change to this position in the Commission’s latest proposals. What this means is that it is open to any EU member state to apply a more restrictive definition of pre-marketing to a non-EU manager than to an EU manager. We don’t think this will happen in practice, but it is nevertheless important for non-EU managers to remember that the good aspects of the proposed definition of pre-marketing would not automatically benefit them.

• However, that is not the real sting in the tail. Of much greater concern to non-EU managers are the requirements in the Commission’s proposal in relation to:
  o Notification of pre-marketing activity, and
  o Reverse solicitation.

The proposal expressly bars EU member states from adopting a regime that is more advantageous for non-EU managers than for EU managers. So, when the domestic legislation is implemented in each country, we can expect that the position for non-EU managers will be the same as (or potentially worse than) the new rules for EU managers. As a result, the issues we explain below in relation to notification of pre-marketing activity and restricting use of reverse solicitation should be looked at very carefully by all non-EU managers.

Notification of pre-marketing activity

Paradoxically, but very cleverly, the EU authorities are actually using the liberalisation of pre-marketing to exert much greater control over pre-marketing. The way they propose to achieve this is by requiring the manager to notify its home regulator whenever it starts pre-marketing in another EU country. It’s not clear in the proposal how this mechanism would be applied to a manager whose home regulator is outside the EU, but on paper this would represent a sea-change for non-EU managers as they can currently pre-market without any EU regulatory monitoring at all. Crucially, it provides a means for the local regulator to obtain a lot more information regarding which managers are promoting fund products in their territory, and it also will help them to police the more restrictive new rules on reverse solicitation (see below).
**Reverse solicitation**

Under the proposed new rules, a subscription made within an 18 month period of pre-marketing activity will be deemed to have resulted from marketing (i.e. rendering reliance on reverse solicitation impermissible). It has always been the case that a manager cannot (lawfully) use preliminary marketing activities in relation to a fund in order to, in effect, solicit a reverse enquiry from an investor. However, an 18 month moratorium is a very long period indeed.

The other key issue with the moratorium is that it is unclear whether it applies to each investor or to each country. The drafting is very loose, and one reading of it (which we have seen several market commentators adopting) would imply that any pre-marketing in one country would put all investors in that country offside for 18 months as regards the possibility of reverse solicitation. Such an outcome would seem perverse, since in the world of private funds it is perfectly possible for one investor in Munich genuinely to reach out to a manager on its own initiative without having any prior knowledge of very discreet, one-to-one promotional activity that the same manager may coincidentally have engaged in with an investor 800km away in Hamburg (and even more so where the discussion in Hamburg took place 17 months before the discussion in Munich).

**Conclusion**

Although the current patchwork of pre-marketing rules presents some major challenges for fund managers and their placement agents, currently they are at least able to take a business decision based on facts and circumstances (overlaid with some legal advice). However, if/once the proposed definition of pre-marketing becomes written in law it will be much harder to take a pragmatic view.

Moreover, the "carrot" of a permissive UK-style approach to defining the boundary between pre-marketing and marketing has unfortunately been tied to three "sticks", namely (i) an extremely broad definition of what could amount to pre-marketing, (ii) a requirement to notify the regulator as soon as any pre-marketing commences, and (iii) what amounts, in effect, to a clampdown on the use of reverse solicitation.

The EU legislative process in relation to the proposal is not yet complete (e.g. it still has to be signed off by the European Parliament), however the current expectation is that it will be approved and that the new regime will go live around the summer of 2021. Thankfully this means that managers currently on the fundraising trail should not be affected, but funds setting out to raise money from 2020 onwards will need to factor this into their planning.

**Impact of Brexit**

As always, we also need to consider whether Brexit would change the position for (pre)marketing by UK managers or to UK investors, assuming that post-Brexit the UK would not be part of the
single market.

As regards UK-headquartered managers seeking to market their funds in continental Europe, of course many larger managers will probably be doing so through their fund platforms and affiliated businesses in Ireland and/or Luxembourg, in which case the new EU rules would apply anyway. For UK domiciled funds sold into continental Europe that are managed by a UK manager, the manager would need to comply with the proposed new EU rules in just the same way as a U.S. manager would.

As regards promotional activity directed at UK investors, it is extremely unlikely that a more restrictive regime would be adopted than the one set out in the EU's proposal. It is more likely that the UK would either adopt a similar approach, or alternatively decide to operate a more permissive regime (e.g. as currently, not requiring any notification of pre-marketing) and thereby make it easier for US and Asia based managers to market their funds to UK investors than to EU investors. The actual approach will in practice be determined at a political level, depending on whether the UK government decides to seek a long-term, reciprocal access deal for financial services with the EU based on equivalence (i.e. very close alignment to the EU single market) or a clean-break from the single market. Watch this space – but don’t hold your breath!

If you would like further information on the implications of these proposed changes for your next fundraise the Hogan Lovells European funds team would be delighted to help.

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