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## AIFMD "third country" passport: good things come to those who wait

The European Securities and Markets Authority has today published its advice to the EU institutions on the extension of the "third country" provisions of the AIFM Directive to a significant number of third countries.

### **POSITIVE ASSESSMENTS: THE WAIT IS ALMOST OVER?**

ESMA's assessments are positive in respect of: Guernsey, Jersey, Switzerland, Canada and Japan. There are no obstacles to the monitoring of systemic risk which may be caused by managers in these jurisdictions, and no significant concerns about market disruption or competition (i.e. broadly, reciprocal market access).

In some cases, ESMA notes differences between the investor protection regimes in the relevant country and those of the EU, but it does not perceive these differences to be a significant obstacle impeding the application of the passport to those countries.

ESMA's assessment is also positive in respect of Hong Kong and Singapore to the extent that the assessment relates only to AIFs. ESMA notes that both jurisdictions operate regimes which facilitate retail access to UCITS from only certain EU member states. From a technical perspective, it is not clear why questions about retail access are relevant to the assessment.

ESMA's assessment of Australia is subject to a proviso that the Australian Securities and Investment Committee needs to extend to all EU member states a specific class order relief from regulatory requirements which is currently only available for UK and German fund managers.

### **THE US: A QUALIFIED ASSESSMENT**

The assessment in respect of the United States is qualified because ESMA identifies concerns about reciprocity of market access i.e. the cost and complexity for EU managers seeking to market alternative investment funds into the US. ESMA's concern centres on the fact that public offers into the US are complicated and expensive.

ESMA therefore suggests that, if the AIFMD passport were to be granted to the US, the EU legislators may wish to consider possible options, including:

1. granting the AIFMD passport only to those US funds dedicated to professional investors to be marketed in the EU by managers not involving any public offering;
2. granting the AIFMD passport only to those US funds which restrict investment to professional investors as defined in AIFMD; or
3. granting the AIFMD passport only to those US funds which are not mutual funds (under the 1940 Investment Act).

If one works on the basis that the passport is for marketing to professional or institutional investors only, the correct comparison in terms of access would, in our view, be to securities offerings which comply with a private placement exemption under the US Securities Act of 1933, as amended, and an appropriate exemption under the US Investment Company Act 1940, as amended, which are procedurally straightforward with a limited regulatory burden. This is expressly acknowledged in paragraph 63 of ESMA's advice. Very rarely (if at all) would an EU fund be marketed in the US on a public offer basis. ESMA may therefore have slightly overstated any perceived imbalance in the ability to market EU funds to US professional investors and US funds to EU professional investors.

Of the narrower options suggested by ESMA, the first two would not be ideal because many private funds admit some 'retail' investors, if the definition of 'retail' is that used in AIFMD (and MiFID).

#### **NO DEFINITIVE ADVICE: THE WAIT GOES ON**

ESMA cannot currently give definitive advice in respect of Bermuda, Cayman Islands, or the Isle of Man.

#### **WHAT HAPPENS NEXT?**

The EU institutions will now consider ESMA's advice. In theory, the European Commission ought next to publish delegated legislation by mid-October setting a date for the "third country" provisions of AIFMD to be switched on, at least in respect of those jurisdictions that have been assessed positively.

However, ESMA has given the Commission an opportunity to delay, if it wishes, by suggesting that the Commission may want to "wait until ESMA has delivered positive advice on a sufficient [not defined] number of non-EU countries", so that it can properly assess "the potential impact on the market that a decision to extend the passport might have". So the wait may still go on. Whether or not the Commission wishes to delay could be affected by the significance of third country issues generally to Brexit negotiations.

#### **PREPARING FOR THE THIRD COUNTRY PASSPORT**

Those firms considering availing themselves of the third country passport should bear in mind that they will need to become dual-regulated, not only by their home regulator but also by one of the EU regulators. There is not a free choice of EU regulator: which it must be is determined by a relatively complicated set of rules. One part of that test asks where the AIFM "intends to develop effective marketing" of fund interests (i.e. crudely, where is the biggest concentration of EU investors thought to be)? The application of the rules may produce some odd results in the context of the UK having declared its intention to leave the EU. It may be short-sighted for third country AIFMs to seek dual-regulation by the UK Financial Conduct Authority. The firm must also establish a legal representative in the EU.

Firms based in jurisdictions in respect of which a positive assessment has been made will wish to monitor developments closely, with an eye on how individual Member States will respond. Germany, in particular, has declared its intention to close its national private placement regime to any manager from a jurisdiction where the third country passport route opens up.

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