“Main Barriers to the cross-border distribution of investment funds across the EU”

The view of the private equity industry

Earlier this year, as part of the Capital Markets Union project, the European Commission launched its consultation on the “Main Barriers to the cross-border distribution of investments funds across the EU” seeking stakeholders’ feedback on how this distribution could be improved. The results of the consultation will be used by the Commission in its assessment of potential next steps aiming to remove these barriers and allow European capital to flow across borders.

Removing barriers to the cross-border flow of capital is not only of great importance to the inherently cross-border private equity industry, but also to their investors and the companies they invest into. Cross-border barriers prevent European companies from accessing more diverse, stable and resilient forms of funding such as private equity. They can also act as a serious hindrance to the investor/manager relationship and can go as far as preventing access to certain markets. In the current low yield environment, European investors need the opportunity to reach the best fund managers across Europe. In return, fund managers need such access to raise capital to put it to work through investments in European companies.

This paper summarises the main concerns that the private equity industry outlined in its response to the Commission’s consultation. The full response is available [here](#).

1. General comments

Private equity fund managers face various problems when they try to raise capital from investors in Member States other than the one where they are based.

They are subject to burdensome and complex regulatory requirements, whether arising from the transposition of the AIFMD or from national rules, which very often do not seem to be proportionate to the risk they pose and not appropriate to the private equity world. The cost of regulatory/marketing requirements, whether in the context of the AIFMD ([see also point 4](#)) or national regimes, are therefore considered by many private equity managers a serious limitation to the cross-border distribution of funds.

The (small) size of host markets and the lack of demand outside the home market were identified by Invest Europe members as another reason behind the limited cross-border distribution of funds. Access to institutional investors is also notoriously difficult in some EU countries, either for regulatory or for cultural reasons, and this naturally hampers the development of the private equity industry in these markets.

2. Passporting limitations

The existing passporting framework prevents many fund managers, either too small or based outside Europe, to market their funds in some European countries.
i) **AIFMD managers**

For fund managers regulated under the AIFMD, passporting limitations are mostly related to gold-plating and/or inconsistent implementation of the AIFMD framework. This can range from significant delays in reviewing the AIFM’s notification application; to **host authorities still commenting** on the submission of “Annex IV” information to **home authorities**; and, last but not least, **host fees and charges** (see point 3).

ii) **Sub-threshold fund managers**

National private placement regimes (NPPRs) continue to play an important role in private equity and venture capital fund marketing in Europe as sometimes it is the only option for sub-threshold managers to market their funds cross-border. Opting in to the full (and - by definition - disproportionate) AIFMD regime is impossible for very many of those fund managers given the complexity and costs it entails. While smaller managers could in principle market their funds under the EuVECA passporting regime, very often its eligibility criteria and investment requirements prevent them from qualifying. Private placement is therefore essential.

A voluntary passport for all sub-threshold fund managers, with proportionate regulatory obligations (e.g. lower capital requirements, no depositary, etc.) would also be one way to solve this issue.

iii) **Third country fund managers**

It is also vital that the NPPRs continue to be available for third country fund managers. Some non-EU fund managers may decide that they only wish to market their funds in specific Member States, not across the whole EU. For those reasons NPPRs should remain available in the short and long term and co-exist with an efficient, uniform and commercially sensitive third country passport. The AIFMD third country passport should be considered as a complement to, and not a replacement for, the NPPRs.

3. **Host fees and charges**

Several Member States impose additional host fees and charges on AIFMD-authorised fund managers or EuVECA funds not based in their country. Such fees naturally constitute an additional burden and act as a serious disincentive for fund managers to market their funds across the whole Single Market. In a meaningful Capital Markets Union, a fund manager that is compliant with the relevant EU law and that is in possession of a valid passport should be free to market across the EU without any additional requirements being imposed by the host jurisdictions, including fees and charges.

