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EU legislative proposals affecting the cross-border distribution of investment funds

On 12 March 2018, the European Commission published two new legislative proposals which will amend the existing legal regimes for the cross-border distribution of investment funds in the EU. These proposals include a [new directive \(Omnibus Directive\)](#) which will amend the existing regimes for cross-border marketing of alternative investment funds (AIFs) and undertakings for collective investment in transferable securities (UCITS), and a [new regulation \(Omnibus Regulation\)](#) which will introduce new standardised requirements for cross-border fund distribution in the EU.

The Omnibus Directive and the Omnibus Regulation are part of the Commission's wider Capital Markets Union action plan, which is (ostensibly) designed to encourage the development of more unified, efficient EU capital markets and to remove regulatory barriers to cross-border fund distribution. Many of the provisions in the proposed

SUMMARY OF KEY POINTS

- The Omnibus Directive and Omnibus Regulation will amend the existing marketing rules under AIFMD and the UCITS Directive
- A new definition of "pre-marketing" will be introduced for EU AIFMs, EuSEF and EuVECA managers which will mean that marketing will be deemed to begin at a much earlier stage than at present (at least in the UK)
- Where an EU AIFM or UCITS manager has exercised a marketing passport into another EU jurisdiction in relation to an EU AIF or UCITS fund and wishes to cease marketing, it will only be able to do so if the number of investors in the relevant jurisdiction does not exceed a specified minimum level and the manager offers to buy-out existing investors in that jurisdiction
- Where an EU or non-EU AIFM markets an AIF to **retail investors** in another EU Member State, it will be required to maintain facilities in that Member State to process payments with, and provide information to, investors. The existing UCITS requirements for paying agents will be aligned to these new AIFMD requirements
- National regulators will be able to require AIFMs and UCITS managers to submit marketing communications to verify their compliance with the AIFMD or UCITS requirements
- The legislation confirms that host State regulators may levy fees and charges for authorisation or supervision under AIFMD or the UCITS Directive, but only if these are proportionate
- Some parts of the Omnibus Regulation could apply from mid-late 2019 at the earliest (assuming a streamlined legislative process), but the majority of the new rules (and the more significant changes, including the Omnibus Directive) will be unlikely to apply until mid-late 2021 at the very earliest

legislation relate to areas which have previously been identified as problematic by fund managers, particularly in the context of the inconsistent national implementation of the Alternative Investment Fund Managers Directive (**AIFMD**) by individual EU Member States. However, these issues are addressed in ways which many market participants would not necessarily welcome. In certain cases, there will be onerous new obligations. We summarise the key proposals below.

PROPOSED CHANGES RELEVANT TO BOTH AIFMS AND UCITS MANAGERS

DISCONTINUING MARKETING IN A MEMBER STATE

The current AIFMD and UCITS Directive rules are unclear on when an EU AIFM or UCITS manager can be considered to have ceased marketing in a Member State (for example, so that it can withdraw a notification about exercising the marketing passport into that jurisdiction).

The Omnibus Directive will insert a new provision into the AIFMD and an equivalent provision in the UCITS Directive which states that an EU AIFM or UCITS manager may only discontinue the marketing of units or shares of an EU AIF or UCITS in a jurisdiction in which it has exercised the marketing passport if the following conditions are met:

- there is in the relevant Member State a maximum of 10 investors (either domiciled or with a registered office), holding up to 1% of the assets under management (it appears in aggregate, rather than each) of the AIF or UCITS;
- the EU AIFM or UCITS manager has made a blanket offer to repurchase, free of any charges or deductions, all units or shares held in the EU AIF or UCITS by investors in the relevant Member State. This offer must be made publicly for 30 working days and must also be addressed individually to all investors in that jurisdiction whose identity is known to the EU AIFM or UCITS manager; and
- the EU AIFM or UCITS manager has publicised its intention to cease its marketing activities in that jurisdiction through a "publicly available medium which is customary for marketing" AIFs or UCITS (as the case may be) and suitable for a typical AIF or UCITS investor.

In each case, the EU AIFM or UCITS manager is required to continue to provide investor transparency information (e.g. periodic reports) to those investors who choose to remain invested in the relevant fund despite the offer to repurchase their units or shares.

