On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

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Position paper on

the European Commission’s proposed Omnibus legislation on cross-border distribution of investment funds

Introduction

As part of its Capital Markets Union Action Plan, on 12 March 2018 the European Commission published its proposals for a Directive¹ and a Regulation² on cross-border distribution of collective investment funds. One of the main objectives of this “Omnibus” initiative, which suggests targeted amendments to the marketing provisions of the AIFMD, UCITS and EuVECA, is to improve cross-border capital investment flow in the EU by optimising the existing EU internal market passports. Concretely, as the Commission outlines, the new measures aim to reduce regulatory barriers to the cross-border distribution of investment funds in the EU, decrease the cost for fund managers of going cross-border and increase competition in the EU, thus giving investors more choice and better value.

However, as currently drafted, the proposed Directive and Regulation are insufficiently tailored to the private equity and venture capital asset class. In several key respects the proposals fail to take into account the specificities of a typical private equity fundraising process. A private equity fund (unlike UCITS funds and other more retail-focused products) is not a ‘pre-baked’ product. The raising of a closed-ended private equity fund is a negotiated, highly iterative process that allows the interests of the professional investor community to be taken into account in the fund’s development. “Pre-marketing” – the (mainly promotional) activities that are permitted before a marketing notification must be made to the regulator – is an essential part of this process enabling fund managers to test the market’s potential appetite for a product that is still under development and to which – by definition – no investor could yet subscribe.

Because of this lack of differentiation between the asset classes and business models covered, the Commission’s proposal may actually have the contrary effect to that which was intended, increasing the entry level for fund managers by creating more legal uncertainty and making the cross-border marketing of private equity and venture capital funds to EU investors very difficult, if not practically impossible.

Invest Europe believes that this is a missed opportunity. In particular, we are concerned about:

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1. **The harmonised definition of, and conditions for, pre-marketing** (Article 2 of the proposed Directive, Article 12 of the proposed Regulation)

The proposed Directive and Regulation do not sufficiently reflect the characteristics of a typical marketing process of closed-ended private equity funds with no redemption rights, and instead impose unnecessary limitations, such as limiting pre-marketing to AIFs which are *not yet* established and preventing fund managers from sharing *draft* marketing materials with investors. As these documents are an important part of the *ongoing dialogue* between fund managers and investors, including pension funds and insurers, the suggested wording would impede fund managers’ ability to negotiate a deal.

In addition, if the definition of pre-marketing is adopted as proposed by the Commission, then fund managers will be deemed to be “marketing” (and therefore would be required to exercise the marketing passport) at an early stage in the process of development of their fund, likely at a time when negotiations or discussions about structure and terms with investors have not yet even started. In light of the fact that these very preliminary drafts are still subject to substantial edits, this will inevitably make material change re-filings even more extensive and frequent.

2. **Increased transparency of fees charged by host Member States** (Article 6 of the proposed Regulation)

The European Commission could have gone further on the host fees and charges issue, in line with the approach that EU co-legislators took for the review of the EuVECA Regulation. The harmonised legal framework for EuVECA explicitly prohibits the fees and other charges that host Member States may impose on qualifying venture capital fund managers where *no supervisory task* has to be performed.

Increased transparency of host fees is unlikely to have a substantial positive impact on Member States’ behaviour in this field and even risks leading to a perverse outcome, where Member States that are not currently imposing a *host* fee may be encouraged to start doing so.

In a true Capital Markets Union, a fund manager that is fully compliant with the relevant EU law and has a valid passport should be *free to market* across the EU *without any further administrative requirements* being imposed by the host jurisdiction.

3. **Conditions related to (de-)notification** (Article 2(5) of the proposed Directive)

The proposed provisions to harmonise the de-notification process conflict with established practice in private equity. Conditions such as linking de-notification to a certain level of investor presence or requiring managers to make a public offer to buy-out existing investors are never seen in private equity. In reality, these conditions are likely to make ceasing marketing under the AIFMD passport very unattractive.

