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CREATING LASTING VALUE

AIFMD

Introduction of a Third-Country Passport for non-EEA AIFMs/AIFs

A. INTRODUCTION

This paper addresses, at a high level, the EVCA's position on certain technical issues concerning the introduction of a third-country passport for non-EEA AIFMs/AIFs.

The merits of any legislative proposal in this area must be assessed in light of its impact on the ability of EEA institutional investors (such as pension schemes and insurers) to pursue successful diversified global investment strategies[1].

Extending the passport to non-EEA AIFMs/AIFs has the potential to increase competition and investor choice if the passport is introduced in a way that makes it feasible for AIFMs to market interests in the non-EEA AIFs they manage in more Member States than they are currently able to do. This development would be very welcome, since - at a time when they are under increasing pressure to deliver returns - EU investors would benefit from increased competition between AIFMs and a wider variety of investment strategies and geographical focuses. This will enable EEA investors to pursue their investment strategies fully, mitigate concentration risks and promote development of the internal market.

The benefits of extending the passport to non-EEA AIFMs/AIFs could be undermined, however, unless ESMA and the European Commission:

(i) address problems that have emerged with the passport for EEA AIFMs (e.g., the charging of fees by certain competent authorities);
(ii) take an **efficient, common-sense and tailored approach** to:
  a) the specific requirements that will apply only to non-EEA AIFMs (e.g., the approach to determining a non-EEA AIFM's Member State of reference, and the requirement to appoint a legal representative in that Member State); and
  b) the application of certain AIFMD provisions (e.g., those relating to regulatory capital requirements), where application of those provisions to third-country AIFMs may not be straightforward; and
(iii) are able to provide non-EEA AIFMs with adequate **time for transition** in advance of any implementation, enabling them to assess and appropriately structure their businesses in order to become AIFMD compliant.

The third-country passport will be available only to those non-EEA AIFMs who have become authorised by the EEA competent authority in their Member State of reference, and who, as a result, must "comply" with the AIFMD. We therefore do not believe that there is any justification in the AIFMD or any policy basis for making any extension of the passport to non-EEA AIFMs subject to a determination by ESMA that the regulatory regime in the non-EEA AIFM's home jurisdiction is "equivalent" to the AIFMD or that non-EEA AIFMs' jurisdictions offer "reciprocal" access to EEA AIFMs. Such an approach, besides being contrary to the letter and spirit of the level 1 text, would penalise European institutional investors by restricting their investment options.

Although we are supporters in principle of the idea of an EU marketing passport for non-EEA AIFMs, we do not believe this should be the only option for non-EEA AIFMs. It is vitally important to European institutional investors that they **have access to investment opportunities offered by global** (i.e., EEA and/or non-EEA) **fund managers**. In order to qualify for the third-country

[1] Please also see the ILPA's response to the ESMA call for evidence on the AIFMD Passport and Third Country AIFMs, dated 8 January 2015 (available here).

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passport, a non-EEA AIFM will have to be **dual-regulated** by its third-country regulator and by an EEA competent authority applying the AIFMD (insofar as the AIFMD can be simply applied mutatis mutandis). Even if the EU marketing passport is extended to non-EEA AIFMs, some non-EEA AIFMs are likely to be unwilling to subject themselves to dual regulation, especially those high-performing non-EEA managers whose funds are in demand or even over-subscribed.

We would therefore strongly advocate **the retention of national private placement regimes alongside the passport** not just during, but also beyond, the three-year transitional period envisaged by the AIFMD. The benefits of extending the passport to non-EEA AIFMs would be severely undermined if and to the extent Member States that currently allow non-EEA AIFMs to market AIF interests pursuant to national private placement regimes restrict or eliminate this possibility upon extension of the passport to non-EEA AIFMs. In some Member States, however, it is intended or envisaged that the existing national private placement regime will be abolished as soon as the passport is introduced, so that there will be no other way for EEA AIFMs to market (private) (non-EEA) funds or for non-EEA managers to market their funds than by making use of the passport. In Germany, for example, the EVCA understands that the introduction of the passport will likely lead to a severe tightening of the marketing requirements (which will go far beyond the marketing restrictions that apply to EEA managers marketing in many other non-EEA countries, such as the US).

