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Dear Sir or Madam

Feedback on draft Directive and Regulation on facilitating cross-border distribution of collective investment funds

The City of London Law Society ("**CLLS**") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). The Regulatory Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

Thank you for the opportunity to provide feedback on the proposed Directive and Regulation relating to the crossborder marketing of UCITS and AIFs. Our comments focus principally on the proposals relating to AIFs (including EUSEFs and EUVECAs).

As a general background comment we do not agree that the regulation of the distribution of AIFs and that of UCITS should be fully aligned. UCITS are regulated open ended investment funds investing in liquid financial instruments designed for the retail market. AIFs cover a very wide range of different regulated and unregulated funds, both open and closed ended, investing in all types of asset (not just portfolios of financial instruments, as is suggested in the Explanatory Memorandum). The UCITS Directive offers a cross border marketing passport in relation to both retail and professional investors while the AIFMD offers a marketing passport only in relation to professional investors (plus, for EUSEFs and EUVECAs, a limited subset of appropriately qualified, high net worth retail investors). In practice many AIFs are highly tailored and negotiated investment vehicles available only to a limited number of professional investors. Retail distribution, where permitted, is typically limited to high net worth and/or sophisticated individuals only. Although we agree that any divergence between the rules applicable to the different types of fund should be considered and justified, we believe that full alignment of the marketing rules for such different products, and different markets, is inappropriate.

Certain aspects of the proposals do not appropriately recognise the difference between UCITS as a pre-packaged retail product and AIFs as a negotiated institutional investor product. As a result, some of the proposals as drafted could materially inhibit, rather than facilitate, the cross-border distribution of AIFs. We have particular concerns about the proposals relating to pre-marketing and cessation of marketing.

Pre-marketing (draft Directive Art 2(2) in relation to AIFs other than EUVECAs and EUSEFs and draft Regulation Arts 12 and 13 for EUVECAs and EUSEFs)

We recognise the benefits in the Commission's plan to provide a "safe harbour" for pre-marketing to ensure that AIFMs can test the interest of professional investors in a proposed AIF without being required to incur the significant costs of producing full documentation and obtaining regulatory approval to market an AIF which might never be launched. However, the safe harbour currently proposed is too narrow and needs to be both clarified and extended if it is to fulfil the goal of eliminating the current regulatory barriers to the cross-border distribution of investment funds.

Our drafting comments are as follows:

- We note that the definition of marketing has not been changed and we think that it is of fundamental importance to clarify that the purpose of the new pre-marketing rules is to establish a minimum standard of pre-marketing permitted in each EU Member State (in order to facilitate the better functioning of the Single Market) rather than to impose restrictions on the amount of pre-marketing that a Member State may at its discretion permit.

- It is our understanding the "investment idea" referred to in the definition of pre-marketing can include a description of the proposed fund structure and its features/terms, as well the underlying investment strategy. Potential professional investors generally want and need to discuss all of these aspects when their interest in a possible AIF is being tested.

- The investor protection concerns arise from the possibility that an AIFM may attempt to use the concept of pre-marketing to circumvent the requirements to market an AIF in accordance with the requirements of AIFMD. This concern would appear to be addressed by limiting pre-marketing to a situation where an investor in a particular jurisdiction cannot yet subscribe for units or shares in the AIF, coupled with a recognition that such pre-marketing to a particular investor at the initiative of the AIFM precludes any argument that a resulting subscription is at the initiative of that investor. This would be consistent with the definition of marketing under the AIFMD, which – by definition – only occurs at the point in time when there is an offering or placement of units or shares in the AIF at the initiative of the AIFM or on its behalf.

- For that reason, we can see that final form subscription documents should not be provided to investors during pre-marketing, but can see no reason to restrict the distribution of other documents in draft form. As AIFs are typically negotiated products, it is common to present draft fund terms to a limited number of prospective investors for early comment, with a view to assessing likely interest in the product and/or refining the offering before engaging with investors more broadly. We note that paragraph (d) would be a significant change from the current regulatory practice in a number of major EU Member States, where circulation of draft documentation is permitted.

- We assume that either paragraph 1(b) should be amended to cover a reference to the particular AIF that is to be established following the pre-marketing activity, and not references to any established AIF, or is intended to be an anti-avoidance provision. If the latter is the case we suggest that it should be addressed in the anti-avoidance provisions of paragraph 3. Otherwise, this provision potentially excludes from the safe-harbour any reference to, e.g. prior funds raised by the AIFM, other funds with a similar strategy to the

new AIF under consideration, existing master funds for new feeders etc. Such references are frequently needed when testing the interest of institutional investors in a possible new fund so this should be clarified.

- Although we appreciate the wish to ensure that improper advantage is not taken of the "pre-marketing" safe harbour, we suggest that paragraph 3 would be clearer if it read "Subscription by a professional investor for units or shares of an AIF which is managed or marketed by an EU AIFM following pre-marketing in which the strategy or other features of that AIF were described to that investor at the initiative of the AIFM shall be considered the result of marketing."

