# European Commission Proposes Harmonised Pre-Marketing Rules for Funds

**March 15, 2018**

On 12 March 2018, the European Commission issued a proposal for a Directive amending the AIFM Directive[1], along with a proposal for a Regulation on facilitating cross-border distribution of funds (together the "Proposals").[2] Although the Proposals are intended to improve cross-border capital investment flow in the European Union, they will likely make marketing of private funds more difficult in practice. In particular, the Proposals suggest important changes to existing rules on pre-marketing and reverse solicitation.

## Very Limited Scope of Pre-Marketing

The Proposals introduce a definition of "pre-marketing".

The AIFM Directive currently provides a definition of marketing and sets out the conditions for the marketing of funds to professional investors. Under the AIFM Directive, an Alternative Investment Fund Manager ("AIFM") must notify its competent home state authority if it wishes to market a fund. Cross-border marketing to professional investors domiciled in another EU member state is also permissible by making a notification to the competent home-state authority of the AIFM (European Passport).

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However, different interpretations exist in member states as to what kind of activities performed by the AIFM (or on the AIFM's behalf) qualify as marketing (and therefore trigger an obligation of the AIFM to submit a marketing notification), and what kind of activities can be regarded as "pre-marketing" activities (and therefore do not yet trigger any notification requirement). The Proposals, aiming to achieve a more uniform

1 Directive 2011/61/EU on Alternative Investment Fund Managers.

2 Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC of the European Parliament and of the Council and Directive 2011/61/EU of the European Parliament and of the Council with regard to cross-border distribution of collective investment funds and Proposal for a Regulation of the European Parliament and of the Council on facilitating cross-border distribution of collective investment funds and amending Regulations (EU) No 345/2013 and (EU) No 346/2013.

application of the concept of pre-marketing in the member states, suggest a harmonised definition of "pre-marketing".

The rules relating to pre-marketing are very important to AIFMs as they allow them to approach investors and test their interest before making an official marketing notification. However, if adopted as proposed, the new definition will have a substantial impact on marketing activities and add further complexity to the marketing process.

Pursuant to the Proposals, "pre-marketing" means "a direct or indirect provision of information on investment strategies or investment ideas by an AIFM or on its behalf to professional investors domiciled or registered in the Union in order to test their interest in an AIF which is not yet established". Pre-marketing must therefore relate to an investment idea or strategy without referring to an Alternative Investment Fund ("AIF") that is already established.

In the light of the foregoing, the conditions under which pre-marketing is permissible are very restrictive. As stated in the Proposals, information provided to an investor in the pre-marketing phase must not:

- Relate to or contain reference to an existing fund;
- Enable investors to make a commitment of investing in a particular fund; nor
- "Amount to a prospectus, constitutional documents of a not-yet-established AIF, offering documents, subscription forms or similar documents whether in a draft or a final form allowing investors to take an investment decision".

The latter means that by negotiating a draft term sheet with potential investors, or by circulating to potential investors a draft term sheet (let alone a draft partnership agreement or PPM) which has not yet been fully negotiated, the AIFM (or any persons acting on its behalf) will already have exceeded the limits of permissible pre-marketing. Any such action could only be taken after a marketing notification had been made. In other words, no draft fund documents which contain relevant fund data on which an investment decision can be based may be distributed to potential investors unless a marketing notification has been submitted in relation to that proposed fund.

In summary, as currently drafted, the definition of pre-marketing is not helpful for private funds. In such funds, the terms are typically negotiated and most investors will not show any meaningful interest without seeing drafts of the fund documentation. If the definition suggested by the Proposals is adopted, the obligation of an EU AIFM to submit a marketing notification would be triggered very early in the process of speaking to investors about the fund rules or other fund-related documents. That also means that

any material amendments that are later made or negotiated into the documents need to be approved again (triggering another one-month approval period).

Although the definition of pre-marketing applies equally to authorised (full-scope) EU AIFMs, sub-threshold EU AIFMs and all non-EU AIFMs (as well as to managers of European venture capital funds ("EuVECA") and European social entrepreneurship funds ("EuSEF")), the conditions under which pre-marketing is permissible only apply to fully authorised EU AIFMs (and EuVECA and EuSEF managers). In other words, whether a non-EU or sub-threshold EU AIFM may permissibly engage in pre-marketing as defined by the Proposals remains subject to the national regime. It remains to be seen whether national regulators will apply the same restrictions for pre-marketing to non-EU and sub-threshold AIFM. There is certainly a risk that they will.

