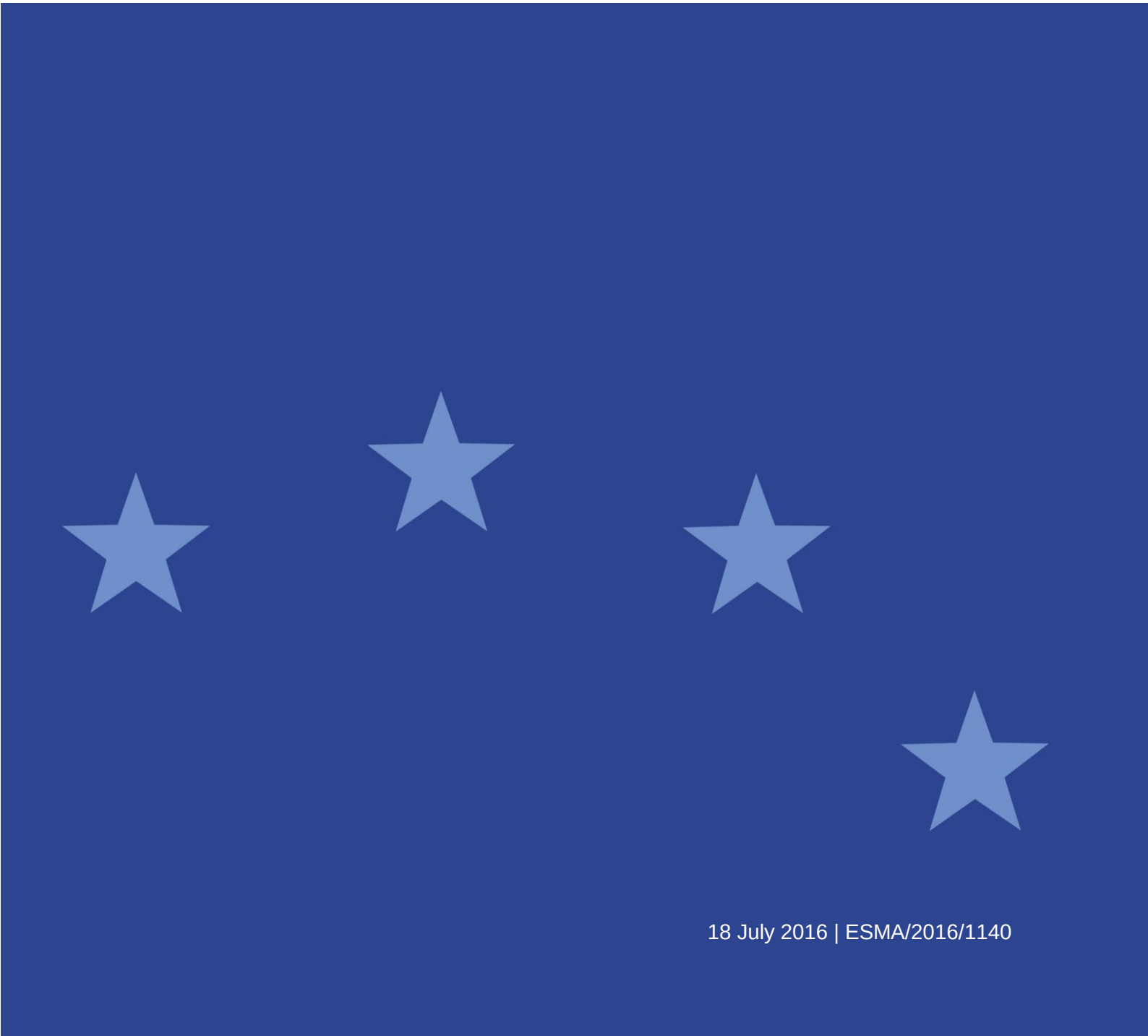
esma European Securities and Markets Authority

Advice

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



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Acronyms used

AIFMD	Alternative Investment Fund Managers Directive (2011/61/EU)
AIFM	Alternative Investment Fund Manager
AIF	Alternative Investment Fund
ESMA	European Securities and Markets Authority
EU	European Union
IOSCO	International Organization of Securities Commissions
MoU	Memorandum of Understanding
NCA	National Competent Authority
NPPR	National Private Placement Regime
UCITS	Undertaking for Collective Investment in Transferable Securities
UCITS Directive	Directive 2009/65/EC

I. Executive summary

Reasons for publication

In accordance with Articles 36 and 42 of the Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD), non-EU alternative investment fund managers (AIFMs) and non-EU alternative investment funds (AIFs) managed by EU AIFMs are subject to the national private placement regime (NPPR) of each of the Member States where the AIFs are marketed or managed.

However, the AIFMD makes provision for the passport, which is currently reserved to EU AIFMs and AIFs, to be potentially extended in future. Article 67(1) of the AIFMD establishes that, by 22 July 2015, ESMA shall issue to the European Parliament, the Council and the Commission advice on the application of the passport to non-EU AIFMs and AIFs in accordance with the rules set out in Article 35 and 37 to 41 of the AIFMD.

Following the publication of a first set of advice on the application of the passport to six non-EU countries (Guernsey, Hong Kong, Jersey, Switzerland, Singapore and the United States) in July 2015, this document sets out ESMA's advice on the application of the passport to twelve non-EU countries: Australia, Bermuda, Canada, Caymand Islands, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Switzerland, Singapore and the United States.

Contents

Section 1 of the advice sets out the background to ESMA's work, while the detailed assessment of each of the aforementioned non-EU countries is contained in section 2.

Next steps

ESMA will continue to work on its assessment of other non-EU countries not covered in this advice with a view to delivering further submissions to the European Parliament, the Council and the Commission. For those non-EU jurisdictions with which there are currently no supervisory cooperation arrangements in place for the purposes of the AIFMD, ESMA will continue its efforts to agree a MoU with the authorities concerned.

1 Background

1.1 AIFMD and the request to ESMA for advice

1. In accordance with Articles 36 and 42 of the AIFMD, non-EU AIFMs and non-EU AIFs managed by EU AIFMs are subject to the NPPR of each of the Member States where the AIFs are marketed or managed. However, the AIFMD makes provision for the passport, which is currently reserved to EU AIFMs and AIFs, to be potentially extended in future. Article 67(1) of the AIFMD establishes that, by 22 July 2015, ESMA shall issue to the European Parliament, the Council and the Commission the following:

- An opinion on the functioning of the passport for EU AIFMs pursuant to Articles 32 and 33 of the AIFMD and on the functioning of the national private placement regimes set out in Articles 36 and 42 of the AIFMD.

- Advice on the application of the passport to non-EU AIFMs and AIFs in accordance with the rules set out in Article 35 and Articles 37 to 41 of the AIFMD.

2. Within three months of receipt of positive advice and an opinion from ESMA, and taking into account the criteria of Article 67(2) and the objectives of the AIFMD, the Commission should adopt a delegated act specifying the date when the rules set out in Article 35 and 37 to 41 of the AIFMD become applicable in all Member States. As a consequence, the EU passport would be extended to non-EU AIFs and non-EU AIFMs.

3. In order to produce this opinion and advice, ESMA must look into the elements listed in Article 67(2) and (4) of the AIFMD[1], notably on the basis of the information provided by the national competent authorities (NCAs) about the EU and non-EU AIFMs under their supervision. Indeed, Article 67(3) of the AIFMD requires NCAs to provide information to ESMA quarterly as from 22 July 2013.

4. Article 67(4) of the AIFMD states that, where ESMA 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, it shall issue positive advice in this regard.

5. In order to supplement the input provided by NCAs via the quarterly surveys, ESMA launched a call for evidence[2] in November 2014 aimed at gathering information from EU and non-EU stakeholders on the functioning of the EU passport, the NPPRs and the potential extension of the EU passport to non-EU countries.

[1] This includes such aspects as the use made of the EU passport and any problems encountered in that context, the functioning of the NPPRs and, more generally, issues such as investor protection, market disruption, competition and the monitoring of systemic risk.

[2] http://www.esma.europa.eu/system/files/2014-esma-1340_call_for_evidence_aifmd_passport__3rd_country_aifms.pdf

6. ESMA received 67 responses (including 15 confidential submissions), from 13 non-EU authorities, 21 EU and non-EU trade associations of asset managers, 17 EU and non-EU asset managers, and 16 other trade associations and private firms (e.g. providers of services for funds, law firms etc).

7. An important point mentioned in the call for evidence is that ESMA has decided to opt for a country-by-country assessment of the potential extension of the AIFMD passport. This allows for greater flexibility in the assessment and for a distinction to be made between the very different situations of non-EU countries in terms of the demand for the passport, the access to the market of these non-EU countries for EU funds and managers, and their regulatory framework as compared to the AIFMD.

8. Such an approach makes it necessary to assess the different non-EU countries on an individual basis, which requires an extensive information-gathering exercise.

9. ESMA published a first advice on the application of the passport to six non-EU countries (Guernsey, Hong Kong, Jersey, Switzerland, Singapore and the United States) in July 2015.

10. Following this first advice, ESMA received a letter from the European Commission dated 17 December 2015[3]. In this letter, the European Commission invited ESMA to complete its advice by 30 June 2016:

- On the assessment of the non-EU countries included in this first advice on which no definitive views had been provided;
- On the assessment of six other non-EU countries: Australia, Bermuda, Canada, Caymand Islands, Isle of Man, and Japan;
- More specifically, on the assessment of the capacity of non-EU supervisory authorities and their track record in ensuring effective enforcement, including those non-EU countries looked at in the first advice;
- On the assessment of the expected inflows of funds by type and size into the EU from the different non-EU countries.

1.2 Structure of the Advice

11. The advice is structured as follows:

a. First, the criteria, methodology and data used to assess the potential extension of the AIFMD passport to non-EU countries is presented (section 2.1);

b. The list of the non-EU countries to be assessed by ESMA for the purposes of the present advice under Article 67 of the AIFMD is then established (section 2.2);

[3] https://www.esma.europa.eu/sites/default/files/library/eu_commission_letter_aifmd_passport.pdf

c. The different non-EU countries listed in section 2.2 are assessed against the methodology set out in section 2.1 (sections 2.3 to 2.14);

d. Information on other non-EU countries is given (section 2.15).

2 Assessment of the different non-EU countries in light of the criteria set out in Article 67 of the AIFMD

2.1 Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to non-EU countries

12. ESMA is of the view that the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries. These criteria were identified both in the course of the surveys mentioned in the ESMA opinion on the EU passport and NPPRs, and in the responses of stakeholders to the call for evidence launched by ESMA on the AIFMD passport. These criteria are used in the following sections to assess the cases of the following twelve non-EU countries: Australia, Bermuda, Canada, Caymand Islands, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Switzerland, Singapore and the United States. The same assessment methodology has been applied to all twelve countries based on the set of information gathered by ESMA.

13. The advice set out in the boxes in each section of this document represents ESMA's view of each non-EU country based on the information available at the time of publication. In some cases, the advice cannot be considered 'positive' in the sense of Article 67(4) of the Directive. The European Council, Parliament and the Commission to which this advice is submitted pursuant to Article 67 of the AIFMD 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.

Level 1 text

14. Article 35 sets down conditions for the marketing in the Union with a passport of a non-EU AIF managed by an EU AIFM. Articles 35(2) says that the following conditions shall be met:

a) *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 in order to ensure at least an efficient exchange of information, taking into account Article 50(4), that allows the competent authorities to carry out their duties in accordance with this Directive;*
b) *the third country where the non-EU AIF is established is not listed as a Non-Cooperative Country and Territory by FATF;*
c) *the third country where the non-EU AIF is established has signed an agreement with the home Member State of the authorised 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.*

15. Equivalent requirements are set out in Article 37(7)(d-f) to cover the situation where the passport is granted to a non-EU AIFM.

16. Article 67(4) says (emphasis added):

> *Where ESMA 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, it shall issue positive advice in this regard.*

Criteria

17. ESMA notes the preconditions for an MoU with non-EU NCAs set out in Articles 35 and 37 and considers that there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation it is necessary to review the way in which the MoUs required under Articles 34(1)(b) and 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

    a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
    b) Is there timely and prompt collaboration in case of emergency situations?
    c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
    d) Have legal limitations been encountered in sharing information or performing on-site visits?
    e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
    f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of an existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU country have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[4] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

18. Regarding investor protection and the information mentioned in 1) ii) above, ESMA notes that under the requirements of Article 37 non-EU AIFMs intending to market and/or manage AIFs in the EU using the AIFMD passport shall acquire prior authorisation by the NCA of their Member State of reference. This authorisation notably implies that this NCA will have to verify that the non-EU AIFM will comply with the requirements of the AIFMD. In that respect, criterion 1) ii) should not be seen as an equivalence assessment since, regardless of the existing regulatory framework in the non-EU country, the non-EU AIFM from that non-EU country wishing to market and/or manage its AIFs in the EU will have to comply with the AIFMD requirements, and these requirements will be verified and subject to ongoing supervision by the NCA of the Member State of reference.[5]

19. This notably means that all non-EU AIFMs from any non-EU country wishing to market and/or manage its AIFs in the EU using the AIFMD passport will have to:

- Comply with rules rules on remuneration set out in Article 13 of the AIFMD;
- Without prejudice to the implementing acts under Article 21(6) of the AIFMD mentioned below in paragraph 24, comply with the rules on the depositary mentioned in Article 21 of the AIFMD. These rules in particular require that an AIFM

[4]And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.
[5] ESMA notes that the different steps described in Art 37 leading to the designation of the Member State of reference might lead to the need for supervisory convergence measures by ESMA in order to ensure consistency in the application of these requirements in the different Member States.

shall not act as a depositary (Article 21(4)), which means that 'self-custody' is not allowed, and that the functions of a depositary (mentioned in Articles 21(7), 21(8) and 21(9)) include oversight functions. These rules also include the requirements on the depositary's liability regimeset out in Article 21(12).

20. However, ESMA also notes that the abovementioned verification exercise may significantly differ depending on the extent to which the non-EU country has put in place a regulatory framework that is similar to the AIFMD (particularly as regards some of the points mentioned in 1)ii) above). In the event of major gaps between the regulatory framework of the non-EU country and the AIFMD, the role of the NCA of the Member State of reference may be particularly challenging, and the extent to which the cooperation agreement with the non-EU Authority is efficient will matter significantly more than in the event of a non-EU regulatory framework that is very similar to the AIFMD. The extent to which the interpretation of the role of the NCA of the Member State of reference differs across the Member States will also be a particularly relevant issue.

21. For these reasons, ESMA is of the view that, while it would not be appropriate to require (for the purposes of giving positive advice on the extension of the passport) that there be a minimum degree of equivalence between the regulatory framework of the non-EU country and the AIFMD, it is nevertheless relevant and necessary to investigate the extent to which the regulatory framework of the non-EU country differs from the AIFMD. However, this assessment will focus only on the most relevant elements of the regulatory framework of each non-EU country. This explains why the format of the assessments of these criteria in the following sections may differ slightly from one non-EU country to another.

22. ESMA notes that Article 21(6) of the AIFMD empowers the Commission to adopt implementing acts stating that the prudential regulation and supervision of third countries with respect to depositaries have the same effect as Union law and are effectively enforced. While there may be some elements of the assessment carried out for the purposes of this advice that are relevant to the assessment that will be done under Article 21(6), ESMA would like to underline that the present advice is a separate exercise and is without prejudice to the more detailed assessment that is likely to be appropriate in the context of the implementing acts.

23. As mentioned above, in its letter dated 17 December 2015, the European Commission asked ESMA to provide more details on the capacity of non-EU supervisory authorities and their track record in ensuring effective enforcement, including those non-EU countries looked at in the first advice. ESMA carefully considered this request, and considering the varying level of information available on this topic in the different non-EU countries, ESMA formed a plan to gather as much information as possible, bearing in mind time and resource constraints. ESMA therefore considered that:

- i.For those non-EU countries that have been recently assessed by the IMF (Financial sector assessment program on the assessment of implementation of IOSCO objectives and principles of securities regulation - FSAP report dated 2013 or later), if the assessment of IOSCO principles 10 to 12 is either "fully implemented" or "broadly implemented", it could be considered that there is no significant obstacle

to the granting of the passport as for this criterion. If one of these abovementioned principles 10 to 12 is only "partially" implemented, then follow-up questions should be sent;

- ii.For those non-EU countries that have been assessed by the IMF, but before 2013 (FSAP report dated before November 2012)[6], follow-up questions should be sent to non-EU authorities even if IOSCO principles 10 to 12 are "fully implemented" or "broadly implemented";

- iii.For those non-EU countries that have not been assessed by the IMF, ESMA would invite non-EU authorities to carry out a self-assessment based on the IOSCO principles 10 to 12, answering the corresponding questions included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation*[7]. ESMA would then send follow-up questions to the corresponding non-EU authorities in order to clarify or specify the contents of their responses to the different questions included in this methodology, if need be.

  ESMA would like to highlight the limitations of the desk-based reviews as described in point (ii) and particularly point (iii) above when compared with assessments carried out in the context of an FSAP as described in point (i). Such desk-based reviews coud not include extensive research, on-site interviews and/or visits to cross-check the information received from the non-EU supervisory authorities, due in particular to the time-frame for the delivery of the advice.

2) Market disruption:

Examples of questions that may be applied under this heading include:

(a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
(b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

24. As mentioned above, in its letter dated 17 December 2015, the European Commission asked ESMA to provide data on the expected inflows of funds by type and size into the EU from the different non-EU countries. In order to meet this request ESMA asked the corresponding non-EU authorities to provide ESMA with such information. The answers

[6] The IOSCO methodology for assessing implementation of the IOSCO objectives and principles of securities regulation was revised in August 2013.
[7] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf

provided by the non-EU authorities to these questions are presented in the corresponding section of each individual assessment on 'market disruption'. In the requested timeframe, ESMA was not in a position to gather more information on this topic than the information transmitted by non-EU Authorities. The figures and information provided in each of these individual assessments therefores only reflects the contents of the answers received from the relevant non-EU Authorities, which explains why the level of detail of the information in this section might differ from one non-EU country to another.

3) Obstacles to competition:

- Examples of questions that may be applied under this heading include:

(a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?
(b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?
(c) Does the non-EU NCA treat all EU jurisdictions equally?

4) Monitoring of systemic risk:

- Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market developments with a view to tracking potential (or actual) systemic risks[8] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Sources of data to support methodological assessment

25. ESMA has carefully evaluated the following sources of information:

1) ESMA's research

[8] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

2) The insights and understandings of EU NCAs

3) Experiences of EU NCAs in liaising with non-EU NCAs in formal and informal supervisory settings

4) Responses of non-EU countries to queries from ESMA

5) IMF assessments (Financial Stability Assessment Plans and Details Assessment Reviews against principles of international standard-setters)

6) Stakeholder responses to the Call for Evidence;

7) Non-EU authority responses to the Call for Evidence

8) Other relevant market intelligence

Quality of assessment

26. ESMA will require a reasonable body of evidence before considering the provision of a positive assessment against the criteria[9]. Particular emphasis will be put on the quality of supervisory liaison/engagement between EU NCAs and the non-EU NCA.

27. For the avoidance of doubt, and due to the amount of information needed to assess comprehensively each non-EU country against the different criteria set out in Article 67 and detailed above, ESMA will reserve judgement where there is insufficient evidence to provide a positive assessment.

