Revised proposals for new AIFMD marketing rules: how might they impact non-EU funds and their managers?

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The European Parliament and European Council have finalised the text of a new Directive (AIFMD 2) which supplements the original Alternative Investment Fund Managers Directive (AIFMD) by creating new requirements in relation to the so-called "pre-marketing" of private equity and other alternative investment funds to European professional investors.

The new AIFMD 2 requirements will apply from 2 August 2021, which is the last date for EU member states to change their domestic law so as to bring it into line with AIFMD 2.

By way of brief reminder:

- Currently, AIFMD only regulates "marketing" to such investors, and not "pre-marketing".
- The boundary between the two concepts is extremely important, because many EU countries have imposed additional barriers in relation to "marketing" and managers don't want to have to comply with the relevant requirements unless they have a reasonably good prospect of securing a commitment from an investor located in the relevant country.
- The 'catch', of course, is that the only way a manager can assess how good its chances are is by testing the market beforehand - so the ability to "pre-market" is essential to avoid significant wasted time and expense.
- Currently, the boundaries in relation to pre-marketing are set unilaterally by each country in relation to its own territory. However, in many cases there is very little guidance and so the position is uncertain (and how far to push things becomes a risk-based judgment for each manager).
- In other cases there is some formal guidance on pre-marketing but it is so restrictive that managers have tended simply to cut the relevant jurisdiction out of their marketing plans. This is bad for investors in the more conservative jurisdictions as they are currently being denied access to many high-performing funds.

AIFMD 2 introduces a uniform definition of pre-marketing across the whole of the EU. Early drafts of the new Directive were based on the rather restrictive approach that had evolved in a number of conservative member states. However, the final text is much closer to the position

that currently applies in more liberal jurisdictions such as the UK and the Netherlands so that, for example, drafts of certain key fund documents will be able to be provided as part of pre-marketing i.e. without falling foul of the rules on marketing.

On the face of it, this is excellent news. However, a closer read reveals several potential bumps in the road that managers need to be very alive to when planning their next fundraise:

- Under AIFMD 2, any "*communication...on investment strategies or investment ideas....in order to test [the investors'] interest in a [fund] which is not yet established*"[1] would be expressly caught within the scope of pre-marketing. In view of the new requirements that will apply to pre-marketing in future (see below), it will be essential for regulators to adopt a pragmatic and common sense approach here, so that this only captures overtly promotional activity that is done with the specific purpose and intent of testing interest in relation to a particular proposed fund. It will be important that, for example, more general discussions about markets and possible investment strategies that managers would typically have with their clients as part of any normal relationship meeting do not end up being treated as pre-marketing of a fund.

- Strictly speaking, AIFMD 2 will only apply to EU managers promoting EU funds. Ever since AIFMD first went live, there has been only modest harmonisation of the rules in relation to non-EU managers. EU member states have always had (and many have utilised) the ability to impose additional requirements of their own on top of the baseline requirements for non-EU managers set out in Article 42 of AIFMD. Unsurprisingly, there is no overt change to this position in AIFMD 2. What this means is that it is open to any EU member state to apply a more restrictive definition of pre-marketing to a non-EU manager than to an EU manager. We very much hope that this will not happen in practice, but it is nevertheless important for non-EU managers to remember that the good aspects of the proposed definition of pre-marketing would not automatically benefit them.

- However, that is not the real sting in the tail. Of much greater concern to many non-EU managers are the requirements in AIFMD 2 in relation to:
    - Notification of pre-marketing activity, and
    - Reverse solicitation.

    Recital 12 to AIFMD 2 states that EU member states many not adopt a regime that is more advantageous for non-EU managers than for EU managers. So, when the domestic legislation is implemented in each country, we can expect that the position for non-EU managers will be the same as (or potentially worse than) the rules for EU managers. As a result, the issues we explain below in relation to notification of pre-marketing activity and restricting use of reverse solicitation should be looked at very carefully by all non-EU managers as well.

