Frankfurt am Main,
9 May 2018

BVI's[1] position on Commission's proposal on cross-border fund distribution

We very much welcome and support the European Commission's intention to remove regulatory barriers for the cross-border distribution of investment funds. While some of the proposed changes will indeed facilitate cross-border distribution, the proposal also contains significant elements which will not only raise barriers in a cross-border context but also have the potential to alter the marketing practices on a domestic basis to the detriment of investors.

Our concerns relate in particular to the following:

- **Marketing/Pre-Marketing[2].** The provision on Pre-Marketing is too restrictive to the detriment of professional investors. In particular, it is important for investors to get a proper understanding of the investment ideas or strategies proposed by the manager. This cannot be achieved if the investor has no possibility to review draft documents. Therefore, in particular the restriction should be deleted that the AIFM may not present to the investor documents which allow the investor to take an investment decision.

  Furthermore, the project of the CMU calls for a proper private placement regime for funds. In this respect, the proposal does not live up to its full potential to broaden financing options for small and medium-sized enterprises while at the same time mobilising capital and providing investment opportunities for investors. From a regulatory point of view, the offering of securities other than fund unites or shares only falls under the Prospectus Regulation which allows a private placement to an unlimited number of professional investors and up to 150 private investors without any information requirements, let alone a marketing notification. Private placements are generally a high priority of the Capital Market Union (CMU), however, the Commission's proposal seems to be heading towards the requirement to notify every placement of every fund unit. We see the urgent need to put the private placement regime for funds on an equal footing with that for comparable to securities.

- **De-Notification.** According to the proposal for harmonising the de-notification procedure, the management company shall no longer be free to decide on withdrawing from a market[3]. There is no objective reason for introducing a threshold to allow de-registration, in particular since investors in a fund shall continue to receive the legally required information. This part of the proposal in fact introduces a new barrier instead of eliminating it, since management companies will likely decide not to enter a market in the first place if they are no longer free to decide to de-notify.

- **National marketing requirements**. Competent authorities may still impose national marketing requirements[4]. While this is generally understandable e.g. due to national tax rules, it contradicts

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of more than 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] Art. 2 (2) of the proposal of the Directive amending Directive 2009/65/EC and 2011/61/EU ("Amending Directive").

[3] Art. 1 (7) and Art. 2 (5) of the Amending Directive.

[4] Art. 3 et seq. of the proposed Regulation on facilitating cross-border distribution of collective investment funds („Distribution Regulation").

the aim to reduce or remove barriers for the cross-border distribution. In this respect, the EU legislator should also explore possible ways of harmonisation. This could for instance comprise a rule allowing the use of marketing material compliant with the detailed rules on marketing material enshrined in MiFID II[5] without any need to submit such material to the competent authority.

Besides the aforementioned concerns, we very much welcome the following parts of the proposal:

- **Abolishment of physical presences.** The abolishment of physical presences for both UCITS and AIF managers is an important step to remove barriers for the cross-border distribution[6].

- **Increased transparency on fees and national marketing requirements.** The rules increasing transparency on fees and national marketing rules will facilitate cross-border distribution[7].

Furthermore, we appreciate the Commission's initiative to address legal implications of the use of Distributed Ledger Technology and facilitate innovations as provided for in the FinTech Action Plan. Fragmentations of the investment operational chain in particular subscription/redemption, settlement, custody and asset servicing are still problematic in a cross-border context. Fragmentation could be reduced through the use of such technologies thereby also reducing barriers for cross-border distribution.

In order to actually remove barriers and standing a chance to improve economies of scale, the proposal should aim for more harmonisation without restricting existing possibilities to distribute funds on both cross-border and national level. This could be achieved with the three adjustments suggested above. We believe that with these changes the proposal would indeed significantly improve the situation regarding cross-border distribution.

In detail:

We fully support the Commission's aim to harmonise the fund distribution regime. This seems to be difficult in cases where the approaches vary significantly between the Member States. NCAs which have established a national regime and/or practice functioning are generally reluctant to abandon such practice. It is therefore obvious that the Commission's proposal tries to find the common ground between these practices. However, harmonisation should not be an isolated goal. Rather, the legislator is obliged to strive for a functioning legal system with reasonable objectives not only from the view of the regulator but also for the end investor and the fund managers. The changes proposed below would facilitate such system for the cross-border fund distribution thereby benefiting investors although it might require some NCAs to giving up established practices.

