

AIFMD for US
Hedge Fund
Managers –
“Marketing” to
UK Investors

The FSA's second Consultation Paper on implementing the Alternative Investment Fund Managers Directive (AIFMD) in the UK (CP13/9, issued on 19 March 2013) provides some draft Guidance on "marketing" and the proposed UK private placement register for AIFMD purposes. The draft Guidance is contained in proposed amendments to the Perimeter Guidance manual (PERG). The consultation period remains open for comment until 10 May 2013.

In addition, HM Treasury has recently published Q&As on issues relating to the transposition of AIFMD into UK law and, in particular, the ability of non-EU hedge fund managers to take advantage of a transitional period – see section 11 below.

The main points of note are:

The definition of "marketing"

The AIFM Directive itself defines "marketing" as: "a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union".

FSA approval and entry on the UK private placement register

The UK has confirmed that its existing private placement regime will be maintained in the UK largely unamended, provided that the AIFMD requirements, for example on disclosure and transparency, are complied with.

However, one of the significant changes to the existing regime will be a requirement to notify the FSA and obtain the FSA's approval to market an AIF before any marketing occurs. The FSA will have 20 working days in which to review and approve such an application. The FSA will maintain and make public a private placement register for US AIFMs managing AIFs who wish to market their AIFs to UK professional investors.

The FSA has not yet published the relevant application forms or instructions on how to submit them but intends to do so before 22 July 2013. The FSA will, as part of its approval process, review and vet compliance by the AIFM/AIF with the AIFMD disclosure and transparency requirements.

Consequences of breach of prohibition on marketing without FSA approval

Guidance: When done by an unauthorised person, it will be an offence under the UK AIFMD regulations and will potentially result in the unenforceability of investor agreements.

Comment: We are often asked: – why should I care? You should care strongly in light of this and could be required to make such an investor whole in the event that the AIF's net asset value declines.

FSA guidance

Guidance: No further guidance has been provided by the European Commission or ESMA on the meaning of "marketing" in AIFMD and therefore the guidance set out by FSA is subject to any future clarification from these European bodies.

Comment: Whilst acknowledging that the European bodies can sometimes be unpredictable, we are not aware of any current proposals to issue such guidance at European level. Until such time as any harmonised EEA guidance emerges, FSA's views will prevail with respect to marketing to UK investors.

The meaning of “marketing”

Guidance: Marketing has a specific meaning in the context of the UK AIFMD regulation and is, in some respects, different from the ordinary meaning of the term.

Comment: It is important to note this point.

What is an offering or placement?

Guidance: The terms ‘offering’ or ‘placement’ are not defined in the UK AIFMD regulation but, in FSA’s view, a person offers or places for the purposes of AIFMD when the person makes a share of an AIF available for purchase by a potential investor.

Comment: “makes available for purchase” is a very broad concept and it will be very difficult to avoid triggering this test – making available the AIF’s prospectus or application form would (it seems) suffice.

What is indirect offering or placement?

Guidance: The reference to indirect offering or placement should, in the FSA’s view, be interpreted broadly to include situations where an AIFM distributes shares of an AIF through a chain of intermediaries (for example, if the shares of an AIF are purchased by a third party, such as an underwriter or placement agent, with the objective of distributing them to a wider investor base, this could be an indirect offering or placement when those shares are made available for purchase by investors).

Comment: Not a particularly relevant example to the way in which shares in privately offered hedge funds are distributed. This is but one example and it remains possible that the use of other intermediaries (e.g., consultants and cap intro teams) could in particular scenarios also amount to indirect offering or placement (making available for purchase) by AIFMs and those AIFMs who do not wish to be “marketing” for AIFMD purposes and who do not propose to seek FSA approval should exercise caution as to their interaction with, and supply of AIF documents to, other intermediaries. See section 9. below re passive marketing.

Territorial scope of the marketing provisions

Guidance: In accordance with the proposed UK regulation 48 (the prohibition on marketing), a person must not market an AIF to investors who are domiciled or have a registered office in the United Kingdom. The FSA state that this means that an offering or placement to investors who are located outside of the United Kingdom may constitute marketing if it is made to investors who are domiciled or have a registered office in the United Kingdom.

Comment: this makes clear the FSA’s intention to apply the marketing prohibition on an extra territorial basis (a break with tradition for the UK). Initial soundings in a variety of other European countries do not (yet) reveal any intention to apply it extra territorially to activity outside the relevant country. The UK approach would therefore cover any “marketing” which is done outside the EEA to or with a UK investor (e.g., at an investor conference or cap intro event in New York where the investor is domiciled in or has its registered office in the UK).

It is also unclear what specific meaning will be given to the word “domiciled”. HM Treasury has stated in its Q&As that words and expressions used in AIFMD, which might be used differently in the UK, will be given the same meaning in HM Treasury’s final regulations as in the Directive. However, neither AIFMD itself nor the Q&As specify what that meaning is. By way of example, a person can be domiciled in the common law sense in the UK but have been resident in a different jurisdiction for over 20 years.

Can I do passive marketing without prior FSA approval?

Guidance: Yes – the FSA has confirmed that an AIFM (or a person acting on its behalf) has an automatic right to passively market an AIF and there is no need for the AIFM to have obtained permission from the FSA before the AIF can be passively marketed in the United Kingdom.

