New European Rules on Marketing in the UK by Non-EEA Alternative Investment Fund Managers

UK Rules Implementing the Alternative Investment Fund Managers Directive and Marketing in the UK by a Non-EEA Manager

INTRODUCTION
The European Alternative Investment Fund Managers Directive (the “AIFMD”) came into force on 22 July 2013. Although initially the AIFMD principally regulates UK and other EEA\(^1\) based alternative investment fund managers, certain of its provisions also apply to non-EEA based alternative investment fund managers that wish to market alternative investment funds in the EEA.

The UK rules implementing the AIFMD, which came into force on 22 July 2013, comprise primary legislation, “The Alternative Investment Fund Managers Regulations 2013” (the “UK Regulations”), together with amendments to the Financial Conduct Authority’s Handbook (including amendments to the Perimeter Guidance Manual, which contains useful guidance on the interpretation and application of the AIFMD in the UK). The UK Regulations also contain certain transitional provisions which, if satisfied, will enable non-EEA managers to market an alternative investment fund in the UK during the transitional period without having to comply with the AIFMD.

WHAT DOES THE AIFMD DO?
The AIFMD regulates managers of alternative investment funds and imposes a number of new obligations on such managers. Registered fund managers will be subject to obligations with respect to governance and business conduct standards (\(e.g.,\) with respect to conflicts of interest, risk management...
and liquidity management), regulatory capital requirements, remuneration requirements, disclosure and transparency requirements and asset stripping restrictions.

**EEA Based Managers**

UK and other EEA managers became subject to the AIFMD on 22 July 2013 although there are transitional rules in place that provide managers some relief for a limited time period. Fund managers whose registered office is in an EEA state have until 22 July 2014 to become compliant with the AIFMD and to register with and become authorised by their home competent authority (the regulator where they have their registered office). UK fund managers have until 22 July 2014 to become compliant with the AIFMD and to apply for registration with the UK’s Financial Conduct Authority (the “FCA”). Although subject to significant obligations, UK and other EEA managers of alternative investment funds that register and comply with the AIFMD will benefit from the ability to market their funds across the EEA using a single passport without the need for further regulatory approval.

**Non-EEA Based Managers**

Managers of alternative investment funds who do not have a registered office in an EEA state (“non-EEA managers”) cannot register under the AIFMD until 2015. This means that prior to 2015 a non-EEA manager will be subject to certain provisions of the AIFMD but cannot benefit from the AIFMD passport to market its alternative investment funds across the EEA. Instead, a non-EEA manager wishing to market an alternative investment fund in the EEA prior to 2015 will have to comply with (a) the private placement regime of each EEA member state where marketing takes place and (b) the AIFMD’s private placement regime. Certain EEA states, including the UK, France and Germany, have adopted transitional rules which permit a non-EEA manager to market in the particular EEA state for a transitional period without becoming subject to the requirements of the AIFMD’s private placement regime. The requirements of the AIFMD’s private placement regime and the UK transitional rules are described in more detail below.

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**MARKETING BY NON-EEA ALTERNATIVE INVESTMENT FUND MANAGERS IN THE EEA UNDER THE AIFMD’S PRIVATE PLACEMENT REGIME**

Non-EEA managers are subject to the AIFMD if they market a fund (a “non-EEA alternative investment fund”) in the EEA which (a) is not authorized or registered in an EEA member state or (b) does not have its registered office and/or head office in an EEA member state.

**Conditions for Marketing a Non-EEA Fund by a Non-EEA Manager in the EEA from 22 July 2013**

From 22 July 2013 to a date in 2018 (to be determined by the European Commission, and only if the European Commission decides to activate certain provisions of the AIFMD), a non-EEA manager that markets a non-EEA alternative investment fund in the EEA using an individual EEA state’s private placement regime (to the extent available) must notify the regulator in the EEA state in which it intends to

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market and comply with the AIFMD requirements listed below, in each case, before any marketing can take place within that EEA state:

First, appropriate cooperation arrangements for the purpose of systemic risk oversight must be in place between the regulators of the EEA state where the non-EEA fund is marketed, the regulators of the non-EEA country where the non-EEA fund is established and the supervisory authorities of the non-EEA country where the non-EEA manager is established. The UK regulator has signed cooperation agreements with the regulators of 34 non-EEA countries, including the United States of America, Canada, Switzerland, Bermuda, the Cayman Islands, BVI, Guernsey, Jersey, Isle of Man, Singapore, Mauritius and Hong Kong. The U.S. Securities and Exchange Commission has also signed cooperation agreements with regulators from 27 other EEA states.²

Second, the non-EEA country where the non-EEA manager or the non-EEA fund is established must not be listed as a non-cooperative country by the Financial Action Task Force on anti-money laundering and terrorist financing.