These changes do not apply to non-EU AIFMs marketing under Member States' individual national private placement regimes (**NPPRs**), or to EU AIFMs marketing non-EU AIFs under the NPPRs. However, there may be a risk that Member States may choose to exercise national discretions to impose equivalent requirements under their NPPRs for such managers.

In practice, these conditions (and particularly the requirement to make a public offer to buy out existing investors) are likely to make ceasing marketing under the passport very unattractive. If the legislation is adopted in this form, EU AIFMs and UCITS managers will need to think carefully in the future about whether they want to exercise the marketing passport in jurisdictions where they may only attract a relatively small number of investors who may not contribute significant funds.

ABILITY OF NATIONAL REGULATORS TO APPLY FEES AND CHARGES IN CONNECTION WITH MARKETING

The Omnibus Regulation permits national regulators (including home and host State regulators) to levy fees or charges on AIFMs or UCITS managers for the purpose of authorisation or registration or the exercise of supervisory or investigatory powers under the AIFMD or UCITS Directive, provided that these are proportionate to the regulator's expenditure. It appears that these requirements are intended to apply in relation to both EU and non-EU AIFMs. Regulators will also be required to provide invoices for each financial year to the relevant manager, indicating how payment should be made and the date upon which it is due.

In addition, national regulators must publish and maintain on their websites a central database of applicable fees and charges, or relevant calculation methodologies for them, in at least "a language customary in the sphere of international finance". They must also notify ESMA of this information so that it can publish an interactive database containing the relevant information.

NEW REQUIREMENTS FOR MARKETING COMMUNICATIONS

The Omnibus Regulation will introduce new requirements for all marketing communications made to investors by an AIFM (including, it appears, both EU and non-EU AIFMs) or a UCITS manager. These communications must:

- be identifiable as marketing communications;
- be fair, clear and not misleading; and
- present risks and rewards of purchasing units or shares of an AIF in an equally prominent manner.

In the abstract, it seems unlikely that these requirements will significantly increase the existing obligations of UCITS managers. For UCITS managers in particular, they are very similar to existing requirements under the UCITS Directive (which will be deleted by the Omnibus Directive when the new rules enter into effect). However, ESMA will also be empowered to issue guidelines to supplement these rules, including in the context of online marketing communications. The extent to which any such guidelines may have a more significant impact on current marketing documentation remains to be seen.

AIFMs may need to reflect on the meaning of equal prominence, as well as monitoring the impact of any supplementary rules issued by ESMA.

AIFMs and UCITS managers must also ensure that any marketing communications do not contain statements which contradict or diminish the significance of any information contained in any prospectus, key information document or required investor disclosure document for the relevant fund.

VERIFICATION OF COMPLIANCE OF MARKETING COMMUNICATIONS WITH REQUIREMENTS

The Omnibus Regulation will empower national regulators in EU Member States to require notification of marketing communications which:

- UCITS managers intend to use directly or indirectly in their dealings with investors; and
- AIFMs intend to use directly or indirectly in their dealings with **retail** investors (within the MiFID II definition),

for the purposes of marketing in that Member State. Again, it would appear that this requirement will apply in relation to both EU and non-EU AIFMs.

The legislation states that national regulators are not permitted to make such notification a pre-condition of marketing. However, the relevant national regulator has up to 10 working days following receipt of a notification to inform the relevant manager of any request to amend a marketing communication.

If the national regulator chooses to require this, it must publish on its website the relevant rules and procedures for such notifications and must make annual reports to ESMA on any decisions it makes requiring adaptations to marketing communications and the breaches of the marketing requirements giving rise to such requests. This is presumably so that ESMA can exercise oversight to ensure that individual regulators are not misusing these powers in a manner which restricts marketing in the relevant Member State.

PROPOSED AMENDMENTS SPECIFIC TO THE AIFMD REGIME

The Omnibus Directive and Omnibus Regulation will make a number of direct amendments to the AIFMD regime which are likely to have a significant impact on the marketing activities of alternative investment fund managers (AIFMs).

NEW DEFINITION OF "PRE-MARKETING"

Under the current AIFMD regime, individual Member States have taken divergent views about when "marketing" for the purposes of the AIFMD is deemed to begin. This is important because the existing AIFMD marketing passport only applies to activities that fall within the definition of "marketing", meaning that the promotional activities that may be undertaken in individual Member States in reliance upon the marketing passport will vary.

