

CUMMINGS PEPPERDINE ON REVERSE SOLICITATION AND THE AIFMD

The Alternative Investment Fund Managers Directive ("AIFMD") is a European Union ("EU") legislative measure which, in brief, intends to regulate: (i) managers of Alternative Investment Funds ("AIFs"); and (ii) how AIFs are marketed/distributed to professional investors throughout the European Economic Area ("EEA").

Where the AIF has a no-EU investment manager ("AIFM") the AIFM will need to go through a local notification or registration process in respect of each AIF it markets in each jurisdiction.

However, a professional investor established in the EEA may invest in AIFs on its own initiative, irrespective of where the AIFM or the AIF is established. It is this combination - professional investor and own initiative - which are critical to the possibility of using reverse solicitation.

That said, we raise a very important warning here. The AIFMD explicitly states that reverse solicitation MAY NOT be used and will not be valid if used for the purpose of circumventing the AIFMD. This requires you to think very carefully, and be honest about, your reasons for considering the use of reverse solicitation.

The regulators have been very clear about the penalties that may be imposed on any firm which breaches the rules on reverse solicitation. The provision of investment services without proper authorisation in accordance with national

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law exposes service providers to the risk of administrative or criminal proceedings and the application of relevant sanctions.

In the UK, where an AIFM unlawfully markets an AIF, such unlawful marketing qualifies as a criminal offence with possible fines and imprisonment. In addition, AIFMs should be aware that non-compliance with the AIFMD marketing regime raises not only the risk of regulatory enforcement by member state regulators, but also the risk of private law actions from disgruntled investors who may seek to recover their investment in a fund by claiming that the AIFM engaged in unlawful marketing.

It is also important to pay heed to the UK's Financial Services and Markets Act 2000 ("FSMA"). This contains provision for directors/partners to be guilty of an offence under FSMA and liable to be proceeded against and punished if they have consented or connived in an offence, or even been negligent.

Looking in more detail at the two crucial points which must be met if reverse solicitation were to be considered:

A professional investor - this is anyone falling within the definition of Professional Client under MiFID and generally covers most types of institutional investor (but this needs to be checked each time)

The 'own initiative test' - this means that as long as the initial initiative to invest and, as part of that process, each initiative to make a request for information or documentation was taken by the investor rather than the AIFM (or someone acting on behalf of the AIFM), the AIFM can accept the investment or, as part of that process, the request for information or documentation from the investor.

For example, where the relevant investor has contacted the AIFM or someone acting on behalf of the AIFM and requested information about the AIF without first having been approached by the AIFM or by someone acting

on behalf of the AIFM, the AIFM is able to provide the requested information, which may subsequently lead to an investment.

This has got to be real. It cannot be a construct. And nor can it be used to circumvent the AIFMD.

There is no common definition of the "own initiative test" or what is meant by the 'own initiative test' or 'reverse enquiry'. It is different across each EEA member state. However, there are some areas of common ground and, as a general rule, the more specific the investor's request is as to the AIF and the documents or information the more likely it is that a AIFM (or someone acting on behalf of the AIFM) can accept the request.

Practically, an AIFM should only accept reverse solicitation where at least the following has occurred, and at all times considering the definition of professional advisor and the AIFMD circumvention issue.

The potential investor itself and without any initiative from the AIFM or anyone acting on its behalf, should:

Make a written request – i.e. contact the AIFM in writing;

Set out in that request very precise information on the AIFs in which it is interested. This should include the name of each AIF at the very least and set out the information or documentation it wants to receive.

In respect of the AIFM, the documentation to be requested may include:

- due diligence questionnaire;
- risk reports;
- investor presentation, including information about the various investment strategies that the manager pursues;
- summary details of the AIFs that pursue those strategies (names, jurisdictions, fees/liquidity terms); and

- past and, on an on-going basis, any future investor newsletters and/or fund fact sheets prepared by the manager that relate to the AIF.

In respect of the AIF, the documentation to be requested may include:

- offering memorandum or prospectus;
- subscription agreement or application form; and
- annual and any interim accounts prepared by the AIF

The potential investor should expressly state the following in its note:

- that it is a professional investor;
- that it alone is initiating contact with the manager; and
- that its contact with the manager has not been requested or solicited in any way by the manager or any person acting on the manager's behalf.

An example of wording may be:

"We confirm that we are a professional investor and that by sending this [letter]/[email] we are initiating contact with the Manager." and then adding precise information about the relevant AIF including the name.

IMPORTANT NOTE: each jurisdiction in the EEA may interpret the scope of "reverse enquiry" and "marketing" differently (as those concepts are not clearly defined within the AIFMD). Additionally, investors from certain jurisdictions may find that some managers may have specific requirements that they require the investor to satisfy before they are prepared to provide information to them.

THE TEAM

Cummings Pepperdine is a leading advisor in crypto. We are one of a select few that advises a large and diverse global client base in the crypto space and the only to provide a complete crypto solution building on the three key areas of law, tax and FCA with legal underpinning at every point.

In law, we have a team of qualified and regulated solicitors and a barrister who retains right of audience.

In tax, we have one of the only crypto tax advisors who is both a qualified solicitor and qualified chartered accountant.

In regulation, our team comprises specialists in crypto compliance monitoring structures and governance oversight who are known to the FCA for the quality of their work.

The team is led by Claire Cummings, a leading solicitor specialising in crypto law and the current and evolving regulation. Claire is on the advisory boards of a crypto exchange and an NFT gaming guild and is also a member of the Global Digital Finance working group on



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stablecoins. Claire has also acted as compliance officer, MLRO and director of an FCA regulated fund manager and qualified under SIB to trade derivatives. As a leading expert in crypto, Claire is a sought after speaker and has published multiple articles on the legal and regulatory issues surrounding cryptocurrencies and the crypto eco-system. Claire is named at the Top 10 influencer in London for hedge funds (2&20, 2022) and is included in the CityWealth Crypto Top 100

The Cummings Pepperdine Online Training Programme, includes sections focussing on reverse solicitation and the AIFMD, has been designed by a specialist board of compliance consultants, solicitors, chartered accountants, tax advisors and regulatory consultants. We believe that we are the only firm which offers training created by this range of qualified advisors.

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