Response to the ESMA Call for Evidence on the AIFMD Passport and Third Country AIFMs Doc. 7 November 2014 | ESMA/2014/1340

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Introduction

EMPEA welcomes the opportunity to respond to the European Securities and Markets Authority ("ESMA") Call for Evidence on the Alternative Investment Fund Managers Directive ("AIFMD") passport, alternative investment funds ("AIFs") and third country alternative investment fund managers ("AIFMs") (the Consultation) and submits this response on behalf of its members.

EMPEA is the global industry association for private capital in emerging markets. Founded in 2004, EMPEA has over 300 member firms with offices in more than 100 countries including many in the European Union ("EU") and the European Economic Area ("EEA"). Member firms include investment fund managers ("GPs"); banks, development finance institutions, endowments, family offices, foundations, fund-of-funds, government agencies, insurance companies and pension funds (collectively, "LPs"); and industry advisors. Together EMPEA’s members control or manage over US$1 trillion of assets (much of which is EU derived). EMPEA seeks to be a thoughtful, neutral and objective voice; its industry research is deep and respected; and its training and educational programs are sought out for their strength and impact.

EMPEA’s members share EMPEA’s belief that private capital is a highly suited investment strategy in emerging markets, delivering attractive long-term investment returns for global investors and promoting the sustainable growth of companies and economies. EMPEA supports its members’ activities through authoritative intelligence, conferences, networking, education and advocacy. For more information, please see www.empea.org

Since EMPEA is an industry association and not itself an AIFM (or an investor in an AIF managed by an AIFM), we have not attempted to answer all the questions posed in the Consultation. We believe that other associations, including the European Private Equity and Venture Capital Association ("EVCA"), with whom EMPEA has a close and collegial relationship, may be better placed to answer the questions that we do not address below. However, where we can and to the extent possible, we have provided answers based on anecdotal evidence in responses gathered from our members, in particular institutional investors, development finance institutions, non-EU fund managers and EU fund managers engaged across emerging markets including in emerging Europe, emerging Asia, Africa, the Middle East and Latin America.

EMPEA respects ESMA’s mission to gather input on the key issues that will determine the orientation of ESMA’s opinion to the European Parliament. EMPEA is mindful of ESMA’s responsibility to submit an opinion to the European Commission on the following matters by 22 July 2015:

1) the functioning of the EU passport under the AIFMD; and
2) the functioning of the marketing of non-EU AIFs by EU AIFMs in the EU and the management and/or marketing of AIFs by non-EU AIFMs in the EU (under the national private placement regimes); and

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1 "Private capital" encompasses private equity and venture capital and adjacent investment approaches including infrastructure, real assets, private credit and institutional quality impact investing
2 Including the European Investment Bank and European Bank for Reconstruction and Development
3 Including the French (PROPARCO), Dutch (FMO), German (DEG), Finnish (Finnish Fund for Industrial Cooperation), British (CDC), Belgian (BIO), Norwegian (Norfund) and Swedish (Swedfund) development finance institutions
3) whether the current passporting regime should be extended to the management and/or marketing of AIFs by non-EU AIFMs and to the marketing of non-EU AIFs by EU AIFMs.

EMPEA has focused this submission on point 3. Our GP members with direct experience of points 1 and 2 note their strong agreement with EVCA’s submission on these points. We stand ready to provide whatever further contribution to this work the Commission might find helpful, including attending meetings and contributing further materials in writing.

Executive Summary

EMPEA Members have observed that the prompt expansion of a robust passporting system, implemented in a practical and common-sense manner, allowing them to work closely with the regulatory regime of one EU Member State of Reference before raising capital across the EU would be optimal.

• **Opportunity:** Some of our members have experienced significant difficulties with current national private placement regimes (“NPPRs”) and question whether the changes which were made to a number of European NPPRs as a result of the AIFMD might have actually worked against the interests of investors in the affected countries, as they have decreased investor choice (though discouraging non-EU GPs from marketing their funds in Europe) without meaningfully increasing investor protection. EMPEA Members from both the LP and GP communities generally regard the proposed extension of the passport to non-EU AIFMs as an opportunity to remedy this situation and, specifically, to ensure that the passport system works in the interests of the EU without impeding access to global private capital and the economic benefits it brings.