Other potentially relevant issues not assessed by ESMA

28. ESMA is providing this advice based on a methodology which is grounded in the Level 1 text of AIFMD. ESMA is conscious that the assessment methodology focusses on regulatory issues. Other issues which the Commission and co-legislators may also wish to consider may include: (a) fiscal matters in the non-EU country and (b) latest intelligence on the Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) regime in the non-EU country (to the extent that this aspect is not covered under Articles 35(2)(b) and 37(7)(e)).

29. On a separate topic, ESMA notes that Article 42 of the AIFMD allows Member States to permit non-EU AIFMs to manage EU AIFs or market AIFs in their jurisdictions (NPPR). Article 37 (if and when it becomes applicable) indicates that Member States shall require non-EU AIFMs intending to manage EU AIFs or market AIFs in the Union with a passport to be authorised.

[9] Although it should be understood that, in order for ESMA to arrive at a definitive view (positive or negative) it is not necessary that information be available from all sources and on all elements of the methodology.

30. ESMA understands that, once Article 37 is switched on, non-EU AIFMs will be able to continue to operate under Article 42 notwithstanding that they could be authorised under Article 37, at least during the transitional period mentioned in Art 68. Nevertheless, ESMA sees merit in clarifying this issue.

31. ESMA also notes that Article 37 refers to “authorisation” of non-EU AIFMs but makes no mention of registration. Accordingly, if and when Article 37 is switched on it will be important to ensure that Member States have a common understanding on the treatment of non-EU AIFMs which are below the thresholds set out in Article 3(2) of the AIFMD.

2.2 List of the non-EU countries to be assessed by ESMA for the purposes of the advice of Article 67 of the AIFMD

32. In view of the present advice on the possible extension of the AIFMD passport to non-EU AIFMs and AIFs, NCAs have reported to ESMA quarterly on the functioning of the EU passport, the NPPRs and the coexistence of both regimes.

33. In that context, ESMA has sought feedback from the NCAs of those Member States that have reported a significant presence of non-EU AIFMs and AIFs in their jurisdictions. The authorities from these Member States have provided a detailed breakdown by third country of the number of non-EU AIFs and non-EU AIFMs active in their territories in accordance with Articles 36 and 42 of the AIFMD. The results of this survey allowed ESMA to draw up a list of non-EU countries that should be assessed against the criteria of Article 67 of the AIFMD.

34. On the basis of an aggregation of the figures provided by the relevant NCAs, the following non-EU countries have been identified as the domicile of non-EU AIFMs that market AIFs in the Member States examined and/or domiciles of non-EU AIFs marketed in the Member States examined:

- Australia
- Bahamas
- Bermuda
- Brazil
- British Virgin islands
- Canada
- Cayman Islands
- Curacao
- Guernsey
- Hong Kong
- Isle of Man
- Japan
- Jersey
- Mexico
- Mauritius

- Singapore
- South Africa
- South Korea
- Switzerland
- Thailand
- USA
- US Virgin Islands

35. Linked to the issue of the assessment methodology and the list of abovementioned non-EU countries is the question of how best to organise the assessment overall given the country-by-country approach mentioned above and the deadline of 22 July indicated in Article 67 of the AIFMD. In essence, the assessment methodology relies on (i) a sufficient level of information about each relevant non-EU jurisdiction and (ii) a substantive assessment of the information having regard for Art 67(4) of AIFMD. At this stage, it is clear that ESMA does not have sufficient information in relation to many of the non-EU jurisdictions in order to make a substantive assessment which would underpin advice pursuant to Art 67(1)(b). Therefore, ESMA only considers it appropriate to issue advice for non-EU jurisdictions once it is satisfied that there is a sufficient level of information about that jurisdiction.

36. Finally, in its letter dated 17 December 2015, the European Commission explicitly invited ESMA to complete its advice by 30 June 2016 on the assessment of six non-EU countries: Australia, Bermuda, Canada, Caymand Islands, Isle of Man, and Japan

37. At present, ESMA is therefore in a position to issue such advice in respect of the following non-EU jurisdictions:

i) United States

ii) Guernsey

iii) Jersey

iv) Hong Kong

v) Switzerland

vi) Singapore

vii) Australia

viii) Bermuda

ix) Canada

x) Cayman Islands

xi) Isle of Man

xii) Japan

38. This list takes into account a number of factors including the amount of activity already being carried out by entities from these countries under the NPPRs, the existing knowledge and experience of EU NCAs with respect to their counterparts in these jurisdictions and the efforts made by stakeholders from these countries to engage with the process.

39. This would then be followed by assessments of other batches of non-EU countries beyond June 2016.

2.3 U.S

40. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to the US based on the methodology described in section 2.1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to the U.S

41. ESMA notes the preconditions for an MoU with non-EU NCAs set out in Articles 35 and 37 and considers that there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation it is necessary to review the way in which the MoUs required under Articles 34(1)(b) and 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
b) Is there timely and prompt collaboration in case of emergency situations?
c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
d) Have legal limitations been encountered in sharing information or performing on-site visits?
e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

42. In the absence of evidence in relation to the working of an existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of the US

43. ESMA is of the view that the MoUs are in place and working well. Positive experiences have been reported by NCAs.

44. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i. Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii. What rules or mitigants does the non-EU country have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii. How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[10] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv. What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of the US

45. ESMA is of the view that overall, the rules in the US seem comparable to the rules in the EU (diversification, disclosure requirements, limitation in ability to borrow money etc.). Funds must value securities in accordance with US generally accepted accounting principles (GAAP) but foreign funds can use IFRS. The U.S Regulatory framework in relation to funds and their manager is therefore robust and comprehensive, and its enforcement guaranteed by the supervisory powers of the SEC and other relevant U.S regulators.

46. As regards investor complaints the SEC created the Office of Investor Education and Advocacy to serve individual investors. The OIEA receives many types of complaints, including complaints against brokers, brokerage firms, investment advisers, transfer agents, mutual funds, and other market participants. However, their efforts are informal and they cannot force a firm to resolve the complaint. On top of this, OIEA can advise investors on other ways to complain. Both federal and state securities laws provide important legal rights and remedies (as per SEC website). When OIEA receives a complaint, they may decide to pass it on to relevant parts of the SEC so that the SEC can use the information and launch investigations if they deem it to be appropriate. Investors can also turn to FINRA, which has a dispute resolution centre where arbitration and mediation can be used – both are less costly than going to the courts.

47. With regards to Custodians**,** a Mutual fund must place and maintain its assets with a qualified custodian as per the rules under the ICA. This is typically a US bank meeting certain capital requirements or a broker dealer but the ICA also permits the use of regulated

[10]And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

foreign banks or foreign securities depositaries. Under certain conditions, the fund can act as its own custodian. Under the requirements of the AIFMD, because the Member State of reference has to authorize the non-EU AIFM wishing to market AIFs in the EU, and that the non-EU AIFM has to comply with the AIFMD requirements, including depositary rules, the system with self-custody would not be accepted for AIFMs and AIFs that intend to use the EU-passport[11].

48. In relation to the regulatory scope, there are several regulatory bodies responsible for the regulation of retail funds in the USA: the SEC which is the principal regulatory body; FINRA which is a self-regulatory organisation overseeing securities firms doing business in the US (Regulation promulgated by the FINRA govern FINRA members' sales and marketing of fund shares.). FINRA is overseen by the SEC and must report to it in order to ensure compliance. Finally, the CFTC regulates futures, options and swaps markets in the US (and mutual funds that invest in these markets) and their advisers. Funds regulated by the SEC may therefore also be subject to regulation from the CFTC. The SEC also shares information relating to private funds with the OFR (Office of Financial Research).

49. As regards authorisation and supervision, at registration stage, the SEC requires a mutual fund to file a notification of registration and a registration statement. This statement, which must be updated annually, requires disclosure, inter alia, of:

- The fund's investment objectives, strategies and related risks;
- Fees and annual fund operating expenses;
- Performance information;
- The fund's adviser;
- How to purchase shares.

50. Mutual funds may offer their shares through a distributor registered with the SEC as a broker-dealer under the Exchange Act. Distributors are also members of FINRA and subject to its rules and regulations. The distributor purchases shares from the fund and then sells them to the public directly or indirectly through intermediaries.

51. As regards the alignment of incentives between the AIFM and investors, similar remuneration rules as set out in the AIFMD do not seem to be currently applied in the US.

[11] SEC registered investment advisers are neither permitted to deal on behalf of clients nor to hold client assets, unless they are separately regulated to perform such functions (*e.g.*, an investment adviser that is also registered and regulated as a broker-dealer). If an investment adviser has "custody" (as defined) and is subject to the custody rule, such an investment adviser must use a "qualified custodian" to hold client assets. In particular, under the Investment Advisers Act of 1940, an investment adviser may not legally hold its clients assets (unless the adviser also is a broker-dealer, bank or other entity that meets the definition of a "qualified custodian" and is regulated as such). An investment adviser also cannot hold client assets indirectly by putting them in a bank account or broker-dealer account in the adviser's own name (except if the assets are held in the name of the adviser as agent or trustee for clients). Client assets are required to be kept with qualified custodians, such as banks or broker-dealers, because those institutions are regulated specifically for the safekeeping of assets. The Advisers Act nonetheless deems an adviser to "have custody," and be subject to additional regulation (e.g. an annual surprise exam by an independent accountant to verify client assets), in certain situations, such as when the adviser is authorized or permitted to direct client assets to a third party (such as being able to instruct a bank to pay bills) or the adviser is authorized or permitted to obtain possession of client assets, such as when an adviser acts in a capacity (such as trustee of a trust) that gives that adviser or any of its supervised persons legal ownership of or access to client assets. In other words, an adviser can "have custody" in certain circumstances under the very broad definition in the Advisers Act (and be subject to additional regulation for the protection of investors), even though it does not "hold custody" in the more common way that custody is understood.

ESMA notes that some stakeholders mentioned that the implementation of such rules in the case of US managers wishing to market their funds in the EU using the AIFMD passport might be an obstacle to the success of the AIFMD passport. This might tend to show that AIFMD-like rules on remuneration do indeed not exist at the moment in the US, and that the AIFMD rules on remuneration are significantly different from what is being applied in the US[12].

52. With respect to question 1) iii) ESMA notes that, according to the 2015 IMF financial sector assessment program (FSAP) detailed assessment of implementation on IOSCO objectives and principles of securities regulation on the US[13], the US was assessed as "Fully Implemented" for most of the principles referred to (except principles 12, 25 and 27, which are "Broadly Implemented", and principle 24, which is "Partially implemented" – please see below).

53. According to the 2015 IMF FSAP, principles 10 to 12, which notably relate to the effectiveness of enforcement in the US, are therefore fully or broadly implemented.

54. Regarding principle 24 IOSCO**,** on the regulatory regime in the US, the FSAP report on the US indicates that Principle 24 of the IOSCO principles is only Partly Implemented. The FSAP report states that the reasons for the partly implemented grade were "the limited examination coverage of IAs and investment companies" and "the absence of express eligibility requirements for CPO and IAs in particular in relation to internal controls and risk management". In relation to the latter the FSAP team noted that, in practice, many elements that a risk management framework would entail are covered by the existing obligations. These include the compliance rule, the record keeping rules, the custody rules, the obligation to supervise and the segregation requirements. The assessors considered that, as such, the current framework broadly achieves the objectives of the principle, but encouraged the authorities to add an explicit rule so as to comply with IOSCO Principles and ensure their expectations in this area are well understood by the market.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

[12] Section 205(a)(1) of the Advisers Act includes some rules on performance fees for registered funds. In addition, In terms of remuneration of investment advisers to registered funds, the fund's board of directors, particularly the independent directors, and the fund's shareholders bear primary responsibility for assessing the remuneration of the fund's asset manager. Section 15(a) of the Investment Company Act prohibits a person from serving as an investment adviser to a registered fund except pursuant to a written advisory contract that has been approved by a vote of the majority of the fund's independent directors and by a vote of the majority of the holders of the fund's outstanding voting securities. In addition, section 15(c) requires fund directors to request and evaluate such information as may be reasonably necessary to evaluate the continuing terms of the advisory contract and requires investment advisers to furnish this information to the registered fund's directors. In certain cases, material changes to an existing advisory contract require shareholder approval. When shareholder approval of the adviser's contract is sought under section 15, certain information regarding the adviser and the contract, including the compensation to be paid under the contract, must be provided in the shareholder proxy statement provided to shareholders. Section 36(b) of the Investment Company Act imposes on investment advisers of registered investment companies a specific fiduciary duty with respect to the receipt of any compensation for services, or of payments of a material nature, paid by the fund or its shareholders to the adviser or an affiliate. It authorizes the Commission or any security holder of the investment company, on behalf of the investment company, to sue for breach of that duty.

[13] Detailed assessment of implementation of the IOSCO objectives and principles of securities regulation in the US: https://www.imf.org/external/pubs/ft/scr/2015/cr1591.pdf

a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of the US

55. ESMA is of the view that the granting of the passport to non-EU AIFMs might result in more US AIFs on the EU market. However, as the SEC has pointed out, it is difficult to predict this in more detail, as it is difficult to predict the impact on investor choice from the increased number of funds made available on the EU market in the long term.

56. Please see the following assessment of questions related to the "obstacles to competition" criteria.

3) Obstacles to competition:

- Examples of questions that may be applied under this heading include:

a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?
b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of the US

57. ESMA is of the view that as of today, it is possible to market funds in the US for EU-AIFMs. The easiest way for EU-AIFMs to publicly market and sell issues/shares in the USA is to organize a fund in the USA and register this fund under the Investment Company Act of 1940 the so-called '1940 Act'. The 1940 Act imposes the same regulatory standards on all funds, regardless of whether they are managed by a domestic or foreign manager. The funds can be managed and administered outside of the USA. A foreign or an American manager to a fund is required to register under the Investment advisers Act of 1940. This Act does not require a U.S place of business requirements. EU managers can therefore establish wholly-owned affiliates in the USA or decide to provide services from Europe.

58. However, it remains generally more difficult to market foreign funds in this jurisdiction, especially to retail investors. A foreign manager that does not want to establish funds in the U.S but want to market its existing foreign funds in the USA has two options.

    1. Under Section 7(d) of the 1940 Act, an investment company organized in a foreign jurisdiction may offer publicly its securities if the SEC finds that 'it is both legally and practically feasible to effectively enforce the provisions of the 1940 Act' against the fund. Section 7(d) represents a prudential standard to ensure that US investors receive the same investor protections whether they acquire shares in a foreign fund or in a US-domiciled fund. Only a few foreign funds use this approach because the requirements of Section 7(d) imposes constraints on their ability to sell their shares in the USA because of differences in business and regulatory environments between the USA and the country of origin;

    2. A foreign manager can sell its foreign fund shares privately without registering the fund or receiving approval to sell the fund from the SEC under Section 7(d) of the 1940 Act.

    3. The manager, in this instance, is required to
        a. Claim an exception for the fund itself under the 1940 Act;
        b. Claim an exemption for the shares of the fund under the Securities Act;
        c. Register or claim an exemption for itself and the fund under the commodity Exchange Act;
        d. qualify the fund under state blue sky laws (make a notice filing and pay a fee in each state in which an investor in the fund resides).

59. Overall only a few non-US funds have used the process under Section 7(d) to sell to U.S. retail investors. Most firms use the following: (1) organize funds in the U.S.; (2) set up master-feeder structures in the U.S. and non-U.S. funds pool their assets in a U.S. master fund: (3) create mirror funds in which a U.S. fund pools their assets in a U.S. master fund; or (4) privately offer securities of a non-U.S. fund in the U.S.

60. The implications of the Volcker rule could also be considered as part of the evaluation under these criteria. The Volcker Rule was published in December 2013 by the five US financial authorities (Federal Reserve, CFTC, SEC, FDIC, OCC). It provides different obligations/restrictions regarding proprietary trading and investment in "covered funds" by "banking entities". ESMA's current understanding is that the potential application of the Volcker Rule for European actors in the asset management industry, notably in relation to the scope of the entities that might qualify as "banking entities" or "covered funds", has been clarified by the SEC[14]. However, the full implications of the Volcker Rule are still being assessed and, subject to the outcome of that assessment, it may be appropriate to consider this as a relevant factor in the decision on whether to extend the passport.

[14] https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm (please see notably news 7/16/15 and 6/12/15)

61. ESMA is of the view that in the context of a potential extension of the AIFMD passport to the US, there is the risk of an unlevel playing field between EU and non-EU AIFMs as regards market access.[15]

62. ESMA is of the view that the market conditions which would apply to U.S funds dedicated to professional investors in the EU in the event that the AIFMD passport is extended to the U.S would be different from the market access conditions applied to EU funds dedicated to professional investors in the U.S. This is due to registration requirements under the U.S regulatory framework (which generate additional costs), and particularly in the case of funds marketed by managers involving public offering. The term 'public offering' used in this paragraph refers to the term 'public offering'[16] used in in Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act[17], and has the same meaning that it has in Section 4(2) of the Securities Act[18]. Please see also the final rule on the non-public offering exemption wich discusses the concept of public offering[19].

63. ESMA acknowledges that in the case of funds marketed in the US by managers but not involving any public offering, the market access conditions which would apply to of U.S funds dedicated to professional investors in the EU would be broadly comparable to the market access conditions of EU funds dedicated to professional investors in the U.S.

64. As a result, if the AIFMD passport were to be granted to the U.S possible options would include:

    a. granting the AIFMD passport only to those U.S funds dedicated to professional investors to be marketed in the EU by managers not involving any public offering. This option would allow for similar market access conditions to apply to EU and US managers. However, it has the drawback that marketing AIFs under AIFMD is not defined in terms of public or non-public offerings.;

    b. granting the AIFMD passport only to those U.S funds which are not mutual funds (under the 1940 Investment Company Act). The term 'mutual funds' refers to what is legally known in the U.S as an 'open-ended company'[20]. Although this

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[15] It is the understanding of ESMA that there exists a more favourable regime for the marketing of funds domiciled in certain jurisdictions (e.g. Canada).
[16] Please also see: https://www.sec.gov/divisions/investment/invcoreg121504.htm#P84_14584
[17] https://www.sec.gov/about/laws/ica40.pdf
[18] https://www.sec.gov/about/laws/sa33.pdf
[19] https://www.sec.gov/rules/final/33-4552.htm
[20] https://www.sec.gov/answers/mfinvco.htm

As also specified by the SEC (https://www.sec.gov/answers/mutfund.htm), here are some characteristics of these 'mutual funds':

- Investors purchase shares in the mutual fund from the fund itself, or through a broker for the fund, and cannot purchase the shares from other investors on a secondary market, such as the New York Stock Exchange or Nasdaq

option would be easily applicable, one of its drawbacks would be that it does not strictly mirror the abovementioned situation observed in the U.S;

c. granting the AIFMD passport only to those U.S funds the investors of which are only professional investors[21].

4) Monitoring of systemic risk:

- Examples of questions that may be applied under this heading include:

i. Does there exist tangible evidence of adequate surveillance of market developments with a view to tracking potential (or actual) systemic risks[22] by the NCA in the non-EU country?

ii. How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of the US

65. ESMA is of the view that the reporting obligations for US Managers are extensive, but differs from the requirements in the AIFMD to some extent. The FSAP report indicates that IOSCO Principle 6 is Broadly Implemented.

