



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

Response to the European Commission's Public Consultation on the main barriers to the cross-border distribution of investment funds across the EU

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.

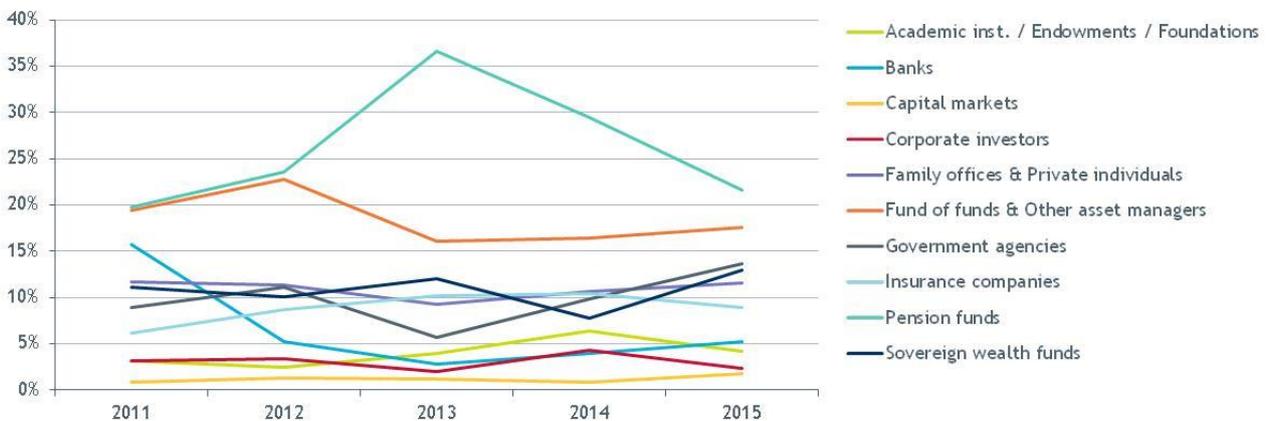
For more information please visit www.investeurope.eu.

INFORMATION ABOUT YOU

Question 1.1a - If you have a general policy of differentiating between high net worth individuals and other retail investors then please also provide information on this.

With certain limited exceptions (such as investment trusts and venture capital trusts), our members (private equity and venture capital fund managers) do not seek to raise capital from “pure retail” investors investing small amounts of capital. Many private equity funds will raise a very high proportion of their capital from institutional investors. Please find below an overview of the funds raised by private equity and venture capital fund managers, by type of investor between 2011 and 2015.

Graph 1: Incremental amount raised during the year - % of total amount (2011-2015)



Source: Invest Europe / PEREP_Analytics

Firms do, however, want to raise capital from high net worth individuals (or the family offices). Such investors are typically advised by, or their portfolios are managed by, professionals and an investment into a private equity firm may well be appropriate for these investors as part of a diversified portfolio. In our members’ experience, there is a significant level of demand from this type of investor, which cannot always be fulfilled owing to marketing restrictions.

In addition, private equity fund executives will often invest their own money alongside the main fund. This promotes alignment of interests and ensures that the investment team has “skin-in-the-game”. In some cases, executives’ family members or personal trustees - as well as in some cases the chairmen of the portfolio companies - will also make an investment into the relevant vehicle.

The problem is that **some types of investor into private equity and venture capital - such as the ones described above - could potentially be considered “retail” (i.e. non-professional) under the MiFID definition (Annex II)**. More broadly, this is the case for academic institutions, endowments, foundations, corporate investors, family offices and high net worth individuals (including entrepreneurs). Although experts in their field and with significant wealth and often sophisticated investment strategies, these investors do not satisfy the MiFID criteria for being considered a professional investor “upon request”. In addition, the executives, family members, personal trustees and chairmen are also likely to be “retail” investors despite having experience of the private equity industry and being sufficiently sophisticated to



understand the risks of doing so.

We consider all these investors to be sophisticated due to the size of the investments they are able to make (i.e. they are sufficiently high net worth to have sophisticated personal investment programmes, often advised or managed by professionals) and/or their knowledge and understanding of the types of companies into which investments will be made (in the case of entrepreneurs, for example); the broader investment environment (in the case of family offices, for example); or the private equity or venture capital industry (in the case of executives working for the fund management vehicle who are investing alongside the fund).

For this reason, we strongly believe that **there is a distinction to be made between such sophisticated, “semi-professional” investors and “pure” retail investors.** A reassessment of the definition of professional investor, taking into account the specific characteristics of private equity and venture capital and the investors into this asset class, is needed. This is explained in further detail in our response to Questions 1.2 and 3.2.

Question 1.1b - Which channels do you use to distribute funds cross-border? Does your cross-border distribution policy differ depending on the type of investor you wish to address and the Member State?

Private equity funds are typically marketed on a private placement basis, with prospective investors being identified and targeted individually. **It would not be usual for a private equity fund to be advertised publicly or marketed through a mass marketing campaign.**

In some cases, private equity funds will be marketed by the manager’s own investor relations team, using their network of contacts. In other cases, a placement agent will be used to effect introductions to prospective investors in the placement agent’s network of contacts.

Certain private equity firms may work with private wealth managers, who will offer the fund (or, more commonly, a dedicated feeder fund product) to its private wealth management clients where they consider this suitable or appropriate for their underlying client and where permitted under applicable marketing restrictions.

Question 1.1c - What types of funds do you market and to which types of investors do you market directly? [for each type of fund and investor] Please expand upon your response to Question 1.1, 1.1a and 1.1b.

Invest Europe is the association representing Europe’s private equity, venture capital and infrastructure sectors, as well as their investors. Our members are private equity firms who market private equity funds. Some members also have other product lines. Many of our members market funds on a cross-border basis and more would do so (or would market into more jurisdictions) if barriers to cross-border distribution were reduced.

Private equity funds are **not typically mass-market retail products.** They are predominantly marketed to institutional investors who qualify as professional clients under MiFID. However, there is also investor demand from (ultra-)high net worth individuals and their family offices who do not qualify as “per se professional clients” under MiFID and who, for the reasons given below, may not be eligible to be treated as elective professional clients in respect of this type of product. Our members’ ability to satisfy this demand



is therefore limited in many jurisdictions.

In addition, employees and other individuals associated with a private equity firm (e.g. former employees, close family members, consultants, operating partners) will often invest their own money into the fund. This is an important tool for ensuring alignment of interests with investors. Although these individuals will typically be sophisticated (having detailed knowledge of the product from their association with the firm) and/or high net worth, investments by such executives or employees involved in the management of a fund would also be considered retail investment unless stated otherwise.

Question 1.2 - Please provide your definition of high net worth retail individuals. Does this definition vary from one national market to another?

There is no standard definition of high net worth retail individual used across the private equity industry.

However, we fully support the existing reference to and description of “sophisticated” investors in the [EuVECA Regulation](#) (Article 6.1) and believe this definition would cover most high net worth individuals investing in private equity and venture capital funds.

“1. Managers of qualifying venture capital funds shall market the units and shares of qualifying venture capital funds exclusively to investors which are considered to be professional clients in accordance with Section I of Annex II to Directive 2004/39/EC or which may, on request, be treated as professional clients in accordance with Section II of Annex II to Directive 2004/39/EC, or to other investors that:

- (a) commit to investing a minimum of EUR 100 000; and*
- (b) state in writing, in a separate document from the contract to be concluded for the commitment to invest, that they are aware of the risks associated with the envisaged commitment or investment.”*

In addition, as mentioned above, there may be interest from individuals who, although wealthy, are not ultra-high net worth but who are associated with the firm or otherwise have experience of the private equity industry and are sufficiently sophisticated to understand the risks of doing so. Against this background, we also welcome and are fully supportive of the explicit exemption in Article 6.2 of the EuVECA Regulation for certain executives, directors or employees:

“2. Paragraph 1 shall not apply to investments made by executives, directors or employees involved in the management of a manager of a qualifying venture capital fund when investing in the qualifying venture capital funds that they manage.”

Given their importance as an investor group and the additional investment channel private equity and venture capital represents for these “semi-professional” investors, it is vital in the context of private equity and venture capital that a harmonised EU definition of “sophisticated” or “semi-professional” investors captures high net worth individuals. This would also ensure that managers of venture capital and private equity funds, who are co-investing alongside the fund, are not forced to comply with legal provisions that are designed for pure retail investors.

One solution would be to use the EuVECA approach more generally in EU law as a definition encompassing those investors currently deemed retail who have a significantly greater understanding of the product than typical retail investors. Indeed, these investors often have extensive industry or sector

experience (for example, in an operational role or as an entrepreneur) that provides a sophisticated understanding of the specific investment into a private equity or venture capital fund that they are intending to make.

In determining which investors are deemed to be sophisticated or “semi-professional”, the *level of experience* of the investor remains the most relevant factor, although the *level of wealth* may also provide an indication of the credibility of the investor, as recognised in the existing EuVECA wording. The types of high net worth individuals interested in private equity funds will typically have investable assets running into millions, and in many cases tens of millions, of Euro.

It is our firm view, as already expressed in previous submissions including our [response to the recent European Commission Call for Evidence](#) (Issue 11, Example 2), that **the current distinction between investors, drafted in the context of regulated markets as part of the MiFID Regulation, is not sufficiently tailored to take into account the specificities and types of investors into the private equity and venture capital asset class.**

Examining the three elements of the MiFID test shows that the definition clearly favours some type of investments independently of the risk they carry. While the proposed test tries to take into account the diversity of financial investors, it fails to do for the following reasons:

- The first test (“frequency”) is inherently discriminatory due to the long-term and illiquid nature of private equity. The test is calibrated for participants in liquid markets such as those for exchange-traded equities but it is applied in other contexts such as the marketing of interests in private equity funds. Not even the most seasoned institutional investors, with an active private equity investment programme, make as many as 10 commitments per *quarter* to private equity funds. These investors will typically build portfolios of say 20-40 private equity fund managers over a number of *years* in order to spread vintages and manage cash-flows.
- The third test (“expertise”) may be met by some investors but not by new entrants (such as serial entrepreneurs who decide to invest into a fund for the first time). Most high net worth individuals and business angels as well as entrepreneurs will not have worked in the financial sector, but are very well suited to invest in venture capital and private equity funds, bringing with them both capital and expertise in building companies.

As a result, despite their level of wealth and/or their often sophisticated investment strategies many high net worth individuals will not meet the “professional upon request” criteria in MiFID (the “two out of three” quantitative test) and will usually be treated as ‘retail investors’ under MiFID (and consequently also under the AIFMD). In practice, this means that fund managers wishing to market to such investors:

- may not be allowed to do so under their national frameworks;

The AIFMD marketing passport permits AIFMs to market funds to “professional investors”, defined (in Article 4(1)(ag) of the AIFMD) as an investor which is considered to be a professional client or may, on request, be treated as a professional client within the meaning of Annex II to MiFID.

According to Article 43 of AIFMD, marketing to retail investors is subject entirely to the discretion of the Member States, who “*may impose stricter requirements on the AIFM or the AIF than the*

requirements applicable to the AIFs marketed to professional investors in their territory in accordance with this Directive”.

As a result, some jurisdictions impose additional requirements on AIFMs which have retail investors in their funds (e.g. related to disclosure), which adds further cost and complexity for the manager. This has led to a patchwork of different approaches that is inconsistent with a Capital Markets Union.

Furthermore, most EU jurisdictions have materially more onerous rules about marketing to retail investors, which are difficult and costly for firms to comply with. The rules in some jurisdictions not only restrict mass retail distribution (which has a clear policy rationale), but also effectively prohibit distribution to the types of high net worth individuals described above. The practical result is that private equity firms cannot, or do not, approach high net worth investors in many jurisdictions, leaving investor demand unfulfilled and shutting down an important source of capital for the private equity and venture capital industry without any meaningful increase in investor protection.

This is in contrast to the US where it is possible to market to natural persons where, broadly, their individual net worth (or joint net worth with their spouse) exceeds USD 1 million or where their/their joint income exceeds certain thresholds (individual income in excess of USD 200,000 in each of the two most recent years or joint income with their spouse in excess of USD 300,000 in each of those years and the person has a reasonable expectation of reaching the same income level in the current year). The net worth threshold for US natural person investors was revised under Dodd-Frank to exclude the value of a person’s primary residence. The SEC is also currently considering whether to include persons that are sophisticated based on other criteria such as financial job experience or education.

It might also be worth looking elsewhere at equivalent tests in other jurisdictions like Asia, where net wealth and risk tolerance are required to be assessed by the manager, without a need to have the investor confirm a certain level of trading activity (i.e. 40 transactions in 12 months).

- will be faced with obligations that are not suited to the sophistication of these investors (in particular the obligation to produce a Key Information Document for investors who are very well aware of the risks such an investment might have) (see [Invest Europe’s response to the European Commission’s Call for Evidence](#), Issue 3, Example 2).

For the reasons stated above, we suggest that an EU wide definition of “sophisticated” or “semi-professional” investors is developed, based on the EuVECA Regulation, in order to allow marketing to these investors. The creation of such a new category or definition of investor would provide a much needed layer of flexibility and better represent the diversity of the financial investors. It would facilitate investments by high net worth individuals into private equity, growth and venture capital funds without any loss of protection for true retail investors. More information on the inappropriateness of the cross-reference to MiFID in the AIFMD definition of “professional investor” can be found in our answer to Question 3.2.

Question 1.5a - Do you use the UCITS passport in order to market your UCITS funds in other EU Member States? Please explain why you do not use the UCITS passport.

In general, private equity firms are not currently able to offer UCITS products as private equity investments



do not qualify as eligible assets under the UCITS regime. Our responses are therefore limited to the AIFMD passport.

Question 1.6a - Do you use the AIFMD passport in order to market your EU AIFs in other EU Member States? Please explain why you do (not) use the AIFMD passport.

Yes. A number of Invest Europe members will use (and have used) the AIFMD passport to market EU AIFs cross-border. Others are not eligible for the passport, because of either:

- their location (non-EU) - our members cover a large number of organisations, including many operating under Article 36 AIFMD and many operating under Article 42 AIFMD; or
- their size - for smaller, sub-threshold managers the cost of opting-in to AIFMD in full may outweigh the benefits of access to the passport.



Questions for LPs

Question 1.11 - Do you invest in investment products? If so, please indicate in which product.

	Yes	No
Investment funds	<input checked="" type="radio"/>	<input type="radio"/>
Structured notes	<input type="radio"/>	<input type="radio"/>
Unit linked insurance contracts	<input type="radio"/>	<input type="radio"/>
Others	<input type="radio"/>	<input type="radio"/>

Question 1.11a - Please expand on your response to Question 1.11.

In order to enable us to provide answers to the questions addressed to investors, Invest Europe has compiled the responses of more than 20 investors in private equity and venture capital (all members of Invest Europe). 70% of them are fund-of-funds; others are large institutional investors such as pension funds, insurers, banks and corporate investors.

All answers to the investor questions are based directly and solely on the feedback of these respondents. By contrast, for the asset manager questions the responses have been built based on and combining the feedback from Invest Europe's fund manager members and from legal and regulatory experts from the industry.

Question 1.13 - In which type of fund(s) do you invest?

AIFs, EuVECAs and ELTIFs.

Question 1.14 - What is the approximate allocation of your assets between funds? If it is helpful, please expand upon your answers to Question 1.14.

All investors - with one exception - on whose input our responses are based are making cross-border investments within the EU.

While all of the 20 investors we surveyed invest into AIFs, 40% have invested into EuVECA funds and 20% are planning to invest into ELTIF funds.

GENERAL OVERVIEW

Question 2.1 - What are the reasons for any limitation on the cross-border distribution of your funds?

Please note that the figures in the tables below reflect the number of members who, when responding to our survey, ticked each of these boxes.

Country	Regulatory costs and/or marketing requirements costs are too high	Lack of demand outside your home market	Host market size is too small	Tax issues	Other
Austria	5	5	7		2
Belgium	1	4	5		1
Bulgaria		7	12		1
Croatia		7	14		
Cyprus		8	13		
CZ		7	13		
Denmark	4	2	2		1
Estonia		7	14		
Finland	4	2	2		
France	7	1		1	1
Germany	4				
Greece		7	10		
Hungary		5	10		
Ireland		4	7		
Italy	5	4	2		2
Latvia		7	14		1
Lithuania		7	14		1
Luxembourg	1	1	1		1
Malta		7	14		
Poland		7	10		
Portugal		6	11		1
Romania		7	13		
Slovakia		7	14		
Slovenia		7	14		
Spain	3	5	3		1
Sweden	3	2	1		1
The Netherlands	3	3	1		1
UK	1	1			



If the openness of the distribution network to third parties is a reason for a limitation on the cross-border distribution of your funds, please rank it from 1 (being the less open market) to 5 (being the most open market):

Country	Degree of openness (1 to 5, 5 being most open)
Austria	2
Belgium	3
Bulgaria	2
Croatia	2
Cyprus	2
Czech Republic	2
Denmark	3
Estonia	2
Finland	3
France	3
Germany	3
Greece	2
Hungary	2
Ireland	4
Italy	2
Latvia	2
Lithuania	2
Luxembourg	4
Malta	2
Poland	2
Portugal	2
Romania	2
Slovakia	2
Slovenia	2
Spain	3
Sweden	3
The Netherlands	4
UK	5

Question 2.1a - Please expand upon and provide more detail on your response to Questions 2.1 and 2.1a - please explain what the issues are and how they limit the cross-border distribution of funds? Please cite the relevant provisions of the legislation concerned if possible:

According to our survey, with rare exceptions, the perceived openness of markets is the same for both venture capital and private equity, and was irrespective of the size of the fund managers who responded. It should be taken into account, however, that the situation might be very different for EU and non-EU AIFMs.