We understand that the availability of national private placement regimes in individual Member States is not a matter for ESMA or the Commission to determine and we appreciate that ESMA and the Commission will respect the discretion given to individual Member States in relation to national private placement rules. Nonetheless, we encourage ESMA and the Commission to use their influence to support the continuation of national private placement regimes in parallel with the AIFMD passport in order to give European institutional investors reasonable access to a range of global (EEA and/or non-EEA) AIFs. We believe European institutional investors are sophisticated enough to differentiate between a fully AIFMD-compliant fund and one that is marketed under national private placement regimes.

This is particularly important for **smaller institutional investors**, who are already finding that fewer non-EEA funds are being offered to them. Larger institutional investors may be in a position to overcome this barrier given their scale and resources (e.g. by being able to scan the market and identify managers with new funds to whom they can then make a direct approach), but smaller institutional investors are less likely to be able to do so, with very real implications for competition and investor choice in this part of the market.

Consideration should also be given to the position of **smaller (i.e. sub-threshold) fund managers** (be they EEA or third country). For many of these firms, the costs of opting-in to the AIFMD will be prohibitive, in which case they will not benefit from passporting rights and marketing under national private placement regimes is the only option. The availability of national private placement regimes for sub-threshold EEA AIFMs is already extremely limited, and we would encourage ESMA and the Commission to support the development by Member States of workable national private placement regimes for both EEA and non-EEA sub-threshold managers. For non-EEA managers the thresholds should be applied by reference to the assets under management of those funds that are marketed to professional investors in the EEA, and any EEA AIFs managed, as only those funds are within the ambit of the AIFMD (not including, however, AIFs which are caught by a grandfathering rule (see below)).

If the passport is extended in a way that makes it impracticable or very onerous for non-EEA AIFMs to use, or national private placement regimes are eliminated or materially tightened, this could severely reduce competition and investor choice, with the risk that the best and most in demand non-EEA AIFMs will decide not to market in the EEA since they find it easier and have the ability to raise sufficient capital elsewhere in the world. Our membership is aware of non-EEA AIFMs making such statements publicly. Indeed, for non-EEA funds/managers which only market into a few

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Member States, or only have a few EEA investors, being left with no other option than the passport may well lead them to decide not to market into the EEA at all.

It is particularly important that national private placement regimes continue to be available for smaller EEA as well as non-EEA AIFMs who may otherwise be forced, as early as 2018/19, to cease cross-border marketing activity due to prohibitive costs of becoming AIFMD authorised. This is likely to concentrate assets with a smaller number of non-EEA AIFMs, which would reduce portfolio diversification options for EEA investors and so increase risk.

Finally, regardless of the position taken with respect to non-EEA AIFMs, we believe that the **passport for authorised EEA AIFMs managing non-EEA AIFs** could, and should, be introduced without delay.

EEA AIFMs with non-EEA AIFs are currently subject to Article 36 AIFMD and will, in due course, be subject to Article 35 AIFMD. Such AIFMs are already obliged to comply with the whole of the Directive (save slight relaxation of the depositary rules) – hence they should be treated at par from an investor protection point of view with EEA AIFs managed by authorized EEA managers. However, these AIFMs do not benefit from the one advantage of the Directive, which is the ability to passport.

In all other respects, these AIFMs are already complying in full with the requirements of the Directive in respect of these AIFs. They are already supervised by their EEA home state competent authority, which must have determined that there is no aspect of the arrangement involving the relevant third country of the AIF which prevents effective supervision. There can be no policy justification for denying such AIFMs the benefit of a passport under the Directive, or delaying its application. Treating AIFs managed by the same EEA AIFM differently inherently creates disruptions and distortions in competition (Article 67(2)(c)).

B. KEY ISSUES

As set out in the Introduction, it will be essential – if the extension of the passport to non-EEA AIFMs is to have the desired effect – that it be applied in an **appropriate and reasonable** manner.

