MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

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Via Electronic Submission

DG Financial Stability, Financial Services and Capital Markets Union
Unit C4 – Asset management
European Commission
SPA2 02/076
1049 Brussels
Belgium

Dear Sir or Madam,

Re: CMU action on cross-border distribution of funds across the EU

Managed Funds Association ("**MFA**")[1] welcomes the opportunity to provide comments to the European Commission (the "**Commission**") on its public consultation on CMU action on cross-border distribution of funds across the EU (the "**Consultation Paper**"). MFA members, as investors in European markets and professional asset mangers for European institutional investors, have a shared interest with policy makers in promoting the cross-border distribution of investment funds across the EU. MFA therefore supports the Commission's efforts to understand and reduce barriers to such cross-border distribution.

We have focused our response to the Consultation Paper on barriers to the cross-border distribution of alternative investment funds ("**AIFs**") by non-EU alternative investment fund managers ("**AIFMs**") under Article 42 of the AIFMD. Although we note that the Consultation Paper focuses primarily on the distribution of EU investment funds, we believe that the distribution of non-EU AIFs managed by non-EU AIFMs is equally relevant to the Commission's objectives, as many EU professional investors invest in such AIFs and many of those AIFs invest significantly in EU markets, for example through investments in EU investment funds and financial instruments issued by other EU entities. The ability of non-EU AIFMs to distribute units or shares in their AIFs

[1] Managed Funds Association ("MFA") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

to professional investors in EU Member States is therefore a key part of the overall picture of cross-border distribution of funds and the mobilisation and channelling of capital in Europe.

We have set out our responses to certain questions in the Consultation Paper below and have grouped these where our response addresses multiple questions. Our responses to Questions 2.1-2.2, 3.1b, bb and c, 4.1, 5.1 and 8.4-8.6 address barriers to the cross-border distribution of AIFs managed by non-EU AIFMs under Article 42 AIFMD and our response to Question 10.1 sets out our initial thoughts on how the Commission could help remove certain of these barriers and support a harmonised approach to the rules governing such distribution activities.

MFA would like to reiterate its thanks to the Commission for the opportunity to engage constructively in these issues. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact Benjamin Allensworth or the undersigned at +1 (202) 730-2600 with any questions that the Commission or its staff have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell

Executive Vice President & Managing Director, General Counsel

MANAGED FUNDS ASSOCIATION

RESPONSE TO CONSULTATION ON CROSS-BORDER DISTRIBUTION OF FUNDS ACROSS THE EU

Limitations to cross-border distribution under Article 42 of the AIFMD (Questions 2.1-2.2 and 8.4-8.6)

Article 42(1) of the AIFMD gives EU Member States discretion to allow non-EU AIFMs to market units or shares in AIFs they manage to professional investors in their territory, subject to certain conditions set out in that provision. This forms the basis of the national private placement regime for non-EU AIFMs (the "**NPPR**"), which is relied upon by a number of non-EU AIFMs to distribute AIFs to professional investors in certain EU Member States.

As discussed in MFA's January 30, 2016 letter to the Commission in response to the Commission's Call for Evidence on the EU Regulatory Framework for Financial Services,[2] there have been a number of studies documenting that non-EU AIFMs do not plan to market AIFs under the AIFMD third country passport because of compliance costs and uncertainty related to the passport regime. As such, the NPPR is vital to enable EU professional investors to invest freely in AIFs that suit their particular risk profiles and investment criteria. Further, as many of the AIFs marketed under the NPPR invest back into assets in EU Member States in various ways (*e.g.*, by investing in financial instruments traded on EU trading venues), the NPPR is also ultimately an important gateway for investment in EU capital markets.

There is, however, a high degree of national variation in the application of the NPPR across the EU. This variation also creates significant compliance costs and uncertainty, which are significant barriers to the cross-border distribution of AIFs in the EU, limiting the ability of EU professional investors to allocate investment capital efficiently and undermining competition in the asset management sector generally.[3] These barriers also limit investment in EU markets that would otherwise come through underlying investments made by the relevant AIFs.

