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CLIENT MEMORANDUM

ESMA's Advice on the Application of the AIFMD Passport to Non-EU AIFMs and AIFs

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On 18 July 2016 the European Securities and Markets Authority ("ESMA") published its advice in relation to the extension of the AIFMD passport to non-EU alternative investment fund managers ("AIFMs") and non-EU alternative investment funds ("AIFs") in respect of 12 jurisdictions: Australia, Bermuda, Canada, Cayman Islands, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Singapore, Switzerland and the United States.

In relation to some of these jurisdictions, including the United States, where the advice from ESMA is largely positive, the European Commission may set a date for the extension of the passport; however, the timing for when such an extension might occur is still unclear. Although the availability of the passport for some may be getting closer, for the time being non-EU AIFMs must continue to rely on local national private placement regimes or reverse solicitation.

Current position under AIFMD for marketing of funds within the EU by third country AIFMs and AIFs

Currently, non-EU AIFMs and AIFMs of non-EU AIFs that wish to market in the EU must comply with the national private placement regime of each country in which they market to investors or rely on the availability of reverse solicitation.

Member states have adopted varying approaches as to what is required under their national private placement regimes ("NPPRs"). This ranges from countries such as the UK and the Netherlands, where the process for marketing under the NPPR is straightforward and speedy to countries such as Denmark and Germany, which have additional requirements such as the appointment of a depositary, and countries such as Italy, where the NPPR does not appear to allow marketing for such funds.

Likewise, the interpretation of reverse solicitation is uneven, creating uncertainty for fundraisers. The combination of these factors has inhibited fundraising efforts for non-EU AIFMs from European-based investors under AIFMD.

This is in contrast to the position of EU authorised AIFMs. EU AIFMs may market EU AIFs to professional investors across all member states using a passport, subject to notification to their home country regulator. Accordingly, such EU AIFMs are greatly advantaged in their ability to market to investors throughout the EU.

ESMA’s advice

AIFMD does allow for the provision of the passport, currently reserved for EU AIFMs and AIFs, to be potentially extended to third country (i.e., non-EU) firms and AIFs. This extension of the passport is subject to ESMA determining that there are no significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk impeding the application of the passport to the marketing of non-EU AIFs by AIFMs and the management and/or marketing of AIFs by non-EU AIFMs in member states.

The advice follows ESMA’s review of these criteria in each of the 12 jurisdictions listed.

The United States: ESMA stated that there were no significant obstacles with regard to investor protection and monitoring of systemic risk that would impede the application of the AIFMD passport to the United States. With respect to the competition and market disruption criteria, whilst ESMA considers there are no significant obstacles for funds marketed to professional investors where there is no public offering, the position is different for funds involving a public offering. ESMA’s view is that a potential extension of the passport to marketing that involves a public offering risks an un-level playing field between EU and non-EU AIFMs. ESMA considers that the market access conditions that would apply to such US funds in the EU under the AIFMD passport would be different from and potentially less onerous than the market access conditions applicable to EU funds involving a public offering in the United States.

ESMA has suggested three possible options if the AIFMD passport were to be granted to the United States:

- granting the AIFMD passport only to those US funds dedicated to professional investors to be marketed in the EU not involving any public offering;
- granting the AIFMD passport only to those US funds that are not mutual funds (under the Investment Company Act of 1940);
- granting the AIFMD passport only to those US funds that restrict investment to professional investors.

Thus listed open-ended funds may find that the passport is not extended to them and the passport is, in effect, only available to private funds normally sold via private placement.

Canada, Guernsey, Japan, Jersey and Switzerland: ESMA found no significant obstacles impeding the application of the AIFMD passport for any of these jurisdictions.

Hong Kong and Singapore: ESMA's advice in respect of these jurisdictions applies only to AIFs, but it finds no obstacles to the application of the passport to AIFs established in Hong Kong or Singapore.

Australia: ESMA found that there are no significant obstacles regarding the monitoring of systemic risk and whilst there are differences relating to investor protection, they are not seen as significant. In relation to market disruption and competition, there are no significant obstacles, provided that "class order reliefs" from some aspects of the Australian regulatory framework that are available to some member states are extended to all member states. Before the passport is available to Australia, legislation relating to "class order reliefs" will need to be amended.

Bermuda and the Cayman Islands: Until each of these countries has implemented new regulatory regimes, ESMA is unable to provide definitive advice on the criteria for investor protection and the effectiveness of enforcement.

Isle of Man: ESMA said that in the absence of an AIFMD-like regime, it is difficult to assess whether the investor protection criterion is met.

Next steps/uncertainties

To the extent the advice is positive in respect of a country, it will be considered by the European Commission, Parliament and Council. Article 67(4) of AIFMD provides that within three months of receiving such advice, the Commission should adopt a delegated act specifying the date when the passport should be available to non-EU AIFMs and AIFs from the countries in which ESMA considers there are no significant obstacles.

The Commission could delay extension of the passport until there are a larger number of countries for which ESMA has provided positive advice and to which the extension would apply.

Implications for third country AIFMs using passport

AIFMs based in countries to which the passport is extended will want to note that whilst this brings significant advantages and simplification to the process of marketing to investors in the EU, it does, of course, bring with it obligations to comply with a number of provisions under AIFMD. Such firms that have to date complied with the NPPR in any member state will already be complying with requirements to provide annual reports, pre-investment disclosure and regulatory reporting on liquidity, risk management arrangements and leverage, and where applicable, the "asset stripping" requirements.

Firms that have access to the passport will in addition have to comply with rules on remuneration and (if not already done so) rules relating to the appointment of a depositary. Such firms will want to ensure that they fully understand applicable obligations before exercising any passporting right.

Non-EU AIFMs that manage EU AIFs will need to seek full authorisation to market such AIFs with a passport. ESMA has noted that it will be important for member states to have a common understanding on the treatment of sub-threshold firms (i.e., firms with assets under management not exceeding €100m where leverage is used and €500m where no leverage is involved) as to whether or not they would be required to register.

Following an extension of the passporting regime, there will be a three year period following which ESMA will review and advise whether the availability of the NPPR should be terminated. During that three year period the NPPR will operate in parallel to the passport.

Further country review

ESMA has gathered intelligence on investor protection, competition, potential market disruption and monitoring of systemic risk with respect to: Malaysia, Egypt, Chile, Peru, India, China and Taiwan; however, until MOUs are agreed with their supervisory authorities and/or there is a greater level of activity from those countries, a more detailed assessment will not be done.

Other countries with more significant activity that are to be assessed include the Bahamas, Brazil, British Virgin Islands, Curacao, Mexico, Mauritius, South Africa, Thailand and the US Virgin Islands. ESMA has not said when the results of any such review will be available.

A full copy of ESMA's advice can be found here:

https://www.esma.europa.eu/sites/default/files/library/2016-1140_aifmd_passport_1.pdf

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If you would like further information about this, please contact Henrietta de Salis (+44 20 3580 4710; hdesalis@willkie.com) or the Willkie attorney with whom you regularly work.

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