
# Access to EU markets under AIFMD and MIFID – an update

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## Summary

The ability for third-country firms to access EU markets under the AIFMD, MiFID II and MiFIR is of significant benefit. However, some uncertainty remains as to the ease by which third-country firms can (or will be able to) avail themselves of such access rights and the willingness of Member States to facilitate access where such decisions are within the auspices of the regulatory authorities of individual Member States.

The decision of the United Kingdom to leave the European Union on 23 June 2016 has caused further uncertainty in this regard. Third-country access may be used as a political bargaining chip in Brexit negotiations. This will inevitably result in delays to any decisions being reached (as has already been seen in the case of the AIFMD) and may result in more onerous terms being applied to the granting of any such rights.

The current situation (relying on national private placement regimes for access to EU markets under the AIFMD; no current access under MiFID I; theoretical access under MiFID II / MiFIR from 3 January 2018) is likely to persist until the Brexit question is resolved. But we should remember that – in the case of firms relying on national private placement regimes for access to EU markets under the AIFMD – this is not necessarily a bad situation (quite the opposite in many cases). Clearly unsatisfactory, however, is the situation currently facing third-country firms hoping to acquire access to EU markets when MiFID II / MiFIR comes into force.

## Outline of legislation

- AIFMD provides third-country firms two possible means of accessing EU markets:
  a. National private placement regimes. We continue to see significant use made by clients of national private placement regimes, achieving satisfactory access to their target investors in specific Member States. The national private placement regimes of Member States are not harmonised. We have found those easiest-to-navigate in the United Kingdom, The Netherlands, Ireland and Luxembourg.
  b. Passport extension. Guernsey and Jersey, together with Switzerland, were given an "unqualified and positive assessment" in July 2015 in connection with the third-country passport. This was reconfirmed in July 2016. The EU Commission is yet to specify the date by which the third-country passport should be extended to those jurisdictions. The delay may actually be beneficial. The national private placement route continues to offer clients access to almost all of the EU's largest capital markets, whilst avoiding many of the most burdensome AIFMD obligations which the third-country passport would entail.
- MiFID I contains no passporting provisions.
- MiFID II and MiFIR (scheduled to replace MiFID I in January 2018) enable third-country firms to access:
  a. eligible counterparties and per se professional clients in any Member State (i) by registering with ESMA once the Commission has deemed the third-country firm's home regulatory regime "equivalent" and has put in place

co-operation arrangements with ESMA and/or (ii) by establishing a branch in a Member State once "equivalence" is achieved (in this second option, there is no need to register with ESMA; passport rights are then available to the branch across the EU)

b. retail clients and elective professional clients by establishing a branch in a Member State. There is no need to register with ESMA or achieve "equivalence". This only provides access to retail clients and elective professional clients in the Member State where the branch is established.

- MiFID II / MiFIR "equivalence" is confirmed by the EU Commission. Brexit may result in this being delayed.
- Member States must opt into the branch requirement. This, plus their ability to determine the satisfaction of the branch authorisation requirements, will mean non-harmonised (and potentially wildly varying) standards for accessing retail and elective professional investors. Approvals can also be withdrawn at short notice.

## Background

On the 23rd of June 2016, the United Kingdom voted to leave the EU by a margin of 51.9% to 48.1%. Some ten months have passed since this momentous vote, during which we have witnessed some very public and somewhat bemusing political hari-kiri, a new Prime Minister take office, a High Court challenge to determine the extent of the Government's prerogative powers to trigger Article 50 of the Lisbon Treaty (and a subsequent appeal of the High Court's decision direct to – uniquely – an 11-man panel of the Supreme Court), a public debate at times only marginally less acrimonious than that leading up to the vote itself, and many rather splendid contenders for the 2016 international word of the year.

At the time of writing, amidst the fog of claim and counter claim by Remainers/Remoaners and Leavers/Brexiteers, the one thing we do know is this: we still don't know what the precise terms of "Brexit" are likely to be. Nor, sadly, are we likely to for some months.

Not surprisingly, much commentary on the potential impact of Brexit has focused on the United Kingdom's trading relationship with the EU. In 2015, the UK exported 44% (£223.3bn) of its goods and services to the EU and imported 53% (£291.1bn) from the EU[1]. Whilst the EU represents a declining share of the United Kingdom's imports and exports, it nonetheless remains its largest trading partner.

The potential for a "hard Brexit" (leaving the single market and inter alia losing the pan-EU passporting rights enjoyed by its members) has seen an increased focus on the means by which firms in non-EU countries can potentially obtain (or, in the case of the UK, retain) some degree of access to the single market.