Goldplating of the minimum requirements under Article 42 AIFMD

Article 42(2) AIFMD states that EU Member States may impose stricter rules than the minimum requirements under Article 42(1) on non-EU AIFMs in respect of the marketing of units or shares of AIFs to investors in their territory. Some EU Member States, such as Finland, Ireland, Luxembourg, Sweden and the United Kingdom, generally have opted not to impose significant requirements on non-EU AIFMs marketing under the NPPR beyond the minimum requirements set out in Article 42(1). At the other end of the spectrum, some Member States such as France, Italy

[2] *Available at:* https://www.managedfunds.org/wp-content/uploads/2016/02/MFA-Response-to-CMU-Call-for-Evidence1.pdf.

[3] *See*, MFA's January 30, 2016 comment letter to the Commission's Call for Evidence on the EU Regulatory Framework for Financial Services.

and Spain effectively have no NPPR and, for all intents and purposes, it is not possible for a non-EU AIFM to distribute units or shares in the AIFs it manages in those countries.

Other Member States have an NPPR but have imposed substantive additional national requirements. For example, Denmark and Germany require non-EU AIFMs to appoint one or more entities to perform the depositary functions under Article 21 of the AIFMD in respect of AIFs marketed under the NPPR (commonly referred to as a "depositary-lite" or "depo-lite" requirement). Further, the Netherlands generally requires an attestation from the home state regulator of the AIFM[4] and Denmark requires a reciprocity statement from the home state regulator of the relevant AIF stating that it is prepared to grant similar Danish AIFs equivalent access to market units or shares in that state.[5] These additional pre-conditions can cause delays and significant costs and, in some cases, constitute a major barrier to the cross-border distribution of AIFs in the relevant Member States.

Initial notification and application processes

All EU Member States that permit marketing under the NPPR require some form of initial filing with the relevant national competent authority ("**NCA**") before the non-EU AIFM is allowed to start marketing. In some Member States, such as Ireland, Luxembourg, the Netherlands and the United Kingdom, this is a relatively straightforward pre-notification process, under which a prescribed form must be completed and submitted to the NCA. Other Member States, such as Denmark, Finland, Germany and Sweden require prior regulatory approval before marketing may commence. Timeframes for determining these applications can range between a few weeks and several months, both between and within these jurisdictions.

The relatively lengthy timeframes and the lack of predictability in the time taken to determine an application in these Member States dissuades some AIFMs from distributing AIFs there. This is particularly likely where interest stems from one large prospective investor in the Member State and the AIFM is unable to rely on reverse solicitation to enable the investor to subscribe for units or shares without falling within the definition of "marketing" under the AIFMD as transposed into national law (see below). In such cases, the timeframe during which the relevant prospective investor may invest could be limited, for example due to internal constraints on the periods during which the investor may allocate capital to new investments. The AIF in which the relevant prospective investor would seek to invest may also be subject to time constraints regarding when it may issue shares or units to new investors. For these reasons, lengthy and unpredictable timeframes in NPPR application processes are undermining distribution of AIFs by non-EU AIFMs in certain Member States.

Uncertainty of NPPR implementation

There is no central register of Member States that have (or have not) implemented the NPPR under Article 42 of the AIFMD. Consequently, non-EU AIFMs must seek local legal advice

[4] However, we understand there are exceptions for U.S. AIFMs that can provide evidence that they are registered with the U.S. Securities and Exchange Commission as an "investment adviser" or a "relying adviser."

[5] However, we understand that if the AIF is not under regulatory supervision in its home state, a statement to the same effect issued by a law firm in that state may be provided instead.

in each Member State to determine the scope and conditions of the regime. This can be costly and time-consuming where the non-EU AIFM markets its AIFs in several Member States.

