

Brexit and Alternative Investment Fund Managers

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Abstract

In the aftermath of Brexit, the European alternative investment fund industry is confronted with legal uncertainty regarding the post-Brexit relationship between market participants in the EU and the UK. The aim of this article is to shed light on the potential implications of Brexit on AIFMs and AIFs in the UK and discuss the options available to UK AIFMs wishing to access the European market post-Brexit.

Introduction

Alternative investment funds play an important role for the European economy and the promotion of economic growth in the EU. In 2016, the European Commission reported approximately €5 trillion worth of alternative investment funds under management in the EU with 40% of all funds marketed across border.¹ According to a report by PricewaterhouseCoopers in 2016, European hedge funds have reached a total volume of USD 663 billion in funds under management, making Europe the second largest hedge fund centre in the world after the US.² Following the global financial crisis and the criticism levelled against alternative investment funds for aggravating the crisis, the European legislator moved forward with the adoption of the Alternative Investment Fund Managers Directive (AIFMD), which represents the first pan-European effort to regulate the alternative investment fund industry.³ The AIFMD provides an encompassing regulatory framework for the authorisation and operation of alternative investment fund managers

(AIFMs), which manage and/or market alternative investment funds (AIFs) in EU Member States. The main rationales underpinning the adoption of the Directive are the protection of investors in alternative investment funds and the safeguarding of financial stability.⁴

Following the decision by the UK to leave the EU, the European alternative investment fund industry has been confronted with legal uncertainty regarding the future application of the AIFMD and the post-Brexit relationships between market participants in the EU and the UK. The UK's asset management industry is the second largest in the world and the largest in the EU managing approximately £9 trillion of assets.⁵ Investment fund managers utilise the UK as a hub out of which they market their funds to investors across Europe. Brexit threatens to upend the European fund industry choking off the access of European investors to the UK's investment fund industry. The aim of this article is to shed light on the potential implications of Brexit on AIFMs and AIFs in the UK and discuss the options available to UK alternative investment managers wishing to access the European market post-Brexit.

The next section of this article seeks to decipher the possible scenarios concerning the outcome of the negotiations between the UK and the EU with regards to the UK's withdrawal from the EU. This article then offers an overview of the AIFMD and analyses the effects of a "Hard Brexit" on AIFMs and AIFs in the UK. The article goes on to examine the regime introduced by the AIFMD for non-EU AIFMs and AIFs. The final section scrutinises some alternative strategies that UK AIFMs may utilise in order to access the European market post-Brexit.

Possible Brexit scenarios

General remarks

On 23 June 2016, the UK held a public referendum, which resulted in a majority of votes supporting the withdrawal of the UK from the EU. On 29 March 2017, the UK triggered the respective withdrawal proceedings in accordance with art.50 of the Treaty on the European Union⁶ and submitted a notification about its intention to leave the EU to the European Council.⁷ Currently, the EU and the UK are negotiating the arrangements for the withdrawal and their future post-Brexit relationship. The withdrawal of the UK will become effective upon the

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¹ European Commission, "Consultation Document CMU Action on cross-border distribution of funds (UCITS, AIF, ELTIF, EUVECA and EUSEF) across the EU" (2016), p.3 available at: http://ec.europa.eu/finance/consultations/2016/cross-borders-investment-funds/docs/consultation-document_en.pdf [Accessed 4 February 2019].

² PwC, *Fund Distribution in Europe 2016* (2016), p.5 available at: <http://irishfunds-secure.s3.amazonaws.com/1485964631-2016-pwc-ireland-fund-distribution-services-report-june.pdf> [Accessed 4 February 2019].

³ Directive 2011/61 on Alternative Investment Fund Managers and amending Directives 2003/41 and 2009/65 and Regulations 1060/2009 and 1095/2010 [2011] OJ L174/1.

⁴ Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers COM(2009) 207 final 3.

⁵ Jennifer Thompson, "UK Asset Management Sector Passes £9tn Milestone" (13 September 2018), *Financial Times* available at: <https://www.ft.com/content/f64b4a65-d440-398c-9b24-7fda9e4d913a> [Accessed 4 February 2019].

⁶ Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community [2007] OJ C 306/01; Consolidated Version of the Treaty on European Union [2008] OJ C 115/13 (TEU).

⁷ European Council Press Release, "Statement by the European Council (Art 50) on the UK notification" (29 March 2017) available at: <http://www.consilium.europa.eu/en/press/press-releases/2017/03/29/euco-50-statement-uk-notification/> [Accessed 4 February 2019].

conclusion of the withdrawal agreement or two years from the date of the notification.⁸ Thus, the agreement between the EU and the UK would need to be effectively concluded before 29 March 2019, unless this term is prolonged by the European Council in accordance with art.50(3) TEU.

The UK's withdrawal from the EU will have profound implications for the EU's and the UK's financial system and economy. The financial services industry represents approximately 7% of UK's GDP with the London market providing wholesale market services to the rest of the EU.⁹ The Bank of England has warned of the financial stability risks posed by a disorderly Brexit, including the disruption of the provision of financial services to UK and EU clients and the fragmentation in financing sources to the detriment of both EU and UK companies and households.¹⁰ During the Brexit negotiations, several possible scenarios regarding the future relationship between the EU and the UK have been proposed. It should be noted that it is unlikely that the consequences of Brexit will become immediately effective. In particular, the transition period in the short and medium term will be characterised by legal uncertainty regarding the final outcome of post-Brexit arrangements.¹¹

As far as financial services are concerned, the crucial issue in Brexit negotiations is the access of UK financial institutions to the single market. EU financial firms benefit from so-called passporting rights, which allow them to operate across the EU.¹² Passporting rights emanate from the principles of free movement enshrined in EU treaties. According to the passport system, a firm which is authorised in its home Member State can freely offer its services through branches or on a cross-border basis across the EU without being subject to regulation and supervision by the host Member State.¹³ As a member of the EU, the UK benefits from passporting rights. Indeed, the unhindered access of UK financial firms to the single market based on passporting rights is one of the main reasons for the growth of the financial sector in the UK. The withdrawal of the UK from the EU will result in the loss of the financial services passport for UK financial firms.

Soft Brexit

The so-called "Soft Brexit" solution refers to the UK withdrawing from the EU but remaining a member of the European Economic Area (EEA) with UK firms continuing to enjoy access to the European single market.¹⁴ The EEA was established on 2 May 1992 with the signing of the Agreement on the European Economic Area (EEA Agreement), which entered into force on 1 January 1994. The contracting parties to the agreement are the EU, each of its Member States, including the UK, and Iceland, Liechtenstein and Norway.¹⁵ Membership in the EEA gives access to the single market with the EEA Agreement establishing the four fundamental freedoms, namely the free movement of goods, persons, capital and services. In return for access to the single market, EEA members are required to apply EU law in numerous areas, including financial services. In addition, the members of the EEA, which are not EU members, must make financial contributions to the EU. Finally, it should be noted that membership in the EEA does not entail membership in the customs union.

