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Investment Management Alert

August 7, 2015

Extension of the AIFMD Passports to Non-EU Alternative Fund Managers and Non-EU Alternative Investment Funds

Hardwired into the European Union (EU) Alternative Investment Fund Managers Directive (**AIFMD**) is a mechanism that could enable a non-EU alternative fund manager domiciled outside the EU to become authorised by an EU regulator and then to utilise the "AIFMD passport". The AIFMD passport would allow the non-EU manager to market its funds throughout the EU following a simplified regulatory notification process. The AIFMD passport would be an alternative to the "patchwork" of country-specific private placement rules currently in place for non-EU managers seeking to market their funds in the EU. This mechanism has not yet been activated by the decision-making bodies of the EU.[1]

On 30 July 2015, the European Securities and Markets Association (**ESMA**) published its advice to the European Parliament, Council and Commission as to whether that mechanism should be activated so as to extend the AIFMD passport to non-EU managers and non-EU funds in non-EU jurisdictions. ESMA also issued an opinion on how the AIFMD passport and the national private placement regimes (**NPPRs**) have functioned to date. ESMA's views are indicative of, but not binding on, the decision-making bodies of the EU, which will make the final decisions about extending the AIFMD passport and possibly removing the NPPRs.[2] A final decision as to whether the non-EU AIFMD passport may be available is expected at the end of October 2015

Summary of ESMA's Advice on the AIFMD Passport

ESMA has taken a "country-by-country" approach to considering the jurisdictions to which the AIFMD passport may be extended. ESMA determined that it had sufficient information to undertake a substantive assessment of only six jurisdictions: Guernsey, Hong Kong, Jersey, Singapore, Switzerland and the United States. Of these six, ESMA has recommended that the AIFMD passport be extended to only three: Guernsey, Jersey and Switzerland.[3]

ESMA has suggested that it may be advisable to delay the application of the AIFMD passport altogether until ESMA has made positive recommendations on a sufficient number of non-EU jurisdictions for the

[1] ESMA is required to base its opinion and advice on the AIFMD passport and the NPPRs on, inter alia, the considerations specified under article 67 of the AIFMD. Such considerations include investor protection, market disruption, monitoring of systemic risk and interregulator cooperation, including information-sharing.

[2] ESMA is required to issue an opinion on the functioning of the AIFMD passport and the NPPRs, and advice on the termination of the existence of the national regimes where the AIFMD passport is extended to non-EU managers and funds in 2018. It is technically possible—although unlikely—that the NPPRs would be terminated, leaving the AIFMD passport as the only route to actively market funds to EU investors.

[3] In respect of Switzerland, this applies only following the oncoming changes in legislation, expected to come into effect on 1 January 2016.

extension of the AIFMD passport to be meaningful. This means that it is likely to be some time before the necessary legal mechanisms in AIFMD are activated to extend the passport to any non-EU jurisdiction.

Summary of ESMA's Opinion on NPPRs

ESMA observed that delays in the implementation and transposition of the AIFMD across the EU has made it difficult to assess definitively how the NPPRs function. Consequently, ESMA may issue another opinion after a further assessment period.

However, ESMA's opinion confirms that it does not consider the NPPRs to compromise the functioning and implementation of the AIFMD framework. It therefore seems unlikely that the NPPRs will be phased out until the AIFMD passport is fully implemented and working smoothly, particularly given the complexity of the process for extending the AIFMD passport to non-EU jurisdictions.

Delay of Extension of AIFMD Passport to US AIFMs

With respect to the United States, ESMA noted that it had not had time to comprehensively analyse all of the differences between the regulatory regime in the United States and the AIFMD.[4] It is possible that, on closer analysis, ESMA may determine that certain gaps in regulatory requirements (for example, remuneration requirements) constitute major disparities in the level of substantive regulatory oversight and investor protection.

ESMA identified as problematic the risk of asymmetrical market access between EU managers seeking to market funds to US investors and US managers seeking to market funds to EU investors under the AIFMD passport. As a result, ESMA has recommended that the decision on the application of the AIFMD passport to US managers and funds be delayed until the regulatory requirements that may result in EU managers suffering a competitive disadvantage compared to US managers are addressed. However, ESMA's assessment does not seem to include all relevant elements of the US regulatory framework, and it may adjust its views after considering the same.[5]

Cayman Islands and Other Jurisdictions to be Assessed at a Later Date

ESMA will, in due course, complete an assessment of all key non-EU jurisdictions (including the Cayman Islands, BVI and Bermuda) and advise whether the AIFMD passport should be extended to each jurisdiction. Given the willingness of the key offshore fund jurisdictions to ensure the compatibility of their regulatory regimes with the AIFMD, the main obstacle for the AIFMD passport being extended to US managers will be the resolution of the contention regarding access to the US markets. If ESMA does not change its position on that issue, any resolution to the same is likely to be political, rather than regulatory.

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[4] In order to conduct the assessment, ESMA sought information from the regulators in the relevant non-EU jurisdictions and feedback from the industry in order to assess the regulatory regimes in the non-EU countries on a number of points, including the symmetry of access by EU managers to investors in the non-EU country.

[5] For example, ESMA's assessment does not consider the exemptions available under Rules 504, 505 and 506 of Regulation D.

Meanwhile, Business as Usual

The most common fund structure a US manager will seek to market to EU investors is a fund established in the Cayman Islands (or in certain other key offshore jurisdictions), managed by a US manager. For such a structure to benefit from the AIFMD passport, the AIFMD passport must be extended to both the United States and the Cayman Islands (or other relevant offshore jurisdiction).

This will take time, and it is probably premature for non-EU managers, including US managers, to plan any material changes to their business structures or marketing plans based on the prospective extension of the AIFMD passport. It is likely that, for the foreseeable future, managers will continue to rely on NPPRs when marketing in the EU, and any real improvements to the marketing process under the AIFMD will comprise ESMA's efforts to ensure greater regulatory convergence.

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