CT Réglementation européenne et internationale - 28.06.2017

AFG's response to the European Commission's questionnaire on cross border distribution of investment funds

Industry questionnaire

As a preliminary remark, AFG strongly believe that ESMA should take the lead and propose a set of common guidelines and standards based upon best practices at national level with the aim of clarifying existing rules. Including those rules in a level 1 text of Regulation would be too burdensome in case of a need of amendment and have no evident additional value considering the practical nature of the identified barriers to cross-border distribution of funds in the EU.

Overall economic benefits

- Do you have any further overall estimates of the total costs imposed by national requirements relating to the cross-border distribution of funds? We are particularly interested in indirect costs, so for example, we have a good understanding of regulatory fees, but less so of legal support fees etc. Where possible, please provide a breakdown along the categories described in the public consultation:
  - marketing requirements
  - regulatory fees,
  - administrative arrangements (e.g. local agents),
  - notification procedures;
  - taxation.

Here are some examples of estimated costs reported by some of our members for 2016:

- One of our member reported that on the basis of **AUM €** XX **billion of funds marketed in European countries outside of France**, **the total estimated cost linked to national requirement (i.e** XX **M€)** represent a **2 basis points reported to AUM.** It is worth mentioning however that this ratio may be much higher for smaller asset managers that have not the same size of funds nor the same negotiating power.

  The breakdown of costs per category communicated is as follows:

  - marketing requirements: X **M€ including notification**
  - regulatory fees: X **M€**
  - administrative arrangements (e.g. local agents**):** X **M€ of which** X **M€ for Italian correspondent bank**
  - notification procedures: (included in marketing requirement)
  - taxation: **nearly** X **M€**

  Additional comments: The largest part of marketing costs is linked to national legal specificities and reporting requirements. High disparities in term of costs are obvious from one country to the other. Some national regulations make an obligation of having a local agent which is not always useful. We consider that local agents should not be compulsory when another solution

is provided, for example through a local intermediary which can provide additional services to those legally attributed to the local agent.

- The 2016 total on going registration costs for cross border funds reported by another French asset manager are the following:

  - X **M€** (including the following fees: local agent / NAV publication / Legal document dissemination / host regulators maintenance fees / Tax reporting);

  - Translation costs: around XXX **K€**.

  - Service provider costs for cross border new registration / maintenance requirement filing and KIDS production costs are excluded from the above costs and should thus be added.

Attached an overall estimate costs spreadsheet with the estimate costs for 2016 per country.

- Do you have evidence that lower costs for asset managers are passed on to investors through lower fees? If yes, please could you provide the evidence.

When external administrative costs are disclosed separately from management fees, as it is the case in Luxembourg, **global costs for investors are automatically lowered** if a reduction of administrative charges may be achieved.

- Do you have evidence that large funds provide economies of scale, which leads to lower fees and/or other benefits for investors? If yes, please could you provide the evidence, including where possible the potential range of savings from fees.

A large part of costs linked to fund management is fix costs and economies of scale are possible. This being said, the size of funds is not always extendable and may be restricted by the size of the investment universe. In this respect, comparisons of funds sizes between the US and Europe are often irrelevant due to the disparity of financial market size.

Specific areas:

Deregistration

- Have you incurred costs due to inefficiencies in, or lack of clarity of, the deregistration process in the host Member State? If yes, please provide an estimate (or range) of the costs, including fees to the host competent authority.

The requirements based on which companies can exit a market via a de-registration are not harmonized across the EU. Indeed, there are differences across countries in terms of publications, communication media to the authorities (CIFRADOC for Spain or DEPROF for Italy), payment of fees, deadlines to update the registers etc. Furthermore, some authorities provide explicit feedback after deregistration requests while others remain silent which lead to difficulties in knowing if the deregistration has been taken into account. This situation creates uncertainty for cross border fund distribution activities and lead to inefficiencies.

As an illustration of the different de-registration processes in place across the EU, please find enclosed a Powerpoint document listing the de-registration requirements per country.

The costs incurred by such lack of standardization of the deregistration process are mainly linked to the **legal fees and the advice necessary for the asset manager to understand the local (and often cumbersome) de-registration requirements.**

It would be difficult to provide a concrete estimation of such costs, due to the lack of common standards and different national provisions. Moreover, **the conditions linked to de-registration can produce indirect costs for investors, as a fund that remains registered due to the complex de-registration processes even if active distribution is suspended, can increase costs for the investors**.