Third, the non-EEA manager (subject to transitional arrangements described below) must comply with certain disclosure requirements, anti-asset stripping requirements and notification of voting interests requirements described below:

Disclosure requirements
In order to market a non-EEA alternative investment fund in the EEA a non-EEA manager must make the following types of disclosures (collectively, the “Disclosure Requirements”):

- publish a fund-specific annual report (which will be available to the fund’s investors and regulators) including financial statement disclosure and disclosure on aggregate remuneration (including carried interest) paid to the fund manager’s employees and disclosure with respect to aggregate remuneration paid to certain classes of employees;
- make certain disclosures to investors prior to their investment, including the details of a fund’s investment strategy, fees and expenses and with respect to any special arrangements, or side letters, with other investors in the fund; and
- make certain annual and ongoing disclosures to the fund manager’s EEA regulator³ including disclosure of the categories of assets the fund has invested in, the portion of a fund’s assets which are subject to special arrangements due to a lack of liquidity and the use of leverage by the fund.

Restrictions on asset-stripping
In order to market a non-EEA alternative investment fund in the EEA, a non-EEA manager must comply with certain rules that prohibit any non-EEA manager that obtains control⁴ of another company (which includes a listed and unlisted company, provided such company’s registered office is in an EEA state and, if listed, its securities are listed on an EEA regulated market) from taking any steps permitting certain distributions out of that company’s capital or dividends above a certain level for a period of 24 months
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from the date of obtaining control ("Restrictions on Asset Stripping"). These Restrictions on Asset Stripping could limit a manager’s ability to facilitate portfolio company level transactions, such as leveraged recapitalizations, and should be understood in advance of commencing (or continuing) any marketing in the EEA.

**Notification of voting rights**

In addition, managers of alternative investment funds which invest in private companies and which want to market a non-EEA alternative investment fund in the EEA are required to notify the manager’s EEA regulator whenever they reach (or fall below) 10%, 20%, 30%, 50% or 75% of the voting rights in a private company whose registered office is in an EEA member state ("Notification of Interests in Voting Rights").

In the UK, if a non-EEA manager breaches these marketing rules then not only will it have, potentially, committed a criminal offense, but any contract that arises in consequence of the marketing activity can be set aside and damages can be claimed by the investor.

**The Marketing Passport Regime from 2015**

From a date in 2015 (to be determined by the European Commission) until 2018 (and only if the European Commission decides to activate certain provisions of the AIFMD), a non-EEA manager that wishes to market a non-EEA alternative investment fund in the EEA can choose to opt in to the full provisions of the AIFMD and obtain a passport to market across the EEA without the approval of the regulators in the other EEA states where marketing activity is undertaken. Alternatively, between 2015 and 2018, a non-EEA manager can continue to market a non-EEA alternative investment fund using an individual EEA state’s private placement regime (to the extent available), provided it complies with the conditions for marketing under the AIFMD’s private placement regime described above.

**The End of the EEA Private Placement Regime for Non-EEA Fund Managers**

If the European Commission decides to activate certain provisions of the AIFMD, the AIFMD contemplates that from a date in 2018 non-EEA managers will no longer be permitted to market non-EEA alternative investment funds using the private placement regimes of individual EEA states. Such managers’ only option will be to market a non-EEA alternative investment fund using the AIFMD passporting regime by complying with the full provisions of the AIFMD.

