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Interpreting Vague Provisions of the Alternative Investment Fund Managers Directive Through a Systemic Cost-Benefit Analysis

Zeshawn Qadir*

Abstract

The Alternative Investment Fund Managers Directive (Directive) is a European Union (EU) directive issued in response to recent economic crises with the goal of reducing systemic economic risk and protecting EU investors, primarily through enhanced corporate governance requirements, leverage limits, liquidity requirements, transparency measures, and disclosure requirements. The Directive regulates alternative investment fund managers and creates two harmonized regulatory regimes called “passport systems,” one for use by EU fund managers, and one for use by third-country fund managers. The passport system for EU fund managers is already in effect, but the European Commission has not yet implemented the passport system regulating third-country fund managers.

The third-country passport system is a novelty in EU law and invokes unique policy issues. For example, both EU and third-country regulatory authorities face the challenge of supervising and enforcing compliance by third-country fund managers with the Directive. They also must determine how to address regulatory arbitrage that results from discrepancies in the legal frameworks of different jurisdictions. Furthermore, the Directive contains numerous vague provisions that are relevant to the implementation of the third-country passport regime; and the ways in which these provisions are interpreted will have significant consequences for stakeholders.

This Comment constructs and applies a systemic cost-benefit analysis framework and assesses the merits of potential interpretations of the Directive’s provisions. The framework incorporates the Directive’s policy objectives, applicable regulations, and related EU financial law, as well as the private and social costs imposed by each interpretation. This Comment illustrates this framework’s utility by applying it to two vague provisions of the Directive that are significant in light of the pending expansion of the passport system to cover third-country funds and fund managers. In the course of analyzing these two provisions, this Comment raises

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important considerations that are relevant in evaluating interpretations of numerous other provisions of the Directive. Finally, this Comment suggests which interpretation is preferred for the two provisions examined and discusses important empirical assumptions and questions, highlighting relevant facts that may favor a different interpretation.

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I. INTRODUCTION

The Alternative Investment Fund Managers Directive (AIFMD or the Directive) is a European Union (EU) law that addresses the high level of economic instability and systemic risk revealed by recent financial crises.¹ The European Commission (the Commission) promulgated this law in 2010 to address the inadequate protection for investors and to manage and minimize the systemic risk created by hedge funds and other relatively risky investment vehicles.² The Directive labels these funds as “alternative investment funds” (funds) and refers to their managers as “alternative investment fund managers” (fund managers).³

The Directive’s primary policy objectives are (1) risk management and (2) the creation of a unified, or “harmonized,” regulatory framework that allows fund managers to market and manage funds across EU countries (Member States) if they meet the Directive’s requirements.⁴ The first policy goal of “risk management” includes addressing both systemic market risks and providing greater protection to EU investors.⁵ The second policy goal concerning the creation of a “harmonized [p]an-European regulatory framework” is intended to increase transparency in the alternative investment funds market by applying uniform rules to the conduct of fund managers active in the EU, and to protect EU fund managers that comply with the Directive from competitors in third-countries that have weaker regulations.⁶

The Directive creates this harmonized regulatory framework through a “passport” regime that allows fund managers that comply with the Directive’s provisions to provide services throughout the EU “on the basis of a single

¹ Gianna Sagan, *Alternative Investment Fund Managers Directive Impact on Non-EU Managers*, 34 REV. BANKING & FIN. L. 506, 506 (2014).

² Alexandros Seretakis, *Taming the Locusts?, Embattled Hedge Funds in the E.U.*, 10 N.Y.U. J.L. & BUS. 115, 137 (2013) (noting that the target of the EU regulators was mainly hedge funds, but the Directive also applies to private equity funds, real estate funds, and commodity capital funds).

³ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, 2011 O.J. (L 174) 1 (AIFMD), recitals 2-4 [hereinafter AIFMD].

⁴ Dirk A. Zetsche, *Introduction*, to THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE, 1, 10-11 (Dirk Zetsche ed. 2d ed., 2015). The Directive covers all European Economic Area (EEA) member states, which includes all EU countries as well as Iceland, Norway, and Liechtenstein. However, for ease of reference and to maintain consistency with the Directive’s language, I will use the term “EU.” *Id.* at 20.

⁵ *Id.* at 10.