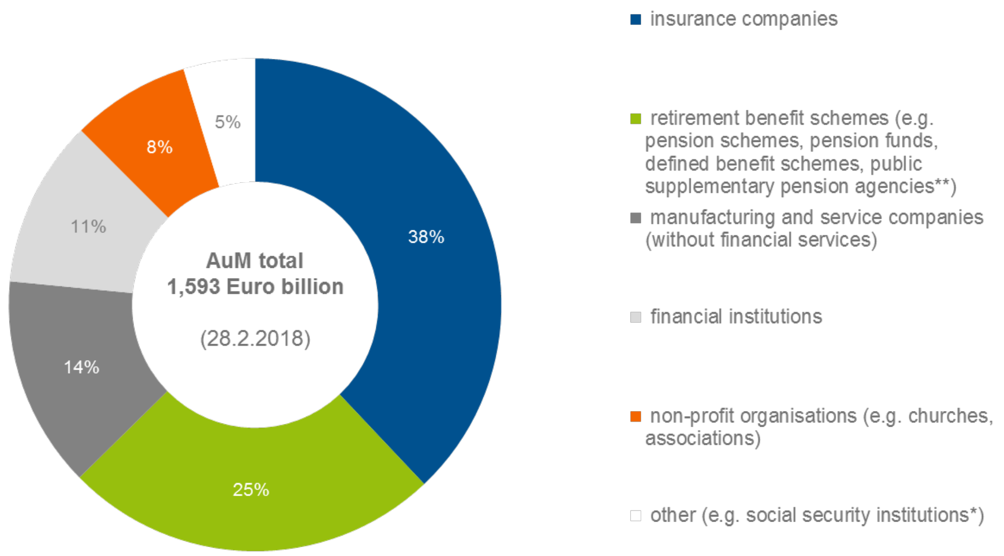
1. Marketing/Pre-Marketing – Art. 2 of the Amending Directive

Content of the proposal: Management companies shall be allowed to engage in pre-marketing which is defined as the provision of information on investment strategies or ideas to test interests in an AIF which is not yet established.[8] *Pre-Marketing shall, however, not relate to an established AIF, contain references to an established AIF or amounts to draft or final documents allowing investors to take an investment decision.*[9]

[5] See Art. 24 (3) of the Directive 2014/65/EU and Art. 44 of the Implementing Directive 2017/565.
[6] Art. 1 (5) and Art. 2 (5) of the proposal of the Amending Directive.
[7] Art. 3 (1) and Art. 7 (1) of the proposal of the Distribution Regulation.
[8] Art. 2 (1) of the proposal of the Amending Directive.
[9] Art. 2 (2) of the proposal of the Amending Directive.

As outlined above, the pre-marketing provision as suggested by the Commission is too restrictive. It will likely have a negative impact on the set-up of AIFs to the detriment of professional investors generally, since it does not only relate to cross-border situations but also to the general understanding of marketing. For professional investors, it is important to be able to discuss with the management company concrete possible investment ideas and strategies. This also comprises the possibility to review draft documents. It will be difficult in practice for investors as well as management companies to ensure that the investor in no case will be able to make an investment decision on the basis of the documents exchanged or discussed. As a consequence, the flexibility prior to the set-up of an AIF will suffer though it is of utmost importance in order to find the ideal solution for the investor.

This is for instance very relevant for the German market, where AIFs are a successful, safe and alternative solution compared to segregated accounts – BVI members currently manage around 1.6 trillion Euros in mostly open-ended institutional funds (*Spezialfonds*) which qualify as AIFs. These funds offer solutions addressing the needs of highly regulated entities such as insurance companies, pension funds and financial institutions. In addition, they are also a popular investment solution for non-profit organisations such as churches or foundations.



Furthermore, potential investors may have an interest in existing AIFs which are not registered for marketing. Management companies should be able to refer to existing AIFs e.g. to show a track record without the requirement to notify any marketing. Investors will have the possibility to better understand the types of products the management company manages.

While we understand that the AIFMD not only covers the distribution to professional investors but also sets the minimum standards for distribution to private investors (see Art. 43 AIFMD), the proposed Art. 43a introduces specific rules only relevant for private investors. Therefore, pre-marketing should be defined with the sole focus on professional investors. Provided there is a need for additional safeguards for retail investors, these could be included in Art. 43a AIFMD without depriving professional investors from their flexibility to invest via AIFs.