The impending "Guernseyfication" of the United Kingdom (currently the fastest growing advanced economy, and the world's fifth[2] largest, now inexorably destined to become "a little country on the world scale"…) presents us with an opportune moment to update our earlier client briefings on the AIFMD and MifiD II / MiFIR, since the issues raised in connection with Guernsey domiciled entities may become relevant for the United Kingdom (and, indeed, be influenced by Brexit).

This memorandum is intended to provide a detailed reminder of the principal provisions of the legislation facilitating access to the EU for "third-country" (i.e. non-EU domiciled) firms; an update as to the latest developments in the granting of access rights; some market colour on the approaches taken, and views held, by our clients in accessing the EU markets; as well as our thoughts for the future. This memorandum is written as of January 2017. At the time of writing, the stated position of Theresa May's government is that the Article 50 notification will be triggered by the end of March 2017. Given the prescribed 2 year negotiation process, we would expect that some of the current uncertainties will become more clearer by March 2019, if not sooner.

## The AIFMD

Directive 2011/61/EU[3] of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (the "AIFMD") was formally signed in Strasbourg on 8 June 2011 on behalf of the European Parliament and the EU Council. The AIFMD "aims at establishing common requirements governing the authorisation and supervision of AIFMs in order to provide a coherent approach to the related risks and their impact on investors and markets in the Union[4]". The AIFMD "aims to provide for an internal market for AIFMs and a harmonised and stringent regulatory and supervisory framework for the activities within the Union of all AIFMs, including those which have their registered office in a Member State (EU AIFMs) and those which have their registered office in a third-country (Non-EU AIFMs)[5]."

As is clear from the above, the scope of the AIFMD is broad, covering both the management and the marketing of an alternative investment fund (an "AIF": broadly, non-UCITS collective investment schemes).

Thus any manager of an AIF (an "AIFM"), whether established in the EU (an "EU AIFM") or otherwise (a "Non-EU AIFM") and whether managing an AIF established in the EU (an "EU AIF") or otherwise (a "Non-EU AIF") is impacted by the AIFMD should they market into, or operate in, the EU.

*1 Source: Office of National Statistics, UK Perspectives 2016: Trade with the EU and beyond.*
*2 Source: IMF, based on estimated GDP (current prices) for 2016.*
*3 For the full text of the AIFMD please see here.*
*4 AIFMD, recital, paragraph (2).*
*5 AIFMD, recital, paragraph (3).*

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## Guernsey, Jersey and the Cayman Islands vis-à-vis the EU

Neither Guernsey nor Jersey nor the Cayman Islands are members of the EU. Thus, any AIF established in Guernsey, Jersey or the Cayman Islands is classified as a Non-EU AIF, and any Guernsey, Jersey or Cayman AIFM is a Non-EU AIFM.

This section of the briefing note provides a reminder of the means by which the AIFMD permits Non-EU AIFMs (whether managing an EU- or Non-EU AIF), and EU AIFMs managing Non-EU AIFs, to market those AIFs in the EU, and the additional operational burden imposed by the AIFMD of them doing so[6]. It also reviews how Non-EU AIFMs and EU AIFMs of Non EU AIFs in Guernsey and Jersey are dealing with the requirements of the AIFMD in developing and implementing their EU marketing strategies of the AIFs for which they are responsible. Finally, it provides an update on the potential third-country passport regime for Guernsey and Jersey.

## Marketing of AIFs in the EU by non-EU AIFMs and of non-EU AIFs by EU AIFMs

The AIFMD provides for two principal means by which Non-EU AIFMs (whether managing an EU- or Non-EU AIF) and EU AIFMs managing Non-EU AIFs can market such AIFs in the EU:

- pursuant to national private placement regimes ("NPPRs"); and
- pursuant to the third-country passport regime (the "Passport Extension").

## Accessing the EU via National Private Placement Regimes

Currently, the only means by which by which Non-EU AIFMs (whether managing an EU- or Non-EU AIF) and EU AIFMs managing Non-EU AIFs can market[7] such AIFs in the EU is via the NPPR route, pursuant to AIFMD Articles 36 and 42.

For EU AIFMs managing a Non-EU AIF, AIFMD Article 36 permits Member States to allow authorised EU AIFMs to market units of the Non-EU AIF to professional investors[8] in that Member State only, provided that:

- the EU AIFM complies with all of the requirements of the AIFMD with the exception of Article 21 (which prescribes specific requirements relating to the AIF's depositary), provided that an entity other than the AIFM is appointed to satisfy cash flow monitoring requirements[9], safe-keeping criteria[10], and provisions[11] relating to valuation and creation/ redemption of units;
- appropriate information sharing arrangements are in place between the EU AIFM's domestic regulators and those of the Non-EU AIF to facilitate systemic risk oversight ("Co-Operation Arrangements")[12]; and
- third-country where the Non-EU AIF is established is not listed as a Non-Cooperative Country and Territory by the Financial Action Task Force on anti-money laundering and terrorist financing (the "FATF Requirement")[13].