Also in this respect, the proposed rules *insufficiently differentiate* between AIF(M)s and UCITS, and do not appropriately take account of the differences between closed-ended and open-ended funds. Private, institutional funds (like private equity) are completely different from and should not be treated like retail products.
Key concerns

Invest Europe’s main concern is that the proposed Directive and Regulation do not adequately reflect the characteristics of a typical private equity fund’s marketing process. A private equity fund is not a ‘pre-baked’ product. In the private equity industry, marketing (or more accurately, fundraising) is a negotiated, highly iterative process involving parties who have broadly similar negotiating power, sophistication and access to specialist professional advice. This has traditionally involved early-stage discussions between fund managers and prospective professional investors to gauge the market’s likely appetite (Annex I). This iterative process allows investors to have early input into the development of a fund product and increases the chances that managers will ultimately offer investors investment opportunities that meet the market’s needs.

This is in stark contrast with (and the proposed rules should therefore differentiate between) the simple “sales” process used in the distribution of a retail fund (such as a UCITS fund). This involves the UCITS management company manufacturing and then offering a “finished” product to investors on non-negotiable terms.

1. The importance of pre-marketing in the context of private equity fundraising

Invest Europe appreciates the European Commission’s efforts to strive towards a harmonisation of the definition of “pre-marketing” - an exercise which, in addition to contributing to convergence of interpretation across Member States, could, if drafted appropriately, reduce the time and cost burden for private equity and venture capital fund managers. Moreover, a clear-cut distinction between “pre-marketing” and “marketing” is necessary to ensure that managers are not facing more legal uncertainty due to a risk of pre-marketing activities being re-qualified ex post as marketing activities, for instance on the grounds that an investor subscribed to a fund subsequent to pre-marketing activities.

“Pre-marketing” is an essential part of the private equity and venture capital fundraising process. During this phase private equity fund managers test the market for a particular product and discuss with prospective professional investors, at an early stage, the market’s likely interest. These discussions could be general in nature (i.e. prior to a specific fundraising, without referring to a particular product) or be more targeted (i.e. in the context of developing a particular fund idea). The ability to gauge potential market interest is important for fund managers to determine whether it is worth incurring both the costs of registering the fund and the ongoing costs.

This pre-marketing phase is also in the interests of investors, who wish to be able to engage with fund managers at any time. It is typical for an institutional investor to start to get to know a fund manager many years before they finally decide to invest with them: early investor due diligence is often conducted on the explicit basis that they do not intend to invest in the next fund to be raised, but with a view to considering investing in future funds. It is also customary for managers to have very regular relationship meetings with their existing investors in addition to annual investor days and meetings of the Limited Partner Advisory Committee. It is a natural part of those meetings for investors to enquire about the fundraising plans of the manager and for there to be a dialogue about funds that the manager might be considering or developing.

However, the Commission’s proposed definition of, and conditions for, pre-marketing include unnecessary limitations such as ruling out the possibility to present draft documents to investors and permitting pre-marketing only in the context of AIFs which are not yet established. These risk making private equity (and venture capital) fundraising more difficult (or, in certain cases, practically impossible) and, as such, would
restrict the market’s ability to provide investors with investment solutions that meet their needs. They would restrict the choice available to investors and lead to uncertainty for both managers and investors where relationships already exist. The process for raising a fund could also be hampered as private equity managers typically maintain an ongoing, collaborative relationship with their investors as the fund terms are developed; this helps investors to achieve their investment aims.

Sharing draft marketing materials with investors

The ability to circulate draft documents, such as proposed term sheets or a draft private placement memorandum or limited partnership agreement, is a crucial aspect of pre-marketing. Fund managers want to ascertain potential investor interest by showing drafts, for example to establish whether there is sufficient in-principle demand for a particular strategy, underlying asset class and type of fund. And later on, most investors will expect to see such draft documents as part of their own initial due diligence when filtering funds to identify those worthy of more detailed review.

If this is no longer permitted, pre-marketing would be meaningless and have no solid basis. It is important to bear in mind that:

(i) these very preliminary drafts are not final documents; they are subject to substantial changes and will be amended (often extensively) during the negotiation between investors and managers.

Over the many months in which fundraising occurs the terms are subject to negotiation between potential investors and the fund manager prior to the final closing of the fund taking place. Often the final terms are not agreed until just before the subscription process begins (i.e. the process during which the investor makes an offer to subscribe to the fund, with such an offer/proposal needing to be approved/accepted by the fund manager).

(ii) there is no risk of circumvention of the marketing rules because the filing with the national competent authority will be made if there is sufficient interest from investors and before any final offering documents are shared.

Pre-marketing takes place before any contractual offer to the investor to enter into a binding contractual agreement or before an invitation to the investor to make a binding contractual offer to do so (i.e. the formal subscription process).

