Regulatory updates – pre-marketing and its practical challenges

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With the recent introduction of a European pre-marketing legal framework in the member states of the European Union ("EU") which applies since August 2nd, 2021 common provisions for the advertisement of alternative investment funds ("AIFs") to professional investors before the actual marketing process were established. The EU legislators' intention was to create a consistent pre-marketing approach within all EU member states to better protect investors however the newly established provisions also cause practical problems to some extent in its adoption for AIFMs and initiators.

The Directive (EU) 2019/1160 of 20 June 2019 with regard to cross-border distribution of collective investment undertakings ("**CBD**") was implemented into Luxembourg laws through the law of 21 July 2021 amending the law of 12 July 2013 on alternative investment fund managers, as amended ("**AIFM Law**") in relation to AIFs and the law of 17 December 2010 on undertakings for collective investment, as amended for UCITS funds.

Common "pre-marketing" approach

So far, for "pre-marketing" no European but only sporadic national provisions existed in some EU member states. The CBD and its implementation in the AIFM Law define pre-marketing as "*provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf, to potential professional investors domiciled or with a registered office in the European Union in order to test their interest in an AIF or a compartment which is not yet established, or which is established, but not yet notified for marketing in accordance with Article 31 or 32 of Directive 2011/61/EU, in that Member State where the potential investors are domiciled or have their registered office, and which in each case does not amount to an offer or placement to the potential investor to invest in the units or shares of that AIF or compartment.*"

Pre-marketing activities shall test the interest of potential investors in an AIF either before its set-up or after its establishment but before the formal marketing notification under the EU passporting regime is carried out. For fulfilling the regulatory notification requirements an AIFM has to send a letter containing certain information to the CSSF by e-mail within two weeks after the start of the pre-marketing. In comparison, the actual marketing notification requires a package of different fund documents to be sent to CSSF, the payment of fees for some countries and the waiting for prior green light from CSSF. Thus, the use of pre-marketing can be more cost and time efficient.

As no investor is able to subscribe for any shares or units of an AIF before such AIF was established, only a draft issuing document or other draft fund documents of the AIF can be handed out during the pre-marketing period. Such draft documents need to contain a disclaimer which mentions that this issuing document (or other draft documents) are not final and may be subject to changes.

Consequences and practical challenges

Although the pre-marketing rules produce clear benefits for investor protection they can also cause practical problems. The CDB states that the pre-marketing is carried out by an EU AIFM or on its behalf. This relates to the situation that the set-up of an AIF will be implemented by an AIFM as either it establishes an own AIF product or it is approached by a third party and was assigned with the set-up process of the AIF. However, quite regularly a fund initiator with a fund product idea would like to do a market sounding whether the fund project would be successful and if it can find interest with potential investors already before involving an AIFM. During this process of developing an investment idea the initiator might not yet have decided if it takes the next steps for the set-up of an AIF or if it stops the project. Very often the AIFM is also not yet designated at such stage. For such "reflection" period it will then be difficult to be in line with the requirements of the CBD and the AIFM Law if no AIFM has been appointed yet.

When does "pre-marketing" start?

This also raises the question *when* pre-marketing actually starts. Pre-marketing requires the provision of information or communication on investment strategies. Therefore, once draft fund documentation is handed out to potential investors this is definitely a pre-marketing activity. In case only an idea like the set-up of a fund product investing in real estate without an indication about the fund structure or the definitive jurisdiction of the AIF is communicated to an investor by the initiator, it can be questioned if this shall already be considered as "pre-marketing". At such an early stage, no fund documentation has been prepared yet which could be handed out and potentially no AIFM has been appointed yet.

Such activity should not yet be considered as "pre-marketing" as this is far from allowing a potential investor to gather detailed knowledge about the AIF and to take an investment decision. Such assessment of the appetite of a potential initiator should be possible without being subject to the overall regulatory requirements under the CBD. Any different view would cause inefficiency and unnecessary delay for an initiator in situations when it only intends to verify the attractiveness of a potential investment idea. When reviewing the relevant CSSF notification letter an AIFM has to inform the CSSF about the following aspects: the potential name of the AIF, its legal form, compartments, if any etc. If the investor presents only a vague investment idea as described before, such information could not be provided in the notification letter. Such details are not yet known at the described early stage of market sounding. This is yet another argument to not include such activities in the pre-marketing phase of the CBD.

In order to better be aware if such first approach by an initiator towards potential investors at an early stage is definitely no "pre-marketing" it would be appreciated to receive additional information or examples from the regulator. Some sponsors would like to advertise their idea without the appointment of third parties and without paying fees yet. If any presentation of an idea was "pre-marketing" this could also prevent initiators from implementing an investment idea due to the applicable hurdles. In any case it is clearly recommended to appoint an AIFM at an early stage during the fund establishment process. The AIFM can notify the CSSF about the pre-marketing activities and can support the initiator during the entire AIF set-up process.

Challenging license requirements

Another challenge can be that pre-marketing activities shall be carried out either by the AIFM or by a third party on behalf of the AIFM. This third party needs to be authorised as an investment firm, a credit institution, a UCITS management company, an AIFM or acts as tied agent(1). Often, the AIFM will not carry out the pre-marketing itself but appoints another party similar to the appointment of a distribution agent for AIFs during the marketing process. It is also likely that the initiator would like to carry out the pre-marketing as it knows its product best and can refer to existing relationships with interested investors. No problem arises if the initiator holds one of the before mentioned licenses. Initiators of an AIF often also act as investment advisor or portfolio manager of the AIF what requires a license also satisfying the requirements under pre-marketing rules. In other cases, the initiator of an AIF holds no license or another license being insufficient for the pre-marketing.

As a result, in some situations neither the initiator can carry out the pre-marketing due to the missing license nor the AIFM would like to be responsible and has the capacities to do the pre-marketing in other jurisdictions. A third party holding one of the necessary licenses would need to be appointed and be paid for the pre-marketing. This might be an interesting opportunity for companies with the relevant license to offer such third-party pre-marketing services. Another option would be to leave the responsibility for the pre-marketing with the AIFM and to inform the CSSF in the notification letter accordingly. The initiator could anyway attend meetings with potential clients to present its fund product strategy but would be supervised by the AIFM also being present or participating via video conference or via phone. Other solutions for such license issues might still be developed in the near future.

Resume

The CBD and its implementation create a common (pre-) marketing approach at EU level and provide more clarity about the Do's and Don't's of attracting potential investors before the incorporation of an AIF or before the start of the actual marketing process under the EU passporting regime. Pre-marketing activities can easily be notified by the AIFM to the CSSF and the notification procedure is time efficient. On the other hand, the rules also cause practical challenges e.g. when no AIFM has been appointed yet or when it shall be clarified at what moment the expression of an investment idea in front of potential investors shall be considered as "pre-marketing".

At a very early stage pre-marketing rules should not apply what would be more practical and efficient for initiators. "Pre-marketing" occurs definitely once the fund documentation or final details about a fund product are presented to potential investors. It would be appreciated to receive more information from the authorities on how the practical existing issues of pre-marketing could be solved as they become more visible now several months after the implementation of the CBD. The authorities are also asked to show administrative restraint in interpreting the pre-marketing rules to allow sufficient flexibility for market participants to sound investment ideas and start initial discussions with potential investors.

1) Art. 28-1 (5) of the AIFM Law.