

# LEGAL INSIGHT

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**Practice Group:**

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## AIFMD PASSPORT A “NO-GO” FOR U.S. MANAGERS

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On July 30, the European Securities and Markets Authority (ESMA) provided its advice and opinion to the European Commission, Council and Parliament with respect to the extension of the EU’s Alternative Investment Fund Managers Directive (AIFMD) passport to non-EU funds and managers.<sup>1</sup> Although ESMA recommended extension to a number of jurisdictions, the United States was not included in that group.

The AIFMD, creates a regulatory structure around the oversight, registration, and distribution of alternative investment funds (AIFs) and their managers. One of the primary benefits of registration under the AIFMD is the availability of a UCITS-like passport that enables managers of AIFs to offer their funds and to manage AIFs on a cross-border basis in the EU under a single set of regulations and private placement rules. Upon implementation of the AIFMD in 2013, and up to now, registration and access to the passport has only been available to EU-based AIF managers and funds, and ESMA was required to provide further advice to the European Commission, Council and Parliament with respect to possible extension of the passport to non-EU entities, such as U.S. managers.

ESMA issued that further advice yesterday, and recommended that the passport should only be extended outside the EU at this point to managers and AIFs in Jersey, Guernsey and, subject to certain legislative changes that are in process, Switzerland. ESMA declined to recommend the extension of the AIFMD passport to Hong Kong, Singapore and the United States at the present time.<sup>2</sup>

ESMA has, so far, evaluated a total of six potential non-EU jurisdictions for the AIFMD passport. The three recommended jurisdictions are not surprising, particularly Jersey and Guernsey, which have a long history of implementing funds regulations that mirror those in the EU. With respect to Switzerland, ESMA is satisfied that there will be no significant obstacles impeding the potential application of the AIFMD passport to Swiss managers and funds when amendments are made to the Swiss Federal Act on Stock Exchanges and Securities Trading. ESMA explained that, in its view, those amendments would enhance the required level of cooperation of the Swiss regulator, Financial Market Supervisory Authority (FINMA), with non-Swiss regulators. The amendments are due to be enacted on 1 January 2016.

<sup>1</sup> <http://www.esma.europa.eu/news/ESMA-advises-extension-AIFMD-passport-non-EU-jurisdictions?t=326&o=home>

<sup>2</sup> The omission of the Cayman Islands from this review is surprising, given that it is a jurisdiction of key importance to many U.S. managers, and many hedge fund managers worldwide, but the jurisdiction does appear on the “long-list” of jurisdictions that ESMA has identified as being most relevant. ESMA attributes its failure to deal with the Cayman Islands, for example, to both a lack of time and an absence of a “sufficient level of information about that jurisdiction”. There is accordingly a challenge for jurisdictions not in the first wave of ESMA’s review that wish to be considered for the passport both to supply any necessary information and data to ESMA and to expedite relevant legislative changes, so as potentially to move themselves up the queue.

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ESMA evaluated each country under the following general headings set out in AIFMD: investor protection, market disruption, competition and the monitoring of systemic risk. This is not a formal test of “equivalence” in this context, but, nonetheless, it appears from the ESMA recommendations that they have undertaken a detailed survey of rules in each jurisdiction under consideration. This detailed approach appears to make it less likely that non-EU jurisdictions will be accepted for the passport, and this appears to be true of the United States.

Applying its detailed approach, ESMA has concluded that there are relevant obstacles to the extension of the AIFMD passport to the United States. Two of the more significant obstacles appear to be the lack of AIFMD-like remuneration rules applicable to U.S. managers and the lack of U.S. market access for EU-based funds to retail investors (the “unlevel playing field” in the context of reciprocal access). ESMA’s advice is basically to take a “wait and see” approach with respect to the United States until “*better conditions of market access are granted by the US Authorities to EU AIFMs/AIFs, as abovementioned*”. Interestingly, ESMA also cited the potential applicability of the Volcker Rule to certain EU managers and AIFs as an additional barrier to entry to U.S. markets since such AIFs would likely be “covered funds” under the rule.

It is unlikely that U.S. federal securities laws and regulations impacting the private offering of funds in the United States will be amended anytime soon to grant broader access in a manner that would be likely to satisfy ESMA. Accordingly, U.S. managers who were hoping to gain broader and easier access to European markets for their private funds or U.S. registered investment companies will need to continue to rely on a country-by-country analysis of the national private placement regimes (NPPRs) based on Article 42 of AIFMD for the foreseeable future. This is subject to the European Commission, Council and Parliament in due course coming to a view on the United States, or indeed on the extension of the AIFMD passport more generally, that is different to that expressed by ESMA so far.

It will, in any event, be some time before any resulting legislative change comes to fruition as the European Commission has, under the procedures set out in AIFMD, three months to draft a “delegated act” having regard to the positive ESMA advice with respect to Guernsey, Jersey and Switzerland, and there is then a process of EU Council and EU Parliament scrutiny, which can last up to six months and which can potentially send the Commission back for redrafting which would re-set the timetable. It is also possible that the Commission may delay producing the delegated act beyond the three-month period mentioned and until more information on the suitability of other non-EU countries for the AIFMD marketing passport is available from ESMA. Indeed, ESMA has indicated that the European Council, Parliament and Commission may wish to consider whether to wait until ESMA has delivered positive advice on a sufficient number of non-EU countries before bringing forward legislation “taking into account such factors as the potential impact on the market that a decision to extend the passport might have”. This suggestion, and the fact that there is no fixed timetable for further ESMA work, points towards a likely slippage of other AIFMD-related dates, such as the 2018 date for the end of the availability of NPPRs to U.S. and other non-EU managers.

It also seems unlikely that the NPPR approach would be removed for a jurisdiction that has not been offered the AIFMD passport as this would entirely remove the ability for U.S. managers to actively market non-UCITS funds into Europe. Thus, the fact the United States is not currently being recommended as a suitable jurisdiction for the passport might also

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signal longer term availability of the NPPR approach for U.S. managers than is anticipated in AIFMD itself.

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