As far as the implications of Brexit on the UK's EEA membership are concerned, the opinion of the UK Government and numerous legal scholars is that, since the UK is a EEA member solely by virtue of its membership in the EU, the withdrawal from the EU will result in the UK ceasing to be a contracting party to the EEA Agreement.¹⁶ According to this view, the UK Government's notification of its intention to withdraw from the EU also contained an implied notice to withdraw from the EEA. Consequently, if the UK decides, after its exit from the EU, to become again an EEA Member, it must apply for membership and its application must be accepted by all other remaining contracting parties.

It should be noted that the AIFMD has been enacted as a European legislative act "with EEA relevance". In September 2016, the EEA Joint Committee adopted the resolution to incorporate the AIFMD into the EEA Agreement in accordance with art.102 of the EEA Agreement and expanded its scope to Liechtenstein, Iceland and Norway.¹⁷ Consequently, the AIFMD equally applies in these EEA Member States.¹⁸ Provided that the UK (re)joins the EEA, UK AIFMs would benefit from the management and marketing passport introduced by the Directive allowing them unfettered access to the European market.

⁸ TEU art.50(3).

⁹ Niamh Moloney, "Brexit, the EU and Its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market", LSE Law, Society and Economy Working Papers 5/2017 (2017), p.8 available at: http://eprints.lse.ac.uk/73429/1/WPS2017-05_Moloney.pdf [Accessed 4 February 2019]

¹⁰ Bank of England, *Financial Stability Report*, Issue No.41 (June 2017) available at: <https://www.bankofengland.co.uk/financial-stability-report/2017/june-2017> [Accessed 4 February 2019].

¹¹ Markus Demary, "The Future of the European Financial System after Brexit" (2017) 36 *Banking & Financial Services Policy Report* 9.

¹² John Armour, "Brexit and Financial Services" (2017) 33 *Oxford Review of Economic Policy* 54, 57.

¹³ Armour, "Brexit and Financial Services" (2017) 33 *Oxford Review of Economic Policy* 54, 57.

¹⁴ Julia Told, "(BR)Exit from the EU—A Legal Perspective" (2017) 14 *ECFR* 490, 518–526.

¹⁵ Agreement on the European Economic Area [1994] OJ L1/3 (EEA Agreement).

¹⁶ See Ulrich G. Schroeter and Heinrich Nemeček, "The (Uncertain) Impact of Brexit on the United Kingdom's Membership in the European Economic Area" (2016) 27 *European Business Law Review* 921 and Dominic Webb, Arabella Lang, Matt Keep, Gaughne Miller and Melanie Gower, "The European Economic Area", No.8129 Briefing Paper (House of Commons Library, 2018), pp.23–27.

¹⁷ EEA Agreement art.102, para.1; Decision of the EEA Joint Committee 2012/2016 amending Annex IX (Financial services) to the EEA Agreement [2017] OJ L46/30.

¹⁸ Karel Lannoo, "EU Financial Market Access after Brexit" (2016) 51 *Intereconomics/Review of European Economic Policy* 255, 256.

Nevertheless, in her speech in Florence, the UK Prime Minister Theresa May stressed that the UK will not be seeking membership in the EEA.¹⁹ Membership in the EEA would force the UK to implement EU rules over which it will have no say after its exit from the EU. As Armour notes, this will leave the UK exposed to politically motivated rule-making that might jeopardise its interests.²⁰ Moreover, EEA members are required to abide by the four fundamental freedoms, including the freedom of movement of persons. Nevertheless, one of the stated objectives of supporters of the UK's withdrawal from the EU was curbing immigration to the UK.²¹ As a result, Theresa May has forcefully affirmed that free movement of EU nationals to the UK will end after Brexit and the UK will reject any future relationship with the EU which requires it to comply with the principle of the free movement of persons. Finally, as a member of the EEA, the UK would have to continue making contributions to the EU budget. As a result, based on the advocated objective of the Brexit referendum and the official declarations of the UK Prime Minister, a Soft-Brexit scenario seems unlikely.

Hard Brexit

The so-called "Hard Brexit" solution refers to any other potential post-Brexit arrangement between the EU and the UK whereby the UK exits both the EU and the EEA and thus loses its access to the European single market.²² In its April 2017 Negotiating Guidelines, the European Council noted that the EU is open to negotiating a trade deal with the UK.²³ Nonetheless, it stressed that any such agreement should preserve the single market, should not grant the UK as a non-member the same rights as an EU member and should not allow cherry-picking of single market rights.²⁴ Consequently, any post-Brexit arrangement that grants the UK full access to the single market must be accompanied by full acceptance of the four fundamental freedoms and acceptance of the jurisdiction of the European Court of Justice both of which are politically impossible for the UK government to accept.

As a result, in a Hard Brexit scenario the UK will immediately become a third country vis-à-vis the EU. As far as financial services are concerned, the UK will lose its access to the single market with UK firms unable to benefit from the freedom of establishment or passporting

rights. Consequently, UK firms wishing to operate and offer their services to customers in the EU must become authorised in each Member State they want to operate in and comply with its regulations. Indeed, EU Member States are allowed to impose on third-country firms more stringent rules than EU firms. Nonetheless, in the aftermath of the financial crisis, the EU is increasingly relying on a new regime, the so-called third-country equivalence regime, to manage third-country entities' access to its market and EU firms' interactions with third-country entities.²⁵ It should be noted that the equivalence regime is not a general framework but merely refers to a body of rules contained in the main post-crisis financial services legislative acts, including the Regulation on Credit Ratings Agencies²⁶ and MiFID II.²⁷ In general, equivalence provisions provide that third-country firms operating in the EU or dealing with EU counterparties will be subject solely to home country authorisation and regulation without having to be authorised by EU Member States and/or comply with EU regulations. A precondition is that the third country's regulatory or supervisory regime is equivalent to the corresponding EU regime. Equivalence assessments are performed by the European Commission often on the basis of advice from the European Supervisory Authorities, reports of international organisations or other public bodies. The equivalence regime seeks to protect financial stability in the EU by curbing systemic risk emanating from third countries while at the same time promoting an open and globally integrated EU market.²⁸ It should be noted that the AIFMD's third-country regime, which allows non-EU AIFMs to access the European market, is not based on equivalence but rather on the authorisation of non-EU AIFMs within the EU.²⁹

In relation to the AIFMD, a Hard-Brexit scenario will indeed result in immediate and perceptible consequences. The AIFMD distinguishes between the authorisation of EU AIFMs and non-EU AIFMs and the management and marketing of EU AIFs and non-EU AIFs. As will be explained below, once a Hard Brexit becomes effective, the UK will automatically be qualified as a third non-EU country and UK AIFMs will lose their access to the management and marketing passport introduced by the AIFMD.³⁰ Recent comments in the media support the view that the ongoing Brexit negotiations could likely result in the UK leaving the European single market.³¹ In

¹⁹ Prime Minister Theresa May, "Speech: PM's Florence Speech: A New Era of Cooperation and Partnership between the UK and the EU" (22 September 2017) available at: <https://www.gov.uk/government/speeches/pms-florence-speech-a-new-era-of-cooperation-and-partnership-between-the-uk-and-the-eu> [Accessed 4 February 2019].