The Omnibus Directive attempts to address these issues by introducing a new definition of "pre-marketing", which is defined as:

"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".

It appears that the intention is that if a promotional activity does not fall within the definition of "pre-marketing", it should be treated by Member States as amounting to "marketing" instead. The proposed definition of pre-marketing implies that an authorised AIFM will cross the line into full marketing (and therefore would be required to exercise the marketing passport) at a relatively early stage. It is clear, for example, under the above definition that promotional activities cannot amount to pre-marketing where the fund vehicle is already in existence.

A new provision would also be inserted into the AIFMD which would require Member States to ensure that an **authorised EU AIFM** may engage in pre-marketing (as defined above) within the EU without having to make passporting notifications to individual Member State regulators, provided that the information given to professional investors does not:

- relate to, or contain any reference to, an established AIF. It is unclear precisely how far this prohibition extends – for example, whether it would prevent information being provided to investors about an EU feeder fund "sleeve" from amounting to pre-marketing where the corresponding master fund is already established because the documents for the sleeve would reference the master fund;
- enable investors to commit to acquiring units or shares of a particular AIF; or
- amount to a prospectus, constitutional document of an AIF which has not yet been established, offering document, subscription form or similar document, whether in draft or final form, which would allow an investor to take an investment decision.

Since this requirement is expressed to apply only to authorised EU AIFMs, the new definition of pre-marketing does not directly affect non-EU AIFMs marketing under individual NPPRs. However, it is possible that individual Member States may seek to amend the general definition of "marketing" for these purposes under their NPPRs to reflect these changes.

These new requirements mean that the circulation of draft offering documents or constitutional documents (e.g. draft versions of a limited partnership agreement) will constitute AIFMD marketing. This is a significant change from the current approach in the UK (which also reflects the approach in some other important EU markets), where the FCA considers that promotional activities do not amount to AIFMD marketing if they do not involve a contractual offer to the investor to enter into a binding agreement or an invitation to the investor to make a binding contractual offer to do so.

The amendments also make it clear that if an investor invests in an AIF as a result of pre-marketing activities by an authorised EU AIFM, the investment cannot be considered to result from reverse solicitation.

MARKETING TO RETAIL INVESTORS

AIFMD currently permits authorised AIFMs to exercise a passport to market to professional investors (as defined under MiFID II), but leaves the regulation of marketing AIFs to retail investors to each individual Member State's own national rules. Similarly, non-EU AIFMs marketing under individual Member States' national private placement regimes are subject to national rules in relation to their marketing to all investors, subject only to the specific requirements imposed by the AIFMD.

The Omnibus Directive will insert new requirements into the AIFMD which will apply where **any** AIFM (i.e. an EU or a non-EU AIFM) is marketing units or shares in an AIF to retail investors (within the MiFID II definition). In such a case, the AIFM will be required to put in place "facilities" in the relevant Member State that must perform all of the following tasks:

- processing the investors' subscription, payment, repurchase and redemption orders in connection with units or shares of the AIF in accordance with the conditions set out in the marketing documents (i.e. essentially, fulfilling the functions of a paying agent in the jurisdiction);
- providing investors with information on how subscriptions or payments can be made and how repurchase and redemption proceeds will be paid;
- handling the information relating to the exercise of investors' rights arising from their investment in the AIF in that jurisdiction;
- making available to investors copies of the AIF's rules or instruments of incorporation and its latest annual report; and
- providing investors with information, in a durable medium, relevant to the above tasks being performed by the facilities put in place.

The Directive expressly states, however, that these facilities do not need to amount to a "physical presence" – i.e. it appears that the AIFM could provide them through online means or over the telephone, for example, without needing to have an establishment in the relevant jurisdiction. The AIFM must ensure that the relevant facilities perform the above tasks in the official language(s) of the relevant Member State. In addition, the facilities must be provided either by the AIFM itself or by a third party which is subject to regulation governing the tasks that are being performed (e.g. regulated paying agent) and is appointed through a written contract.

AIFMs should note that since these requirements are triggered by marketing to MiFID retail investors, this will include investors such as high net worth individuals or local authorities who cannot be opted-up to MiFID professional status. However, many AIFMs may already be taking steps to minimise their marketing to such investors wherever possible in order to avoid becoming subject to the EU PRIIPs regime.