Comment: It is helpful to have this confirmation since the distinction between passive marketing and active marketing previously had little or no consequence in the UK and was not formally a recognised part of the UK regulatory landscape prior to AIFMD.

What is passive marketing?

Guidance: The FSA says that, in determining whether marketing is at the initiative of the investor and not of the AIFM (and hence is passive marketing), consideration needs to be given to the course of communication or relationship between the investor and those involved with, or connected to, the AIFM or the AIF. Only communications which are solicited by the investor should be considered to have occurred at the initiative of the investor. The FSA provides the following example: communications which are sent to investors as part of an organised marketing campaign or documentation which is available on a publicly 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 AIF and no previous involvement with the AIFM could be at the initiative of the investor.

Comment: This is quite a restrictive interpretation of passive marketing – it seems to require both a potential investor with prior knowledge of the AIF and no previous involvement with the AIFM. Many AIFMs have asked us whether they can avoid carrying out active marketing post 22 July this year by starting a low level non AIF specific dialogue now with potential EEA investors so that post 22 July requests for follow up can be said to be at the potential investor's initiative. The FSA's guidance makes it very hard to achieve this outcome.

Cap intro events are capable of being organised such that they are not regarded as active marketing for AIFMD purposes on the basis that no AIF offering document or other marketing material is provided to investors at that point in time. However, if a potential investor approaches the AIFM following the event, the course of any prior communication or relationship between the potential investor and those involved with, or connected to, the AIFM or the AIF needs to be considered. In this scenario, the FSA could say that communications in response to such a post event approach would be treated as active marketing since the earlier interaction between, or meeting with, the AIFM and the potential investor amounted to "previous involvement with the AIFM".

Investors introduced to the AIFM by consultants, such as the large pension fund consultants, should, in the absence of any arrangement or agreement between the AIFM and the consultant, not be treated as having been actively marketed to. Again, the position will be blurred if the AIFM has given an AIF offering document or other marketing material to the consultant. It is less clear on the basis of the FSA's statements whether there is meaningful risk that such arrangements with a consultant could be treated as indirect marketing – we would hope not where there is no direct communication or relationship with the potential investor. The FSA Guidance is however very brief and generic and it is unclear at this stage how it will be applied in practice. For example, should the guidance be applied on a look through basis?

Any US managers who may be considering the use of a non-passworded website pursuant to the removal of the prohibition on general solicitation by the JOBS Act should note the FSA comments above (i.e. that communications which are available on a publically accessible website would not be considered to be sent at the initiative of the investor). From a UK investor perspective (and likely that of other EEA country investors), if a US AIFM wishes to avoid being seen to have actively marketed for AIFMD purposes, keeping a passworded website would be preferable.

If I want to market in the UK after 22 July 2013, what do I need to do and when?

It will be difficult for most US hedge fund managers who seek UK (or other EU) investors to avoid marketing for AIFMD purposes.

Until publication of HM Treasury's Q&As, it appeared that US hedge fund managers marketing to UK investors after 22 July this year would need to comply fully with the relevant provisions of AIFMD from that date.

However, HM Treasury has now announced its intention to amend its regulations so that US (and other non-EU) hedge fund managers which were marketing the relevant AIF in the UK by 22 July 2013 will be able to take advantage of a transitional period, to 22 July 2014, before having to comply with the Directive's disclosure and reporting requirements and registering the relevant AIF with the UK's Financial Conduct Authority.

As well as marketing existing AIFs, such managers would also be able to launch and market new AIFs during the transitional period.

At this stage, it is unclear which other EU Member States will adopt the same approach to a transitional period for non-EU AIFM marketing their AIF to investors in their respective jurisdictions.

In summary, a US hedge fund manager which intends to make use of HM Treasury's transitional provisions will need to do the following:

Before 22 July 2014

OM/investor disclosures:

- Perform a gap analysis between the fund's current offering materials and the requirements of article 23 of AIFMD.
- Take policy decisions whether to make amendments to OM or exclusively use AIFMD disclosure document and as to universe of investors who will be eligible to receive article 23 information (i.e. non EU as well?).
- Produce additional updated OM/AIFMD disclosure document.

By end October 2014 (see below as to timing)

Regulator reporting form (Annex IV template):

- Evaluate lead time for regulator reporting form.
- Determine relevant timing for frequency of reporting (quarterly or half yearly).
- Consider IT + systems/process changes required.

Although there is some lack of clarity in the Level 2 Regulation, we consider that the first such report would be made within one month after the first calendar quarter or half year, so by end October 2014 for quarterly reporting, and by end January 2015 for half yearly reporting. ESMA and local regulatory implementation should be monitored for any varying approaches.

From December 2014 (see below as to timing)

AIF Annual report:

- Take policy decision re universe of investors who will be eligible to receive annual report (i.e. non EU as well?).
- Define universe of staff covered by remuneration disclosure requirement.
- Discuss with fund auditors.
- Prepare annual report for 1st year end Dec 2014.

Although there is some lack of clarity in the Level 2 Regulation, we consider that the first annual report should be made available, in respect of AIF with a December year end, within six months following 31 December 2014. This annual report will need to be supplied as part of the prior disclosure document from that time. ESMA and local regulatory implementation should be monitored for any varying approaches.

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