WILLIAM FRY

// ASSET MANAGEMENT & INVESTMENT FUNDS

Cross-Border Fund Marketing Post August 2021: Six Key Impacts of New EU Fund Distribution Rules

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On 2 August 2021, most of the provisions of the EU Cross-Border Distribution of Funds (**CBDF)** legislation come into effect. The CBDF legislation, designed to reduce barriers to the cross-border marketing and sale of funds, includes a Directive amending the cross-border marketing provisions of both the UCITS Directive and AIFMD and a Regulation setting down disclosure rules for UCITS and AIF marketing communications. The Regulation's marketing disclosure rules will be supplemented by ESMA Level 3 guidelines, a draft of which were issued for consultation last November with a scheduled date for finalisation and publication of pre-2 August 2021.

While the CBDF Regulation is directly effective and applicable from 2 August 2021, the provisions of the CBDF Directive must be transposed into national law before becoming applicable in individual Member States. The deadline for transposing and applying provisions of the CBDF Directive under national law is 2 August 2021. As Ireland, along with several other Member States, has yet to transpose the CBDF Directive (2019/1160), this briefing is based on the provisions of the CBDF Directive and could be impacted by individual Member States' national laws transposing the CBDF Directive.

In this briefing we analyse six key impacts of the CBDF legislation and ESMA Level 3 guidelines on fund managers' existing marketing operations and processes.

Impact one: an end to physical local facilities

From 2 August, the CBDF Directive prohibits host Member States (in which UCITS or AIF shares are marketed) from requiring UCITS managers and AIFMs (in respect of retail investor AIFs) to have a physical presence in the host Member State for the purpose of making available local investor facilities. As such, Member States, who have to date gold plated the UCITS and AIFMD (retail investor marketing) rules by requiring the appointment of a local entity to provide local facilities, will, subject to local law transposition, be prevented from doing so from 2 August 2021.

Managers may wish to review their existing local agent arrangements and, provided ongoing compliance with local facilities' requirements can be ensured, amend and/or discontinue such arrangements in line with local laws transposing the CBDF Directive.

Impact two: protracted UCITS process for changes post-passporting

The CBDF Directive amends the process for notifying changes to a UCITS which is registered to market on a cross-border basis (a **Passported UCITS**). From 2 August (subject to local law transposition), a UCITS manager must provide one month's prior notice, to both the home and relevant host regulatory authorities, of any changes to a Passported UCITS' initial notification letter, as filed with the host regulatory authority when first registering to market cross-border (**Passport Notification Letter**). This contrasts with the current process which requires only prior notification to the host regulatory authority of any changes to the Passport Notification Letter.

UCITS SHARE CLASSES

Under the CBDF legislation, changes regarding share classes to be passported (e.g. resulting from a share class launch) are specifically included as changes to the Passport Notification Letter requiring one months' prior notice to home and host regulatory authorities. In general, the current practice across Member States for passporting a new share class of a Passported UCITS simply involves an advance filing of the relevant translated KIID with the applicable host regulatory authority. As such, a requirement to file translated KIIDs at least one month in advance and with both the home and host authorities is likely to have a significant and unwelcome impact on UCITS managers' plans for passporting share classes. Notably, it is also is in stark contrast to the 10-day turnaround for passport notifications of funds.

A stated objective of EU legislators in amending the UCITS process was to align it with the AIFMD process for passporting EU AIFs across the EU. However, the revised UCITS process clearly (but perhaps unintentionally) deviates from the AIFMD process.

Under the AIFMD process, only planned, material changes to a passported AIF are required to be made one month in advance of implementation and only to the AIFM's home authority (this remains the case post 2 August 2021). Furthermore, ESMA has confirmed that the launch of a new share class of a passported AIF does not constitute a material change requiring one month's prior notice. While a similar clarification of the UCITS process would be most welcome, the possibility of providing such a clarification could be frustrated by the specific inclusion of the new share class requirement in the relevant CBDF legislative provision.