As can be seen in the table above, **the size of host markets** and **the lack of demand outside the home market** are considered to limit severely the distribution of funds in the majority of EU Member States. **Access to institutional investors** is also notoriously difficult in some of the countries, either for regulatory or for cultural reasons.

In the remaining countries, our members believe that **the cost of regulatory/marketing requirements** can constitute a serious limitation to the cross-border distribution of their funds. Private equity fund managers are usually subject to complex regulatory requirements, whether arising from the transposition of the AIFMD or from national rules, which do not seem to be justified by the systemic risk profile of the sector. Where there are no systemic risk implications and an investor base that is professional/institutional in nature there is a strong case for arguing that these fund managers face a regulatory burden that is not proportionate to the risks they pose. The UK and Luxembourg are the only countries with a large private equity industry where nearly all fund managers found that costs of marketing requirements were NOT a sufficient reason not to market in the country.

It is important to note that the openness of these markets will also depend on **the regime through which funds are marketed**: through the AIFMD passport for larger EU fund managers or under the national private placement regimes for smaller players and for those from a third country. Some countries, such as Austria, France, Italy, Spain, Denmark and the Netherlands are simply not accessible due to the closing of their national private placement regimes, either for AIFMD sub-threshold managers and/or for third country fund managers. In addition, the use of the EuVECA regime is problematic in certain countries such as Germany where it can take up to 12 months to obtain a EuVECA authorisation. This naturally severely limits **cross-border marketing of AIFMD sub-threshold (and third country) funds**, as we explain further in Question 3.3.

Overall, some markets are very negatively perceived by our members, in particular France and Italy due to the burden created by the national rules. Importantly, none of our respondents felt they were able to enter these markets without hiring local lawyers (at significant expense) due to the complexity of the local regime.

Specific concerns relate to the definition of marketing (see our comments in relation to Question 2.2), existing requirements (such as the depositary requirements in Germany and Denmark) or long lead times (3+ months) to process applications (see our response to Question 8.5).

Although none of our members felt that the tax regime of a Member State was a sufficient reason not to market in it, developments in taxation do not exist in isolation and will necessarily impact on the broader investment environment.

More specifically, the tax system has an impact on the relative attractiveness of investing via a fund

structure. If fund structures are unfairly penalized such cross-border investments will be impeded. Institutional investors must not be left in a disadvantageous tax position from investing in a fund when compared to investing directly in assets. This tax disadvantage for investors could come from any of several sources such as national withholding tax, application of a potential EU Financial Transaction Tax, or disallowance of tax treaty benefits via proposals from the OECD. Tax on capital gains realised by foreign shareholders on the sale of shares in a company established in a host country or differences between entity classification rules may also act as tax barriers.

If an investor is penalised for investing through a fund this becomes a less attractive option. Given that a fund is the only realistic means by which many institutional investors can invest in, for example, innovative start-ups (given the high costs of direct investment, largely arising from the difficulty of identifying investment opportunities and of carrying out due diligence) a tax disincentive would have significant impacts on investment decisions.

With the fund structure and the fund manager playing an essential role in connecting institutional investors' capital with those hard-to-reach companies looking for finance **it is vital that the tax system operates in a way that does not discriminate**. An investor's decision whether to invest directly or via a fund structure should not be influenced by the tax implications of these two options.

Question 2.2 - Which of the following issues are the **major regulatory and tax barriers** to the cross-border distribution of funds in the EU? Please rank them in order of importance.

Issue	Importance (1 - most important, 6 - relatively less important)
Different definitions across the EU of what marketing is	1
Marketing requirements imposed by host Member States	2
Regulatory fees imposed by host Member States	3
Administrative arrangements imposed by host Member States	Not applicable
Lack of efficiency of notification process	3
Difficult/cumbersome refund procedures for claiming relief from withholding taxes on distributions by the UCITS, AIFs, ELTIF, EuVECA or EuSEF	4
Higher taxation of investment funds located elsewhere in the EU/EEA than of domestic funds	5
Differences between the tax treatment of domestic and foreign fund managers as regards withholding tax/income reporting responsibilities and	4



opportunities on income distributed by UCITS, AIF, ELTIF, EuVECA or EuSEF	
Differences between Member States in tax reporting	4
Other - Please specify	Not applicable

MARKETING REQUIREMENTS

Question 3.1b - Are you aware of member state interpretations of marketing that you consider to go unreasonably beyond the definition of marketing in AIFMD?

As a starting point, it is important to note that the AIFMD approach to marketing is lifted from UCITS and as such was never appropriate for the private equity world. This has a direct impact on Member State regulators who take different views as to when “AIFMD marketing” is deemed to commence.

Typical private equity/venture capital fundraising process - Link with AIFMD

Private equity and venture capital funds are ‘closed-end’ funds. Private equity funds are typically partnerships or other *negotiated* structures, and not off-the-shelf unitized collective investment funds that are merely “sold” to investors. Participation in these closed-end 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-end 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-end fund conducts their own, lengthy due diligence process before deciding whether or not to invest. While the 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 as their due diligence and decision-making process is concluded. From first close to final close can be as long as 12-18 months.

In the closed-end fund context fundraising for a new fund typically involves preliminary discussions with investors in the manager’s 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 at the manager. Investors do not regard such communication as 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 fund and will. Indeed, for investors not invested in the existing fund, part of their role as managers of 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 document of these closed-end 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, is finalized.

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 ‘pre-marketing’ with no information on the fund (both with investors in the

existing/current fund and potential investors who are not current investors, as described in the opening paragraph of the response to this question above)

2. Teaser presentations to the investors and high-level term sheets
3. Draft private placement memorandum (PPM) (subject to change) and draft LPA (subject to change)
4. Final private placement memorandum, issued by the AIFM
5. Finalisation of the Limited Partnership Agreement (LPA)

Member State interpretations

There are significant divergences of view from Member State authorities on the question of when marketing begins for the purposes of the AIFM Directive. In certain Member States the simple fact of mentioning that a particular fundraising is proposed can be seen as marketing (some regulators consider that even brand marketing and/or 'pre-marketing' can be AIFMD marketing), while others - correctly in our view - consider that **circulation of early draft fund documentation generally does not constitute AIFMD marketing and that marketing can only start at a time where a near-final document is available and presented to the investor** (i.e. at the point at which there are legal documents relating to a fund that are no longer negotiable).

Please find below a few examples of differences in interpretation:

- In the UK, neither brand marketing, pre-marketing nor 'soft circling' would constitute "AIFMD marketing". The UK FCA is of the view that AIFMD marketing takes place *only* from the point at which a person makes an interest in an AIF available for *purchase* by a potential investor (i.e. AIFMD marketing occurs when final form or near final form documentation allowing the investor to accept or make an offer to subscribe are distributed). This means that AIFMD marketing does not start until fairly late in the fundraising process. The UK FCA rightly considers that making promotional presentations or circulating early draft fund documentation or PPMs generally does not amount to AIFMD marketing. There is no marketing until the manager circulates a near final PPM, Limited Partnership Agreement and subscription document.
- Broadly, the interpretation is similar in Germany, provided there is a pre-marketing disclaimer.
- In Sweden, the national law transposing the AIFMD defines "marketing an AIF" as occurring when the manager, or a person on behalf of the manager (or an investment firm) makes a "direct or indirect offering or placement of units or shares of an AIF to or with an investor domiciled or with a registered office in an EEA State". It is not limited to activity that leads to a sale. "Marketing" is deemed to occur relatively early in the process - at the time when a number of investors have been approached but does not include marketing activity that takes place before first close in a private equity structure (although our members have received divergent legal advice on this point).
- In the Netherlands, early-stage discussions or "soft-circling" with a potential investor could be considered marketing, although there is no formal guidance from the Dutch regulator.
- In Denmark, the Danish FSA is likely to interpret the definition of marketing broadly. Introductory meetings held with potential investors prior to establishing the AIF and in advance of any PPM and/or subscription documents are not considered to be marketing activities, provided that the investor cannot

undertake any commitment to acquire shares/units in the AIF, e.g. by a letter of intent. This form of pre-marketing must cease before the fund vehicles are established if the fund has not been approved for marketing. Further, sales made on request (execution only) are not considered “marketing”, in so far as the AIF has not been advertised (or marketed) by any means.

- In Finland, the preparatory works to the law implementing AIFMD suggest that “marketing” under AIFMD requires an offering of fund units / shares to an investor, i.e. activities that are, in fact, aimed at obtaining/securing an investment by the potential client. Soft-circling activities to gauge investor appetite including road shows, distributing, flip books and general conversations about fund strategy will therefore not be “marketing”, especially if the fund vehicle(s) has/have not yet been established.
- In France, subject to certain conditions, the sale of an interest in a fund through a manager expressly authorised (or passported) to (i) provide portfolio management services or (ii) manage a fund of funds does not constitute marketing. It is therefore possible to market to such intermediary investors outside the scope of AIFMD.

According to an AMF press release of 4 July 2016, the AMF introduced the concept of marketing along the following lines:

“(…) the practice of management companies contacting up to a maximum of 50 investors (professionals or individuals whose initial subscription would be at least €100,000) to assess their interest prior to the launch of a UCITS or AIF will not constitute an act of marketing, provided that the investors are not given a subscription form and/or documentation containing definitive information on the fund’s characteristics. However, any subsequent subscription by the investors contacted will be considered to constitute an act of marketing.”

Other situations that would trigger the application of marketing rules in France include:

- a management company responding to a request for proposal (RFP) by a professional investor that is a legal entity;
- participation by a management company in conferences or meetings of professional investors, provided the investors are not asked to invest in a specific product.
- In Austria, Italy, Belgium and Luxembourg, there is no further regulatory guidance on the meaning of “marketing”.
- In Czech Republic, the general interpretation seems to be that even soft marketing is considered marketing.
- In Latvia, it appears that everything other than reverse solicitation is considered marketing.

The combination of a lengthy negotiated process and a definition of marketing that is triggered early in the fundraising process creates significant difficulties in applying for and using the AIFMD passport. In principle, the passport for a particular fund should be granted before any ‘marketing’ takes place, but to obtain the passport it is necessary to submit near-final drafts of the fund documents, which (as noted above) are typically not capable of being finalised until much later in the process. This also makes it difficult for the private equity fund to test the market for a particular product in some jurisdictions without incurring significant up-front costs.

These problems could be substantially alleviated by providing that marketing only takes place **once subscription documents are provided to investors as no offer can exist prior to that point**. In other words, AIFMD marketing should take place *only* from the point at which a legal entity exists in which the investor could make an investment. This is in line with the position/approach taken by the German and UK regulators and in fact is the **only workable model** from a private equity and venture capital point of view.

See our response to Question 3.2 for more detail.

Question 3.1c - Are you aware of any member state interpretations of marketing having had a material impact upon the cross-border distribution of investment funds?

Yes.

The examples in Question 3.1b suggest that those markets where marketing is held to apply from very early on in the process will be less attractive to managers than those in which the interpretation of marketing is more in line with market and regulatory approaches that were adopted in longer-established markets before AIFMD was introduced. Consequently, investors in those markets where managers are less likely to go are potentially deprived of good quality investment opportunities as a result of the great divergences between Member States' interpretations of marketing. The issue also makes it very difficult for a fund manager to market its fund across the European market without requesting the help of a local counsel for each of the jurisdictions it wants to market into.

This can have direct implications on the cross-border distribution of private equity and especially venture capital funds, which do not always have at their disposal sufficient (staff and funding) resources to face these costs, or are simply put off by the amount of work required to have access to jurisdictions other than their home market.

Finally, it might be worth noting that the impacts may be different for EU and non-EU AIFMs.

Please see also our response to Question 3.2 (bullet point 1).

Question 3.2 - Which of the following, if any, is a particular burden which impedes the use of the marketing passport? Please can you expand on this below?

Issue	Yes	No
Different interpretations across Member States of what constitutes marketing	X	
Different methods across Member States for complying with marketing requirements (e.g. different procedures)	X	
Different interpretations across Member States of what constitutes a retail or professional investor	X	
Additional requirements on marketing communications imposed by host Member States	X	
Translation requirements imposed by host Member States		X
Other domestic requirements		X

1. Different interpretations across Member States of what constitutes marketing

While the term “marketing” is defined in the Directive, Member State regulators are taking different views as to when “AIFMD marketing” is deemed to commence. As stated in our response to Question 3.1b, these varied interpretations of the concept of marketing raise issues for the private equity industry.

In practice, this lack of harmonisation means that:

- (a) AIFMs must incur additional time and costs in assessing when AIFMD marketing commences in each relevant jurisdiction and what promotional activities they can undertake in that jurisdiction prior to (for EU AIFMs) obtaining the marketing passport or (for non-EU AIFMs) making an “Article 42 filing” (see Question 8.4).
- (b) Those AIFMs which are authorised in Member States where the regulator does not expect the firm to apply for the marketing passport until fairly late in the fundraising process face problems when seeking to engage with prospective investors in those jurisdictions where AIFMD marketing commences at an *earlier* point in the process. This is because the AIFM requires the passport *prior* to the point at which it is able to apply for it. This creates a ‘marketing gap’ which would not exist if there was a shared view between regulators of when AIFMD marketing commences.

Further divergences are seen at the pre-marketing stage. Certain Member States (e.g. the UK) regulate pre-marketing under their domestic regimes (viewing this as a non-harmonised activity). AIFMs therefore also face a time and cost burden at the pre-marketing stage, assessing which jurisdictions regulate pre-marketing and, where pre-marketing is regulated, what is required.

These issues could be addressed by **recognising 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 that is required to be filed with regulators under the AIFMD marketing passport is made available to investors.**

The possibility to discuss or gauge potential investor interest is important for fund managers to determine whether it is worth incurring the costs of registering the fund and also incurring the ongoing costs. Any limitations to this would restrict our members’ ability to respond and provide investors with an investment solution that meets their needs and also restrict the choice available to investors. The product development process can also be hampered as private equity and venture capital managers typically like to maintain a collaborative relationship with their investors to develop products that will help them achieve their investment aims. They also try to seek a verbal commitment once a product concept has been developed to justify the cost of putting it together.

Given the importance of such pre-marketing to fund managers’ ability to assess investor interest, it is key that any interpretative guidance on the meaning of “marketing” recognises that certain activities (e.g. brand marketing, or investor discussions and negotiations) remain outside the scope of “marketing” under the AIFMD.

‘Marketing’ should not include pre-marketing: it would not offer anything in terms of investor protection and it would be disproportionately burdensome on managers to have to obtain a passport (and produce the documentation necessary to do so) without being able to first ascertain general investor interest.

2. Different methods across Member States for complying with marketing requirements

Another key issue for our members is the lack of clarity and of consistency - and sometimes conflicts - between regulators as to what is considered a “material change”.

The initial marketing notification, followed by 30 days’ notice of planned “material changes”, is inconsistent with, and difficult to apply in the context of, closed-ended funds’ iterative marketing process. Multiple fund closing dates means information such as performance data included in the private placing memorandum needs to be updated over the months, while amendments to the governing document (LPA) as a result of negotiations with investors invariably occur between the first and final closing.

We refer to our response to Question 3.1b for a description of how our members typically approach fundraising. Set out below are the problems they are encountering with the notification process given this approach (more information can be found in the section dealing specifically with the Notification Requirements).

Material change

A planned “material change” to the contents of an initial marketing notification requires one month’s prior notification to the AIFM’s home Member State regulator before ‘implementing’ the change. This creates significant delay and uncertainty for the fund manager. In the closed-ended fund context we consider ‘implementing’ a change to mean closing (i.e. admitting investors to the fund) on the basis of the change.

An unplanned material change requires notification only *after* the change has taken place.

Whilst the term “material change” is used in the marketing context, it is defined only in the context of an AIF’s annual report. In that context, Article 106(1) of the Level 2 Regulation provides that, *“Any changes in information shall be deemed material within the meaning of [Article 22(2)(d) of the Level 1 Directive] if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF, including because such information could impact an investor’s ability to exercise its rights in relation to its investment, or otherwise prejudice the interests of one or more investors in the AIF”* (the “Article 106 test”).

Whilst the Article 106 test does not technically apply in the marketing context, we consider that it sets a sensible basis on which to commence an analysis of whether changes to the information or documentation provided to a regulator as part of an initial marketing notification (which will include the limited partnership agreement) must subsequently be notified to that regulator. Whilst the UK FCA has helpfully expressly adopted this Article 106 test in its AIFMD marketing notification forms, we understand that not all Member State regulators are taking this approach. In Finland, for example, the law does not actually even include the word “material”, i.e. it appears to require *any* changes to be notified.

Although we consider it sensible to apply the Article 106 test in the marketing context (that is, under Articles 31(4) and 32(7) of the Directive), we think the test would benefit from improvements in this context. We consider that a change which is advantageous to investors (such as a reduction in the management fee payable by investors) and/or purely administrative (such as a change of name of an AIF) is not a material change at all for the purposes of Articles 31(4) and 32(7) of the Directive and therefore does not require prior notification to the AIFM’s home Member State regulator.