PROPOSED CHANGES SPECIFIC TO THE UCITS REGIME

The Omnibus Directive makes a number of amendments to the existing UCITS Directive, which will affect the cross-border activities of UCITS managers.

REQUIRED FACILITIES WHERE MARKETING IN AN EU MEMBER STATE

Existing rules under the UCITS Directive require UCITS managers to maintain facilities in any EU Member State in which the UCITS is marketed for making payments to unit holders, repurchasing and redeeming units and making available any required investor information.

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The Omnibus Directive will delete those provisions and substitute requirements for the UCITS manager to maintain facilities that are essentially the same as those required for AIFMs that are marketing to retail investors (see above).

CHANGES IN MARKETING ARRANGEMENTS

Currently, a UCITS manager is required to give prior written notice when it is making changes to its marketing arrangements set out in its notification of the marketing passport. The Omnibus Directive will amend that requirement to clarify that this written notice must be given at least one month before implementing any planned change, or immediately after an unplanned change has occurred (thereby aligning it with equivalent requirements under the AIFMD passporting regime).

The relevant national regulator then has 10 working days to inform the UCITS manager if the proposed change would not comply with the requirements under the UCITS Directive. If the change is still made, or if an unplanned change has occurred which has resulted in the UCITS manager ceasing to comply with the UCITS Directive, the national regulator may take enforcement action, including by expressly prohibiting the marketing of the UCITS in its jurisdiction.

CHANGES IN BRANCH ARRANGEMENTS

Currently, when a UCITS manager has exercised the passport to establish a branch in another EU Member State, if it subsequently makes changes to those branch arrangements, it must notify the relevant national regulator at least one month before implementing the change. The Omnibus Directive will retain this requirement, but introduce new rules under which the relevant national regulator must inform the UCITS manager within 10 working days if the proposed changes would result in the UCITS manager ceasing to comply with the UCITS Directive. As with changes to marketing arrangements discussed above, the regulator may take enforcement action if the change is implemented notwithstanding an objection.

CHANGES TO EUSEF REGULATION AND EUVECA REGULATION

The Omnibus Regulation will introduce changes to the existing European Social Entrepreneurship Fund (**EuSEF**) and European Venture Capital Fund (**EuVECA**) Regulations in connection with pre-marketing. These new provisions will essentially extend the new definition of "pre-marketing" being introduced for AIFMs above to the EuSEF and EuVECA regimes, along with the same conditions for engaging in pre-marketing (e.g. such marketing activities cannot relate to established EuSEF or EuVECA funds). As with AIFMs, this may lead to significant changes to the ways in which the marketing rules are currently interpreted in Member States (including the UK), meaning that marketing notifications may be required at a much earlier stage in the marketing process.

NEXT STEPS

The Commission is inviting feedback on the legislative proposal within an 8 week period which will end on **7 May 2018**. Interested parties can submit comments through the Commission's online form, available on its [website](#) (new users may be required to register first).

The proposed timeline for the entry into force of the proposals is not yet clear. The Omnibus Regulation is stated to take effect 20 days after it is published in the EU Official Journal, except for the following provisions, which are stated to take effect 2 years after that date:

- the requirements for all AIFM and UCITS marketing communications to be identifiable as such, to present risks and rewards equally and to contain information that is fair, clear and not misleading;
- the requirements for EU national regulators to publish and maintain information on marketing requirements for AIFMs and UCITS in their jurisdictions on their websites; and
- the amendments to the EuSEF and EuVECA "pre-marketing" regimes.

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EU Member States will have 2 years after the Omnibus Directive enters into force to adopt and apply laws implementing the relevant requirements contained in that Directive.

In practice, this means that if there were a very smooth passage through the legislative process, some parts of the Omnibus Regulation could apply as early as mid-late 2019. However, the more significant provisions, and all of the new provisions in the Omnibus Directive, would be unlikely to apply before **mid-late 2021 at the very earliest**.

The Omnibus Regulation requires the Commission to carry out a review of the application of its requirements within 5 years of its entry into force. A similar review of the Omnibus Directive will be required 3 years after the transposition deadline (i.e. effectively, 5 years after its publication on the Official Journal, aligning the review with the review of the Omnibus Regulation).

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