Options available to Canadian managers under the European AIF marketing rules

June 29, 2016

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This article is supplementing the May 2016 issue of the Lavery Capital newsletter, number 9, which discusses the potential extension of the European passport regime (the "**Passport**") – established under EU Directive no. 2011/61/EU (the "**Directive**") – to Canadian investment fund managers ("**Canadian managers**"). In that article, we described the conditions for the possible extension of the Passport regime to Canadian managers and, once so extended, the obligations such managers will have to meet to benefit from this regime.

As we indicated in the previous article, the Directive gives every manager established in a third country, i.e. any country not a member of the European Union (the "EU"), the opportunity to market, in a country of the EU, units or shares of alternative investment funds ("AIFs") established in the EU or in a third country, either under the Passport regime, or under article 42 of the Directive. Article 42 of the Directive already allows Canadian managers to market the AIFs that they manage, provided they comply with the so-called "private placement" mechanisms applicable in each country of the EU where they wish to market their AIFs.

In this second article, our analysis will therefore focus more closely on the options currently available to Canadian managers under those private placement regimes. We will also consider the regime known as reverse solicitation.

Firstly, we refer the reader to our discussion in the previous article on what constitutes an AIF for purposes of the Directive.

1. The European private placement mechanisms

Until the Passport regime is extended to Canadian AIF managers, the only mechanism available to them is the national private placement regime of each EU country. These regimes in fact vary widely

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between the different EU countries.

The conditions applicable to marketing, without a Passport, in EU-member countries, of AIF units or shares managed by managers established in third countries, are set out in article 42 of the Directive.

Under this article, member countries “may allow non-EU AIF managers (AIFMs) to market to professional investors, in their territory only, units or shares of AIFs they manage.”

However, the Directive lays down certain conditions for such marketing for the protection of European investors. Thus, managers from third countries must comply with two sets of conditions: the obligations provided for in the Directive, and the obligations specific to each member country having authorized such marketing.

1.1. Requirements under the Directive

Under article 42 of the Directive, national private placements are open to managers in third countries if they meet the minimum requirements, as follows:

> compliance with the transparency requirements provided in articles 22, 23 and 24 of the Directive: obligation to draft an annual report for each AIF marketed in the EU (art. 22), obligation to provide adequate and periodic disclosure to the investors in the AIF (art. 23), and various reporting obligations to the competent authorities (art. 24);
> the existence of appropriate cooperation arrangements between the regulatory authorities of each member country of the EU where the marketing will take place and the authorities of the third country concerned (i.e. where the manager is established), but also the third country where the domicile of the AIF is located, if the AIF is domiciled in a country other than the domicile of its manager;[1]
> also, the third country in which the manager is established must not be listed as a non-cooperative country or territory by the Financial Action Task Force on anti-money laundering and terrorist financing (FATF).

1.2. Requirements imposed by member countries

The foregoing requirements are characterized as “minimum” by the Directive, with each member country being free to impose stricter rules. Thus, managers from third countries must also comply with the specific conditions regulating the private placement mechanisms of each of the member countries of the EU in which marketing of the AIF is being considered.

1.3. Specific requirements governing the French private placement regime

The French legislation does not use the term “private placement” for the purposes contemplated by the Directive. Indeed, the concept of private placement already exists in French law, but refers to another type of transaction (the raising of capital from a small number of professional investors as opposed to a public offering).

Nevertheless, a regime has in fact been adopted to allow managers from third countries to market AIFs in France.

Article 42 of the Directive was transposed into French law by articles L. 214-24-1 and D. 214-32 of the French *Code monétaire et financier*, which set out the conditions for such marketing by managers from third countries both to professional and non-professional clients on French territory.

a) Conditions applicable to professional clients:[2] :

The conditions for marketing derived from the Directive and transposed to and set out in article D. 214-32 of the French *Code monétaire et financier* are as follows:

1. The manager must comply with the legislative and regulatory provisions applicable to management companies subject to the Directive, including:
   - it must have designated one or several entities to perform the functions of the depositary (set out in article L. 214-

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24-8 of the French *Code monétaire et financier*);
- it must be in compliance with the other requirements laid down in the Directive for the management of the AIF.

2. Appropriate cooperation arrangements for the purpose of systemic risk oversight and in line with international standards should exist between the French regulatory authority, namely the Autorité des marchés financiers (France) (the "AMF"), and the competent authorities of the EU-member country concerned, or of the third country where the AIF or its manager is established, to ensure the exchange of information allowing the AMF to fulfill its functions.
3. The third country in which the manager or the AIF is established must not be on the list of non-cooperative countries or territories published by the FATF.

