



Extension of the AIFM Passport to non-EU AIFMs and non-EU AIFs

Insights - 14/09/2015

Background - AIFM Passport

The main purpose of the Alternative Investment Fund Managers Directive 2011/61/EU (AIFMD) is to create a harmonised pan-European passport allowing managers of alternative investment funds (AIFM) to market alternative investment funds (AIF) to EU-based professional investors via a simple regulator to regulator prior notification procedure.

Currently the passport is reserved to authorised EU AIFMs of EU AIFs. Until 2018, non-EU AIFMs may continue to market AIFs to professional investors across the EU provided that they comply with national private placement regimes (NPPRs) of each of the Member States where the AIFs are managed or privately marketed.

Subject to positive advice from the European Securities and Market Authority (ESMA) and positive consequential approval from the EU Commission, AIFMD contemplates the extension of the passport to non-EU AIFMs and to non-EU AIFs managed by EU AIFMs provided that the following requirements laid down in the AIFMD are met:

- application to act as authorised AIFM addressed to the national competent authorities (NCAs) of the Member State of reference;
- full compliance with all provisions of the AIFMD;
- appropriate cooperation arrangements in place between the third country where the AIF is established and the home Member State of the EU AIFM or between each of the Member States where the AIF is marketed and the third country where the non-EU AIFM is established;
- neither the non-EU AIF, nor the non-EU AIFM is established in a Non-Cooperative Country and Territory according to the Financial Action Task Force;
- tax information exchange agreements complying with the standards of the OECD Model Tax

Convention on Income and on Capital in place between the Member State where the AIF is established and the home Member State of the EU AIFM or between the countries where the AIF is marketed and the non-EU country where the AIFM is established.

By 2018, ESMA is required to provide an opinion on the termination of the NPPRs. In light of this opinion, the Commission may adopt, within three months, a delegated act specifying the date when the NPPRs will be abolished. All AIFMs will therefore have to comply in full with the AIFMD requirements to access the EU market.

ESMA's advice on the application of the passport to non-EU AIFMs and non-EU AIFs

On 30 July 2015, ESMA issued its awaited advice on the application of the passport to non-EU AIFMs and non-EU AIFs (the **Advice**) and its opinion on the functioning of the passport and of the NPPRs.

Based on data gathered from EU NCAs, ESMA has identified twenty-two countries for which extension of the passport should be assessed, namely Australia, Bahamas, Bermuda, Brazil, British Virgin Islands, Canada, Cayman Islands, Curacao, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Mexico, Mauritius, Singapore, South Africa, South Korea, Switzerland, Thailand, United States and US Virgin Islands.

Seven other non-EU countries namely Chile, China, Egypt, India, Peru, Malaysia and Taiwan were also identified by ESMA insofar as their respective markets are relatively accessible to UCITS and AIFs. However ESMA has considered that those countries do not qualify for a detailed assessment at this stage since no memoranda of understanding (**MoU**) are yet in place with these countries. Also the level of activity from entities of those countries within the EU is relatively low. ESMA will continue efforts to negotiate MoU with those countries and monitor the level of activity so as to determine in due course whether a detailed assessment of one or more of these jurisdictions should be carried out.

In the Advice, ESMA assessed only the situation of six non-EU countries namely Guernsey, Hong Kong, Jersey, Singapore, Switzerland and the United States, deferring the assessment of the other non-EU countries identified to the coming months.

Detailed assessment carried out for Guernsey, Hong Kong, Jersey, Singapore, Switzerland and the US

Pursuant to the AIFMD provisions, in order to issue positive advice, ESMA should be convinced that *“there are no significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk”* that would impede the application of the passport to non-EU AIFMs and non-EU AIFs managed by EU AIFMs.

The assessment methodology implies that a sufficient level of data and information are gathered on each non-EU country on the above aspects. For this purpose, ESMA has not treated all non-EU countries as a single block but has opted for a country-by-country assessment methodology, the main prerequisite being the ongoing existence of MoU with the relevant non-EU NCAs.