For Non-EU AIFMs (whether managing an EU- or Non-EU AIF), AIFMD Article 42 permits Member States to allow the Non-EU AIFMs to market units of the Non-EU AIF to professional investors provided that:

- the Non-EU AIFM complies with the requirements of AIFMD Articles 22 to 24, and – where the AIF being marketed acquires control of a non-listed company – AIFMD Articles 26 to 30[14] (please see below for an explanation of these provisions);
- Co-Operation Arrangements are in place between the each of the relevant regulatory authorities (i.e. those of the Member State where the AIF is marketed and the Member state / third-country (as applicable) where the AIFM and AIF are established)[15]; and
- the third-country where the Non-EU AIFM or Non-EU AIF is established (as applicable) satisfies the FATF Requirement[16].

It is important to note that access to the markets in Member States under both Article 36 and Article 42 is at the discretion of Member States (meaning they may choose not to have a private placement regime) and, where a Member State does permit access to its market, it is permitted "to impose stricter rules on the AIFM in respect of the marketing of units or shares[17]" their territory. Thus the use of the NPPRs needs to be considered on a Member State by Member State basis to determine whether or not it is permitted and, if so, whether there are any additional obligations imposed by that Member State over and above the requirements of AIFMD Articles 36 and 42.

## Routes to market being selected by non-EU AIFMS

We continue to see many Non-EU AIFMs, with significant assets under management in respect of new Non-EU AIFs, elect to market those AIFs under the national private placement regime particular to the relevant Member State where marketing is proposed.

*6 An EU AIFM managing an EU AIF is, of course, caught by the full provisions of the AIFMD.*
*7 It is important to note that the provisions of the AIFMD do not apply in the case of reverse solicitation (the AIFMD defines marketing as "any direct or indirect offering or placement at the initiative of the AIFM …").*
*8 The AIFMD defines a "professional Investor" as an investor which is considered to be a "professional client" or may, on request, be treated as a professional client as per the criteria set out in Annex II to the Markets in Financial Instruments Directive ("MiFID", Directive 2004/39/EC, see here).*
*9 See AIFMD Article 21(7).*
*10 See AIFMD Article 21(8).*
*11 See AIFMD Article 21(9).*
*12 Please see Schedule 1 for the list of EU / EEA jurisdictions with which Guernsey has in place co-operation agreements.*
*13 Guernsey is not listed as a Non-Cooperative Country and Territory by the FATF.*
*14 Guernsey's AIFMD (Marketing) Rules, 2013 ensure that Guernsey funds and Guernsey fund managers established in Guernsey who wish to market into the EEA meet the requirements of AIFMD Article 42. These Rules introduce minimal notification requirements to the GFSC by Guernsey fund managers and Guernsey funds in respect of marketing into the EEA. These Rules will also allow the Commission to co-operate effectively with the relevant EEA securities regulator.*
*15 Please see Schedule 1 for the list of EU / EEA jurisdictions with which Guernsey has in place co-operation agreements.*
*16 Guernsey is not listed as a Non-Cooperative Country and Territory by the FATF.*
*17 See AIFMD Article 36(2) and Article 42(2).*

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We do, however, see a limited number Non-EU AIFMs taking the decision not to register under the national private placement regime of the Member State where their investors are based. Why would they take this decision? Many that hold back from marketing into the EU on an active basis (choosing to rely instead on the passive route of reverse solicitation) perceive a lack of cohesion across the Member States in terms of the registration requirements and obligations being imposed. This has the inevitable consequence of increased costs for AIFMs, both of identifying the specific requirements of each jurisdiction in order to proceed with marketing, and ongoing compliance therewith. We have also noted in particular the unattractiveness to many non-EU AIFMs of the requirement to disclose staff remuneration and carried interest mechanisms[18].

Under the NPPRs, the legal processes and routes to market are prescribed entirely by the Member State where marketing is proposed. The jurisdictions with the quickest routes to market are those which require a notification process, immediately after the completion of which marketing can commence (e.g. the United Kingdom, The Netherlands, Ireland and Luxembourg). Next are those where an AIFM will need to wait for the regulator to confirm that marketing can commence (which can take some weeks).

