ESMA Advises on the Extension of the AIFMD Passport

On 19 July 2016, the European Securities and Markets Authority ("**ESMA**") published its second set of advice ("**Advice**") on the possible extension of the Alternative Investment Fund Managers Directive ("**AIFMD**") passport to non-EU alternative investment funds managers ("**AIFMs**") and non-EU alternative investment funds ("**AIFs**").

ESMA concludes in its Advice that the passport should be applied to **Canada, Guernsey, Japan, Jersey** and **Switzerland**. In relation to **Singapore, Hong Kong** and **Australia**, ESMA concludes that these jurisdictions have met the relevant assessment criteria, subject to some caveats relating to market access. In the case of the **United States** ("**US**"), concerns relating to reciprocal market access and the creation of an unlevel playing field have led ESMA to suggest that the AIFMD passport be extended to a restricted category of US funds. ESMA was unable to finalise its assessment of the **Cayman Islands** and **Bermuda** due to the pending implementation of AIFMD-like regimes in those jurisdictions, while it could not reach a definitive assessment of the **Isle of Man** at this time.

Background

The AIFMD passport is currently only available to authorised EU AIFMs and EU AIFs, while marketing by non-EU AIFMs and marketing of non-EU AIFs is governed by national private placement regimes ("**NPPRs**"). Pursuant to the AIFMD, ESMA is required to issue advice to the European Commission ("**Commission**"), the European Parliament and the Council of the EU ("**Council**") on the application of the passport to the marketing of non-EU AIFs by EU AIFMs and the management and / or marketing of AIFs by non-EU AIFMs in the EU.

ESMA's November 2014 call for evidence, which aimed to gather information from stakeholders on the potential extension of the AIFMD passport and related matters, outlined ESMA's decision to opt for a country-by-country assessment of the potential extension of the AIFMD passport. Based on the responses to its call for evidence, information received from national competent authorities, assessments by the International Monetary Fund, its own research and market intelligence, ESMA has now completed its assessment of 12 jurisdictions in total.

Summary of ESMA's Conclusions

ESMA has assessed each of the jurisdictions considered in its Advice under the headings of: ongoing compliance with memoranda of understanding; investor protection; competition; potential market disruption; and the monitoring of systemic risk. Under the heading of competition, ESMA considers the reciprocal market access available to EU and non-EU managers and funds, both in relation to AIFs and funds marketed to retail investors, including UCITS. This is despite the fact that the AIFMD passport only applies to the marketing of AIFs to professional investors.

The list of jurisdictions assessed in the Advice was decided upon based on a number of factors, including: (1) the amount of activity already being carried out by entities from these countries under the NPPRs; (2) the existing knowledge and experience of EU national competent authorities with respect to their counterparts in these jurisdictions; and (3) the efforts made by stakeholders from these jurisdictions to engage with the process.

ESMA's conclusions in respect of the 12 countries assessed to date are summarised in the table below.

Country	ESMA's Conclusions
Canada **Guernsey** **Japan** **Jersey** **Switzerland**	ESMA concludes that there are **no significant obstacles** impeding the application of the AIFMD passport to these jurisdictions.
United States	ESMA's advice in relation to the extension of the AIFMD passport to the US suggests that the passport be extended to a restricted category of US funds, due to ESMA's concern that there is a risk of an unlevel playing field between EU AIFMs and US AIFMs as regards market access. While ESMA is of the view that there are no significant obstacles regarding the monitoring of systemic risk and investor protection impeding the application of the AIFMD passport to the US, ESMA finds that the market access conditions that would apply to US funds marketed to EU professional investors under an AIFMD passport would differ to those applicable to EU funds marketed to US professional investors. ESMA states that this is due to registration requirements under the US regulatory framework (which generate additional costs), particularly in the case of funds marketed by managers involving public offerings. ESMA acknowledges that, in the case of funds marketed by managers that do not involve any public offering, the conditions that would apply to US funds if the passport was extended and to EU funds would be broadly comparable. ESMA concludes that, if the AIFMD passport is to be extended to the US, the EU institutions may wish to consider possible ways to mitigate the risk of an unlevel playing field between US and EU managers and funds, including: ▪ granting the AIFMD passport only to those US funds marketed to EU professional investors by managers not involved in any public offering; ▪ granting the AIFMD passport only to those US funds which are not mutual funds (under the US 1940 Investment Company Act); or ▪ granting the AIFMD passport only to those US funds which restrict investment to professional investors as defined in the AIFMD.
Hong Kong	Under the heading of obstacles to competition, ESMA notes that the Hong Kong Securities and Futures Commission ("**SFC**") operates a regime in relation to the access of retail funds (including UCITS) in Hong Kong where certain jurisdictions are deemed to be "acceptable inspection regimes" ("**AIR**"). Only five EU member states are currently deemed to be AIR by the SFC. However, an AIF is not required to be authorised by the SFC as long as it is solely offered to professional investors in Hong Kong. Overall, ESMA is of the view that there seems to be a level playing field