Adopting this interpretation would not adversely impact investor protection. In addition, it would also minimise disruption to AIFMs' businesses and reduce the administrative burden on Member State regulators. **Unless Member State regulators accept that changes to fund documentation during the negotiation process described above are “unplanned” (and therefore subject only to a post-change notification requirement) or the approach set out here is adopted (our preferred approach), fundraisings will be disrupted by a series of one-month wait periods before closings.** This is frustrating for both managers and investors (the latter will have already agreed to the changes during the negotiation process and will therefore be aware of them) and does not benefit any parties.

Finally, whichever test is adopted it would be helpful if all Member State regulators could adopt the same approach to assessing materiality and whether changes require notification. This would ensure that there is a level playing field across the EU and avoid there being a more onerous regulatory notification burden in some Member States. From a practical perspective, there is a risk of uncertainty for an AIFM if its *home* Member State regulator adopts the Article 106 test but a *host* Member State does not (although, as noted earlier, we consider that the Directive considers the opinion of the *home* Member State regulator to be determinative).

3. Prohibition in many Member States to market to “sophisticated” or “semi-professional” investors

The issue faced by private equity and venture capital fund managers is not so much the different interpretations across Member States of what constitutes a retail or a professional investor but rather the express prohibition in many jurisdictions to market to all types of retail investors, as defined under EU law.

While we recognise - and welcome - these limitations when it comes to small, inexperienced investors (i.e. the genuinely retail investor), the current EU definition set out in MiFID also captures investors with great experience in the industry and/or the companies invested in.

As explained in our answer to Questions 1.2 and 2.1, although many investors in private equity and venture capital funds are institutional investors and will be 'per se' professional clients under the MiFID client classification test, there are a number of high net worth and/or sophisticated investors in private equity and venture capital who, although clearly not typical retail investors, will not meet the requirements to be considered as a professional investor.

Among this 'semi-professional' investor group, a further distinction can be made between “industry experts” (who are “sophisticated” because of their industry knowledge, but may not be ultra-high net worth) and “(ultra-)high net worth investors” (who will have a sophisticated investment programme and usually professional advice/management, but who may not personally have experience of or expertise in the private equity industry).

Against this background, as we expressed in our answer to Question 1.2 and in our [response to the recent Call for Evidence](#), we have welcomed the recognition in EuVECA that not all so-called retail investors are alike and that the binary distinction set within MiFID might impose unnecessary or disproportionate restrictions in some cases. We believe that a similar distinction (between semi-professional investors and the average retail investor) in respect of private equity funds more generally would be welcomed by both fund managers and investors. The same goes for Article 6.2 of EuVECA, which permits marketing to executives (although executives of an AIFM do not really market the fund to themselves). AIFMD should be

in line with this.

The Commission should develop a definition of sophisticated (or “semi-professional”) investors, for example based on the existing wording in the EuVECA Regulation, in order to allow investments of knowledgeable and experienced high net worth individuals into the asset class. More concretely, **removing the MiFID quantitative requirement for a minimum number of transactions and introducing a simple minimum wealth level or minimum investment threshold** (such as the one set in Article 6.1 of EuVECA) **would widen the scope of the AIFMD marketing passport, ease fundraising and fit the realities of private equity**. This would not damage investor protection since there would still be the requirement to ensure that the investor had appropriate knowledge and experience to understand the risks involved.

While high standards of protection are necessary for retail investors, use of the MiFID definition in a private equity context will in many cases prevent fund managers from being able to access these experienced investors - and in turn prevent these investors from investing their capital and expertise in these funds and in the businesses they support.

In addition to ensuring that the passport provides access to a larger investor base with genuine knowledge and expertise and who have a record of investing in the asset class, it may also address some of the restrictions applying to non-professional investors in national legislation. For example, in Finland, there are some restrictions relating to non-professionals, perhaps the most significant being that a sub-threshold AIFM may not market its AIFs to non-professionals (unless the Finnish FSA grants an exemption).

This is an issue that goes beyond the AIFMD because, as mentioned above, the definition of “professional client” in MiFID is often adopted by cross-reference into other legislation, with insufficient tailoring for the different nature of other asset classes such as private equity.

Question 3.3 - Have you seen any examples of Member States applying stricter marketing requirements for funds marketed cross-border into their domestic market than funds marketed by managers based in that Member State? Please explain your reply and provide evidence.

Yes. For entities regulated under the AIFMD, stricter marketing requirements imposed by Member States are mostly related to **gold-plating and/or inconsistent implementation of the AIFMD framework**. These examples are referred to in the various parts of this response.

- One of the key concerns raised by Invest Europe members in this respect is the impossibility for AIFMD sub-threshold fund managers to market under the national private placement regimes into Denmark and the Netherlands. Indeed, neither of these countries allows non-domestic sub-threshold fund managers (i.e. sub-threshold managers based in another EU country) to market into their domestic markets.
- In Germany, the introduction of the notion of equivalence for marketing by sub-threshold fund managers has led to a catch-22 situation. More concretely, EU sub-threshold AIFMs may use a simplified marketing notification procedure with the German regulator (BaFin) but this procedure requires, among others, a confirmation of the registration status of the AIFM in its home member state and reciprocity. ‘Reciprocity’ means that the home member state must allow the marketing of AIFs managed by a German sub-threshold manager without imposing stricter requirements than Germany. Such reciprocity is currently recognised for instance with regard to the UK and Luxembourg,

but not with regard to Austria, Belgium or Sweden. In such countries a German sub-threshold manager could market under the same requirements as domestic sub-threshold managers; but given that those requirements are different from the German requirements under which an EU sub-threshold manager could market in Germany, the reciprocity is not recognised.

As explained in more detail elsewhere in this submission, in the light of implementation of the AIFMD and EuVECA passport regimes NPPRs continue to play an important role in private equity and venture capital fund marketing in Europe because:

- (i) opting in to the full (and - by definition - disproportionate) AIFMD regime is unlikely to be attractive for very many in light of the costs it entails.

Indeed, requirements for full-scale authorisation under the AIFMD ‘opt-in’ procedure are extensive and risk imposing a barrier to entry and a reduction to investor returns, particularly if the costs (many of which are fixed) cannot be spread across a high level of funds under management.

- (ii) although smaller fund managers could in principle apply for the parallel EuVECA passporting regime, the current EuVECA’s eligibility requirements/criteria in reality mean that many of these managers cannot use this marketing label as their specific investment strategy prevents them from qualifying. (Though we welcome the Commission’s recent proposals in this regard).

Private placement is therefore essential to enable smaller EU managers and EU institutional investors to be able to connect, enhancing investor choice and competition amongst managers.

However, cross-border marketing by sub-threshold funds/AIFs under the NPPRs has, post-AIFMD, become increasingly difficult due to the tightening and even abolition of the NPPRs. With the abolition of such regimes in certain Member States many small fund managers who are below the AIFMD threshold are simply denied *any* access to such markets and investors denied the ability to invest in such funds. They are, *de facto*, facing discrimination, being subject to stricter requirements than equivalent fund managers based in that Member State.

A **voluntary** passport for sub-threshold fund managers, with proportionate regulatory obligations (e.g. lower capital requirements, no depositary, etc.), would be one way to solve this issue. These small funds should be provided with a mean to market across EU borders, as failure to do so undermines the objective of establishing a single market for capital. Fund managers who do not need to be authorised under the AIFMD do not pose systemic risk (which is the justification for them not requiring full AIFMD authorisation), are not likely to pose a higher degree of risk for investors than venture capital funds, and would still only enjoy a pan-EU passport to market to “professional investors” (and not to retail investors). Since development and growth finance are as important for the EU economy as start-up capital, an internal market passporting regime should be made available to these fund managers as well. More details on NPPRs and the voluntary passport can be found in our response to Question 10.1.

Question 3.4 - Are domestic rules in each Member State on marketing requirements (including marketing communications) easily available and understandable? Please provide details and specify in which Member State(s) the rules are not easily available and understandable and why.

No. This concerns all EU countries except Bulgaria, Germany, Ireland, Luxembourg, Poland, Spain, the



Netherlands and the UK.

The problem does not lie with the availability of the information but rather its **complexity**, the **variety of interpretations** that can arise and **other practical matters**, which require local legal advice to be sought. **Language** may also be an issue. For example, in the Netherlands, the information is only available in Dutch and is not readily available to the fund manager.

As a result, standard practice in the industry is that fund managers rely on legal advice to confirm whether or not it is possible to approach investors. This results in material additional costs, and still leaves a residual uncertainty as to whether marketing is in accordance with regulators' expectations.

Question 3.5 - When you actively market your funds on a cross-border basis to **retail investors/High Net worth retail individuals/Professional investors** do you use marketing communications (Leaflet, flyers, newspaper or online advertisement, etc.)?

Yes, with specific qualifications.

Evidence shows that while marketing communications in paper form are used in the vast majority of cases it should be noted that information of any kind is **only distributed to professional/high net worth investors who have some existing connection to the manager** (such as individual members of the manager's team, Chairmen of the investee companies in which the manager's previous funds have invested, etc.). Private equity funds are not "advertised" in the press or in any generic fashion to individuals unrelated to the specific fund manager.

A private equity fund will typically be marketed on a private placement basis, so general advertising (flyers, adverts, etc.) are very rarely used. Investors are typically approached on an individual basis, and will generally involve face-to-face meetings or presentations in addition to the provision of detailed marketing and due diligence information through a secured website with restricted access.

The relationship between a fund manager and its investor in a private equity fund context is further detailed in responses given by investors into the funds, in particular Question 3.11.

Question 3.5b - To what extent are marketing communications important in marketing your funds to retail investors, high net worth individuals and professional investors? Please explain your answer.

As explained above, our members consider that targeted marketing communications are generally extremely important, but general advertisements or untargeted marketing communications are rarely used.

It should be noted, however, that although targeted communications are crucial, they are mostly used as formal provision of information to individuals connected to the manager who will generally already have deep knowledge of the manager and its business. In addition, they precede long negotiations leading to the creation of a "limited partnership agreement", which defines the commitment of the investor into the fund and the distribution of returns at its close.

In a private equity fund context, the fund managers' relationship with their investors is a privileged one and a face-to-face meeting is often seen as a prerequisite for the investor before it invests into the asset class.

Given the size of the investment that they make into a fund, investors - whether institutional or 'sophisticated retail' - do not take investment decisions lightly.

Question 3.15 - Do you consider that rules on marketing communications should be more closely aligned in the EU? Please explain your answer - and if appropriate, to what extent do you think they should be harmonised?

Yes, provided that the harmonised rules are reasonable and practicable, in particular permitting pre-marketing activities and described in detail previously, such as negotiation of terms, without restriction (acknowledging that *subscriptions* could only be permitted following a marketing filing). Care would be needed to ensure that any such harmonised rules did not make marketing of private equity funds more difficult or practically impossible owing to the need to negotiate the terms heavily throughout the marketing process.

Question 3.16 - Is there a case for harmonising marketing communications for other types of investment products (other than investment funds)? Please explain your reply and what should the other products be?

N/A.

Question 3.17 - What role do you consider that ESMA - vis-à-vis national competent authorities - should play in relation to the supervision and the monitoring of marketing communications and in the harmonisation of marketing requirements? If you consider both should have responsibilities, please set out what these should be.

Each European market is different and there can be legitimate reasons for national regulators to take different approaches in certain areas, but the breadth of divergence around the concept of "marketing" requires some level of intervention by the European regulator.

ESMA should investigate the rationale behind the various marketing regimes across the EU and analyse the costs and benefits of these differences. It should provide a forum for supervisors to exchange views, with the general objective of facilitating fund managers in marketing their funds across borders (thus promoting competition in the EU, which is to the benefit of EU investors) and ensuring no investors are deprived of the opportunity to invest simply as a result of the Member State in which they are based. Over the medium term, ESMA could take a more active advisory role in promoting soft convergence between supervisors, taking into account the peculiarities and interactive nature of the private equity fundraising process compared to strategies of other types of market players.

Where there is evidence that particular Member States' approaches have the effect of discriminating against market participants in other jurisdictions there may be a case for ESMA (or the Commission) to consider enforcement action.

Question 3.18 - Do you consider that detailed requirements - or only general principles on marketing communications - should be imposed at the EU level when funds are marketed to retail investors? Please explain your reply.

We have no specific comments to make on this point as private equity and venture capital funds are not marketed to 'retail' investors. However, we would like to use this opportunity to remind the European Commission that many categories of sophisticated investors are currently deemed retail investors under EU law. If detailed requirements for retail investors were to be imposed at EU level, legislators should take into account that they would also apply, under current EU definitions, to investors who have an in-depth understanding of the funds they invest into (see our responses to Questions 1.1 and 1.2 for more information).

Question 3.19 - Do you consider that the requirements on marketing communications should depend on the type of funds or the specific characteristics of some funds (such as structured funds or high leverage funds) when those funds are marketed to retail investors? Please describe the specific requirements. Please describe the types of products which should have additional requirements on their marketing and their specific characteristics.

In this context, we think it is crucial to differentiate between sophisticated and/or high net worth investors and 'true' retail investors. In general, sophisticated and/or high net worth investors will be able to differentiate between different types of products and their related risks (or will be able to afford sophisticated advice on the point), whereas 'true' retail investors may require additional protections.

As noted above, it is important to recognise the difference between the marketing process for a highly negotiated alternative investment fund and that for a more standard financial instrument or product.

Question 3.20 - Do you consider that detailed requirements - or only general principles on marketing materials, at the EU level - should be imposed when funds are marketed to professional investors only? Please explain your reply.

In general, we consider that current requirements are sufficient (and in many cases already go beyond what is necessary) to afford professional investors appropriate information about the fund being marketed. We do not consider that imposing additional detailed requirements would be justified or proportionate. If additional requirements are considered necessary, only general principles on marketing materials should be imposed at EU level and Member States should have only very limited - if indeed any - right to impose additional requirements.

Questions for LPs

Question 3.11 - To what extent do marketing communications play a role in your investment decision?

Feedback from investors into private equity funds showed that marketing communications play an important role in their investment decision - none of our members felt that they had no importance at all. Depending on the investor, marketing communications can be considered as essential or simply as useful documents. But again it is important to note that what is defined as “marketing communications” is more generally regarded by investors as just one element of the information that feeds into their due diligence process to be analysed, challenged and tested. These are experienced investors who will not take decisions on the basis of such information alone.

While marketing communications play a part in the investment decision, in practice investors into private equity often demand more detailed and tailored information from the fund managers with whom they are considering investing. **It is standard practice for the investor to undertake long and detailed due diligence before deciding whether or not to invest in a fund.** This will include gaining an understanding of the fund management team’s capabilities, experience, resources and its ability to create value. Investors will screen the private equity market for good opportunities and build long-term relationships with fund managers through face-to-face meetings and on-going interaction.

The information gathered during this due diligence process goes far beyond that contained in a standard investment prospectus or marketing document. Marketing communications thereby can act as an initial motivation for the investor to meet with the fund manager. But the final decision to invest will come as a result of a much longer and more detailed assessment of the fund and the management team. For investors who have previously invested with the manager it is slightly less material to their due diligence process, simply because much of the general information contained in it will already be known to them. It is also worth noting that the development of what information needs to be included in marketing material over the years within the private equity industry has evolved as a result of the interaction between investors and managers on what sort of information investors need in order to be able to best conduct their due diligence.

Do you consult marketing materials before making your investment decision?

Yes.

Question 3.11.a - Please explain your answer.

Marketing materials are always consulted. None of the investors into private equity and venture capital that we surveyed responded that they did not consult these documents.

Question 3.12 - Do marketing communications you receive provide you with a balanced view of the up and downsides of a particular investment? Do they contain meaningful information to assess risk?

Invest Europe’s investor members believe that marketing communications represent a useful tool, which contains important information to assess the risk of the investment and its appropriateness to their needs.

However, investors into private equity generally require much more detailed information from the fund manager as part of their due diligence and investment decision-making process and before reaching a detailed and legally binding agreement (the so-called “limited partnership agreement”). See also Question 3.11.

Question 3.13 - How important is it for you to have marketing communications in your national language?

A large majority of investors into private equity and venture capital funds consider that either English or their national language is sufficient.

Question 3.14 - How relevant is the disclosure of the following information in the marketing communications? (from 1 to 5, 5 being the most relevant)

- The asset management company: 5 (Highly relevant)
- Price: 5 (Highly relevant)
- Costs: 5 (Highly relevant)
- Past performances: 5 (Highly relevant)
- Future potential performance: 4
- Performance of the benchmark: 4
- How to get additional information: 4
- Specific risks: 4
- How to make a claim: 3
- How to get your money back: 3
- Information on tax treatment of income distribution by the fund: 4

If possible, please explain further what are the most important marketing communications for you?

As explained above (Question 3.11), marketing communications contain information, which is only part of the investors’ decision to invest into a private equity fund. The investor will also look at a range of different factors (some of which may be specific to that investor) and request further information based on their own due diligence process and on issues which may only arise in the course of the investor’s due diligence on the fund, before an investment decision is made. The marketing document should mostly contain a clear articulation of the product, the value proposition and some sense of the risk and return. Specific discussions between the individual investor and the fund manager are a key part of the due diligence process.

