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PERSPECTIVES

MARKETING ALTERNATIVE FUNDS IN EUROPE: A CHANGED LANDSCAPE

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Recent regulatory reforms have changed the way in which private funds are being offered to European investors. The Alternative Investment Fund Managers Directive (AIFMD) became law across the EU during 2013 and 2014, and the new Swiss regime is due to come fully into force on 1 March 2015.

Regulation of marketing in the EU

The AIFMD regulates marketing by alternative investment fund managers (AIFMs), or others on their behalf, of investments in alternative investment funds (AIFs), regardless of their investment strategy, structure or underlying investments. The marketing restrictions apply whenever a fund is being offered *at the initiative* of the AIFM, or on its behalf, to an investor domiciled or with a registered office in an EU country. Offers of managed accounts, single investor funds (subject to certain conditions) and UCITS funds remain outside the scope of the AIFMD and its marketing restrictions. However, some EU jurisdictions (such as Ireland) do not accept that

single investor funds are out of scope, and the domestic Irish fund rules regulate them as if they are AIFs with AIFMs. In contrast, Malta and the United Kingdom treat them as out of scope.

AIFMD and national private placement regimes

AIFMD requirements when marketing occurs. Each EU member state has amended its private placement regime to incorporate the minimum elements of the marketing regime set out in the AIFMD. For non-EU AIFMs, the obligations, which are triggered by marketing in the EU, now include compliance with prior and ongoing investor disclosure requirements, regulatory reporting (Annex IV reporting), certain disclosures in the AIF's annual accounts and the private equity provisions in AIFMD (which include disclosure obligations and prohibitions on asset stripping). EU AIFMs are required to file an Annex IV report whether or not they market their funds in the

EU, but marketing in the EU also triggers a further requirement that the AIF appoints a depositary.

Different member state approaches. EU member states are not required to have national private placement regimes, and some member states have decided not to allow AIFMs that do not have access to the AIFMD marketing passport to market funds in their jurisdiction. Other member states (such as France) have effectively restricted their private placement regimes to offers of closed-ended funds, precluding the marketing of offshore hedge and other open-ended funds.

Prior notice, approval or fund registration? EU regulators have taken different approaches to the procedure that must be followed before marketing can occur. Some (such as in the United Kingdom, Luxembourg and the Netherlands) only require a simple notice to be given that the AIFM proposes to market; others (such as in Finland, Sweden and Norway) require that prior approval of the regulator is obtained before marketing occurs; and others (such as in Denmark and Germany) go even further and require that the AIF itself go through a lengthy registration process before marketing can occur, a process that can take two to four months to complete. Denmark and Germany have also included additional 'gold-plating' by requiring the AIF to appoint a depositary (which is not otherwise required where the AIFM is non-EU).

Different approaches to disclosure and reporting. A degree of variation also exists in individual country approaches to the investor disclosure and regulatory reporting requirements of the AIFMD. These include a requirement for an AIFM to produce additional disclosure supplements (such as in Sweden). As regards Annex IV reporting, some EU regulators (such as in the United Kingdom) have issued guidance confirming that non-EU AIFMs only need to report feeder-level information with no look-through to the positions of the master fund. Other EU regulators (such as in Germany and Sweden) have indicated that they would expect separate Annex IV reports to be submitted in respect of both a feeder fund and its master fund.

The new Swiss regime

The new regime segments Swiss investors into three categories: (i) unregulated qualified investors (pension plans, corporates, family offices, family trusts and high-net-worth individuals); (ii) regulated qualified investors (regulated financial entities such as banks, securities dealers, fund managers and insurance companies); and (iii) non-qualified investors (effectively retail).

Under the new regime, investment managers who expect to be distributing their funds to unregulated qualified investors in Switzerland will be required to have their funds appoint a Swiss-licensed representative and a Swiss bank as a paying agent, and the manager must enter into a distribution agreement with the appointed Swiss representative.

The new Swiss regime is much less onerous than the AIFMD marketing rules, since it does not require prior notice to, or approval from, the Swiss regulator. There is no equivalent of Annex IV reporting and the disclosure requirements are much simpler.