- We understand the anti-avoidance concerns leading to the inclusion of the second limb of paragraph 3 (similar funds) as drafted, but consider this is likely to cause considerable uncertainty and difficulty of application which may negate the whole purpose of the safe harbour. It is commonly the case that general discussions are held with professional investors on possible future investment ideas without there being any concrete intention to launch a fund. The more high level and unspecific these discussions are the less likely it is that a record will be kept of the discussion and the fewer features are likely to have been discussed by which "similarity" can be assessed. For this reason, we suggest that consideration should be given to imposing a time limit within which the investor must invest for it to be assumed that the investment results from the pre-marketing activity.

- We consider it important to limit paragraph 3 to situations where pre-marketing has been undertaken at the initiative of the AIFM, as we assume is the case in order to protect the right of professional investors to access funds at their own initiative.

- In relation to paragraph 4, it should be clarified (as we believe is intended) that provided that it does not receive notice to the contrary within the revised timescale in the second sub-paragraph of Article 32(7) an AIFM is still permitted to implement a planned change at the expiry of the initial one month period specified in the first sub-paragraph of Article 32(7) of the AIFMD, and that marketing can continue notwithstanding the revised timescale for the regulator-to-regulator notifications under the fourth sub-paragraph.

Cessation of Marketing (draft Directive Art 2(5))

While we agree that it is desirable to have a clear process for ceasing to market in a particular member state, the new provisions appear to have been drafted with publicly marketed open ended retail funds such as UCITS in mind. They do not seem to be workable or appropriate for closed ended funds where redemptions and repurchases are not permitted and subscription is also not possible once the initial launch period has closed, nor for funds which are not publicly marketed.

We have the following drafting suggestions:

- It should be clarified that an AIFM is not obliged to continue to market a fund or make it available for subscription in any jurisdiction.

- Where no investors in a particular jurisdiction hold units or shares of an AIF, no further conditions should apply to the filing of a notification of discontinuance of marketing in that jurisdiction. In such circumstances no investor protection concerns can arise.

- Where a limited number of investors in a particular jurisdiction do hold units or shares of an AIF:

    - The second half of condition (a) should be clarified by inserting either the word "each" or the words "in aggregate" before the words "hold units or shares of the AIF representing less than 1% of assets under management"

- We recommend the deletion of condition (b) since as noted above many AIFs will have no power to repurchase units. Even in circumstances where the fund's constitution permits the repurchase of AIF units, making such a blanket offer, which may be on different terms from those provided for in the fund's constitution, to certain investors risks treating other investors unfairly, contrary to the AIFM's obligations under the AIFMD. Where the fund is open ended and able to repurchase/redeem units the investor will be able to exercise its rights to redemption or repurchase under the fund's constitution whether or not a marketing notification has been given or withdrawn.

- If retained, condition (b) should apply only to AIFs where the fund's constitution permits the repurchase of units or shares, and the offer should be required to be made by way of direct communication with each of the affected investors sent to the most recent address given in the AIF's investor register or in the manner otherwise provided for giving notice to investors in the AIF's rules or instruments of incorporation and not by way of a public offer. It should also be made clear that a required offer of this kind should not be regarded as turning a closed ended fund into an open ended one for the purposes of the AIFMD.

- Most AIFs are not publicly marketed, so public notice of cessation of marketing is inappropriate. Condition (c) should be amended to require notification to be sent directly to each affected investor at the most recent address given in the AIF's investor register or in the manner otherwise provided for giving notice to investors in the AIF's rules or instruments of incorporation, rather than through a publicly available medium.

- Paragraph 4 relating to the continued provision of information under Articles 22 and 23 is unnecessary since the EU AIFM will continue to be subject to all the requirements of the AIFMD and may be undesirable since it may be taken to imply that other obligations cease in relation to investors in that jurisdiction, which should not be the case.

More generally, since the provisions only apply to EU AIFMs marketing EU AIFs who will be subject to all the investor protection requirements of the AIFMD throughout their management of the relevant AIF, we suggest that no investor protection concerns would arise from allowing such AIFMs to give notice of cessation of marketing once it is in fact the case that the relevant AIF is no longer being marketed in or available for subscription to investors from that jurisdiction (i.e. once the fund is closed to new investment).

Marketing Communications (draft Regulation Art 2)

As noted above we do not think it appropriate for identical provisions to be applied to the marketing of AIFs to professional investors as to the marketing of UCITS (and, where permitted, AIFs) to the general retail market. We suggest that this Article should only apply to marketing to retail investors. In any event it should be made clear that, when interpreting the requirement for marketing communications to be clear, fair and not misleading, it is appropriate to take into account whether the intended recipient is retail or professional and if the former what its experience and level of expertise We also suggest that any guidelines issued by ESMA should either apply only to the retail market or take account of the nature of the target market for the.

Verification of Marketing Communications (draft Regulation Art 5)

Clearly these provisions also form a regulatory barrier to cross-border marketing. We would expect that the obligation to provide a PRIIPs Key Information Document to reduce the perceived need for verification of communications.