COSTS

EXAMPLES OF EU AND LOCAL COSTS FACED BY FUND MANAGERS (Question 4.1)

General messages

- It needs to be borne in mind that negotiation costs will vary very much from one fund to another, and percentages/proportions will also depend and vary per fund size.
- Furthermore, operational expenses (including depositary, administrator, regulatory fees) tend to be borne by the fund.

Concrete examples

Implementation of the AIFMD has not been consistent across the EU. Market participants operating on a cross-border basis must often comply with both EU-wide and additional local requirements. One such example relates to the depositary requirement.

1. Depositary Costs in the context of the AIFMD passport

- One of the most significant additional costs that fund managers now face 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 the investor protection implications of such AIFMD obligations as the requirement to appoint a depositary¹.
- Notwithstanding these doubts about the depositary provision the costs that fund managers, and ultimately investors, bear are increased further by **the absence of a passport for depositaries**. Ideally (and in a well-functioning Capital Markets Union), there should not be an obligation to appoint a depositary that is located in the *same* Member State as the manager; managers should be able to benefit from the efficiencies and other benefits that would flow from being able to choose freely from amongst depositaries located across the EU. In smaller Member States with few managers and/or funds the inefficiencies are particularly acute.
- These costs are compounded by the AIFMD requirement for a manager to employ a depositary in *each* Member State in which it has set up a fund, denying the manager the opportunity to achieve economies of scale by appointing a single depositary.

In addition, certain Member States have, as part of the AIFMD implementation process, added new and more onerous requirements to their NPPRs (obligations which in some cases go beyond the AIFMD requirements for third country fund managers).

¹ In a survey of institutional investors carried out by the Institutional Limited Partners Association (ILPA) more than 50% felt that AIFMD had had either a 'Somewhat Negative' or 'Extremely Negative' impact on investor protection.

2. Ongoing compliance and operational costs under National Private Placement Regimes (NPPRs)

- AIFMs which have registered under a NPPR must comply with certain ongoing obligations following registration. For above-threshold managers these obligations include making available to investors in the relevant AIF an AIFMD-compliant annual report, filing periodic reports with the regulator and complying with Articles 26 to 30 of the Directive (which set out the asset stripping and notification/disclosure obligations which apply to AIFMs when their funds acquire control of/holdings in certain EU companies).
- Where the non-EEA AIFM has registered under multiple NPPRs it must comply with these requirements in each jurisdiction. The AIFM must, for instance, file ‘Annex IV’ periodic reports and notifications required under Articles 27 and 28 of the Directive with each Member State regulator and must comply with each Member State’s interpretation of the applicable requirements. As a result, AIFMs incur significant costs and suffer an onerous administrative burden in order to ensure that they satisfy their regulatory obligations across the EU. EEA AIFMs by contrast only need to file materials with a single regulator.

Furthermore, there is **no harmonisation on the procedures for submitting Annex IV reports**, which means that non-EEA AIFMs have to use **different reporting forms and online submission platforms** to submit reports in different EEA jurisdictions, resulting in a significant and unnecessary increase in ongoing compliance costs. This has also resulted in the rather unusual result that non-EEA AIFMs (not subject to the full Directive) are subject to a higher compliance burden than EEA AIFMs (subject to the full Directive) in this respect.

It is **time-consuming and costly for firms to comply with a patchwork of local implementing laws**, which often differ in their detailed requirements. A single registration/filing hub, managed by ESMA and to which Member State regulators would have access, could resolve many of the issues described above. Such a hub would be most effective if it permitted AIFMs to file a single NPPR registration and submit only one version of any Annex IV report or notification required to be made under Articles 27 or 28 of the Directive.

Whilst we acknowledge that the implementation of such a hub would require Member State regulators to agree on the interpretation of applicable parts of the Directive, we would strongly encourage regulators to seek to reach common views even prior to the implementation of any such hub in order to increase legal and regulatory certainty for third country managers and funds. (Such agreement, particularly on the scope and application of Articles 26 to 30 of the Directive, would also benefit EU managers and funds.)

Examples of compliance costs arising from legal fees involved with registering a non-EEA AIF managed by a non-EEA AIFM under certain European NPPRs

The amounts below are estimates of the cost of hiring legal counsel in each of the following jurisdictions to complete the relevant notification form and to undertake the filing with the local regulator (registration requirements differ between each jurisdiction). Any additional work (e.g. dealing with queries from the local regulator; commenting on or translating any documents; and, in the case of Austria, Denmark and Germany, appointing a depository) are not included in these costs and will be billable separately.

Austria: €6,000-€7,000
 Belgium: €1,500
 Denmark: €6,000
 Finland: €4,000-€6,000
 Germany: €12,000-€15,000
 Ireland: €2,000
 Luxembourg: €2,500
 The Netherlands: €2,500
 Norway: €5,500
 Sweden: €3,500
 United Kingdom: €6,000-€8,500*

Please note that all of these figures exclude VAT and any local counsel disbursements (to the extent applicable) and the non-EEA AIFs to be registered are not an umbrella AIF with sub-funds.

** UK counsel's fee estimate includes assisting the non-EEA AIFM's fund counsel with drafting the investor pre-transparency wrapper, completing the appropriate registration form and filing it with the FCA.*

If the non-EEA AIFM's counsel is required to coordinate registrations under a number of different NPPRs then they will likely incur additional coordination fees. These are set between around €11,000 and €27,000 in the UK.

3. Costs arising from divergent local requirements under AIFMD and different interpretations/implementation of the AIFMD

As mentioned above, there are material inconsistencies in the ways in which different Member States have implemented the AIFMD. The costs of operating under the NPPRs will inevitably vary significantly depending on the number of jurisdictions an AIFM has/or is potentially planning on marketing to. In any case, it is fair to say that the differences and fragmentation necessitate taking relatively expensive (legal and other professional) advice whenever 'marketing' may be deemed to take place within a particular Member State.

Amongst the divergent requirements in certain Member States (and therefore key issues that AIFMs seeking to use private placement are facing) are:

- A requirement, in effect, to comply with the whole of the AIFMD in respect of the third country fund and its manager.
- A requirement for staff of the manager to pass examinations which can be undertaken only in the local language.
- Variety in the conditions that Member States impose and which must be met for private placement to be permitted, such as the requirement in Denmark for letters assuring reciprocity of market access.
- A requirement to appoint a depositary in respect of a third country fund. In some cases, this can be inconsistent with the custody rules applicable to the fund under its local laws or rules.
- A requirement to provide confirmation from the regulator in the jurisdiction of the third country fund that there is reciprocal market access. Few regulators in significant markets are willing to make the requisite assessment, let alone provide such confirmation.
- Local elaboration on the transparency requirements concerning remuneration of the staff of the AIFM, going beyond Article 42 AIFMD.

- Insufficient priority given by many national supervisors to the processing of applications, which introduces significant delays to fundraising. This in turn has consequences for the speed with which funds can begin the process of investing - the longer it takes to fundraise the longer it will be before the capital can be invested in the portfolio company.
- Differences between the expectations of Member State competent authorities about the approach to certain of the pre-investment transparency obligations required under Article 23 AIFMD, and minor variations in the data fields required to be completed as part of reporting on the activities of funds under Article 24 AIFMD (see above).

4. Costs charged in the context of the EuVECA passport

The barriers and disincentives that many Member States have put in place whilst implementing the EuVECA Regulation represent good examples of how the intentions of EU legislation to *remove* barriers to cross-border flows of capital may not be realised in practice. For example, while in some Member States the registration requirements are moderate and manageable, in other countries **the time, costs and administrative burden** associated with registering a small venture capital fund are not only too onerous but also a heavy burden for most managers of EU venture capital AIFs.

While it will ultimately be up to each manager to carry out a cost-benefit analysis in relation to the timing of compliance, we generally consider these costs to be obstacles to setting up a EuVECA fund and do not agree these costs are proportionate for smaller fund managers.

Ensuring that the EuVECA Regulation (which by definition is directly applicable EU law) is applied consistently and appropriately across Member States remains vital. Reducing incoherence and inconsistency will give smaller funds a better opportunity to make use of the EuVECA passport and to fundraise cross-border under this label. The more requirements are added by Member States and the greater complexity these generate, the less attractive the regime will be for the small fund managers at whom this regime is aimed.

National examples of Member States imposing additional, onerous registration requirements that were not foreseen by the Regulation itself

- The additional organisational requirements imposed by the German competent authority (BaFin) are substantial (the process in Germany is more akin to a full authorisation) and are only accepted because otherwise there is no alternative to market for small fund managers. However, not all managers can afford these costs and so some venture capital funds simply refrain from cross-border marketing, so depriving investors of the opportunity to invest.
- In Italy, the legislative framework for implementation of AIFMD has not provided a lighter regulatory regime for sub-threshold managers. As a result, *all* national AIFMs, including sub-threshold managers, are required to be authorised by the supervisor and to comply with the same organisational, structuring and supervisory requirements (there are certain limited exemptions for sub-threshold managers).

More specifically, in Italy a venture capital fund manager wishing to use the EuVECA designation/passport must comply with the full set of obligations and operational, organisational and

transparency requirements under the AIFMD, including in relation to portfolio composition, and regarding borrowing, delegation, conflicts of interest and valuation.

These requirements impose additional costs on the setting up of such funds linked to:

- the authorisation process, including legal and advisory costs;
- the arrangements needed for the appointment of a depositary; and
- initial marketing notification and documentation.

As a result, setting up a EuVECA fund in Italy is more expensive than in other European jurisdictions.

- Other countries (e.g. France) take a similar approach and require full-scope AIFMD authorisation, completely obviating any benefit of the EuVECA regime.
- In other countries like Finland, managers have been facing local “fit & proper” requirements which were not clear at all and took some time to resolve.
- In Luxembourg, registration requirements are also perceived as a barrier. Inappropriate requirements include high minimum capital requirements (see below), high registration and marketing fees, the requirement to set up a local IT infrastructure or to use local service providers (rather than as opposed to well-known international providers of cloud services), the requirement to hire an external auditor for the manager, and finally the separation of roles for micro entities.

Moreover, the requirements are to a large extent aligned to the requirements of the AIFMD, especially in terms of human resources (segregation between portfolio and risk management), own funds (see below), infrastructure (including IT) and audit requirement at manager level (with annual costs of around €20,000).

Capital Requirements

In practice national regulators interpret the requirements for minimum own funds differently and as a result, the level of own funds requirements differs from Member State to Member State (and as such, the appropriateness and proportionality of such requirements varies, creating an uneven competitive environment).

We understand that there are or have been discussions in certain Member States about imposing high capital requirements, along the lines of those required under the AIFMD, on venture capital fund managers using the EuVECA label.

- In Germany the manager is required to retain $\frac{1}{4}$ of the average yearly overhead costs.
- A similar case can be observed in Luxembourg, where the own funds requirement currently amounts to €125,000.
- In Denmark the own funds requirement totals $\frac{1}{8}$ of the costs for the preceding year, which is considered to be reasonable.
- In Ireland, under certain circumstances the $\frac{1}{4}$ can be reduced to $\frac{1}{8}$ of the yearly overhead costs.

REGULATORY FEES

IMPORTANT CAVEAT

Private equity invests over the long term with a typical fund having a ten-year life. Consequently, some managers will only raise new funds every 3-5 years and many fund managers will not yet have raised a fund under the AIFMD and so will not have experience of its full impact on their operations. It therefore remains difficult to provide an authoritative assessment of the Directive's impact on the costs to fund managers of setting up and marketing funds across the EU.

Nevertheless, it is clear even at this stage in the Directive's life that certain of its provisions impact adversely on fund establishment and marketing, i.e. capital raising and its application.

Question 5.1 - Does the existence and level of regulatory fees imposed by host Member States materially affect your distribution strategy?

Yes. Fund managers have become more selective about which Member States in which to set up parallel partnerships and, especially in relation to pre-marketing, will not want to incur fees where no ultimate marketing will take place.

Several Member States impose additional fees and charges on AIFMD-authorized EU fund managers not based in their country, thereby reducing access to market in a significant part of Europe, including larger markets such as Germany, France, Spain and Italy. Austria, Belgium, Croatia, Czech Republic, Denmark, Estonia, Finland, Latvia, Luxembourg, Malta and Poland also charged host fees. Similar local registration and/or supervisory fees are being imposed on smaller fund managers under the EuVECA Regulation in most of these countries (see Annex 1 and Annex 2 for more details).

Although the costs of such fees may appear relatively low compared to overall marketing costs (including legal costs, placement fees, etc.), they can end up being substantial given how most private equity and venture capital funds are structured (see our response to Question 5.2). As such, they constitute an additional burden, which may act as a serious disincentive for a fund manager, especially a small one, to market across the whole Single Market. Even larger managers have been surprised at the aggregate level of fees incurred when marketing across multiple jurisdictions, especially as the funds often comprise multiple parallel partnerships, thereby multiplying the fees charged for essentially the same product.

In light of this, it is no surprise that **more than half of our members indicated that they are avoiding some countries because of the fees charged**, including larger countries such as France and Italy. When the anticipated investor demand is relatively low (which will often be the case in smaller Member States), the existence of even a small fee will be sufficient for the fund manager to avoid that Member State completely (thereby limiting the range of options open to investors in those jurisdictions). The impact of such charges is particularly acute where annual fees are levied.

It is also not always clear whether jurisdictions expect a fee to be paid: (a) only during each year that marketing takes place; or (b) even after marketing has ceased but where there are still investors in the fund in that jurisdiction. (For private equity and venture capital funds, there is no marketing after 'final close' - broadly, the point after which no new investors can be admitted to the fund). Some Member State regulators

have implied in correspondence with our members that fees would cease to be due *only* if the AIFM cancelled its marketing passport, but the position remains unclear and there are divergent approaches.

Where an AIFM has been granted a marketing passport by its home Member State regulator, we consider there to be **no legal justification** under the AIFMD for any additional restrictions and/or requirements to be imposed on the AIFM by the host Member State regulator. Not only are we concerned about the legality of such practice, but we are also concerned about the long-term and potentially significant adverse impacts that this may have on market participants' behaviour and the operation of the single market.

The same goes for the host fees that are being charged under the EuVECA regime. Such fees are particularly significant for smaller venture capital firms for whom the imposition of additional fees tends to be felt more acutely. Local marketing fees discourage managers from marketing a fund in the whole EU and for many sub-threshold AIFMs seeking to market in only one or a few Member States, the cost of compliance may be higher than the benefit of the EuVECA passport.

Irrespective of whether (or not) a fee affects the marketing strategy of a fund manager, in a Capital Markets Union a fund manager that is fully compliant with the relevant EU law (particularly when it is a Regulation that has direct effect, as in the case of EuVECA and ELTIFs) and that is 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, even minimal, undermine the concept of a Capital Markets Union and remain an unwarranted barrier to the single market and to cross-border marketing, not only for their cost *per se* but also for the administrative burden they create.

It should be made explicit that there are no circumstances under which national competent authorities retain the right to impose additional obligations.

Question 5.2 - In your experience, do any Member States charge higher regulatory fees to the funds domiciled in other EU Member States marketed in their Member State compared to domestic funds? Please explain your reply and provide evidence.

Yes. For an overview of *home* fees being charged by EU Member States, please see Annex 1.

It is important to keep in mind that any *host* fees need to be paid in addition to the *home* national registration costs and any legal and other professional advisory fees. For more detailed information on the level of such host fees, and whether they are charged on a one-off and/or ongoing basis, we invite the Commission to review the summaries of the fees charged in the context of AIFMD and EuVECA in Annex 1 and Annex 2.

Even if the cost per annum may seem relatively low, it can become much more significant if taken into account for the whole life of the fund. It is important to consider in this respect that very few, if any, private equity funds are structured as umbrella funds with sub-funds. It would be more typical for private equity funds to be structured as a series of parallel limited partnerships (perhaps six or seven), each of which is itself an AIF. Each limited partnership will have slightly different characteristics to suit the needs of investors in different jurisdictions. By way of example, it has been common in the past for UK-based AIFMs to use English limited partnerships with a parallel German KG for German and Austrian investors. There may also be limited partnerships denominated in different currencies (e.g. EUR and USD) to fit the



preferences of the funds' investors.

Each limited partnership is an AIF, so where fees are charged on a 'per-AIF' basis, and where funds are marketed into a number of Member States each of which is imposing fees or charges, the total fees incurred can be substantial. For example, the French authorities charge €2,000 per *annum* per *sub-fund*. Managing five sub-funds over a 10-year period - the standard minimum life-span of a fund in the private equity world - will therefore cost €100,000 in total, an amount that is far from being insignificant for a manager. And this is only one Member State; AIFMs would usually spread their marketing strategy over several countries.

Furthermore, this is before indirect costs such as the management cost of attending to the administration involved and the cost of payment transfers are included.

These fees and charges clearly add and could have the effect of unintentionally increasing the cost of investing for investors, for example if such fees are being recouped as a direct fund cost or indirectly out of a higher management fee.

Question 5.3 - Across the EU, do the relative levels of fee charged reflect the potential returns from marketing in each host Member State? Please explain your reply and provide examples.

No. It appears there is no correlation between the level of the fee and the potential return.