> **We therefore suggest deleting the proposed Art. 30a (1) (a) and (b) AIFMD in Art. 2 (2) of the Amending Directive. Furthermore, in Art. 30a (1) (d) AIFMD in Art. 2 (2) of the Amend-**

> **ing Directive the wording should be amended as follows: "amounts to a subscription form or similar documents in a final form". In addition, in proposed Art. 4 (1) (aea) in Art. 2 (1) of the Amending Directive, the pre-marketing definition should also include already established AIFs, i.e. the wording "which is not yet established" at the end should be deleted.**

Furthermore, the proposal does not cover the possibility to place funds to a limited number of investors without the same legal consequences as an offer to a broad range of investors (private placement). Within the project of the CMU, the Commission acknowledged the potential merit of private placements to broaden financing options for small and medium-sized enterprises while at the same time mobilising capital and providing investment opportunities for investors. In particular, the CMU aims at mobilising capital throughout Europe on a cross-border basis. Private placement regimes contribute to this aim. The new Prospectus Regulation broadly retained the exemption from the prospectus requirements of the previous Prospectus Directive, thereby allowing issuers to directly sell securities to an unlimited number of professional investors without information, let alone notification requirements. Furthermore, the Commission recently published a study on private placements of debts. It had initiated this study in order to evaluate how politics can facilitate innovative forms of business financing and funding choices for Europe's businesses and SMEs by way of private placements. The study acknowledges management companies as important investors for private placement of debts. Funds bring together the capital provided by millions of investors on the one hand and the demand for capital from Europe's businesses and SMEs and the state on the other hand. Funds are also in the unique position to bundle smaller investments which individually would simply be too small for economically feasible investments.

Allowing issuers to privately place securities for instance with professional investors[10] like management companies without any restrictions, but on the other hand not allowing management companies to privately place such securities when they are collectively managed presents a regulatory imbalance which should be fixed with a proper private placement regime for funds. There is no justification for a more restrictive approach concerning funds compared to securities. Rather, the AIFMD provides for a regime of prudential regulation and supervision containing a coherent set of rules for managers of AIFs, including risk and liquidity management requirements and conflict of interest management as well as fair treatment of investors. Compared to a simple disclosure regime, the standard of investor protection is much higher than it could ever be in an issuance only being subject to the Prospectus Regime. Securities in such issuances can come in any form and with significant risk. An issuer can place highly risky securities to institutional investors without any limitations. Therefore, fund managers being subject to prudential regulation and supervision should the more be able to place fund units privately with professional investors at least without being required to notify such placement and also without the need for the minimum information requirement according to Art. 23 AIFMD.

> **We therefore call for the inclusion of a private placement regime for funds in the AIFMD comparable to the Prospectus Regime which at least allows for placement of funds to a specified number of investors without the requirement of a notification procedure or the minimum information requirement according to Art. 23 AIFMD.**

2. De-Notification

*Content of the proposal: The proposal introduces rules on the withdrawing a marketing notification ("**De-Notification**") of funds which comprise*

[10] Art. 1 (4) lit. a) of the Regulation (EU) 2017/1129 („Prospectus Regulation").

- *the following pre-conditions for a de-notification:*
    - *the maximum number of ten investors holding fund units in that jurisdiction holding a maximum of 1 % of assets under management ("**Thresholds**")*[11]
    - *a blanket offer to repurchase the fund units or shares*
- *the requirement to continuously provide investors with the legal documentation such as key investor information, the prospectus and reports*[12].

We very much support the aim to harmonise rules on De-Notification. However, we strongly doubt the need for Thresholds. In order to reduce barriers on cross-border distribution, it is crucial to have a clear understanding of the concept and objectives of such rules. For these objectives, the Thresholds raise new barriers instead of reducing them while at the same time are not required for ensuring an appropriate level of investor protection.

- First, the management companies should generally be able to withdraw from a market, in particular if distributing in this jurisdiction is no longer economically viable. For instance, marketing might originally have been successful but over time the success diminishes or such placement might not have been as successful as the management company assessed. The existing amount of investors is therefore not necessarily an indication for a marketing success in that market in future. Given the fact that the proposal intends to allow for national marketing rules[13], a management company can only reduce the expenses for researching and complying with individual national regimes including time-consuming translations and required changes to marketing materials the Commission acknowledged[14] by way of De-Notification. If the management company no longer markets the funds, it should be allowed to reduce the expenses by way of De-Notification.

- Secondly, investors should be protected despite any withdrawal. According to the proposal, the existing investors have the choice to either dispose of their investment or to retain it without an impact on the access to the legally required information[15]. Furthermore, the management company withdrawing from a market will still be supervised by its home state NCA. Since the management company will no longer market the fund, protection of new investors does not need to be different to the protection of investors in case a fund has never been marketed in that jurisdiction. In both cases, the general rules foreseen in the Directives allow for an intervention by both the host and the home state NCA (see e.g. Art. 98 and 108 UCITS-Directive and Art. 45 et seq. AIFMD).