There is no definition of "marketing communications" for purposes of this paragraph. To avoid uncertainty as to which retail communications should be notified to competent authorities, it should be make clear that Member States imposing pre-vetting requirement should limit them to standardised marketing communications only and should not extend to, e.g. a course of personalised correspondence with a prospective investor via email. It should also be made clear that Member States may, if they wish to do so, to establish a system under which pre-notification is required only for mass market communications or public advertisement but not for communications with certain more limited groups of retail investor (e.g. semi-professional investors).

Fees and Charges (draft Regulation Arts 6-9)

In our experience the imposition of fees and charges (and, in particular, ongoing or recurring fees and charges) by individual Member States in relation to the exercise of a passport under the AIFMD or UCITS Directive – an imposition which does not occur in relation to the exercise of other Single Market cross border passporting rights – is becoming increasingly significant when fund managers consider whether to make funds available in multiple Member States.

Permitting such fees and charges seems to be contrary to the stated purpose of the new Regulation – as well as out of line with other Directives - since such charges are clearly regulatory barriers to the cross-border distribution of investment funds and the continuance of such does not enable a better functioning Single Market.

If fees and charges are nevertheless to be imposed, we agree that the proposed requirements that they should be at a proportionate level (which we suggest may differ for professional and retail marketing) and published nationally and on an interactive ESMA database are desirable.

As a practical matter, it may be unhelpful to specify that invoices must be sent "to the registered office" of the AIFM or UCITS management company, as this may not always be its principal place of business.

Retail marketing (draft Directive Art 2(7))

An obvious way to increase the cross-border distribution of investment funds and depth of the Single Market would be to consider extending the AIFMD passport to permit EU AIFMs to market all the AIFs they manage, not just EUSEFs and EUVECAs, to the limited range of retail investors permitted under the EUSEF and EUVECA Regulations. Those regulations considered investor protection issues relating to a risky asset class (indeed asset classes which are more risky than those invested in by other AIFs) very extensively and a similar approach might be applied to other AIFs where all the protections offered by the AIFMD are in place, backed up as they are by the provisions of the PRIIPs Regulation and MiFID. However, the extension of the AIFMD passport is a policy question rather than a legal one so we make no further comments on this.

We note that, rather than extending the passport available for retail marketing of AIFs, it is proposed that Member States discretion to permit marketing to retail investors should be further restricted by the imposition of a new minimum requirement for the establishment of certain investor servicing facilities. Clearly this new obligation does not reduce the regulatory barriers to cross-border marketing and is unlikely to increase the extent of such marketing. We appreciate the desire to make this aspect of investor protection regulation consistent where AIFs are (like UCITS) offered to the mass retail market, but suggest these additional requirements are necessary only in that highly unusual situation, and should not apply to limited retail offerings of AIFs to sophisticated or high net worth investors.

We have a number of drafting comments as follows:

- The recognition that physical presence in the relevant Member State is not required and that the new facilities can be provided online is welcome and clearly appropriate for the

ways in which investors now like to invest and have facilities and information. We suggest that this point should be clarified by saying that the relevant facilities must be "made available" in each relevant Member State, rather than that they must be "established in" the Member States. Generally the term "established" is defined in the AIFMD as requiring a registered office or domicile and seems to us inappropriate for the provision of cross-border facilities online.

- The requirement that all these tasks should be "performed in the official language or official languages of the Member State where the AIF is marketed" is potentially very onerous for AIFs which are not widely marketed and is likely to restrict very severely the availability of AIFs cross-border, even to the most limited, sophisticated and high net worth retail investors. Fund managers will be reluctant of unable to incur the additional costs of multilingual facilities to reach a small number of potential investors. The draft is also inconsistent with the requirements of the PRIIPs Regulation, which provides in Article 7 that the Key Information Document should be "written in the official languages or in one of the official languages used in the part of the Member State where the PRIIP is distributed or in another language accepted by the competent authorities of that Member State or where it has been written in a different language it shall be translated into one of these languages." We recommend that the wording used in the PRIIPs Regulation should be adopted with minor amendment to require that the relevant facilities should be made available to the investor in that language, rather than that document(s) be written or translated in the language.

- In many Member State jurisdictions some or all of the functions described are not currently the subject of an authorisation requirement and direct regulation of the party performing the function, when not performed by the AIFM. The delegation provisions of the AIFMD do not require a delegate of functions other than investment management itself to be regulated. We therefore recommend that the requirement that any third party contracted to provide these facilities itself should itself be subject to regulation in the performance of the tasks should be deleted. It should suffice that the AIFM is regulated and has the primary responsibility to ensure that they are properly performed (and is subject to the depositary's oversight in relation to most of them).

- It should be expressly stated, as we believe is implied, that where there are no ongoing subscription rights, or rights of repurchase or redemption under the AIF's constitution, there is no obligation to provide facilities for subscription, payment, repayment or repurchase.

- It should be expressly stated, as we believe is implied, that there is no requirement to provide these facilities to professional investors.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours faithfully

Karen Anderson
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
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