Jurisdictions such as Germany and Denmark are a little more stringent for Non-EU AIFMs. For example, both require Non-EU AIFMs to comply with a "depositary-lite" regime (this puts them on a par with the requirements of EU AIFMs of Non-EU AIFs – see above). Further, the turn-around time for applications to regulators, which can take months, can be a disincentive for Non-EU AIFMs trying to access an EU market. Such processes impact on timing for routes to market and contrast starkly with those Member States operating a "notification-only" regime.

## The Practical Impact of the AIFMD requirements for an above threshold non-EU AIFM

As described above, the AIFMD sets out a minimum compliance regime for Non-EU AIFMs (which are above threshold)[19] seeking to market into the EU. These require that certain disclosures are made to investors, that there is regular reporting to regulators, that an annual report is prepared including certain specific disclosures and that the AIFM complies with certain stake-building notifications and asset stripping restrictions.

**Annual report of the non-EU AIF (Article 22)**

The AIF's annual report must be made available to investors based in the EU and filed with the relevant regulator in the Member State where marketing is conducted within six months of the AIF's financial year end. Disclosures to be included in the financial statements include the total remuneration for the financial year, split into fixed and variable remuneration, paid by the AIFM to its staff, as well as the number of beneficiaries and (where relevant) any carried interest paid by the AIF.

**Disclosures to investors (AIFMD Article 23)**

Usually the enhanced disclosures required under AIFMD Article 25 are very easily incorporated into the offering document. It has become quite usual to do this by way of appendix (for ease of reference by any regulator or investor and to facilitate any required review by any EU counsel as relevant). So, for example, any details of preferential treatment of shareholders by way of side letters will need to be disclosed to investors. So too, the disclosure of leverage used will need to be calculated and disclosed in accordance with the EU Commission's Delegated Regulation of 19 December 2012 supplementing the AIFMD[20].

**Regular reporting to regulators (AIFMD Article 24)**

A Non-EU AIFM of a Non-EU AIF will be required to file an "Annex IV" report[21] quarterly with the regulator of any Member State where the AIF is being marketed. The form of the report has been specified by the European Securities and Markets Authority ("ESMA") and has been adopted by and large wholesale in each Member State.

Where Non-EU AIF feeder funds are marketed into the EU, in respect of Non-EU AIF master funds, an Annex IV report should only be required in respect of the feeder fund. However, to comply with ESMA's guidance, each Member State is likely to ask for basic information about the master fund concerning its investment strategies, principal exposures and concentrations, risk profile and leverage.

**Stake Building Notifications and Asset Stripping Restrictions (AIFMD Articles 26 to 30)**

In the event that an AIF holds investments in companies which have their registered offices in the EU, certain notifications to EU regulators will be required where interests in unlisted target companies exceed or fall below certain thresholds. Where control is acquired by the relevant AIF then certain information might need to be made available, not only to the applicable regulator, but also to the company (whether listed or not) and its shareholders.

*18 Although accessing Member State markets via AIFMD Article 42 does not (in the absence of individual Member States imposing additional requirements) result in the application of the remuneration policies specified by AIFMD Article 13, it does result in certain remuneration disclosures under AIFMD Article 22.*

*19 AIFMD Article 3(2) defines the AUM thresholds for the AIFMD to apply to AIFMs. Broadly speaking, these are (a) assets under management (including any assets acquired through the use of leverage ) of not more than €100 million; and (b) assets under management (where there is no use of leverage and the funds are closed-ended and whose) of not more than €500 million.*

*20 Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision. See here for the full text.*

*21 AIFMD Annex IV (Documentation and Information to be Provided in the case of Intended Marketing in Member States other than the Home Member State of the AIFM) prescribes the information to be disclosed.*

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Restrictions on certain transactions (commonly known as asset stripping) apply for a period of 24 months following a transaction where any AIF individually or jointly acquires control of a non-listed company.

## Reverse solicitation

For those AIFMs who wish to avoid active marketing in the EU, it will be critical that they understand what activities constitute "marketing" in their target Member State market. The AIFMD defines marketing as meaning a "direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union"[22]. The AIFMD does recognise that it does not intend to regulate the circumstances where an investor approaches an AIFM on the basis that it is seeking an investment at its own initiative[23]. There may be varying interpretations between Member States of what constitutes "marketing" and there may be different ways across the Member States of evidencing that a specific investment is made at an investor's initiative. All AIFMs should take measures to understand the varying requirements of the jurisdictions where their potential investors are based before transacting with them.