General advice on the potential extension of the passport to the U.S

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding the monitoring of systemic risk impeding the application of the AIFMD passport to the U.S.

Stock Market. The price that investors pay for mutual fund shares is the fund's approximate net asset value (NAV) per share plus any fees that the fund may charge at purchase, such as sales charges, also known as sales loads.

- Mutual fund shares are "redeemable." This means that when mutual fund investors want to sell their fund shares, they sell them back to the fund, or to a broker acting for the fund, at their current NAV per share, minus any fees the fund may charge, such as deferred sales loads or redemption fees.
- Mutual funds generally sell their shares on a continuous basis, although some funds will stop selling when, for example, they reach a certain level of assets under management.
- The investment portfolios of mutual funds typically are managed by separate entities known as "investment advisers" that are registered with the SEC. In addition, mutual funds themselves are registered with the SEC and subject to SEC regulation.
- There are many varieties of mutual funds, including index funds, stock funds, bond funds, and money market funds.

Please note that the rules that apply to "mutual funds" differ from the UCITS framework in several respects, as already mentioned in the advice (for example regarding the custody of their assets) or in terms of exposure limits and use of derivatives.

[21] In the context of this option, the definition of 'professional investors' included in Article 4(1(ag)) of the AIFMD could be used.
[22] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

With respect to investor protection, ESMA is of the view that there are differences between the U.S regulatory framework and the AIFMD as described in the corresponding paragraphs above.

However, given the general requirements mentioned in paragraph 19 applicable to all non-EU AIFMs wishing to make use of the AIFMD passport, these differences are not seen as a significant obstacle impeding the application of the AIFMD passport to the U.S.

With respect to the extent to which there would be significant obstacles regarding market disruption and obstacles to competition impeding the application of the AIFMD passport to the U.S, ESMA is of the view that the market access conditions which would apply to U.S funds dedicated to professional investors in the EU in the event that the AIFMD passport is extended to the U.S would be different from the market access conditions applicable to EU funds dedicated to professional investors in the U.S. This is due to registration requirements under the U.S regulatory framework (which generate additional costs), and particularly in the case of funds marketed by managers involving public offerings.

ESMA acknowledges that in the case of funds marketed by managers but not involving any public offering, conditions which would apply to U.S funds dedicated to professional investors in the EU in the event that the AIFMD passport is extended to the U.S would be broadly comparable to the market access conditions of EU funds dedicated to professional investors in the U.S.

As a result, if the AIFMD passport were to be granted to the U.S the EU legislators may wish to consider possible options including[23]:

- granting the AIFMD passport only to those U.S funds dedicated to professional investors to be marketed in the EU by managers not involving any public offering;

- granting the AIFMD passport only to those U.S funds which are not mutual funds (under the 1940 Investment Company Act);

- granting the AIFMD passport only to those U.S funds which restricted investment to professional investors as defined in AIFMD.

[23] These possible options are further specified above in paragraph 64

2.4 Guernsey

66. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Guernsey based on the methodology described in section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Guernsey

67. First, ESMA notes that the preconditions, including that for an MoU with non-EU NCAs set out in Articles 35 and 37 and there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation we need to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

1. Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
2. Is there timely and prompt collaboration in case of emergency situations?
3. Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
4. Have legal limitations been encountered in sharing information or performing on-site visits?
5. Has there been a significant level of lack of cooperation from the non-EU AIFMs?
6. Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of an existing MoU, does previous supervisory engagements provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Guernsey

68. ESMA is of the view that there have been positive experiences in terms of cooperation between NCAs and the Authority of Guernsey (Guernsey Financial Service Commission – Guernsey FSC).

69. One NCA explicitly indicated they are of the opinion that the existing MoU has worked well. The Guernsey NCA has responded within 15 days when this NCA has asked for

assistance. This NCA has performed on-site visits together with the Authority of Guernsey and has good experiences from this. As regards other NCAs, there is limited experience when it comes to the criteria in 1. e). It is therefore difficult for them to evaluate the possible lack of cooperation from non-EU AIFMs.

70. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU country have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[24] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Guernsey

71. ESMA first notes that the Jersey and Guernsey Authorities indicated that the Joint Channel Islands (Jersey and Guernsey) Financial Services Ombudsman scheme will be open to all individual/small businesses and is not limited to retail clients. It will be able to look at complaints from individual customers and small businesses, wherever they reside in the world. Complaints will be able to be made about financial services provided by a business in Jersey or Guernsey involving: banking; lending; money services; insurance; pensions; and investments. The ombudsman will be able to award compensation of up to £150,000. This is similar to the scheme in place in the UK.

[24]And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

72. In Guernsey, ESMA also notes that professional clients usually use the Courts although there is also the possibility to use alternative dispute resolution through mediation mechanisms. The Commission also has an official complaint handling procedure and openly and publically welcomes information regarding unsolved complaints from professional investors and institutions. Based on such information, the Commission may decide to instigate its own investigation into matters connected with a complaint which could lead to supervisory or enforcement actions against the entity in question. Whilst the Commission has no power to adjudicate in a dispute they actively use the information about unresolved complaints as intelligence to highlight potential shortcomings in policies and/or procedures at regulated firms and determine that a complaint raises conduct, financial crime or prudential concerns about a regulated firm which the Commission can then act to correct.

73. As for the criteria in 1 ii), Guernsey has put in place an AIFMD-like regime which is an opt-in regime for Guernsey AIFMs wishing to market their AIFs in the EU under the AIFMD passport requirements. The current framework applicable in Guernsey (i.e. not the aforementioned opt-in regime) includes certain differences with the AIFMD, especially regarding the custody and the remuneration requirements. However, the AIFMD-like rules will apply under the abovementioned opt-in regime for Guernsey AIFMs wishing to market their AIFs in the EU under the AIFMD passport requirements.

74. On depositaries, ESMA is of the view that Guernsey's traditional and current approach to trustee oversight of open-ended funds is to a certain extent similar to AIFMD requirements and was in essence based on the UK's regulatory framework. Designated Custodian/Trustees are required to perform oversight of valuations, share dealing and investment restriction functions, in addition to providing safe custody of assets. Prudential requirements are stringent: designated Custodian/Trustees are also required to maintain net assets of £4,000,000. Under the law (The Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended ("the POI Law")), the requirement is for a locally licensed Designated Custodian/Trustee to be appointed to an authorised or registered open-ended collective investment scheme, and this Designated Custodian/Trustee to provide safe custody and trustee oversight, where applicable. However there is no obligation in the case of a closed-ended authorised or registered fund to appoint a custodian as long as it is clear in the prospectus of the Fund who is responsible for safe-keeping of the assets. This service may be carried out by the Designated Manager of the relevant fund and in such circumstances the Designated Manager of the scheme must be licensed to provide custody services under the POI Law. Historically, there was no requirement for separate trustee oversight over closed-ended funds. This was addressed in the AIFMD equivalent regime and the regime for Article 36 business. During 2014 a document was issued to provide guidance on how Article 36 of AIFMD interacts with the Bailiwick of Guernsey's existing regime[25]. Therefore, the AIFMD depositary rules

[25] These guidance notes can be found at: http://www.gfsc.gg/The-Commission/Policy%20and%20Legislation/Article%2036%20of%20AIFMD%20-%20Depositary%20Requirements%20Guidance%20Notes%20Post-Consultation.pdf

will apply under the abovementioned opt-in regime for all Guernsey AIFMs wishing to market their AIFs in the EU under the AIFMD passport requirements.

75. In regards to remuneration, the Guernsey Authority explained that they follow an impact and risk based supervision model. The current regime contains eleven discrete risk categories. Whilst they have no set quantitative remuneration rules, management remuneration is a component factor of the evaluation of supervised entities' business model risk; governance risk; and conduct risk.

76. However the Guernsey AIFMD regime is identical to the EU regime. Article 13 of AIFMD was transposed verbatim into section 8.1 of The AIFMD Rules, 2013:

"*Guernsey AIFMs must have remuneration policies and practices for those categories of staff, including senior management, risk takers, control functions, and any employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the risk profiles of the AIFMs or of the AIFs they manage, that are consistent with and promote sound and effective risk management and do not encourage risk-taking which is inconsistent with the risk profiles or AIF constitutional documents of the AIFs they manage*"

77. As regards IOSCO principles in Guernsey, there is only one NCA in Guernsey with oversight duties. The IMF FSAP on Guernsey dates back to 2009 and Guernsey received positive outcomes at the time.

78. With respect to the assessment of the effectiveness of enforcement in Guernsey, as mentioned in section 2.1, ESMA therefore invited the Guernsey FSC to carry out a self-assessment based on the IOSCO principles 10 to 12, answering the corresponding questions included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation*[26].

79. The results of this self-assessment carried out by the Guernsey FSC between February and May 2016 show that the legal framework in place in Guernsey allowed the Guernsey FSC to answer positively to all questions. The corresponding legal framework in place in Guernsey in relation to enforcement has elements which appaear to be consistent with the IOSCO principles.

80. Although the Guernsey FSC provided ESMA with a significant amount of information on the actual implementation of this framework on enforcement, including statistics on the activity and its output in terms of enforcement actions which have been taken vis a vis firms, ESMA's advice on the assessment of IOSCO principles 10 to 12 in the case of Guernsey is subject to the limitations described in paragraph 23.

2) Market disruption:

[26] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf

- Examples of questions that may be applied under this heading include:

(a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
(b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Guernsey

81. ESMA is of the view that the granting of the passport to non-EU AIFMs would probably result in more Guernsey AIFs on the EU market. It is difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

82. However, the Guernsey FSC indicated that, according to the results of a survey of firms collectively administering over £35bn of alternative investments they carried out, the extension of the EU AIFMD passport to Guernsey would lead to a general 10% increase in fund launched and marketed into the EU and, potentially more significantly, an increase in capital raising per fund by around 20% on average. Whilst both impacts are expected, this differential is justified by recourse to anticipated efficiency effects of a passport.

83. The scale of the positive impact is expected to be largest for the infrastructure investment asset class being more than twice that of the impact on other alternative fund classes such as private equity for example.

84. Their calculations demonstrate that overall they expect that a passport extension would lead to a cumulative marginal increase (i.e. net new additional) in aggregate investment of around 27% into EU assets through Guernsey based funds over a five year period.

3) Obstacles to competition:

- Examples of questions that may be applied under this heading include:

(a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?

(b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Guernsey

85. ESMA is of the view that EU-AIFMs that wish to establish business in Guernsey have to comply with the same rules as national AIFMs. ESMA is of the view that there are no identified competition issues on that aspect. ESMA also notes that, given its population, the investor base in Guernsey is limited as compared to the investor base in the EU.

4) Monitoring of systemic risk:

- Examples of questions that may be applied under this heading include:

1) Does there exist tangible evidence of adequate surveillance of market developments with a view to tracking potential (or actual) systemic risks[27] by the NCA in the non-EU country?

2) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Guernsey

86. ESMA is of the view that Guernsey has frameworks in place for addressing systemic risks. Reporting obligations in Jersey are similar to the AIFMD reporting obligations.

General advice on the potential extension of the passport to Guernsey

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding investor protection, competition, market disruption and the monitoring of systemic risk impeding the application of the AIFMD passport to Guernsey**.**

[27] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

2.5 Jersey

87. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Jersey based on the methodology described in the section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Jersey

88. First, ESMA notes that the preconditions, including that for an MoU with non-EU NCAs set out in Articles 35 and 37 and there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation we need to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
b) Is there timely and prompt collaboration in case of emergency situations?
c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
d) Have legal limitations been encountered in sharing information or performing on-site visits?
e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of existing MoU, does previous supervisory engagements provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Jersey

89. ESMA is of the view that there have been positive experiences in terms of cooperation between NCAs and the Authority of Jersey (The Jersey Financial Service Commission – Jersey FSC). The Jersey FSC indicated that they have provided assistance to 21 European authorities – both in the funds sector and in other sectors (including the Spanish tax authority).

90. One NCA explicitly indicated they are of the opinion that the existing MoU has worked well. The Jersey FSC has responded within 15 days when this NCA has asked for assistance. This NCA has performed on-site visits together with the Authority of Jersey and has good experiences from this. As regards other NCAs, there is limited experience when it comes to the criteria in 1. e), it is therefore difficult for them to evaluate the possible lack of cooperation from non-EU AIFMs.

91. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU countries have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[28] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Jersey

92. ESMA first notes that the Jersey and Guernsey Authorities indicated that the Joint Channel Islands (Jersey and Guernsey) Financial Services Ombudsman scheme will be open to all individual/small businesses and is not limited to retail clients. It will be able to look at complaints from individual customers and small businesses, wherever they reside in the world. Complaints will be able to be made about financial services provided by a business in Jersey or Guernsey involving: banking; lending; money services; insurance; pensions; and investments. The ombudsman will be able to

[28]And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

award compensation of up to £150,000. This is similar to the scheme in place in the UK.

93. In Jersey, ESMA also notes that there is also a complaints process through the Jersey Commission although, as in Guernsey and the UK, institutional clients usually tend to resort to the courts in relation to their disputes. The complaints process is the same for all clients/investors. In relation to Jersey public funds, under the CIF Codes of Practice and in relation to Jersey fund service providers to public funds, under the FSB Codes of Practice there are also Codes of Practice requirements setting out the minimum complaints handling standards.

94. As for the criteria in 1 ii), Jersey has put in place an AIFMD-like regime which is an opt-in regime for Jersey AIFMs wishing to market their AIFs in the EU under the AIFMD passport requirements. The current framework applicable in Jersey includes certain differences with the AIFMD, especially regarding the requirements on custody and remuneration. However, the AIFMD-like rules will apply under the abovementioned opt-in regime for Jersey AIFMs wishing to market their AIFs in the EU under the AIFMD passport requirements.

95. On depositaries, ESMA is of the view that the requirements are similar to those under AIFMD but are based on IOSCO principles rather than AIFMD requirements. The requirement for a custodian relates to open-ended Jersey funds rather than closed-ended Jersey funds whereas AIFMD, although there is some provision for closed-ended funds, focuses on the type of assets, custody or record-keeping (i.e. transferrable and non-transferrable assets). For the purposes of a Jersey AIF Depositary then such depositary will need to comply with the AIFMD requirements in additional to the Jersey requirements. The Jersey requirements do show the level of functional independence which is similar to AIFMD. The requirements for retail funds (Recognized Funds / OCIF Funds) are more detailed than for expert funds, however all expert funds under the Expert Fund Guide ("EFG"), be they closed or open-ended funds, are required (again similar to AIFMD) to have an independent Jersey monitoring functionary in relation to the actions of the Investment Manager.

96. In regards to remuneration, the Jersey Authority indicated that they follow the ESMA guidance in relation to third countries (disclosure) but they have no other specific requirements currently. They are however keeping this under review and would be able to implement specific AIFMD remuneration requirements if required.

97. As regards IOSCO principles in Jersey, there is only one NCA with oversight duties. The IMF FSAP on Jersey dates back to 2009 but Jersey received positive outcomes at the time.

98. With respect to the assessment of the effectiveness of enforcement in Jersey, as mentioned in section 2.1, ESMA invited the Jersey FSC to carry out a self-assessment based on the IOSCO principles 10 to 12, answering the corresponding questions

included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation*[29].

99. The results of this self-assessment carried out by the Jersey FSC between February and May 2016 show that the legal framework in place in Jersey allowed the Jersey FSC to answer positively to all questions asked by ESMA . The corresponding legal framework in place in Jersey has elements which appear to be consistent with the IOSCO principles.

100. Although the Jersey FSC provided ESMA with a significant amount of information on the actual implementation of this framework on enforcement, including statistics on the activity and its output in terms of enforcement actions which have been taken vis a vis firms, ESMA's advice on the assessment of IOSCO principles 10 to 12 in the case of Jersey is subject to the limitations described in paragraph 23.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

(a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
(b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Jersey

101. ESMA is of the view that the granting of the passport to non-EU AIFMs would probably result in more Jersey AIFs on the EU market. It is however difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

102. The Jersey FSC indicated that currently £73.8bn worth of funds under management in Jersey have reported some marketing into the EU since July 2013. The total size of the Jersey funds industry is such that at the end of 2015, the net asset value of funds under administration in Jersey is £225Bn. Approximately 50% of the £225Bn is invested into EU assets with an equal split of the £225Bn between EU and non-EU investors.

3) Obstacles to competition:

[29] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf

- Examples of questions that may be applied under this heading include:

a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?
b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Jersey

103. ESMA is of the view that EU-AIFMs that wish to establish business in Jersey have to comply with the same rules as national AIFMs. ESMA is of the view that there are no identified competition issues on that aspect. ESMA also notes that, given its population, the investor base in Jersey is limited as compared to the investor base in the EU.

4) Monitoring of systemic risk:

- Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market developments with a view to tracking potential (or actual) systemic risks[30] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Jersey

104. ESMA is of the view that Jersey has frameworks in place for addressing systemic risks. Reporting obligations in Jersey are similar to the AIFMD reporting obligations.

General advice on the potential extension of the passport to Jersey

[30] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding investor protection, competition, market disruption and the monitoring of systemic risk impeding the application of the AIFMD passport to Jersey.

2.6 Hong Kong

105. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Hong Kong based on the methodology described in the section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Hong Kong

106. First, ESMA notes the preconditions for an MoU with non-EU NCAs set out in Articles 35 and 37 and considers there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation it is necessary to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
b) Is there timely and prompt collaboration in case of emergency situations?
c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
d) Have legal limitations been encountered in sharing information or performing on-site visits?
e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Hong Kong

107. Based on the feedback received from NCAs, ESMA is of the view that the experiences of cooperation with the Hong Kong Authorities are, in general terms, positive. Previous supervisory engagements provide support for the expectation of good supervisory cooperation.

108. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU countries have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[31] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Hong Kong

109. As regards investor complaints, based on the feedback received from NCAs, ESMA is of the view that there is no evidence of complaints not being adequately tackled by the non-EU NCA of Hong Kong.

110. As regards depositaries, various requirements apply to all funds which are authorized in Hong Kong. These include:

- Limited scope of entities eligible for the function of depositary (mainly, banks and trust companies which are subsidiaries of such banks). These entities are subject to strict capital requirements;
- Rules on the management of conflicts of interest between the asset manager and the depositary;
- Rules on the segregation and safeguarding of assets;
- Clear liability regime of the depositary;

[31] And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

111. ESMA is of the view that, overall, these rules seem comparable to the rules in the EU. However, under certain conditions, some types of funds in Hong Kong are not subject to these rules.

112. Indeed the Hong Kong regime allows the offering of AIFs which are not managed by SFC-licensed managers solely to professional investors or on a private placement basis in Hong Kong without seeking the Securities & Futures Commission's (SFC) authorization, as long as the distribution of these fund products complies with the applicable distribution requirements in Hong Kong (e.g. by appointing SFC-licensed distributors in compliance with applicable conduct regulations). These fund products are not subject to the aforementioned requirements (as they are not authorized by the SFC). There are no requirements on depositaries for these fund products in Hong Kong.

