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Legal Update
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Granting of an AIFMD passport to Canada, Guernsey, Japan, Jersey and Switzerland shifts closer as ESMA publishes advice

The European Securities and Markets Authority (**"ESMA"**) has said that there are "no significant obstacles" impeding the application of the Alternative Investment Fund Managers Directive (**"AIFMD"**) passport to Canada, Guernsey, Japan, Jersey and Switzerland, as it published its advice on extending the passport to 12 non-European Economic Area (**"EEA"**) countries on 19 July 2016 (the **"Advice"**).[1] The conclusions ESMA reached mean that it would be difficult for the European Commission, Parliament and Council (the **"EEA Institutions"**) not to grant these five jurisdictions AIMFD passporting rights in the future.

ESMA also provided comments on extending the AIFMD passport to seven other countries: Hong Kong, Singapore, Australia, the US, Bermuda, the Cayman Islands and the Isle of Man, setting out what these countries must do before they may also be deemed eligible for a passport. ESMA has said that the market access rights of EEA Alternative Investment Fund Managers (**"AIFMs"**) in the US still present a significant obstacle when deciding whether to grant US AIFMs full passporting rights but ESMA has set out alternative options that could allow US AIFMs greater access to EEA investors.

The Advice is positive news for non-EEA AIFMs in certain jurisdictions who may soon be able to access EEA investors more easily. It is also good news for UK AIFMs who may be concerned if they will have access to the AIFMD passport after the UK leaves the EU. While the extent to which the UK retains its passporting rights is still to be decided during political negotiations, it seems extremely unlikely that ESMA would find that the UK regime contained any significant obstacles that would impede the application of the AIFMD passport, given that the UK has already implemented AIFMD. Nevertheless, it remains the case that if non-EEA countries are granted the AIFMD passport before the UK exits the EU, those countries may seek to attract alternative investment fund business from the UK by promoting certainty as compared to the UK's currently ambiguous position.

What is current state of play?

Under the current rules, non-EEA AIFMs must comply with each EEA country's national private placement regime (**"NPPR"**) before they can market to EEA investors in those countries. Compliance with such rules is often time consuming and costly. However, the granting of an AIFMD passport (which is only available to EEA AIFMs at the moment) to non-EEA AIFMs, would give non-EEA AIFMs better access to EEA investors.

AIFMs that are able to take advantage of the passport do not need to comply with each NPPR separately (as non-EEA AIFMs do). Instead, EEA AIFMs currently only need to notify their home regulator of their intention to market to professional investors and in which country this marketing would take place. Although some EEA jurisdictions have "gold-plated" AIFMD so that AIFMs marketing to investors in these jurisdictions have to comply with additional rules, marketing to investors with a passport is still less onerous than dealing with individual NPPRs.

1 ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EEA AIFMs and AIFs, ESMA/2016/1140 https://www.esma.europa.eu/sites/default/files/library/2016-1140_aifmd_passport_1.pdf .

The EEA includes all EU countries and also Iceland, Liechtenstein and Norway.

This is particularly the case because the NPPRs and approach of individual regulators to non-EEA AIFMs currently differs largely between countries. While countries such as the UK and The Netherlands have regimes in place that make it comparatively straightforward for non-EEAs to market to investors in those jurisdictions, countries such as France, Italy and Spain make it extremely difficult, if not impossible, for non-EEA AIFMs to market in those jurisdictions. Furthermore, the interpretation of reverse solicitation differs across EEA jurisdictions; creating uncertainty for managers seeking investors and limiting the amount that can be raised from EEA investors. The latest Advice is therefore very important for non-EEA AIFMs because granting of the passport to non-EEA AIFMs would allow non-EEA AIFMs to market to EEA investors in more jurisdictions.

However, if non-EEA AIFMs are permitted use of the passport and are able to market to investors in jurisdictions that are currently difficult or impossible to access, they will need to comply with the AIFMD in full. Whereas the current obligations of non-EEA AIFMs are limited under AIFMD, full compliance will be more costly, time consuming and onerous even if granting the passport will allow non-EEA AIFMs access to more investors.

Why has ESMA published the Advice?

Article 67(1) of AIFMD states that ESMA shall issue advice by 22 July 2015 on the application of the passport to the marketing of non-EEA AIFs by EEA AIFMs in Member States and the management and/or marketing of AIFs by non-EEA AIFMs in the Member States. ESMA set out its advice in July 2015 on the application of the passport to six non-EEA countries: Guernsey, Hong Kong, Jersey, Switzerland, Singapore and the United States – but the advice ESMA gave was not definitive enough to enable the EEA Institutions to make a decision.[2] ESMA was then asked by the Commission to provide more definitive advice regarding these countries by 30 July 2016 and in addition to assess the application of the passport to the regimes of Australia, Bermuda, Canada, the Cayman Islands, the Isle of Man and Japan.[3]

The Advice looks at the application of the passport to non-EEA AIFMs and AIFs in these 12 jurisdictions, assessing them against whether their regimes contain significant obstacles in terms of investor protection, competition, market disruption and the monitoring of systemic risk that would impede the application of the passport. In determining whether a country has met these criteria, ESMA sought views from a broad range of stakeholders, including non-EEA authorities, EEA and non-EEA trade associations of asset managers and individual asset managers.

What was ESMA's verdict?