(iii) allowing more detailed information and discussions before the passport is granted is more efficient for the investor, the manager and the regulator and does not result in any reduction in investor protection.

Lastly, the process is at risk of becoming inefficient if multiple material change notifications have to be prepared as a result of investor negotiations following the formation of the fund.

“Material changes” to terms are subject to a 30-day waiting period before they may become effective. As terms are heavily negotiated in a private equity context, it is generally preferable to test and discuss the draft fund terms before enacting them in a close to final form. The Commission’s proposal would lead to multiple “material change” notifications being made with the national competent authority following discussion with the market, thereby triggering time-consuming and costly delays in the fundraising process. This in turn risks a delay to the onward investment of that capital into the underlying businesses and entrepreneurs that are supported by private equity funds.
Such a scenario would also use up valuable supervisory resources without offering any commensurate gain in investor protection, since these changes would generally be occurring far in advance of the point at which an investor could contractually commit to invest in the private equity fund. In turn, if supervisors pass such costs on to fund managers, this is likely to ultimately lead to increased costs for investors and/or a reduction in the capital available for investment into the underlying businesses and entrepreneurs.

Establishment of the fund entity

The Commission also suggests that for pre-marketing to be recognised as such under the AIFMD, it should concern an investment idea or strategy without having an actual AIF already established. Establishment of the fund vehicle (i.e. the formation or existence of the legal entity) should not determine whether a manager is deemed to have ‘marketed’ or ‘pre-marketed’ the fund. More importantly, what matters is whether the fund has had an actual closing whereby investors have been admitted. This interpretation would be in line with the position taken by some national competent authorities, which generally consider that it is the establishment of the AIF (not the legal entity as such) that is the relevant event.

The formation (or incorporation) of the fund entity(ies) is often done early in the fundraising process, as there are various time-consuming procedures that need to be completed between incorporation and closing, if the structure is to be ready to admit investors once final terms are agreed. These include registering on national commercial registers, opening bank accounts, processing the necessary tax registrations, engaging service providers and concluding other critical tasks such as AML checks. That does not mean that the limited partnership agreement (that governs the fund) is in any way finalised when the vehicle(s) that will become the fund (when investors are admitted) is incorporated. Instead, the fund vehicle is initially formed using a short constitutional document containing few substantive terms or specific fund provisions.

Also, the fund entity needs to be established prior to making a passport application, with the passport only granted maybe a month later. The language proposed by the Commission therefore has the result that a manager may not be able to carry out pre-marketing in the period while they wait for their passport to be approved, effectively requiring them to suspend the conversations they have been having with the pre-marketing investors for around a month. This pre-marketing ‘blackout’ will likely have a material impact on a manager’s fundraising momentum and will affect all fund managers.

Against this background, when defining pre-marketing, it is key to recognise that:

- an AIFM should be entitled to carry out pre-marketing (or “market-sounding”) activity, including the negotiation of draft constitutional documents across the EU, prior to the point at which the “almost final” documentation that is required to be filed with regulators under the AIFMD marketing passport is made available to investors; and
- a private equity manager should be allowed to pre-market a fund after “establishment” of the fund vehicle.

The language in the European Commission’s report to the Council and European Parliament on the Capital Markets Union (March 2017) is helpful in this respect: “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”. In line with the Expert Group’s proposed wording, marketing should only be deemed to take place once subscription documents are provided to investors as no offer can exist or be validly made prior to that point.
The European Commission should have no concern that a less restrictive approach to the definition of pre-marketing might lead to avoidance. If there is sufficient market interest, a filing with the national competent authority will have to be made before any final offering documents are shared with specific investors. In particular, it is clear that, if an AIFM has approached a prospective investor with a view to pre-marketing a particular AIF, the same AIFM could not subsequently claim that the investor has approached the AIFM on its own initiative in respect of such pre-marketed AIF.

There would also seem to be little point in national regulators receiving applications for approval of the exercise of the marketing passport at a very early stage, when the fund manager will necessarily be able to provide very limited information on the ultimate product. It is unclear how regulators could be expected to provide meaningful approval at that stage and there is a risk that such notifications could become a form of “rubber stamping” which does not confer any increased regulatory oversight or investor protection. Alternatively, marketing could become a practical impossibility if national regulators refuse approval of the exercise of the marketing passport due to an absence of sufficient detail about the fund - details that the private equity fund manager is unable to confirm precisely because it cannot engage in the market-sounding discussions that are necessary to develop an appropriate product as they would be deemed to be “marketing” under the new definition.