Notification of pre-marketing activity

Paradoxically, but rather cleverly, the EU authorities have used the liberalisation of pre-marketing to exert much greater control over pre-marketing. The way they achieve this is by requiring the manager to notify its home regulator whenever it starts pre-marketing in another EU country. It's not clear in the proposal how this mechanism would be applied to a manager whose home regulator is outside the EU, but on paper this would represent a sea-change for non-EU managers as they can currently pre-market without any EU regulatory monitoring at all. Crucially, it provides a means for the local regulator to obtain a lot more information regarding which managers are promoting fund products in their territory, and it also will help them to police the more restrictive new rules on reverse solicitation (see below).

Reverse solicitation

Under AIFMD 2, any subscription made within an 18 month period of the commencement of pre-marketing activity will be deemed to have resulted from marketing (i.e. rendering reliance on reverse solicitation impermissible). It has always been the case that a manager cannot (lawfully) use preliminary marketing activities in relation to a fund in order to, in effect, solicit a reverse enquiry from an investor. However, an 18 month moratorium for other potential investors is a very long period indeed.

The other key issue with the moratorium is that it is unclear whether it applies to each investor, to each country or across the whole EU. The drafting is rather loose, and one reading of it (which we have seen some market commentators adopting) would imply that *any* pre-marketing would put all *EU investors* offside for 18 months as regards the possibility of reverse solicitation. Such an outcome would seem rather perverse, since in the world of private funds it is perfectly possible for one investor genuinely to reach out to a manager on its own initiative without having any prior knowledge of very discreet, one-to-one promotional activity that the same manager may coincidentally have engaged in with another investor (and even more so where the discussion with the first investor took place 17 months previously in another country). Another reading would imply that it only puts a manager offside with investors in the same country in which the pre-marketing took place. Both of these possible interpretations present genuine issues for managers. An alternative view is that this restriction is to be looked at only on an investor-by-investor basis - this is obviously the interpretation that is more favourable to managers, however it is far from clear at present that this is the approach that will be adopted.

Conclusion

Although the current patchwork of pre-marketing rules presents some major challenges for fund managers and their placement agents, currently they are at least able to take a business decision based on facts and circumstances (overlaid with some legal advice). However, once the AIFMD 2 definition of pre-marketing becomes written in law it will be much harder to take a pragmatic view.

Moreover, the "carrot" of a permissive UK-style approach to defining the boundary between pre-marketing and marketing has unfortunately been tied to three "sticks", namely (i) an extremely broad definition of what could amount to pre-marketing, (ii) a requirement to notify the regulator as soon as any pre-marketing commences, and (iii) what amounts, in effect, to a major clampdown on the use of reverse solicitation.

As mentioned above, the new regime will go live on 2 August 2021. Many managers currently on the fundraising trail should not be affected, but managers who are only just starting to raise money for a new fund will certainly need to factor this into their planning if there is a chance of final closing being later than July 2021.

Impact of Brexit

As always, we also need to consider whether Brexit would change the position for (pre)marketing by UK managers or to UK investors, assuming that post-Brexit the UK would not be part of the single market.

As regards UK-headquartered managers seeking to market their funds in continental Europe, of course many larger managers will probably be doing so through their fund platforms and affiliated businesses in Ireland and/or Luxembourg, in which case the AIFMD 2 rules would apply anyway. For UK domiciled funds sold into continental Europe that are managed by a UK manager, the manager would need to comply with AIFMD 2 in just the same way as a U.S. manager would.

As regards promotional activity directed at UK investors, it is extremely unlikely that a more restrictive regime would be adopted by the UK than the one set out in AIFMD 2. It is more likely that the UK would either adopt a similar approach, or alternatively decide to operate a more permissive regime (e.g. as currently, not requiring any notification of pre-marketing) and thereby make it easier for U.S. and Asia based managers to market their funds to UK investors than to EU investors. The actual approach will in practice be determined at a political level, depending on whether the UK government seeks a long-term, reciprocal access deal for financial services with the EU based on equivalence (i.e. very close alignment to the EU single market) or a clean-break from the single market.

If you would like further information on the implications of these proposed changes for your next fundraise the Hogan Lovells investment funds team would be delighted to help.

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[1] *The "not yet established" test is currently key to the boundary between pre-marketing and marketing in some countries and it can cause a number of problems. Going forward this should cease to be an issue because, under the new proposal, even if the fund has been established it will still be possible to pre-market so long as there is no subscription document*

(whether draft or final form) or final form PPM that has been provided to the relevant investor.

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