## Limitation of Scope for Reverse Solicitation

Furthermore, the Proposals explicitly state that if an AIFM has engaged in pre-marketing activities and, following these pre-marketing activities, an investor decides to acquire shares or units (i) of a fund which implements the investment strategy or investment idea previously tested by the AIFM with such investors or (ii) of a fund implementing a similar investment strategy or investment idea, this is regarded as marketing and therefore triggers an obligation of the AIFM to submit a marketing notification. This statement—that an investor who comes into a fund following pre-marketing activities cannot be seen as having been admitted to the fund following a "reverse solicitation" by the investor—seems obvious and should reflect current practice. However, saying that an investor to whom the manager has presented an investment strategy may never be admitted to any fund of that manager which has the same or a similar investment strategy will in practice significantly restrict the scope of reverse solicitation.

## Special Requirements for De-Notification

The Proposals further specify the conditions under which an AIFM may de-notify the marketing of an EU AIF which is notified for marketing in another member state (the "Host Member State"). These conditions include (among other things) certain thresholds with regard to the maximum number of investors domiciled or having a registered office in the host member state ("Host Member State Investors") which may be invested in the fund, and the maximum percentage of assets in the fund which may be represented by the shares or units held by those investors. Pursuant to the Proposals,

an AIFM may de-notify an EU AIF marketed in a Host Member State by submitting a notification to its home state authority.

However, de-notification is only permissible if the following conditions are met:

- No more than 10 Host Member State Investors hold units or shares of the AIF;
- The units or shares held by those Host Member State Investors represent less than 1% of assets under management of that AIF;
- A repurchase offer by the AIFM regarding the fund units or shares held by the Host Member State Investors has been made public for at least 30 working days and also been addressed individually to any Host Member State Investor whose identity is known;
- the repurchase offer is free of any charges or discounts for the Host Member State Investors; and
- The intention of the AIFM to stop marketing the EU AIF in the Host Member State has been made public.

The de-notification of the EU AIF in the Host Member State would become effective no later than 20 working days after the AIFM has successfully submitted the de-registration notification to its home state authority. If Host Member State Investors remain invested in the fund following the de-notification, the AIFM remains subject to the investor information duties set out in the AIFM Directive (such as the provision of the annual report and information memorandum of the fund) with regard to those investors.

The purpose of such a harmonisation of de-notification rules remains unclear to us. De-notification makes sense in connection with non-EU AIFs where the manager would no longer be subject to ongoing depositary (where applicable) or reporting requirements under the national private placement rules. However, in an EU context, where as a consequence of the EU passport the manager is subject to the reporting rules of the AIFM Directive in any event, we cannot see the benefit of such new rules.

## Central Databases Concerning Supervisory Fees

One aspect of the EU marketing passport that has been heavily criticised is the fact that some member states charge fees as a condition to granting the passport. This has been

seen by some as a violation of the EU harmonisation rules. In other European laws, such as the EuVECA Regulation, the Commission has clarified in recent amendments that no fees may be charged.

Unfortunately, the Proposals take a different approach. They suggest that fees may be charged by national regulators, but aim to establish common principles by stating that fees and charges have to be proportionate to the level of supervision applied to the AIFM and the supervisory powers necessarily performed by the regulator. In this context, the Proposals oblige national regulators to publish on their website (among other information related to marketing) the level of fees and charges levied on AIFMs (including, where applicable, the calculation methodologies for those fees or charges) in a language customary in the sphere of international finance. Such information will also be published on a consolidated basis for all member states by the European Securities and Markets Authority ("ESMA"), including an interactive tool enabling calculations of fees and charges levied by the relevant national regulators.

The purpose of these databases is to improve transparency for AIFMs who intend to market their funds into other member states. However, it may also encourage regulators which have not charged fees so far to introduce fees going forward.

## Next Steps

Should the Proposals be adopted in their current form, the provisions of the proposed directive concerning pre-marketing and de-notification would have to be implemented into national law within two years. Different transposition periods apply to the databases to be established by the national regulators and ESMA.

The European Parliament and the Council will now discuss the Proposals in the context of the legislative procedure.

## Comment

Generally, the Proposals are disappointing. The restrictive definition of pre-marketing will make cross-border marketing more difficult for EU AIFMs, and probably also for non-EU AIFMs. They introduce complicated new rules on de-notification, the benefit and practical relevance of which seem unclear. Finally, the Commission missed the opportunity to improve aspects which are really seen as problematic by the industry; for example, the fees charged by host member states, which are a particular concern for smaller AIFMs, and the complicated rules requiring material changes to the fund rules

to be re-approved by the regulator following negotiations. It would have been good to get more guidance on what is deemed to be material in this respect, and to reduce the approval period (which is currently one month and may hold up closings). This last point will be even more problematic if the restrictive definition of pre-marketing is adopted, because the early notification of marketing, at a time when negotiations or discussions about structure and terms with investors have not yet even started, will make material change re-filings even more extensive and frequent.

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Please do not hesitate to contact us with any questions.

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