

Client Update

U.S. Fund Managers— ESMA’s Advice on the Extension of the AIFMD Passport (Take Two)

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On Tuesday, July 19, 2016—more than a year after the AIFMD mandated deadline—the European Securities and Markets Authority (“ESMA”) published its advice on the application of the AIFMD passport to fund managers from certain non-European jurisdictions (the “2016 Advice”). However, this advice is not the end of the story, or even the start of the story.

ESMA’S INITIAL ADVICE

On July 30, 2015, ESMA published its initial advice on the application of the AIFMD passport to non-European fund managers, along with an opinion on the functioning of the AIFMD passport (currently available only to European fund managers) and the functioning of the national private placement regimes.

One of the surprising elements of the initial advice was ESMA’s decision to analyze the extension of the AIFMD marketing passport on a non-European jurisdiction by non-European jurisdiction basis. This approach equates to a significant detailed review by ESMA of the individual regulatory regime in a non-European jurisdiction before determining whether the AIFMD passport should be extended to fund managers established in that particular non-European jurisdiction.

The initial advice only considered the following non-European countries: Guernsey, Hong Kong, Jersey, Switzerland, Singapore and the United States. The initial advice reached the following conclusions:

- The AIFMD passport should be extended to fund managers established in Guernsey, Jersey and Switzerland (subject to certain legislative amendments).

- It was not yet possible to recommend that the AIFMD passport be extended to fund managers established in the United States, Hong Kong or Singapore as ESMA had failed to reach a definitive view on these jurisdictions.

ESMA was requested to next consider, or continue to consider, the following non-European countries: United States, Hong Kong and Singapore (all as a continuation of the consideration that began as part of the initial advice), as well as Australia, Bermuda, Canada, the Cayman Islands, the Isle of Man and Japan. ESMA's consideration of these countries forms the basis of the 2016 Advice.

CURRENT AIFMD POSITION FOR U.S. FUND MANAGERS: BRIEF RECAP

As things currently stand, a non-European fund manager wishing to market a private investment fund in Europe must (a) rely on the national private placement regimes then effective in the relevant European jurisdictions and (b) comply with the AIFMD disclosure rules and "no asset stripping" provisions.

The AIFMD contemplates a second (and third) stage of implementation that have not yet occurred.

The 2016 Advice is integral to the second stage of the AIFMD. A key aspect of the *second stage* of the AIFMD is the extension of the AIFMD marketing passport to non-European fund managers. Broadly, this would mean that a non-European fund manager may opt to become an AIFM-authorized fund manager and freely market its private funds to professional investors in Europe pursuant to an AIFMD marketing passport, thereby no longer having to rely on the national private placement regime in each European jurisdiction where it wishes to market. Currently, the only fund managers eligible to be AIFM-authorized, and obtain AIFMD marketing passports, are EU-based fund managers.

The key aspect of the *third stage* of the AIFMD is the "turning off" of the national private placement regime in each EU jurisdiction—meaning that the only way in which a non-European fund manager will be able to actively access European capital is if that fund manager is AIFM-authorized and holds an AIFMD marketing passport. The earliest the third stage of the AIFMD can be implemented is three years after the second stage of the AIFMD has been implemented.

ESMA'S ADVICE: KEY TAKEAWAYS

- ESMA is analyzing the extension of the AIFMD passport on a non-European jurisdiction by non-European jurisdiction basis. Currently, there are 22 non-European jurisdictions that have been identified for the purposes of the

assessment process. Based on the initial advice and the 2016 Advice, the assessment has only been undertaken in respect of 12 jurisdictions—Australia, Bermuda, Canada, the Cayman Islands, Guernsey, Hong Kong, the Isle of Man, Japan, Jersey, Singapore, Switzerland and the United States.