## The availability of a passport for non-EU AIFMS

The specifically stated intention of the AIFMD[24] is that a passport regime created by the AIFMD to EU AIFMs managing EU AIFs be extended (after a 2 year transitional period) to both Non-EU AIFMs (whether managing an EU- or Non-EU AIF) and EU AIFMs managing Non-EU AIFs (the "Passport Extension"). Furthermore, after a 3 year period of co-existence, the NPPR should be phased out such that the Passport Extension remains the only means by which Non-EU AIFMs (whether managing an EU- or Non-EU AIF) and EU AIFMs managing Non-EU AIFs are able to market such AIFs in the EU[25].

Pursuant to AIFMD Article 67, ESMA was required to issue (by July 2015) an opinion on the application of the passport to the marketing of Non-EU AIFs by EU AIFMs in the Member States and the management and/or marketing of AIFs by non-EU AIFMs in the Member States in accordance with the rules set out in AIFMD Articles 35 and 37 to 41 (i.e. the extent to which the limitations of the NPPRs (currently the only means of accessing EU markets unless you are an EU AIFMs managing an EU AIF) can be replaced by the Passport Extension).

More specifically, AIFMD Article 67(4) requires ESMA:

- where it "considers that there are no significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk, impeding the application of the passport to the marketing of non-EU AIFs by EU AIFMs in the Member States and the management and/or marketing of AIFs by non-EU AIFMs in the Member States in accordance with the rules set out in Article 35 and Articles 37 to 41"; to
- "issue positive advice in this regard" (i.e. approve the granting of the Passport Extension).

Under AIFMD Article 67(6), the Commission should, within 3 months of the issue of such "positive advice", adopt a delegated act specifying the date when the relevant rules become applicable in all Member States and the Passport Extension can be granted.

As regards the retention of the NPPRs, AIFMD Article 68 provides for a period of at least three years during which – theoretically – Non-EU AIFMs (whether managing an EU- or Non-EU AIF) and EU AIFMs managing Non-EU AIFs can access both the NPPR and the enjoy the Passport Extension. Even after the end of the three year period, the NPPRs will only be phased out if ESMA opines that a phase out is feasible and recommended and (after input from the industry) these recommendations are accepted.

The principle of the Passport Extension is that, in order to enjoy the same rights, Non-EU AIFMs should comply with the same obligations, meaning that Non-EEA AIFMs will be able to benefit from the Passport Extension so long as they abide by the rules of the AIFMD.

As a consequence, the competent authority of the Member State of reference will have responsibility for supervising compliance with the AIFMD by non-EU AIFMs.

The conditions for the grant of the Passport Extension are as follows:

- EU AIFMs managing Non-EU AIFs[26]
  a. The EU AIFM must comply with all the requirements of the AIFMD except those of AIFMD Chapter VI (Rights of EU AIFMs to Market and Manage EU AIFs in the EU).
  b. Appropriate cooperation arrangements must be in place between the competent authorities of the home Member State of the AIFM and the supervisory authorities of the third-country where the Non-EU AIF is established which ensure an efficient exchange of information that allows the competent authorities to carry out their duties in accordance with the AIFMD.
  c. The third-country where the Non-EU AIF is established must satisfy the FATF Requirement.

*22 AIFMD Article 4(1)(x).*
*23 AIFMD, recital, paragraph (70).*
*24 AIFMD, recital, paragraph (4): "It is intended that … a harmonised passport regime become applicable to non-EU AIFMs performing management and/or marketing activities within the Union and EU AIFMs managing non-EU AIFs after the entry into force of a delegated act by the Commission in this regard. It is intended that the harmonised regime, during a further transitional period of 3 years, co-exist with the national regimes of the Member States subject to certain minimum harmonised conditions. After that 3-year period of co-existence, it is intended that the national regimes be brought to an end".*
*25 Note that marketing is only permitted to professional investors.*
*26 AIFMD Article 35*

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d. The third-country where the Non-EU AIF is established must have signed an agreement with the home Member State of the AIFM and with each other Member State in which the units or shares of the non-EU AIF are intended to be marketed, which fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements (a "Suitable Tax Agreement").