Impact three: enhanced marketing disclosure requirements

The CBDF Regulation sets out high-level, principles-based disclosure rules for UCITS and AIF marketing communications and provides for the publication by ESMA of guidelines to further specify disclosure standards for such communications. The CBDF disclosure rules apply to UCITS managers and EU AIFMs (including internally managed structures) from 2 August 2021.

In November 2020, ESMA issued a consultation on draft guidelines on marketing communications under the CBDF Regulation (**Guidelines**). The consultation closed on 8 February 2021 and ESMA is scheduled to issue final Guidelines by 2 August 2021.

Given the timing to compliance with the CBDF Regulation, fund managers would be well advised to have regard to the Guidelines, key of which are summarised below, in preparing for compliance with the new disclosure requirements under the CBDF Regulation from 2 August 2021.

Many of the below guidelines will be familiar to UCITS managers already subject to the Central Bank's advertising standards (Schedule 6 of Central Bank UCITS Regulations) by virtue of marketing in Ireland or in a Member State which does not regulate marketing disclosures. The Guidelines are not intended to replace the Central Bank's standards, however UCITS managers will need to comply with the Guidelines to the extent they do not already do so pursuant to their compliance with Central Bank rules. AIFMs, who are subject to far more limited Central Bank rules for marketing disclosures should pay particular attention to the ESMA guidelines in their preparations for compliance with the CDBF disclosure rules.

Fund managers should be aware that the category of marketing communications in scope of the Guidelines is broadly defined and includes all paper-based, electronic and verbal fund related communications, fund-specific social media communications, direct investor/prospective investor communications and distributor and third party communications used by a fund manager to market a fund. The Guidelines also set out a negative list of marketing communications considered outside the scope of the Guidelines which include legal and regulatory fund documents, communication of fund manager activities or limited social media message which in either case do not refer to a specific fund or group of funds.

DISCLAIMERS	Include a prominent disclosure of the terms "marketing communication" incorporating a disclaimer such as the following: "This is a marketing communication. This is not a contractually binding document. Please refer to the [prospectus of the [UCITS/ AIF/] and to the [KIID/ KID](delete as applicable)] and do not base any final investment decision on this communication alone." Determining prominence should be by reference to the type of communication e.g. in the case of a video, displaying disclaimer only at the end of the video would not be sufficient.
RISK/REWARD	Disclosure of risks and rewards in marketing communications is not mandatory. However, marketing communications should not refer to the rewards without referring to the risks. When disclosing risks and rewards information, the font, size and position used to describe the rewards should be the same as those used to describe the risks. Information on risks should not be disclosed in a footnote or in small characters within the main body of the communication. Presenting risks and rewards in the form of a two-column table or summarised in a list clearly differentiating the risks and the rewards on a single page is a good example of how risks and rewards can be presented in an equally prominent manner. Disclosure of the risk profile should refer to the same risk classification as that included in the KID or the KIID. For funds recently set up and for which no past performance records are available, the reward profile may be represented only by reference to the benchmark's past performance or to the objective return, when a benchmark or objective return are envisaged in the legal and regulatory documents of the promoted fund.
SUITABILITY FOR TARGET INVESTOR	the level of information and its presentation may be adapted depending on whether the fund is available for subscription by retail investors (UCITS or retail AIFs), or professional investors only (non-retail AIFs).
CONSISTENCY WITH REGULATED DOCUMENTS	the wording or the presentation used in the marketing communication should not be inconsistent with, add to, diminish or contradict any information mentioned in the legal or regulatory documents of the promoted fund. Where indicators, simulations or figures relating to risks and rewards, costs, or past and expected future performance returns are mentioned or disclosed in marketing communications, they should be the same indicators, simulations or figures as those used in regulated fund documents.

