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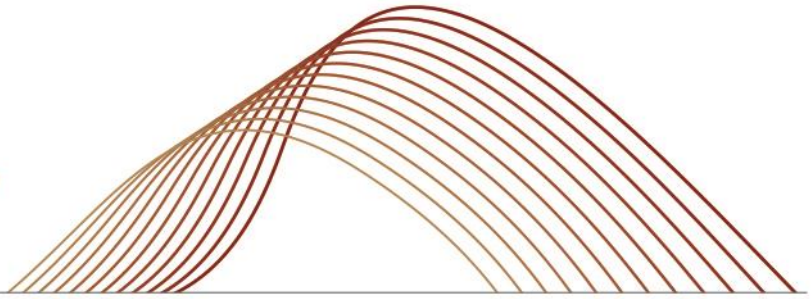

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AIFMD and Pre-Marketing – Helpful Clarification or an Additional Surveillance Camera?

By Steven Ward

On April 16, 2019, the European Parliament (the "EP") voted to adopt a raft of measures which include measures to harmonise standards around the marketing and sale of interests in alternative investment funds across the EU. To date, there have been divergences in approach by national regulators as to when "marketing" is deemed to occur and thus compliance with the Alternative Investment Fund Managers Directive (the "AIFMD") is triggered. The forthcoming changes to the AIFMD will bring about consistency of approach, though also resulting in tougher standards in some jurisdictions.

The new legislation includes rules on the standardisation of fees and charges with respect to the passporting of AIFs and rules regarding the ability of AIFMs to de-register a passported AIF and, crucially, formally recognises and codifies the concept of "pre-marketing" into EU legislation, thus amending the European Union Directive on Alternative Investment Fund Managers. The new rules will be required to be implemented by summer 2021.

This alert focuses on the new definition of "pre-marketing" and its impact on fundraisings by both EU AIFMs and non-EU AIFMs. Whilst many market participants have long lobbied for a consistent interpretative approach across EU regulators with respect to key AIFMD concepts, the new proposed definition of "pre-marketing" shows that the price for clarity can be restriction and that sometimes you should be careful what you wish for.

Background

When, on January 10, 2019, the EC published a report prepared by KPMG in relation to the operation of the AIFMD (the "Article 69 Report"),[1] respondents had bemoaned the lack of harmonisation across member states with respect to the interpretation of key concepts such as "marketing", "pre-marketing", and "reverse solicitation". The divergent views of European regulators on these key concepts had, respondents noted, created complexities in (and hampered their ability in) raising capital across the EU. Indeed, the Article 69 Report showed that only around three (3) per cent. of AIFs are currently registered for distribution in more than three (3) member states, showing that the AIFMD passport was not being as widely used as had been expected upon the introduction of the AIFMD.

"Marketing" an AIF within the EU triggers compliance obligations for an AIFM (whether EU or non-EU). Given the lack of clarity and inconsistency across the EU as to what constitutes "marketing" an AIF, a concept of "pre-marketing" (i.e., permissible activity that an AIFM could undertake with respect to an AIF to gauge investor appetite before triggering additional AIFMD compliance

requirements) had developed into market practice as a form of "shadow concept". Some competent authorities within the EU, such as the Financial Conduct Authority (the "FCA"), had formally recognised the concept of "pre-marketing" and provided guidance as to permissible activity, whereas other regulators had not (formally or informally) recognised it.

In March 2018, the EC published a draft set of measures (the "Draft Measures"), which were the initial iteration of the legislation adopted by the EP on April 16, 2019. As part of this package, a new definition of "pre-marketing" was included, giving the concept a codified basis for the first time at the EU legislative level. Whilst providing recognition of the concept, many respondents noted that the original proposals from the EC were much more restrictive than the current pre-marketing "rules" in many member states and the introduction of such a narrowly construed definition may actually hamper cross-border distribution of AIFs rather than facilitate it.

After consultation with stakeholders, the EC published updated and much improved language regarding "pre-marketing". The final text, however, still presents difficulties and includes ambiguities that need to be resolved urgently.

The Definition

The new rules will apply to EU full-scope AIFMs in respect of AIFs that are either (a) not yet established; or (b) not yet notified for marketing to an EU regulator pursuant to Articles 31 or 32 of the AIFMD.

We unpack the new definition of "pre-marketing" below.