• **Impact on Investor Choice:** EMPEA Members have observed that EU investment institutions are experiencing limited investor choice and access to high quality investment options in emerging markets as non-AIFMs severely limit their efforts to raise capital in Europe and concentrate their efforts elsewhere. This is not only the case for the strongest performing and established GPs who have the greatest choice as to whether and where to raise capital, but also for younger, high performing GPs offering high quality investments in emerging markets. The consequence is a limitation on the EU investment institutions’ ability to diversify their investment portfolios by accessing emerging market investment opportunities and obtain their target returns. This, in turn, impacts both risk and return expectations over the near, medium and long terms with the final result limiting not only returns to, for example, occupational pension holders, but also the ability of

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4 Our answers to the following questions on the AIFMD marketing passport are based on:

1. Discussions with our membership, in particular the large non-EU private equity firms most likely to be affected by the eventual extension of the passport for non-EU AIFMs;
2. Anecdotal evidence from those of our industry advisor members (such as fund administrators, law firms and accountancy firms) that have been assisting non-EU AIFMs to comply with the Directive and, where relevant, national private placement regimes; and
3. Discussions with and a review of drafts provided by colleague industry associations including the European Venture Capital Association (EVCA), and the Private Equity Growth Capital Council (PEGCC). EMPEA expects that it will be able to broadly endorse the reflections and approach suggested by both groups. EMPEA also had discussions with the Institutional Limited Partners Association (ILPA) and understands their comments will be included as part of the EVCA submission.
EU development finance institutions to deploy development funds consistent with their mandates. Taxpayer-funded development finance institutions are expected to focus funds on socially beneficial investments that are profitable and therefore, scalable and sustainable to address poverty eradication and economic development in emerging markets. Foregone development opportunity is not recoverable and, once private capital exits, new collaborative opportunities take time and resources to pursue. EMPEA Members have also questioned why there is no distinction between “professional qualified investors” (whose capital fuels the private capital industry) and “retail investors” (whose capital does not). Retail investors do not typically invest in capital funds. The members see this as one example of how the AIFMD does not take into account the difference between private capital investing funded by “professional qualified investors” and other forms of investing funded by retail investors.

**Impact on Competition and WTO Compliance:** EMPEA Members note that the extension of the passport to non-EU AIFMs could improve the situation by increasing competition and investor choice, particularly if it is introduced in an efficient, common-sense way. Certain EMPEA Members also express concerns that the AIFMD is being applied in a manner that gives rise to WTO issues under the EU’s obligations for financial services under the General Agreement on Trade in Services (“GATS”), both as to market access and possible licensing, among other issues:

- **Experience with current NPPRs:** For non-EU AIFMs from emerging markets the current NPPR has proven onerous and burdensome with the result that in practice non-EU AIFMs are generally limited to only the largest AIFMs and EU Member States. As a result, the AIFMD has limited competition and investor choice in the EU. Among concerns expressed are the legal uncertainty created by the AIFMD’s mechanism for selecting the Member State of Reference and the absence of clear grandfathering and transition rules. Without clear grandfathering and transition rules EU Member States can further restrict or even eliminate private placement regimes. In addition some Member States have delayed and incomplete transposition to the AIFMD and there are Member States where no formal memorandum of understanding is yet in place between such Member State and the legal domicile of a non-EU AIFM and there appears to be little willingness to enter into one.

- **Cost and resource commitment:** The already non-harmonious and ambiguous NPPRs give rise to costs that are amplified when considering the wide variety and changeability of existing and new “fee” structures imposed by multiple Member States on a single fund. Advisory and support costs such as legal and compliance do not decrease and fall disproportionately on the smaller non-EU AIFMs. Even after incurring substantial costs in an effort to comply, there is often surprising uncertainty about whether the non-EU AIFM has, in fact, complied because some regulators are unfamiliar with the new AIFMD rules and are reluctant to interpret them. While some larger AIFMs may take the view that this is simply a cost of doing business, it raises a spectre of being a market barrier and is inconsistent with the EU’s obligations under the GATS. These costs also raise questions of the potential for unintended discrimination against newer AIFMs from emerging markets, which do not have
long-standing investor relationships within the EU and precludes them from becoming better known and playing on a level field.