**TRANSITIONAL ARRANGEMENTS IN THE UK**

The UK AIFMD Regulations provide a transitional period to non-EEA managers that have been (a) “managing” a non-EEA alternative investment fund immediately before 22 July 2013 and (b) undertaking “marketing” activities *in the UK* before 22 July 2013 in respect of that non-EEA alternative investment fund.
fund to an investor domiciled, or with a registered office in, the EEA. The UK transitional period will continue until 22 July 2014.

A non-EEA manager that is able to avail itself of the UK transitional arrangements can market a non-EEA alternative investment fund (including a new fund) in the UK without notifying the FCA and without needing to comply with the AIFMD Disclosure Requirements, the Restrictions on Asset Stripping and Notification of Interests in Voting Rights during the transitional period. A non-EEA manager would, however, have to comply with the UK private placement regime.

After 22 July 2014, any marketing activity under the UK private placement regime by non-EEA managers also must be done in accordance with the AIFMD. However, if the non-EEA manager has carried out marketing activities under the UK’s transitional arrangements prior to 22 July 2014 but does not market in the UK after 22 July 2014, it will not have to comply with any provisions of the AIFMD or the UK Regulations in respect of alternative investment funds it marketed under the transitional arrangements prior to 22 July 2014.

WHAT IS MANAGING?
Under the AIFMD, managing a fund means undertaking at least the activities of portfolio management or risk management, but neither of these terms is defined. There is also no guidance on the interpretation of the requirements of managing a fund “immediately before” 22 July 2013 or on marketing that fund before 22 July 2013, and the UK Treasury decided not to provide further clarification or guidance on the time period. Whether an alternative fund manager can come within the UK transitional regime will depend on the facts and circumstances of each particular case.

WHAT IS MARKETING?
Under the AIFMD, marketing means “a direct or indirect offering or placement at the initiative of the manager or on behalf of the manager of units or shares of a fund it manages to or with investors domiciled or with a registered office in the EEA.” The term “marketing” is a broad definition and covers activities from the initial conversation regarding the potential investment in a fund with a prospective investor until the closing of the investment (i.e., negotiating the terms of the investment and signing final documents).

Under the UK’s Perimeter Guidance Manual, an “offering” or “placement” takes place for the purposes of the UK Regulations when a person seeks to raise capital by making a unit or share of a fund available for purchase by a potential investor. An “offering” includes situations where the units or shares of a fund are made available to the general public, and a “placement” includes situations where the units or shares of a fund are only made available to a more limited group of potential investors.
Activities only constitute marketing under the AIFMD and the UK Regulations, however, if they are undertaken at the initiative of the non-EEA manager. Passive marketing and reverse solicitation are not activities that are considered to be at the initiative of the non-EEA manager. There is no guidance in the AIFMD or the UK Regulations as to what constitutes passive marketing. However, the Perimeter Guidance Manual advises that “a confirmation from the investor that the offering or placement of units or shares of the fund was made at its initiative, should normally be sufficient to demonstrate that this is the case, provided this is obtained before the offer or placement takes place. However, managers and investment firms should not be able to rely upon such confirmation if this has been obtained to circumvent the requirements of AIFMD.”

An earlier draft of the Perimeter Guidance Manual included guidance which stated that, in determining whether the marketing is at the initiative of the investor, consideration needs to be given to the course of communication or the relationship between the investor and those involved with, or connected to, the non-EEA manager or the fund. Only communications solicited by the investor should be considered to have occurred at the initiative of the investor. For example, communications sent to investors as part of an organised marketing campaign or documentation available on a publically accessible website should not be considered to be sent at the initiative of the investor. However, communications in response to an approach from a potential investor with prior knowledge of the fund and no previous involvement with the manager could be considered to be at the initiative of the investor. This guidance was removed from the final version of the Perimeter Guidance Manual in response to feedback the FCA received as part of the pre-publication consultation process, but is indicative of the way the FCA was intending to approach interpreting this area and may in the future interpret the rules (if, for example, there is evidence of intentional anti-avoidance).

Non-EEA managers that have been marketing a non-EEA alternative investment fund in the UK before 22 July 2013 and that want to undertake additional marketing in the UK after 22 July 2013 should make sure they keep copies of any written communication which will demonstrate to the FCA that marketing activity has taken place in the UK prior to 22 July 2013.