We are of the views that **a fund should be able to de-register from any Member State across the Union if the assets under management borne by investors from this Member State fall below a threshold of the fund's total asset under management (5% for example) and below a limited number of single investors.** Investors would then be offered the possibility to exit the fund free of charges and the asset manager would be exempt from paying regulatory fees. If the investors have the ability to choose to remain in the fund, the asset manager keeps his information duties towards the investors. In such cases, the asset managers need to maintain the administrative arrangements that may have been required to be put in place by host country regulation. Hence, costs continue to incur even though active distribution is suspended. The absence of necessity to keep alive local representative and/or information and/or paying agent Agreements in case of de-registration of funds should thus be considered if such option is offered to the investor.

Marketing – pre-marketing / reverse solicitation

- What do you consider to be pre-marketing / reverse solicitation? Do you have any comments on the definitions recently considered by the Expert Group on barriers to free movement of capital?[1]

  "The expert group considered that pre-marketing should cover situations in which draft fund documentation, but not subscription material, is provided to a limited number of potential professional clients, in the absence of any possible subscription choice.

  Reverse solicitation was then construed as a request by a professional client regarding units or shares of a specifically designated existing fund without a prior direct or indirect offer or placement (i.e. solicitation) from the management company or on its behalf. The contact is thus to be established only on the investor's initiative and may not constitute a reaction to previous offers or placements."

The absence of a common understanding of pre-marketing and reverse solicitation activities is a significant market entry barrier for investment funds since this situation lead to a lack of clarity as to the applicable rules in each jurisdiction and lack of legal consistency.

[1] http://ec.europa.eu/info/sites/info/files/170227-report-capital-barriers_en.pdf

For that reason, AFG strongly supports EFAMA proposal for:

- ✓ Further coordination at EU level, via setting **common guidelines and standards** as to the scope of marketing activities on which the AIFMD rules apply and the definition of pre-marketing activities and reverse solicitation. We do believe that ESMA should be assigned this task with the aim of clarifying existing rules without imposing new requirements in order to ensure regulatory stability.

- ✓ The publication by ESMA, in association with NCAs, on a specific internet portal which will be publicly and freely accessible and in a language customary in the sphere of international law, of a **harmonized and easily accessible Guide to national UCITS, AIF, EUVECA, EUSEF and ELTIF marketing regimes** (already in place at least for UCITs funds), regularly updated by the NCAs (updates should be visible by investors in real time).

We also see merit in **increasing transparency of applicable fees in all jurisdictions** and support the publication of centralized information on ESMA's website.

AFG's members tend to generally agree with the definitions proposed by the Expert Group, but raise the following comments:

Pre - marketing:

- **Pre-marketing should not be restricted to professional investors only**. As regards AIF in particular, even if AIFMD, which defines marketing, provides a passport for funds marketed to professional investors, it should still be fully acknowledged that, at national level, distribution of AIFs to non-professional investors is allowed. In that context, national authorities should be given the possibility to apply the definitions of pre-marketing and reverse solicitation also to non-professional investors, who can invest in an AIF. The recent AMF guidance on UCITS and AIF marketing regimes in France authorizes the practice of management companies contacting up to a maximum of 50 investors (professionals or individuals whose initial subscription would be at least €100,000) under pre-marketing rules.

- The definition should **clarify the exact period during which pre-marketing is allowed**, and particularly which event closes it (e.g. premarketing to be performed until final approval by the regulator). This would avoid ending up with a non-harmonized regime across EU, and with different rules that could have significant practical impacts on the monitoring of our pre-marketing activities.

- We consider that the **term "draft fund documentation" is too restrictive** and that it should be possible for management companies to provide potential investors with draft by-laws, private placement memoranda, term sheets or fact sheets regarding the fund, etc as far as they are not definitive documentation. Hence, **we would suggest to align as far as possible the definition of pre-marketing with the one provided by the "AMF Guide on UCITS and AIF marketing regimes in France" under which the practice of management companies contacting up to a maximum of 50 investors (professionals or individuals whose initial subscription would be at least €100,000) to assess their interest prior to the launch of a UCITS or AIF does not constitute an act of marketing, provided that the investors are not given a subscription form and/or documentation containing definitive information on the fund's characteristics**. However, any

subsequent subscription by the investors contacted will be considered to constitute an act of marketing.

- **The reference to "limited number" should be considered at jurisdiction level** and interpreted in consideration of the size of such markets and characteristics of the relevant fund. Indeed, contacting "a limited number" of potential clients in Germany or in Malta will not represent the same number due to the size of these respective markets.