- **Asymmetrical impact with regulatory regimes in other countries:** Other countries’ regulatory regimes do not disadvantage or delay the offering of EU-based AIFs in the same way as the AIFMD impacts non-EU AIFs. Generally, EU funds experience a freedom to solicit investments in non-EU countries and this has an asymmetrical impact on the financial service provider of the non-EU countries, for example the costs mentioned above and requirement for the use of depositaries (which are not required in the non-EU jurisdictions), and raises questions of whether the EU intends to create additional restrictions, requirements and fees to create a market access barrier.

In summary, EMPEA adds its support to EVCA to encourage ESMA to issue positive advice on enhancing and modifying the existing passporting system based on the experience of current participants and expanding the application of the enhanced passporting system to non-EU AIFMs and AIFs. EMPEA believes that such advice is consistent with removing obstacles to investor protection; contributes to smooth, efficient and harmonious EU-wide market operations and continues to fulfill the EU’s commitment to free trade in services while benefiting the economies of the EU member states and Europe as a whole.
Consultation Response

QUESTIONS ON THE FUNCTIONING OF THE PASSPORT FOR EU AIFMS

Q1: Please describe your experience using the AIFMD passport:

a) Indicate your home Member State
b) Number of funds marketed in other Member States (please provide a breakdown by host Member State)
c) Number of funds managed in other Member States (please provide a breakdown by host Member State)

Answer: EMPEA is an industry association with member firms in over 100 countries and not itself an AIFM (or an investor in an AIF managed by an AIFM). As a result, EMPEA represents members from a number of EU countries and many other developed and developing countries.

Q2: How have you found the passport application process?

a) Very satisfactory
b) Satisfactory
c) Problems encountered. Please explain

Answer: Since EMPEA is an industry association and not itself an AIFM (or an investor in an AIF managed by an AIFM), we refer to EVCA’s submission to ESMA, which is representative of the views of our GP members who are EU AIFMs.

Q3: What is your overall experience of using the passport of the AIFMD? Please explain

Answer: Since EMPEA is an industry association and not itself an AIFM (or an investor in an AIF managed by an AIFM), we refer to EVCA’s submission to ESMA, which is representative of the views of our GP members who are EU AIFMs.

Q4: What difficulties have you encountered when trying to use the passport?

We refer to EVCA’s submission to ESMA, which is representative of the views of our GP members who are EU AIFMs. EMPEA notes in particular the thorough analysis and commentary by EVCA on the experience of its members under the operation of the existing AIFMD passporting regime including restrictions, fees, lack of harmonization, no distinction related to qualified professional investors and the potential for adverse impact on emerging European countries among other observations. A number of these are also applicable to the current patchwork of NPPRs.
**Q5:** Have you been deterred from using the passport and if so – why?

**Answer:** Since EMPEA is an industry association and not itself an AIFM (or an investor in an AIF managed by an AIFM), we refer to EVCA’s submission to ESMA, which is representative of the views of our GP members who are EU AIFMs.

**Q6:** Have you experienced issues of investor protection in relation to AIFs marketed or managed from another Member State, including AIFs marketed to retail investors under Article 43? If so, please provide details (e.g. number of complaints from investors, the reasons for those complaints, etc.).

**Answer:** Since EMPEA is an industry association and not itself an AIFM (or an investor in an AIF managed by an AIFM), we refer to EVCA’s submission to ESMA, which is representative of the views of our GP members who are EU AIFMs.

**QUESTIONS ON THE FUNCTIONING OF THE NATIONAL PRIVATE PLACEMENT REGIMES**

**Q7:** Please describe the activity of your organisation in the EU:

a) Identify whether your organisation operates under Article 36 (marketing of non-EU AIFs by EU AIFMs in a Member State) or Article 42 (management and/or marketing of AIFs by non-EU AIFMs in a Member State) of the AIFMD

b) Identify the non-EU country of the AIFM and/or the AIF

c) Number of funds marketed in an EU Member State (please provide a breakdown by Member State)

a) A number of EMPEA member firms engage in the management and/or marketing of AIFs by non-EU AIFMs in a Member State of the AIFMD under Article 42.

b) EMPEA Members operate in over 100 countries.

c) EMPEA does not have access to this information in respect of all of our GP members but believes the number to be significant. We note that emerging market funds, whether based inside or outside of the EU, have historically sought to raise capital from European investors and believe that capital sourced from European investors accounted for a material portion of the emerging markets private equity funds raised before the AIFMD. We note that from Q3 2013 (note AIFMD effective date July 22, 2013) through Q3 2014, GPs in total (inclusive of both members and non-members) raised US$58 billion through 218 emerging markets private equity and venture capital funds.