113. Under the requirements of the AIFMD, because the Member State of reference has to authorize the non-EU AIFM wishing to market AIFs in the EU, and that the non-EU AIFM has to comply with the AIFMD requirements, including depositary rules, these funds would not be accepted for AIFMs and AIFs that intend to use the EU-passport.

114. As regards the alignment of incentives between the AIFM and investors, similar remuneration rules as set out in the AIFMD do not seem to be currently applied in the Hong Kong. AIFMD rules on remuneration are therefore significantly different from what is being applied in Hong Kong.

115. The overarching principles section of the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (the Products Handbook)[32] provides that product providers must discharge their functions with due skill, care and diligence and that product providers shall avoid situations where conflicts of interest may arise. In addition, the SFC's Fund Manager Code of Conduct (FMCC) provides guidance on the alignment of incentives between the asset manager and the investors in relation to best execution – A fund manager should execute client orders on the best available terms, taking into account the relevant market at the time for transactions of the kind and size concerned.

116. To ensure that funds are not taking on excessive risks, the SFC's Internal Control Guidelines (ICG)[33] also requires a licensed person (including fund managers) to establish and maintain effective policies and procedures to ensure the proper management of risks to which the firm and, if applicable, its clients are exposed, particularly with regard to their identification and quantification, whether financial or otherwise, and the provision of timely and adequate information to management to enable it to take appropriate and timely action to contain and otherwise adequately

[32] See http://en-rules.sfc.hk/net_file_store/new_rulebooks/h/k/HKSFC3527_1969_VER30.pdf.
[33] The ICG, which are published under section 399 of the SFO, sets forth the manner in which the SFC proposes to perform its function of ensuring that all SFC-licensed persons are fit and proper in relation to the manner in which they conduct the regulated activities for which they are licensed. Intermediaries and their representatives are expected to comply with the ICG in carrying on the regulated activities for which they are licensed or registered.

manage such risks. For instance, ICG requires management to establish and maintain effective risk management measures to quantify the impact on the firm (especially if it deals in derivative financial products) and, if applicable, its clients from changing market conditions. These measures should cover all risk elements associated with the procedures traded or services provided by the firm.

117. Under the requirements of the AIFMD, because the Member State of reference has to authorize the non-EU AIFM wishing to market AIFs in the EU, and that the non-EU AIFM has to comply with the AIFMD requirements, including rules on the alignment of incentives between the AIFM and investors, the remuneration rules as it stands in Hong Kong would not be accepted for AIFMs and AIFs that intend to use the EU-passport.

118. With respect to question 1) iii) ESMA notes that, according to the 2014 IMF financial sector assessment program (FSAP) detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Hong Kong[34], Hong Kong was assessed as "Fully Implemented" with most of the principles referred to (except principle 12, which was assessed as "Broadly Implemented").

119. ESMA also notes that the enforcement of the framework is guaranteed by the supervisory powers of the Hong Kong Securities and Futures Commission.

120. According to the 2014 IMF FSAP, principles 10 to 12, which notably relate to the effectiveness of enforcement in Hong Kong, are therefore fully or broadly implemented.

121. With respect to question 1) iv), based on the 2014 IMF financial sector detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Hong Kong and the answers provided by the SFC to the questions asked by ESMA, ESMA is of the view that a positive opinion can be expressed regarding the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in Hong Kong.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

(a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?

(b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

[34] https://www.imf.org/external/pubs/cat/longres.aspx?sk=41750.0

Assessment in the case of Hong Kong

122. ESMA is of the view that the granting of the passport to non-EU AIFMs might result in more Hong Kong AIFs on the EU market. It is however difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

123. The Hong Kong Securities and Futures Commission (SFC) indicated that their surveys on the Hong Kong hedge fund industry show that:

- 17.7% and 18.6% of the total reported assets under management were sourced from the EU as of 30 September 2014 and 30 September 2012 respectively;
- The total reported assets under management (as of 30 September 2014, US$120.9 billion and as of 30 September 2012, US$87.1 billion) represented the net asset value of all hedge fund assets managed by SFC-licensed investment managers, which included assets managed by the Hong Kong affiliates of EU AIFMs.

124. Please also see the following assessment of questions related to the "obstacles to competition" criteria.

3) Obstacles to competition:

- Examples of questions that may be applied under this heading include:

(a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?

(b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Hong Kong

125. ESMA is of the view, based on answers of the SFC, that the procedures seem similar to the authorisation procedures for EU AIFMs.

126. ESMA notes that the SFC operates a regime in relation to the access of retail funds (including UCITS) in Hong Kong where certain jurisdictions are deemed to be "acceptable inspection regimes" (AIR), with the consequence that only five Member States are to-date deemed as AIR. However, an AIF is not required to obtain prior

authorization from the SFC as long as it is solely offered to professional investors in Hong Kong. There is no limit on the number of professional investors to which an AIF may be offered under this exemption. Therefore, the AIR requirements do not apply, even if the offering of AIFs to professional investors goes beyond pure private placement activity, as long as an AIF is offered solely to professional investors in Hong Kong.

127. Overall ESMA is of the view that there seems to be a level playing field between EU and non-EU AIFMs that market funds solely offered to professional investors as regards market access in Hong Kong (that is, EU AIFMs would benefit from similar market access conditions in Hong Kong as Hong Kong managers in the EU if Hong Kong were to be granted the AIFM passport and EU AIFMs and EU AIFs seem to be treated in a similar way as managers and collective investment schemes of Hong Kong in terms of regulatory engagement).

4) Monitoring of systemic risk:

- Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market development with a view to tracking potential (or actual) systemic risks[35] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Hong Kong

128. The regulatory regime of Hong Kong was assessed as “Broadly Implemented” in the 2014 IMF financial sector detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Hong Kong, with respect to principle 6. The responses of Hong Kong Authority to ESMA’s questions are in line with this assessment.

[35] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

General advice on the potential extension of the passport to Hong Kong

ESMA is of the view that if ESMA considers the above assessment only in relation to AIFs, there are no significant obstacles regarding investor protection, competition, market disruption and the monitoring of systemic risk impeding the application of the AIFMD passport to Hong Kong.

ESMA notes that the SFC operates a regime in relation to the access of retail funds (including UCITS) in Hong Kong where certain jurisdictions are deemed to be "acceptable inspection regimes" (AIR), with the consequence that only five Member States are deemed as AIR. However, this procedure is applicable only for funds offered to retail investors. Being considered as "acceptable inspection regimes" by the Hong Kong Authorities notably means that the market access conditions of UCITS (marketed to retail investors) established in those Member States which are AIR in Hong Kong are different from the market access conditions of UCITS (marketed to retail investors) established in other Member States.

2.7 Switzerland

129. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Switzerland based on the methodology described in section 2.1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Switzerland

130. First, ESMA notes the preconditions for an MoU with non-EU NCAs set out in Articles 35 and 37 and considers that there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation it is necessary to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?

b) Is there timely and prompt collaboration in case of emergency situations?

c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?

d) Have legal limitations been encountered in sharing information or performing on-site visits?

e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?

f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Switzerland

131. Although evidence is scarce on these points, ESMA notes that generally positive experiences have been reported by NCAs on the cooperation with the Swiss Authority.

132. However in respect to question 2, one NCA reported that the cooperation process set out by article 38 of the Federal Act on Stock Exchanges and Securities Trading (SESTA) envisages some requirements for the transmission of information by the Swiss Authority to foreign National Competent Authorities. ESMA considered that the

extent to which these requirements may affect the effectiveness of the entire cooperation process in terms of complexity and length merited further investigation.

133. ESMA notes that SESTA has recently been amended, including the provisions on cooperation. The new version of these requirements entered into force on 1 January 2016. One provision of the previous version of the Act that was potentially problematic related to the possibility for the decision of FINMA on the transmission of information to a foreign financial market supervisory authority to be challenged by a client before the Federal Administrative Court within ten days. The new version of the Act adopted by the Swiss Parliament introduces the possibility for FINMA to choose not to inform the client in advance of information being shared with a foreign regulator in cases where such prior information would undermine the purpose of the request and adversely affect the objectives of the requesting authority[36].

134. However, ESMA notes that FINMA will be allowed to apply the ex post notification procedure envisaged under new provision only "exceptionally". As such, it will be important to monitor the practical implications of the amendment and, in particular, assess the number of cases in which the current ex-ante notification procedure will be applied.

135. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

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[36] There are in fact two legislations to be mentioned in this context:

- The Swiss Financial Market Infrastructure Act (FMIA) which entered into force on 1 January 2016 and *replaced* the former Swiss Stock Exchange Act (SESTA).

  FMIA: https://www.admin.ch/opc/en/classified-compilation/20141779/201601010000/958.1.pdf

- The Swiss Financial Market Supervision Act (FINMASA) which sets out the relevant provisions for FINMA's cooperation with foreign bodies (Articles 42 to 43). When the FMIA was adopted, the Swiss Parliament amended at the same time Articles 42 to 43 FINMASA (cf. Annex of the FMIA, "Amendment of Other Legislative Instruments", which is not translated in the English version of the FMIA). The new provisions of the FINMASA also entered into force on 1 January 2016.

  FINMASA: https://www.admin.ch/opc/en/classified-compilation/20052624/201601010000/956.1.pdf

Articles 42 to 43 FINMASA are now applicable to any field of supervision in which FINMA cooperates with foreign bodies. This includes not only financial market infrastructures, but also banks, insurances and – particularly significant for the AIFMD passport – investment funds. The relevant provision regarding client's information is specified in Article 42*a* FINMASA

- The FMIA, which replaces the SESTA, has entered into force on 1 January 2016 and is published on the Swiss government's official website;

- The new version of the relevant Articles 42 to 43 FINMASA, in particular Article 42a FINMASA, has entered into force at the same time and is also published on the Swiss government's official website.

1) Investor protection:

Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU countries have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[37], having regards to whether the regime is assessed as being 'broadly' or 'fully' implemented' under each of these principles?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Switzerland

136. On depositaries, ESMA is of the view that the requirements are overall similar to those under AIFMD. However these requirements differ on some specific points notably related to the situations where the appointment of a depositary is not mandatory (this is possible for some contractual funds in the Swiss regulatory framework if FINMA authorizes it, although it has never granted such an authorization thus far).

137. On remuneration rules, ESMA notes that FINMA has issued a Circular which sets out minimum standards for remuneration schemes of financial institutions („Circular 2010/1 Remuneration schemes"). The Circular, which entered into force on 1. January 2010, applies to banks, securities traders, financial groups and insurance companies, but also to fund management companies and other persons and firms authorized under the Collective Investment Schemes Act (CISA). The minimum standards set out in the Circular are more simple than the ones required by the AIFMD but are comparable.[38]

138. Furthermore, the Swiss Funds & Asset Management Association SFAMA has issued a Code of Conduct (7 October 2014) which requires CISA Institutions to "*apply a salary*

[37] And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.
[38] http://www.finma.ch/e/regulierung/Documents/finma-rs-2010-01-e.pdf

and remuneration policy that is appropriate in accordance with the principle of proportionality, their size and their risk profile, and that motivates their employees to promote the long-term success of the collective investment schemes (in keeping with the minimum standards set out in FINMA Circular 2010/1 "Remuneration schemes")."[39]

139. With respect to question 1) iii), and subject to the limitations set out in paragraph 23, ESMA notes that according to the 2014 IMF financial sector assessment program (FSAP) detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Switzerland[40], Switzerland was assessed as "Fully Implemented" with most of the principles referred to (except principles 11, 15, 24 and 25, which are "Broadly Implemented", and principles 12 and 32, which are "Partially implemented" – please see below).

140. According to the 2014 IMF FSAP, principles 10 and 11, which relate to the effectiveness of enforcement in Switzerland, are therefore fully or broadly implemented.

141. With specific reference to Switzerland ESMA notes that there are "Partially Implemented" ratings on principles 12 (effective and credible use of powers) and 32 (dealing with failure). According to the IMF report, the rating on principle 12 "*is primarily due to the fact that FINMA is still in the process of implementing its new supervisory approach regarding a more proactive engagement with audit firms and increased use of FINMA own supervisory reviews*." The IMF comments on principle 32 refer to the need for FDF (Federal Department of Finance) to "*introduce appropriate legal requirements for the segregation of clients' funds by securities dealers that apply on ongoing basis and in bankruptcy*". Moreover, the Swiss authorities "*should consider introducing an investor compensation scheme or equivalent regime to protect clients' securities in case of non-compliance with the segregation requirements*."

142. On principle 12, FINMA indicated that following these ratings its Asset Management Division had elaborated a new policy on how on-site supervisory reviews should be carried out in order to match the quality of supervisory reviews in the Banking and Insurance divisions. In addition, FINMA mentioned that a general reform of the supervisory audits was concluded in 2014 to give more guidance to external auditors when conducting work on behalf of FINMA. In preparation for the upcoming implementation of a new "Financial Services Act", that will significantly strengthen conduct rules for financial service providers, a cross-divisional working group has also been established to develop consistent processes to supervise new investment suitability rules.

143. As regards principle 32, FINMA indicated that an improvement in the segregation of client assets is under consideration for an upcoming amendment of insolvency law.

[39] https://www.sfama.ch/en/self-regulation-model-documents/codes-of-conduct
[40] https://www.imf.org/external/pubs/cat/longres.aspx?sk=41882.0

2) Market disruption:

Examples of questions that may be applied under this heading include:

(a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
(b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Switzerland

144. ESMA is of the view that the granting of the passport to non-EU AIFMs might result in more Swiss AIFs on the EU market. It is, however, difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

145. Please also see the following assessment of questions related to the "obstacles to competition" criteria.

3) Obstacles to competition:

Examples of questions that may be applied under this heading include:

(a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or to (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?
(b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Switzerland

146. ESMA is of the view that there is no evidence of significant obstacles regarding competition and market disruption impeding the application of the AIFMD passport to Switzerland. However, the extent to which there could be different treatments of EU funds and managers depending on the existence of bilateral agreements between the Swiss Authority and the authority of some Member States could be relevant to the assessment of whether there are obstacles to competition.

147. In that respect, FINMA indicated that the distribution of EU CIS to retail clients in Switzerland is subject to approval by FINMA and requires, inter alia, an agreement on

cooperation and the exchange of information between FINMA and the relevant foreign supervisory authorities. FINMA indicated that Switzerland has already concluded bilateral agreements (MoUs) with all interested EU Member States.

4) Monitoring of systemic risk:

Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market development with a view to tracking potential (or actual) systemic risks[41] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Switzerland

148. ESMA is of the view that it does not have evidence of major issues in relation to the monitoring of systemic risk. The IMF assessment on the implementation of IOSCO Principle 6 (2014 IMF financial sector detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Switzerland[42]) qualifies it as Broadly Implemented.

149. ESMA is of the view that there are no significant obstacles regarding the monitoring of systemic risk impeding the application of the passport to the Switzerland.

General advice on the potential extension of the passport to the Switzerland

Having regard to the above assessment by ESMA regarding the extent to which there would be significant obstacles regarding investor protection, competition, market disruption and the monitoring of systemic risk impeding the application of the AIFMD passport to Switzerland, ESMA advises the European Parliament, the Council and the Commission that there are no significant obstacles impeding the potential application of the AIFMD passport to Switzerland.

[41] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.
[42] https://www.imf.org/external/pubs/cat/longres.aspx?sk=41882.0

2.8 Singapore

150. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Singapore based on the methodology described in section 2.1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Singapore

151. ESMA notes that the preconditions for an MoU with non-EU NCAs set out in Articles 35 and 37 and considers there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation it is necessary to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
b) Is there timely and prompt collaboration in case of emergency situations?
c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
d) Have legal limitations been encountered in sharing information or performing on-site visits?
e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of an existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Singapore

152. ESMA notes that the information regarding the cooperation between NCAs and the Monetary Authority of Singapore (MAS) is scarce and difficult to assess. ESMA notes that there have been no reported negative experiences in terms of cooperation between NCAs and the MAS.

153. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection.

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU countries have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[43] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Singapore

154. ESMA is of the view that overall the requirements in terms of investor protection seem to be fulfilled. 163.

155. On depositaries, strict requirements, including segregation and safekeeping requirements apply to all funds which are managed in Singapore. Under the Securities and Futures Act ["SFA"] and Securities and Futures (Licensing and Conduct of Business) Regulation ["SF(LCB)R"], the requirement for segregation and custody of assets are applied at both the level of the fund and the fund management company, as follows:

a. Requirement for fund management companies: Fund management companies that operate in Singapore are required to maintain a custody account in which it deposits customers' assets. A fund management company can deposit customers' assets with a bank, a finance company, a depository agent, an approved trustee or a person licensed to provide custodial services for securities. Subject to the customer's prior written consent, a fund management company may also maintain the custody account with a custodian outside Singapore which is licensed, registered or authorised to act as a custodian in the country or territory where the account is maintained. The custody account must be separate from any other account in which the fund management company deposits its own assets;

[43]And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

b. Requirement for funds: All Singapore-constituted funds are required to have a MAS-approved trustee, who provides independent oversight of the funds. This requirement applies whether the funds are authorised by MAS for retail offer or restricted schemes offered only to accredited investors. The MAS-approved trustees may then sub-delegate the custody of the fund's assets to custodians or sub-custodians. Under trust law, the trustee also has obligations to act in the best interests of investors.

156. As regards the alignment of incentives between the AIFM and investors, similar remuneration rules as set out in the AIFMD do not seem to be currently applied in the Singapore. AIFMD rules on remuneration are therefore significantly different from what is being applied in Singapore.

157. The Singapore Regulation 13B of the Securities and Futures (Licensing and Conduct of Business) (SF(LCB)R) requires fund managers to ensure effective controls and segregation of duties to mitigate conflicts of interest arising from the management of assets and, where appropriate, disclose such conflicts of interest to the customer concerned. MAS currently does not prescribe specific regulatory requirements on the remuneration policies of fund managers.

158. Under the requirements of the AIFMD, because the Member State of reference has to authorize the non-EU AIFM wishing to market AIFs in the EU, and that the non-EU AIFM has to comply with the AIFMD requirements, including rules on the alignment of incentives between the AIFM and investors, the remuneration rules as it stands in Singapore would not be accepted for AIFMs and AIFs that intend to use the EU-passport.

159. With respect to question 1) iii) ESMA notes that according to the 2013 IMF financial sector detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Singapore[44], Singapore was assessed as "Fully Implemented" with most of the principles referred to (except principles 4, 12, 24, 25, 28 which are "Broadly Implemented").

160. According to the 2013 IMF financial sector assessment program (FSAP) detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Singapore, principles 10 to 12, which notably relate to the effectiveness of enforcement in Singapore, are therefore fully or broadly implemented.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment

[44] https://www.imf.org/external/pubs/ft/scr/2013/cr13344.pdf

in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Singapore

161. ESMA is of the view that the granting of the passport to non-EU AIFMs might result in more Singapore AIFs on the EU market. It is, however, difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

162. MAS indicated that, as at end 2014, Singapore's assets under management (AUM) was S$2.4 trillion (or about €1.6 trillion). The total AUM comprised of both traditional funds as well as alternative funds. Traditional fund managers were the main contributors to both the total AUM, as well as net flows in 2014. Approximately S$239 billion (or €156 billion) of the total AUM as at end 2014 came from managers of alternative funds (hedge funds, private equity funds and real estate funds).