Besides the very important issue of keeping the national private placement regimes in place, as discussed above, the EVCA has identified the following main issues that will need to be addressed in the Commission's Delegated Regulation for the passport to work as intended in the special circumstances of non-EEA AIFMs:

1. appropriate transitional regimes;
2. determination of Member State of reference;
3. reasonable substance requirements for a legal representative;
4. requirement for OECD Model Tax Convention-compliant agreements and supervisory co-operation agreements;
5. the application of AIFMD rules to non-EEA AIFMs

We also set out our thoughts on two very important and closely related issues:

- how far, if at all, the AIFMD allows the third country passport to be introduced on a jurisdiction by jurisdiction basis;
- cross-border marketing by sub-threshold managers in general.

1. Appropriate Transitional Regimes

Articles 37, 39, 40 and 41 set out the requirements under which a non-EEA AIFM can manage EEA AIFs and/or market AIFs managed by them in the EEA. It is crucial that **appropriate transitional rules** be put in place **for** both:

- **non-EEA AIFMs managing EEA AIFs**, to allow sufficient time for those non-EEA AIFMs to become authorised in their Member State of reference, which would mirror the transitional provision in Article 61(1) of AIFMD (and we would ask the Commission and ESMA to consider whether funds that are already closed could be grandfathered on a similar basis to that set out in Articles 61(3) and 61(4) of AIFMD); and

- **non-EEA AIFMs marketing funds that have already commenced marketing under national private placement regimes** (we would suggest that a period of two years would be appropriate to enable funds already in market to reach a final closing), and to the extent this is in the discretion of individual Member States, we would encourage the Commission and ESMA to advocate this.

A transitional provision is particularly important for closed-ended funds such as private equity funds because the time from the beginning of preliminary discussions about the launching of a new AIF to reaching a final close can be anywhere between 18 to 24 months. Without an appropriate transitional rule these non-EEA AIFMs would be under pressure to finish their closing before the passport was introduced as they would otherwise have to interrupt their fundraising process. Accordingly some EEA investors who wished to take sufficient time to fully assess the investment opportunity before committing themselves could be prevented from investing unless appropriate transitional rules were put in place.

2. Determination of Member State of reference

Perhaps the most difficult question of all for non-EEA AIFMs is the mechanism for designating a Member State of reference. The AIFMD and the Level 2 measures adopted so far do not provide a reasonable level of legal certainty where a non-EEA AIFM intends to market AIF interests in multiple Member States. It is important that regulatory authorities apply **a reasonable and predictable approach** in relation to the interpretation of that concept.

According to Article 37, the determination of Member State of reference in many circumstances is linked to the concept of "effective marketing", i.e. the Member State of reference is one of the Member States where the AIFM intends to develop effective marketing for one or "most" of the AIFs it manages. In practice, any third country manager wishing to commit to the EEA market and obtain authorisation is sure to want to market in more than one EEA Member State. Accordingly, it will very rarely, if ever, be the case that only a single Member State of reference is possible.

In some cases, specifically the situations referenced in Articles 37(4)(b), (c)(i), (e), (f) and (g)(i), there is a specific procedure under which competent authorities are to determine the Member State of reference. It is important that this process is as quick, efficient and certain as possible.

In other cases, notably the situation referenced in Article 37(4)(h), this process does not apply, and turns solely on the concept of "developing effective marketing". This concept must therefore be given an appropriate meaning.

It is important to note, in relation to these matters, that the AIFMD is a maximum harmonization measure, supported by the European Commission Delegated Regulation with direct effect and directly binding Regulatory Technical Standards and Implementing Technical Standards providing for very limited Member State discretion. Consequently, a non-EEA AIFM

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should be subject to an equivalent regulatory regime and equivalent supervisory oversight regardless of its Member State of reference. The peer review process in Article 38 will also support this.

Length and uncertainty of process

The process laid out in Article 37(4) to (6) for determining the Member State of reference is potentially long, drawn out and uncertain. As much as possible should be done to bring certainty and finality to that process as soon as possible.

