

AIFMD–Time for reflection and extension

ESMA release their advice and opinion

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After much debate, the Alternative Investment Fund Managers Directive (AIFMD) became a reality and entered into force on 21 July 2011. AIFMD provides the framework within the European market for the cross-border distribution of Alternative Investment Funds (AIFs). The key challenge is to understand the practicalities of not only how to comply with the Directive but also how to continue to raise capital.



Distribution

AIFMD, like UCITS, has introduced the notion of a passport enabling European Alternative Investment Fund Managers (AIFMs) to offer their management services and to market their European AIFs to professional investors throughout the European Union. For the purposes of AIFMD, professional investors are those that are defined as professional clients under the Markets in Financial Instruments Directive (MiFID).

National Private Placement Regimes

AIFMD mandates that an EU AIFM which wishes to market non-EU AIFs within the European Union must make separate applications (AIFMD Article 36 notifications) per fund to the individual host state regulators. Similar individual applications are required for non-EU AIFMs wishing to market either EU or non-EU AIFs across Europe (AIFMD Article 42 notifications). This marketing system is called the National Private Placement Regime (NPPR).



ESMA publications: opinion and advice

On 28 July 2015, a week later than expected, ESMA released their highly anticipated opinion on the potential extension of the European Passport to Non EU AIF's/AIFM's. The extension of the passport to a non-EU jurisdiction would allow alternative investment managers to gain access to European investors without the restrictions of the NPPR. The NPPR is scheduled to be reviewed by ESMA for 2018, however, it is important to note that each individual jurisdiction may choose to withdraw their private placement regimes at any point prior to this date. This becomes relevant for those managers still wishing to avail of NPPR currently as Germany has stated its intention to withdraw the regime as soon as non-EU manager passports become available¹.

Having previously stated their intention to extend the passport in stages, there was no surprise as to the structure of ESMA's opinion.

However, there was uncertainty in the industry regarding which countries were being assessed by ESMA and which would receive the passport. In the months prior to the publication, regulatory authorities in both the Cayman Islands and Bermuda publicized their legislative changes in order to position themselves for the passport. It transpired that only two countries, Guernsey and Jersey, received the recommendation for the "third country" passport, with Switzerland endorsed subject to the enactment of pending legislation.

In addition to the above opinion, ESMA also released its advice on the functioning of the AIFMD in the year since it came into force. ESMA advised that as AIFMD was still in embryonic stages, they recommend that more time elapse before they comment in detail on the success of AIFMD. They did, however, note that there was a lack of consistency on the operation of AIFMD between Member States.

¹ <http://cooconnect.com/news/aifmd-passports-for-the-channel-islands-and-switzerland-could-backfire>

	Guernsey 	Jersey 	Switzerland 	USA 	Hong Kong 	Singapore 
Reciprocity of market areas						
Remuneration		Follow AIFMD disclosure rules 	Comparable 		More Information required	More Information required
Systemic oversight				Extensive but different		More Information required
Depository	Similar to AIFMD 			Overall similar	More Information required	More Information required
Co-operation between regulators	Mous and co-operation are working well	Mous and co-operation are working well	Mous and co-operation are working well	Mous and co-operation are working well	More time is needed	Information is scarce and difficult to answer More time is needed

Countries considered by ESMA

ESMA reviewed six jurisdictions as part of their review: Guernsey, Jersey, Switzerland, the United States, Singapore and Hong Kong – according to the same criteria. We have summarized ESMA's findings for each of these criteria for each jurisdiction below.

1. Reciprocity of market access

The key feature of the non-EU regimes which ESMA considered was the degree of reciprocity extended to EU funds and fund managers. They found that in each of the three countries which received positive outcomes, EU managers and funds were subject to the same treatment as local funds and managers. ESMA found that this was not the case with the United States; a finding which was unpopular with U.S. funds industry stakeholders.

ESMA concluded that it was unclear whether Hong Kong applied a level playing field between EU and non-EU AIFMs regarding market access and regulatory engagement; noting that some EU Member States are considered as "acceptable inspection regimes" by the Hong Kong Authorities, but most are not.

In Singapore, ESMA found that managers are required to have a "sufficient nexus with Singapore" and therefore should have at least SGD 500m AuM (EUR 335m) to be authorized. They wanted to investigate this requirement further to assess whether it could create a barrier to market access in the context of making the AIFM passport available to Singapore managers.

2. Remuneration

Another key feature was the existence of remuneration rules akin to the AIFMD rules. As Guernsey has an optional AIFMD compliant regime where managers can choose to apply the AIFMD requirements, these jurisdictions accordingly have AIFMD equivalent rules. Jersey and Switzerland were also found to have broadly similar rules. ESMA's report noted that equivalent remuneration rules do not seem to be applicable in the United States.