Definitional Element	Commentary
"the provision of information or communication (direct or indirect)"	Very broad and would appear to include discussions as well as written information.
"on investment strategies or investment ideas"	The focus is on strategy rather than the terms of the fund itself and investors' participation therein.
"by an EU AIFM or on its behalf"	Consistent with the AIFMD marketing definition, placement agents can undertake pre-marketing activities on behalf of an AIFM (and therefore, it follows, can tip an AIFM into compliance with the new rules).
"to potential professional investors domiciled in or with a registered office in the EU"	No scope for pre-marketing to retail investors in the EU, the possibility of which under the AIFMD does not seem to have been taken up, in any event, by AIFMs given the enhanced regulatory obligations attaching to retail distribution.
"to test their interest in an AIF which is not yet established or which is established but has not yet been notified for marketing in accordance with Article 31 or 32 of the AIFMD"	The "pre-marketing" definition in the Draft Measures provided that pre-marketing was not possible with respect to any AIF that was "established". After much consultation, this has now been removed so that pre-marketing of established AIFs is permitted, subject to certain rules below, which is a substantial improvement.

Under the new rules, EU member states must permit pre-marketing unless the information provided by the AIFM:

- enables investors to commit to acquiring units or shares of a particular AIF;
- amounts to a subscription agreement (in final or draft form); or
- amounts to a final constitutional document, prospectus or offering document.

Under the Draft Measures, no pre-marketing was permissible if the AIF had been established (similar to the current Danish rules on pre-marketing) – as such, the new rules are a clear improvement. Likewise, the Draft Measures had precluded the provision of draft constitutional and offering documents, which would have been a departure from market practice in a number of member states (notably the U.K.) and hamstrung the ability of AIFMs to test a potential investor's interest in a fund, simply as the investor would have had such limited visibility on its proposed terms.

The new rules provide that literature relating to an AIF must not contain "sufficient information to allow investors to take an investment decision", must clearly state that the material does not constitute an offer to subscribe for units/shares/interests, and the information must be clearly flagged as subject to change. What constitutes "sufficient information to allow investors to take an investment decision" is inherently subjective and will vary on an investor-by-investor basis. For instance, some investors may decide to invest on the basis of the AIFM's track record or on the back of a term sheet. Arguably, whilst not a constitutional or full form offering document, a flipbook noting that the terms of a future AIF will mirror those of a predecessor AIF (or that such terms will be in line with market standards for a type of fund, such as private equity) could be seen to provide sufficient information to permit an investor to make an investment decision (particularly if they have been in the prior fund). As such, query whether pre-marketing to existing investors in an existing fund with respect to a successor fund (the terms of which are noted as being "substantially similar" to those of the existing fund) is possible absent a reverse solicitation/immediate marketing notification.

Pre-Marketing Process – A New Surveillance Camera?

If an AIFM intends to pre-market an AIF (or potential AIF) in a member state, it will have to notify its home state competent regulatory authority within two (2) weeks after the commencement of pre-marketing activity within the EU and provide details of the timeframes for pre-marketing, a brief description of the pre-marketing and a list of AIFs being pre-marketed. This information will then be communicated to the competent authorities of the other member states in which pre-marketing is conducted, which can then request additional information about any pre-marketing activity occurring within their territorial jurisdiction.

The notification requirement adds an additional compliance obligation into what is already a regulatory obstacle course for fundraisings. It is unclear why competent authorities need this additional surveillance camera so early on given that a number of such potential AIFs will never be launched.

The inevitable result of the notification requirement is that a new concept of "pre-pre-marketing" is likely to evolve in the market, such action being action that can be taken by an AIFM without triggering the "pre-marketing" compliance obligation. For example, such communication would need to be limited to high level discussions around strategies or more generic matters and not be limited in any way to a prospective fund. This might be difficult to construct and control, particularly with marketing staff eager to promote a forthcoming investment.

Reverse Solicitation

The new rules state that any participation by a professional investor domiciled or with its registered office in the EU within 18 months of the commencement of pre-marketing will be deemed to be the result of marketing and a formal passporting application will need to be submitted.