163. MAS also pointed out that approximately S$458 billion (or €299 billion) of the total AUM (traditional and alternative) was sourced from EU investors. The AUM sourced from EU investors for alternative funds was about S$32 billion (or €21 billion). In terms of investments, Singapore alternative managers focus on Asia Pacific investment strategies. As of end-2014, 82% (€128 billion) of the funds were invested in Asia Pacific, 7% (€11 billion) invested in North America, 4% (€6 billion) in Europe and 7% (€11 billion)in Rest of World.

164. Finally, MAS highlighted that over the last five years, Singapore's industry AUM have expanded at a 14% compound annual growth rate.

165. Please also see the following assessment of questions related to the "obstacles to competition" criteria.

3) Obstacles to competition:

Examples of questions that may be applied under this heading include:

a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?
b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of

regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Singapore

166. ESMA notes that the FSAP report mentions that managers should have a "sufficient nexus with Singapore" and therefore should have at least SGD 500 Mio AuM in Singapore (~EUR 335 Mio) to be authorised.

167. MAS indeed confirmed that under the Securities and Futures (Financial and Margin Requirements) Regulations, Singapore or foreign-incorporated companies that are licensed to carry out fund management activities in Singapore are required to meet a base capital requirement and a financial resources requirement[45] on an on-going basis.

168. However, overall ESMA is of the view that EU AIFMs that wish to establish business in Singapore have to comply with the same rules as national AIFMs. ESMA is of the view that there are no identified competition issues on that aspect.

169. This is also due to the fact that investment funds that are not offered to retail investors in Singapore, i.e. EU AIFs or UCITS marketed only to accredited investors, do not have to be authorized or recognised in order to be marketed in Singapore. EU AIFs or UCITS marketed only to accredited investors will only have to be entered into MAS' list of restricted schemes.

170. The key conditions for entry to MAS' list of restricted Singapore schemes and restricted foreign schemes are the same. They will be required to have a manager that is fit and proper, and licensed or regulated to carry out fund management activities in the jurisdiction of its principal place of business.

171. ESMA notes, however, that with respect to funds offered to retail investors, MAS may recognise a foreign fund for sale to the retail investors in Singapore, if the laws and practices under which the foreign fund is constituted and regulated affords to investors in Singapore protection at least equivalent to that provided to schemes that are locally constituted and regulated under the Singapore regulatory framework. Currently, MAS has generally assessed UCITS from UK, Ireland, France, Germany and Luxembourg to satisfy the abovementioned criteria. Reflecting on the current relationships with Singapore in the UCITS context, it follows that at the moment only UCITS from certain Member States are recognised in Singapore. It is not clear if this is because no

[45] Under the Securities and Futures (Financial and Margin Requirements) Regulations, fund managers are required to meet a base capital requirement and financial resources requirement. The base capital requirement serves an entry requirement and must be met at all times. The requirement varies from $250,000 to $1 million, depending on the type and number of investors. The financial resources requirement is a risk-based requirement, meant to absorb potential losses as a going concern. Fund managers are required to hold sufficient financial resources, taking into account illiquidity adjustments, to meet their total risk requirements. Where a fund manager breaches the capital requirements, MAS will follow up to ensure that it rectifies any shortfall. MAS will also assess whether to take regulatory action against the fund manager

managers of other Member States sought authorisation before, or if Singapore does not recognise UCITS from other Member States as equivalent.

4) Monitoring of systemic risk:

Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market development with a view to tracking potential (or actual) systemic risks[46] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Singapore

172. ESMA is of the view that it does not have evidence of major issues in relation to the monitoring of systemic risk in Singapore (IOSCO principle 6 was notably "fully implemented" according to the abovementioned 2013 IMF assessment).

General advice on the potential extension of the passport to Singapore

Having regard to the above assessment ESMA is of the view that if ESMA considers the above assessment only in relation to AIFs, there are no significant obstacles regarding investor protection, competition, market disruption and the monitoring of systemic risk impeding the application of the AIFMD passport to Singapore.

ESMA notes that some EU Member States are considered as 'recognised' by MAS, but most of them are not. However, this procedure is applicable only for funds offered to retail investors. Being 'recognised' by MAS notably means that the market access conditions of UCITS (marketed to retail investors) established in those Member States which are recognised in Singapore are different from the market access conditions of UCITS (marketed to retail investors) established in other Member States.

[46] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

2.9 Australia

173. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Australia based on the methodology described in the section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Australia

174. First, ESMA notes the preconditions for an MoU with non-EU NCAs set out in Articles 35 and 37 and considers there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation it is necessary to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
b) Is there timely and prompt collaboration in case of emergency situations?
c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
d) Have legal limitations been encountered in sharing information or performing on-site visits?
e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Australia

175. Although information regarding the cooperation between NCAs and the Australian Authorities (Australian Securities and Investments Commission - ASIC) in the field of AIFMD is limited, based on the feedback received from NCAs, ESMA is of the view that the experiences of cooperation with the Australian Authorities are, in general terms, positive. Previous supervisory engagements provide support for the expectation of good supervisory cooperation.

176. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU countries have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[47] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Australia

177. As regards depositaries, ESMA is of the view that overall, the rules in Australia do not seem completely comparable to the rules in the EU under the AIFMD.

178. Overall, while under the AIFMD, the manager of an AIF appoints a depositary which carries out several functions including monitoring cash flows, oversight, holding assets and safeguarding against breach of certain applicable national laws, in Australia the operator of the collective investment scheme (CIS)[48] which is called the responsible

[47] And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

[48] In Australia, a CIS is regulated by the *Corporations Act 2001*. ASIC indicated that the universe of CIS is broad and overall includes the universe of AIFs and retail funds similar to UCITS together. The characteristics of a CIS are the following ones (http://asic.gov.au/for-finance-professionals/managed-investment-scheme-operators/starting-a-managed-investments-scheme/what-is-a-managed-investment-scheme/):

- people are brought together to contribute money to get an interest in the scheme ('interests' in a scheme are a type of 'financial product' defined in the *Corporations Act 2001*);

- money is pooled together with other investors (often many hundreds or thousands of investors) or used in a common enterprise

entity (RE)**,** and which is a registered managed investment scheme has these functions.

179. In Australia, most CIS are referred to as 'managed investment schemes' (MIS). The statutory definition of MIS is very broad[49]. Australia's regulatory regime draws a distinction between MIS according to whether they are able to be marketed to retail clients generally (registered MIS) and non registered MIS such as those that are generally only permitted to issue to wholesale clients[50] (wholesale MIS).

180. The regulatory framework for registered MIS in Australia structures the asset holding function to be exercised by the RE or its delegates. Oversight across all obligations under the regulation for CIS is through the board of directors of the RE (if at least half are external) or, if not, the compliance committee with a majority of external members and an external compliance plan auditor**.** These oversight responsibilities apply whether the RE undertakes the investment management functions through its own staff or through engaging a separate entity as its delegate to perform the investment management functions.

181. The RE of a MIS must generally hold an Australian financial services licence (AFSL) for issuing the interests in the MIS unless an exclusion applies. In addition, the RE of a registered MIS must also hold an authorisation in its AFSL for the RE to act as the RE of the MIS.

182. All types of registered MIS, and all other MIS under which financial products (e.g. securities) are held are subject to requirements to use a separate entity from the RE and investment manager as the asset holder (custodian) unless they can meet the prescribed requirements for holding the assets themselves.

183. As a consequence, while it is required that the RE of a registered MIS ensures that scheme property is clearly identified and held separately from the property of the RE or any other MIS, and while the RE of a registered MIS must generally appoint a separate entity as the custodian to hold scheme assets, there are certain cases or exceptions under which self-custody is allowed[51].

- a 'responsible entity' operates the scheme. Investors do not have day to day control over the operation of the scheme.

[49] The regulatory framework for MIS is set out in part in Chapters 5C and 7 of the *Corporations Act 2001* (**CA**) supported by various ASIC regulatory guides (RG) and regulations and other legislative instruments (eg, ASIC class orders).
[50] Wholesale clients include investors that meet certain tests to demonstrate they have sufficient investment knowledge and experience such as financial institutions.
[51] Irrespective of whether scheme assets are held by a custodian or the RE or for a wholesale MIS the investment manager itself ('self-custody'), certain minimum standards must be met. The asset holder must:

- have an adequate organizational structure that supports the separation of the assets held from its own assets and those of any other MIS;

184. ASIC indicated that self-custody for publicly offered CIS was at one stage not permitted, but this requirement was removed in favour of a focus on functional independence e.g. separate reporting lines. ASIC also pointed out that there have been no examples of custodial failure in the minority of cases where self-custody has been used since this change in 1998. ASIC also underlines that as a practical matter self-custody is not common and generally assets are held by custodians.

185. With respect to depositaries, ESMA also notes that there are exceptions to the requirement to hold scheme property separately (eg, pooling arrangement). ASIC indicates that holding certain classes of assets separately may be inconsistent with market practice involving omnibus accounts where it is likely to substantially add to the cost of holding scheme property. ASIC has however given limited relief to REs from the requirement to hold scheme property separately from property of the RE and any other scheme, in certain circumstances, subject to requirements to ensure that the interests of members are not put at any additional risk of being lost by any pooling arrangement. Similar provisions apply to licensed custodians generally.

186. As regards the alignment of incentives between the AIFM and investors, similar remuneration rules as set out in the AIFMD do not seem to be currently applied in Australia. AIFMD rules on remuneration are therefore significantly different from what is being applied in Australia.

187. Australian regulations do not prescribe rules about particular remuneration, but rather apply general requirements to remuneration or other things that may create conflicts.

188. An RE, and its officers, of a registered MIS must act in the best interest of the members of the MIS and, if there is any conflict, give priority to the members' interests. More generally there are general obligations on AFS licensees that require them to do all things necessary to ensure that the financial services covered by their licence are provided efficiently, honestly and fairly, and to have in place adequate arrangements for the management of conflicts of interest.

189. This would include having adequate arrangements to manage conflicts with the duties of an asset manager, as an AFS licensee, that may arise from the structure of remuneration of its employees

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- have adequate custodial staff with the knowledge and skills necessary to perform their functions properly;
- have adequate capacity and resources to perform core administrative activities including IT, record keeping and systems for handling client instructions; and
- hold assets on trust for the client, which includes the obligation to separate assets, other than for certain foreign assets where holding on trust is impracticable, where an appropriately bankruptcy remote holding is permitted.

In addition, the compliance plan of a registered MIS must set out adequate measures to ensure that all scheme property is clearly identified as scheme property and held separately from property of the RE and property of any other MIS.

190. With respect to question 1) iii) ESMA notes that according to the November 2012 IMF financial sector assessment program (FSAP) detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Australia[52], Australia was assessed as "Fully Implemented" with respect to a number of the principles referred to (principles 4, 10, 11, 14, 27, 32), "Broadly Implemented" with respect to other principles referred to (principles 12, 13, 15, 25, 26, 28), but also "Partly Implemented" with respect to principle 24.

191. According to the 2012 IMF FSAP, principles 10 to 12, which relate to the effectiveness of enforcement in Australia, are therefore fully or broadly implemented.

192. However, because the abovementioned IMF FSAP dates back to November 2012, as mentioned in paragraph 23 and subject to the limitations noted in that paragraph, ESMA invited ASIC to carry out a self-assessment based on the IOSCO principles 10 to 12, updating their answers to the questions included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation*[53][54].

193. The results of this self-assessment carried out by ASIC between February and May 2016 show that the legal framework in place in Australia allowed ASIC to answer positively to all questions asked by ESMA.

194. The corresponding legal framework in place in Australia in relation to enforcement seems comprehensive and able to meet the requirements of the IOSCO methodology

195. However, in addition to the abovementioned 2012 IMF assessement of principles 10 to 12 and to the fact that the legal framework in place in Australia allowed ASIC to answer positively to all questions included in the updated IOSCO *Methodology* related to principles 10 to 12, ESMA notes that the amount of activity and related output in terms of enforcement actions which have been taken vis a vis firms in Australia has remain relatively stable from 2011 to 2015.

196. As regards principle 24, the aforementioned 2012 IMF report notably indicates that "Wholesale CIS are not subject to any regulatory requirements."[55] ASIC clarified that if

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[52] https://www.imf.org/external/pubs/ft/scr/2012/cr12314.pdf
[53] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf
[54] The IOSCO methodology for assessing implementation of the IOSCO objectives and principles of securities regulation was revised in August 2013.
[55] A wholesale MIS is an investment scheme that is marketed to wholesale clients only and it is not a registered MIS. A person is a wholesale client where a financial product or a financial service is provided to the person and:

- the price of the financial product or service provided exceeds $500,000 (this amount can be varied in certain circumstances);

- it is a business above a certain size, that is, it is not a small business;

MIS is not required to be a registered MIS, it is indeed not subject to any ASIC process in relation to its establishment and many of the regulatory requirements do not apply to its operation. However, ASIC pointed out that key financial services relating to such wholesale MIS are regulated such as the issue of interests, dealing in financial products and holding financial products in custody. If the MIS is a registered MIS it must meet the requirements for a registered MIS regardless whether it was required to be a registered MIS.

197. As regards principles 13 and 15, the aforementioned 2012 IMF report indicates that 'The Government is progressing amendments to the relevant law and regulations expected to be in place by late 2012 that are intended to remove at least some of these limitations and bolster ASIC's capacity for international regulatory cooperation on supervisory matters'.

198. The relevant Australian statutes in this area are the *Australian Securities and Investments Commission Act 2001* (ASIC Act) and the *Mutual Assistance in Business Regulation Act 1992* (MABRA). The ASIC Act governs the release of confidential information by ASIC to foreign agencies. MABRA enables certain Australian business regulators (including ASIC) to give assistance to foreign regulators in their administration or enforcement of foreign business laws by obtaining from persons relevant information, documents and evidence and transmitting the same to foreign regulators.

199. ASIC pointed out that since the 2012 FSAP report a number of limitations in ASIC's ability to share information with foreign counterparts have been removed. These legislative reforms comprised:

- In 2012 MABRA was amended to allow for the Minister's power to grant a request from a foreign regulator, under MABRA, to be delegated to an ASIC employee. Previously, MABRA only allowed the Minister power to delegate his authorisation function to the Treasury Secretary or an APS employee in the Treasury.
- In 2013 MABRA was amended to expand the definition of "foreign business law" from "a business law of a foreign country" to also include "a law or regulation that an international business regulator administers or enforces". The reason for this amendment was to assist pan-European regulators (such as ESMA and the European Systemic Risk Board), that were established under regulations of the European Parliament and Council, and which perform regulatory functions and exercise related powers. There was doubt as to whether those pan-European regulators fell within the former definition of "foreign regulator" under

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- the person is a professional investor (for example, AFS licensees, banks, superannuation fund trustees, listed companies or investment companies);
- the person is determined by an AFS licensee to meet a test of sophistication where the client's previous experience allows the client to assess the merits, values and risks of the financial service or product; or
- the person meets minimum net assets or gross annual income requirements - who has net assets of at least A$2.5 million or has a gross annual income of A$250,000.

MABRA, as the definition did not include regulators of multiple jurisdictions. This amendment now allows an international business regulator (such as ESMA and ESRB) to make a request for information under MABRA to a prescribed Australian business regulator (which includes ASIC). The MABRA amendments brought pan-European regulators such as ESMA and ESRB into the definition of "foreign regulator" and so enables ASIC to give assistance in connection with the foreign regulators' administration and enforcement of foreign business laws.

200. In 2013 a sub-section of the ASIC Act was inserted into the ASIC Act to allow for the release of confidential information if ASIC is satisfied that it would "enable or assist an international business regulator to perform its functions or exercise its powers." The meaning of "international business regulator" tracks the meaning of that term as used in MABRA and now includes regulators such as ESMA and ESRB.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

(a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?

(b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Australia

201. ESMA is of the view that the granting of the passport to non-EU AIFMs might result in more Australian AIFs on the EU market. It is, however, difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

202. Please also see the following assessment of questions related to the “obstacles to competition” criteria.

3) Obstacles to competition:

- Examples of questions that may be applied under this heading include:

(a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?

(b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Australia

203. With respect to the circumstances under which EU AIFMs and UCITS management companies have to be authorized or registered in order to manage or market AIFs or UCITS in Australia, the operator of a CIS (eg, EU AIFMs and UCITS –) must generally hold an AFSL (whether offered to retail clients or wholesale clients - please also refer to previous paragraphs 187 to 190). There is no distinction in the requirements for obtaining an AFSL between Australian persons and foreign persons. The provision of financial services associated with operating a wholesale CIS will normally result in the operator being required to be licensed for those activities. There are additional requirements for an RE of a registered MIS, which is specified in the RE's AFSL and the RE of a registered MIS must be an Australian company.

204. Foreign entities can however provide asset management services to registered MIS if they obtain an AFSL appropriate for carrying out that service. They may be also required to complete certain administrative processes to be registered as a foreign company and appoint a local agent for service of documents. The same requirements will apply to foreign companies in any industry in Australia, not just investment management.

205. ASIC has provided foreign financial services providers (FFSPs) of financial services to wholesale clients with 'class order relief' from the requirements to hold an AFSL.[56]

206. ASIC indicates that in Australia, a person provides a financial service if they, among other things:

- provide financial product advice;
- deal in a financial product (eg, acquiring, issuing or selling a financial product);
- operate a registered MIS; or
- provide a custodial or depository service.

207. ASIC indicates that if EU persons are issuing interests or dealing in financial products in Australia, they will need an AFSL. The same requirements for getting an AFSL will

[56] a person provides a financial service if they, among other things:

- provide financial product advice;
- deal in a financial product (eg, acquiring, issuing or selling a financial product);
- operate a registered MIS; or provide a custodial or depository service

apply to them as apply to Australian entities. To facilitate cross-jurisdictional financial investments, ASIC has used exemption (the so caled class order relief) powers under the CA so that an FFSP can provide particular financial services in Australia without an AFSL only if:

a. the particular financial services are provided in Australia to wholesale clients only;

b. the particular financial services are regulated by an overseas regulatory authority;

c. the regulatory regime overseen by the overseas regulatory authority is sufficiently equivalent to the Australian regulatory regime;

d. there are effective cooperation arrangements between the overseas regulatory authority and ASIC; and

e. the FFSP meets all the relevant conditions of relief

208. ASIC class order relief is currently available for the UK and German fund managers. However, ASIC indicated they are willing to discuss extending this to EU AIFMs or UCITS managers from the EU member states more generally on a reciprocal basis.

4) Monitoring of systemic risk:

- Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market development with a view to tracking potential (or actual) systemic risks[57] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Australia

209. The regulatory regime of Australia was assessed as “Fully Implemented” in the 2012 IMF FSAP, with respect to principle 6. The responses of ASIC to ESMA’s questions are in line with this assessment.

General advice on the potential extension of the passport to Australia

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding the monitoring of systemic risk impeding the application of the AIFMD passport to Australia.

[57] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

With respect to investor protection, ESMA is of the view that there are differences between the Australian regulatory framework and the AIFMD. However, given the general requirements mentioned above in paragraph 19 applicable to all non-EU AIFMs wishing to make use of the AIFMD passport, these differences are not seen as a significant obstacle impeding the application of the AIFMD passport to Australia.