We note that the paragraph (4) requirement to submit a determination request to all possible Member States of reference – which will generally be all those in which the AIFM plans to develop effective marketing - includes a one-month time limit for Member States to reach that determination and then a 7-day period to notify the AIFM of that determination. If these time limits are not met the AIFM can choose its own Member State of reference. Overall that would be a reasonable time period to add to the basic authorisation timetable for a non-EEA AIFM. However it is not the end of the process since it is followed by:

A. application by the AIFM to its chosen Member State of reference based on the criteria listed under paragraph (5);

B. then assessment by the Member State of reference as to whether that is a correct choice without a time limit for that assessment;

C. if that assessment is not favourable presumably the AIFM has to start again and select another Member State of reference (potentially repeatedly) even though it considered its first choice to meet the applicable criteria;

D. if that assessment is positive it is followed under paragraph (5) by reference by the Member State to ESMA for advice on whether the assessment by the Member State of reference and AIFM is correct, with a time limit of one month for giving that advice, during which the application timetable is suspended;

E. if ESMA's view is that the assessment is correct the Member State can proceed with the authorisation application;

F. if ESMA's view is that the assessment by the AIFM and Member State was incorrect the Member State may decide to comply with that advice in which case it will presumably refuse the application so that the AIFM must start the process again;

G. the Member State may also decide not to comply with ESMA's advice if it disagrees with ESMA and still considers it is the correct Member State of reference and to proceed with the application but in that case it must notify ESMA and the competent authorities of other potential Member States of reference;

H. other Member States of reference may refer the matter back to ESMA under paragraph (6) of Article 37 for action under Article 19 of Regulation 1095/2010. This means that even if the non-EEA AIFM is duly authorised by its chosen Member State of reference after following the process set out above the choice of Member State of reference may still be re-opened and changed in the course of either the conciliation process between Member States or a subsequent decision of ESMA, leaving substantial commercial uncertainty for the non-EEA AIFM for a very long period.

Before the passport is introduced, serious work needs to be done by ESMA together with Member State competent authorities to ensure that as often as possible a joint decision is made on the appropriate Member State of reference within the initial one-month period and

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promptly notified to the non-EEA AIFM. It should also be clarified that if this is done and the AIFM applies to the relevant Member State of reference for authorisation then the remainder of the process set out above does not apply and the Member State should proceed to consider the application without needing to further assess the determination of Member State of reference and refer to ESMA for advice.

Similarly it should be made clear that where ESMA gives advice confirming the AIFM's choice of Member State of reference as assessed and agreed by the Member State of reference then that decision should not be reopened by a reference under Article 37(6). Such references should only be possible where a Member State has failed to comply with ESMA's advice. Moreover where authorisation has been granted by a Member State the non-EEA AIFM should be entitled to rely on that authorisation and exercise its EU passporting rights accordingly even if another Member State has referred the decision to ESMA under Article 37(6) unless and until a final decision is reached about changing the Member State of reference.

Finally as much clarity as possible should be given by ESMA of the basis on which it will give its advice in order to minimise the risk of long drawn out processes of selection of the Member State of reference as set out above. Uncertainties and delays over that process are likely to severely damage the viability of the passport.

Intention to develop effective marketing

The AIFMD correctly identifies the concept of "developing effective marketing" as principally dependent on the marketing strategy planned by the AIFM and presented by it to the competent authority(ies). It is, however, important to recognise that it is unusual to market private equity and venture capital AIFs by way of advertisement, since only a limited number of professional investors are sought. Even roadshows may not be decided on at the outset of a marketing campaign but only by reference to the level of interest indicated in initial communications. An estimate made at the outset of the "expected share, in terms of assets under management, in the overall promotion in the Union" of individual Member States (Article 1(5)(b)(i) of Regulation 448/2013/EU) is unlikely to be more than tentative at most. Sometimes only one or two major institutional investors will be approached in each relevant Member State and the result will be entirely dependent on the investment decisions taken by them.

It is important that the ability of individual Member States and ESMA to request further relevant information and documentation is properly limited to that "necessary" for determining the Member State of reference as provided for in Article 1(9) of Regulation 448/2013/EU and is not used in a disproportionate manner to seek irrelevant or unduly detailed information in an endeavour to achieve absolute certainty in a situation where the AIFM itself cannot achieve certainty, since its marketing strategy and other business plans must always remain subject to the wishes and decisions of investors.