⁶ *See id.* at 11. *See also* AIFMD, *supra* note 3, at recital 4.

authori[z]ation.”⁷ In particular, once a fund manager is authorized in one Member State, the fund manager will be able to market funds to professional investors in all Member States.⁸ Currently, the passport system is available only to EU fund managers managing and marketing EU funds.⁹ However, in accordance with the Directive, the Commission will expand it by enacting a legislative act that creates a corresponding passport regime (third-country passport) applicable to third-country fund managers and to EU fund managers that manage third-country funds.¹⁰ Only the EU passport is currently in effect; the third-country passport system has not yet been implemented.¹¹

A pan-European passport regime for third-countries is a novelty in EU law.¹² The legislation that implements this new passport regime ideally will address the important policy considerations that it raises. A primary concern is a lack of coherence between the two passport systems, which may lead to “regulatory arbitrage.” In the context of this Comment, “regulatory arbitrage” refers to situations in which fund managers choose whether to register their funds in a Member State or a third-country based on which regulatory regime imposes lower costs or burdens relative to its benefits.¹³ A second major concern is whether the third-country passport regime will afford EU investors the same level of protection as the EU passport.¹⁴

⁷ Directive on Alternative Investment Fund Managers (“AIFMD”): Frequently Asked Questions (EC Memo/10/572, 3 (Nov. 11, 2010).

⁸ *Id.*

⁹ AIFMD, *supra* note 3, at recital 4.

¹⁰ *Id.* (stating that a harmonized passport regime will become applicable to non-EU fund managers and EU fund managers managing non-EU funds after the Commission delegates an act that so provides). I will use the phrases “third-country” and “non-EU” interchangeably to refer to fund managers and funds based outside of the EU.

¹¹ 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, at 5 (July 30, 2015), available at http://www.esma.europa.eu/system/files/2015-1236_advice_to_ep-council-com_on_aifmd_passport.pdf [hereinafter ESMA’s Advice].

¹² William Yonge, *AIFMD: Renewed Focus on Its Impact on Non-EU Managers of Private Funds*, MORGAN LEWIS PUBLICATIONS, July 22, 2014, https://www.morganlewis.com/pubs/pif_aifmdrenewedfocusimpactonnoneuprivatefundmanagers_22july14.

¹³ See Hossein Nabilou & Alessio M. Paces, *The Hedge Fund Regulation Dilemma: Direct vs. Indirect Regulation*, 6 WM. & MARY BUS. L. REV. 183, 194 (2015) (“The degree to which a firm engages in regulatory arbitrage . . . is a function of the private costs and benefits of regulation and the existence of alternative regulatory regimes available to the firm. Assuming two alternative regulatory regimes and zero switching costs, a firm facing marginal costs of a regulatory regime ‘A’ that exceed its marginal benefits will tend to locate its business in jurisdiction ‘B’ where the marginal benefits of regulation exceed its marginal costs”). See also AIFMD, *supra* note 3, at art. 4(1)(j) (defining where fund managers and funds are “established” on the basis of the location of their registered office).

¹⁴ Zetzsche, *supra* note 4, at 1, 10.

The ability of the Directive to serve its policy objectives in a practical and effective manner depends on how the Commission or a given country's regulators interpret its provisions, and how consistently these provisions are enforced across jurisdictions. Although the Commission has promulgated several regulations that have clarified and supplemented portions of the Directive, these regulations have not adequately addressed some important but vaguely worded articles.¹⁵ While the Commission should by no means address every ambiguity in the Directive, it should more clearly define the scope and implications of those provisions that have a significant impact on key stakeholders and that have been interpreted in contradictory ways by various jurisdictions. In doing so, the Commission will promote consistent application of the Directive and reduce legal uncertainty for fund managers. This uncertainty increases the liability risks and costs for many fund managers, as well as their counterparties and investors.¹⁶

Unfortunately, there is scant literature analyzing alternative interpretations of the Directive's vague provisions that might help the Commission interpret them so as to promote the Directive's policy objectives, while minimizing private and social costs. "Private costs" include costs to individual economic agents like firms, fund managers, investors, or other financial market participants that result from an event, action, or policy change.¹⁷ In contrast, "social costs" refers to the costs to society as a whole from an event, action, or policy change and includes negative externalities and private costs that are not simply transfers to others.¹⁸

This Comment aims to help fill this analytical gap by providing a cost-benefit analysis framework that can be used to analyze vague rules in the Directive, and applies it to two provisions that are particularly important in light of the passport system's expansion. The interpretation of these provisions will significantly affect whether the Directive meets its policy objectives, and also will affect the costs to relevant stakeholders.¹⁹

Section II of this Comment discusses the Directive's scope, provides an overview of its legislative framework, and reviews its substantive requirements. Section III considers the regulatory burdens third-country fund managers face and discusses the "national private placement regimes" that are the only present means of authorization under the Directive for third-country fund managers. Finally,

¹⁵ Dirk A. Zetzsche & Thomas Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept*, in *THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE*, *supra* note 4, at 431, 473-474.