Furthermore, unlike retail-focused funds, a typical private equity fund may only have around 25-50 investors, and that investor pool will generally be split across many geographies. Managers may only have a handful of prospective investors in certain jurisdictions and be put off from marketing in a given jurisdiction if they do not have the opportunity to properly identify interest from prospective investors. If the proposed rules result in managers limiting the number of jurisdictions in which they ultimately market (which we consider to be a likely result), that is detrimental to both the managers and the prospective investors and would go against the ultimate goal of creating a true single market and building a Capital Markets Union.

Given that we anticipate that some jurisdictions may seek to adopt the new definition of “pre-marketing” in their national private placement regimes, we think that this will also create a material barrier to entry to non-EU fund managers from the US, Asia and other parts of the world (in particular high performing ones who may be oversubscribed without European investors and many of whom may have established a fund before they decide to market in Europe), and thereby reduce European investors’ ability to maintain an attractive and diversified portfolio. This would also lead to substantial inefficiency since non-EU fund managers marketing under the national private placement regimes do not have a central host state regulator and therefore there would be a multitude of material change notifications through the iterative negotiation period made to multiple national regulators. This has the potential to consume significant supervisory capacity which would be better focused on genuine investor protection issues.

In light of the above, Invest Europe would like to suggest the following amendments to the European Commission’s proposal for a Directive amending Directive 2011/61/EU on AIFMs with respect to cross-border distribution of collective investment funds:

(Bold underline / bold strikethrough indicate suggestions for amendments to the Commission’s original text.)
• **Amendment 1 to Recital 11**

(11) For pre-marketing to be recognised as such under this Directive, it should concern an investment idea or strategy without having **an the actual AIF subscription materials** already established available. Accordingly, during the course of pre-marketing, investors are unable to subscribe to the units or shares of an AIF because the fund does not exist yet, and no offering documents, even in a draft form, that are capable of being accepted should be permitted to be distributed to potential investors during this stage. However, when following the pre-marketing activities the AIFM offers for subscription units or shares of an AIF with the features akin to established as a direct result of the pre-marketed investment idea, the appropriate marketing notification procedure should be observed and the AIFM should not be able to invoke reverse solicitation in connection with any subsequent investment in that AIF by an investor who was the subject of such pre-marketing activities by the AIFM or upon the AIFM’s initiative.

• **Amendment 2 to Article 2(1), suggesting the insertion of a new point (aea) in Article 4(1) AIFMD**

(nea) ‘pre-marketing’ means a direct or indirect provision of information on investment strategies or investment ideas by an AIFM or on its behalf to professional investors domiciled or registered in the Union in order to test their interest in an AIF which is not yet established.

• **Amendment 3 to Article 2(2), suggesting to insert a new Article 30a “Conditions for pre-marketing in the Union by an EU AIFM” into the AIFMD**

1. Member States shall ensure that an authorised EU AIFM may engage in pre-marketing in the Union, excluding where the information presented to potential professional investors:

(a) relates to an established AIF;
(b) contains reference to an established AIF;
(ae) enables investors to commit to acquiring units or shares of a particular AIF;
(bd) amounts to a prospectus, constitutional documents of an not-yet-established AIF, private placement memoranda offering documents, subscription forms or similar documents whether in a draft or a final (or substantially final) form allowing investors to take an investment decision.

2. Member States shall ensure that no requirement to notify the competent authorities of pre-marketing activities is necessary for an EU AIFM to engage in pre-marketing activities.

3. Subscription by professional investors to units or shares of an AIF established following as a direct result of the pre-marketing to those investors in accordance with paragraph 1 or to the units or shares of AIFs managed or marketed by the EU AIFM that had engaged in pre-marketing of a not-yet-established AIF with the similar features shall be considered the result of marketing accompanied with the applicable marketing notification procedures.