Regulatory reporting requirements

Notwithstanding the policy objective of collecting systemic risk information across jurisdictions and the stipulation of the precise information in Commission Delegated Regulation (EU) No 231/2013, there is no single template for regulatory reporting under Article 24 AIFMD ("**Annex IV reporting**"). Instead, Member States specify their own Annex IV reporting templates at a national level. The method by which Annex IV reports are submitted also differs across Member States, for example, through web portals run by NCAs, such as the UK FCA's "GABRIEL" reporting portal, or through licensed third party providers, such as "FundSquare" in Luxembourg.

In situations where a feeder AIF is marketed in an EU Member State but its master AIF is not, certain Member State NCAs require Annex IV reports only for the feeder AIF, while others impose an additional requirement that an Annex IV report also be prepared and filed for the feeder AIF's related master AIF (notwithstanding that the master AIF is not marketed in the Member State).

There are also inconsistencies regarding the transposition of Article 22 AIFMD. Certain NCAs, such as the Netherlands Authority for the Financial Markets, require that the AIFM actively submits the AIF annual report to them, while others, such as the UK Financial Conduct Authority (the "**FCA**"), only require that annual reports are made available on request.

Additionally, Member States differ in the requirements they impose on non-EU AIFMs marketing under the NPPR to update the NCA of changes to information about the AIFM and the relevant AIF. Some Member States have only limited requirements to provide updates to the NCA after the initial notification is submitted or the initial application is approved. For example, the UK has a prescribed form that AIFMs are required to use to provide updates to certain basic information provided to the FCA in the initial notification (*e.g.*, the legal name and registered office address of the AIFM). However, other Member States such as Finland and Sweden have more extensive update requirements that may extend to certain changes to the offering documents of the AIF. The materiality threshold for when such changes should be notified to the NCA is not always clear and the requirement to provide such updates imposes additional compliance costs on the relevant AIFMs.

Requirements on cessation of marketing

Because the implementation of the NPPR in each Member State is a matter of local law, the requirements relating to a non-EU AIFM's obligations upon the cessation of marketing of its AIFs in a Member State is also unclear. For example, there is some variation between Member States regarding when final Annex IV reports must be submitted and for how long the AIFM is required to continue to submit or make available AIF annual reports under Article 22 AIFMD to the NCA. This uncertainty may result in additional costs for some AIFMs and may discourage future distribution activities in the relevant Member States.

Inconsistent definition of "marketing" (Questions 3.1b, bb and c)

Although the term "marketing" is defined at Article 4(1)(x) of the AIFMD[6] and is often transposed directly into national law in the same or a similar form of words, the definition is subject to inconsistent interpretation under national law across EU Member States. This results in uncertainty over whether, and when, a notification to, or approval from, the relevant NCA is needed in order for the non-EU AIFM to "market" its AIFs in a particular Member State.

Helpfully, some NCAs have provided guidance clarifying that an AIFM is only "marketing" if it provides final offering documents or subscription documents to a prospective investor, on the basis of which the invest may make or accept an offer to invest in shares or units in the relevant AIF. For example, the FCA has stated as follows in respect of what constitutes "an offering or placement", which is a key term in the AIFMD definition of "marketing":[7]

> "[...] in our view, an offering or placement takes place for the purposes of the [UK Alternative Investment Fund Managers Regulations 2013] when a person seeks to raise capital by making a unit [or] share of an AIF available for purchase by a potential investor. This includes situations which constitute a contractual offer that can be accepted by a potential investor in order to make the investment and form a binding contract, and situations which constitute an invitation to the investor to make an offer to subscribe for the investment."

In other Member States, such as the Netherlands and Sweden, the term "marketing" is defined or interpreted far more broadly and extends beyond activities that are directly attributable to offering, or inviting an investor to offer to invest in, shares or units of an AIF on a clear set of contractual terms. These broader interpretations of the term "marketing" deviate from the plain reading of the AIFMD definition. They also make it far more difficult for non-EU AIFMs to gauge the interest of prospective investors in a particular AIF or investment strategy, as any references to a particular AIF could constitute illegal marketing in those Member States.