²⁰ Armour, "Brexit and Financial Services" (2017) 33 *Oxford Review of Economic Policy* 54, 58.

²¹ "Brexit and Immigration—The Vital Questions" (18 May 2016), *Financial Times* available at: <https://www.ft.com/content/e1f6c0ee-1c41-11e6-a7bc-ee846770ec15> [Accessed 4 February 2019].

²² Told, "(BR)Exit from the EU—A Legal Perspective" (2017) 14 *ECFR* 536–540.

²³ European Council, *Guidelines Following the United Kingdom's Notification under Article 50 TEU* (2017).

²⁴ European Council, *Guidelines Following the United Kingdom's Notification under Article 50 TEU* (2017), p.8.

²⁵ Niamh Moloney, "Capital Markets Union, Third Countries, and Equivalence: Law, Markets, and Brexit" in Danny Busch, Emiliios Avgouleas and Guido Ferrarini (eds), *Capital Markets Union in Europe* (Oxford: Oxford University Press, 2018), Ch.6, pp.106–108.

²⁶ Regulation 1060/2009 on credit rating agencies [2009] OJ L302/1.

²⁷ Directive 2014/65 on markets in financial instruments and amending Directive 2002/92 and Directive 2011/61 [2014] OJ L173/349. Moloney, "Capital Markets Union, Third Countries, and Equivalence" in *Capital Markets Union in Europe* (2018), pp.108–115.

²⁸ European Commission, "EU Equivalence Decisions in Financial Services Policy: An Assessment", SWD(2017) 102 final, pp.4–6.

²⁹ Moloney, "Brexit, the EU and Its Investment Banker" (2017), p.28.

³⁰ James Smethurst, "No passport for Pimlico: equivalence and the UK post-Brexit" (2017) 4 *J.I.B.F.L.* 234.

³¹ "Brussels and Paris to rebuff May's Brexit hopes for City", *Financial Times*, 5 March 2018.

July 2017, the European Securities and Markets Authority (ESMA) also acknowledged the potential impacts of a Hard Brexit on the European financial markets and specifically addressed several regulatory aspects of the AIFMD in the case of a Hard Brexit.³²

The Alternative Investment Fund Managers Directive

General remarks

Before being able to assess the potential implications of a Hard Brexit on the future business conduct of AIFMs and AIFs in the UK, it is essential to provide a brief overview of the provisions of the AIFMD. Apart from certain exceptions for smaller institutions,³³ the AIFMD requires the authorisation of AIFMs and their compliance with various provisions seeking to enhance investor protection and financial stability. The Directive applies to EU AIFMs managing one or more EU or non-EU AIFs, non-EU AIFMs managing one or more EU AIFs and non-EU AIFMs marketing one or more AIFs to professional investors in the EU irrespective of whether such AIFs are EU or non-EU AIFs.³⁴ Marketing to retail investors is left to the discretion of individual Member States.³⁵

AIFMs are defined as legal persons whose regular business is managing one or more AIFs. According to the AIFMD, AIFs are defined as

“collective investment undertakings, including investment compartments thereof, which raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and do not require authorisation pursuant to Article 5 of Directive 2009/65”.³⁶

Since Directive 2009/65 (UCITS Directive)³⁷ addresses investment funds that have been authorised as UCITS funds, the scope of the AIFMD is generally limited to non-UCITS funds. It should be noted that the AIFMD

does not target investment funds but regulates the manager instead. Individual Member States remain responsible for regulating and supervising AIFs.

If applicable, the AIFMD imposes a rather complex and extensive set of rules for the operation and business conduct of AIFMs, including, inter alia, certain initial capital and minimum funds requirements,³⁸ the obligatory appointment of an independent depositary for each AIF under management,³⁹ detailed operating and organisational requirements,⁴⁰ as well as encompassing transparency and reporting obligations towards the competent national authorities of EU Member States and investors.⁴¹

EU alternative investment fund managers and alternative investment funds

The cornerstone of the AIFMD concerns its authorisation and passport system. Pursuant to the management passport introduced by the AIFMD, once authorised, an EU AIFM may manage EU AIFs established in any other EU Member State either directly or through a branch.⁴² In addition, the AIFMD’s marketing passport allows an EU AIFM to market EU AIFs to professional investors in its home Member State and in any other EU Member State.⁴³ The management and marketing of EU AIFs by EU AIFMs under the AIFMD follows a two-stage process, which consists of: (1) a single authorisation procedure; and (2) subsequent notification requirements (passport system).

The competent national authorities may generally grant an authorisation under the AIFMD when the AIFM disposes of the required initial capital⁴⁴ and, if applicable, the minimum amount of own funds⁴⁵ and the authorities are satisfied that the AIFM will be able to meet all operational and organisational requirements.⁴⁶ Furthermore, the persons who conduct the business of the EU AIFM must be of sufficiently good repute and possess sufficient experience.⁴⁷ In addition, the shareholders of the AIFM that have qualifying holdings

³² ESMA, “Opinion to Support Supervisory Convergence in the Area of Investment Management in the Context of the United Kingdom Withdrawing from the European Union”, ESMA35-45-344 (12 July 2017).

³³ Such as the thresholds, which are exempt from authorisation being leveraged alternative investment funds that do not exceed €100 million in aggregate or unleveraged alternative investment funds that do not exceed €500 million in aggregate. AIFMD art.3.

³⁴ AIFMD art.2(1).

³⁵ AIFMD art.43.

³⁶ AIFMs must at least perform portfolio and risk management services. AIFMD Recital 21.

³⁷ Directive 2009/65 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [2009] OJ L302/32.

³⁸ AIFMD art.9.

³⁹ AIFMD art.21.

⁴⁰ AIFMD arts 12–21.

⁴¹ AIFMD arts 22–4.

⁴² AIFMD art.33.

⁴³ AIFMD arts 31–32.

⁴⁴ With regards to the minimum capital requirements, art.9 of the AIFMD distinguishes between internally managed AIFs (requiring an initial capital of at least €300,000) and externally managed AIFs (requiring an initial capital of at least €125,000).

⁴⁵ With regards to the minimum funds requirement, art.9 requires AIFMs with an overall portfolio value exceeding €250 million to retain own funds in the amount of 0.02 of the amount by which the value of the portfolios of the AIFM exceeds €250 million, but a maximum of €10 million.