(Bold underline / bold strikethrough indicate suggestions for amendments to the Commission’s original text.)
• **Amendment 1 to Article 12(1), suggesting the addition of a new point (o) to Article 3 EuVECA**

'(o) ‘pre-marketing’ means a direct or indirect provision of information on investment strategies or investment ideas by the manager of a qualifying venture capital fund, or on its behalf, to potential investors domiciled or with a registered office in the Union in order to test their interest in a **not yet registered** qualifying venture capital fund’;

• **Amendment 2 to Article 12(2), suggesting the insertion of a new Article 4a in EuVECA**

1. Managers of qualifying venture capital funds may engage in pre-marketing in the Union, excluding where the information presented to potential investors:
   (a) relates to established qualifying venture capital funds;
   (b) contains any reference to established qualifying venture capital funds;
   (c) enables investors to commit to acquiring units or shares of particular qualifying venture capital funds;
   (d) amounts to a prospectus, constitutional documents of **not yet registered** qualifying venture capital funds, **private placement memoranda offering documents**, subscription forms or similar documents whether in a draft or a final (or substantially final) form allowing investors to take an investment decision.

2. Competent authorities shall not require managers of qualifying venture capital funds to notify their intention to engage in pre-marketing.

3. Subscription by investors to units or shares of qualifying venture capital funds registered following the as a direct result of pre-marketing to those investors in accordance with paragraph 1 or to the units or shares of qualifying venture capital funds managed and marketed by managers of qualifying venture capital funds that engaged in pre-marketing of not yet registered qualifying venture capital funds with the similar features shall be considered the result of marketing accompanied with the applicable marketing notification procedures.

4. Managers of qualifying venture capital funds offering for subscription units or shares of qualifying venture capital funds that were the object of pre-marketing shall inform the competent authority in accordance with Article 15.

2. **Host fees and charges**

While the European Commission’s proposed Regulation includes positive changes to tackle the fees and charges levied by national competent authorities, we feel that the Commission could have been more ambitious and gone further, in particular with regard to **host** fees.

In some Member States, the costs for fund managers to market their funds under the AIFMD passport - both financial and in terms of the time and administrative burden required - can be excessive. The cumulative cost to a private equity fund manager marketing in different Member States can amount to tens of thousands of euros.

In a true Capital Markets Union, a fund manager that is fully compliant with the relevant EU law and in possession of a valid passport should be **free to market** across the EU without any further administrative requirements being imposed by the ‘host’ jurisdiction, including fees and charges. Such charges, particularly in combination with the proposed definition of pre-marketing, are an **unwarranted barrier** to the single market and to cross-border marketing.
We therefore regret that the Commission has not proposed further restrictions on Member States’ ability to charge a host fee, as they did with the recent EuVECA review. The final version of the revised EuVECA Regulation (agreed by the Council and the European Parliament), which entered into force in March 2018, states that national competent authorities are only allowed to impose a host fee on fund managers as long as they can justify that they are performing supervisory tasks [in relation to that manager]. The wording of the Commission’s original proposal to review the EuVECA Regulation went even further, suggesting that fees and similar charges may not be imposed by competent authorities of host Member States at all.

- Relevant extracts from the final revised EuVECA Regulation (emphasis added):

(12) The fees and other charges that host Member States impose on qualifying venture capital fund managers and on qualifying social entrepreneurship fund managers contribute to regulatory divergence and may sometimes represent significant obstacles to cross-border activities. Such fees and charges impede the free flow of capital across Union borders, thereby undermining the principles of the internal market. It is therefore necessary to emphasise and clarify that the prohibition on the imposition by the host Member State of requirements or administrative procedures in relation to the marketing of qualifying venture capital funds and qualifying social entrepreneurship funds in its territory includes a prohibition on the imposition of fees and other charges on the managers for the marketing of such funds if no supervisory task has to be performed.

Article 1, paragraph 9 amending Article 16(2) of the EuVECA Regulation
2. The competent authorities of the host Member States shall not impose on the managers of qualifying venture capital funds any requirements or administrative procedures in relation to the marketing of their qualifying venture capital funds, nor shall they require any approval of that marketing prior to its commencement. Such requirements or administrative procedures include fees and other charges.

- Relevant extracts from the original Commission proposal to review the EuVECA Regulation (emphasis added):

Article 1, paragraph 6 amending Article 16(2) of the EuVECA Regulation
2. The competent authorities of the host Member States shall not impose on the managers of qualifying venture capital funds any requirements or administrative procedures in relation to the marketing of their qualifying venture capital funds, nor shall they require any approval of that marketing prior to its commencement. The requirements or administrative procedures referred to in the first subparagraph shall include fees and other charges.