Non-EEA managers that do not come within the UK transitional arrangements and that want to remain outside the ambit of the AIFMD must ensure that they do not undertake any marketing in the EEA, including restricting potential investors domiciled or with a registered office in the EEA from accessing any marketing materials on any website they control.
WHO IS THE INVESTOR?
Under the UK’s Perimeter Guidance Manual the “investor” is the person that will make the decision to invest in the fund.

If a person acts on its own behalf and subscribes directly to a fund, the investor is the person that subscribes to the unit or share of the fund. However, if that person engages another person to subscribe to the fund on its behalf, including, for example, where a nominee company will subscribe as bare trustee for an underlying beneficiary, or a custodian will subscribe on behalf of an underlying investor, the manager or investment firm marketing the fund should ‘look through’ the subscriber to find the underlying investor that will make the decision to invest in the fund, and that person should be regarded as the investor. Where a discretionary manager subscribes, or arranges for another person to subscribe, on behalf of an underlying investor to the fund and the discretionary manager makes the decision to invest in the fund on that investor’s behalf without reference to the investor, it is not necessary to ‘look through’ the structure and the discretionary manager should be considered to be the investor for the purposes of the UK Regulations.

CONCLUSION
The AIFMD creates a new, comprehensive framework for the regulation of alternative investment fund managers and the marketing and management of non-EEA alternative investment funds. Accordingly, beginning on 22 July 2013, and through at least 2015, non-EEA managers that want to market a non-EEA alternative investment fund under the private placement regime of any EEA member state should understand the requirements, including transitional arrangements (if any), of that EEA member state and also determine whether a private placement regime will be available. Sullivan & Cromwell can assist any client with advice regarding the UK, France and Germany, and can facilitate obtaining advice on these matters from counsel in other EEA states.

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ENDNOTES

1. *i.e.*, the 28 EU member states and Norway, Liechtenstein and Iceland.

2. The European Securities and Markets Authority has agreed to template cooperation agreements with the regulators of 35 non-EEA states, including, from the United States of America, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission and the Securities and Exchange Commission. These template agreements are bilateral agreements between each of the relevant regulators, and each agreement must be signed by the relevant regulators from each EEA state and each non-EEA state. The SEC has signed cooperation agreements with regulators from the following EEA states: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Sweden, the United Kingdom, Norway, Liechtenstein and Iceland.

The SEC has published a webpage (in the link below) with links to the cooperation agreements it has signed. (See the list of cooperation agreements under the heading “Certain Entities in the Asset Management Industry (MOUs with European Union and the European Economic Area member state regulators)”: [http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml](http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml).)

The U.S. Federal Reserve Board and the Office of the Comptroller of the Currency have signed cooperation agreements with the UK regulator but it is not known if the U.S. Commodity Futures Trading Commission has signed any cooperation agreements with any EEA regulators other than the German regulator.

3. The regulator of a non-EEA alternative investment fund manager will be the competent authority of the EEA state where the alternative investment fund manager markets (or does the majority of marketing of) a non-EEA alternative investment fund.

4. For these purposes “control” means a person obtaining more than 50% of the voting rights of an entity.

5. See Article 4(1)(x) of the AIFMD.

6. The FCA has clarified that it would not ordinarily regard an offering or placement to include secondary trading so, for example, the mere fact that a fund is listed in the UK would not constitute marketing (provided the listing itself does not include any capital raising).

7. See the Perimeter Guidance Manual section of the FCA Handbook at paragraph 8.37.11.
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CONTACTS

New York
Whitney A. Chatterjee +1-212-558-4883 chatterjeew@sullcrom.com
Gary Israel +1-212-558-4005 israelg@sullcrom.com
Jennifer P. Elworth +1-212-558-4052 palmj@sullcrom.com
Saul P. Sarrett +1-212-558-4816 sarretts@sullcrom.com

London
Vanessa K. Blackmore +44-20-7959-8480 blackmorev@sullcrom.com

Paris
Olivier de Vilmorin +33-1-7304-5895 devilmorino@sullcrom.com

Frankfurt
Carsten Berrar +49-69-4272-5506 berrarc@sullcrom.com
Wolfgang Feuring +49-69-4272-5511 feuringw@sullcrom.com