- Non-EU AIFMs managing EU AIFs[27]
  a. The Non-EU AIFM must be authorised[28] by its Member State of reference pursuant to the provisions of AIFMD Article 37.
  b. The Non- EU AIFM, and its management of the EU AIF, must comply with the provisions of the AIFMD[29].
- Non-EU AIFMs managing Non-EU AIFs[30]
  a. The Non-EU AIFM must be authorised[31] by its Member State of reference pursuant to the provisions of AIFMD Article 37.
  b. The Non-EU AIFM must satisfy the requirements imposed upon EU AIFMs managing Non-EU AIFs[32] (see above).
  c. Appropriate cooperation arrangements must be in place between the competent authorities of the Member State of reference of the AIFM and the supervisory authorities of the third-country where the Non-EU AIF is established which ensure an efficient exchange of information that allows the competent authorities to carry out their duties in accordance with the AIFMD
  d. The third-country where the Non-EU AIF is established must satisfy the FATF Requirement.
  e. The third-country where the Non-EU AIF is established must have signed a Suitable Tax Agreement with the Member State of Reference the AIFM and with each other Member State in which the units or shares of the Non-EU AIF are intended to be marketed.

### Where are we with the passport extension?

Guernsey and Jersey (together with Switzerland) received an "unqualified and positive assessment" in the first set of advice on the third-country passport issued by ESMA in July 2015 (as required pursuant to AIFMD Article 67). In July 2016, ESMA extended this to Canada and Japan.

Under Article 67(6), the Commission should within 3 months (i.e. by October 2016) of "having received positive advice and an opinion from ESMA" have adopted a delegated act specifying the date when the relevant rules become applicable in all Member States and the passport can be extended to third countries.

At the time of writing, this is yet to occur.

ESMA's advice[33] suggested that "The European Council, Parliament and the Commission ... may wish to consider whether to wait until ESMA has delivered positive advice on a sufficient number of non-EU countries before triggering the legislative procedures foreseen by Articles 67(5) and (6), taking into account such factors as the potential impact on the market that a decision to extend the passport might have".

It cannot be stated for certain whether Brexit (and the fact that a post-Brexit United Kingdom would inevitably satisfy third-country passporting requirements, and would therefore seek to take advantage of the Passport Extension) has resulted in what appears to be an indefinite pause in the process. It would, however, appear to be the most likely explanation.

Uncertainty aside, the delay may in fact have a net benefit for those entities currently relying on the NPPRs. As set out above, the NPPRs impose fewer burdens than the full AIFMD adherence that the Passport Extension would necessitate. For example, the Passport Extension would require adherence to the remuneration provisions of AIFMD Article 13, whereas the NPPR regime requires only disclosure of remuneration policies.

Theoretically there will be a minimum of three years during which the NPPRs and the Passport Extension are both available. Given that this would put non-EU AIFMs and EU AIFMs managing Non-EU AIFs in a better position than EU AIFMs managing EU AIFs, it may well be that the various Member States decide to end their NPPRs once the Passport Extension is granted.

Thus although the delays to the Passport Extension apparently caused by Brexit have given rise to uncertainty, the net result may be an overall benefit in that they postpone the full impact of the AIFMD on AIFMs currently relying on the NPPR.

## MiFID II and MIFIR

Directive 2004/39/EC[34] of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments ("MiFID I") replaced the Investment Services Directive. MiFID was adopted in April 2004 and came into force in November 2007. Its aim was to improve the competitiveness of EU financial markets by creating a single market for "investment services and activities[35]" relating to "financial instruments ", and ensure a high degree of harmonised protection for investors.

*27 AIFMD Article 39*
*28 AIFMD Article 39(1)*
*29 AIFMD Article 39(3). Note that this is determined by the "The competent authorities of the Member State of reference".*
*30 AIFMD Article 40*
*31 AIFMD Article 40(1)*
*32 AIFMD Article 40(2).*
*33 See paragraph 13 of ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs, 12 September 2016. See here for the report.*
*34 For the full text of MiFID please see here.*
*35 See MiFID I, Annex I, Section A.*

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Following the 2008 financial crisis, the EU Commission conducted a consultation in December 2010 to reform MiFID. This resulted in a revised Directive (Directive 2014/65/EU[37] of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("MiFID II")) and a new Regulation (Regulation (EU) No 600/2014[38] of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending ("MiFIR")). Both MiFID II and MiFIR entered into force on 2 July 2014 and are required to be transposed into national law by 3 July 2017. Currently, they must apply within Member States by 3 January 2018.

### MIFID I - no current passport regime

MiFID I does not harmonise access to EU markets for third-country firms. Each Member State currently decides its own regulations regarding access subject to certain EU Treaty principles, provided that a third-country firm should not receive more favourable treatment than an EU firm. There is no "passport" by which a third-country firm can establish an authorised branch in one Member State and then provide those services in another Member State. Each Member State may require a new authorisation.