Canada, Guernsey, Japan, Jersey and Switzerland

ESMA has said that there are no significant obstacles that impede the application of the AIFMD passport to these countries and the EEA Institutions will now make a decision. Although it is subject to the EEA Institutions' decision, the Advice indicates that these five jurisdictions should, in principle, be granted an AIFMD passport.

Hong Kong and Singapore

ESMA concluded that there were no significant obstacles with respect to AIFs in Hong Kong and Singapore. However, AIFMs in Hong Kong and Singapore do not currently comply with AIFMD requirements. For example, remuneration rules in Singapore and Hong Kong differ significantly from those required under AIFMD and certain AIFMs do not have to be authorised in the jurisdictions, as would be required under AIFMD. ESMA also noted in the Advice that access in Hong Kong and Singapore to Undertakings for Collective Investment in Transferable Securities from certain EEA Member States is restricted.

2 ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EEA AIFMs and AIFs, ESMA/2015/1236: https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1236_advice_to_ep-council-com_on_aifmd_passport.pdf.

3 ESMA's opinion and advice to the European Parliament, the Council and the Commission on the AIFMD passport: https://www.esma.europa.eu/sites/default/files/library/eu_commission_letter_aifmd_passport.pdf.

US

ESMA said there are "no significant obstacles" regarding the monitoring of systemic risk and with respect to investor protection that could impede the application of the AIFMD passport to the US.

However, in terms of competition and market disruption, ESMA said it remains generally more difficult to market EEA funds in the US than for US funds to market in the EEA (for instance certain EEA funds must comply with SEC registration requirements therefore increasing costs) particularly in the case of funds marketed by managers that involve public offerings. ESMA is concerned that this could create an unlevel playing field between EEA and non-EEA AIFMs.

ESMA has therefore set out a number of options for the EEA Institutions to consider as a compromise, such as granting the AIFMD passport only to those US funds dedicated to professional investors to be marketed in the EEA that do not involve any public offering or granting the passport only to funds that are not mutual funds.

Australia

ESMA said there are no significant obstacles regarding the monitoring of systemic risk, market disruption or investor protection impeding the application of the AIFMD passport in Australia. However, there are obstacles to competition that can only be resolved if class order reliefs that facilitate cross-jurisdictional financial investments are extended to all EEA Member States. Class order reliefs are currently only available for UK and German fund managers although the Australian regulator has said it is willing to discuss extending this relief to other countries.

Bermuda and the Isle of Man

ESMA said there are no significant obstacles regarding the monitoring of systemic risk, market disruption or competition impeding the application of the AIFMD passport in Bermuda or the Isle of Man. However, ESMA cannot provide definitive advice on investor protection until the final version of the AIFMD-like regime is available in Bermuda and the Isle of Man nor can it currently provide definitive advice on enforcement.

The Cayman Islands

ESMA said there are no significant obstacles regarding market disruption or competition impeding the application of the AIFMD passport in the Cayman Islands. However, ESMA cannot provide definitive advice on investor protection or monitoring of systemic risk until the final version of the AIFMD-like regime is available in the Cayman Islands, nor can it currently provide definitive advice on enforcement.

What's next?

The Advice will now be considered by the EEA Institutions. In principle, on the basis of the Advice, it seems that the EEA Institutions should approve the passport for the five countries with regimes deemed to have "no significant obstacles". However, the decision to be taken by the EEA Institutions on the basis of the Advice and the timetable for extending the application of the AIFMD passport remains uncertain. According to Article 67(6) of the AIFMD, the European Commission should adopt a delegated act within three months of receiving positive advice and an opinion from ESMA, specifying the date on which the passport should be available to non-EEA AIFMs from the regimes that ESMA considers have no significant obstacles.

However, in the Advice, ESMA has repeated the recommendation it made in July 2015 that the EEA Institutions may wish to consider whether to wait until ESMA has delivered positive advice on a sufficient number of non-EEA countries before triggering the passport for non-EEA countries because of the potential impact that a decision to extend the passport may have on the market. If the EEA Institutions follow this advice, it therefore seems unlikely that passporting will be extended to non-EEA AIFMs until a positive assessment has been made by ESMA in relation to a larger number of non-EEA jurisdictions. ESMA also said that it will be important to ensure that Member States have a "common understanding" on the treatment of below threshold non-EEA AIFMs[4] and whether or not they would be required to register with a regulator.

4 Those AIFMs that are below the thresholds set out in Article 3(2) of AIFMD (i.e. management companies with assets under management not exceeding €100m where leverage is used and €500m where there is no leverage).

ESMA says it will continue to work on its assessment of other non-EEA countries (in particular Malaysia, Egypt, Chile, Peru, India, China and Taiwan) that are not covered in the Advice with a view to delivering further submissions to the EEA Institutions. Where jurisdictions do not have supervisory cooperation arrangements in place for AIFMD purposes, ESMA says it will work towards agreeing Memoranda of Understanding with the authorities concerned.

As political negotiations on Brexit progress, UK AIFMs should closely monitor discussions between the EEA Institutions regarding passporting rights as it may give an indication of the outcome of any future UK discussions on passporting rights, the stance the EEA Institutions may take and any timetable for change.

Non-EEA AIFMs however, should continue to seek legal advice on the NPPRs of jurisdictions in which they wish to market and, where feasible, continue to notify the regulators of their intention to market in EEA jurisdictions under AIFMD while awaiting further updates from ESMA on whether, when and under what conditions the passport may be extended.

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