ESMA publications

Publication	Topic	AIFMD Articles	Content
Opinion	Functioning of the AIFMD passport and NPPR's	<ul style="list-style-type: none"> Article 67(1) Articles 32 and 33 Articles 36 and 42 	<ul style="list-style-type: none"> Feedback on the surveys conducted by ESMA on the AIFMD passport Opinion on the functioning of the EU passport Opinion on the functioning of the NPPRs Feedback received by ESMA via the responses to the call for evidence
Advice	The application of the AIFMD passport	<ul style="list-style-type: none"> Article 35 and 37 to 41 	<ul style="list-style-type: none"> Detailed assessment of the countries considered for extension of the passport including methodologies, criteria and data Specific analysis and advice on each of the 6 countries selected for consideration. Overview of those countries not considered Summary of the responses to the call for evidence on transversal views on the impact of the possible extension of the passport to non-EU AIFMs

Countries considered by ESMA



British Virgin Islands	Australia	Bahamas	Bermuda
Thailand	Canada	South Korea	Curacao
Cayman Islands	US Virgin Islands	Mauritius	Japan
Mexico	Brazil	Isle of Man	South Africa

3. Systemic oversight

Systemic oversight was another of the critical features. ESMA are confident that the three successful jurisdictions have equivalent regimes and that cooperation between the authorities of those jurisdictions and with EU authorities are working well.

Reporting on their review of the United States, ESMA noted that the reporting requirements were significant, but differed from AIFMD. It added that it could have benefited from having more time to assess the detailed information it received on the U.S. regulatory framework, particularly to allow ESMA to analyze whether the differences between the U.S. regulatory framework and AIFMD would affect their present assessment.

Reporting on the Singapore regime, ESMA found that overall, the requirements in terms of investor protection seem to be fulfilled. The FSAP Report concluded that the Singapore authorities are strict when it comes to market entry and that the authorization process is detailed – however, the follow up and ongoing supervision does not keep those high standards. This might lead to difficulties with reporting and monitoring of systemic risk.

ESMA delivered a positive opinion on the Hong Kong authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in Hong Kong.

4. Depositary regime

In Guernsey, the AIFMD opt-in includes identical depositary requirements; while the original trustee oversight system for open ended funds resembles AIFMD. Jersey's depositary requirements follow the IOSCO principles which are similar to the AIFMD requirements. A Jersey depositary will therefore need to comply with AIFMD as well as local requirements. Overall, Switzerland's depositary requirements are similar to those under AIFMD.

In the United States, ESMA found that mutual funds must place and maintain assets with a qualified custodian. However, certain funds qualify for 'self-custody' under U.S. rules; ESMA noted that these funds would not be appropriate for the EU passport.

5. Co-operation among national competent authorities

Guernsey, Switzerland, the United States and Jersey all received commendable reports on their interaction with national competent authorities (NCAs). ESMA reported that the feedback from NCA's on interaction with the Hong Kong authorities was 'in general terms, positive', while the information available on the interaction with the Singapore authorities was scarce and difficult to address.

Jurisdictions not considered

The jurisdictions which were not considered by ESMA were arguably more significant in terms of impact.

One of most notable being Cayman Islands, especially given Cayman domiciled funds use the NPPR's more than any other jurisdiction. This will have implications for the hedge fund industry and the possibility of this changing soon seems quite minimal².

ESMA identified four assessment methods for determining which countries to consider for this first opinion:

- Sufficient level of information about each relevant Non-EU jurisdiction
- Amount of activity currently being carried out under NPPR
- Existing knowledge and experience of EU NCA's with respect to their counterparts
- Efforts made by stakeholders to engage in the process

All, one, or a combination of the above resulted in sixteen countries not being considered in this opinion.

Next steps

There are two potential outcomes:

- Either the European Commission decides to extend the AIFMD passport to non-EU domiciled AIFMs by adopting a Delegated Act specifying the date when this would become applicable in all Member States
- Or the European Commission may decide to defer any action until ESMA has completed further analyses

In either case, the question that remains for Managers who cannot access the passport is how to raise capital in the EU? As the non-EU marketing regimes are not changing, NPPR remains the option for EU Managers wishing to market non-EU AIFs and non-EU Managers wishing to market AIFs within the EU.

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² See: <http://www.aima.org/en/media/press-releases.cfm/id/EF6EE637-F471-4D1E-BF926D3339CB0DEF> "Cayman islands is confident of being granted AIFMD passport"

To the point

- Only 2 out of the 22 countries considered received the recommendation
- ESMA will continue to work on its assessment of non-EU countries not covered in the first advice in the coming months
- AIFMD has been deemed successful so far with the lack of harmonization being highlighted as a weakness to be addressed.