⁴⁶ AIFMD art.8.

⁴⁷ AIFMD art.8(1)(c).

must be able to ensure the prudent management of the AIFM.⁴⁸ Finally, the head office and the registered office of the AIFM must be located in the same Member State.⁴⁹

In a second step, a duly authorised EU AIFM may notify the intended management and/or marketing of EU AIFs in EU Member States to the competent authorities of its home Member State.⁵⁰ Provided that the AIFM complies with the provisions of the AIFMD, the competent authorities of the home Member State must forward the respective documentation to the competent authorities of the host EU Member State.⁵¹ Once forwarded, the EU AIFM may commence its notified business activities. Overall, the passport system allows AIFMs authorised in only one EU Member State to subsequently access the whole European market and expand their business activities to other EU Member States.

Non-EU alternative investment fund managers and alternative investment funds

As far as Brexit is concerned, the main point of interest concerns the applicable legal framework and the authorisation of non-EU AIFMs and the management and/or marketing of EU or non-EU AIFs in EU Member States. In this regard, the AIFMD provides for a scaled implementation procedure,⁵² which has not been completed yet. Initially, the AIFMD introduces the passport system for EU AIFMs, which are managing and marketing EU AIFs. Non-EU AIFMs intending to manage EU AIFs and/or market AIFs in the EU cannot become authorised under the AIFMD and benefit from the passport regime.⁵³

Non-EU AIFMs may manage EU AIFs depending on the national law of each Member State. Therefore, non-EU AIFMs seeking to market non-EU or EU AIFs to professional investors in the EU are subject to the national private placement regimes (NPPRs) of individual EU Member States.⁵⁴ Non-EU AIFMs marketing their funds on a private placement basis must also abide by the requirements imposed by art.42 of the AIFMD. Non-EU AIFMs must comply with the transparency requirements introduced by the AIFMD, including disclosure and reporting obligations to investors and authorities. In addition, appropriate co-operation arrangements regarding systemic risk oversight must be established between the competent EU authorities and the supervisory authorities

of the third countries where the non-EU AIFM and non-EU AIF, if applicable, are established. Finally, the third country where the non-EU AIFM and the non-EU AIF are established must not be listed as a Non-Cooperative Country and Territory (NCCT) by the Financial Action Task Force (FATF). It should be noted that the introduction of a NPPR is left to the discretion of individual Member States with certain major jurisdictions either imposing additional requirements, such as Germany and France, or banning NPPRs, such as Italy.⁵⁵

Only in a second step and following a defined procedure to be followed by ESMA and the European Commission will the passport system be extended to third countries, namely non-EU AIFMs and non-EU AIFs. After a further interim period, the NPPRs of EU Member States will ultimately be terminated by the European Commission. Pursuant to art.67 of the AIFMD, ESMA is instructed to issue an opinion on the functioning of the passport system under the AIFMD as well as the NPPRs of EU Member States and advise on the possible extension of the passport system to third countries. The AIFMD provides for an assessment of third countries pursuant to the criteria of investor protection, market disruption, competition and the monitoring of systemic risk.⁵⁶ On 12 September 2016, ESMA submitted a final first version of its opinion and advice and issued positive assessments for an extension of the AIFMD passport to Canada, Guernsey, Japan, Jersey and Switzerland.⁵⁷ For Australia, Hong Kong, Singapore and the US, ESMA advocated certain conditions for a potential extension.⁵⁸ The European Commission would now be expected to adopt a delegated act in accordance with art.67(6) of the AIFMD to extend the passport system to positively assessed third countries. Nevertheless, ESMA suggested that the European Commission, Council and Parliament may wish to delay commencing the legislative procedure until ESMA has delivered positive advice on a sufficient number of non-EU jurisdictions.⁵⁹ As a next step, art.68 of the AIFMD further instructs ESMA within three years after the expansion of the AIFMD's passport to issue an opinion on the functioning of the extended passport system and advise on the termination of the NPPRs, which must then be ordered by the European Commission subject to the approval of the European Parliament and Council.

⁴⁸ AIFMD art.8(1)(d).

⁴⁹ AIFMD art.8(1)(e).

⁵⁰ AIFMD arts 32–33.

⁵¹ AIFMD arts 32–33.

⁵² See Gianna Sagan, "Alternative Investment Fund Managers Directive Impact on Non-EU Managers" (2015) 34 *Review of Banking and Financial Law* 506, 511–512.

⁵³ AIFMD art.67.

⁵⁴ Alternative Investment Management Association (AIMA), "Brexit and Alternative Asset Managers: Managing the Impact" (April 2018), pp.6–7 available at: <https://www.aima.org/resource/brexit-and-alternative-asset-managers-managing-the-impact.html> [Accessed 4 February 2019].

⁵⁵ Loyens&Loeff, "How Brexit Affects your Investment Management Business" available at: <http://cdn.loyensloeff.com/media/7364/brexit-investment-management.pdf> [Accessed 4 February 2019].

⁵⁶ AIFMD art.67(4).

⁵⁷ ESMA, "ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs", ESMA/2016/1140 (12 September 2016).

⁵⁸ ESMA, "ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs" (2016).

⁵⁹ ESMA, "ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs" (2016), p.7.

Against the background of the current Brexit negotiations and the potential realisation of the Hard-Brexit solution, UK AIFMs would no longer benefit from the management and marketing rights introduced by the Directive. In case of a Hard-Brexit scenario, UK AIFMs will automatically be reclassified as non-EU AIFMs and will no longer be able to manage EU AIFs and market AIFs in the EU pursuant to the management and marketing passport.⁶⁰ In addition, after Brexit funds which have been authorised in accordance with the UCITS Directive will no longer be classified as UCITS funds. Pursuant to the UCITS Directive, UCITS funds must be established in the EU and managed by an EU management company. It is likely that these funds will be considered AIFs and their managers AIFMs for purposes of the AIFMD.⁶¹

After a Hard Brexit, UK AIFMs will be able to manage EU AIFs only in accordance with the national laws of the Member States. Furthermore, marketing of AIFs in the EU will be subject to national private placement regimes of Member States and the requirements introduced by art.42 of the AIFMD. Conversely, EU AIFMs will not be able to manage UK funds or market their AIFs in the UK pursuant to the management and marketing passports.⁶² If the passport system is extended to the UK, then UK AIFMs will have the option to access the European market either through the NPPRs of individual Member States or through the third-country passport regime. As soon as the NPPRs are terminated by the European Commission, the only regular option for UK-based AIFMs would be to access the European market through the third-country passport regime.⁶³