In the Advice, ESMA has provided for examples of information and questions that may be relevant in respect of the following aspects:

- Investor protection: e.g. how investors' complaints are dealt with by the relevant non- EU NCA? Is the regulatory environment compliant with the relevant IOSCO (International Organization of Securities Commissions) principles (in particular Principles 4, 10 to 15, 24 to 28 and 32)? What are the rules (if any) applicable in relation to the safeguarding of assets, depositary functions and mechanisms to solve conflicts of interests, prudential soundness of the AIFMs, timeliness and accuracy of disclosure to investors, alignment of incentives between the AIFM and investors?
- Market disruption: e.g. would granting the passport to non-EU AIFMs and non-EU AIFs (i) create a risk of market disruption due to differences in regulatory environments and/or (ii) have a positive or negative impact on investors' choice?
- Obstacles to competition: e.g. is there a risk of distortions of competition that would put the EU fund industry at a disadvantage vis-à-vis the non-EU fund industry due to differences in regulatory regimes? Is the current NPPR to authorize EU AIFMs or to market EU AIFs in the relevant non-EU country reasonable in terms of clarity, predictability, costs? Does the non-EU country treat all EU countries equally?
- Monitoring of systemic risk: e.g. is there (i) an adequate surveillance of systemic risk in the non-EU country, (ii) a smooth cooperation between EU NCA and non-EU NCA regarding the monitoring of systemic risk?

In light of these aspects, ESMA has carried out a substantive assessment of the relevant data and information gathered mainly from the NCAs via the quarterly surveys provided for in the AIFMD and the call of evidence launched by ESMA in November 2014 addressed to EU and non-EU fund managers and investors on the functioning of the passport and the NPPRs.

Limited positive advice

ESMA has noted that sufficient information has not currently been received in relation to most of the non-EU countries identified. Due to this, ESMA considered it appropriate at this stage to carry out a detailed assessment of Guernsey, Hong Kong, Jersey, Singapore, Switzerland and the United States.

These countries were selected by ESMA on the basis of a number of factors such as the level of

engagement and responses of entities of these non-EU countries to ESMA's queries, data gathered from EU NCAs about AIFMs under their supervision and the level of their activity under NPPRs as well as the level of knowledge and experiences of cooperation between the relevant non-EU NCAs and EU NCAs.

For the purpose of advising in relation to the extension of the passport, ESMA has followed a pragmatic approach by distinguishing between the countries having implemented or willing to implement the AIFMD equivalent provisions in their domestic legislative framework over a relatively short period of time and the countries which have not done so. For the latter, ESMA notes the need to assess to what extent the regulatory frameworks of those individual non-EU countries differs from the AIFMD regime.

ESMA advised as follows:

- Positive advice - Jersey, Guernsey and Switzerland.
 - No significant obstacles exist on the extension of the passport to Jersey and Guernsey.
 - No significant obstacles will exist on the extension of the passport to Switzerland following the enactment of the new Swiss legislation as from 1 January 2016.
- No change advice - Hong Kong, Singapore and the US
 - ESMA raises concerns on the extension of the passport to Hong Kong, Singapore and the United States due notably to a lack of reciprocal market access leading to potential distortions of competition detrimental to EU AIFMs and EU AIFs.

As regards the investor protection in the United States, ESMA notes that it could have benefited of more time to assess to what extent the US regulatory regime differs materially from the AIFMD regime.

ESMA notes that it has not currently received sufficient detailed information regarding investor protection, competition, market disruption and monitoring of systemic risk in Hong Kong and Singapore and thus considers that more time is needed to assess to what extent the regulatory regimes in Hong Kong and Singapore respectively differ materially from the AIFMD regime.

Next steps

ESMA emphasizes that it will deliver further advice in the coming months and anticipates negotiating pending MoU with the NCAs of the jurisdictions concerned.

It is likely that ESMA will assess positively non-EU countries with regulatory regimes with options sufficiently similar to AIFMD for fund managers proposing to distribute to EU investors and, where such options are not implemented, will carry out a gap analysis followed by an assessment of materiality.

It is to note that positive advice from ESMA does not automatically lead to an immediate extension of the passport to the non-EU countries concerned. Indeed ESMA leaves the Commission to consider whether to wait until ESMA has delivered further positive advices on other non-EU countries before starting the legislative proceeding. If the Commission comes to the conclusion that it should proceed, it will then have three months to adopt a delegated act determining the date when the passport will apply to non-EU AIFMs and non-EU AIFs established in Jersey, Guernsey and Switzerland unless objection raised by the Parliament and the Council.

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