¹⁶ Sagan, *supra* note 1, at 515; Zetzsche, *supra* note 4, at 1, 10.

¹⁷ *Private cost*, ALAN V. DEARDORFF, DEARDORFF'S GLOSSARY OF INTERNATIONAL ECONOMICS, <http://www-personal.umich.edu/~alandear/glossary/index.html> (last visited Apr. 10, 2016).

¹⁸ *Social cost*, ALAN V. DEARDORFF, DEARDORFF'S GLOSSARY OF INTERNATIONAL ECONOMICS, <http://www-personal.umich.edu/~alandear/glossary/index.html> (last visited April 10, 2016).

¹⁹ Zetzsche, *supra* note 4, at 1, 10.

Section IV discusses two vague Directive provisions that substantially bear on the passport regime's expansion to third-countries. It approaches two possible interpretations of each provision through a "systemic" cost-benefit analysis framework that incorporates the Directive's policy objectives, the Directive's language and associated regulations, relevant EU financial law, and private and social costs. Section IV also analyzes the interpretations for each Directive provision by identifying crucial empirical questions and indicating relevant factual information that may bear on which interpretation is preferred.

II. THE DIRECTIVE: SCOPE, CONTENT, AND ACCESS

This Section briefly discusses the Directive's scope in terms of the types of investment fund managers it applies to, the categories of funds within its purview, and the class of investors that it protects. It also explains how the Commission and the European Securities and Markets Authority (ESMA) have set forth regulations that implement the Directive's provisions. The Section further discusses some of the Directive's significant substantive requirements. Lastly, it concludes by explaining how third-country fund managers currently can only access the EU market through the "national private placement regime," but that the Directive contemplates their transition to a third-country passport system.

A. The Directive's Scope and Content

The Directive defines an alternative investment fund manager, or "AIFM," to include any "legal person[s] whose regular business is managing one or more AIFs."²⁰ An alternative investment fund, or "AIF," is defined as a "collective investment undertaking[]...which raise[s] capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors" and which does not need to be registered under the Undertakings for Collective Investment in Transferable Securities Directive (UCITS).²¹ The AIFMD includes all funds that do not fall within the scope and authority of the UCITS, "including hedge funds, private equity funds, commodity funds or real estate funds."²² The UCITS covers funds authorized to be sold to the retail market, like mutual funds, while funds under the AIFMD are considered to have risk levels unsuitable for retail investors.²³

²⁰ AIFMD, *supra* note 3, art. 4(1)(b).

²¹ *Id.* at art. 4(1)(a).

²² Anne Rivière, *The Future of Hedge Fund Regulation: A Comparative Approach*, 10 RICH. J. GLOBAL L. & BUS. 263, 279 (2011).

²³ *Id.*

The Directive's scope is limited to "professional investors."²⁴ The term "professional investor" refers to "an investor which is considered to be a professional client or may, on request, be treated as a professional client within the meaning of Annex II to Directive 2004/39/EC."²⁵ Additionally, only fund managers that engage in the "management" or "marketing" of funds within the EU fall under the ambit of the Directive.²⁶ The term "marketing" has been subject to divisive interpretations by the national authorities of Member States that are empowered by law or regulation to supervise fund managers (Competent Authorities).²⁷

The Directive grants authority to the Commission to delegate legislative acts that implement its provisions.²⁸ These legislative acts are called "Level 2" measures, and consist of the Commission Delegated Regulation No 231/2013 (Primary Directive Regulation) as the main body of implementing legislation, along with three smaller regulations.²⁹ The Directive's legal framework also includes "Level 3" measures, which consist of guidelines issued by the ESMA. These guidelines deal with the Directive's scope, reporting obligations, remuneration, and a number of other issues with regulatory implications.³⁰

With regards to its substantive content, the Directive imposes "minimum capital requirements, as well as conflicts of interest, risk and liquidity management requirements, an independent valuation of assets, threshold disclosure, and would

²⁴ However, the Directive specifically recognizes that Member States can allow marketing to retail investors and can impose stricter requirements if they choose to do so. AIFMD, *supra* note 3, art. 43(1).