- **The term "In the absence of any possible subscription choice" should be clarified and illustrated with practical examples.**

- We believe that it should be considered to **extend pre-marketing to testing the potential interest of foreign investors for an already existing fund created in one Member State but not yet passported for distribution in other Member States.** The expert group definition could thus be extended to this situation. Indeed, pre-marketing as it is currently understood aims at testing the interest of investors for a new fund to be created in order to ascertain, before engaging in the time and cost consuming procedure of creating the fund, that there is commercial potential for such a product. Similarly, it should be possible before engaging in the time and cost consuming procedure of passporting a fund, to test its potential interest towards a limited number of professional investors in another Member State being specified that similarly to what the proposed definition currently state, no subscription material would be available (since the fund is not passported yet and it should be made clear to the potential investors that no subscription is yet possible).

- We are of the views that **the characteristics of other situations that would not trigger the application of marketing rules should also be clarified**. For example (but not limited to) : participation by a management company in conferences or meetings of professional investors, provided the investors are not asked to invest in a specific product; OTC trades between investors; The purchase, sale or subscription of units or shares in UCITS or AIFs in the context of a management company's compensation policy, units or shares in UCITS or AIFs on behalf of the management company's management team, which manages them, or its senior management, or the management company itself, or carried interest shares; A management company responding to a **request for proposal (RFP) by a professional investor** that is a legal entity. Furthermore, we do believe that **a special regime should be granted in particular to UCITS in case of Request for proposals (RFP)** coming from Institutional investors and Corporates. In such a context, it should be authorised for a European professional investor to subscribe to any UCITS proposed as an answer to the RFP without the need of prior registration of that UCITS in the country of that investor. In a more general fashion, our members consider that UCITs funds should be authorized to be sold to professional investors without any need of prior registration/passport procedure notification.

Reverse solicitation:

- **Reverse solicitation should not be restricted to professional investors** (see above).

- The final reference to "**previous offers or placements**" **would need to be clarified**. We agree that pre-existing relationship with a professional investor shouldn't be used to unlawfully promote funds not authorised for distribution in a relevant jurisdiction. However, there shouldn't be a presumption that an investor has been inappropriately approached simply because there has been a pre-existing investment or commercial relationship.

- The definition of reverse solicitation, which is supposed to provide a negative definition of the notion of Marketing, refers to terms like "offer", "placement" or "solicitation" which are themselves not defined. **We would suggest to have a clarification of what is or is not marketing, through ESMA guidance including practical examples** (e.g. status of RFP, presentation/conference on investment strategies, use of funds by discretionary portfolio managers), in addition to high level negative and positive definitions. Particularly, it would be beneficial to understand interactions between the notion of marketing and the practical activities performed by the different regulated firms, like MiFID Firms, UCITS ManCo, AIFM, or insurance brokers. We believe it would help clarifying the interactions between asset manager and intermediaries, and allow a better assessment of the risks and governance needs, particularly in case of cross boarder relationships.

- **The definition needs to reflect cases in which professional investors contact an asset manager not in respect of a specifically designated and existing fund, but concerning an expertise on a concrete type of investment strategy asking to give them further details**. In such a situation, there is a reverse solicitation for an "expertise" and not for a specific fund and we consider it should also fall in the scope of reverse solicitation and not be considered as marketing. The risk of not allowing this possibility for investors asking for more details on a expertise is limiting the choice of investors and ability to find the products that better reflect their investment needs.

- To what extent are a) reverse solicitation and b) pre-marketing used in your home Member State and in the other Member States where you market your funds? Please can you estimate / quantify if possible.

AMF has recently provided guidance for pre-marketing which our members consider as being a very good initiative.

Our members reported that pre-marketing and reverse solicitation are used with different type of clients in France and on a cross border basis when local regulations authorise so but without being able to quantify such use.

Pre-marketing is mainly used at a time prior to a fund's launch or to entering a new market (when local rules permits so) since the asset managers need to communicate with potential investors based on draft documentation in order to **test the attractiveness of the project** and in order to **seed money**.

Pre-marketing is also used by non-EEA asset managers as a way to create awareness for their products and "**test" the market's appetite**.

- What would be the cost saving be if legal certainty were created at EU level around the concepts of (a) pre-marketing and (b) reverse solicitation?

Inconsistencies on pre-marketing and reverse solicitation are an additional disincentive for cross-border distribution as this aggravates legal confusion, burden and duplicative work, in particular for smaller asset managers that are lacking the necessary resources to further analyze the difficulties and complexities of a certain jurisdiction. Engaging local advisors in order to clarify these national requirements is necessary, in particular in relation to a number of marketing requirements, such as:

- The marketing material itself, its different purposes and uses according to the jurisdiction it is provided (e.g. in some Member States marketing material needs to not only be filled, but also be approved by the NCA prior to its use);
- The ways the marketing activities are triggered (in some jurisdictions marketing is not only triggered by subscription and filing requirements, but this also depends on whether there is an initial registration of a fund or, in the case of additional share classes, whether these have to be filed separately).