Among the 30 fund managers who responded to our survey, no one considered that the fees reflected the potential returns from marketing in each host Member state. Our understanding is that annual Member State fees for one fund range from €1,000 to €5,000 depending on where the fee is charged, while the potential returns from marketing will differ much more significantly depending on the host country.

For example, Spain imposes a €2,500 registration fee while Malta's notification fee for one fund is €2,450. To take two extremes, the UK and German authorities, who are supervising markets of a broadly similar size charge respectively an entry ticket of £250 and €6,582 to third country fund managers marketing under the national private placement regimes. Further examples of Member State fees and charges can be found in Annex 1.

The lack of any correlation between the level of fees being charged by a supervisor and the fundraising potential of its market creates a situation in which smaller Member States risk being completely unattractive to fund managers: the fee imposed is not justified by the funds that might be raised.

In summary, the imposition of such fees - which can be substantial - is acting as a disincentive to managers to market their funds. **This issue is felt most acutely where the investor base in the host Member State is comparatively small and these additional regulatory costs are disproportionate to the perceived fundraising potential.** As a result of this practice, investors in those Member States risk having fewer investment opportunities open to them or facing higher costs to access opportunities where they remain available. Such practice is therefore likely to lead to distortion and fragmentation of the market.

Question 5.8 - Where ongoing fees are charged, are they related to use of the passport?

Generally yes. Member States imposing host fees on fund managers for the use of the passport do not always justify or give the reason behind that. When they do so, however, for example in France and Croatia, fees are deemed to be there to “compensate” for the cost of supervision.

More information on the justification given by competent authorities for imposing such fees under the AIFMD and EuVECA regimes can be found in Annex 1 and Annex 2.

Question 5.9 - Do differing national levels of, and bases for, regulatory fees hinder the development of the cross-border distribution of funds? Please explain your answer.

Yes, please see our answers to the previous questions in this Section.

An additional challenge with these ‘host’ fees and charges is that they have made fundraising uncertain because there is a **patchwork of different approaches around the EU** which changes over time.

It is therefore important that the EU prohibit the practice by some ‘host’ Member States of imposing additional fees and charges and/or additional requirements on EU fund managers looking to use their passport to market in that jurisdiction. These additional costs are an impediment to cross-border marketing and are already causing some fund managers not to market in certain jurisdictions; the removal of such additional requirements would bring immediate advantages.

Where an AIFM has been granted a marketing passport by its home Member State regulator there is no legal justification under the AIFMD for any additional restrictions and/or requirements to be imposed on the AIFM by the host Member State regulator. In a meaningful Capital Markets Union a fund manager that is fully compliant with the relevant EU law and that is in possession of a valid passport should be free to market across the EU.

The same rationale applies to the application of the EuVECA Regulation. In this respect, we welcome the European Commission’s recent proposed revisions to the EuVECA Regulation, which clearly prohibit the imposition of such host fees and charges by national regulators.

Question 5.10 - On who are regulatory fees charged: managers or funds? Please describe if there are different practices across the EU.

Fees (including marketing registration and regulatory fees) are generally imposed on/charged to the fund *manager* (albeit often calculated on the basis of the *fund*) but are generally being charged as a fund expense, i.e. borne by the fund, which ultimately negatively impacts the return to investors. Whether fees are effectively on-charged as a fund expense is a matter for negotiation between the manager and the investors.

There are different justifications across the EU for such charges: some Member States will charge a fee for examining the request for authorisation (Belgium, Luxembourg), some for processing the application (Croatia, Finland), some for the marketing and management of the fund (France) and some for a combination of these factors (Germany). For more details, we invite the Commission to review the summary of fees charged in the context of AIFMD and EuVECA in Annex 1 and Annex 2.



ADMINISTRATIVE ARRANGEMENTS

Question 6.5 - Do you consider that the administrative arrangements should differ if the fund is marketed to retail investors or professional investors?

Yes.

Questions for LPs

Question 6.9 - Have you experienced any problems in obtaining information on, and investing in, foreign EU funds?

No. Although it should be noted that this may be due to the fact that most of the investors who responded have probably not had the issue of EEA AIFMs not marketing in their country and so they will not have had a problem investing in EEA funds.

Question 6.10 - Which facilities do you deem necessary to invest in EU funds domiciled in another Member State?

The **neutrality of investment across borders** is crucial for the investor. As long as such neutrality is maintained, there are no specific facilities that are required to invest in EU funds.

Furthermore, institutional investors do not see the need for local agents or other entities as that would only make the process costlier.

Question 6.11 - What are your main problems when investing in funds domiciled in jurisdictions other than your jurisdiction of residence?

Local regulatory and tax practices cause significant problems. In order to invest into a foreign jurisdiction, the investor needs to consider the high costs resulting from advice from external counsel to comply with national regimes. Taxation, and in particular withholding tax, is a particular concern.

The closure of national private placement regimes in certain countries (see our response to Question 3.3) reduces the universe of available investment opportunities and limits choice. It also constrains opportunities to diversify and reduce risk and - critically - hampers the ability to invest in those funds which are felt to provide the best potential for returns.

While it is possible for the investor to contact the fund manager on their own initiative, this requires time and effort they may not be able or prepared to make. In the countries where national private placement regimes were switched off, the margin of manoeuvre for investors is reduced, as fund managers are deprived of access to those markets.

Question 6.12 - Are language differences an important issue?

Language differences do not seem to be a major issue for institutional investors, provided the fund manager is able to produce marketing documents in English. It is nonetheless true that some investors and managers, especially smaller teams, will not investigate some markets due to the language barrier.

Question 6.13 - Which kind of information do you need when making transactions on EU funds domiciled in another Member State?

As the information required from fund managers is already heavily detailed, there is not much more information required when it comes to cross-border transactions. Many of our respondents therefore explain the information will be the same as for domestic funds. However, an investor will also require, as detailed above, information on local rules, in particular regarding taxation.



NOTIFICATION PROCESS

IMPORTANT CAVEAT

Please note that we have responded to this section from a pure private equity and venture capital perspective, focusing on our members' experiences with the notification requirements under the AIFMD and EuVECA regimes.

Question 8.4 - Do your clients have difficulties with the AIFMD notification process? If yes, please describe these difficulties.

Yes. The **lack of harmonisation between national rules** and the **length of the procedures** are cited by our members as reasons for the difficulties they are facing. The **lack of experience of the regulators** is also seen as a concern.

To get a better understanding of the issues faced by our members, it is important to distinguish between EU fund managers who are marketing under the AIFMD passport (Article 32 AIFMD) and non-EU fund managers marketing under the national private placement regimes (Article 42 AIFMD).

A. AIFMD EU internal market passport (Article 32 AIFMD)

Issue 1: An over-regulated process for raising institutional funds

In order to raise a new fund, an in-scope EU AIFM must file with its home Member State regulator: (1) a complete list of all limited partnerships which will constitute the fund (even though certain investors may subsequently make special requests for additional limited partnerships); (2) a fully-developed private placement memorandum (PPM) including, or appending, pre-investment transparency disclosures mandated by the AIFM Directive; (3) a near-final long-form version of its limited partnership agreement (LPA); plus (4) a number of regulatory forms.

Following submission, the AIFM may face questions from the regulator. The firm must also wait one month (or up to two months in exceptional circumstances) for the regulator to approve marketing of the fund. Until approved, the manager has no “passport” to market the fund across EU borders.

There are a number of issues associated with this process:

- (1) The act of filing the required documentation with the AIFM's home Member State regulator in practice precludes pre-marketing discussions in a number of Member States.
- (2) If, during the fundraising, investors negotiate changes to the LPA, a decision must be made as to whether these changes are “material” (see also our response to Question 3.2). If they are - and often they are - a further filing must be made with a further one-month wait period before any subsequent closing can be held.

- (3) The law requires that any preferential treatment given to one investor must be disclosed to all others before they invest. It is clearly impossible 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.

Similar issues arise for non-EU AIFMs marketing under some (but not all) NPPRs.

In all of these respects, the process assumes that an institutional private equity or venture capital fund is a 'pre-baked' product (like a UCITS fund) and fails to recognise that marketing (or more rightly in the private equity industry context "fundraising") is a negotiated, iterative process. The formalities front-load the effort required to raise a fund (and also front load costs, when there may be no guarantee that the fundraise will be successful) and generally complicate and disrupt the process. It is far from clear that the regulators' review adds substantively to the quality of offering documents.

Issue 2: Certain host Member State regulators commenting on materials (such as Article 23 disclosures) communicated to them by the home Member State regulator

When applying for a marketing passport an AIFM must submit, to its home Member State regulator, a notification comprising the documentation and information described in Annex IV to the Directive (Article 32(2) of the Directive).

Under Article 32(3) of the Directive, the competent authority of the AIFM's home Member State must, no later than 20 working days after receiving a complete notification, transmit the notification to the competent authorities of the Member State(s) where it is intended that the AIF will be marketed. The competent authority of the home Member State will only transmit the notification if it is satisfied that the AIFM's management of the AIF complies with the Directive. The competent authority of the home Member State must inform the AIFM of the notification's transmission and the AIFM may start marketing the AIF in the host Member State(s) as of the date of that notification (Article 32(4) of the Directive).

As is clear from the above, nowhere in Article 32 of the Directive (or elsewhere in the AIFMD) is it contemplated that the *host* Member State competent authority should review the content of the notification (and, in particular, the 'Article 23 disclosures') and/or contact the AIFM about its intended marketing activity in their Member State. We are, however, aware that both of these have been occurring in practice.

Some host Member State regulators have been communicating with AIFMs either through the relevant home Member State regulator or directly. Where this concerns obvious omissions or errors in the mandatory Article 23 disclosures not identified by the home Member State regulator, there can be little objection. On some points, however, there is a risk of multiple divergent views being expressed by different regulators (e.g. how to approach disclosure of NAV when this will fluctuate). Given that under the architecture of the Directive an AIFM is required only to deal with its *home* Member State regulator in the context of the marketing passport, the views of that regulator must be determinative. Any other result undermines the operation of the passport, creates legal and regulatory uncertainty and will hinder AIFMs' cross-border marketing activities.

In some cases, local expectations about the content of a marketing passport notification go beyond the requirements set out in the Directive. We understand, for example, that at least one national regulator is

in some instances requiring an AIFM to provide certain confirmations in its passport notification about its marketing arrangements and (where relevant) the arrangements in place to prevent marketing to retail investors. Whilst we acknowledge that, pursuant to Article 32(5) of the Directive, such arrangements are subject to the laws and supervision of the host Member State, we believe this means that the arrangements should secure compliance with the local laws and do not think that a host Member State competent authority has any legal basis on which to require additional confirmations from an AIFM as part of its passport notification.

The development of common supervisory expectations about the passport and the contents of the passporting notification would allow the marketing passport application process to function more effectively, provide AIFMs with the certainty they need to ensure their notifications will meet regulatory expectations on a cross-border basis and avoid disruption to AIFMs' fundraising activities.

Material change notifications

In addition, the requirement to give prior notice of material changes to marketing documents, triggering a one-month 'wait period' while the notice is considered by the regulator, creates material difficulties for private equity firms given the negotiated marketing process described above. Prior to the AIFMD, investors would often negotiate with the fund manager right up to closing, with the partnership agreement being signed once the final negotiation points are resolved. If any of the changes negotiated late in the process are considered 'material' for notification purposes, there is then necessarily a delay between agreement being reached in principle and the final agreement (incorporating the proposed changes) being signed. In some cases, this can have material commercial implications, and it is a significant change to prior market practice.

For more detail, please see our response to Question 3.2.

Issue 3: Annex IV reporting - Inconsistent forms and lack of tailoring to private equity

Our members are facing a variety of difficulties with the Annex IV reporting processes.

First of all, there is a lack of clarity around (i) frequency of reporting for AIFs and AIFMs (it should be clearer that AIFMs of closed-ended non-leveraged AIFs are only required to do annual reporting); and (ii) when an AIFM subject to annual reporting should file its first report (one view was that they should file for the period ended 31 December despite their authorisation date, but there has been some confusion over this). More guidance is also needed around the limited scope reporting for sub-threshold, as well as non-EU (and non-leveraged) managers.

Furthermore, 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 and venture capital fund managers. Some concrete examples include:

- inaccurate classifications regarding positions, instruments and exposures: there is no definition of what each of these terms mean in a private equity context and they can be interpreted as referring to a Portfolio Company as a whole, separating debt and equity in investments, or separating out all instruments leading to a list of Equity, PECs, CPECs, IFL etc. As a result, there will be some incomparable fund reporting information. This is a significant issue and leads to many assumptions

being required to be made by firms to deal with the lack of clarity.

- the Risk Management information table is not applicable for private equity in general and has been a meaningless exercise. Private equity and venture capital employ a wide range of risk management techniques that includes both qualitative and quantitative analysis; the current reporting does not appreciate this.
- the information on Fund Turnover is unclear for private equity as this is a relatively meaningless statistic for the fund. Investments are typically held for a long period of time, but on acquisition and disposal there are a number of capital movements which may present an unrealistic position.
- the requirement to provide monthly IRR is meaningless in a private equity fund context. Closed-ended private equity funds will monitor the IRR over a longer term as the investor returns are considered over the life of the fund rather than a monthly basis.

From a more national perspective, in Denmark a large portion of the form is not relevant and appropriate for the investment strategy of private equity fund managers. Given there is limited possibility to only respond to the relevant questions, fund managers often have to leave much of the form blank. This may be confusing for the competent authority which is unable to know for certain if the investor has decided not to answer the question or if the question does not apply to the fund manager.

Another, perhaps more technical, issue relates to the complexity and number of fields. Set out below is a selection of the more practical feedback we have received from our members:

1. In certain countries, there is no guidance on some of the reference numbers that should be used regarding fund types.
2. Inability to print the completed form - The current system only allows printing of individual screens which is cumbersome given the form is split over multiple pages/screens.
3. Rounding/netting off issues were experienced in several sections. Returns were rejected multiple times before being accepted.
4. The Validate and Save option within the data input screen did not work in many instances.
5. When completing the initial filing, the frequency was not automatically set up based on the AIF or AIFM reporting code. Members had to subsequently modify the AIF001 and AIF002 with a filing frequency change code to set up the correct reporting frequency on Gabriel.
6. Templates in certain Member States have questions in a different order to the ESMA template which can have an impact on how assumptions are made.

Divergent national approaches to reporting (such as different reporting interfaces and technical structures) imply that fund managers are diverted from the core business, with no obvious benefit to financial stability or investor protection. The ability to register with, and to report only once to, a single authority who could then share such information with Member State regulators (e.g. through ESMA) as deemed necessary would greatly reduce costs and complexity for fund managers.

B. AIFMD national private placement regimes (Article 42 AIFMD)

While we recognise that NPPRs are, by definition, a non-harmonised regime, there are a few issues our members are facing that we would like to bring to your attention.

Issue 1: Absence of a harmonised registration process

When marketing units or shares in a “host” Member State without a passport, a non-EEA AIFM must submit a notification to the competent authorities of its “home” Member State, including documentation and information detailed in Annex IV of AIFMD. However:

- the absence of a consistent approach across the EU to determining what (and when) activities and communications constitute “AIFMD marketing” means that the NPPR registration obligation does not arise at the same point in time in each Member State. This means that managers must devote additional resources to monitoring *when* during their fundraising process the notification obligation arises in *each* Member State. They cannot make all their notifications at a single point in time. This can have implications for a non-EEA AIFM’s global fundraising efforts for a particular AIF as it can result in disparities with other EEA regimes and causes unnecessary timing or logistical issues during the fundraising process.

In addition, as mentioned previously, given the importance of pre-marketing to fund managers’ ability to gauge investor interest, it is key that any interpretative guidance on the meaning of “marketing” recognises that certain activities remain outside the scope of “marketing” under the AIFMD. This is particularly important for non-EEA firms, who typically want to understand whether there is any significant investor interest in a particular EEA jurisdiction and where much depends on the outcome of negotiations, before submitting to that jurisdiction’s NPPR registration or approval process.

- another key issue facing AIFMs seeking to use/register under Member States’ NPPRs (i.e. mainly third country managers and managers of third country funds) is the **absence of a harmonised ‘Article 42 registration process’** across the EU and the varying conditions which must be met to satisfy different national private placement regimes. Indeed, the requirements as such vary from one Member State to the other.

There is a different form which must be filed with each Member State regulator and there are differences also between:

- the supporting information which must be supplied with the form (some Member State regulators require significant amounts of supporting information and documentation whilst others do not);
- whether contractual agreements need to be established between an AIF and a service provider (e.g. depositary) prior to the form being filed;
- the way in which the form must be filed;
- the fees/charges imposed on the AIFM when filing the form (see Section on Regulatory Fees); and
- the time period for the regulator to consider the application and the form/material submitted. In Austria and Germany, for instance, it can take up to four months for the national competent authority (FMA or BaFin) to review the AIFM’s notification application, whilst in other Member States a manager may (be allowed to) market immediately following filing (see next question).

Furthermore, regulators in certain key jurisdictions for fundraising are not appropriately resourced to deal with the volume of NPPR registration applications. In many cases, regulators seem to be giving priority to AIFM authorisation applications from domestic managers. In addition to creating an unequal market for EEA and non-EEA AIFMs, this has resulted in the regulators being unable to meet their own deadlines for

processing NPPR registration applications from non-EEA AIFMs. These uncertainties make it difficult for non-EEA AIFMs to draw up and adhere to fund formation and closing timetables.