Increased disclosure and transparency, and linking fees and charges to a certain level of proportionality (i.e. the need for fees and charges to be proportionate to the regulator’s costs and the performance of supervisory and investigatory powers) are a step in the right direction. However, we fear that in practice these proposed changes to the AIFMD will not lead to a major shift in national competent authorities’ behaviour and will not reduce costs borne by fund managers when they market their funds cross-border.

In particular, there is a risk that where a national regulator undertakes supervisory activities in an inefficient manner and as a result, incurs costs which are objectively unnecessary or unjustified, it would still be able to charge those costs to the AIFM on the basis that the fees imposed are nonetheless proportionate to its expenditure and have arisen in the context of supervisory activities. The ability to incur and recover such fees may represent a barrier to entry to AIFMs seeking to market in the relevant jurisdiction and/or may
actively discourage distribution of funds in that jurisdiction, which is contrary to the spirit of the Capital Markets Union.

Rather than reducing costs, increased transparency may even be counterproductive and lead to a perverse situation, where Member States that are not currently charging a fee would be encouraged to start imposing host fees on non-domestic fund managers making use of the AIFMD passport.

In light of the above, Invest Europe would like to suggest the following amendments to the European Commission’s proposal for a Regulation of the European Parliament and of the Council on facilitating cross-border distribution of collective investment funds and amending Regulations (EU) No 345/2013 and (EU) No 346/2013:

(Bold underline / bold strikethrough indicate suggestions for amendments to the Commission’s original text.)

- **Amendment 1 to Recital 5**

  (5) To ensure equality in treatment and facilitate decision-making of AIFMs and UCITS management companies whether to engage in cross border distribution of investment funds, it is important that fees and charges levied by competent authorities for the authorisation, registration and supervision referred to in Directives 2009/65/EC and 2011/61/EU are proportionate to the supervisory tasks carried out and publicly disclosed only permitted where there is a legitimate need for supervisory tasks to be carried out and only to the extent that such fees and charges are proportionate to the costs incurred by the competent authority and are objectively reasonable, and that those fees and charges are published on their websites. For the same reason, the ESMA website should include an interactive tool enabling calculations of fees and charges levied by competent authorities.

- **Amendment 2 to Article 6 “Common principles concerning fees or charges”**

  1. Fees or charges levied by competent authorities may only levy fees and charges in relation to the authorisation or registration and the performance of the supervisory and investigatory powers pursuant to Articles 44, 45 and 46 of Directive 2011/61/EU and Articles 97 and 98 of Directive 2009/65/EC where all of the following conditions are met:
     
     (a) there is a legitimate need for the supervisory activities to be carried out;
     
     (b) the fees or charges are proportionate to the costs incurred by the competent authority in connection with the supervisory activities; and
     
     (c) the overall costs and charges imposed by the competent authority are objectively reasonable.

  2. Competent authorities shall send an invoice for the given financial year to the registered office of the AIFM or UCITS management company. The invoice shall indicate the fees or charges referred to in paragraph 1, the means of payment and the date when payment is due.

3. **Conditions for de-notification**

   Invest Europe acknowledges that the current AIFMD rules are unclear on when an EU AIFM can be considered to have ceased marketing in a Member State (for example, so that it can withdraw a notification about
exercising the marketing passport into that jurisdiction). However, the suggested conditions under which an AIFM may de-notify the marketing of an EU AIF that is notified for marketing in another Member State would conflict with established practice in private equity (see Annex I). For example, linking de-notification to a certain level of investor presence (e.g. an AIFM can be authorised to de-notify the marketing of an EU AIF it manages only if there are a maximum of 10 investors who hold up to 1% of assets under management of this AIF in an identified Member State) or requiring managers to make a public offer to buy-out existing investors is never seen in private equity. In practice, these conditions are likely to make ceasing marketing under the AIFMD passport very unattractive.

It is important to avoid a one-size-fits-all approach. Private, institutional funds are completely different from and should not be treated like retail products. Yet, no proper differentiation has been made in the proposed Directive between AIFs (and AIFMs) and UCITS on the one hand, and open-ended and closed-ended funds on the other. Because of this lack of tailoring, the proposal would make it almost impossible for private equity fund managers to de-notify. It is important to bear in mind at all times that AIFMD and UCITS were designed from a different background, with a different purpose and for different market players.

In particular, in our view, it is unnecessary and likely to be deeply problematic to require the AIFM to make an offer to buy-out investors in the relevant jurisdiction. In any event, there should be no requirement to buy-out professional investors who, by their nature, are capable of conducting their business cross-border and in different languages.