### MiFiR - access to eligible counterparties and certain professional investors without using an EU branch

For the first time, MiFIR allows third-country firms[39] to provide investment services or perform activities directly to eligible counterparties[40] and "per se" professional clients[41] throughout the EU. Under MiFIR, these firms may do so without necessarily having to establish a branch in any Member State provided that they are registered with ESMA as a permitted third-country firm. The conditions for such registration are as follows[42]:

- the European Commission has made a determination pursuant to MiFIR Article 47 that the firm's country has a relevant legal and supervisory regime broadly equivalent to the EU's (an "Equivalence Decision");
- the firm is authorised to provide the relevant investment services or activities in the jurisdiction of its head office; and
- co-operation arrangements exist between ESMA and the relevant third-country.

Significantly, Member States do not elect to grant this access, nor can they opt-out of it, nor can they impose any additional requirements on third-country firms, nor can they treat them more favourably than an EU firm. Once a positive Equivalence Decision is made and a third-country firm is on ESMA's register, access is granted and there can be no gold-plating by any Member State.

### MiFIR - access to eligible counterparties and certain professional investors using an EU branch

Under MiFIR Article 47(3), a third-country firm established in a country with a positive Equivalence Decision, and which has established an authorised[43] branch in a single Member State, may provide its investment services to eligible counterparties and "per se" professional clients throughout the EU without having to establish further branches and without the third-country firm or its branch having to register with ESMA (provided the branch complied with MiFID II's cross-border information requirements[44]).

### MiFID II - access to retail clients and elective professional clients

Where a third-country firm intends to provide investment services or perform investment activities to retail clients or "elective" professional clients[45] in a Member State, MiFiD II Article 39 permits[46] that Member State to require that third-country firm to establish a branch in that Member State.

### Requirements for the establishment of a branch

Where a Member States does require the establishment of a branch, it must be authorised by that Member State's competent authority, which must be satisfied that:

- the third-country firm is appropriately authorised in its home country (e.g. Guernsey or Jersey);
- co-operation arrangements are in place between the Member State and the firm's country;
- the branch has adequate capital available to it;
- the firm's senior management systems and controls are sufficient;
- the third-country where the third-country firm is established has signed a Suitable Tax Agreement with the Member State; and
- the firm belongs to an EU authorised or recognised investor compensation scheme.

*36 See MiFID I, Annex I, Section C.*
*37 For the full text of MiFID II please see here.*
*38 For the full text of MiFIR please see here.*
*39 A "third-country firm is defined as "a firm that would be a credit institution providing investment services or performing investment activities or an investment firm if its head office or registered office were located within the Union".*
*40 See MiFID II Article 30.*
*41 See MiFID II, Annex 2, Section 1.*
*42 See MiFIR Article 46(2).*
*43 Such branches must be authorised in accordance with MiFID II Article 39. See the discussion below on access to retail clients and elective professional clients for further information.*
*44 See MiFID II Article 34.*
*45 See MiFID I, Annex II, Section II.*
*46 MiFID II Article 39 states that a Member State "may" require the establishment of a branch. It does not clarify the access requirements for third-country firms seeking access to retail clients and "elective" professional investors in a Member State which has no branch requirement. A Member State may presumably waive the requirement of a branch for third-country firms seeking to access such clients and impose other restrictions.*

Continued

For authorisation to be granted, once the above conditions are satisfied, the Member State must also be satisfied that the branch will be able to comply with significant portions of both MiFID II and MiFIR[47].

The branch will also be subject to the ongoing supervision of the competent authority in the Member State where the authorisation was granted.

Although Member States may elect not to impose the branch requirement, if they do they cannot impose any additional requirements on the organisation and operation of the branch in respect of MiFID business, nor can they treat them more favourably than an EU firm. There can be no gold-plating by any Member State.

## The equivalence decision

Given the scope of MiFIR and MiFID, it is unsurprising that much market commentary since Brexit has focused on the possibility of an Equivalence Decision in favour of the United Kingdom (the economic significance of such a decision on the City of London being more pronounced than that of a Passport Extension under the AIFMD).

For a positive Equivalence Decision, the European Commission must be satisfied that "the legal and supervisory arrangements of that third-country ensure that firms authorised in that third-country comply with legally binding prudential and business conduct requirements which have equivalent effect[48]" to the requirements set out in MiFIR, the Capital Requirements Directive and MiFID II (as well as the various implementing measures) and that the third-country has reciprocal equivalence provisions.

## Reverse solicitation

The MiFID and MiFIR restrictions do not apply where a third-country firm provides its services at the "own exclusive initiative" of the prospective client. This is subject to the interpretation of the relevant Member State in which the prospective client is situated.