The absence of a harmonised process means that AIFMs incur **considerable (and often duplicatory) costs** in relation to any non-EEA fund which is to be marketed across the EU as legal and other advice must be taken in each relevant jurisdiction and administrative charges are incurred on a per-jurisdiction basis. This imposes *de facto* barriers to entry to other EU markets and the consequent implication that it could lead to a market distortion as the number of managers in the market declines.

It also imposes an unnecessarily onerous compliance burden on managers that, at a time when resources should be focused on raising funds for investment into the real economy, must instead divert certain of those resources towards ensuring that they meet their regulatory notification obligations across the EU.

Streamlining the notification process and subsequent (post-registration) periodic reporting requirements would help to reduce costs. For more information on issues that arise in relation to the periodic regulatory reports set in Annex IV of AIFMD which must be filed with regulators post-registration, please see our answer to Question 4.1. A potential solution could be to enable fund managers to register with, and to report only once to, a single authority who could then share such information with Member State regulators as deemed necessary.

Question 8.5 - As a lawyer, have you experienced unjustified delay in the notification process before your client was able to market their AIFs in another Member State? Please describe your experiences.

Yes. Feedback we have received from our members indicates that it can take up to 6 months in Sweden, Norway or Germany for the national competent authorities to review the AIFM's notification application. There may be differences of course depending on whether the notification is for the purposes of the AIFMD EU passport or for marketing under the NPPRs (Article 42).

Many factors seem to be at the origin of such delays.

- Some concern the obligation(s) imposed by Member States before the notification process can begin. At least one Member State forced fund managers to enter into a custodian agreement before they were able to submit a registration file under Article 42.
- Others are related to the information which needs to be provided by the fund manager. It often happens that the authority requests new information (e.g. filing the document in the official language of the home country, filing additional original documents) at the last minute.
- According to our members' experience, it also occurs that authorities do not respond within the waiting period, which prevents the fund manager from marketing their AIF before a complete new waiting period is over.

More generally, within the context of the AIFMD EU internal market passport it is also important to note that the initial marketing notification, followed by one month's notice of planned "material changes", is inconsistent with and difficult to apply in the context of closed-ended funds' iterative marketing process. More concretely, the marketing passport notification process - where an initial notification must be made to the AIFM's home Member State regulator followed by subsequent notifications to that regulator of any "material changes" to the contents of the initial notification - is difficult to apply in the closed-ended fund



context where marketing takes place on an iterative basis.

We refer to our responses to Question 3.1b for a description of how our members typically approach fundraising and to Question 3.2 for the problems fund managers face with these material change requirements.

Question 8.6 - What should be improved in order to boost the development of cross-border distribution of funds across the EU?

As alluded to above, the requirement to notify “material” changes and the mandatory approval period of one month are problematic. Private equity fund terms are typically heavily negotiated and hence there will always be changes - although usually LP-friendly changes to the fund terms throughout the marketing / pre-marketing process.

The other main areas we think should be improved include: (i) harmonisation of the registration process for AIFMs, (ii) harmonisation of the NPPR process and requiring specified response times (some countries can take 3 months to respond), and (iii) consistent and centralised reporting.

TAXATION

Question 9.1 - Have you experienced any difficulties whereby tax rules across Member States impair the cross-border distribution and take-up of your UCITS or AIF or ELTIF or EuVECA or EuSEF?

Yes, tax rules across Member States may, in certain cases, impair the cross-border distribution and take-up of AIFs.

Question 9.1a - Please describe the difficulties, including whether they relate to discrimination against UCITS or AIF (including ELTIF, EuVECA or EuSEF) sold on a cross-border, and provide examples. Please cite the relevant provisions of the legislation concerned.

The tax treatment of investors into an AIF certainly influences the success of the fund's distribution. In this regard, it is to be noted that private equity funds generally have a range of investors, having both different locations and different legal status, and therefore may be subject to different tax treatment. Uncertain tax treatment and the imposition of additional taxes are two of the main barriers to cross-border distribution of funds. Once tax has been paid on the portfolio company's trading profits, the return of those profits should not result in additional tax until they reach the shareholder, i.e. ideally, investors should be taxed only in their state of residence and there should be no source taxation (i.e. taxation where the fund is established or managed), no withholding taxes on distributions from the fund, and no non-recoverable VAT on the management of the fund. In other words, the investor should be taxed as if it had invested in the underlying assets directly, so that the investment through the fund does not give rise to an additional layer of tax.

In particular, the taxation of AIFs varies greatly between Member States. Some Member States have special vehicles intended to be used as AIFs, in some Member States normal tax transparent entities are used (typically limited partnerships), whereas taxable entities (such as corporations) are favoured in other Member States. Some Member States exempt from VAT the management of all or most funds, whereas other Member States only exempt the management of UCITS funds.

Another difficulty is that some Member States view fund vehicles as having legal personality, whereas others do not. This may also lead to different or uncertain tax treatment. In summary, the choice between what fund vehicle to use and where the fund and the fund manager should be established is distorted by differences in tax regimes, and may thus not reflect what would be best from a commercial point of view.

The Swedish example:

A Swedish investor investing in an AIF in another Member State must first determine how the fund should be treated under Swedish tax law, which in turn requires an analysis of the fund's characteristics under the law in the jurisdiction where it is based. This is not always easy since some concepts in local laws do not translate well into Swedish law. There can even be uncertainty as to whether the fund's assets for Swedish tax purposes are held by the AIF, the AIFM, or by the investors directly.

The next step is to determine whether the AIF has legal personality, which again requires an analysis of the fund's characteristics under local law. The last step is to determine whether or not the AIF is tax transparent

(also done relying on local law).

Depending on the outcome of all of this analysis, the Swedish investors could for Swedish tax purposes be considered (i) to hold the underlying assets directly; (ii) to hold an interest in a tax transparent entity; or (iii) to hold an interest in a taxable entity. Each alternative may give rise to different tax treatment, also with respect to different assets held by the AIF. Not only is knowledge of Swedish tax law required to perform this analysis, but also quite detailed knowledge of civil and tax law in the jurisdiction of the fund. This drives up the cost for evaluating and making cross-border fund investments. It also drives up the on-going compliance costs, since tax laws are constantly changing.

In some jurisdiction profits from the participation in a fund may be subject to a withholding tax. This withholding tax may be applied in advance of the redemption of shares/units in the fund or upon final payment depending on the legal status of the investor. The withholding tax may not apply on the profits received by certain categories of investors. In particular, the domestic legislation of Member States may provide for the exemption of the profit received by non-resident investors who either (i) are resident in a “qualified” country or (ii) are included in a “qualified” category. In this regard, if the “qualified” category is not sufficiently characterized, the lack of clarity of the subjective scope of the application of the exemption/reduced taxation may create difficulties for investors in understanding the tax burden of the investment. This results in lower returns for the investor and reduces the appetite of such investors to put their capital into similar investment opportunities in the future.

Moreover, domestic legislation may exclude such “qualified” investors from the exemption regime if their presence in the investment structure is intended to enable participants who may not be exempt (e.g., as residents in an uncooperative State) to (unduly) benefit from the exemption. Tax authorities may have different views in identifying the nature of the non-resident investors (e.g., in case of funds of funds or holding companies) and disregard the investor as the beneficial owner, with the related consequences in terms of tax treatment of the profits distributed by the AIF or of the gains realized on the units’ transfer. In this respect, the risk to the investors of not being considered as “qualified” investors are increased by the fact that the notion of “beneficial owner” is not always clarified in Member States’ domestic laws.

The Italian example:

Italian tax law provides for the exemption of “qualified” non-resident investors, i.e. investors residing in a cooperative country (see Legislative Decree No. 239/1996, Art. 6, par. 1). Moreover, a special category of “qualified” investors, i.e. the “institutional” investors, although not subject to tax (e.g. partnerships, trusts or other tax transparent entities), established in a cooperative country, are exempt from the withholding tax (see Legislative Decree No. 239/1996, Art. 6, paragraph 1, letter b and the Decree of the Italian Minister of Economy dated December 12, 2001).

The notion of “institutional” investors is not definitively specified by Italian legislation however. It has been interpreted by the Italian Tax Authorities in various Circular Letters (see Circular Letters of the Italian Tax Authorities No. 23/E of March 1, 2002, No. 20/E of March 27, 2003, No. 61/E of December 31, 2003 and No. 33/E of July 15, 2011). In general terms, an “institutional” investor is an entity that carries out or manages investments, as its principal activity, on its account or on behalf of third parties, regardless of whether it is subject to tax in its country or not.

Thus, the notion of “institutional” investor is rather broad, since it comprises *both* the entities subject to

tax in the country of residence or of establishment *and* the entities not subject to tax as a consequence of a specific exemption or because they are tax transparent. Moreover, according to the Italian Tax Authorities, both (i) the entities subject to supervision of the competent authorities in the country of residence or establishment and (ii) the entities not subject to supervision but having specific competence and experience in transactions in financial instruments can be regarded as “institutional” investors. However, this “institutional” investor classification can be denied to those entities which are deemed to have been established to grant investors the tax status under the exemption regime.

In this light, the “institutional” investors who request the application of the exemption regime are subject to the control of the Italian Tax Authorities, who could verify the eligibility of the investor and control possible abuses, also by way of the exchange of information procedure.

In addition to this issue, the documentation (e.g., self-declaration, application forms, declaration by the competent tax authorities) that investors have to disclose to the tax authorities of the source State in order to benefit from exemption/reduced taxation regimes is relevant. The documentation to be submitted generally varies according to the category of investor and it may differ from one Member State to another. For example, in Italy “qualified” non-resident investors are required to submit to the management company or to the intermediary bound to apply the withholding tax, a certificate of tax residence. Moreover, they must submit a “self-certification” by the beneficial owner of the fund’s profits, attesting the existence of the requirements to benefit from the exemption/reduced taxation (i.e. residence in a “qualified” country or qualification in one of the “qualified” categories).

Institutional investors not subject to supervision in their country of establishment are required to self-declare, in a written document by the legal representative, to have specific competence and experience in transactions in financial instruments. Moreover, the institutional investors not supervised nor subject to tax (e.g. trust/partnership) are required to submit a declaration stating that they have not been established for the purpose of managing investments carried out by a limited or closed number of Italian resident investors or of investors who are not resident in “qualified” countries.

Therefore, the lack of uniformity and the uncertainties about both the category to which the investor belongs (as explained above), and secondly type of documentation to be supplied, may generate difficulties in the cross-border distribution of funds.

In addition to the tax treatment of the profits/capital gains in the hands of the investors, the success of the distribution of AIFs units may be affected by the tax treatment of the AIFs investments themselves. A relevant issue here regards the applicability of Double Taxation Conventions (DTC) to AIFs. The AIFs that normally take part in international investment structures are not liable to tax in the State of establishment, with the result that the provisions of the DTCs generally do not apply to them. In fact, in some cases AIFs are qualified as “transparent” for tax purposes. The concept of “transparency” may vary from State to State, creating opportunities for double taxation or double non taxation. In case of transparent entities, the application of the DTC may be required directly by the investors, with regard to their share of participation and provided that, in turn, they qualify for the application of the Convention in force between the State of the investment and the State in which they reside. Moreover, it is to be noted that international investment structures are frequently characterized by the presence of one or more holding companies generally established in a cooperative jurisdiction.

The distribution of dividends and interest between the target company and the intermediate vehicle



established in an EU Member State, under certain conditions, may benefit from the withholding exemption which is in general not applicable directly to the fund. Moreover, possible capital gains on the sale of the target company shares, under certain conditions, may benefit from the exemption provided for by the applicable Double Taxation Convention.

However, it may happen that the tax authorities of the source State disregard the intermediate vehicle, based on the circumstance that it represents an “artificial arrangement” (i.e. it does not carry out an effective business activity and it is not provided with sufficient substance and presence in the country of establishment). The uncertainties about the tax treatment of the investment are increased by the vagueness of the definition of “sufficient substance” (or “not marginal non-tax purposes”).

For example, in Italy, the Italian tax Authorities, in the recent Circular Letter n. 6/E of March 30, 2016, have expressly analyzed the case of international fund investment structures, expressing the view that intermediate vehicles between the fund and the target company can be disregarded if they have a “light” organizational structure (for example when personnel and premises are provided by a third domiciliary under a management service agreement), with no effective activity and real substance and, as a matter of fact, without autonomy of decision, except for the formal ratification and execution of decisions taken by the fund manager (for example with regard to the investment plan). The vehicle can be disregarded also with respect to single conduit transactions (as back-to-back).

In conclusion, it is to be noted that differences provided for by the legislation of EU Member States in the tax treatment of domestic (generally exempt or transparent) and non-domestic funds, may represent in principle a violation of the freedom of movement of capital and may affect the success of the cross-border distribution of AIFs.

Question 9.3 - Feedback to earlier consultations has suggested that the levying of withholding taxes by Member States has impeded the cross-border distribution of UCITS or AIFs (including ELTIF, EuVECA and EuSEF). Withholding taxes are usually reduced or even eliminated under double taxation treaties. But in practice it has been claimed that it is difficult for non-resident investors to collect any such withholding tax reductions or exemptions due under double taxation treaties. Have you experienced such difficulties?

As a general remark, it can be said that no particular issues arise in respect to proceeds paid out by investment funds established under the source State rules (some difficulties are outlined below for the UK). However, obstacles and difficulties may stem from the tax qualification of the same fund by the jurisdiction of the prospective investor (see below, German investors with the Italian Fondo Chiuso or French Investors with UK Limited Partnerships).

Question 9.3a - Please provide examples of the difficulties with claiming withholding tax relief suggest possible improvements and provide information on any best practices existing in any Member States. Please cite the relevant provisions of the legislation concerned.

Italy:

Under Italian law, proceeds paid out by Italian AIFs are tax exempt provided that the recipient is established

in a white list jurisdiction. This conclusion holds true also for investors structured in the form of tax transparent entity/partnership if it falls within the definition of Institutional investors. Accordingly, in general, Italy does not raise any particular issue in respect to the application/recoverability of withholding tax within the EU. However, from a different perspective, fund managers in Italy have recently faced substantial marketing problems with German Investors. Indeed, since the Fondo Chiuso is not a partnership from a technical standpoint due to some recent position of the German tax authorities, certain German investors may not benefit from the exemption regime on such investments.

However, it is worth noting that non-Italian AIFs investing into Italy are not entitled to the general exemption regime which is indeed provided for Italian funds. Accordingly, non-Italian funds need to rely on provisions in Double Taxation Conventions (DTC) to avoid double taxation and, given the juridical form of most such funds (e.g. partnership) they are not able to recover or reduce taxes paid in Italy. It may be possible, under certain conditions to look through the partnership and apply the DTC provisions at the investors' level. However, this is not practicable in most cases. In addition to the above, a very recent Circular letter issued by the Italian tax authorities raised a substantial concern amongst the private equity industry. Under such interpretation, the Italian tax administration seems to deny the benefit of EU Directive provisions (such as the Interest and Royalties Directive 2003/49 and the Parent-Subsidiary Directive 2011/96) as well as the DTC application to holding companies (e.g. special purpose vehicles) established by private equity houses. As a consequence of the above, there may be some difficulties in marketing non-Italian funds to certain Italian investors.

As a final remark, please note that Italian investors may not be able to recover any withholding tax paid by the AIFs since they are all seen as opaque entities for Italian tax purposes, regardless of whether they have legal personality or not.

Spain:

Spain's imposition of a withholding tax regime on distributions from Spanish funds (FCR, SCR, UCITS) to its non-resident investors is clear and legally well-established, and it varies from type to type. Spain grants a withholding tax exemption for EU investors in Spanish listed UCITS and a general withholding tax exemption for foreign investors in Spanish ECRs, which are the AIFs more commonly used, so no issue normally arises on this from a Spanish withholding tax perspective. In the hypothetical case that a Spanish fund (with no corporate form, such as a non-listed UCITS or a non-ECR AIF) imposed a withholding tax on an EU investor, it would hardly be recoverable under a DTC as such vehicles are not covered normally by the Spanish treaties.

UK:

Subject to a few exemptions, the UK imposes withholding tax on payments of UK source interest at a rate of 20% (there is typically no UK withholding tax on dividends). In general terms, the process of claiming exemptions from UK withholding tax, or reliefs/credits under a DTC does not cater particularly well for tax transparent vehicles such as UK limited partnerships. For example, the UK legislation imposing the withholding tax obligations (section 937 Income Tax Act 2007) contains an exemption allowing UK source interest to be paid gross to a specific category of partnership. However, the exemption is drafted very narrowly and only applies where every partner falls into a narrow list of entities that are entitled to gross payment in their own right. Notably it does not apply where an investor is treaty eligible. In practice

therefore it is unlikely to apply in the context of a widely held investment fund.

Further, the process for partners in a limited partnership to try to claim a tax credit in respect of withholding tax suffered by the partnership is not entirely straightforward. This is because the relevant tax vouchers would in the first instance be issued by the payer of the interest to the partnership, rather than the partners of the partnership.

Also, partnerships are not currently permitted to use the Double Tax Treaty Passport (DTTP) scheme and so cannot take advantage of the simplified process the DTTP scheme offers, whereby treaty eligible recipients can obtain gross payment. The ability of partnerships to use the DTTP scheme is currently under consultation by the UK government.