- In order to determine whether a non-European jurisdiction is “up to scratch” from an AIFMD perspective, ESMA assesses that jurisdiction based on the following criteria: investor protection, market disruption, obstacles to competition and monitoring of systemic risk.
- According to ESMA, the AIFMD passport should be extended to fund managers, established in Australia (subject to certain conditions), Canada, Guernsey, Hong Kong (subject to certain conditions), Japan, Jersey, Singapore (subject to certain conditions) and Switzerland.
- According to ESMA, the AIFMD passport should be extended to U.S. fund managers, but only if limits are placed on the types of U.S. funds that may be marketed using the AIFMD passport. ESMA has presented three options to the European Commission as to the types of limits that may be established. These are that the AIFMD passport should only be available to U.S. fund managers in respect of U.S. funds that (a) do not involve a public offering, (b) are not mutual funds or (c) restrict investment to professional investors. ESMA’s reluctance to give unequivocally positive advice in respect of the United States stems from its view that the U.S. regulatory regime does not provide for a level playing field for European fund managers seeking to market mutual funds in the United States. It is not clear why the assessment focused so extensively on the marketing of funds to retail investors, given that the AIFMD is concerned only with the marketing of funds to professional investors.
- According to ESMA, no definitive advice currently can be provided in respect of Bermuda, the Cayman Islands or the Isle of Man.

WHAT HAPPENS NEXT?

The next step for ESMA is to begin review of its next “batch” of non-European jurisdictions. No information has been provided as to which countries will be next in line for assessment and whether the United Kingdom will be added to the list, given Brexit.

In terms of timing for the extension of the AIFMD passport, the AIFMD provides that, within three months of receipt of positive advice from ESMA, the European Commission should determine the date on which the AIFMD passport will be made available to non-European fund managers. It is not clear whether

the European Commission considers that the clock has now started ticking on this three-month period following the issuance of the 2016 Advice.

NEAR AND LONG-TERM IMPACT

The third stage of AIFMD implementation (i.e., the withdrawal of the national private placement regimes across the European Union) will occur, at the earliest, within three years of implementation of the second stage of the AIFMD.

Assuming that the European Commission takes the view that it is now in a position to implement the second stage of the AIFMD:

- The earliest the second stage will be introduced is in the final quarter of 2016, although this is more likely to be delayed until early 2017.
- The earliest the third stage will be introduced is in the final quarter of 2019 or, if the second stage is delayed until early 2017, early 2020.

For U.S. fund managers, the ideal scenario—both for U.S. fund managers and European professional investors seeking access to U.S. fund managers—is that, until the third stage of AIFMD implementation, U.S. fund managers have two options when seeking actively to access European capital:

- *Option 1*—as part of the implementation of the second stage of the AIFMD, the AIFMD passport is extended to U.S. fund managers. This would mean that a U.S. fund manager that decides to become AIFM-authorized would be able to hold an AIFMD marketing passport.

Given the limits ESMA has suggested should be placed on a U.S. fund manager's access to the AIFMD marketing passport, it is unclear as to whether a U.S. fund manager that becomes AIFM-authorized would be permitted to obtain the AIFMD marketing passport for non-U.S. (e.g., Cayman Islands) funds that it manages.

- *Option 2*—the status quo (that is, marketing in Europe based on the now-established national private placement regimes and subject to compliance with the AIFMD disclosure rules and “no asset stripping” provisions). This would mean that a U.S. fund manager that is not ready to take on all the burdens associated with being AIFM-authorized in order to have access to the AIFMD marketing passport could continue to access European capital in the same ways as it has to date.

The problem with Option 2 is that as things currently stand, on and from the date on which the AIFMD passport is extended to fund managers from one or more non-European jurisdictions, Germany will no longer allow a non-European

fund manager based in any such non-European jurisdiction actively to market its funds to German professional investors unless that non-European fund manager holds an AIFMD marketing passport. If the AIFMD passport is extended to U.S. fund managers but subject to the limits that ESMA has suggested, it is not clear as to whether a U.S. fund manager would be permitted to continue to rely on the national private placement regime in Germany for non-U.S. (e.g., Cayman Islands) funds that it manages.

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Please do not hesitate to contact us with any questions.