That said, it is worth noting that there are some additional areas which can support the marketing strategy of an AIFM and add to the reasons for selecting a particular Member State of reference. A fund management group will often already have some EU entities and personnel even if they are not responsible for AIF portfolio management or risk management. For example, a PE/VC fund management group may have an affiliate providing advisory and transaction arrangement services to the non-EEA AIFM or AIF and propose to involve it in marketing and/or to appoint it, or another entity in its group which has offices in a Member State, as its legal representative.

These factors should be taken into account when determining where the AIFM intends to develop effective marketing and determining the Member State of reference.

Subsequent changes to Member State of reference

We note that Articles 37(11) and (12) require an AIFM to correct its Member State of reference. However, it is important that a non-EEA AIFM should not be required to change its Member State of reference simply because the marketing strategy which was relevant for determining the Member State of reference does not pan out as expected (for example, if few or no prospective investors in the Member State of reference ultimately decide to invest, notwithstanding the marketing strategy followed); ESMA should provide specific guidance clarifying that this should not be viewed as a 'change in marketing strategy' for the purposes of Article 37(11) or (12) or a failure to follow the marketing strategy presented or making false statements for the purposes of Article 37(12).

When there is a change of Member State of reference after a non-EEA AIFM has been authorised in its original Member State of reference, the Delegated Regulation should make it clear that the transfer of the authorisation and supervision file to the new Member State of reference as provided for in Article 37(1) does not invalidate the original authorisation or require the authorisation decision to be reopened. The new Member State of reference should continue to supervise the relevant non-EEA AIFM and exercise its supervisory powers in the normal way, as if it had granted the original authorisation.

3. Reasonable Substance Requirements for a Legal Representative

Article 37(3) provides that a non-EEA AIFM must have a legal representative in its Member State of reference, who may be a natural person domiciled in the EU or a legal person with its registered office in the EU (Article 4(1)(v)), which shall be the contact point of the non-EEA AIFM in the EU and together with the non-EEA AIFM will perform the compliance function relating to the management and marketing activities performed by the non-EEA AIFM under the AIFMD.

It is fundamental that the legal representative's responsibilities should be confined to those specified in Article 37(3), and any substance requirements limited to that necessary to perform those functions; the requirement to appoint a legal representative should not indirectly require a non-EEA AIFM to establish its own presence or substance in the EEA in order to become authorised under (and compliant with) the AIFMD.

4. Requirement for OECD Model Tax Convention-compliant agreements and supervisory co-operation agreements

Several Articles of the AIFMD concerning non-EEA AIFMs and AIFs require that there should be OECD Model Tax Convention-compliant agreements in place between third countries and EU Member States. Examples include Article 35(2)(c) and Article 37(7)(f).

It is important that as soon as possible ESMA collate and publish a table summarizing which third countries have – in their view – entered into OECD Model Tax Convention-compliant agreements with EEA Member States, in much the same way as ESMA helpfully published the matrix of supervisory co-operation arrangements for the purposes of Articles 42 and 36.

Similarly a number of provisions of the Directive (not limited to those relating to non-EEA AIFMs) require supervisory co-operation agreements to be in place with the supervisory authorities of the third country where a non-EEA AIF is established. Examples include Article 34(1)(b), Article 35(2)(a), Article 36(1)(b), Article 40(2)(a) and Article 42(1)(b). In a number of jurisdictions, both EEA and non-EEA, some, or all, AIFs are not themselves authorised and subject to supervision (as is also the case under AIFMD). We believe this is fully understood and accepted and that in relation to such AIFs the relevant supervisory co-operation agreements only have to be entered into with an appropriate regulator in the

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jurisdiction, even though it has no direct supervisory powers over the AIF itself, but it would be helpful to state this expressly in the context of extension of the passport.

5. Application of AIFMD rules to non-EEA AIFMs

Extending the passport to non-EEA AIFMs could increase competition and investor choice, but **only** if it is introduced in an **efficient, tailored, and commercially sensitive** way. Non-EEA AIFMs making use of the passport would need to be able to comply with relevant AIFMD requirements **in an appropriate and proportionate way**; strict application of certain AIFMD provisions that diverge significantly from global regulatory norms – in particular those relating to remuneration and capital requirements – would be disproportionate and would likely discourage non-EEA managers even further from marketing within the EU.

