Further Delay Likely Before the AIFMD Marketing Passport Is Extended to Non-EU Jurisdictions

STEVEN WHITTAKER AND ANNA MALEVA-OTTO, SCHULTE ROTH & ZABEL

ESMA's further advice published on 12 non-EU countries

The European Securities and Markets Authority ('ESMA') published[1] its first set of advice to the European Parliament, the Council and the Commission in July 2015 on the extension of the AIFMD marketing passport to six non-EU countries (Guernsey, Hong Kong, Jersey, Switzerland, Singapore and the United States).

ESMA has for the past 12 months continued its country-by-country assessment of the potential extension of the AIFMD marketing passport and published its second set of advice on 19 July 2016 on the application of the passport to 12 non-EU countries, comprising the original six and six new ones: Australia, Bermuda, Canada, Cayman Islands, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Switzerland, Singapore and the United States.

The marketing passport is currently only available to alternative investment fund managers ('AIFMs') and alternative investment funds ('AIFs') established in the EU. A passport allows such an AIFM to market its AIFs freely across the European Economic Area ('EEA') without the need to register the AIFs under the national private placement regimes in each EEA country. The marketing passport can only be extended to non-EU AIFMs and non-EU AIFs once the relevant EU legislation allowing such passport has been adopted.

Positive advice on five countries

ESMA has now concluded that no significant obstacles exist to the extension of the passport to the following five countries: in the July 2015 advice: Guernsey, Jersey and Switzerland; and in the July 2016 advice: Canada and Japan.

No decision yet regarding seven countries

ESMA has given qualified advice and raised concerns as to some issues in respect of the remaining seven countries: Australia, Bermuda, Cayman Islands, Isle of Man, Hong Kong, Singapore and the United States. ESMA has also confirmed that it proposes to assess a further 10 non-EU countries, and work on these has not yet commenced.

United States

ESMA concluded that that there are no significant obstacles to the extension of the passport to the United States regarding the investor protection and monitoring of systemic risk criteria. However, ESMA raised concerns as to obstacles in the areas of market disruption and competition and advised that, if the passport were to be granted to US AIFMs and AIFs, the EU legislators may wish to consider making it available on a limited basis to certain types of funds only, and suggested three options for achieving this:

- Granting the AIFMD passport only to those US funds dedicated to professional investors to be marketed in the EU by managers not involving any public offering;
- Granting the AIFMD passport only to those US funds which are not mutual funds (under the Investment Company Act of 1940); or
- Granting the AIFMD passport only to those US funds which restrict investment to professional investors as defined in AIFMD.

At some point, the likelihood is that the passport will be granted to US AIFMs/AIFs probably with one of the above limitations attached. This is unlikely to be problematic for the vast majority of US managers who typically market their funds on a private placement basis.

Cayman Islands

ESMA concluded that that there are no significant obstacles to the extension of the passport to the Cayman Islands regarding the competition and market disruption criteria. However, with respect to investor protection and the effectiveness of enforcement and the monitoring of systemic risk ESMA concluded that:

- No definitive advice can be provided until the final version of Cayman's proposed AIFMD-like regime is available.
- No definitive advice can be provided until certain legislative amendments are adopted in the Cayman Islands.

ESMA has seen drafts of Cayman's AIFMD-like regime and has confirmed that it 'seems to show that the new AIFMD-like regime would be broadly similar to the AIFMD framework'.

Whilst ESMA's advice states that it may take 12 to 18 months for Cayman to address the points raised, there is little doubt that they will be addressed, and most Cayman practitioners do not expect it to result in a 12- to 18-month delay — a more likely timeframe is by the end of 2016 at the latest.

Relevance and impact on managers

EU managers who market Cayman funds will not be able to take advantage of the third country marketing passport until ESMA has issued its final advice in respect of the Cayman Islands and the legislative act extending the passport to the Cayman Islands AIFs has been adopted and takes effect.

For US managers who manage and offer Cayman funds, it is worth remembering two things:

- The passport cannot be used in respect of a Cayman fund until it has been granted to both the country of the AIFM (the United States) and to that of the AIF (the Cayman Islands). If, for example, the passport were granted to the United States before it is granted to the Cayman Islands, a US AIFM could exercise it either in respect of a US fund (e.g., Delaware) or an EU fund.
- Use of the passport will require a US AIFM to become authorised in a 'Member State of Reference' under AIFMD and to comply with the full requirements of the AIFMD regime; something which very few managers will in practice be prepared to do.

Conclusions

Further delay is likely. ESMA moves slowly and has again (as it did last year in July 2015) invited the European Commission, Council and Parliament to consider waiting until ESMA has delivered positive advice on a 'sufficient' number of non-EU countries before introducing the passport. It is unclear what 'sufficient' means, but five out of 22 may not be enough.

The next step is for the European Commission to decide. The decision whether to grant the passport only to a small number of non-EU countries (or to wait longer) rests with the European Commission. Whilst it is not known at this stage what the Commission will decide to do, it is again faced with positive ESMA advice in respect of a very small number of countries (five this year, compared to three last year when it chose to wait).

United States and the Cayman Islands. Whilst some issues have been raised in the advice so far, there do not appear to be any immovable obstacles to the grant of the passport and this is, in our opinion, likely to happen — a question of when, not if.

Status quo and private placement rules continue in the interim. Cayman Islands and other non-EU funds can, where that is desired, continue to be marketed without access to the AIFMD passport under the relevant national private placement regimes in the EU. This will continue at least until 2018 when the continued availability of the national private placement regimes will be considered. ESMA has not made any comments in its latest advice about ending the national private placement regimes early, although it remains an open question whether and when they will end.

Benefits of the passport. The benefits of the passport will be: (a) greater certainty and freedom in the way in which managers can interact with their EU prospects and investors (as compared to the constraints on such behaviour when operating on a reverse inquiry basis and the different geographic interpretations of, and grey areas associated with, reverse inquiry); and (b) greater marketing reach since it will confer a clear legal right to market a fund actively in all EU member states and will mean that some EU countries which are currently effectively 'closed' (such as France, Spain and Italy) and do not allow the active marketing of non-EU funds will become open to active marketing. Once the passport becomes available, managers will however have to weigh whether its benefits will outweigh the detriments of having to comply with the full requirements of the AIFMD regime. **THFJ**

Schulte Roth&Zabel
New York | Washington DC | London | www.srz.com

1. See our 3 August 2015 Alert, 'AIFMD Update: ESMA Advice on Extension of Marketing Passport Published'.