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding market disruption and obstacles to competition impeding the application of the AIFMD passport to Australia, provided the abovementioned class order reliefs are extended to all EU Member States.

2.10 Bermuda

210. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Bermuda based on the methodology described in section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Bermuda

211. First, ESMA notes that the preconditions, including that for an MoU with non-EU NCAs set out in Articles 35 and 37 and there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation we need to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:
a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
b) Is there timely and prompt collaboration in case of emergency situations?
c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
d) Have legal limitations been encountered in sharing information or performing on-site visits?
e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of an existing MoU, does previous supervisory engagements provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Bermuda

212. While information regarding the cooperation between NCAs and the Bermuda Authority (Bermuda Monetary Authority - BMA) in the field of AIFMD is scarce ESMA notes that there have been no reported negative experiences in terms of cooperation between NCAs and the BMA.

213. With respect to the cooperation between the BMA and foreign regulators, BMA indicated that the Bermuda legislative framework enables the Authority to share information and engage in supervisory cooperation, and that the supervisory cooperation is broadly dealt with in two ways:

a. Firstly, the BMA would rely on the relevant provisions in the legislative framework for any particular regulated sector when assisting a foreign regulator

to access information that has been submitted to the BMA for regulatory purposes[58]. The BMA should be satisfied that the foreign regulator a) exercises the functions and duties corresponding to those required of the Authority and b) would keep the information provided by the Authority as confidential and not to disclose it without the prior consent of the BMA;

b. Secondly, the BMA is entitled to obtain information from a person(s) in Bermuda, whether they are a person licensed by the BMA or not.[59]

214. The BMA indicated they make every effort to assist foreign regulators with their enquiries and would very rarely refuse to cooperate or share information. At times the BMA has sought clarification as to the nature of requests received from foreign regulators if it is not clear. The BMA may refuse to provide assistance or information to foreign regulators only in some very specific circumstances[60]. The foreign regulator is expected to exercise the same functions and duties, corresponding with those required of the BMA, and should have equivalent confidentiality laws in place.

215. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU country have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[61] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

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[58] Section 80(2) of the Investment Business Act 2003 (IBA) expressly enables the BMA to assist an authority in a country or territory outside of Bermuda

[59] the BMA would rely on Sections 30A and 30B of the BMA Act when assisting a foreign regulator to access information that is not held directly by the Authority. For this purpose, Sections 30A and 30B of the BMA Act provide powers to the Authority to obtain such information.

[60] if the jurisdiction in question fails to fulfil the criteria as set out in Section 30A of the Bermuda Monetary Authority Act (if the information requested is held outside of the BMA) or fails to fulfil the criteria specified in the respective regulatory Act, with regard to disclosure of information.

[61] And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Bermuda

216. As for the criteria in 1 ii), Bermuda intends to put in place an AIFMD-like regime which would be an opt-in regime for Bermuda AIFMs wishing to market their AIFs in the EU under the AIFMD passport requirements. The current framework applicable in Bermuda (i.e. not the aforementioned opt-in regime) is significantly different from the AIFMD, especially regarding the depositary and the remuneration requirements.

217. The BMA indicated they expect the new AIFMD-like regime to be finalized and put in place in the coming months, as for the level 1, 2 but also level 3 measures similar to the AIFMD ones.[62]

218. With respect to the contents of the new AIFMD-like regime, and more specifically the extent to which this AIFMD-like regime differs from the AIFMD framework, at the time this Advice was drafted ESMA could not assess the final versions of the draft Regulations and rules.

219. However, ESMA is of the view that the interim versions of the draft Rules and Regulations seem to show that the new AIFMD-like regime would be very similar to the AIFMD framework. This would need to be confirmed having regard to the final published versions of the aforementioned rules and related implementing texts.

220. There is only one NCA in Bermuda with oversight duties. As regards IOSCO principles in Bermuda, there is no IMF FSAP on Bermuda.

221. With respect to the assessment of the effectiveness of enforcement in Bermuda, as mentioned in section 2.1, ESMA invited the BMA to carry out a self-assessment based on the IOSCO principles 10 to 12, answering the corresponding questions included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation*[63]*.*

222. Although the BMA provided ESMA with a significant amount of information on the actual implementation of this framework on enforcement, including statistics on the activity and its output in terms of enforcement actions which have been taken against firms, ESMA's advice on the assessment of IOSCO principles 10 to 12 in the case of Bermuda is subject to the limitations described in paragraph 23.

223. There are two elements that ESMA would like to highlight:

[62] Although the BMA has the legislative authority to make the Rules, the Attorney General's Chambers of the Bermuda Government is required to review the Rules and formalise them before issuing them as an official legal text. The main trigger to give effect to the regime in its entirety would be for the Minister of Finance to make an Order to commence the IBA Amendment Act.

[63] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf

a. One of the main features of the enforcement related framework in Bermuda is that specifically in relation to the fund industry, a number of the key service providers and fund operators are located outside of the jurisdiction. Accordingly, a good proportion of enforcement cases handled by the BMA involve assisting foreign regulators with their investigations and with actions taking place in their territory;

b. The BMA indicated they have committed to undertake a review of the Investment Funds and Management frameworks as currently set out under the Investment Funds Act 2006 (IFA) and Investment Business Act 2003 (IBA). Changes to these regimes will be discussed and developed as part of a phased approach. The BMA indicated that one of the more urgent aspects relates to enforcement in the funds sector on which they expect adoption of the legislation by July of this year. This review would notably aim at adding the following powers to the enforcement toolkit related to the investment fund sector: application of civil penalties, injunctions, public censure and prohibition orders against individual directors and officers.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Bermuda

224. ESMA is of the view that the granting of the passport to non-EU AIFMs would probably result in more Bermuda AIFs on the EU market. It is, however, difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

225. The BMA indicated that as for 31 December 2012 (data gathered as part of Bermuda's first National Risk Assessment (NRA) of money laundering risks):

a. Total value of assets under management ("AUM") for Bermuda investment providers within scope of the Investment Business Act = $141.7 billion

b. Sub-total of above AUM total which relates to clients resident within EU = $99.4 billion

c. Net Asset Value of Bermuda funds = $187.8 billion

d. Net Asset Value of investments in Bermuda funds attributable to EU resident investors: $35.7 billion.

226. Please also see the following assessment of questions related to the "obstacles to competition" criteria.

3) Obstacles to competition:

Examples of questions that may be applied under this heading include:

(a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?

(b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Bermuda

227. ESMA is of the view that EU-AIFMs that wish to establish business in Bermuda have to comply with the same rules as national AIFMs. ESMA is of the view that there are no identified competition issues on that aspect. ESMA also notes that, given its population, the investor base in Bermuda is limited as compared to the investor base in the EU.

4) Monitoring of systemic risk:

Examples of questions that may be applied under this heading include:

1. Does there exist tangible evidence of adequate surveillance of market developments with a view to tracking potential (or actual) systemic risks[64] by the NCA in the non-EU country?

2. How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

[64] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

Assessment in the case of Bermuda

228. ESMA is of the view that Bermuda has frameworks in place for addressing systemic risks.

229. ESMA notably noted that as part of the financial stability initiative, the Ministry of Finance and the BMA have established the Council (Financial Policy Council), the primary objective of which is to promote the stability of Bermuda"s financial system. The FSC (Financial Stability Committee) has existed since mid-2014 and now supports the Council in the discharge of its responsibilities. The FSC is an inter-agency committee comprising senior officials of the Ministry of Finance and the BMA.

230. In pursuing its objectives, the main roles of the Council and the FSC are to:
    a. Identify and propose responses to systemic financial threats, whether domestic or international;
    b. Oversee the continued development of a robust recovery and resolution regime;
    c. Ensure the overall coherence of financial policies in Bermuda;
    d. Provide a channel through which, as necessary, financial policy issues can be exposed to and assessed by Cabinet;
    e. Ensure that agreed actions of the Council are carried through effectively and in a timely manner

General advice on the potential extension of the passport to Bermuda

Having regard to the above assessment, ESMA is of the view that there are no significant obstacles regarding competition, market disruption and the monitoring of systemic risk impeding the application of the AIFMD passport to Bermuda.

With respect to investor protection, ESMA is of the view that no definitive Advice can be provided until the final version of the AIFMD-like regime referred to in the paragraphs above are available.

With respect to the assessment of the effectiveness of enforcement, while ESMA is also of the view that no definitive Advice can be provided until the review mentioned in paragraph 223 is adopted, ESMA is not in a position to provide the Parliament, Council and Commission with a more thorough assessment than the one presented in the paragraphs above, due to the nature and timeline of the assessment.

2.11 Canada

231. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Canada based on the methodology described in the section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Canada

232. First, ESMA notes the preconditions for an MoU with non-EU NCAs set out in Articles 35 and 37 and considers there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation it is necessary to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?

b) Is there timely and prompt collaboration in case of emergency situations?

c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?

d) Have legal limitations been encountered in sharing information or performing on-site visits?

e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?

f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Canada

233. Although information regarding the cooperation between NCAs and the Canadian Authorities (The Canadian Securities Administrators[65] – CSA – and in particular the Autorité des marchés financiers of Québec and the Ontario Securities Commission) in

[65] The Canadian Securities Administrators (CSA) is an umbrella organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets

the field of AIFMD is limited, based on the feedback received from NCAs, ESMA is of the view that the experiences of cooperation with the Canadian Authorities are, in general terms, positive. Previous supervisory engagements provide support for the expectation of good supervisory cooperation.

234. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU countries have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[66] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Canada

235. As regards depositaries, ESMA is of the view that overall, the rules in Canada broadly pursue the same objectives as the rules in the EU under the AIFMD, but there are some differences regarding notably the oversight function of the depositary and scope of funds subject to depositary requirements.

236. Overall, while under the AIFMD, the manager of an AIF appoints a depositary which carries out several functions including monitoring cash flows, oversight, holding assets and safeguarding against breach of certain applicable national laws, in Canada the depositary does not carry out the oversight function.

237. In fact in Canada, a 'depository' (or central securities depository, as it is typically referred to in Ontario) is understood to be an entity that provides centralized facilities

[66]And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

for the holding of securities accounts, central safekeeping services, and asset services, which may include the administration of corporate actions and redemptions. Different from the depository (which is therefore not a depositary) is the custodian of an investment fund, whose primary responsibility is to maintain possession, physical or otherwise, of the underlying assets of the investment fund (usually only with reference to the legal title of the assets, with the beneficial title remaining with the investment fund and/or its securityholders). The custodian's primary responsibilities are to keep the assets safe and act within the appropriate standard of care. Therefore the custodian does not conduct any oversight of, or question any decisions made by, the investment fund manager that directs the business, operations or affairs of an investment fund, nor does the custodian have a prescribed duty to detect fraud.

238. Apart from this difference, various requirements apply to these custodians. These include:

a. Limited scope of entities eligible for the function of custodian;

b. Rules on the management of conflicts of interest between the asset manager and the depositary;

c. Rules on the safeguarding of assets;

d. Clear liability regime of the depositary;

239. In addition, ESMA notes that in Canada investment funds that sell securities to the public under capital raising exemptions in securities legislation (also referred to as pooled funds, private placements, or exempt distributions)) are not subject to any prescribed requirements in regards to the custody function. The CSA indicated they are currently reviewing their Rules and may propose further guidance or enhancements regarding the custodianship of assets of pooled funds.

240. As regards the alignment of incentives between the AIFM and investors, similar remuneration rules as set out in the AIFMD do not seem to be currently applied in Canada. AIFMD rules on remuneration are therefore significantly different from what is being applied in Canada.

241. Under the requirements of the AIFMD, because the Member State of reference has to authorize the non-EU AIFM wishing to market AIFs in the EU, and that the non-EU AIFM has to comply with the AIFMD requirements, including rules on the alignment of incentives between the AIFM and investors, the remuneration rules as it stands in Canada would not be accepted for AIFMs and AIFs that intend to use the EU-passport.

242. With respect to question 1) iii) ESMA notes that according to the March 2014 IMF financial sector detailed assessment of implementation on IOSCO objectives and

principles of securities regulation on Canada[67], Canada was assessed as "Fully Implemented" with respect to most principles referred to (principles 4, 10, 11, 13, 14, 15, 25, 26, 27, 28), and "Broadly Implemented" with respect to the other principles referred to (principles 12, 24, 32).

243. According to the 2014 IMF financial sector assessment program (FSAP) detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Canada, principles 10 to 12, which notably relate to the effectiveness of enforcement in Canada, are therefore fully or broadly implemented.

244. On a separate topic, due to the internal structure of Canada, ESMA notes that while the CSA is the umbrella organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets, there are in Canada different Authorities in charge of the regulation of capital markets in the different provinces of Canada (e.g. the Autorité des marchés financiers of Québec and the Ontario Securities Commission). This specific structure of the regulation of capital markets, which mechanically affects the processes of authorization of investment funds and their managers, is further discussed in paragraphs below on 'Obstacles to competition'.

2) Market disruption:

245. Examples of questions that may be applied under this heading include:

(a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?

(b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Canada

246. ESMA is of the view that the granting of the passport to non-EU AIFMs might result in more Canadian AIFs on the EU market. It is however difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

247. Please see the following assessment of questions related to the "obstacles to competition" criteria.

3) Obstacles to competition:

[67] https://www.imf.org/external/pubs/ft/scr/2014/cr1473.pdf

- Examples of questions that may be applied under this heading include:

(a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?

(b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Canada

248. In Canada, Firms and individuals are required to register with the securities regulatory authority in each province or territory where they do business[68].

249. Prior to managing or marketing AIFs or UCITs in a local jurisdiction in Canada, EU AIFMs and UCITS management companies must assess and determine whether they need to register with the local jurisdiction and in which registration categories.

250. Entities that direct the business, operations or affairs of an investment fund must be registered in the category of investment fund manager (IFM). In addition, advisers that provide portfolio advice to an investment fund must be registered in the category of adviser and dealers that market or sell an investment fund must be registered in the category of dealer.

251. An IFM that does not have a place of business in Canada (an international IFM) will need to refer to a specific regulatory framework[69], to assess whether registration is required in a local jurisdiction (province or territory) of Canada.

252. In Ontario, Quebec and Newfoundland and Labrador, a specific set of rules apply[70]. There, an international IFM is required to register if it directs the business, operations or affairs of an investment fund that distributes or has distributed securities to resident of the local jurisdiction unless it can rely on exemptions[71].

253. These exemptions from the registration requirement may be available under if:

[68] The registration requirements are set out in securities legislation and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and related rules, which create a Canada-wide registration regime company.
[69] Multilateral Instrument 32-102 *Registration Exemptions for Non-Resident Investment Fund Managers* (MI 32-102) and its Companion Policy (CP 32-102), as well as Multilateral Policy 31-202 *Registration Requirement for Investment Fund Managers* (MP 31-202)
[70] MI 32-102 and CP 32-102
[71] under MI 32-102

- No securityholders in the investment fund(s) that are managed by the international IFM are resident in the local jurisdiction, and there has been no “active solicitation” in the local jurisdiction by the IFM (or the funds that it manages) after September 27, 2012 (the no solicitation exemption); or;

- all securities of the investment funds that have been distributed in the local jurisdiction were distributed under an exemption from the prospectus requirement to a “permitted client” (the permitted client exemption).

254. In the other local jurisdictions of Canada, another set of rules[72] applies. In these local jurisdictions, an international IFM needs to register in the local jurisdiction if it directs the business, operations or affairs of an investment fund from a physical place of business in the jurisdiction or has its head office in the jurisdiction. In circumstances where the IFM does not have a physical place of business or head office in the local jurisdiction, the IFM will need to register in the local jurisdiction if it carries out the activities of an IFM in that jurisdiction[73].

255. Therefore, an international IFM generally needs to register if it intends to develop its activities in Canada but the level of activities triggering this registration duty depends on the jurisdiction involved.

256. In addition, if it is determined that an international IFM must register in more than one Canadian jurisdiction, then a passport is available. International IFMs can use the passport system to register in several jurisdictions. This can occur if the international IFM cannot rely on the no solicitation exemption or the permitted client exemption mentioned above, in force in Ontario, Québec and Newfoundland and Labrador. In such circumstances, the three provinces apply the passport system so that the IFM only has to deal with one regulator. The no solicitation exemption and the permitted client exemption do not need to be applied for asthey automatically apply if the conditions of the exemptions are met. In this case an international IFM is required to file a report indicating that it is relying on either one of these two exemptions, in any given year.

257. ESMA is of the view that the consequence of these different requirements is that the market access conditions for Canada which apply to EU funds and managers are *per se* more difficult than the market access conditions the Canadian funds and managers would benefit from if the AIFMD passport were to be granted to Canada. However, this difference is related to the structure of the jurisdictions in Canada, and not to the specific situation of market access for investment funds in this country.

[72] MP 31-202
[73] MP 31-202 provides guidance on activities that result in the IFM directing or managing the business, operations or affairs of an investment fund in the local jurisdiction

258. Other than this specific issue, ESMA is of the view that there are no identified competition issues.

4) Monitoring of systemic risk:

- Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market development with a view to tracking potential (or actual) systemic risks[74] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Canada

259. The regulatory regime of Canada was assessed as "Broadly Implemented" in the 2014 IMF FSAP, with respect to principle 6. The responses of Canada to ESMA's questions are in line with this assessment.

General advice on the potential extension of the passport to Canada

Having regard to the above assessment, ESMA is of the view that there are no significant obstacles regarding the monitoring of systemic risk impeding the application of the AIFMD passport to Canada.

With respect to investor protection, ESMA is of the view that there are differences between the Canadian regulatory framework and the AIFMD. However, given the general requirements mentioned above in paragraph 19 applicable to all non-EU AIFMs wishing to make use of the AIFMD passport, these differences are not seen as a significant obstacle impeding the application of the AIFMD passport to Canada.

Having regard to the above assessment, ESMA is also of the view that there are no significant obstacles regarding market disruption and obstacles to competition impeding the application of the AIFMD passport to Canada.

[74] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

2.12 Cayman Islands

260. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Cayman Islands based on the methodology described in section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Cayman Islands

261. First, ESMA notes that the preconditions, including that for an MoU with non-EU NCAs set out in Articles 35 and 37 and there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation we need to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?

b) Is there timely and prompt collaboration in case of emergency situations?

c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?

d) Have legal limitations been encountered in sharing information or performing on-site visits?

e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?

f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of an existing MoU, does previous supervisory engagements provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Cayman Islands

262. While information regarding the cooperation between NCAs and the Cayman Islands Authority (Cayman Islands Monetary Authority - CIMA) in the field of AIFMD is scarce, ESMA notes that there have been no reported negative experiences in terms of cooperation between NCAs and CIMA.

263. With respect to the cooperation between CIMA and foreign regulators, CIMA indicated that the Cayman Islands regulatory framework[75] requires CIMA to assess each request for information from foreign regulators against the following criteria:

a. definition of "overseas regulatory authority" – as a preliminary matter, CIMA reviews public information about the entity making the request to ensure that it is an entity that "exercises functions corresponding to…(a) any of the regulatory functions of the Authority; or (b) any additional functions as may be specified in regulations including the conduct of civil and administrative investigations and proceedings to enforce laws, regulations and rules administered by that authority;

b. The following conditions are met by the overseas regulator in their request:

i. that the overseas regulator is subject to adequate legal restrictions on further disclosures; or

ii. that CIMA has received undertakings by the overseas regulator not to disclose the information provided without the consent of CIMA; and

iii. that the assistance required is for regulatory purposes including the conduct of civil and administrative investigations; and

iv. that the information will not be used in criminal proceedings against the person providing the information other than proceedings for an offence of perjury.