**Q8:** How many times has your organisation received a request for information from an EU NCA? Please indicate your average time of response.
Q9: How many times has your organisation refused to provide the information requested by an EU NCA? Please explain the reasons.

N/A

Q10: How many times has an EU NCA performed an on-site visit at your organisation?

N/A

Q11: How many times has an EU NCA initiated enforcement action against your organisation?

N/A

Q12: How many times has an EU NCA imposed a sanction on your organisation?

N/A

Q13: Are there any specific limitations in the legal framework in your country that impede or limit your organisation from collaborating with an EU NCA? If yes, please specify.

N/A

Q14: Has your organisation experienced issues of investor protection in relation to AIFs marketed or managed in an EU Member State? If so, please describe (e.g. number of complaints from investors, the reasons for those complaints, etc.).

EMPEA notes that some of its members have historically marketed funds in the United States as well as the EU and EMPEA notes the thorough description by PEGCC of the legal framework for investor protection as applied in the United States.

Additionally, the EMPEA Guidelines produced by EMPEA (please see attachment A) identify the key elements of legal and tax regimes optimal for the development of private equity and EMPEA believes the Guidelines include a framework that provides for investor protection.

Q15: What have been the benefits of the National Private Placement Regimes (NPPR) to you?

EMPEA notes EVCA’s observation that the private equity and venture capital industry is an inherently global one. Private equity is about raising money worldwide to invest locally and/or regionally. Cross-
border structures and cross-border marketing are key elements of the industry and the free movement of capital on a global basis is important both for European companies, which are the recipients of significant third country private equity investment and European investors, who invest in third country private equity funds as part of their asset allocation and risk diversification strategies.

Managers raise funds from professional investors which are then invested into the real economy. As a commercial matter, the location of the manager does not limit where funds are raised or where funds are invested. For instance, provided the relevant laws permit this, a US manager can raise funds from European investors for investment in Europe. Similarly an African manager can raise money from European investors for investment into Africa. Indeed, foreign direct investment from emerging markets private equity funds is a critical source of capital for businesses in emerging markets and for the economies in which those businesses operate. Under the current AIFMD regime, the only legal avenue to raise and invest money in this way is the NPPR regime. In this sense NPPRs have provided a benefit to our members, and to those emerging markets businesses and economies, in that without NPPRs there would be no such avenue. However, our members view a robust passporting system as a far superior, effective, and impactful architecture than the existing NPPRs for the reasons set forth below.

**Q16: What have been the obstacles or barriers to entry of the NPPR to you?**

EMPEA’s non-EU AIFM members have faced a number of practical issues when seeking to market into Member States under NPPRs. We note the experience of our members who have stressed the high cost of seeking counsel’s guidance in order to comply with marketing restrictions and seek waivers where appropriate and then discovering that there is a surprising lack of clarity in the final responses. The uncertainty seems to be the result of uncertainty within the national regulatory authority around the AIFMD rules and the regulator’s reluctance to be “early” to interpret the rules.

EMPEA notes our members’ support of EVCA’s detailed analysis of some of the barriers and obstacles the NPPRs raise including among others, lack of harmonization, compliance costs and time, registration requirements at differing points in time and ambiguous disclosure requirements.

**Q17: What obstacles did you encounter when trying to register through the NPPR?**

Answer: Since EMPEA is an industry association and not itself an AIFM (or an investor in an AIF managed by an AIFM), we refer to EVCA’s submission to ESMA, which is representative of the views of our GP members who are EU AIFMs.

**Q18: What have been the costs?**

EMPEA Members have identified extensive resource requirements when trying to register through the NPPR including money and time. Costs include not only legal, accounting and other advisory costs, but
also “fees” (see EVCA analysis) that vary by jurisdiction. The number of legal advisors alone, with offices in the relevant jurisdictions, is itself not small. All of this absorbs time and focus on the part of fund managers and their internal and outside counsel often leading to frustratingly ambiguous opinions as to whether the fund is compliant. In one case a fund was being helped by the EU investors who were heavily engaged in structuring the fund and the fund sought a simple waiver under “reverse solicitation” analysis and ended with surprising uncertainty as to whether they had complied.

Q19: Have you exited countries since the entry into force of the AIFMD NPPR – and if so, why?