²⁵ *Id.* at art. 4(1)(ag) (citing Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments Amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and Repealing Council Directive 93/22/EEC, 2004 O.J. (L 145) annex II, (defining "professional client" as a "client who possesses the experience, knowledge and expertise to make its own investment decisions and properly assesses the risks that it incurs" and including a list of institutional investors as examples)).

²⁶ *See id.* at recital 4.

²⁷ *See id.* at art. 4(1)(f) (defining "competent authorities" as "the national authorities of Member States which are empowered by law or regulation to supervise [fund managers]"). For a discussion of plausible interpretations of the term "marketing," see *infra* Section IV.A.

²⁸ *See Zetzsche, supra* note 4, at 1, 7.

²⁹ *Id.* *See also* Commission Delegated Regulation 231/2013 of 19 December 2012, Supplementing Directive 2011/61/EU of the European Parliament and of the Council with Regard to Exemptions, General Operating Conditions, Depositaries, Leverage, Transparency and Supervision, 2012 O.J. (L 83) [hereinafter Primary Directive Regulation].

³⁰ See Letter from Verena Ross, Exec. Director of European Securities and Markets Authority, to Roberto Gualtieri, Chair of the European Parliament (July 30, 2015), available at <http://www.esma.europa.eu/system/files/esma-2015-1233.pdf> (noting that ESMA's area of expertise and responsibility falls in the realm of regulatory concerns).

limit the fund's use of leverage."³¹ Additionally, Articles 19-21 impose transparency requirements that require greater disclosure and will help lower asymmetric information and increase investor confidence in funds.³² Moreover, the Directive requires significant disclosures that are expected to increase regulatory oversight of fund operations and to reduce the systemic risk associated with them.³³ Among these requirements are an annual report for each fund managed or marketed in the EU and disclosures "regarding the main markets in which the [fund manager] trades, the principal exposures, and most importantly concentrations of each fund managed."³⁴

B. The Passport System and National Private Placement Regimes

As discussed in Section I, the Directive provides for both an EU and third-country "passport" regime, which is a harmonized regulatory framework that allows fund managers to market and manage funds across the EU with a single authorization.³⁵ Nevertheless, as a directive, the AIFMD is binding, "as to the result to be achieved upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods."³⁶ Accordingly, each Member State has broad discretion in how it implements and enforces the passport system.³⁷

Currently, the passport system is available only to EU fund managers managing EU funds.³⁸ Third-country fund managers cannot market or manage funds under the EU passport system, nor can EU fund managers manage non-EU funds under it.³⁹ Fund managers unable to access the EU passport system must instead obtain access to EU investors through a country-by-country authorization regime referred to as the "national private placement regime."⁴⁰

³¹ Rivière, *supra* note 22, at 311.

³² *Id.*

³³ *Id.* (citing Charles River Assocs., *Impact of the Proposed AIFM Directive Across Europe*, 36-37 (2009), available at <http://www.crai.com/ProfessionalStaff/AuxListingDetails.aspx?id=11778&fID=34>).

³⁴ Seretakis, *supra* note 2, at 139.

³⁵ Zetzsche, *supra* note 4, at 1, 20.

³⁶ Barbara C. George & Lynn V. Dymally, The End of An Era of Limited Oversight: The Restructured Regulatory Landscape of Private Investment Funds Through the U.S. Dodd-Frank Act and the E.U. Alternative Investment Fund Managers Directive, 25 FLA. J. INT'L L. 207, 210 n.8 (2013) (citing the Treaty Establishing the European Community, Mar. 25, 1957, 298 U.N.T.S. 11, art. 189).

³⁷ See AIFMD, *supra* note 3, at recital 64.

³⁸ Zetzsche, *supra* note 4, at 1, 20.

³⁹ AIFMD, *supra* note 3, at recital 4.

⁴⁰ *Id.* at 85.