Regarding the future expansion of the passport regime, it has been argued that, since the UK has fully implemented the AIFMD into its national laws, in case of a Hard-Brexit scenario, the passport regime would be extended to the UK.⁶⁴ However, a European Commission decision extending the third-country passport regime to the UK cannot be adopted before the UK officially withdraws from the EU. UK-based managers may therefore not be able to manage EU funds and market their funds in the EU until a decision extending the passport regime is adopted by the European Commission.⁶⁵ As a result, specific transitional arrangements may be necessary in order to avoid

disrupting the provision of investment fund management services by UK managers in the EU.⁶⁶ In addition, one should not rule out the possibility of the UK amending its regulatory framework for investment funds after Brexit.⁶⁷ Even if the third-country regime is extended to the UK post-Brexit, the European Commission has the power to amend or withdraw its decision if it considers that the UK no longer fulfils the criteria on the basis of which a positive assessment was previously made.⁶⁸

The passport system for non-EU alternative investment fund managers and alternative investment funds

General remarks

Provided that the European Commission expands the passport system, the AIFMD imposes a set of rules targeting non-EU AIFMs.⁶⁹ The AIFMD introduces specific requirements in relation to the authorisation of non-EU AIFMs and imposes on non-EU AIFMs numerous obligations regarding their organisation and conduct of business. The following section provides an overview of certain significant aspects of the third-country regime introduced by the AIFMD.

Authorisation

Pursuant to art.37 of the AIFMD, a non-EU AIFM seeking to manage EU AIFs and/or market EU or non-EU AIFs in the EU must acquire prior authorisation by the competent national authorities of its Member State of reference. The AIFMD introduces a complex set of rules regarding the proper determination of the Member State of reference whose authorities are competent to authorise it and conduct supervisory functions. More specifically, the competent Member State of reference is determined by focusing on the location of all or a substantial part of the intended future business activities of the non-EU AIFM.⁷⁰ The non-EU AIFM must initially determine its Member State of reference and direct its application to the competent authorities of such Member State.⁷¹ In case of several possible Member States of reference, the non-EU AIFM must submit a request to the authorities of all possible Member States of reference to determine its Member State of reference.⁷² Those authorities will

⁶⁰ AIMA, "Brexit and Alternative Asset Managers: Managing the Impact" (2018), p.6.

⁶¹ Clifford Chance, "Brexit—Assessing the Impact on Asset Managers" (July 2016), pp.1–2 available at: <https://www.cliffordchance.com/briefings/2016/07/brexit-assessingtheimpactonassetmanagers.html> [Accessed 4 February 2019].

⁶² See Stephen G. Sims, Patrick Brandt and Daniel F. Faundez, "The Future of Marketing Non-EU Alternative Investment Funds in Europe" (2014) 131 *Banking LJ* 278.

⁶³ AIFMD art.68(4).

⁶⁴ See Lannoo, "EU Financial Market Access after Brexit" (2016) 51 *Intereconomics/Review of European Economic Policy* 258. Indeed, the UK Government has even announced its intention to adopt a Great Repeal Bill at the moment of exit from the EU, which will repeal the European Communities Act 1972 and transpose all EU law into domestic UK law.

⁶⁵ Haut Comité Juridique de la Place Financière de Paris, "Rapport Brexit et Gestion D'Actifs" (12 September 2018), p.31 available at: https://www.banque-france.fr/sites/default/files/rapport_22_f.pdf [Accessed 4 February 2019].

⁶⁶ Haut Comité Juridique de la Place Financière de Paris, "Rapport Brexit et Gestion D'Actifs" (2018), p.31.

⁶⁷ Eilis Ferran, "The UK as a Third Country Actor in EU Financial Services Regulation" (2017) 3 *Journal of Financial Regulation* 40, 59.

⁶⁸ European Commission, "EU Equivalence Decisions in Financial Services Policy: An Assessment", SWD(2017) 102 final 2.

⁶⁹ See European Private Equity and Venture Capital Association (EVCA), *A simple introduction to the impact of the EU's Alternative Investment Fund Managers Directive (AIFMD) on non-European GPs and LPs* (December 2013), pp.5–7 available at: https://www.investeurope.eu/media/82990/evca_aifmd_third_country_paper.pdf [Accessed 4 February 2019].

⁷⁰ AIFMD art.37(4).

⁷¹ AIFMD art.37(1).

⁷² AIFMD art.37(4).

then decide the Member State of reference of the non-EU AIFM. To facilitate these proceedings, the European Commission issued detailed procedural guidelines for cases where the AIFMD provides for more than one potential Member State of reference.⁷³

Furthermore, the AIFMD imposes various conditions on non-EU AIFMs applying for an authorisation under the third-country regime. First, the AIFMD refers to the conclusion of appropriate co-operation agreements between the authorities of the Member State of reference, the authorities of the home Member State of marketed EU AIFs and the competent authorities of the third country where the non-EU AIFM is established.⁷⁴ These co-operation agreements shall at least ensure an efficient exchange of information and allow the competent authorities to carry out their duties under the AIFMD. Similar co-operation agreements are required in relation to the notification of the intent to manage and/or market non-EU AIFs in the EU⁷⁵ and the authorisation under the NPPRs.⁷⁶ Secondly, non-EU AIFMs and non-EU AIFs are generally denied access to the European market when they are established in a country listed as a NCCT by the FATF.⁷⁷ The NCCT list aims to highlight jurisdictions, which are generally vulnerable for the financial markets systems and impose high risks of money laundering and terrorism financing.⁷⁸ Thirdly, the AIFMD demands the concerned third country to co-operate in matters of income and capital tax. In detail, the third country must comply with international taxation standards laid down in art.26 of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and Capital 1992 and ensure an effective exchange of information in tax matters, including any multilateral tax agreement.⁷⁹ This requirement also applies for the marketing of non-EU AIFs in the EU.⁸⁰ Finally, it must be ensured that the supervisory functions of competent European and/or third-country authorities are not restricted by the laws, regulations or administrative provisions of the third country governing the non-EU AIFM.⁸¹

Concluding, the majority of the aforementioned requirements are dependent on the international co-operation between the national authorities of the concerned jurisdictions, such as with regards the co-operation and tax agreements. Therefore, these issues must not only be addressed in the current Brexit

negotiations between the UK and the EU but also during bilateral negotiations between the UK and each EU Member State and their competent authorities. In this respect, the AIFMD states that co-operation arrangements should not be used as a barrier to impede non-EU AIFs from being marketed in a Member State.⁸² Furthermore, the AIFMD instructs ESMA to develop draft regulatory technical standards on the contents of such co-operation arrangements and provides ESMA with dispute resolution functions to conclude such co-operation agreements.⁸³ However, it could be argued that the negotiation and conclusion of 27 co-operation and tax agreements will likely impose massive efforts, take substantial time and delay the potential expansion of the AIFMD passport system to the UK.