## Assessing the potential impact of MiFID II / MiFIR

So, what is the likely impact of the access provisions? On the plus side, assuming Equivalence Decisions and ESMA registrations are forthcoming and Member States are amenable to the establishment of a branch (which typically requires less capital and fewer resources than a subsidiary) in their jurisdiction, MiFID II and MiFIR theoretically enable a third-country firm to provide MiFID II services to all categories of investors throughout the EU. Unfortunately it may not be as simple in practice.

First, the Equivalence Decision is the gift of the Commission. Although in theory a technical decision, it will involve a significant political element. The negotiations resulting from the Article 50 notification to initiate Brexit will doubtless include discussions on "equivalence". The ability of the Commission to give a positive Equivalence Decision and the ensuing access rights this provides represents a significant bargaining chip for the Commission in Brexit negotiations. The Financial Times[49] quotes a senior French official who has discussed the issues with the European Commission: "They [the Commission] are already reviewing all of this. The equivalence rules were never envisioned for the City", as well as a senior EU official who suggested that equivalence was "bound to be considered in the light of Brexit". If the "equivalence rules were never envisioned for the City", the manner in which they are applied to the United Kingdom may result in the access process and requirements for other third-country firms such as Guernsey being more onerous than would otherwise have been the case.

Second, even if a positive Equivalence Decision is made and ESMA accepts a third-country firm on the register, such consents can be withdrawn at short notice. In the case of the Equivalence Decision, this can be[50] by the Commission at any time (so long as certain procedures are adhered to); ESMA can withdraw the registration of a third-country firm on as little as 30 days' notice. That threat of such withdrawals hanging like the sword of Damocles over third-country firms may prove a disincentive to invest the time and resources necessary to avail themselves of such access rights.

Third, unlike the access granted under MiFIR Article 46, each Member State may decide whether or not to have the branch requirement. There is therefore no harmonised approach to granting the access to the markets and to the clients which a branch provides. To access eligible counterparties and "per se" professional investors under the passport granted to a branch, there may be a degree of "regulatory arbitrage" and "jurisdiction shopping" whereby third-country firms from jurisdictions with an Equivalence Decision establish a branch in a Member State more amenable to granting such authorisation[51]. As regards retail and "elective" professional investors, there are no such passport rights given to branches. As a result, a third-country firm with an authorised branch in one Member State cannot provide services to retail and "elective" professional investors in another Member State. Notwithstanding that a branch typically requires less capital and fewer resources than a subsidiary, the need to establish a branch in every Member State in which retail and "elective" professional investors are targeted means higher overall costs, bureaucracy and delays which in turn inevitably means fewer such branches.

*47 MiFID II Articles 16 to 20, 23, 24, 25, 27, 28(1), 30, 31 and 32; MiFIR Articles 3 to 26.*
*48 See MiFIR Article 47(1).*
*49 EU reconsiders financial market access rules, Financial Times, 16 November 2016.*
*50 See MiFIR Articles 47(4) and 51(2).*
*51 Remember that where a branch is required the conditions for granting authorisation are the same. However, the determination as to whether the conditions are satisfied is made by the relevant Member State. The conditions are subjective and thus likely to be applied differently across Member States.*

Continued

Finally, it is important to remember that the scope of MiFID II / MiFIR is limited to the provision of investment services and activities (with or without any ancillary services).

## Schedule 1

Summary of Co-Operation Agreements entered into with EU / EEA Jurisdictions[52]

| Country | Co-Operation Agreement in Place? |
|---|---|
| Austria | Yes |
| Belgium | Yes |
| Bulgaria | Yes |
| Croatia | No |
| Cyprus | Yes |
| Czech Republic | Yes |
| Denmark | Yes |
| Estonia | Yes |
| Finland | Yes |
| France | Yes |
| Germany | Yes |
| Greece | Yes |
| Hungary | Yes |
| Iceland | Yes |
| Ireland | Yes |
| Italy | No |
| Latvia | Yes |
| Liechtenstein | Yes |
| Lithuania | Yes |
| Luxembourg | Yes |
| Malta | Yes |
| The Netherlands | Yes |
| Norway | Yes |
| Poland | Yes |
| Portugal | Yes |
| Romania | Yes |
| Slovak Republic | Yes |
| Slovenia | No |
| Spain | No |
| Sweden | Yes |
| United Kingdom | Yes |

*52 Please see the GFSC's website here for the most up-to-date information.*

FIND US

Carey Olsen (Guernsey) LLP
PO Box 98
Carey House
Les Banques
St Peter Port
Guernsey GY1 4BZ
Channel Islands

T +44 (0)1481 727272
E guernsey@careyolsen.com

FOLLOW US

Visit our corporate team at careyolsen.com