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Positive advice of the European Securities and Markets Authority to the extension of the European passport to the managers of alternative investment funds in Canada

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On July 18, 2016, the European Securities and Markets Authority (ESMA) issued a favourable advice for a future extension of the European passport concerning Alternative Investment Fund Managers (**AIFMs**)[1] in Canada. This advice, which is based on objective criteria of cooperation and guarantee of overall protection level equal to that in force in European State members, constitutes the last stage prior to the effective extension of the European regime to Canada.

1. Assessment criteria

The ESMA reviewed the individual situation of twelve non-European countries[2], including Canada, to assess the guarantees offered by their respective local legislation against the requirements of the AIFM Directive (**AIFMD**).

With respect to cooperation, the assessment criteria relate to:

- the possibilities for the exchange of information, on site visits, between the competent monitoring authorities respectively in Canada and those of the European State member;
- the fact that the non-European third country in which the Alternative Investment Fund (**AIF**) is established is not listed as a Non-Cooperative Country and Territory of the Financial Action Task Force (FATF);
- the existence of agreements for exchange of information in tax matters.

Furthermore, sufficient guarantees (as defined by the AIFMD) must exist in respect of:

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investor protection, particularly in relation to complaint management, the safeguarding of assets, the prudential soundness of the depositary, the separation and management of conflicts of interests between the depositary function and that of alternative investment fund manager, the scope of monitoring by local regulatory authorities, compliance with the requirements of the AIFM Directive;
market disruption as a result of a potential extension of the AIFM passport to a non-European country;
competition, by the assessment of the level of reciprocity in respect of the marketing of European AIFs in a non-European third country;
systemic risk management, particularly the mechanism for monitoring existing markets.

2. Final result of the assessment of Canada by ESMA

The ESMA notes that the Canadian financial system had been assessed by the International Monetary Fund (IMF) in 2014, the IMF concluding that the international principles on securities regulations were “fully implemented” in Canada.

In its advice dated July 18, 2016 respecting a possible extension of the AIFM passport to Canada, the ESMA thus confirms that there is no significant obstacle which may hinder the application of the passport to Canada with respect to the systemic risk, market disruption and obstacles to competition. Nevertheless, it notes differences between the Canadian regulations and the AIFMD. These differences particularly relate to the supervisory function that are imposed on the European AIF depositary (contrarily to the Canadian custodian which, pursuant to National Instrument 81-102 – *Investment Funds (Regulation 81-102 respecting Investment Funds* in the province of Quebec) (“**NI 81-102**”), is not subject to supervisory functions but rather only subject to obligations of custodianship of the portfolio assets). The ESMA also mentions the rules pertaining to the compensation of the manager (notably to align the interests of the manager and of the investors). There are various rules regarding compensation in Europe while NI 81-102 provides for very few rules in that regard (further, many investment funds in Canada are not subject to NI 81-102).

However, the ESMA concludes that these differences between the Canadian regulatory framework and that of the AIFMD do not constitute a significant obstacle to the application of the European passport to Canada.

Conclusion

Where ESMA[3] considers that “*there are no significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk, impeding the application of the passport to the marketing of non-EU AIFs by EU AIFMs in the Member States and the management and/or marketing of AIFs by non-EU AIFMs in the Member States in accordance with the rules set out in Article 35 and Articles 37 to 41, it shall issue positive advice in this regard*.”

It is this positive recommendation that the ESMA sent on July 18, 2016 to the European Commission (EC), to the European Parliament and Council, which should allow the EC, within three months, to define by delegated act the date of coming into force and the terms for the extension of the European passport to Canadian Alternative Investment Fund Managers to market these funds in EU countries.

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1. Includes notably private equity funds, venture capital funds and hedge funds. See our article entitled “Impact of the possible extension of the European passport regime on Canadian fund managers” published in the *Lavery Capital* newsletter, May 25, 2016.
2. Australia, Bermuda, Canada, United States, Guernsey, Hong Kong, Cayman Islands, Isle of Man, Japan, Jersey, Singapore, Switzerland.
3. See article 67(4) of the Directive 2011/61/UE on Alternative Investment Fund Managers.

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