	between EU and Hong Kong AIFMs that market solely to professional investors.
Singapore	Similar to its assessment of Hong Kong, ESMA notes in relation to Singapore that, in the case of funds offered to retail investors, the Monetary Authority of Singapore ("**MAS**") may recognise a foreign fund for sale to retail investors in Singapore, provided certain conditions are met. To date, MAS has generally recognised UCITS from the United Kingdom ("**UK**"), Ireland, France, Germany and Luxembourg as satisfying the relevant criteria. ESMA states that it is not clear if this is because no managers of other EU member states sought authorisation before, or if Singapore does not recognise UCITS from other members states as equivalent. ESMA concludes that if ESMA considers its assessment of Singapore only in relation to AIFs, there are no significant obstacles impeding the application of the AIFMD passport to Singapore.
Australia	To facilitate cross-jurisdictional financial investments, the Australian Securities and Investment Commission ("**ASIC**") has provided for an exemption known as the "class order relief" from the usual requirement for all entities (whether Australian or foreign entities) issuing interests or dealing in financial products in Australia to obtain an Australian financial services licence. ASIC class order relief is currently available to UK and German fund managers. However, ASIC has indicated that it is willing to discuss extending this to EU AIFMs or UCITS managers from all EU member states on a reciprocal basis. Subject to this extension, ESMA concludes that there are no obstacles impeding the application of the AIFMD passport to Australia.
Cayman Islands **Bermuda**	ESMA notes that both the Cayman Islands and Bermuda intend to put in place AIFMD-like regimes which would be an opt-in regime for Cayman Island or Bermuda AIFMs wishing to market their AIFs in the EU on a passported basis. ESMA concludes that it cannot give definitive advice in relation to these jurisdictions until the new regulatory regimes have been implemented.
Isle of Man	ESMA is of the view that the absence of a regulatory plan to put in place an AIFMD-like regime makes it difficult to assess whether the investor protection criterion is met.

Next Steps

ESMA's Advice has been sent to the Commission, European Parliament and Council for their consideration. Under the AIFMD, the Commission is required to adopt a delegated act within three months of receipt of positive advice from ESMA on the extension of the AIFMD passport (the "**Delegated Act**"), which would specify the date when non-EU AIFMs managing EU AIFs will be permitted to seek authorisation under AIFMD and when AIFMs can market non-EU AIFs on a passported basis in the EU. The European Parliament and Council would have a three month period within which they could object to the Delegated Act proposed by the Commission. In the area of EU financial services legislation, such objections are generally not made, although it is noteworthy that there has been suggestions that the European Parliament may object to the proposed Commission delegated act relating to the key information document (KID) for packaged retail investment products (PRIIPs).

ESMA suggests in its Advice that the Commission, European Parliament and Council may "*wish to consider whether to wait until ESMA has delivered positive advice on a sufficient number of non-EU countries*" before triggering the legislative procedures outlined by AIFMD, taking into account such factors as the potential impact on the market that a decision to extend the passport might have. The text of the AIFMD itself does not appear to provide for this flexibility in relation to the adoption of the Delegated Act where positive advice has issued from ESMA, but the Commission's position in deciding not to adopt legislation to date has not been challenged since ESMA issued its first positive advice on 30 July 2015.