FUND FEATURES	when detailing fund characteristics, the communication should: a) make it clear that the investment is shares in a fund, not in a given underlying asset; b) include at least a short description of the fund investment policy and an explanation on the types of assets into which the fund may invest.
INVESTMENT POLICY	when marketing communications describe a fund's investment policy recommended practice is to include: a) in the case of index-tracking funds, the words "passive" or "passively managed" in addition to the words "index-tracking"; b) in the case of actively managed funds, the terms "active" or "actively managed"; c) in the case of active funds which are managed in reference to an index, additional disclosure on the use of the benchmark index and indicate the degree of freedom from the benchmark; and d) in the case of active funds which are not managed in reference to any benchmark index, disclosure making this clear to investors.
PERFORMANCE	the communication should refrain from using overoptimistic wording, such as "the best fund" or "the best manager", wording that would diminish the risks, such as "safe investment" or "effortless returns", or wording that may imply high returns, such as "high yield", without clearly explaining that such high returns may not be reached and that there is a risk of losing all or part of the investment. PAST PERFORMANCE Information on past performance should not be the main information of the marketing communication and, if disclosed, should be consistent with regulated fund documents and be based on historical data. It should mention the reference period chosen for measuring the performance and the source of the data in a clear manner. As an example, disclosing the reference period and the source in a footnote should not be deemed as disclosed in a clear manner. SIMULATED PAST PERFORMANCE Disclosing simulated past performance should be limited to marketing communications relating to a new share class of an existing fund and a feeder fund whose performance can be simulated by taking the performance of its master.

PERFORMANCE (CONTINUED)	FUTURE PERFORMANCE When information on expected future performance based on past performance and/or current conditions is presented, this information should be preceded by the following statement: "The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies, and/or current market conditions and are not an exact indicator. What you will get will vary depending on how the market performs and how long you keep the investment/product."
SUSTAINABILITY RELATED DISCLOSURES	to ensure that the information on sustainability-related aspects of the promoted fund is fair, clear and not misleading, marketing communications should be based on the content of the prospectus of a UCITS or of the information document of an AIF. The sustainability-related information of a marketing communication should be commensurate with the extent to which the investment strategy of the fund promotes environmental or social characteristics, or sustainable investment objectives. For example, if the investment strategy of a fund is primarily pursuing financial performance, any sustainability-aspects of the investment in the promoted fund should not be the main information of a marketing communication.

Impact four: new harmonised procedure for ceasing to market UCITS or AIFs

The CBDF Directive sets down a new process for UCITS managers and AIFMs wishing to cease cross-border marketing. The creation of a harmonised process for de-registering a fund with a host authority is useful given the lack of clarity, particularly in respect of AIFs, as to whether and how fund managers can cease marketing in a host Member State.

The marketing cessation processes for UCITS and AIFs are broadly similar under the CBDF Directive, which sets down several pre-conditions including (i) the issuance of a 30-day standing blanket offer to repurchase, free of charge, all shares held by investors in the Member State in which the fund manager wishes to cease marketing; (ii) public notification of the intention to terminate local marketing arrangements; and (iii) termination of intermediary arrangements such that further marketing does not happen post cessation.

Notification of compliance with the above should be submitted to the UCITS/AIFM home authority, which then has 15 working days to confirm to the UCITS/AIFM that the relevant host authority has been notified of the intention to cease marketing. From this date, the UCITS/AIFM is no longer obliged to comply with applicable host Member State laws; however, the UCITS/AIFM must continue to comply with its governing regime's investor reporting requirements in respect of any local investors remaining in the fund post cessation of marketing.

HOW UCITS PROCESS (DISADVANTAGEOUSLY) DIFFERS FROM AIFM PROCESS

Similar to the new share class issue outlined under 'Impact Two' above, and, unlike the AIFM process, the de-registration process for UCITS specifically refers to de-registration of a UCITS share class. Initially this reads as a facilitative measure as it permits de-registration of a share class on the same terms as for a fund. However, given the current (simpler) practice for UCITS share class de-registration, this is again likely to result in an unwelcome burden for UCITS managers. In general, the current practice across Member States for de-registering a share class involves a simple notification to the host authority. Subject to local law transposition and in the absence of any regulatory mitigation measures, this provision will significantly, and to the detriment of UCITS managers, alter the current practice.