Sometimes 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 and the work on Action 6 there is a concern that, given the uncertain position so far as regards the treatment of non-CIV funds, even in a situation where all of the investors are treaty eligible, or otherwise tax exempt (as is often the case in the private equity funds industry), the use of such holding vehicles may cease to be a workable solution in the future.

Question 9.4 - What are the compliance costs per Member State (in terms of a percentage of assets under management) of managing its withholding tax regimes (fees for legal and tax advisers, internal costs, etc.)? Do they have a material impact on your UCITS or AIF (including ELTIF, EuVECA and EuSEF) distribution strategy?

This is not an easy question to answer, because the position for funds and fund managers will vary greatly. Nevertheless, dealing with withholding taxes fall into a number of different categories and we set out the most common below and highlight what kind of costs and administrative burdens may be incurred.

Tax transparent fund vehicles

Firstly, where the fund is tax transparent and holds its investments directly, then the administration of reclaiming withholding taxes is likely to fall on the investor and not on the fund manager. We set out below how this might operate where - as an example - the fund is established as a limited partnership, the investor is a tax exempt pension fund and withholding tax applies on a payment made to the fund.

- The pension fund will receive an amount which is net of the withholding tax.
- The pension fund must consider whether it can reclaim all or any of the tax under a double tax treaty between its jurisdiction and the jurisdiction of the underlying paying company. To do this it will need (a) information from the fund about the nature of the underlying payment (for example, was it interest income or dividend income?); (b) professional advice on whether both jurisdictions (the pension fund's and the paying company's) consider the partnership to be tax transparent; and, assuming a treaty claim is available, (c) to follow the relevant domestic procedure to claim a refund of the tax.
- In this example, the fund does not bear the economic cost of the withholding and, once the treaty

reclaim process is complete, the pension fund is in no worse a position than it would have been had it invested directly.

- But this process does have a cost implication for the fund. A well-advised pension fund will, on subscribing for an interest in the fund, negotiate terms which set out the type of tax-related information it requires from the fund (and the frequency and time-limits within which the information must be provided). Legal costs will be incurred in negotiating these provisions. Consequently, the fund manager may, in addition to any information it has agreed to provide to all investors, have to provide detailed and bespoke tax-related reports to particular investors to enable them to reclaim or claim a credit for the withholding tax.

Other fund vehicles

Where a fund vehicle does not fall into the group above then it is this vehicle which incurs the withholding tax on payments to it. However, the manager will need to ensure (as far as practicable) that the fund's investors do not (indirectly) bear significantly more tax cost than they would have done had they invested in the paying company directly.

Steps

The fund manager must identify where withholding taxes might arise and this may be a significant exercise if the fund has a broad geographic reach. In addition, it is unlikely that any jurisdiction will have a blanket withholding tax rate: many countries provide for domestic exemptions or reduced rates provided conditions are met. For example, the US has an exemption for "portfolio interest" and the UK has exemptions for interest on certain listed securities and on certain private placements. The fund manager must have a good handle on which exemptions may be relevant to the kind of investments to be made by the fund.

Assuming that the fund vehicle needs to make a treaty claim to reduce or eliminate withholding taxes, it will need legal or tax advice (in each relevant jurisdiction) on whether the fund vehicle is entitled to rely on the treaty. The advice will need to consider the case law relating to the international principle of beneficial ownership and may also need to consider the degree of substance and commercial presence in the vehicle's jurisdiction. The advice may also look at the vehicle's principal purpose and/or the identity of each of the fund's investors (these aspects are likely to increase in importance once BEPS Action 6 is widely implemented).

This advice will then need to be applied on a transaction-by-transaction basis and a specific treaty claim may be needed. This is not necessarily a quick process. The UK is currently reviewing its treaty passport process, but - by way of example - the current mechanism for a non-UK company to ensure that no withholding tax on interest arises on UK source income under a treaty is as follows.

1. Check that the terms of the relevant tax treaty give the taxing rights over interest income to the recipient jurisdiction (and not the paying jurisdiction).
2. Check that the recipient is permitted to rely on the treaty.
3. Recipient fills in HMRC form DTP1.

4. Recipient either (i) applies to their own tax authorities for a certificate of tax residence to be sent to HMRC with the form; or (ii) sends completed form DTTP1 to their own tax authorities for stamping to confirm residency. When things run smoothly, this is likely to take a minimum of 2-4 weeks.
5. HMRC then has 30 days to consider the application and then issues the recipient with a DTTP number.
6. The recipient must then tell the (potential) borrower (the UK entity paying the interest income) its DTTP number.
7. The borrower must complete and file form DTTP2 with HMRC.
8. HMRC has 30 days to consider form DTTP2. Assuming it is satisfied with the arrangements, it will issue a gross payment direction to the borrower. Only then can interest be paid on a gross basis.

FATCA type withholding

Withholding taxes are not only used by governments to raise funds but also as a 'stick' to encourage certain behaviours. A good example of this is FATCA, where the threat of additional US withholding taxes has resulted in jurisdictions and financial institutions complying with US requirements to provide information about US account holders. Fund managers may not categorise their FATCA compliance as a withholding cost, but it is an example of where the indirect impact of a potential withholding tax has resulted in significant compliance costs.

Holding companies / portfolio companies

Where the fund makes majority-position equity investments (as is common for many private equity funds), the fund manager also may have to consider whether it can and whether it is appropriate to minimise withholding taxes on payments made between companies which it owns, for example, by relying upon the withholding tax exemptions provided for in an EU Directive (such as the Interest and Royalties Directive 2003/49 or the Parent-Subsidiary Directive 2011/96) rather than the withholding tax rates under a double tax treaty. However, reliance on a directive will not necessarily eliminate compliance costs. This is because the Member State in which the payer company is located may require extra steps to be undertaken in order to access the exemption. For example, the UK requires that an exemption notice is obtained from HMRC in order that an interest payment is exempt from withholding tax under domestic legislation implementing the Interest and Royalties Directive. The recipient of the payment must apply to HMRC for an exemption notice. The application must demonstrate that the recipient is entitled to the benefit of the Interest and Royalties Directive and include proof of the tax residence of the recipient. HMRC have 3 months to respond to an exemption notice request.

Question 9.5 - What if any income reporting or tax withholding obligations do you have in the Member States where the UCITS or AIF (including ELTIF, EuVECA and EuSEF) is located and what if any difficulties to you have with reporting formats?

What kind of solutions and best practices, if any, would you suggest to overcome these difficulties? If a single income reporting format were to be introduced across the EU, what would be the level of costs saved?

Would this have a material impact on your UCITS or AIF (including ELTIF, EuVECA and EuSEF) distribution strategy?

Member States differ in their income reporting and tax withholding obligations and in the table below we provide a summary of the position in France, Germany, Italy, Spain, Luxembourg and the UK.

In practice the nature of income reporting and withholding tax obligations often depends on whether a vehicle is tax transparent or opaque. Where tax transparent vehicles are used in the funds context (e.g. an English limited partnership), in practice, withholding tax is usually levied at the portfolio company level (i.e. beneath the fund), rather than having to be levied by the fund itself (although please see our comments below in relation to the potential impact of the OECD BEPS initiative in this regard) as such the comments below address withholding at this level as well as by the AIF itself.

A common difficulty for AIFs faced in the various Member States lies in complying with withholding tax reporting obligations. For example:

- In the UK:
 - In general terms, the process of claiming exemptions from UK withholding tax, or reliefs/credits under a DTC does not cater particularly well for tax transparent vehicles such as English limited partnerships.
 - For example, the process for partners in an English limited partnership (a tax transparent vehicle) trying to claim a tax credit in respect of withholding tax suffered by the partnership is not entirely straightforward. This is because the relevant tax vouchers would in the first instance be issued by the payer of the interest to the partnership, rather than the partners of the partnership.
- In Italy, the main difficulties for Italian withholding tax agents consist in obtaining and verifying the accuracy of documents/information required for granting the exemption from the Italian withholding tax to white list investors.

Another difficulty encountered is the inconsistent treatment between the taxation of local funds and foreign PE funds by the relevant Member State.

For example, under French domestic law, there is a 45% tax applicable to capital gains realised by non-residents on substantial participations (i.e. more than 25% of financial rights in a French company). Non-residents may be able to eliminate this tax if they are able to rely on a double tax treaty with France. The French tax authorities do not, generally, consider a foreign fund to be tax transparent even if its local jurisdiction considers it to be so. As such, neither it nor its investors will be entitled to claim a capital gains exemption under a double tax treaty. The funds industry in France have historically dealt with this issue by the foreign PE fund investing through treaty eligible holding vehicles, however, as mentioned above, in light

of the OECD's BEPS initiative, the use of such holding vehicles may cease to be a workable solution in the future.

By contrast, in the case of dividend income, we see an example of a potential solution to this type of issue. In the case of *Santander*, the European Court of Justice decided that the application of withholding tax to foreign funds was inconsistent with EU law, because French funds would not bear a similar tax. The French tax code was therefore amended and provides an exemption (at section 119 bis.2 of the French tax code) from French withholding tax on dividends, where those dividends are paid to certain foreign funds (including AIFs situated in the EU). In order to benefit from this exemption, the AIF must comply with certain conditions, namely:

- it must raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
- have features similar to those of certain French funds.

The French Tax authorities have provided guidance on the application of condition (b) in respect of various types of funds (the guidance is found in guidelines BOI RPPM-RCM-30-30-20-70-20130812). In relation to AIFs which are open to professional investors, the guidance on this category states that the conditions that must be satisfied by the foreign fund are as follows:

- the fund must be an AIF;
- it must have a management company;
- it must have its financial statements certified by an auditor; and
- it must have a custodian subject to prudential supervision.

The fund must also be in a position to provide justification to the French tax authorities that it has complied with these requirements. In a recent case, the French Administrative Supreme Court held that the requirement for providing such justification was not inconsistent with EU principles (*CE, 9 December 2015, The International Value Series of DFA Investment Trust Company*).

It would improve the position in France, if the *Santander* reasoning could be extended to capital gains so that foreign PE funds investing in France could benefit from a capital gains exemption. More broadly, however, the introduction of a category of fund which is entitled to receive gross payment (whether dividend, interest or capital gain), may provide a wider solution to these withholding tax issues across the EU.

In terms of further solutions, it may also be helpful if there were a standard EU certification form that could be used to obtain the exemption from withholding tax on dividends, capital gains tax, and interest.

A point to note is that if a single income reporting format were to be introduced across the EU, it would probably require that funds are treated in the same way throughout the EU which is not currently the case and so this brings with it its own difficulties.

	Summary of income reporting and withholding tax obligations
Germany	<p>German AIFs in the form of a partnership can trigger income reporting obligations for themselves (in the case of trading) and for its limited partners resident in Germany. However no withholding tax is due.</p> <p>If the AIF is established in a corporate form, then the AIF itself is subject to reporting obligations and profit distributions are subject to withholding tax.</p>
Italy	<p>As a general rule, Italian AIFs are not subject to tax on proceeds from their investment. Accordingly, no income tax reporting is required.</p> <p>Italian AIFMs, or Italian distributors of Italian/EU AIFs are required to apply a 26% Italian withholding tax on (i) proceeds paid out by such AIFs or, under certain conditions, on (ii) capital gain arising from sale/transfer/redemption of units in such AIFs.</p> <p>However, the 26% Italian withholding tax does not apply to white list foreign investors, including private individuals and institutional investors, even tax transparent entities. The white list relevant for this purposes has been recently amended (August 9th, 2016) and broadened - more than 120 jurisdictions are now listed (including Switzerland, Liechtenstein, Channel Islands, Cayman Islands, BVI). Italian withholding tax agents are required to (i) draft and file an annual withholding tax agent return and (ii) to pay on a monthly basis the Italian withholding tax due to the Italian Tax Authorities. The main difficulties for Italian withholding tax agents consist in obtaining and verifying the accuracy of documents/information required to grant the exemption from Italian withholding tax to white list investors and also considering the analysis to be carried out in respect to the certain multiple layers investment structure with different jurisdictions involved (including black list countries).</p>
France	<p>As a rule, there is no French withholding tax on interest (except in the case of payment to a non-cooperative jurisdiction such as Brunei). Low tax jurisdictions used by AIFs, such as Channel Islands, Cayman Islands or the BVI are not currently blacklisted by France.</p> <p>Dividends paid by a French company to a non-resident, including, as the case may be, through a French fund attract as a rule a 30% withholding tax. However, there is an exemption to this withholding tax where dividends are paid to certain foreign funds and certain conditions are met (described in further detail above). Satisfying the requirements for this exemption, is generally not too difficult.</p>
Spain	<p>There are no particular reporting or withholding obligations concerning Spanish ECRs (the most commonly used AIF vehicle in Spain). Spanish UCITS are subject to reporting obligations regardless of whether a withholding tax is imposed on the profit distribution of a Spanish UCITS.</p>

	<p>Spain grants a withholding tax exemption for EU investors in Spanish listed UCITS. Spain also has a general withholding tax exemption for “non-tax haven” foreign investors in Spanish ECRs. If these exemptions are not available, then a 19% withholding tax will normally apply.</p>
Luxembourg	<p>There is no withholding tax on distributions made by a Luxembourg UCITS, SIF, SICAR or RAIF (except in limited cases).</p> <p>Luxembourg AIFs constituted in the legal form of a partnership (e.g. SCS or SCSp) are in principle transparent and therefore no withholding tax is made by such AIFs (as long as the transparency conditions are fulfilled).</p> <p>Distributions made by Luxembourg AIFs established in a corporate form (and not falling in any of the specific fund forms noted above) are subject to general withholding tax of 15% unless an exemption can apply under a double tax treaty or by virtue of the Luxembourg participation exemption regime.</p>
UK	<p>In terms of income reporting obligations, any partnership would have to submit partnership tax returns to HM Revenue & Customs (“HMRC”) if requested to do so to aid the assessment to tax of the partners. Whilst a system is in place to request that no UK tax returns need to be filed where no UK tax is due (which is helpful for funds with no UK nexus), this process in itself can be unnecessarily costly. HMRC are currently consulting alternative ideas in this area to ease the burden for investment funds.</p> <p>Subject to a few exemptions, the UK imposes withholding tax on UK source interest at a rate of 20% (there is typically no UK withholding tax on dividends).</p> <p>It may be possible to obtain relief from UK withholding tax on UK source interest if a double tax treaty claim can be made (please see comments above in terms of difficulties experienced by English limited partnerships in claiming treaty relief).</p>

Question 9.6 - Are there any requirements in your Member State that the UCITS or AIFs (including ELTIF, EuVECA and EuSEF) need to invest in assets located in that Member State in order to qualify for preferential tax treatment of the proceeds of the UCITS or AIF (including ELTIF, EuVECA and EuSEF) received by the investors in the UCITS or AIFs?

There are no such requirements or possibilities to obtain preferential tax treatment by investing in assets located in that Member State that we are aware of.

Question 9.8 - Have you encountered difficulties in selling a UCITS or AIF cross-border because your UCITS or AIF (including ELTIF, EuVECA and EuSEF) or the proceeds produced by the UCITS or AIF (including ELTIF, EuVECA and EuSEF) would not receive national (tax) treatment in the Member State where it was sold? Please provide a detailed description, including quotes of the national provisions leading to the not granting of national treatment.

One of the obstacles that private equity funds face when marketing their AIFs in Europe is the wide variety of approaches used to distinguish between transparent and other vehicles. Although most Member States consider limited partnerships to be transparent ('look-through'), it sometimes requires an in-depth analysis to reach this conclusion. While the tax classification of domestic partnerships is usually straightforward and follows directly from national legislation, the classification of foreign partnerships often involves a more complex exercise.

Moreover, the tax legislation of some Member States requires resident investors to continue analyzing the chain of fund entities downstream until a non-transparent entity is encountered. In order to enable these investors to perform this analysis, a private equity fund will need to provide a detailed breakdown of the income at that lower-tier level between interest, dividends and capital gains. The administrative difficulties in providing this level of detail can be burdensome, as private equity funds normally only report to their investors at the level of the fund itself (equity pick-up accounting).

In France for example, there are certain favourable French tax code provisions which only apply to investments by French residents (corporates or individuals) in a French private equity fund that complies with a tax quota. Under the French tax code, it is not contemplated that such provisions apply to investments in another EU private equity fund (e.g. one situated in the UK or in Luxembourg). This possibility might be inferred from some wording in recent French tax authorities' guidelines but this is still far from clear. As a result, it could be more difficult to market foreign funds to French investors.

We also note that the French tax administration generally treats limited partnerships as tax opaque rather than as tax transparent, which can result in a less favourable tax treatment (e.g. taxation of a distribution as fully taxable income rather than as capital gain). Therefore, French investors can be reluctant to invest in UK limited partnerships.

Finally, it may be noted that under French domestic rules applying the *Santander* ECJ case, the French withholding tax on dividends does not apply to distributions made to a foreign fund (under certain conditions). Therefore, such foreign funds are on a level playing field with French funds, which are not subject to tax and do not pay tax on dividends received for instance. It would be important that the same principle applies also to capital gains realised by foreign funds. Note that the same issue could in theory arise for interest but there is as a rule no French withholding tax on interest.