Another important requirement under the AIFMD, which exclusively applies to non-EU AIFMs, is the obligation to appoint a legal representative in the EU. According to the AIFMD, the legal representative is a natural or legal person, which has been expressly designated by a non-EU AIFM to act on its behalf.⁸⁴ The legal representative must have its official address (legal person) or domicile (natural person) in the competent Member State of reference.⁸⁵ He/she acts as contact point and is responsible for the correspondence with the competent European authorities and investors in the EU and additionally performs a compliance function for the management and marketing activities of the non-EU AIFM.⁸⁶

Operational requirements

According to art.37 of the AIFMD, non-EU AIFMs seeking to manage EU AIFs and/or market EU and/or non-EU AIFs in the EU must comply with the provisions of the AIFMD. As a result, the AIFMD has a broad extraterritorial reach. Non-EU AIFMs seeking to access the European market must abide by the AIFMD's provisions aimed at improving investor protection and tackling systemic risk. The AIFMD introduces extensive conduct of business, valuation, depositary, disclosure and capital requirements. Non-EU AIFMs are subject to transparency requirements, including the obligation of fund managers to disclose specific information to investors both prior to the investment and periodically thereafter, including the fees charged to investors, the

⁷³ Regulation 448/2013 establishing a procedure for determining the Member State of reference of a non-EU AIFM pursuant to Directive 2011/61 [2013] OJ L132/3 (Implementing Regulation).

⁷⁴ AIFMD art.37(7)(d).

⁷⁵ AIFMD arts.34(1)(b), 35(2)(a), 36(1)(b), 40(2)(a).

⁷⁶ AIFMD art.42(1)(b).

⁷⁷ AIFMD art.37(7)(e).

⁷⁸ FATF, "About the Non-Cooperative Countries and Territories (NCCT) Initiative" (9 July 2009) available at: <http://www.fatf-gafi.org/publications/fatfgeneral/documents/aboutthenon-cooperativecountriesandterritoriesncctinitiative.html> [Accessed 4 February 2019].

⁷⁹ AIFMD art.37(7)(f).

⁸⁰ AIFMD arts 35(2)(c), 40(2)(c).

⁸¹ AIFMD art.37(7)(g).

⁸² AIFMD Recital 63.

⁸³ AIFMD Recitals 63, 74, art.37(7).

⁸⁴ AIFMD art.4(1)(u).

⁸⁵ AIFMD art.4(1)(j)(iv)-(v).

⁸⁶ AIFMD art.37(3).

investment strategy and the amount of leverage employed and reporting requirements in order to allow national supervisors to assess the financial stability risks posed by the activities of AIFs.⁸⁷ AIFMs must implement organisational and administrative arrangements for identifying and managing any conflicts of interest that could adversely impact the interests of the AIFs that they manage or the funds' investors.⁸⁸ AIFMs must act with due care, skill and diligence and fairly in conducting their activities.⁸⁹ What is more, the Directive imposes modest initial and ongoing capital requirements for AIFMs subject to an overall cap of €10 million.⁹⁰ Hedge fund managers must also devise and implement appropriate risk and liquidity management systems.⁹¹ Finally, remuneration restrictions are also introduced for "identified staff", whose professional activities have a material impact on the fund's risk profile.⁹²

A substantial organisational aspect of the AIFMD concerns the obligation of AIFMs to ensure the appointment of a depositary for each AIF under management.⁹³ In general, the depositary is responsible for various crucial functions in order to ensure the effective protection of investors, such as asset safe-keeping and cash management.⁹⁴ According to the AIFMD, the role of the depositary shall be assumed by credit institutions, investment firms or other similarly regulated institutions.⁹⁵ As far as the location of the depositary is concerned, in the case of EU AIFs, the depositary must be established in the home Member State of the AIF. Non-EU AIFMs managing non-EU AIFs must ensure the appointment of a depositary either in the third country where the AIF is established or in the Member State of reference of the AIFM.⁹⁶ As regards the appointment of a third-country depositary, the AIFMD provides for several additional requirements. First, the AIFMD requires the conclusion of co-operation and exchange of information arrangements between the authorities of the third country, the EU Member States where the non-EU AIFs are intended to be marketed or, if different, the home Member State of the AIFM managing the non-EU AIF.⁹⁷ Moreover, the AIFMD requires the conclusion of tax agreements in accordance with art.26 of the OECD Model Tax Convention on Income and Capital and the effective exchange of information in tax matters between the involved authorities of the third country, the EU Member States

where the non-EU AIFs are intended to be marketed or the home Member State of the AIFM managing the non-EU AIF.⁹⁸ Furthermore, the third country must not be listed as a NCCT by the FATF.⁹⁹ In addition, the appointed third-country depositary must be subject to national laws of the third country, which ensure its prudential regulation, such as minimum capital requirements and supervision.¹⁰⁰ Such laws must have the same effect as EU law and be effectively enforced. According to the AIFMD, the European Commission has been mandated to regularly review third-country regimes and adopt implementing acts stating the jurisdictions meeting this requirement.¹⁰¹ Finally, the depositary must contractually agree to assume liability to the AIF or to the investors of the AIF for the loss of financial instruments held in custody by the depositary or a third party to whom custody has been delegated.¹⁰²

Since non-EU AIFMs are additionally subject to the national laws and the national regulatory regime of their third country, it is likely that such national regime deviates from or even contradicts with the provisions of the AIFMD. The AIFMD explicitly addresses this issue and generally orders the precedence of the AIFMD. The obligation of a non-EU AIFM to comply with the regulatory framework of the AIFMD may only be suspended in rare circumstances where the non-EU AIFM can demonstrate that it is impossible to combine certain provisions of the AIFMD with the mandatory national laws of the third-country jurisdiction; these mandatory national laws provide for equivalent rules having the same regulatory purpose and providing the same level of protection for investors; and the non-EU AIFM complies with such equivalent rules.¹⁰³

Our analysis of the provisions of the AIFMD has shown that non-EU AIFMs seeking to access the European market are subject to stringent operational requirements in addition to any obligations imposed by their home country. It could be argued that these ensure that third-country managers are acting under the same level of regulatory density as EU managers. In light of a potential Hard Brexit, however, it is obvious that the operation of UK AIFMs under the third-country regime would also impose substantial organisational and financial burdens, which might limit their competitiveness.

⁸⁷ AIFMD art.23.

⁸⁸ AIFMD art.14(1).

⁸⁹ AIFMD art.12(1)(a).

⁹⁰ AIFMD art.9.

⁹¹ AIFMD arts 15–16.

⁹² AIFMD Annex II.

⁹³ AIFMD art.21(2).

⁹⁴ AIFMD Recital 32.

⁹⁵ AIFMD art.21(3).

⁹⁶ AIFMD art.21(5)(a)–(b).

⁹⁷ AIFMD art.21(6)(a).

⁹⁸ AIFMD art.21(6)(d).

⁹⁹ AIFMD art.21(6)(d).

¹⁰⁰ AIFMD art.21(6)(b).

¹⁰¹ AIFMD art.21(6).

¹⁰² AIFMD art.21(e).