This is of importance for the German market. We estimate that around 790 billion assets under management in investment funds have been distributed cross-border into Germany and around 80 billion assets under management in investment funds have been distributed cross-border from Germany into other EU member states.[16] Therefore, the Thresholds should be deleted. While in some cases retail funds may be able to reach the Thresholds, funds for institutional investors may generally not. For these funds it is very common that there is only a handful of investors, each of whom holds a significant part of the fund. Consequently, it will simply not be possible to reach a threshold of no more than 10 investors holding units or shares representing less than 1 % of the assets under management. This means that based on the Commission's proposal, the fund manager will not have the possibility to withdraw from this market at all. Accordingly, fund managers will evaluate these situations before they enter

[11] Art. 1 (7) and 2 (5) of the Amending Directive (proposed Art. 93 (1) (a) of the UCITS-Directive and Art. 32a (1) (a) of the AIFMD).
[12] Art. 1 (7) and 2 (5) of the Amending Directive (proposed Art. 93 (4) of the UCITS-Directive and Art. 32a (4) of the AIFMD).
[13] Art. 5 of the Distribution Regulation.
[14] See Report from the Commission to the Council and the European Parliament, 24 March 2017, COM(2017) 147, p. 4.
[15] Art. 1 (7) and 2 (5) of the Amending Directive (proposed Art. 93 (1) (a) of the UCITS-Directive and Art. 32a (1) (a) of the AIFMD).
[16] Estimates as of 31 December 2017 based on BVI and Bundesbank figures.

a market in the first place – likely with a negative result. In particular, they will evaluate the burden for maintaining the registration. This will be significant in some Member States – given the fact that also in future Member States and NCAs will be allowed to impose national provisions concerning marketing requirements[17]. As a result, it is likely that fund managers will remain in their home market and set up funds on a national level only or will limit their cross-border activities to selected, potentially large Member States. This outcome clearly contradicts the objective of the Commission's proposal: to facilitate cross-border distribution and to improve the economies of scale for European Funds.

> **The thresholds to be reached before the funds are allowed to discontinue marketing according to Art. 93a (1) (a) UCITS Directive as proposed in Art. 1 of the Amending Directive as well as Art. 32a (1) (a) AIFMD as proposed in Art. 2 of the Amending Directive should be deleted.**

As a more technical point, in case of De-Notification management companies shall be obliged to offer repurchasing the fund units to the investors in that jurisdiction[18]. It is unclear whether the term "repurchase" also relates to redemption of shares. From the investor's point of view, there is no difference whether he can redeem the unit or whether the management company purchases the units. The wording should be aligned to the UCITS Directive, i.e. include also the possibility of redemption[19]. Likewise, the word "de-notification" should be used instead of the term "discontinuation" in order to avoid legal uncertainty. The former is the opposite of the term notification which is used as legal term for the legal procedure relating to the approval of marketing activities.

> **The wording in Art. 93a (1) (b) UCITS Directive as proposed in Art. 1 of the Amending Directive as well as Art. 32a (1) (b) AIFMD as proposed in Art. 2 of the Amending Directive should also comprise the blanket offer to redeem the fund units. Furthermore, the term "discontinuation" should be replaced by the term "de-notification".**

3. Abolishment of physical presences

Content of the proposal: The proposal prohibits member states requiring a physical presence for facilities that process investors' subscription, payment, orders and provide investor with information[20].

The abolishment of physical presences for both UCITS and for AIFs is an important step to remove barriers for the cross-border distribution. Requirements such as provision of a paying agent or other local representatives trigger both direct and indirect costs such as costs for the process of finding the local representative or understanding the national standards. In times of digitalisation, we highly welcome the abolishment of physical presences.

> **We fully support the proposed rules regarding facilities available to retail investors, in particular Art. 92 (2) UCITS Directive as proposed in Art. 1 of the Amending Directive as well as Art. 43a (2) in Art. 2 of the Amending Directive.**

4. Period for changes to the UCITS marketing notification

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[17] Art. 3 (1) of the Distribution Regulation.
[18] Art. 1 (7) and 2 (5) of the Amending Directive (proposed Art. 93 (1) (a) of the UCITS-Directive and Art. 32a (1) (a) of the AIFMD).
[19] See Art. 1 (2) (b) UCITS Directive.
[20] Art. 1 (5) and 2 (7) of the Amending Directive (proposed Art. 92 (2) of the UCITS-Directive and Art. 43a (2) of the AIFMD).