EMPEA’s members, including its LP members, have cited examples of non-EU GPs deciding not to market in European countries, or in Europe as a whole, for the reasons set out in our responses to Q16-18.

Q20: Have you been deterred from undertaking private placement, and if so why?

EMPEA’s GP members have cited legal uncertainty and costs as the primary reasons for being deterred from undertaking a private placement.

QUESTIONS ON THE FUNCTIONING OF BOTH REGIMES

Q21: What is the possible impact of an eventual extension of the passport to non-EU AIFMs on competition?

EMPEA notes EVCA’s extensive submission to this question and agrees that appropriate grandfathering and transition rules would be necessary as well as predictability around what constitutes “marketing” within the Member State of Reference.

EMPEA expresses concern that ESMA not delay passport expansion while trying to resolve the international policy and complexity surrounding “tax compliant” regime determinations.

Q22: What are the risks of an eventual extension of the passport to non-EU AIFMs in relation to market disruptions and investor protection?

No unusual risks that have not already been identified during the period prior to expansion. The greatest risk would derive from delaying the extension.
Q23: Is there any particular non-EU country where, as a consequence of the regulatory environment (financial regulation, supervision, tax and anti-money laundering provisions), an eventual extension of the passport would put EU AIFMs and UCITS management companies at a disadvantage vis-a-vis the AIFMs from that country? Please specify and explain.

None are known. In fact, the reverse may be true. Non-EU funds have been freely able to solicit investment in most other countries except the EU and EU funds have been able to freely solicit investment in the non-EU jurisdictions. The EMPEA Guidelines setting out the key elements of legal and tax regimes optimal for the development of private equity have served as a framework in emerging economies. They address a number of the numerous types of laws, including those EVCA has cited in operation to protect investors:

- laws governing the vehicle(s) used to establish the fund, such as limited partnership laws;
- in some cases, local product regulation (although this is the exception not the rule);
- tax laws applicable to investors and/or fund vehicles;
- tax reporting or filing obligations e.g. FATCA and the Common Reporting Standard;
- laws concerning permissible investments by investors e.g. CRD IV, Solvency II, the Volcker rule and ERISA;
- laws concerning the preparation, audit and publication of accounts e.g. the EU Accounting Directive; and
- laws concerning the prevention of financial crime including the identification of investors and sanctions laws.

EMPEA agrees that, quite properly, the AIFMD seeks to normalise (and to an extent harmonise) certain limited aspects of the operation of alternative investment funds, including the fitness and propriety of the non-EU AIFM (and its staff), its governance, certain aspects of the conduct of its business and transparency towards regulators (for the purposes of systemic risk oversight) and investors.

EMPEA also agrees with EVCA’s view that, it would be beyond the scope of ESMA’s review to seek to understand the various laws that affect the competitive landscape relevant to the extension of the passport and, that ESMA’s mission is best achieved by removing barriers to entry and competitive distortions created by the AIFMD and described in the preceding sections of this response.

Q24: Is there any particular non-EU country that imposes heavier requirements for EU AIFMs or UCITS management companies in comparison to those that non-EU AIFMs have to comply with in order to do business in the EU? Please specify and explain.

None known.
Q25: Have you experienced difficulties or limitations in establishing or marketing AIFs or UCITS in any non-EU country? Please specify the non-EU country and the specific difficulties or limitations that you have encountered.

N/A

Q26: Do you have evidence showing that existing difficulties or limitations in non-EU countries have deterred fund managers in your jurisdiction from deciding to establish or market AIFs or UCITS they manage in the non-EU country? Please specify the non-EU country and explain the difficulties or limitations.

None known.

Q27: Could you please identify the non-EU countries that, in your opinion, grant market access to EU AIFMs and UCITS management companies under broadly equivalent conditions?

N/A

Q28: What are the conditions that EU AIFMs and UCITS management companies have to comply with in order to manage or market AIFs or UCITS in your jurisdiction? Please specify.

EMPEA notes, by way of example, the thorough response of the PEGCC describing the investor protection regime in the United States.

Q29: In what way is your current regime (regulatory, tax etc.) different from the EU framework? Please explain.

EMPEA’s members operate in over 100 jurisdictions, each with their own legal regimes. By way of example, see the granular and thorough comparison between one of those jurisdictions and the EU, referenced in answer to Q28 above.