264. CIMA pointed out that as a general matter, all overseas regulators with which CIMA has entered into a memorandum of understanding fulfil the abovementioned requirements.

265. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU country have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest

[75] Monetary Authority Law (2013 Revision) (the "MAL")

between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[76] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Cayman Islands

266. As for the criteria in 1 ii), Cayman Islands intends to put in place an AIFMD-like regime which would be an opt-in regime for Cayman Islands AIFMs wishing to market their AIFs in the EU under the AIFMD passport requirements. The current framework applicable in Cayman Islands (i.e. not the aforementioned opt-in regime) is significantly different from the AIFMD, especially regarding the depositary and the remuneration requirements.

267. CIMA indicated they expect the new complete AIFMD-like regime to be finalized and put in place in the coming 12 to 18 months, as for the full level 1, 2 and 3 measures.

268. With respect to the contents of the new AIFMD-like regime, and more specifically the extent to which this AIFMD-like regime differs from the AIFMD framework, at the time this Advice was drafted ESMA could not assess the final versions of the draft Regulations and rules.

269. However, ESMA is of the view that the interim versions of the draft Rules and Regulations seem to show that the new AIFMD-like regime would be broadly similar to the AIFMD framework. This would need to be confirmed having regard to the final published versions of the aforementioned rules and related implementing texts.

270. There is mainly only one NCA in Cayman Islands with oversight duties. As regards IOSCO principles in Cayman Islands, there is no IMF FSAP on Cayman Islands.

271. With respect to the assessment of the effectiveness of enforcement in Cayman Islands, as mentioned in section 2.1, ESMA invited CIMA to carry out a self-assessment based on the IOSCO principles 10 to 12, answering the corresponding questions included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation*[77].

[76] And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.
[77] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf

272. Although CIMA provided ESMA with a significant amount of information on the actual implementation of this framework on enforcement, including statistics on the activity and its output in terms of enforcement actions which have been taken vis a vis firms, ESMA's advice on the assessment of IOSCO principles 10 to 12 in the case of Cayman Islands is subject to the limitations described in paragraph 23.

273. ESMA notes that CIMA indicated that a legislative amendment is currently being prepared in Cayman Islands which will give CIMA the power to impose administrative fines for breaches of regulatory Laws, Regulations and Rules. CIMA indicated that thanks to this amendment they will be able to impose those fines without the need to invoke a judicial or Court process. CIMA also indicated that the drafting of this legislative amendment is scheduled to be completed by the beginning of July 2016 and the enactment of the legislation is expected before the end of 2016.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Cayman Islands

274. ESMA is of the view that the granting of the passport to non-EU AIFMs would probably result in more Cayman AIFs on the EU market. It is however difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

275. CIMA indicated that based on their data, as at end of December 2014 there were: 1,384 regulated Cayman funds with a fund manager located in the EU (1,070 in the UK); and 170 regulated Cayman managers located in the EU.

276. Approximately 14% of the 11,010 regulated Cayman funds (registered, administered and licensed) have managers located in the EU. The total NAV of these 1,384 funds reported for the 2014 financial year was US$365 billion, approximately 10% of the overall NAV relating to ALL fund managers (no matter their location).

277. CIMA indicated they are unable to say with any certainty if all the regulated Cayman funds marketed by those EU located fund managers are actually being marketed in the EU however it is envisaged that more than likely that is the case. Additionally, their data does not provide information on non-EU fund managers (e.g. US fund managers) that may be marketing Cayman funds in the EU under the National Private Placement

regimes (NPPRs). Their data also does not include closed-ended funds and exempt funds that might be marketed in the EU.

278. CIMA also pointed out that over the period 2011-2014 they have not seen any significant increases in the NAV of Cayman funds with EU located fund managers; in fact the trend has been a downward one. The Net Assets in the “Euro Area” has also declined over this period.

279. CIMA added that while it is difficult to estimate accurately the expected inflows of Cayman funds into the EU in the future, based on discussions with the private Sector, they anticipate that there will be very little increase in such inflows under the Passport regime given that:

    (a) A significant number of Cayman funds are managed by USA firms; as at the end of 2014, firms in the USA managed 74% or US$2.646 trillion of total ending net assets2. USA-based managers would therefore account for a large proportion of the Cayman funds currently being marketed in the EU in accordance with the NPPRs.

    (b) Approximately 10% of the Net Asset value (NAV) of all Cayman Islands funds regulated by CIMA is managed by fund managers based in the EU as at 31 December 2014. The inflows generated via these fund managers under a Passport regime are not expected to significantly increase as compared to the current situation under the NPPRs

280. CIMA also indicated that non-EU managers are the primary users of Cayman registered or licensed funds. Therefore, approximately three quarters of Cayman funds registered or licensed with the Authority will be unable to be marketed in the EU under the AIFMD passport unless the AIFMD passport is also extended to the jurisdiction in which such managers are based. The general thinking of CIMA is that if the AIFMD passport is extended to these third countries, the expense and time required for a non-EU manager (e.g. USA) to obtain this passport in respect of its Cayman fund or any EU-connected fund will likely result in only those fund managers with sufficient resources and commitment to the EU as well as a very high expectation of success in the EU market, will apply to market their funds into the EU.

281. CIMA finally also notes that most of CIMA’s funds are not retail funds and in fact only 101 such funds exist out of the current 11,010 regulated funds.

282. Please see the following assessment of questions related to the “obstacles to competition” criteria.

    3) Obstacles to competition:

Examples of questions that may be applied under this heading include:

a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?
b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Cayman Islands

283. ESMA is of the view that EU-AIFMs that wish to establish business in Cayman Islands have to comply with the same rules as national AIFMs. ESMA is of the view that there are no identified competition issues on that aspect. ESMA also notes that, given its population, the investor base in Cayman Islands is limited as compared to the investor base in the EU.

4) Monitoring of systemic risk:

Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market developments with a view to tracking potential (or actual) systemic risks[78] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Cayman Islands

284. ESMA noted that Cayman Islands has frameworks in place for addressing systemic risks.

285. However, ESMA noted that CIMA is currently working on the development and implementation of a macro-prudential policy framework which is expected to enhance its current systemic risk monitoring. The process of implementing macro-prudential supervision is expected to take 12-18 months.

General advice on the potential extension of the passport to Cayman Islands

[78] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding competition and market disruption impeding the application of the AIFMD passport to the Cayman Islands.

With respect to investor protection, ESMA is of the view that no definitive Advice can be provided until the final version of the AIFMD-like regime referred to in the corresponding paragraphs above are available.

With respect to the assessment of the effectiveness of enforcement, while ESMA is also of the view that no definitive Advice can be provided until the legislative amendment mentioned in paragraph 273 is adopted, ESMA is not in a position to provide the Parliament, Council and Commission with a more thorough assessment than the one presented in the corresponding paragraphs above, due to the nature and timeline of the assessment. Similarly, with respect to the monitoring of systemic risk, ESMA will not be in a position to provide definitive advice until the changes referred to in paragraph 285 have been put in place.

2.13 Isle of Man

286. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to the Isle of Man based on the methodology described in section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Isle of Man

287. First, ESMA notes that the preconditions, including that for an MoU with non-EU NCAs set out in Articles 35 and 37 and there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation we need to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:
a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
b) Is there timely and prompt collaboration in case of emergency situations?
c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
d) Have legal limitations been encountered in sharing information or performing on-site visits?
e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
g) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of an existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Isle of Man

288. While information regarding the cooperation between NCAs and the Isle of Man Authority (Isle of Man Financial Services Authority - IOMFSA) in the field of AIFMD is scarce, ESMA notes that there have been no reported negative experiences in terms of cooperation between NCAs and the IOMFSA. One NCA explicitly indicated they have had positive experiences of collaboration with the Isle of Man FSA in the past. This NCA has performed on-site visits together with the Isle of Man FSA and has good experiences from this.

289. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU country have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[79] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Isle of Man

290. As for the criteria in 1 ii), Isle of Man does not intend to put in place an AIFMD-like regime.

291. The current framework applicable in Isle of Man is different from the AIFMD, especially regarding the depositary and the remuneration requirements.

292. The IOMFSA indicated that overall the Isle of Man regime does not go to the same level of specificity as that in the AIFMD but the concepts included are similar.

293. With respect to depositaries, the main differences between the IOM Regime and the AIFMD seem to be the following:

294. While in the Isle of Man the retail schemes, i.e. Authorised and Regulated schemes, require a fiduciary custodian or trustee, who has various responsibilities under its oversight function, these specific oversight requirements do not apply to non-retail funds, which do not require a fiduciary custodian or trustee.

295. More generally, the scope of the IOM funds subject to custodian requirements is different from the scope of funds subject to the AIFMD and is the following:

[79]And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.

Type of fund	Depositary requirement	Legislation	Link
Authorised Scheme	Fiduciary custodian or Trustee	Authorised Collective Investment Schemes Regulations 2010	http://www.gov.im/lib/docs/fsc/handbooks/guides/Cis/authorisedcollectiveinvestmentsch.pdf
Regulated Fund	Fiduciary custodian or Trustee	Collective Investment Schemes (Regulated Funds) Regulations 2010	https://www.gov.im/lib/docs/iomfsa/handbooks/guides/Cis/regulatedfundregs2010.pdf
Qualifying Fund	Custodian	Collective Investment Schemes (Qualifying Funds) Regulations 2010	https://www.gov.im/lib/docs/iomfsa/handbooks/guides/Cis/qualifyingfundregs2010.pdf
Specialist Fund	Disclosure of custody arrangements	Collective Investment Schemes (Specialist Funds) Regulations 2010	https://www.gov.im/lib/docs/iomfsa/handbooks/guides/Cis/specialistfundregs2010undercis.pdf
Recognised Scheme	Fiduciary custodian or Trustee	Collective Investment Schemes (Recognised Funds) (Offering documents) 2010	https://www.gov.im/lib/docs/fsc/recognisedschemesofferingdocsreg.pdf
Exempt Scheme	Not specified – private arrangement that cannot be marketed to the public		

296. This means that all Isle of Man retail funds (Authorised Funds, Regulated Funds and Full International Schemes) require the appointment of a Fiduciary Custodian or Trustee. Most Isle of Man Funds are required to appoint a custodian. However exempt schemes[80] which cannot be promoted to the general public, or any part of it, anywhere in the world, are not subject to specific rules equivalent to depositary requirements.

297. The custodian is responsible for ensuring that the assets of the fund are in custody and that ownership interests are appropriately evidenced and verified. Various requirements apply to such custodians, including rules on the management of conflicts of interest between the asset manager and the custodian, eligible entities for the function of custodian, rules on the segregation and safeguarding of assets and liability regime of the custodian.

[80] Exempt Schemes (as defined in Schedule 3 to the CIS Act) are unregulated schemes which are private arrangements, can have up to 50 investors, and whose constitutional documents must expressly prohibit the making of an invitation to the public to subscribe in any part of the world.

For legislation applicable to exempt funds please see schedule 3 to the legislation: https://www.gov.im/lib/docs/iomfsa/collectiveinvestmentschemesact2008.pdf

For guidance notes applicable to exempt funds, please click on the following link http://www.iomfsa.im/exemptscheme.xml?menuid=25721

298. As regards the alignment of incentives between the AIFM and investors, similar remuneration rules as set out in the AIFMD do not seem to be currently applied in the Isle of Man. AIFMD rules on remuneration are therefore significantly different from what is being applied in the Isle of Man.

299. In the Isle of Man, rules on remuneration seem to be principle-based[81]. For example, with respect to governance, Isle of Man fund legislation sets out the responsibilities for decision making for each scheme type. Fees payable by a fund are set by the Governing Body of the Fund, with counter agreement of functionaries as appropriate. Within a licenceholder, such as a fund manager, the allocation of remuneration is also subject to regulatory requirements to ensure that there is no misalignment of incentives.

300. Under the requirements of the AIFMD, because the Member State of reference has to authorize the non-EU AIFM wishing to market AIFs in the EU, and that the non-EU AIFM has to comply with the AIFMD requirements, including rules on the alignment of incentives between the AIFM and investors, the remuneration rules as it stands in the Isle of Man would not be accepted for AIFMs and AIFs that intend to use the EU-passport.

301. There is only one NCA in the Isle of Man (IOMFSA) with oversight duties. As regards IOSCO principles in the Isle of Man, there is no IMF FSAP on Isle of Man.

302. However, in 2013, IOMFSA conducted a self-assessment of IOSCO objectives and principles of securities regulation. ESMA notes that the results of this self-assessment notably showed that IOSCO principles 8, 24, 27 and 32 were not implemented, and principle 26 was partly implemented for international schemes. IOMFSA indicated they had taken corrective measures in the meantime and that other measures were currently being taken.

303. With respect to principle 8, the IOMFSA indicated that Section 8, Risk Management and Internal Control, of the Financial Services Rule Book 2013[82], outlines requirements regarding conflicts of interest and misalignment of incentives. A guidance document entitled 'Governance Guidance for the Governing Bodies of Collective Investment Schemes' has been drafted, and was reviewed by the Board of the IOMFSA on 25 February 2016. Amongst other topics, the document addresses conflicts of interest and the misalignment of incentives in relation to schemes.

304. With respect to principle 24, the IOMFSA indicated that corrective measures were included in the abovementioned guidance currently being drafted and that the IOMFSA had also drafted guidance to licenceholders and governing bodies of funds about the

[81] The Isle of Man requirements for a remuneration policy are set out in Rule 8.6A of the Financial Services Rule Book - Remuneration policy *(which applies to relevant licenceholders including all investment businesses, asset managers of a Fund, investment advisers to a Fund)*

[82] http://www.iomfsa.im/lib/docs/fsc/consultations/financialservicesrulebook20131.pdf

IOMFSA's expectations when considering acting for a new fund. This covers areas including the need to maintain comprehensive fund take on procedures; due diligence, risk assessments and assessing the suitability of all parties; Compliance with regulations; and Documentation requirements. Finally, the IOMFSA indicated that a Review of Collective Investment Schemes is currently progressing, having been consulted on with Industry[83]. This review is intended to address a number of the key findings from the assisted self-assessment against IOSCO principles, including closed ended investment companies and authorised schemes.

305. With respect to the assessment of the effectiveness of enforcement in Isle of Man, as mentioned in section 2.1, ESMA invited IOMFSA to carry out a self-assessment based on the IOSCO principles 10 to 12, answering the corresponding questions included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation*[84].

306. The results of this self-assessment carried out by IOMFSA between February and May 2016 show that the legal framework in place in Isle of Man allowed IOMFSA to answer positively to all questions asked by ESMA included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation* and related to IOSCO principles 10 to 12.

307. However, though IOMFSA provided ESMA with a significant amount of information on the actual implementation of this framework on enforcement, including statistics on the activity and its output in terms of enforcement actions which have been taken vis a vis firms, ESMA's advice on the assessment of IOSCO principles 10 to 12 in the case of Isle of Man is subject to the limitations described in paragraph 23 above.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?
b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Isle of Man

308. ESMA is of the view that the granting of the passport to non-EU AIFMs would probably result in more Isle of Man AIFs on the EU market. It is however difficult to predict this

[83] http://www.iomfsa.im/lib/docs/iomfsa/consultations/cisgenrevconsultation2.pdf
http://www.iomfsa.im/lib/docs/iomfsa/consultations/cisgenrevconsultation2response.pdf

[84] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf

as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

309. Please see the following assessment of questions related to the "obstacles to competition" criteria.

3) Obstacles to competition:

- Examples of questions that may be applied under this heading include:

a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?
b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Isle of Man

310. ESMA is of the view that EU-AIFMs that wish to establish business in Isle of Man have to comply with the same rules as national AIFMs.

311. ESMA is of the view that there are no identified competition issues on that aspect with respect to funds marketed to non-retail investors. ESMA also notes that, given its population, the investor base in Isle of Man is limited as compared to the investor base in the EU.

312. With respect to funds marketed to retail investors, ESMA notes that Retail schemes established outside the Isle of Man ('IOM') wishing to be promoted directly to the general public on the Island must obtain 'recognition' from the Commission. These are referred to as Recognised Schemes. To be recognised, a Recognised Scheme should be subject to equivalent regulatory requirements in its own jurisdiction to an IOM Authorised Scheme. One route for a fund to be recognized is to originate from 'designated territories'.

313. To date, the 'designated territories' are: Jersey, Guernsey, UK, Luxembourg and Ireland. They have been selected by the IOMFSA on the basis that there are a reasonable number of schemes recognised from this jurisdictions and the IOMFSA has determined that adequate protection is afforded to Isle of Man participants in such schemes. Accordingly, the IOMFSA accepts the offering document that has been approved by the jurisdiction and does not impose any additional requirements. The IOMFSA indicated that they would have no objection to extending the list of designated territories such that any EEA UCITS could apply for recognition through this route.

4) Monitoring of systemic risk:

- Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market developments with a view to tracking potential (or actual) systemic risks[85] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Isle of Man

314. ESMA is of the view that Isle of Man has frameworks in place for addressing systemic risks.

315. ESMA notably noted that the results from the aforementioned self-assessment of IOSCO principles conducted in 2013 showed that according to this self-assessment, principle 6 was fully implemented.

316. ESMA also noted that IOMFSA prioritises its work according to a risk and impact assessment of its licence holders. This drives the types of on-site visits, the areas to be examined and the frequency of on-site visits. Licenceholders are risk assessed on an ongoing-basis.

317. ESMA finally noted that the IOMFSA collects quarterly statistics on all Isle of Man funds, overseas funds managed or administered on the Isle of Man, insourced management/administration functions and certain closed ended investment companies. Half yearly statistics on Assets under Management ('AUM') and client numbers are also collected from investment managers, stockbrokers and custodians, including fund custodians and investment managers to funds.

318. In terms of monitoring the systemic risk posed by licenceholders. Licenceholders are risk-assessed against the the IOMFSA's Supervisory Approach as part of this they are prescribed an impact rating (Low/Medium/High), which will be affected, amongst other things, by the value of their Assets under Administration/ Management. The impact rating is predominantly a quantitative rating, reflecting the impact that a licenceholder would have on the the IOMFSA's consumer protection objectives if they failed, the IOMFSA also risk assess licenceholder's based on a qualitative risk assessment, part of this assessment would include whether a licenceholder was conducting business which was systemically important. The combination of the impact rating and risk rating determine the regulatory resources which are applied to the supervision of the licenceholder, including the frequency with which visits are conducted to the licenceholder.

[85] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

General advice on the potential extension of the passport to Isle of Man

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding competition, market disruption and the monitoring of systemic risk impeding the application of the AIFMD passport to Isle of Man.

ESMA notes that some EU Member States are considered as 'designated territories', but most of them are not. However, this procedure is applicable only for funds offered to retail investors. Being considered as a designated territory notably means that the market access conditions of UCITS (marketed to retail investors) established in those Member States which are considered as such designated territories' in the Isle of Man are different from the market access conditions of UCITS (marketed to retail investors) established in other Member States. The IOMFSA indicated that they would have no objection to extending the list of designated territories such that any EEA UCITS could apply for recognition through this route.