¹⁰³ AIFMD art.37(2).

Consequently, this situation could also impose adverse effects on the general appeal of the European market to UK AIFMs.

Alternative strategies for alternative investment fund managers and funds in the UK

General remarks

Our analysis has revealed that a potentially extended passport system under the AIFMD provides for a rather unfavourable environment towards non-EU AIFMs. UK AIFMs would initially be dependent on the NPPRs of EU Member States to access the European market.¹⁰⁴ If the third-country regime is extended to the UK, the NPPRs and the third-country passporting regime will co-exist. At a later stage, however, NPPRs of EU Member States are expected to be terminated by the European Commission, leaving UK AIFMs with the only option to apply for authorisation under the third-country passport regime.¹⁰⁵

Depending on whether the third-country passport regime is extended to the UK, UK AIFMs would either have to comply with the NPPR of each Member State where they intend to market their funds or become authorised as non-EU AIFMs under the AIFMD. However, both of these strategies have significant drawbacks. On the one hand, NPPRs are not available in all Member States with major European countries and economies, such as France and Italy, opting against introducing an NPPR or imposing stringent requirements. Moreover, NPPRs will ultimately be terminated by the European Commission. On the other hand, uncertainty remains regarding the extension of the third-country regime to the UK and the length of time it will take for the European Commission to issue a positive decision. Furthermore, even if the third-country passport regime is extended to the UK, the European Commission may at any time withdraw the extension. Thus, the following section analyses certain alternative strategies that can be utilised by UK AIFMs in order to nevertheless access the European market post-Brexit.

Relocation and delegation

An alternative strategy for UK AIFMs intending to access the European market post-Brexit is to relocate their operations to Europe.¹⁰⁶ In a first step and before the UK withdraws from the EU, a UK AIFM would open a branch in the EU benefitting from the management passport offered by the AIFMD. This would ensure that the

relocation to Europe is gradual. In a second step as Hard Brexit nears, the branch would be converted to a subsidiary. After Brexit, the subsidiary would be considered an EU AIFM and would be required to become authorised and comply with the AIFMD. Once authorised, the EU AIFM would avail of the passport introduced by the Directive.

It has also been proposed that an EU AIF managed by a UK-based AIFM might change its organisational structure from external to internal management. According to the AIFMD, an externally managed AIF is characterised by the appointment of an AIFM being a different legal person than the AIF. Internal management on the other hand means that the management of the AIF is conducted by its own corporate bodies.¹⁰⁷ Provided that the corporate form of the AIF allows for internal management, such as in case of a stock corporation by the board of directors, the AIF would then be qualified as the AIFM established in the EU. Consequently, the EU AIFM would continue to take full advantage of the AIFMD passport system even after a Hard Brexit.

Relocations to Europe of financial institutions leaving the UK give rise to the risk of regulatory arbitrage. The financial services industry generates revenue, taxes and highly paid jobs for host states. As a result, European financial centres seeking to lure business out of the UK may be tempted to offer a lax supervisory regime. Recognising the risk of supervisory arbitrage, ESMA issued, in July 2017, an opinion primarily addressed to national competent authorities setting out general principles in order to tackle cross-sectoral regulatory and supervisory arbitrage risks in the area of investment management (2017 Opinion).¹⁰⁸ ESMA stressed that national competent authorities must ensure full compliance with the authorisation requirements of the AIFMD. UK AIFMs cannot be accorded preferential treatment by relying on authorisations in other Member States or third countries.¹⁰⁹ Furthermore, relocating AIFMs are required to demonstrate that the choice of the Member State for relocation is based on objective factors and not regulatory arbitrage.¹¹⁰ Authorities must deny authorisations to relocating entities, which choose a Member State in order to bypass the more stringent supervisory standards of another Member State where they intend to carry out business.¹¹¹ Moreover, national competent authorities must ensure that relocating entities have established and maintain effective governance structures and internal control mechanisms.

Moreover, in order to minimise relocation costs and continue to leverage the expertise of their UK-based operations, asset managers may decide to delegate certain

¹⁰⁴ See Sagan, "Alternative Investment Fund Managers Directive Impact on Non-EU Managers" (2015) 34 *Review of Banking and Financial Law* 506, 511–512.

¹⁰⁵ AIFMD art.68(4).

¹⁰⁶ Laurent Fessmann and Catherine Martougin, "Brexit: Times Are Changing (Again)" [2017] *Agefi Luxembourg* 31.

¹⁰⁷ AIFMD Recital 20.

¹⁰⁸ ESMA, "Opinion to Support Supervisory Convergence in the Area of Investment Management in the Context of the United Kingdom Withdrawing from the European Union", ESMA35-45-344 (12 July 2017).

¹⁰⁹ 2017 Opinion, pp.3–4.

¹¹⁰ 2017 Opinion, p.3.

¹¹¹ 2017 Opinion, pp.3–4.

functions to their UK units.¹¹² Once a UK AIFM establishes a structure in the EU, it would delegate certain functions, such as portfolio and risk management, back to the existing operations based in the UK. However, the strategy of utilising delegation carries numerous risks, most notably the risk of regulatory arbitrage. UK-based AIFMs could set up so-called letter box entities in the EU, namely entities with minimal personnel and operations, and delegate most of their functions back to their UK units.

While delegation is permitted under the AIFMD, the AIFMD imposes rather strict requirements on the use of delegation arrangements in order to tackle the risk of regulatory arbitrage and the phenomenon of letter box entities. Pursuant to art.20 of the AIFMD, AIFMs, which intend to delegate functions to third parties, must notify the national competent authorities. The AIFMD introduces numerous conditions, which must be fulfilled, in order for the delegation arrangements to become effective. Delegation arrangements must be justified on objective reasons.¹¹³ Objective reasons include cost savings, expertise of the delegate in specific markets or investments and access to global trading capabilities.¹¹⁴ Moreover, the delegate must have sufficient resources to perform its tasks and the persons who conduct the business of the delegate must be of good repute and experienced.¹¹⁵ Furthermore, delegation of portfolio or risk management can be conferred only on entities authorised or registered for the purpose of asset management and subject to supervision.¹¹⁶ If this condition cannot be met, the delegate must be subject to prior approval by the competent authorities of the home Member State of the AIFM. In cases where portfolio or risk management is delegated to a non-EU entity, co-operation between the authorities of the home Member State of the AIFM and the third-country supervisory authority must be ensured.¹¹⁷ Another condition imposed by the AIFMD is the requirement for the AIFM to demonstrate that the delegate is qualified, capable of performing the delegate functions and has been selected with due care and diligence.¹¹⁸ The AIFM must be in a position to monitor and give instructions to the delegate.¹¹⁹ Finally, the delegation must not prevent the effective supervision of the AIFM.¹²⁰