LIMITATION OF AIFM PRE-MARKETING POST DE-REGISTRATION

The AIFM process is distinguished from that applicable to UCITS in order to take account of an AIFM's ability to engage in cross-border pre-marketing of an AIF. For a period of 36 months following a notification to cease cross-border marketing of an AIF, an AIFM is prohibited from engaging in any pre-marketing of that AIF in the relevant host Member State.

Impact five: pre-marketing of AIFs permitted

The facilitative CBDF provisions that will allow EU AIFMs to engage in cross-border pre-marketing of an AIF have been widely published since publication in 2019. Briefly, permitted pre-marketing extends to providing information to prospective professional investors in relation to a yet to be established AIF, or if established, an AIF that has not yet been registered to market cross-border; provided such communication does not amount to an offer to invest in the AIF. Notably, any investment within 18 months of pre-marketing an AIF will result in such pre-marketing being re-categorised as marketing subject to AIFMD marketing notification requirements.

A notification must be made to the AIFM's home authority within two weeks of any pre-marketing and it may only be undertaken by the AIFM or a third party acting on its behalf which is authorised as a MiFID investment firm, EU credit institution, UCITS manager, AIFM or tied agent of an AIFM.

Impact six: limited benefit for non-EU AIFMs

The CBDF legislation is primarily applicable to EU AIFMs and in particular, the facilitative pre-marketing and de-registration processes are available only to EU AIFMs.

Non-EU AIFMs, including UK AIFMs, are dependent on Member States' national private placement regimes or NPPRs facilitating the sale and marketing of AIFs by non-EU AIFMs to EU investors. As such, any impact of the CBDF legislation on non-EU AIFMs will likely only arise to the extent Member States elect to reflect CBDF provisions within their NPPRs.

While certain NPPRs provide relatively straightforward access (the Nordic countries and Ireland for example), others impose a relatively demanding authorisation process and require third party firms marketing to local investors on behalf of the AIFM to be authorised as a MiFID investment firm or EU credit institution. ESMA's Guidelines on marketing disclosures (discussed above) acknowledge this, noting that distributors appointed by AIFMs are generally MiFID investment firms and as such the Guidelines, while not directly applicable to distributors, are aligned with the MiFID rules for investor information to be fair, clear and not misleading.

Notably, the CBDF legislation requires Member State NPPRs not to disadvantage EU AIFMs vis-à-vis non-EU AIFMs. As such, Member States may seek to align NPPRs with the CBDF legislation so that EU AIFMs are not subject to more onerous requirements under the CBDF legislation than those applicable to non-EU AIFMs under Member State NPPRs. To the extent NPPRs are amended to align with the CBDF legislation and if not already provided for under the relevant NPPR, non-EU AIFMs should note that pre-marketing of AIFs which have either not been established or not yet registered to market cross-border, may only be carried out on behalf of the EU AIFM by a third party authorised as a MiFID investment firm, EU credit institution, UCITS manager, AIFM or a third party acting as a tied agent under MiFID.

How Can William Fry Help?

With the CBDF compliance deadline of 2 August 2021 fast approaching, William Fry can assist fund managers' compliance preparations including by:

- advising on Level 1, Level 3 and local legislative obligations scheduled to take effect on 2 August 2021;
- undertaking a current/new obligations compliance gap analysis;
- reviewing fund marketing materials for consistency and compliance with new disclosure obligations;
- supporting fund managers' updates of internal marketing processes and procedures;
- assisting non-EU AIFMs and advising on EU market access options; and
- advising on, co-ordinating and facilitating regulatory filings with host authorities.

Contact Us

For more information, please contact the below or your usual William Fry contact.

Marion Mellett
Head of Global Fund Registrations
Asset Management & Investment Funds
+353 1 639 5071
marion.mellett@williamfry.com

Patricia Taylor
PARTNER
Asset Management & Investment Funds
+353 1 639 5222
patricia.taylor@williamfry.com

James Phelan
PARTNER
Asset Management & Investment Funds
+353 1 489 6590
james.phelan@williamfry.com

Nessa Joyce
SENIOR ASSOCIATE
Asset Management & Investment Funds
+353 1 489 6417
nessa.joyce@williamfry.com