Content of the proposal: According to the proposal, management companies need to file a change to the notification letter regarding marketing of UCITS in a host jurisdiction with the home NCA at least one month before the change is implemented[21].

The newly introduced one-month period for a change to the marketing notification would slow down time to market for an existing UCITS, in particular new share classes, significantly. Given the fact that changes to the fund rules have to be approved by the home NCA[22] and that the period for a new marketing notification only comprises 10 days[23], this additional one month period for a marketing notification seems inappropriate. It only delays the process without any additional value for the investors. The period should therefore be deleted.

> **In Art. 92 (8) in Art. 1 of the Amending Directive the period of one month prior to the change to the information shall be deleted.**

5. National requirements regarding marketing communication

Content of the proposal: Competent authorities may still impose national marketing requirements and require a systematic notification of marketing communication which they will have to review in a period of 10 working days[24].

Clearly, national tax rules or cultural differences may for instance require national standards or specific national regulation. However, national rules in this respect generally contradict the aim to reduce or remove barriers for the cross-border distribution. While we appreciate the prohibition to make the filing of marketing material a pre-condition of the marketing of a UCITS or retail AIF[25], we believe that the EU legislator should aim for harmonisation also with respect to marketing communication. MiFID II[26] provides for a detailed set of marketing requirements in case an investment firm distributes the funds. Management companies using marketing material that is compliant with such rules should not be required to submit such material to the competent authority. In addition, such verification should only be relevant for marketing communication towards retail investors since for professional investors or intermediaries the general requirements for marketing material (clear, fair, not misleading) are sufficient. A prior approval of such material by the NCA would be inappropriate. Furthermore, it is questionable whether mere cultural differences should indeed allow NCAs to request specific contents or formats for marketing material. Finally, it should be clear that in case the NCA does not request any amendment within ten working days, the marketing communications shall be deemed being accepted by the NCA.

> **We suggest striving for more harmonisation on national marketing requirements. At the very least, management companies should not be required to submit MiFID II compliant marketing material to NCAs. Nevertheless, we appreciate that an approval of marketing material can no longer be a pre-condition for the marketing of funds. Furthermore, the flexibility for NCAs to stipulate local requirements provided by Art. 5 of the Distribution Regulation should be limited to communication to the retail end-investor. In addition, in Art. 5 (1) of the Distribution Regulation a sentence should be added at the end that unless the NCA requests an amendment, the marketing communication shall be deemed as being accepted by the NCA.**

[21] Art. 1 (7) and 2 (5) of the Amending Directive (proposed Art. 93 (1) (a) of the UCITS-Directive and Art. 32a (1) (a) of the AIFMD).
[22] Art. 5 (6) of the UCITS-Directive.
[23] Art. 93 (3) of the UCITS-Directive.
[24] Art. 5 of the Distribution Regulation.
[25] Art. 5 (1) (2) as well as Art. 5 (3) of the Distribution Regulation.
[26] See Art. 24 (3) of the Directive 2014/65/EU and Art. 44 of the Implementing Directive 2017/565.

6. Transparency regarding national requirements and fees

Content of the proposal: The proposal suggests building databases with information regarding regulation and fees by both NCAs[27] and ESMA[28]. In addition, it provides for general principles regarding fees levied and invoices[29].

We very much appreciate the proposed transparency regarding regulation through databases to be maintained by both NCAs and ESMA. Such transparency will make it much easier for management companies to evaluate the legal requirements before entering a new market. The same applies to the requirements for NCAs and ESMA to maintain databases regarding fees as well as the common principles concerning fees or charges. However, it would be helpful not only to have a clear understanding of the level of fees and calculation methodology but also the concrete triggering event and the legal basis. We believe this could also be specified at Level 2, but the wording in Art. 7 (1) of the Distribution Regulation might currently be too restrictive.

> **We fully support the proposed rules regarding transparency on applicable rules and fees in Art. 3, 4, 7 and 8 of the Distribution Regulation as well as the attempt for common principles on fees in Art. 6 of the Distribution Regulation. Level 2 measures should also require information on fee triggering events and the legal basis. In this respect the wording in Art. 7 (1) should be broader.**

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[27] Art. 3 (1) of the Distribution Regulation.
[28] Art. 4 of the Distribution Regulation, Art. 7 and 8 of the Distribution Regulation..
[29] Art. 6 of the Distribution Regulation.