Invest Europe would therefore suggest replacing this requirement with one which provides that where no investor has come into the fund as a consequence of the AIFM’s marketing activities, the AIFM should be able to de-notify its marketing activities in the relevant host state by informing investors in that Member State in advance that it is doing so, but that the AIFM remains subject to the supervision of its home state regulator and that those investors may contact the home state regulator if future issues arise in connection with the AIFM. This is appropriate given that the marketing passport may only be exercised in connection with professional clients, who are by their nature more sophisticated investors and do not need the types of protection that may be necessary for retail investors.

More generally, some of the proposed conditions for de-notification potentially raise complex regulatory issues. For example, the above requirement to make a blanket offer to repurchase interests from investors in the relevant jurisdiction in which de-notification is taking place may raise issues about whether such a mandatory offer is fair to remaining investors, who would not benefit from the ability to be bought out of a closed-ended fund.

This is particularly relevant in a single market context, where it would not be right for investors in one Member State to get a different treatment to those in another Member State. The proposal from the Commission risks disincentivising marketing in smaller EU Member States and as such will restrict opportunities for investors in those countries. A fund manager may want to think twice about marketing in a smaller Member State if they are not able to de-notify (i.e. to stop marketing when they have exhausted the opportunities) without that triggering a set of discriminatory provisions. It is not unlikely that a fund manager may want to stick to only those markets where they know there is a deep pool of investors to market to.

Finally, the purpose (benefit and practical relevance) of such a harmonisation of de-notification rules remains unclear. De-notification makes sense in connection with non-EU AIFs where the manager would no longer be subject to ongoing depositary (where applicable) or reporting requirements under the national private placement rules. However, in an EU context, where as a consequence of the EU passport the manager
is subject to the reporting rules of the AIFMD in any event, we cannot see the benefit of such new rules. In practice, host state national regulators may benefit from de-notification of marketing in their jurisdiction because supervisory resources dedicated to the ongoing supervision of the relevant AIFM could then be used for other purposes.

In light of the above, Invest Europe would like to suggest the following amendments to the European Commission's proposal for a Directive amending Directive 2011/61/EU on AIFMs with respect to cross-border distribution of collective investment funds:

(Bold underline / bold strikethrough indicate suggestions for amendments to the Commission’s original text.)

- **Amendment 1 to Recital 8**

(8) The absence of clear and uniform conditions for the discontinuation of marketing of units or shares of a UCITS or an EU AIF in a host Member State creates economic and legal uncertainty for the fund managers. Therefore, this proposal lays down clear conditions, including thresholds, under which deregistration could take place. The thresholds are indicative of when a fund manager may consider that its activities have become insignificant in a particular host Member State. The conditions are set in such a way that they balance, on the one hand, the interests of fund managers to be able to deregister marketed funds when the established conditions are met, and on the other hand, the interests of investors in the fund from the host Member State concerned.

- **Amendment 2 to Article 2(5), suggesting the insertion of a new Article 32a “Discontinuation of marketing of units or shares of EU AIFs in the Member States other than in the home Member State of the AIF”**

1. Member States shall ensure that an EU AIFM may discontinue marketing units or shares of an EU AIF that it manages in the Member State where a notification of its marketing activities has been transmitted in accordance with Article 32, where all of the following conditions are fulfilled:

(a) no investor, which is domiciled or has a registered office in the Member State, where a notification of its marketing activities has been transmitted in accordance with Article 32, holds units or shares of that AIF as a consequence of the AIFM’s marketing activities or no more than 10 investors, which are domiciled or have a registered office in that Member State, hold units or shares of the AIF representing less than 1% of assets under management of that AIF;

(b) a blanket offer to repurchase, free of any charges or deductions, all its AIF units or shares held by investors in the Member State, where a notification of its marketing activities has been transmitted in accordance with Article 32, is made public at least for 30 working days and is addressed individually the AIFM has provided a notification to all investors in that Member State whose identity is known informing them of:

   (i) its intention to discontinue marketing in the relevant Member State;

   (ii) the fact that it will continue to be supervised by the competent authorities of its home Member State following discontinuation of marketing; and

   (iii) the contact details of the competent authorities of its home Member State;

(c) the intention to stop the marketing activities on the territory of the Member State, where a notification of its marketing activities has been transmitted in accordance with Article 32, is made public by means of a publicly available medium which is customary for marketing AIF and suitable for a typical AIF investor.
2. The AIFM shall submit a notification to the competent authority of its home Member State comprising the information referred to in paragraph 1.