In addition to these requirements, article L. 214-24-1 of the French *Code monétaire et financier* provides that managers from third countries may market AIFs established in an EU-member country, or in a third country, to professional clients provided they comply with a procedure for giving notice to the AMF, the terms and conditions of which are set out in article 421-13-1 of the Règlement général (General Regulation) of the AMF (the "**AMFGR**").

Thus, under that article, managers must submit an application to the AMF for prior authorization, whose conditions are provided for in an instruction from the AMF. Under this same article, the AMF has published an instruction entitled [translation] "*Procedure for Marketing Units or Shares of AIFs*", setting out the process to be followed by managers from third countries.[3]

b) Conditions applicable to non-professional clients ("retail investors"):

In addition to the requirements under article D. 214-32 of the French *Code monétaire et financier*, managers must also show that they are in compliance with the specific conditions provided in article 421-13 of the AMFGR.

Firstly, this article states that managers from third countries may market AIFs, established in an EU-member country or in a third country, to non-professional clients provided they submit a prior application for authorization to the AMF, whose conditions are set out in an instruction from the AMF.

Secondly, article 421-13 of the AMFGR provides that this authorization is subject to compliance with the following three additional conditions, which apply depending on whether the AIF is French or not:

1. a system for the exchange of information and mutual assistance in the field of asset management on behalf of third parties has been set up between the AMF and the supervisory authority of the manager, on the one hand, as well as the supervisory authority of the AIF, on the other hand, where the AIF is not established in France;
2. the AIF meets the conditions laid down in a mutual recognition agreement dealing with AIFs that can be marketed to retail investors, signed between the AMF and the supervisory authority of the AIF, where the AIF is not established in France;
3. the manager meets the conditions provided for in a mutual recognition agreement establishing the specific requirements applicable to the authorization of managers of AIFs that can be marketed to retail investors, signed between the AMF and the supervisory authority of the manager.

It should also be noted that in order to apply for authorization to engage in marketing to retail investors, one must either first have complied with the procedure for marketing to professional investors, or submit both applications jointly.

2. Reverse solicitation

Since July 22, 2014, non-European fund managers who are active in the European market are no longer authorized to engage in solicitation of investors located in EU-member countries, unless they comply with the private placement regimes of each of the member countries where their investors

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reside. The only possible form of solicitation for a manager who does not comply with such a private placement regime or regimes is that commonly known as “reverse solicitation”, i.e., where the initial contact for investment purposes is made by the investor himself. In other words, the investment is made solely upon the investor’s initiative with no prior “marketing” by the manager.

Indeed, the Directive 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.”

Thus, in the case of “reverse solicitation”, since it is the investor who initiates discussions with the manager and not the converse, in fact, no marketing takes place within the meaning of the Directive.

The difficulty nonetheless of resorting to reverse solicitation is in determining which, in fact, of the manager or the investor actually initiated the investment process. The regulatory authorities define the concept of reverse solicitation differently from country to country, but the definition is generally a narrow one.

In France, the concept remains vague but, very recently,[4] the AMF issued a warning against this practice.

Reverse solicitation could therefore remain a possible option for Canadian managers (although its application would, in such case, be limited), even if the Autorité européenne des marchés financiers does decide to extend the Passport regime to them, as described in our article published in May 2016.

Conclusion

Given the delays before any potential extension of the European passport regime to Canadian managers, the national private placement regimes of each of the countries of the EU and the reverse solicitation regime may still be viable options, in the meantime, for Canadian managers seeking to market units or shares of AIFs in a country of the EU.

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1. In France, the list of non-European authorities with whom the Autorité des marchés financiers (France) has signed bilateral cooperation agreements, in Canada, includes: the Alberta Securities Commission, the Autorité des marchés financiers (Quebec), the British Columbia Securities Commission, the Ontario Securities Commission, and the Office of the Superintendent of Financial Institutions.
2. Professional investors are defined as investors who, because of their nature or size, are considered by the French legislation to have the experience, knowledge and skills necessary to make their own investment decisions.
3. See, in particular, articles 16 to 20 and schedule 3 of the aforesaid instruction.
4. *Guide de bonnes pratiques à destination des associations, fondations, fonds de dotation et autres petites institutions* (Guide to Good Practices for Associations, Foundations, Endowment Funds and Other Small Institutions) (December 2015).

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