ESMA and the European Commission have stressed in their delegated regulations and guidance under the AIFMD that the AIFMD should be applied in a **proportionate, tailored** way. We submit that this principle should apply equally to the application of the AIFMD to non-EEA AIFMs and, **commercially**, that non-EEA AIFMs (and the AIFs that they manage in accordance with the AIFMD) should benefit from the same treatment as EEA AIFMs under European regulations applying to insurance companies, pension companies, banks and other such investors (as is the case under Solvency II). Otherwise, non-EEA AIFMs will be unlikely to make use of the AIFMD passport and EEA investors will continue to suffer from reduced competition and choice.

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APPENDIX 1 – Limited relevance of Equivalence/Reciprocity to Third Country Passport

As part of ESMA's work on its opinion and advice under Article 67(1), the EVCA understands that ESMA is conducting an in-depth analysis of the conditions under which EEA AIFMs are able to market and/or manage AIFs in specific third countries. The EVCA also understands that ESMA and the Commission are considering whether, based on the results of ESMA's analysis, the Commission should extend the passport to non-EEA AIFMs on a country-by-country basis. We have serious concerns about this approach, which seems contrary to the spirit and the letter of the level 1 text and could lead to unintended consequences without achieving any benefits for EU investors.

As a threshold matter, we note that – contrary to many other EU financial regulatory measures – **the AIFMD does not provide for an "equivalence" test in connection with the extension of the passport**. The difference in approach was intentional and appropriate in view of the different philosophies of these measures. EU measures imposing equivalence tests have been adopted in areas where a global approach to regulation was agreed, notably in the context of the Pittsburgh G-20 summit during the financial crisis. In those measures, ESMA and the Commission are specifically tasked with conducting in-depth reviews of and decisions on the equivalence of non-EU regulatory regimes as a condition to non-EU financial services companies providing services to EU investors and institutions without being subject to EU law. This approach is fundamentally different to the AIFMD, which does not follow a global or G-20 approach. Absent an internationally agreed standard, the AIFMD provided that non-EEA AIFMs and non-EEA AIFs would be entitled to the EU passport (if any) only if they agreed to comply with EU regulation in addition to their home-country regulation, making an equivalence test **superfluous** (and notably imposing uniquely strict and burdensome double-regulation standards on non-EEA AIFMs). An equivalence assessment is not necessary because non-EEA AIFMs will be required to obtain full-scale authorisation, comply with the AIFMD and be subject to the supervision of the competent authorities of their Member State of reference.

More specifically, in lieu of the detailed and specific mechanisms provided in other financial regulatory measures providing for equivalence tests, Article 67(4) provides that ESMA can issue a negative advice if it finds that market disruptions or distortions of competition would create "a significant obstacle" to the application of the passport to the marketing of non-EEA AIFs by EEA AIFMs and the management and/or marketing of AIFs by non-EEA AIFMs in the Member States. It is not clear how differences in non-EU regulation could create an obstacle to extension of the passport to non-EEA AIFMs and AIFs, given that non-EEA AIFMs availing themselves of the passport would become subject to the AIFMD in addition to their home-country regulation.

We note that, in Article 67(2)(c), ESMA is tasked with considering "potential market disruptions and distortions of competition (level playing field) or any general or specific difficulties which EU AIFMs encounter in establishing themselves or marketing AIFs they manage in any third country". The criteria to be applied are unclear, but it would presumably be appropriate to compare the time and expense that non-EEA AIFMs incur when seeking to market AIFs in the EU with the time and expense that EEA AIFMs face in marketing outside the EU, and potentially the size of the respective markets. It is generally recognized that marketing in the EU is more difficult and expensive for non-EEA AIFMs than marketing in any other developed economy. Non-EEA AIFMs seeking to avail themselves of the passport will likely face even greater costs, as they will have to comply with essentially all of the obligations of the AIFMD as well as their home-country rules. It is difficult to quantify marketing costs, however, among other reasons because of the wide range of approaches by different Member States and the different strategies adopted by different AIFMs.

In any case, Article 67(2)(c) is only one of 13 criteria to be considered by ESMA, and we submit that brief reference to market disruption and level playing fields do not evince an intent by the legislator to link the extension of the passport to an equivalency test. As is demonstrated in many other EU financial regulatory measures, when the legislator intended to impose an equivalence test, it knew how to do so and chose not to do so in the AIFMD.