OTHER

Question 10.1 - Are there any other comments or other evidence you wish to provide which you consider would be helpful in informing work to eliminate barriers to the cross-border distribution of AIFs (including EuVECA and ELTIF)?

General comments

We would like to stress once again that this response was based on a combination of comments we received directly from our members and feedback from technical experts.

While we fully support the fact and evidence-driven approach taken, we would urge the Commission to consider that smaller fund managers, which are the most impacted by regulatory requirements, are also the ones that do not usually have the capacity to respond to such questionnaires. This may have an impact on the quality of the response to questions like Question 4.1, where the size of the asset manager is an important component of the story (given the answer was requested in percentages) and where most of the responses received will come from large asset managers.

Topic-specific

1. IMPORTANCE OF NATIONAL PRIVATE PLACEMENT REGIMES (NPPRS²)

European institutional investors need to be able to access the best investment opportunities, within Europe and globally. This helps them to achieve returns and to manage risk by diversifying their portfolio across geographical borders. As intermediaries between these large funds and the often small companies which require financing, private equity fund managers play a key role in providing these investors with diversified investment opportunities.

While the AIFM Directive already allows some private equity fund managers to market their funds to these institutional investors within Europe's borders, through the use of a passport, some fund managers including **smaller fund managers** and **third country fund managers** do not benefit from such passport access.

Against this background and in light of the implementation of the AIFMD regime, **NPPRs** - in respect of fund interests - **continue to play an important role in private equity fund marketing in Europe**, in particular for:

- (i) sub-threshold fund managers, i.e. EEA AIF managers with assets below the €500 million threshold set in AIFMD, for whom the AIFMD regime was considered disproportionate (hence the threshold). They are not able to market cross-border using a passport unless they either opt to seek full-scale AIFMD authorisation (i.e. they opt-in to the - by definition - disproportionate AIFMD regime) or can qualify for the parallel EuVECA passporting regime. However, due to the EuVECA's strict eligibility criteria, many of these managers cannot market their funds under

² The term "private placement" in the AIFMD context has come to be used to cover those situations where Member State discretion permits the placing of funds in circumstances where EU-passported marketing under the AIFMD is not possible. These are no longer private placements in the traditional sense because interaction and registration with the regulators in each relevant Member State is required, together with mandatory investor disclosures and on-going reporting.

EuVECA as their specific investment strategy - while still SME focussed - prevents them from qualifying; and

- (ii) non-EEA fund managers who want to access European institutional investors but are still obliged to operate under national private placement regimes, where they exist. Indeed, non-EEA AIF managers are further restricted in their ability to access European institutional investors (and vice versa) owing to the unavailability to date of a passport and the restrictive features of some NPPRs.

Marketing Options			
	Passport		NPPRs
Type of Fund Manager	AIFMD	EuVECA	
Sub-threshold managers	Opt-in to full-scale AIFMD authorisation -> would be disproportionate, costly and burdensome	Yes, <u>if</u> they qualify -> but very restrictive qualifying requirements	YES -> but many are tightened (or even abolished)
Third Country Fund Managers	Not available (yet)	Not available (yet)	YES -> but many are tightened (or even abolished)

Developments in this area therefore need to ensure that European investors can continue to access the best fund managers, wherever they are located in the world and whatever their size. There are signs that in the light of AIFMD investors may not be getting this access³. But although private placement regimes should remain available to ensure investor and manager choice, the diversity of conditions under which they operate and their unavailability in a number of cases act as serious limitations to the free movement of capital (see previous sections).

Smaller Fund Managers

Given their systemic risk profile and the recognition that the costs of compliance would be disproportionate the co-legislators agreed that it would not be appropriate to apply the full AIFMD regime to private equity and venture capital fund managers with assets below €500 million. But while such smaller managers are - appropriately - excluded from having to comply with many of the AIFMD's requirements many of these managers are also effectively excluded from the opportunity to raise funds from investors located in other Member States because of (i) the AIFMD opt-in being too costly and burdensome; (ii) the EuVECA Regulation (and its qualifying requirements) being too restrictive; and (iii) the tightening of many NPPRs, or in some cases even their abolition. All of this is explained in more detail below.

1. EU fund managers whose assets are below the €500 million threshold set in the AIFMD are not permitted to market their funds to institutional investors in another Member State *via a passport* without opting in to the full AIFMD regulatory regime. These requirements for full authorisation are extensive, and risk imposing a barrier to entry and a reduction to investor returns, particularly if the costs cannot

³ In a survey of institutional investors by the Institutional Limited Partners Association (ILPA) 85% of investors had seen a decrease in marketing by fund managers located outside Europe since AIFMD implementation.

be spread across a high level of funds under management.

2. Although the EuVECA Regulation and its marketing passport is available for some of these smaller funds, many of them - including some that are clearly making venture capital investments - will not meet its particular eligibility criteria. As a result, only a small group of smaller funds will qualify for the voluntary EuVECA passporting regime. In addition, for many 'below threshold' funds wanting to market in only a few Member States the cost of applying for the EuVECA label may not be justified.
3. Given that opting in to the (full) AIFMD (regime) is unlikely to be attractive for very many, due to the costs that this will entail (see above), private placement is essential to enable smaller EU managers and EU institutional investors to be able to connect, enhancing investor choice and competition amongst managers. However, cross-border marketing by sub-threshold funds/AIFs under the NPPRs has, post-AIFMD, become increasingly difficult due to the tightening and in certain EU Member States⁴ even abolition of the NPPRs. (In this regard, it must be understood that the NPPRs applicable to EEA sub-threshold managers are in many cases different from the NPPRs applicable to non-EEA managers of non-EEA funds seeking to access investors in the same Member States, also impacting competitiveness.)

With the exception of a few Member States where rules are accommodating, sub-threshold managers are encountering obstacles in many jurisdictions where they want to register for marketing. Some Member States do not even allow smaller fund managers to make use of the national private placement regime to access investors. This has the effect of denying these managers any means to operate across borders, a state of affairs that arguably contravenes the free movement of capital in the EU and is in breach of Article 63 of the TFEU. Where Member States' rules allow smaller *domestic* funds to be marketed to institutional investors in their jurisdiction but not those from *other* EU Member States (e.g. as is the case with the Dutch regime), the negative consequences are particularly acute and quite contrary to the philosophy of the EU internal market.

Non-EEA Funds and Fund Managers

The private equity industry is inherently global: capital provided by investors in one jurisdiction is put to work by a fund manager in companies located in another. European companies want to be able to receive significant third country private equity investment; and European institutional investors want to be able to invest in third country private equity funds (both for the returns they can offer and for the risk diversification benefits)⁵.

European pension funds and insurance companies, which manage more than €12 trillion of assets, need to be able to diversify their portfolios (by asset class and by geography) for prudent risk management purposes, and they need to achieve returns, not least to deliver to European citizens the growth in their pensions and savings that they expect. To meet these expectations institutional investors need to be able to access fund managers, markets and opportunities across the world.

Access to third country investment opportunities also helps reduce the build-up of systemic risk in the EU

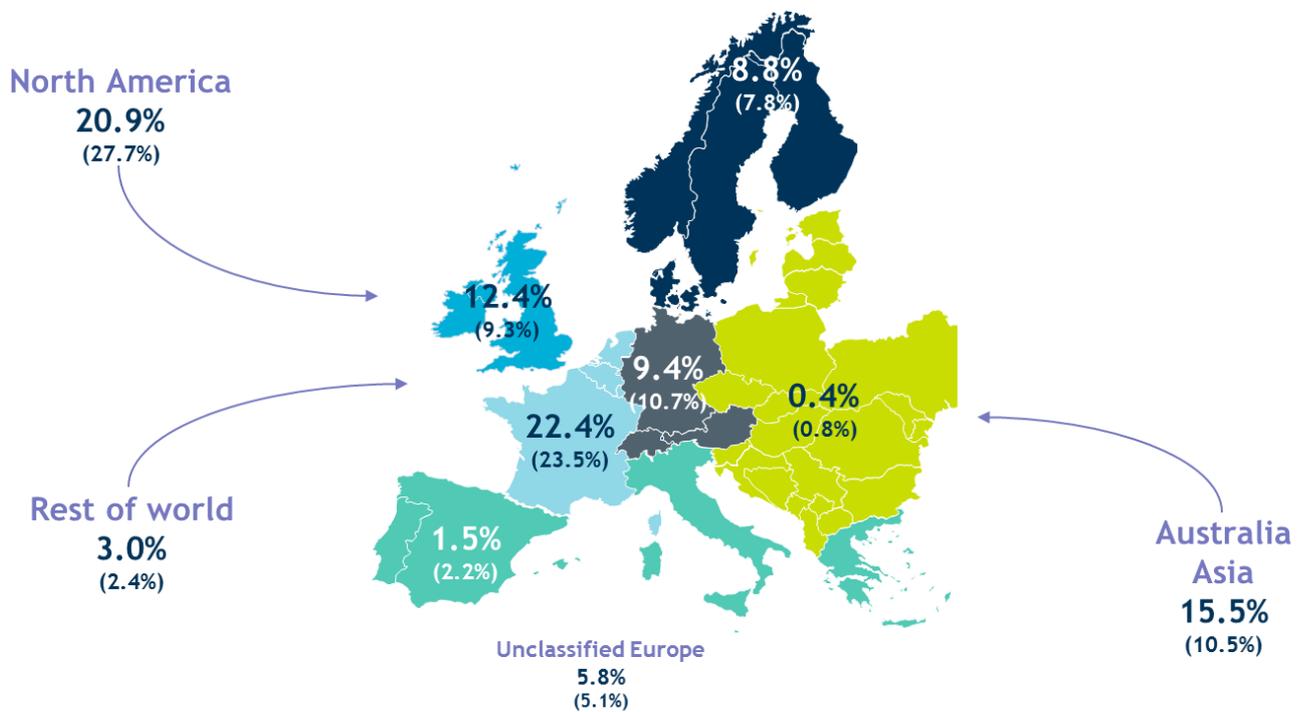
⁴ For example, Germany. Within this context, it is important to keep in mind that the fact that a national private placement regime is abolished means, in the absence of a passport, that the market is completely closed.

⁵ According to an ILPA survey most institutional investors in Europe (78%) have selected more than half of their private equity managers from outside Europe.

by spreading investment more widely.

Furthermore, capital invested by European institutional investors into non-European private equity fund managers has every chance to be reinvested into European companies, provided these are attractive. Between 2010 and 2015, private equity firms located in Europe invested €15.8bn in non-European economies; over the same period of time, private equity firms located outside Europe invested €9.5bn in the European economy. Similarly, from 2009 to 2015 the investment of non-European private equity fund managers into European companies has grown significantly both in nominal and percentage terms (from 2.4% to 8.2% of overall investment for venture capital).

A well-functioning private placement framework is a key part of Europe’s financial regulatory architecture and necessary to ensuring the **global capital flows that are at the heart of private equity**. In the absence of a marketing passport EU investors (also) need to rely on private placement to be able to **access non-EEA fund managers and EEA fund managers with non-EEA funds**.



Source: Invest Europe / PEREP_Analytics
2015 European Private Equity Activity

Private equity fund geographic fundraising breakdown in 2015 (2014)

But also once a third country marketing passport is available, national private placement regimes should be preserved to provide fund managers and investors with options.

Indeed, while Invest Europe supports the marketing passport as a potentially effective means for European investors to access global investment opportunities, it is important that its introduction is done in a proportionate, efficient, uniform, practical and commercially sensitive way and does not jeopardise the



continuation of NPPRs.

It is vital that the national private placement regimes are maintained alongside the third country passport in order to enable third country fund managers who only wish to approach a select number of investors in the EEA to continue to be able to do so without being forced to use the passport.

Some non-EU fund managers will, for commercial reasons, decide that they only wish to market their funds in specific Member States, not across the whole EU. For example, they might only wish to market to investors with whom they already have a relationship and/or might only wish to market to a very small number of investors. For such managers, having to apply for full authorisation in order to obtain the passport would impose disproportionate costs.

Some non-EEA managers will no doubt choose to use the passport (if the arrangements for identification of a Member State of Reference can be made workable and proportional which requires among others more clarity on issues such as determination of Member State of Reference and Grandfathering rules (to name only a few). But other fund managers - especially those with few existing European investors - may simply decide to by-pass European investors completely, instead concentrating their fundraising in other parts of the world. The alternative - requiring their entire fund and management structure and by implication their global investors become subject to AIFMD - may not be attractive.

In such a scenario the primary impact will be felt by European investors, for whom the universe of available investment opportunities will have been reduced, limiting their choice, constraining their opportunities to diversify and reduce risk and - critically - hampering their ability to invest in those funds that they believe provide the best potential for returns. This puts European investors at a potential disadvantage to their competitors in other regions⁶.

Around 40% of the capital that European private equity managers have for investment comes from outside the EU, raised from institutional investors such as pension or sovereign wealth funds who see the potential in European companies but lack the expertise or resources to identify those specific companies that merit investment. As a result, with 40.3% of the capital raised by the European private equity industry coming from outside the EU, impediments to marketing would have a significant impact on private equity and venture capital managers' capacity to continue to invest in European SMEs.

And even if it may not be likely, if European borders / NPPRs are effectively closed, one cannot rule out the risk of some form of retaliatory action by third countries, restricting EU managers from marketing their funds to investors in those jurisdictions.

That the long-term maintenance of private placement as an option for fund managers is a key component of the continued health of European private equity and venture capital is therefore clear. But existing private placement regimes have weaknesses and can be improved. The complexity of 28 individual private placement regimes where they are available (some Member States have simply prohibited them) raises the costs of doing business in Europe. Please see our response to Questions 4.1 and 8.4 for more information.

⁶ According to an ILPA survey 68% of institutional investors felt AIFMD left them at a competitive disadvantage.



2. CREATING A VOLUNTARY PASSPORT FOR SUB-THRESHOLD FUND MANAGERS

Invest Europe members support the distinction between above and sub-threshold funds, which recognises that for fund managers with assets below €500 million the costs associated with application of the AIFMD would simply not be sustainable.

But, as explained in our response to Question 3.3, too many smaller fund managers are now prevented from operating across the EU single market either because Member States are excluding them from their national private placement regime or because they do not qualify for the EuVECA passport given the strict eligibility criteria for that regime (which limit its availability to certain venture capital funds and exclude, for example, growth capital funds). Such smaller fund (manager)s could in theory opt in to the full AIFMD to get access to an internal marketing passport, but this is likely to be unduly burdensome for the type and size of fund they represent and not reflective of the actual (if any) systemic risk that they pose.

A situation in which many managers of growth funds - providing capital to European SMEs - are unable to undertake cross-border marketing unless they opt in to a regime designed for large fund managers and manifestly unsuited to them, seems difficult to justify in a Capital Markets Union and may even run counter to Treaty freedoms.

Financing for SMEs

Smaller managers pursuing a 'growth' or similar strategy also provide essential funding for developing European businesses and help to fill the funding and development gap for more established SMEs.

According to our 2015 statistics, there are 531 private equity and venture capital fund managers in Europe with assets under management between €100 and €500 million. They have a total of €120 billion assets under management, representing about a quarter of all private equity and venture capital firms in Europe and a fifth of assets under management.

During their development smaller companies may be backed at different stages of their life by different types of funds. Funds with a 'Growth', 'Development' or buy-out strategy can play as important a role in the long-term success of a European SME as those with a 'Venture Capital' objective.

Growth and other sub-threshold funds have the potential to make a valuable contribution to the funding of SMEs that are looking to expand and develop, but their ability to do so is being hampered by the restrictions being placed on their ability to market across EU borders. Such managers should as a minimum be able to market cross-border under national private placement regimes on the same basis as domestic managers. But the Commission's level of ambition should extend further and an appropriately tailored pan-European regime - similar to EuVECA - should (also) be introduced.

This can have a direct positive effect on the financing of companies across Europe. Between 2010 and 2015 growth fund managers only raised, in incremental amounts, €14 billion in Europe compared to the €27 billion of capital raised by venture fund managers. Over the same period, nearly 20,000 companies received venture capital investment while only 6,635 were backed by growth capital.



A tailored marketing passport

Building on the above, there is a strong case for considering whether a tailored regime similar to the voluntary EuVECA regime should be developed for all fund managers whose assets under management are below the €500 million threshold, regardless of whether they are venture capital or growth/expansion funds. Such a regime would enable these funds to market more efficiently cross-border and would help growth funds to support more companies with later stage financing.

Limiting EuVECA only to venture capital funds that meet a specific set of fairly restrictive criteria implies a stark distinction between fund investment strategies that may not be helpful nor reflective of the needs and the experiences of either the investors or companies which they are typically looking to finance through different stages of growth.

These small funds should be provided with a means to market across EU borders, as failure to do so undermines the objective to establish a single market for capital. Fund managers who do not need to be authorised under the AIFMD do not pose systemic risk (which is the justification for not requiring full AIFMD authorisation), are not likely to pose a higher degree of risk for investors than venture capital funds, and would still only enjoy a pan-EU passport to market to “professional investors” (and not to retail investors). Since development and growth finance are just as important for the EU economy as start-up capital, an internal market passporting regime should be made available to these fund managers as well.



Contact

Thank you in advance for taking our feedback into account as part of the consultation process. We would be delighted to discuss any of the comments made in this paper in further detail.

For further information, please contact Michael Collins (michael.collins@investeurope.eu) at Invest Europe.