Under the national private placement regime, a fund manager based outside of the EU must separately apply for registration in each Member State in which the fund manager wishes to market or manage funds.⁴¹ Thus, unlike the passport system, the national private placement regime does not allow a fund manager to market and manage their funds across all EU Member States following a single authorization process.⁴²

In order to be authorized under the national private placement regime, third-country fund managers must comply with Chapter IV of the Directive concerning transparency requirements. These include making available an annual report, providing certain disclosures to investors, and meeting reporting obligations to Competent Authorities of Member States in which they market or manage funds.⁴³ They must also have a “cooperation agreement” in place that provides for an exchange of information between EU Member States in which they market or manage funds and their third-country regulatory authorities. Finally, third-country fund managers must not be located in a country that the Financial Action Task Force on anti-money laundering and terrorist financing has listed as a non-cooperative country or territory.⁴⁴

Under their respective country-specific national private placement regimes, Member States “may impose stricter rules on the [fund manager] than those provided for by the AIFMD for the purpose of country-by-country marketing.”⁴⁵ Consequently, fund managers face significant costs and difficulties complying with the different registration requirements in each Member State in which they market or manage funds under the national private placement regime.⁴⁶ This burden can be quite high for fund managers who intend to market or manage their funds throughout the EU, as third-country fund managers have to report to “as many as 27 different regulators.”⁴⁷

⁴¹ *AIFMD 2014 Update – Private Placements: Where Did We End Up, and Where Are We Going?*, SIDLEY UPDATES (Sept. 8, 2014), <http://www.sidley.com/news/2014-09-08-investment-funds-update> (noting that “the process and rules by which the AIFs can be marketed are entirely a matter of local Member State law and process”) [hereinafter Sidley Updates].

⁴² Sagan, *supra* note 1, at 511.

⁴³ Zetzsche & Marte, *supra* note 4, at 431, 451 (citing AIFMD arts. 22-24).

⁴⁴ *Id.* at 455.

⁴⁵ *Id.* at 451.

⁴⁶ Sagan, *supra* note 1, at 510 (indicating that “most EU states vary in their regulatory requirements in some way which makes compliance difficult, adding to the time and cost it takes for [fund managers] to participate in the EU economy.”).

⁴⁷ *Id.* at 507.

III. THE EXPANSION OF THE PASSPORT SYSTEM TO THIRD-COUNTRIES

As laid out in Article 67(1) of the Directive, in July 2015 the ESMA was to issue to the European Parliament, the Council, and the Commission an opinion on the functioning of the passport system for EU fund managers and on the functioning of the national private placement regimes set out in Articles 36 and 42. Additionally, the ESMA was required to provide advice on the application of the passport system to third-country fund managers and funds “in accordance with the rules set out in Article 35 and Articles 37 to 41 of the AIFMD.”⁴⁸

On July 30, 2015, the ESMA issued its advice in a detailed report.⁴⁹ The report sets out the ESMA’s analysis and suggestions concerning the application of the passport to six non-EU countries: Guernsey, Hong Kong, Jersey, Switzerland, Singapore, and the United States.⁵⁰ The ESMA selected these jurisdictions based on a number of factors including

the amount of activity already being carried out by entities from these countries under the [national private placement regimes], the existing knowledge and experience of EU [Competent Authorities] with respect to their counterparts in these jurisdictions and the efforts made by stakeholders from these countries to engage with the process.⁵¹

The ESMA opted for a “country-by-country assessment of the potential extension of the AIFMD passport” because this will allow for greater flexibility in its assessments and an individualized comparison of the different legal frameworks in third-countries that enforce the Directive.⁵² The ESMA will issue positive advice for a particular country’s admission to the third-country passport regime if “there are no significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk, impeding the application of the passport.”⁵³ The ESMA will continue to assess other third-countries and provide additional submissions to the European Parliament, the Council, and the Commission concerning the extension of the passport system to those countries.⁵⁴

Implementing the third-country passport will result in a “single regulatory and supervisory regime for all [fund managers] active in the EU” because all fund

⁴⁸ ESMA’s Advice, *supra* note 11, at 4.

⁴⁹ *Id.*

⁵⁰ *See generally id.*

⁵¹ *Id.* ¶ 34.

⁵² *Id.* ¶ 8.

⁵³ AIFMD, *supra* note 3, art. 67(4).