Moreover, even if there are concrete local requirements it is often the case that it is not easy to have access to them or if access is granted it can be that the information is not easily understandable.
Legal certainty as to those two terms would certainly waive the need for legal and other type of advice related to these definitions. legal costs as being indirect costs, are not easy to be broken down and in this case to assess which part of the costs for the legal advice provided to an asset manager covers only the advice in relation to pre-marketing and reverse solicitation. Moreover, costs charged by law firms can vary significantly, which makes it even more difficult to give an average price of the costs and legal fees related to pre-marketing and reverse solicitation.

- Which types of funds can be subject to a) reverse solicitation and b) pre-marketing? Please provide examples for typical cases where you make use of both.

Pre-marketing is more specifically used for **funds with illiquid assets (such as Real estate and Infrastructure) and long term investment strategy as well as dedicated fund** customized for one or few clients, therefore funds mainly distributed to institutional clients.

We reference the input by one of our members stating that pre-marketing and reverse solicitation are mainly used for **AIFs (Private Equity, Private debt, Infrastructure) but it can also be useful in some other cases**. For example, it has launched recently a **2 billion green bond fund** for which reverse solicitation has been of good support. This being said, it reported that reverse solicitation represents less than 5 % of their global placements.

- Which types of investors can make use of reverse solicitation? How do investors become aware of products they decide to invest in via reverse solicitation? Please provide examples for typical cases where investors use reverse solicitation. What safeguards should be put in place to avoid inappropriate circumvention of marketing requirements?

There are several ways for an investor to become aware of products they then decide to invest in via reverse solicitation, such as access to information via internet or via another existing investor in a fund or being an existing client of the management company and having access to information related to other products of the same company

The current practice is that reverse solicitation is mainly used for professional investors but it is due to the lack of legal certainty as to the rules that apply, which therefore makes its use too risky for an asset manager when it comes to non-professional investors.

However, we believe that **the reverse solicitation should not be limited to situation involving professional clients**, except when the fund itself is restricted to professional investors. UCITS funds are available and accessible to non-professional investors wherever they are domiciled, and UCITS rules

don't impose any restriction to the access of the fund in absence of marketing authorisation. We don't see on which ground we could refuse a spontaneous subscription or request for information coming from a non-professional investor domiciled in a jurisdiction where the fund is non-marketed.

In addition, the nature of the reverse solicitation implies by definition an absence of pre-monitoring/control by the fund manufacturer of the information to which the prospective investor has accessed. It wouldn't be practically manageable for the fund manufacturers to confirm the absence of marketing activity for any request or subscription coming from a retail investor domiciled in a non-eligible country. Especially, the intermediation and use of nominee accounts make this identification event harder, if not impossible.

Nevertheless, and as an ex-post control, we believe that the **monitoring of the target market and distribution channels** should be considered as the most appropriate safeguard to identify unusual, incorrect or unlawful marketing activities. Indeed, in a distribution model, the fund manufacturer relies on its distributor to ensure that it acts appropriately, transfers lawful subscription requests and markets the funds appropriately and in compliance with the local requirements. The result of the oversight performed on the distributors should help identifying and assess the deviations to the distribution strategy in a proportionate way and in consideration of the characteristics of the relevant market (e.g. size, financial education) and fund (e.g. public fund with information easily accessible, well known niche fund).

Finally, the requirement to **maintain letter trails proving the initiative by the investor** could work as safeguards to avoid circumvention of the marketing rules. Still, our members consider that the current conditions are already fairly restrictive – in particular as the asset manager carries the burden of proof - and do not leave room for circumvention.

- Which types of investors can be contacted for pre-marketing?

In the French market, up to a maximum of 50 professionals or individuals whose initial subscription would be at least €100,000 can be contacted by Management companies to assess their interest prior to the launch of a UCITS or AIF without constituting an act of marketing, provided that the investors are not given a subscription form and/or documentation containing definitive information on the fund's characteristics. However, any subsequent subscription by the investors contacted will be considered to constitute an act of marketing.

We would also propose that **the scope of recipients should cover foreign investors with potential interest in a fund not yet passported for cross border distribution**; in that way potential interest of a limited number of foreign investors can be tested before engaging in time and cost consuming procedures of passporting.