It is worth noting that, within three years of the entry into force of the Delegated Act referred to above, ESMA must issue further advice to the Commission, the European Parliament and the Council as to whether NPPRs should be terminated in all member states (ie, as early as 2019, if the Delegated Act were to be adopted this year.) This advice would consider whether there are any significant obstacles to making the passport for managing and / or marketing AIFs by non-EU AIFMs the sole possible regime for such activities. On receiving positive advice from ESMA in this regard, the Commission is required to adopt a further delegated act making the passport regime for the managing and / or marketing of AIFs by non-EU AIFMs the "*sole and mandatory regime applicable in all member states*".

It would appear, therefore, that if the passport is extended to US managers, for example, US managers will be able to continue to manage EU AIFs and market the AIFs they manage under national regimes during this three year transitional period, notwithstanding that they could also apply for authorisation under the AIFMD. ESMA states in its Advice that this is its understanding of the relevant provisions of the AIFMD, but that it sees merit in the EU institutions clarifying this issue.

What are the Implications for non-EU AIFMs managing EU AIFs?

ESMA's mandate under the AIFMD in relation to drafting the Advice was to consider the application of the passport to the "*management and / or marketing of AIFs by non-EU AIFMs*". The analysis and conclusions set out in the Advice have a greater focus on the marketing of funds than on the management of funds. While it would seem from the provisions quoted above (relating to ESMA's future advice on the possible termination of national regimes governing the management and marketing of AIFs by non-EU AIFMs) that the three year transitional period from the date of entry into force of the Delegated Act will apply to both the management of EU AIFs and the marketing of all AIFs by non-EU AIFMs, there is some uncertainty in this regard. The ability of a non-EU AIFM to continue to manage EU AIFs without being authorised under the AIFMD once the passport is switched on will depend on the position adopted by national regulators.

From the perspective of the Central Bank of Ireland ("**Central Bank**"), it has made it clear in guidance that it allows qualifying investor AIFs to appoint a non-EU AIFM. It has stated that it will revisit its currently applicable transitional arrangements for non-EU AIFMs in the event that the Commission adopts legislation extending the passport, with a view to revising its position to align it with the Commission's decision and any transitional arrangements put in place. In the event that the passport was extended and national rules permitting the management of EU AIFS by non-EU AIFMs were terminated, it would be appropriate to provide for lengthy transitional periods to allow sufficient time for a non-EU AIFM to identify its member state of reference, amend its existing policies and procedures where necessary and to prepare its authorisation application.

Comment

ESMA identified a total of 22 countries in its July 2015 advice to be assessed for the purposes of the AIFMD passport extension (being the domicile of non-EU AIFMs that market AIFs in the EU and / or the domicile of non-EU AIFs marketed in the EU). Following two rounds of advice, ESMA has now issued unqualified positive advice in relation to just 5 out of those 22 countries. The Commission has previously confirmed that it would take a decision regarding the Delegated Act when a sufficient number of countries have been appropriately assessed. Whether the Commission will adopt the necessary Delegated Act extending the passport therefore remains unclear, and the date from which identified non-EU AIFMs will be able to apply for the AIFMD passport may still be some way off.

It is unclear from ESMA's analysis in relation to extending the AIFMD passport to the US whether its recommendation is that: (a) only authorised EU AIFMs would be permitted to market a restricted category of US funds on a passported basis, or (b) in addition to permitting EU AIFMs to market certain US funds, a US manager of prescribed US funds would be permitted to apply for authorisation under the AIFMD, but could then only market those prescribed US funds using the passport. The latter scenario does not take account of the fact that US managers may also manage EU-domiciled funds and that the availability of a passport to US managers to market their US funds and not their EU funds would create an unlevel playing field between US AIFs and EU AIFs.

From the perspective of UK AIFMs assessing their options in a post-Brexit environment, there is likely to be some comfort in the fact that ESMA was willing to issue positive advice in relation to Jersey and Guernsey on the basis that both jurisdictions have implemented AIFMD-like regimes. This would suggest that, in the absence of radical regulatory changes for AIFs and their managers in the UK, it would be considered appropriate to extend the AIFMD passport to UK AIFMs post-Brexit, as the UK has already fully implemented the AIFMD regime.

ESMA's Advice may be accessed here: ESMA Advice.

Should you wish to discuss any aspect of this briefing note further, please get in touch with your usual Asset Management and Investment Funds Group contact or any of the contacts listed in this publication.

Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at www.matheson.com.

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