⁵⁴ ESMA’s Advice, *supra* note 11, at 4.

managers marketing or managing funds in the EU will be subject to the passport regime and the Directive's requirements.⁵⁵ If the law works as planned, this harmonized regime will "help market participants to overcome the barriers and inefficiencies created by the current patchwork of national regulation" under the national private placement regime.⁵⁶ Additionally, the expanded passport regime will ideally level the playing field for all fund managers and generate a consistently high level of transparency that will promote competition and consumer choice for EU investors.⁵⁷

IV. INTERPRETING IMPORTANT BUT VAGUE PROVISIONS OF THE AIFMD AND IMPLICATIONS FOR A THIRD-COUNTRY PASSPORT REGIME

As the ESMA continues to consider which countries to admit to the third-country passport system, both the ESMA and Commission should place greater emphasis on how important but inherently vague principles of the Directive should be interpreted, clarified, and enforced with respect to the passport regime. Otherwise, Member States will continue to apply vague provisions differently.⁵⁸ Under the passport regime, Member States authorize fund managers to market their funds to investors across the EU, supervise fund manager activities, and enforce the Directive. Accordingly, the potential for different interpretations fosters legal uncertainty for stakeholders, promotes inconsistent outcomes, and undermines the creation of a level playing field with a high level of transparency.⁵⁹

This Section will consider two vague provisions of the Directive. The first is the definition of "marketing" under Article 4(x) and the second is the "equivalence requirement" in Article 37(2). This Section will advance two interpretations for each of these provisions and perform a high-level cost-benefit analysis to assess the merits and consequences of each approach.⁶⁰

⁵⁵ Directive on Alternative Investment Fund Managers ('AIFMD'): Frequently Asked Questions, *supra* note 7, at 3.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ This is true under the national private placement regime for the reasons discussed in Section II.B, *supra*. This is also true under the passport regime because although only one Member State will need to authorize a fund manager to market a fund throughout the EU, Member States that provide such authorizations can still interpret and enforce the Directive differently if vague provisions are not clarified or interpreted by means of binding regulations. *See* George & Dymally, *supra* note 36, at 260.

⁵⁹ *See* Directive on Alternative Investment Fund Managers ('AIFMD'): Frequently Asked Questions, *supra* note 7, at 3.

⁶⁰ For both of the provisions examined, the discussion of benefits and costs has some overlap because the proposed interpretations for each are approximately opposites.

The term “marketing” is used throughout the Directive and defines the boundaries of the law’s application. In particular, if a third-country fund manager engages in “marketing” within the EU or directed at EU investors, it becomes subject to the Directive.⁶¹ As a result, clearly defining “marketing” is crucial since it will determine whether third-country fund managers must comply with the Directive’s strict regulatory framework. In contrast, the “equivalence requirement” under Article 37(2) exempts fund managers from compliance with a particular rule of the Directive if they are subject to a conflicting third-country rule and certain conditions are met.⁶² Importantly, the equivalence requirement’s scope will affect how often third-country fund managers can circumvent the Directive’s requirements.⁶³

In evaluating the proposed interpretations of marketing and the equivalence requirement, this Comment will focus on a set of factors based on the “Systemic Approach.”⁶⁴ This standard is articulated and applied in the second edition of “The Alternative Investment Fund Managers Directive,” which is one of the most comprehensive recent works covering the Directive.⁶⁵ The Systemic Approach considers the general purpose and goals of the Directive, as well as the relevance of other directives and general principles of EU law.⁶⁶ It is a useful framework because it promotes consistency with legislative intent and the Directive’s policy goals, while considering its context within a larger EU financial law regime that includes analogous provisions and principles.⁶⁷

As discussed in Section I, the Directive’s two primary policy goals are (1) risk management, which includes addressing systemic economic risk and protecting EU investors, and (2) the creation of a harmonized passport regime.

⁶¹ See AIFMD, *supra* note 3, at recital 13 (noting that the Directive is applicable to all EU fund managers that manage [funds] and all third-country fund managers that *market* [funds] in the EU) (emphasis added).

⁶² *Id.* at art. 37(2). See also Zetzsche & Marte, *supra* note 4, at 431, 471 (referring to this as the “equivalence requirement”).

⁶³ See *infra* Section IV.B.

⁶⁴ Zetzsche & Marte, *supra* note 15, at 431, 477.