3. The competent authorities of the home Member State of the AIFM shall, no later than 20 working days following the receipt of the complete notification referred to in paragraph 2, transmit it to the competent authorities of the Member State where marketing of AIF is intended to be discontinued and to ESMA.

Upon transmission of the notification file pursuant to the first subparagraph, the competent authorities of the home Member State of the AIFM shall immediately notify the AIFM of that transmission. As of this date, the AIFM shall cease all marketing of units or shares of the AIF it manages in the Member State identified in the notification letter referred to in paragraph 2.

4. The AIFM shall continue providing investors who remain invested in the EU AIF with the information required under Articles 22 and 23.

5. Member States shall allow for the use of all electronic or other distance communication means for the purposes of paragraph 4.
Annex I - Typical private equity/venture capital fundraising process

Private equity and venture capital funds are “closed-ended” funds. They are typically partnerships or other negotiated investment structures, and not off-the-shelf unitized collective investment schemes that are merely “sold” to investors. The main difference between these schemes is their liquidity or illiquidity. In “closed-ended” funds, investors will not be able to exit at their initiative. Hence, careful consideration will have to be given at inception.

Participation in these closed-ended private equity funds happens after a negotiation between the manager and each investor individually. Although marketing-type material is made available to all prospective investors in a closed-ended fund, the process of fundraising is not really that of “marketing” in the customary sense (as opposed to the technical interpretation of the AIFMD term, which varies from Member State to Member State). Each prospective investor in a closed-ended fund conducts its own, lengthy due diligence process before deciding whether or not to invest. While the “marketing” information supplied by the manager feeds into this process, investors will also request information from the manager of a type and in a format which may be specific to that investor’s due diligence process. This makes for a very fluid fund closing process, with multiple closing dates as investors are admitted to the fund upon conclusion of their specific due diligence and decision-making process. From first close to final close can typically be as long as 12-18 months.

In the closed-ended fund context, fundraising for a new fund typically involves the manager having preliminary discussions with investors in the current fund about the terms upon which they might be prepared to invest in the manager’s next fund. This is often called “pre-marketing” or “soft-circling”. At an even earlier stage, there may be updates on the manager’s business generally without any real focus on any particular fund - so called “brand marketing”. Investors in the manager’s existing fund will be receiving information about the progress of that fund along with general business developments pertaining to the manager. Investors do not regard such communication as AIFMD marketing, but rather as a normal and necessary part of their prudent oversight and monitoring of their existing investment. By definition, such interaction enables investors to make a good judgement on when the manager is next likely to raise a new fund. For investors not invested in the existing fund, part of their role as investors in private equity fund portfolios is to be researching the market and proactively meeting with managers of funds with whom they may wish to consider investing in the future.

As a consequence of the negotiated nature of the governing/constitutive documents of these closed-ended funds, it is only very late in the process that the limited partnership agreement and the information memorandum (which is not a subscription document) summarizing the investment strategy, the main commercial terms and how the fund is to be operated, are being finalized. The fund vehicle, however, is sometimes established earlier in the process, simply to make sure that the entity as such is formed, as that often requires registration with commercial registers, etc. The Limited Partnership Agreement would by no means be final at that point; the entity is rather formed based upon a short constitutional document which at that stage does not yet contain any terms.

This process also means that it can typically take up to 12 or even 18 months before a private equity fund holds its final “close”. In broad terms, the typical fundraising process would entail the following steps:

1. General communication/brand marketing with no information on the fund (both with investors in the existing/current fund and potential investors who are not current investors) to determine their appetite;
2. Teaser presentations to potential investors and high-level term sheets;

3. Draft private placement memorandum (subject to change and negotiation) and draft Limited Partnership Agreement (subject to change and negotiation), around which there would be further more detailed negotiation with investors and their specialist legal counsel and other advisors - this would happen in parallel to an extensive due diligence process by prospective investors;

4. Final private placement memorandum, issued by the AIFM;

5. Finalisation of the Limited Partnership Agreement; and

6. Preparation of a subscription document or subscription booklet together with a side letter agreement, if and when applicable, underpinning the negotiated pre-marketing process.

In our view, only steps 4, 5 and 6 should be considered as marketing, whereas 1 to 3 would all still be pre-marketing.
About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

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.