4. **AIFMD: a framework not tailored to the private equity industry**

Many provisions of the AIFMD are written in a way that does not take into account the specificities of the private equity model. Private equity and venture capital funds are long-term ‘closed-end’ funds with specific characteristics which differ from other alternative investment funds that are captured by the AIFM Directive. Instead of being “pre-packaged” unitized collective investment funds that are merely “sold” to investors, they are typically partnerships or other negotiated structures. Participation in these funds happens after a negotiation between the manager and each investor individually. Private equity funds are not marketed to pure retail investors and are not advertised publicly or marketed through mass marketing campaigns.
i. **Definition of marketing (Article 4.1 (x) AIFMD)**

The current marketing definition restricts private equity managers’ ability to respond and provide investors with an investment solution that meets their needs. Member State regulators are also taking different views as to when “AIFMD marketing” is deemed to commence. Invest Europe’s view is that an AIFM should be entitled to carry out market-sounding activity, including also negotiation of draft documents, across the EU prior to the point at which the “almost final” documentation is made available to investors.

ii. **Sophisticated investors (Article 43 AIFMD, 6 EuVECA)**

Much investment into private equity comes from investors who would not be deemed “elective professional investors” under the MiFID II definition, either because they are high-net-worth individuals, such as family offices, entrepreneurs, wealthy individuals; or managers of venture capital and private equity funds, who are co-investing alongside the fund.

As a result, these investors are either not allowed in certain countries to invest into a private equity or venture capital fund (unless it is an EuVECA); or receive information that is not always suited to their needs and level of understanding of the investment (the cost of which they will ultimately bear). Invest Europe suggested amending MiFID and AIFMD to ensure investors defined in Article 6 of EuVECA are not labelled “retail” and are recognised as a specific investor category.

iii. **Depositary requirement (Article 21 AIFMD)**

One of the most significant additional costs that fund managers face under the AIFMD comes from the requirement to appoint a depositary. Given the nature of the assets into which private equity funds invest, both fund managers and their investors (the supposed beneficiaries of the requirement) have significant reservations about this requirement which raises costs without providing an additional layer of investor protection. The costs that fund managers, and ultimately investors, bear are increased further by the absence of a passport for depositaries.

iv. **Notification process (Article 32 AIFMD)**

The lack of harmonisation between national rules and the length of the procedures are cited by Invest Europe members as reasons for the difficulties they are facing. Moreover, some AIFMD requirements, such as i) the disclosure of a preferential treatment of one investor to all others before they invest or ii) the obligation to notify any material change, are difficult to comply with in a private equity context as private equity funds are structures that are negotiated over time. It should be possible for a private equity manager to disclose to an investor in the fund’s first close the terms of side letters which might be negotiated with investors at a second (or subsequent) close; and to make amendments to the governing document (LPA) between the first and final closing.

Our members are also facing a variety of difficulties with the AIFMD reporting processes. There is a lack of tailoring for private equity and as such, reporting forms may not always be suited to the specificities of private equity managers. Furthermore, national authorities take diverging approaches to the reporting requirements.

5. **Uncertain and inconsistent tax treatment**

Uncertain tax treatment and the imposition of additional taxes are two of the main barriers to cross-border distribution of funds. Another difficulty encountered is the inconsistent treatment between the taxation of local funds and foreign funds by the relevant Member State. These issues
create the potential for unforeseen and unexpected costs when investing cross-border.

**Withholding tax** issues can be ameliorated where the fund holds the investment through a holding company which is treaty eligible. However, in light of the OECD BEPS initiative, even in a situation where all of the investors are treaty eligible, or otherwise tax exempt, the use of such holding vehicles may cease to be a workable solution in the future.

### Key Invest Europe suggestions

- Consistent application and interpretation of the AIFMD and EuVECA rules
- Establishment of voluntary passport for sub-threshold funds
- Maintenance of National Private Placement Regimes for sub-threshold and non-EU fund managers
- An appropriate and coherent definition of marketing (Article 4 AIFMD)
- Differentiate sophisticated investors from “pure retail” ones (Article 43 AIFMD)
- No requirement to appoint a depositary (Article 21 AIFMD)
- A simpler and more-fitted notification process (Article 32 AIFMD)
- Ban on host fees and charges in the AIFMD (and EuVECA) passport context

### Contact

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### About Invest Europe

Invest Europe is the association representing Europe’s private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe’s leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members’ role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry’s professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.

For more information please visit www.investeurope.eu