Whilst the 18 month period is somewhat arbitrary (although better than the open ended period in the Draft Measures), the principle that an AIFM cannot approach an investor on a pre-marketing basis and then later claim reverse solicitation (on the basis that their prior contact did not arise to the level of the regulated activity of "marketing") is not a departure from current market practice as clearly, pre-marketing implies that a certain level of promotional activity has taken place so that the investor cannot reasonably be regarded as approaching the AIFM on the investor's own initiative. That said, in the absence of prescriptive timelines, it may be possible to take a more pragmatic view as to when any initial contact has become stale. What is of concern, however, is the ambiguous drafting of the new language which does not clarify whether the restriction on relying on reverse solicitation within 18 months of pre-marketing applies on an investor-by-investor basis (as would seem sensible and in line with current practice) or on a jurisdiction-by-jurisdiction basis. In practice, this would would mean that if an AIFM pre-marketed an AIF to an investor in the Netherlands, which then decided not to participate, but then a different Dutch investor approached the AIFM completely on their own initiative and did ultimately subscribe, such second investor would be deemed to have been marketed to by the AIFM notwithstanding the actual facts in play. Such a counterfactual approach would not seem logical and it is hoped that the European Securities and Markets Authority will issue guidance on this. Failing this, member states may clarify the situation when implementing the new legislation into local law but this risks asymmetrical approaches being taken towards key concepts across the EU, undermining the very purpose of the new legislation.

If the latter interpretation is the correct interpretation this would appear to have the effect of extinguishing the concept of reverse solicitation in all but the most exceptional circumstances. We understand, anecdotally, the several regulators within the EU are suspicious about the use of reverse solicitation and the lack of regulatory oversight it entails, so it is not out of the realm of possibility that the new rules are being used to crack down on reverse solicitation.

Impact on Non-EU Managers

The new legislation applies to EU "full-scope" AIFMs and not non-EU AIFMs. However, it shows a clear indication of travel and the recitals from the new legislation note that the contents should not create a competitive advantage for non-EU AIFMs over EU AIFMs. Indeed, it is unlikely that the European authorities would permit any regulatory arbitrage to arise in this context as it would undermine their efforts to encourage AIFMs to shift operations into the EU and away from jurisdictions such as the Channel Islands. As such, we can expect (a) member states to update their national private placement regimes ("NPPR") to apply the new rules to non-EU AIFMs; and (b) the definition of "pre-marketing" to be incorporated into the next iteration of the AIFMD following updates made pursuant to the Article 69 Report. As with current "material change" notifications for non-EU AIFMs that have registered AIFs for marketing in the EU, it is likely that each individual EU member state's regulator will need to be notified of any pre-marketing (rather than the single regulatory point of contact for EU AIFMs).

In the interim, it remains to be seen whether EU regulators and local counsel adopt the new definition as *obiter* when discussing fundraisings in Europe by non-EU AIFMs. The above is also likely to be true in connection with the private placement activities by sub-threshold EU AIFMs.

Overall Comment

Whilst the stated aim of the legislation of reducing regulatory complexity and barriers to cross-border distribution of AIFs is laudable, in practice the new definition of "pre-marketing" is likely to reduce cross-border distribution of AIFs by making gauging interest in AIFs by potential investors more complex for AIFMs. The introduction of new notification requirements for pre-marketing seems at odds with the stated objective of reducing regulatory barriers.

The passporting process for EU AIFMs (notwithstanding criticisms of certain EU member states that impose additional fees/local agent requirements) is fairly straightforward. As such, the new rules should not have a dramatic impact on those managers. Where the impact will be most acutely felt is by non-EU managers, which will need to consider the new rules (including the potential for notification requirements) in light of the already costly and time-consuming private placement process.

A number of respondents whose views fed into the Article 69 Report argued that in the event that the AIFMD passport is extended to "third country" AIFMs (the timetable and political appetite for which is currently uncertain), the NPPRs should continue to function alongside the passport in order to maximum flexibility. If the third country passport is extended and the NPPRs are extinguished after a period, and if it is clarified that the restrictions on post-pre-marketing reverse solicitation apply on a jurisdiction-by-jurisdiction basis, this is likely to have a chilling impact on the desirability for non-EU AIFMs to fundraise in Europe and thus effectively lock out European investors from some of the biggest and most successful AIFs in the market.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:

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[1] The KPMG report was commissioned by the EC pursuant to Article 69 of the AIFMD, which required that a formal review into the operation of the AIFMD be commenced by 22 July 2017.