In its 2017 Opinion, ESMA sought to clarify the requirements imposed by the AIFMD and also introduced additional requirements regarding the assessment of delegation arrangements. Most importantly, in an effort to curb the emergence of letter box entities, ESMA stressed that authorised AIFMs may not delegate investment management functions to such an extent that exceeds by a substantial margin the functions performed internally.¹²¹ What is more, portfolio management and risk management cannot be delegated in their entirety.¹²² With respect to relocating entities, ESMA stated that relocating entities must transfer a sufficient amount of portfolio and/or risk management functions to their new home Member State. Relocating entities cannot maintain substantially more portfolio and/or risk management functions and the concomitant resources in a third country than in their new home Member State.¹²³ In addition, authorised AIFMs must have sufficient resources and expertise in order to monitor delegates.¹²⁴

Overall, it can be argued that reliance on extensive delegation of tasks may not be qualified as a long-term solution. Although AIFMs might be able to justify the delegation of certain functions to operations based in the UK on objective reasons, ESMA's opinion aims to prevent the widespread use of delegation structures as a potential post-Brexit solution. AIFMs, which utilise delegation, are required to maintain a parallel operative organisation in the EU resulting in significant operational requirements and costs for managers implementing this alternative strategy.

Reverse solicitation

Another possible option for non-EU AIFMs seeking to access the European market is to engage in a practice known as "reverse solicitation". Reverse solicitation falls outside the definition of marketing introduced in the AIFMD. Thus, a non-EU AIFM relying on reverse solicitation to access the European market is not covered by the AIFMD. According to the AIFMD, marketing means a direct or indirect offering or placement on the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages or with investors domiciled or with a registered office in the EU.¹²⁵ Consequently, any activity outside the scope of the definition of marketing

¹¹² 2017 Opinion, pp.4–9.

¹¹³ AIFMD art.20(a).

¹¹⁴ Regulation 231/2013 supplementing Directive 2011/61 with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision [2013] OJ L83/1 art.76.

¹¹⁵ AIFMD art.20(b).

¹¹⁶ AIFMD art.20(c).

¹¹⁷ AIFMD art.20(d).

¹¹⁸ AIFMD art.20(f).

¹¹⁹ AIFMD art.20(f).

¹²⁰ AIFMD art.20(e).

¹²¹ 2017 Opinion, pp.13–14.

¹²² 2017 Opinion, p.14.

¹²³ 2017 Opinion, pp.14–15.

¹²⁴ 2017 Opinion, pp.14–15.

¹²⁵ AIFMD art.4(1)(x).

does not trigger the obligation to comply with the AIFMD. Reverse solicitation refers to passive activity where the investor approaches the manager at his/her own initiative.

Nevertheless, significant legal uncertainty remains with Member States adopting divergent rules and supervisory approaches regarding the notion of marketing and the activities that constitute marketing.¹²⁶ Inconsistencies abound with respect to pre-marketing activities and activities constituting reverse solicitation.¹²⁷ For instance, some Member States consider preliminary contacts between managers and prospective investors as permitted pre-marketing activities, while other Member States view them as marketing activities.¹²⁸ In addition, Member States exhibit different approaches concerning reverse solicitation. For example, some jurisdictions provide that the investor's unsolicited request must refer to a specific AIF in order to be considered reverse solicitation.¹²⁹ In response to complaints of market participants regarding the prevailing legal uncertainty, the European Commission put forward a proposal amending the AIFMD which defines "pre-marketing" as the direct or indirect provision of information on investment strategies or investment ideas by an AIFM or on its behalf to professional investors domiciled or registered in the EU in order to test their interest in an AIF which is not yet established.¹³⁰ The proposal does not provide for a definition of "reverse solicitation". Nonetheless, the Commission has endorsed the view of the expert group set up to examine national barriers to cross-border capital flows, which considers reverse solicitation as any unsolicited request by a professional investor concerning units or shares of a specifically designated existing fund without any prior direct or indirect offer or solicitation from the manager or on its behalf.¹³¹ Moreover, the Commission encouraged Member States to promote convergence in the national rules and practices regarding reverse solicitation.

Moreover, as Sagan notes, the practice of reverse solicitation may not be qualified as a suitable alternative strategy as it simply refers to a mere reactive behaviour of the AIFM, which requires the constant initiative of potential EU investors in order for it to be conducted on a large scale.¹³² Reverse solicitation might grant non-EU AIFMs intermediate access to the European market outside the scope of the AIFMD in occasional circumstances but cannot be qualified as suitable business model in the medium or long term.

Conclusion

The future legal position of EU and UK investment fund managers under the AIFMD mainly depends on the outcome of the current Brexit negotiations. From the current perspective, only the membership of the UK in the EEA would ensure that UK and EU investment fund managers maintain full access to the alternative investment funds market in the EU and UK territory.

A Hard Brexit would have significant consequences for AIFMs and AIFs based in the UK. NPPRs of the EU Member States involve high organisational and financial burdens for non-EU AIFMs. AIFMs and AIFs based in the UK would need to follow different rules in each EU Member State they intend to conduct business. In addition, numerous Member States have not introduced NPPRs or have imposed additional stringent requirements. What is more, based on the schedule provided by the AIFMD, such authorisation would be valid for an interim period only. As a result, UK AIFMs would have to become authorised under the AIFMD and be confronted with the regulatory requirements of the AIFMD passport system for non-EU AIFMs. Certain proposed alternative strategies, such as reverse solicitation and the extensive use of delegation, are generally not providing full access to the European market and/or imposing significant financial and organisational efforts to implement and maintain in the long run.

¹²⁶ Matteo Gargantini, Carmine Di Noia and Georgios Dimitropoulos, "Cross-Border Distribution of Collective Investment Products in the EU" in Danny Busch, Emiliou Avgouleas and Guido Ferrarini (eds), *Capital Markets Union in Europe* (Oxford: Oxford University Press, 2010), Ch.19, pp.429–431.

¹²⁷ Report from the Commission to the Council and the European Parliament: Accelerating the capital markets union: addressing national barriers to capital flows COM(2017) 142 final arts 3–4.

¹²⁸ Gargantini, Di Noia and Dimitropoulos, "Cross-Border Distribution of Collective Investment Products in the EU" in *Capital Markets Union in Europe* (2010), p.429.

¹²⁹ Gargantini, Di Noia and Dimitropoulos, "Cross-Border Distribution of Collective Investment Products in the EU" in *Capital Markets Union in Europe* (2010), p.430.

¹³⁰ Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65 with regard to cross-border distribution of collective investment funds COM(2018) 92 final art.2.

¹³¹ Report from the Commission to the Council and the European Parliament: Accelerating the capital markets union: addressing national barriers to capital flows COM(2017) 142 final art.4.

¹³² See Sagan, "Alternative Investment Fund Managers Directive Impact on Non-EU Managers" (2015) 34 *Review of Banking and Financial Law* 506, 513.