New approaches to marketing in Europe

In recent months, a number of new approaches to European marketing have emerged among investment managers.

Who is marketing and where? So far, only a small number of non-EU AIFMs are making individual country filings to market under the private placement regimes. The most popular countries for such filings are, in order of popularity, the United Kingdom, the Netherlands, Finland, Sweden and Norway. The least popular are Denmark and Germany.

A significant proportion of UK managers who are AIFMs are currently not marketing and are relying on reverse inquiry.

Whilst it is still too early to tell, it is likely that many more managers will choose to market their funds into Switzerland and, where required, comply with the new Swiss requirements to appoint a representative and paying agent.

AIFM platforms. A small number of non-EU managers are using AIFM platforms, which are typically structured as an EU AIFM and an EU umbrella AIF, where the EU AIFM will enter into a sub-investment management agreement with each non-EU manager who will provide investment management services in relation to a sub-fund in the umbrella. The key attraction here is that the platform can use the European marketing passport under the AIFMD, avoiding the need to rely on the private placement regimes, and the EU AIFM is primarily responsible for compliance with all aspects of the AIFMD.

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The less attractive side of platforms is that the non-EU manager is likely to be asked to comply with certain aspects of the wider AIFMD regime on a delegated contractual basis. Some platform providers have taken a pragmatic and flexible approach to the scope and level of AIFMD compliance imposed on a non-EU manager; others have taken a painfully comprehensive approach.

Reverse inquiry

How many managers are relying on reverse inquiry? The overwhelming majority of non-EU managers (and many UK managers) have so far chosen to stay outside the AIFMD marketing regime by relying on the 'reverse inquiry' exception to the definition of marketing. This is not defined in any detail at the EU level, and only a handful of EU country regulators have issued any new and useful guidance post-AIFMD, which leaves managers and their advisers to make their own determinations as to the boundaries of the concept in many different fact patterns.

Individual country approaches to reverse inquiry. EU countries that have a strict approach to reverse inquiry and interpret the concept narrowly include Austria, France, Germany, Ireland, Italy, Sweden, Norway and Spain. EU countries with a more relaxed approach to the concept include Finland, Luxembourg and the Netherlands. The EU country with the most liberal approach to the concept (and the most comprehensive post-AIFMD regulatory guidance) is the United Kingdom.

How are managers managing the risks inherent in reverse inquiry? Managers are typically adopting a range of risk management techniques including: obtaining 'own initiative' certifications and written requests from potential investors before providing fund-specific information or documents; restricting the countries from which they are generally willing to accept investors to those with a more liberal approach to reverse inquiry; and removing any EU-based prospects who are not yet investors from distribution lists, except where a specific request has been received.

What are the most challenging areas? The boundaries of 'reverse solicitation' are most frequently under stress in the following three scenarios: (i) outreach by the manager before any request is made by the prospect (e.g., where pre-marketing or 'soft marketing' occurs); (ii) the use of general prime broker cap intro services outside organised investor events; and (iii) interaction with prospects in those EU countries which have adopted a strict approach to reverse inquiry.

In an effort to assist their manager clients in relying on reverse solicitation, most prime brokers have implemented detailed pre-screening processes and controls to create a documentary trail of own initiative requests from investors attending organised investor conferences and events. However, concerns remain around *ad hoc* introductions by prime brokers, and many managers are seeking to regulate how such introductions may be made through updating the terms and conditions in place between them and prime broker cap intro teams.

Conclusions

The arrival of the AIFMD regime has made the marketing landscape much more complicated. The regulatory consequences for managers who carry on marketing (particularly the ongoing costs and complexity of Annex IV reporting and concerns about remuneration disclosures in the annual reports) have so far led many managers, both in the EU and outside the EU, to avoid marketing in Europe altogether or restrict their marketing efforts to a smaller number of EU jurisdictions.

Currently, the number of private placement registrations by managers seeking to market in the EU is low but might increase over time. It remains to be seen whether the prospect of the AIFMD marketing passport being made available to non-EU funds and non-EU managers next year will have a significant impact. R&C

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