With respect to investor protection, ESMA is of the view that the absence of either a regulatory project of putting in place an AIFMD-like regime or an IMF FSAP in the case of Isle of Man makes it difficult to assess with the same level of certainty the investor protection criterion mentioned in the article 67(4) of the AIFMD in a way that would be consistent with the assessments of the other non-EU countries.

With respect to the assessment of the effectiveness of enforcement, ESMA is not in a position to provide the Parliament, Council and Commission with a more thorough assessment than the one presented in the corresponding paragraphs above, due to the nature and timeline of the assessment.

2.14 Japan

319. The present section includes the assessment by ESMA on the potential granting of the AIFMD passport to Japan based on the methodology described in the section 2. 1.

Criteria, Methodology and Data to assess the potential extension of the AIFMD passport to Japan

320. First, ESMA notes the preconditions for an MoU with non-EU NCAs set out in Articles 35 and 37 and considers there should be no doubt in relation to the ongoing satisfaction of these. As Article 35 is not yet in operation it is necessary to review the way in which the MoUs required under Article 34(1)(b) and Article 36(1)(b) have been applied. In particular, in relation to the MoUs under Articles 34 and 36, there should be two tests:

1. How has the existing MoU worked? Are there positive or negative experiences to report? For example:

a) Is there efficient collaboration in accordance with the provisions of the MoU on supervisory cooperation?
b) Is there timely and prompt collaboration in case of emergency situations?
c) Is non-requested information shared with the EU authorities at the initiative of the non-EU authority?
d) Have legal limitations been encountered in sharing information or performing on-site visits?
e) Has there been a significant level of lack of cooperation from the non-EU AIFMs?
f) Does the non-EU NCA recognise the role played by each EU NCA (as part of the network of EU securities supervisors) and is the non-EU NCA open to bilateral relationships with each EU NCA?

2. In the absence of evidence in relation to the working of existing MoU, does previous supervisory engagement provide support for the expectation of good supervisory cooperation, or not?

Assessment in the case of Japan

321. Although information regarding the cooperation between NCAs and the Japanese Authorities (The Japanese Financial Service Agency – JP FSA) in the field of AIFMD is limited, based on the feedback received from NCAs, ESMA is of the view that the experiences of cooperation with the Japanese Authorities are, in general terms, positive. Previous supervisory engagements provide support for the expectation of good supervisory cooperation.

322. Second, in relation to Art 67(4), the following criteria should be used to assess the situation of other non-EU countries in relation to the potential extension of the AIFMD passport to those non-EU countries.

1) Investor protection:

- Examples of information that may be relevant under this heading include:

i) Is there evidence that some investor complaints are not being adequately tackled by the non-EU NCA?

ii) What rules or mitigants does the non-EU countries have in relation to (a) the safeguarding of assets, (b) the function of the depositary and management of conflicts of interest between the AIFM and the depository, (c) the prudential soundness of the AIFM, (d) the timeliness and accuracy of disclosures to investors, (e) the alignment of incentives between the AIFM and investors? Insofar as these rules or mitigants exist in the non-EU countries, to what extent do these rules or mitigants measure up to those in AIFMD?

iii) How does the regulatory regime in the third country measure up against the relevant IOSCO principles, in particular its level of regulatory and supervisory engagement as assessed against principles 10 to 12[86] (including whether the regime is assessed as being at least 'broadly implemented' under each of these principles)?

iv) What is the scope of the non-EU authority's regulatory oversight with respect to the range of intermediaries and vehicles operating in the relevant country?

Assessment in the case of Japan

323. As regards depositaries, ESMA is of the view that overall, the rules in Japan broadly pursue the same objectives as the rules in the EU under the AIFMD, but there are some differences regarding notably the oversight function of the depositary and scope of activities that can be delegated by depositaries.

324. Overall, while under the AIFMD, the manager of an AIF appoints a depositary which carries out several functions including monitoring cash flows, oversight, holding assets and safeguarding against breach of certain applicable national laws, in Japan the depositary (the custodian or 'asset custody company' as it is indicated in the Japanese regulatory framework) does not carry out the oversight function.

325. Similar oversight functions are in fact in Japan performed by a trust company, etc. (a trust company or a financial institution which runs trust business) as below:

(a) A trust company, which is a trustee for an investment trust or an asset custody company for a registered investment corporation, shall execute its business with due loyalty and the due care of a prudent manager[87]. Under these duties, a trust company, etc. has to appropriately deal with any activities against regulations with regard to the sale, issue, re-purchase, redemption and cancellation of beneficiary

[86]And the following IOSCO principles: 4, 13, 14, 15, 24, 25, 26, 27, 28 and 32.
[87] Trust Business Act (TBA) Article 28(1) & (2), Act on Engagement in Trust Business Activities by Financial Institutions (AETBAFI) Article 2 which describes the application mutatis mutandis of TBA article 28(1)&(2) and Act on Investment Trusts and Investment Corporations (AITIC) Article 209)

certificates of investment trust or shares of investment corporation of the fund if they recognize those activities.

Furthermore, a trust company, etc. is prohibited from executing a problematic transaction such as one which will cause losses of trusted assets due to unusual trade terms or one which is against the purpose of the trust[88].

(b) A trust company shall also prepare a report on the status of trust property. Under this obligation, a trust company, etc., in practice, calculates daily NAVs separately and reconciles the results with those calculated by the asset manager.

(c) As described in (a) above, a trust company, etc. has faithfully to carry out the instructions of the asset manager, which is part of the due loyalty stipulated in the regulations unless such instructions are against laws.

(d) There are no rules related to the oversight function to specifically ensure delivery consideration'. However, as described in (a) above, a trust company, etc. shall execute its business with due loyalty and the due care of a prudent manager, and therefore they are obliged to execute its business so that any issues related to the relevant regulations and the contract will not occur.

(e) There are no rules related to the oversight function to specifically ensure profit distribution'. However, as described in (a) above, a trust company, etc. shall execute its business with due loyalty and the due care of a prudent manager, and therefore they are obliged to execute its business so that any issues related to the relevant regulations and the contract will not occur.

326. With respect to the scope of activities that can be delegated by Japanese depositaries (or the corresponding body in Japan), there seems to be no specific constraints.

327. However, for a trust company, the party to whom the activity has been delegated shall execute its business with due loyalty and the due care of a prudent manager under the relevant laws as a trust company, etc. shall do[89]. And with respect to the delegation of safekeeping and safeguarding activities the financial instruments business operator has to make the delegated entity clearly separate the account of the securities from their own assets and able to distinguish the securities by clients anytime.

328. Apart from this difference, various requirements apply to the custodians and and trust companies. These include:

i. Limited scope of entities eligible for the function of custodian;

[88] TBA Article 29, AETBAFI Article 2 which describes the application mutatis mutandis of TBA article 29

[89] TBA Article 22(2), Article 28(1)&(2), AETBAFI Article 2 which describes the application mutatis mutandis of TBA article 28(1)&(2): The original contract clearly explains that certain activities can be delegated by the trust company, etc., and whom such activities are delegated to and The party to whom the activity has been delegated should be skilful to perform the delegated activities in a proper manner

ii. Rules on the management of conflicts of interest between the asset manager and the depositary;

iii. Rules on the safeguarding and segregation of assets;

iv. Clear liability regime of the depositary;

329. As regards the alignment of incentives between the AIFM and investors, similar remuneration rules as set out in the AIFMD do not seem to be currently applied in Japan. AIFMD rules on remuneration are therefore significantly different from what is being applied in Japan.

330. For Investment trusts, investment corporations, specific purpose companies, and specific purpose trusts, there are no detailed legislation governing remuneration policies of asset managers in Japan.

331. However, if an asset manager is a subsidiary of a major bank, a major insurance company, or a major securities house in Japan, JP FSA's supervisory guidelines require such an asset manager to comply with international standards of remuneration including disclosure requirements and appropriate control system. These international standards are:
a) "FSF Principles for Sound Compensation Practices," Financial Stability Forum (April 2009)
b) "FSB Principles for Sound Compensation Practices. Implementation Standards," Financial Stability Board (September 2009).

332. Under the requirements of the AIFMD, because the Member State of reference has to authorize the non-EU AIFM wishing to market AIFs in the EU, and that the non-EU AIFM has to comply with the AIFMD requirements, including rules on the alignment of incentives between the AIFM and investors, the remuneration rules as it stands in Japan would not be accepted for AIFMs and AIFs that intend to use the EU-passport.

333. With respect to question 1) iii) ESMA notes that according to the August 2012 IMF financial sector detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Japan[90], Japan was assessed as "Fully Implemented" with respect to most principles referred to (principles 4, 10, 13, 14, 15, 26, 27, 28), "Broadly Implemented" with respect to four other principles referred to (principles 11, 24, 25, 32) and "Partly implemented" with respect to principle 12.

334. According to the 2012 IMF financial sector assessment program (FSAP) detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Japan, principles 10 and 11, which notably relate to the effectiveness of enforcement in Japan, are therefore fully or broadly implemented.

335. However, because the abovementioned IMF FSAP dates back to August 2012, with respect to the assessment of the effectiveness of enforcement in Japan, as mentioned

[90] https://www.imf.org/external/pubs/ft/scr/2012/cr12230.pdf

in paragraph 23 and subject to the limitations outlined in that paragraph, ESMA invited the JP FSA to carry out a self-assessment based on the IOSCO principles 10 to 12, updatding their answers to the questions included in the *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation*[91][92].

336. The results of this self-assessment carried out by the JP FSA between February and May 2016 show that the legal framework in place in Japan allowed the JP FSA to answer positively to all questions asked by ESMA included in the updated *Methodology for assessing implementation of the IOSCO objectives and principles of securities regulation* and related to IOSCO principles 10 to 12. The corresponding legal framework in place in Japan in relation to enforcement seems comprehensive and able to meet the requirements of the IOSCO methodology.

337. Although the JP FSA provided ESMA with a significant amount of information on the actual implementation of this framework on enforcement, including statistics on the activity and its output in terms of enforcement actions which have been taken vis a vis firms, notably because ESMA was not able in the requested timeframe to conduct on-site interviews and visits at the JP FSA, ESMA is not in a position to give a more thoroughfull assessment of IOSCO principles 10 to 12 in the case of Japan.

338. However, in addition to the abovementioned 2012 IMF assessement of principles 10 to 12 and to the fact that the legal framework in place in Japan allowed the JP FSA to answer positively to all questions included in the updated IOSCO *Methodology* related to principles 10 to 12, ESMA notes that the amount of activity and related output in terms of enforcement actions which have been taken vis a vis firms in Japan has remain relatively stable from 2011 to 2014.

339. As regards principle 12, which was “partially implemented” in the abovementioned 2012 IMF FSAP report, the JP FSA indicated they understood the issues pointed out in the IMF assessment were notably[93], (1) the JP FSA should consider implementing a comprehensive framework to determine the risks posted by individual firms because they had too much relied on expert judgement to decide which firms should be inspected on-site, and (2) they should review and expand the coverage of the inspection programfor smaller firms because it had not been sufficient due to the lack of horizontal reviews, random inspections, and inspections at the time of registration.

340. Regarding the first point (1), the JP FSA indicated that together with the Japanese SESC (Securities and Exchange Surveillance Commission) they have been working on integration of on-site inspection and off-site monitoring. Under this initiative, they have been establishing a framework that allows them to select asset managers which have higher risks and should be inspectedby monitoring which focuses on the items such as business model and profitability. In addition, they have strengthened the

[91] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf
[92] The IOSCO methodology for assessing implementation of the IOSCO objectives and principles of securities regulation was revised in August 2013.
[93] P22 of the abovementioned IMF report

mechanism under which monitoring information about individual firms is collected and analysed in an integrated manner. The JP FSA indicated that such monitoring information has been utilized for risk-based approach more effectively and enabled them to perform efficient and effective on-site inspections.

341. Regarding the second point (2), the JP FSA indicated that they have started inspections of registered information, where the SESC will check the setup status in terms of whether they have established a businessmanagement system as reported in the application for registration as early as possible aftertheir registration.

342. With regard more specifically to asset managers, the JP FSA indicated that while strengthening their inspection organization and ressources, the SESC has performed a horizontal review on a number of asset managers based from 2012 to 2015 on the following elements:

- Whether or not the asset manager performs approaches, solicitations and explanationsin an appropriate manner in the process of concluding investment contracts;

- Whether or not the asset manager makes investment decisions and instructions in anappropriate manner on the basis of a sufficient survey of assets under management at thecommencement of investment management under aninvestment contract;

- Whether or not the asset managerappropriately monitors the state of investment assetsunder the investment contract and reports the state properly to each customer.

343. Apart from asset managers, with regard to the expansion of inspection coverage for smaller firms, which were assessed as insufficient by the IMF, the JP FSA indicated that they have set a dedicated action plan in “The Securities Inspection Policy and the Program for 2013”. As a result, the related number of inspections was very significantly increased.

344. On a separate topic, ESMA notes that while most asset managers that engage in business in Japan need to exchange and seek authorizations vis a vis the JP FSA, for investment funds that engage in certain types of activities (commodities, real estate), there might be additional approvals to be obtained from the Japanese Ministry of Agriculture, Forestry and Fisheries (MAFF) and the Japanese Ministry of Economy, Trade and Industry (MLIT). In that case, the JP indicated that consultation takes place between the JP FSA and MLIT or between the JP FSA and MAFF[94] in order to ensure smooth procedure.

2) Market disruption:

- Examples of questions that may be applied under this heading include:

[94] as stipulated in AITIC Article 224-2 and OrderAITIC Article 132

(a) To what extent would the granting of the passport to the non-EU AIFMs and AIFs unduly undermine the activity of existing EU AIFMs due to differences in the regulatory environment in the non-EU country and allow them to change their operating arrangements so as to circumvent the AIFMD?

(b) Is there evidence that the granting of the passport to non-EU AIFMs would reduce or improve investor choice (in the short-run or the long-run)?

Assessment in the case of Japan

345. ESMA is of the view that the granting of the passport to non-EU AIFMs might result in more Japanese AIFs on the EU market. It is however difficult to predict this as well as the impact on investor choice from the increased number of funds made available on the EU market in the long term.

346. The JP FSA indicated that almost all the AIFs placed from Japan to the EU are so-called J-REITs (Real Estate Investment Trust). As J-REITs are freely traded on the exchange, it is not easy to identify what amount of J-REITs is held by investors in the EU. The estimated amount[95] would be a total amount of JPY 1.5 trillion (or EUR 12 billion where EUR 1 = JPY 127).

347. Please see the following assessment of questions related to the "obstacles to competition" criteria.

3) Obstacles to competition:

- Examples of questions that may be applied under this heading include:

(a) Is the process operated by the non-EU NCA to (a) authorise EU AIFMs or (b) allow marketing of EU AIFs in the non-EU country reasonable (in terms of clarity, predictability, cost and regulatory expectation)? Is there a level playing field between EU and non-EU AIFMs as regards market access, particularly in view of the procedures that would apply to non-EU AIFMs under Article 37 in the event that the passport is extended?

(b) Are EU AIFMs and EU AIFs treated in the same way as managers and collective investment undertakings of the non-EU country in terms of regulatory engagement (including regulatory fees and documentation to be provided prior to the authorisation)?

Assessment in the case of Japan

348. In Japan, a foreign investment management company has to register as a financial instrument business operator if it provides invest management services to Japanese

[95] ∑{(Market Cap of a J-REIT)× (% of the J-REIT shares held by non-Japanese investors) × (Share of the European investors among non-Japanese investors for the overall stock trading volume on the TSE)}

investors. However, it can provide invest management services without such registration if it provides such services only to investment management companies.

349. This exemption rule does not apply to Japanese investment management companies.

350. In cases where Dealings in a Public Offering of Beneficiary Certificates of a foreign investment trust or Investment Securities issued by a Foreign Investment Corporation are to be carried out, issuers of Beneficiary Certificates of a Foreign Investment Trust or Investment Securities of a Foreign Investment Corporation shall notify the JP FSA of certain other specific required matters.

351. In cases where an issuer of beneficiary certificate of a foreign investment trust or a foreign investment corporation makes the notification for dealings in public offerings, it shall also appoint a person who has an address in Japan and who has the authority to represent it for any acts concerning the notification.[96] In practice a legal firm will be appointed in Japan

352. Overall, ESMA is of the view that there are no identified significant competition issues with respect to the market access conditions of EU funds in Japan as compared to the market access conditions of Japanese funds in the EU, if Japan were to be granted the AIFMD passport.

4) Monitoring of systemic risk:

Examples of questions that may be applied under this heading include:

a) Does there exist tangible evidence of adequate surveillance of market development with a view to tracking potential (or actual) systemic risks[97] by the NCA in the non-EU country?

b) How does the regulatory regime in the non-EU country measure up against the IOSCO principle 6?

Assessment in the case of Japan

353. The regulatory regime of Japan was assessed as “Broadly Implemented” in the 2012 IMF financial sector detailed assessment of implementation on IOSCO objectives and principles of securities regulation on Japan, with respect to principle 6. The responses of JP FSA to ESMA’s questions are in line with this assessment.

[96] OrdinanceAITIC Article 95, 260
[97] Where the definition of 'systemic risk' is not simply confined to the local jurisdiction but also has regard for spillover effects of the AIFMs or AIFs operating outside of the borders of the local jurisdiction.

General advice on the potential extension of the passport to Japan

Having regard to the above assessment, ESMA is of the view that there are no significant obstacles regarding market disruption, obstacles to competition, and the monitoring of systemic risk impeding the application of the AIFMD passport to Japan

With respect to investor protection, ESMA is of the view that there are differences between the Japanese regulatory framework and the AIFMD.

However, given the general requirements mentioned above in paragraph 19 applicable to all non-EU AIFM whishing to make use of the AIFMD passport, these differences are not seen as a significant obstacle impeding the application of the AIFMD passport to Japan.

2.15 Other non-EU countries

354. In addition to the non-EU jurisdictions on which a detailed assessment was carried out and to the non-EU jurisdictions identified in section 2.2, ESMA gathered intelligence (particularly from the responses to the call for evidence) on investor protection, competition, potential market disruption and monitoring of systemic risk with respect to the following non-EU countries:

    a. Malaysia

    b. Egypt

    c. Chile

    d. Peru

    e. India

    f. China

    g. Taiwan

355. Although some of these countries have been viewed by market participants as countries where the access to the market for EU UCITS and AIFs is less difficult than in the rest of the world, they have not been assessed in detail by ESMA at this stage because:

    a. no MoU has been agreed between these non-EU supervisory authorities and ESMA (acting on behalf of the national authorities within the EU); or

    b. the current level of activity by entities from these countries within the EU (i.e. the marketing of AIFs from these countries in the EU by EU AIFMs and/or the management/marketing of AIFs in the EU by AIFMs from these countries) did not justify a detailed assessment at this stage (please refer to section 2.2).

356. Regarding the first aspect noted above, ESMA will continue its efforts to agree an MoU with the authorities of the relevant jurisdictions. Regarding the second aspect, ESMA will monitor the evolution of the level of activity in order to determine whether a particular jurisdiction should be assessed in detail.