Rather than protecting prospective investors, this has the perverse effect of limiting professional investors' access to investment information, and their range of potential investment opportunities, without serving any clear regulatory purpose. This puts those investors at a competitive disadvantage to investors in other jurisdictions and serves as a barrier to the efficient allocation of investment capital in those Member States. As discussed above, such barriers to cross-border distribution also may limit the availability of investment capital in the EU, as many of the relevant AIFs invest significantly in EU markets.

There is also a high degree of uncertainty across the EU regarding the scope of permitted "reverse solicitations," where an AIFM may permit a prospective investor to invest in its AIF without having to comply with the NPPR if the investor initiated discussions with the AIFM or its

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[6] The definition reads as follows: "'marketing' means a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union."

[7] At section 8.37.5G(1) of Chapter 8 of the FCA's Perimeter Guidance manual, *available at*: https://www.handbook.fca.org.uk/handbook/PERG/8/37.html.

agents and requested the relevant offering and subscription documentation on its own initiative without the AIFM or its agents having "marketed" the AIF. This uncertainty creates similar barriers to cross-border distribution against the interests of non-EU AIFMs and EU professional investors.

Costs of accessing the NPPR (Question 4.1)

There are a number of significant costs involved for non-EU AIFMs to access the NPPR. Key costs include legal advice and other service provider costs (such as providers of depo-lite services for Denmark and Germany), regulatory reporting costs (which can require significant internal resources, as well as external legal and compliance advice) and regulatory fees (see below). These costs vary depending on the relevant Member State, due to the range of different requirements discussed above. For example, legal costs are higher where the initial filing requirements involve a detailed application, especially where follow-up questions from the regulator are common, for example in Sweden.

Fulfilling the "depo-lite" requirements under the NPPR in Denmark and Germany can be expensive, as non-EU AIFMs generally need to obtain additional services from their fund administrators or other service providers in order to satisfy the requirements, particularly the oversight requirements equivalent to Article 21(9) AIFMD.

In addition to these explicit costs, the legal and compliance uncertainty for AIFMs that wish to market into multiple EU Member States under the NPPR creates significant implicit costs for firms. Because firms do not want to face reputational or other risks associated with inadvertent violations of the AIFMD or local rules, they often choose to forego marketing to investors in certain jurisdictions and allocate significant internal resources to ensure compliance in those jurisdictions where they do engage in marketing activities.

Regulatory fees (Question 5.1)

There is broad variation in regulatory fee practices under the NPPR. Some NCAs charge no fees, while others charge an initial filing or application fee and others charge both an initial filing fee and annual fees. Such fees are generally charged on the basis of the number of AIFs marketed in the relevant Member State; however, the level of these fees differs by Member State.

Other suggestions to reduce barriers to cross-border distribution of AIFs (Question 10.1)

We note that the AIFMD was one of the first major pieces of EU financial services legislation following the financial crisis. Since the publication of the AIFMD, there have been other key legislative initiatives that have given policy makers further opportunities to consider the application of rules on a cross-border basis, most notably the Regulation on OTC derivative transactions, central counterparties and trade repositories (Regulation 648/2012) ("**EMIR**") and the new Markets in Financial Instruments Directive (2014/65/EU) ("**MiFID II**") and Regulation (Regulation 600/2014) ("**MiFIR**"). We believe that these further legislative initiatives can provide

valuable insights as the European Commission considers the issue of cross-border distribution of funds in the CMU context.

With this in mind, MFA is keen to engage with the Commission on possible approaches in addition to the existing AIFMD passport regime and the existing NPPR, which we believe could help reduce barriers to cross-border distribution of AIFs, particularly from third country AIFMs. One additional approach the Commission could consider would be a harmonized NPPR approach, which Member States could opt into, which would provide a consistent set of rules for AIFMs marketing into those Member States. Another possible approach would be to permit third country AIFMs that are subject to rules in their home jurisdiction that have equivalent effect to the AIFMD requirements to market to EU professional investors, similar to the approach taken under MiFIR. We would welcome the opportunity for further discussions with the Commission regarding these, or other additional approaches to reduce barriers to cross-border distribution of AIFs.