Similarly, Article 67(6) provides no indication that the legislator intended or authorized the Commission to adopt a delegated regulation extending the passport on a staged, country-by-country basis. The Commission is instructed to “take account” of the 13 criteria listed in Article 67(2)(c) and the objectives of the AIFMD, including those relating to the internal market, investor protection and the monitoring of systemic risk. We respectfully submit that when a decision is taken on extension of the passport it should be a decision applicable to all non-EEA AIFMs and non-EEA AIFs as this will best further these objectives by increasing the access of all EU investors to the widest possible range of investment choices subject to uniform AIFMD standards, thereby furthering the development of the internal market and harmonizing standards of investor protection. There are a number of other provisions built into the AIFMD by which the status of individual Member States is relevant and which will preclude the exercise of the passport by those from non-EEA jurisdictions where there are concerns over matters such as supervisory co-operation, tax disclosure or FATF. There is no indication in Article 67 that some further jurisdiction by jurisdiction assessment is intended or appropriate.

By contrast, extending the passport to non-EEA AIFMs and AIFs piecemeal would in no way promote the development of the internal market or investor protection. On the contrary, such an approach would risk limiting EU investors’ access to the widest possible variety of investment options. If ESMA were to identify protectionist tendencies in some third countries, declining to extend the passport to AIFMs based in those countries could in theory be seen as a means to open those countries’ markets to EEA AIFMs. Such an international trade agenda is not an objective of the AIFMD, however, and the decision of whether and how to extend the EU passport to non-EEA AIFMs and AIFs is not well suited to such an objective in any event. If ESMA does identify such concerns with protectionism in third countries, we are prepared to work hard and closely with ESMA and the Commission to combat such trends.

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APPENDIX 2 - Sub-threshold EEA fund managers

In relation to the continuation of national private placement regimes, which is due to be considered formally in 2018 under Article 68 but, as noted above, is already important when taking decisions about the introduction of an EEA passport given the stated intention of certain Member States (notably Germany) to terminate their national private placement regimes once the passport is introduced, we should note that **it is also very important to smaller EEA fund managers that these national regimes should continue**. Smaller EEA fund managers are those most likely to be investing in SMEs.

The national private placement regimes are important for smaller EEA fund managers as these regimes remain the only way in which 'sub-threshold' EEA AIFMs of EEA AIFs who do not 'opt in' to the AIFMD (and are therefore unable to benefit from the marketing passport) can market on a cross-border basis within the EU.

In this regard, we note that the EuVECA label is available only to a limited number of managers/funds as it is highly restrictive in its approach to what constitutes qualifying investments and/or qualifying portfolio undertakings.

Indeed, many smaller fund managers – including some that are clearly making venture capital investments - will not meet the EuVECA's particular eligibility criteria and will therefore not qualify for the voluntary EuVECA passporting regime. Even for some qualifying 'below threshold' funds, the cost of applying for the EuVECA label may not be justified if they want to market in only a few Member States.

And so there are hundreds of smaller fund managers who either have to 'opt in' to the full AIFMD regime, or rely on national private placement regimes. Opting in to the AIFMD is unlikely to be attractive for very many, given the costs that this will entail. **Private placement is therefore essential to enable smaller EEA managers and EEA institutional investors to be able to connect, enhancing investor choice and competition amongst managers.**

Some Member States do not currently allow smaller fund managers to make use of their national private placement regime to access investors; this has the effect of denying these managers any means to operate across borders. Where Member States' rules allow domestic smaller funds to market to institutional investors in their jurisdiction but not those from other EU Member States, the negative consequences are particularly acute.

Against this background, even if a passport is implemented for various third countries, the position of small managers needs clarifying as the affected third country managers and EU managers should be subject to the same rules. Smaller fund managers should be allowed the option to market in all Member States, whether through the extension of the voluntary EuVECA regime or through private placement regimes. Ideally, **a voluntary EuVECA regime** that provides an optional passport needs to sit **alongside a functioning and open private placement regime**. Smaller fund managers must not be forced to adopt one route or the other but given the freedom to choose that which best suits their specific needs.