⁶⁵ Dirk A. Zetzsche, *Preface to the First Edition*, of THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE, *supra* note 4, at 1xv, 1xv (discussing the extensive and thorough analysis of the Directive accomplished by the text). See also Zetzsche & Marte, *supra* note 4, at 431, 477 (explaining the basis for the “Systemic Approach”). This text was edited by Dirk A. Zetzsche, a professor of law at the University of Liechtenstein that has done advisory work for the European Commission, European Parliament, and ESMA. *List of Contributors*, in THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE, *supra* note 15, at v, v.

⁶⁶ Zetzsche, *supra* note 4, at 1xv, 1xv.

⁶⁷ See *id.* (observing that an isolated approach that doesn’t consider other directives or general principles of EU law risks “making a number of the AIFMD’s provisions lose their purpose and undermine the goals pursued by the regulation of the [fund managers]”).

Determining the effects of different Directive interpretations on systemic economic risk would require a fact-dependent and sophisticated analysis that is better left to EU agencies with the resources and access to relevant data, like the ESMA. Accordingly, this Comment will focus on how effectively the interpretations protect EU investors and promote a harmonized passport regime that equally applies the law to EU and third-country fund managers.⁶⁸

Moreover, this Comment will assess the proposed interpretations based on how coherent they are with the Directive's plain language and how well they incorporate principles from associated regulations. Like the Systemic Approach, the analysis of the interpretations for each vague provision will also take into account their consistency with relevant directives and other EU financial law. However, this Comment incorporates one additional aspect that was not included in the Systemic Approach, namely, the creation of private and social costs. These costs will vary for different interpretations and will affect the incentives of fund managers, the risks and expenses that investors and other stakeholders are subject to, and the broader economic consequences of the Directive's enforcement.

Consequently, the cost-benefit analysis of the marketing and equivalence requirement provisions will emphasize five factors: (1) protection of EU investors; (2) promotion of a harmonized regime that equally applies the law to EU and third-country fund managers; (3) consistency with the Directive's language and with associated regulations; (4) relation to relevant EU financial law; and (5) creation of private and social costs. Because this model is based on the Systemic Approach, it will be referred to as a "systemic" cost-benefit analysis framework.

The cost-benefit analysis for each vague provision discussed aims to reveal the better interpretation. However, given that the empirical data regarding the functioning of the EU passport system and the national private placement regimes is incomplete, this Comment will discuss key empirical questions and also identify relevant facts and data that may affect whether the apparently better interpretation is indeed the preferred approach.

A. Marketing

In the context of the Directive, "marketing" is a "direct or indirect offering or placement," made by or on behalf of a fund manager, of units or shares of a fund that it manages to investors in the EU.⁶⁹ A fund manager engaging in marketing is subject to the Directive's stringent regulatory requirements, as well

⁶⁸ Equal application of the Directive to EU and third-country fund managers is a central goal of the harmonized passport regime, which is intended to provide a "level playing field" for all fund managers active in the EU. Directive on Alternative Investment Fund Managers ("AIFMD"): Frequently Asked Questions, *supra* note 7, at 2–3.

⁶⁹ AIFMD, *supra* note 3, art. 4(x). A "direct or indirect offer or placement" refers to a sale. *Id.*

as supervisory and enforcement actions by Competent Authorities.⁷⁰ The Competent Authorities of Member States may impose administrative penalties or prohibit a fund manager from marketing to EU investors if the fund manager engages in marketing and is found to have violated the Directive.⁷¹

However, the Directive does not apply where an EU investor approaches a fund manager regarding a sale (this situation is referred to as a “reverse solicitation”), provided that the fund manager “has not solicited the investor prior to the approach.”⁷² In particular, Recital 70 of the Directive states that it does not apply where a “professional investor established in the Union” invests “in [funds] on its own initiative, irrespective of where the [fund manager] and/or the [fund] is established.”⁷³

Currently, each Member State’s Competent Authorities can define “marketing” differently both under national private placement regimes and the EU passport.⁷⁴ This increases compliance costs for third-country fund managers that market funds in multiple Member States because they must abide by each Competent Authority’s rules regarding the scope of “marketing.”⁷⁵ Moreover, this system facilitates regulatory arbitrage by encouraging fund managers to register and market in countries that interpret and enforce the Directive more loosely.⁷⁶ The ESMA has identified the “divergent approaches with respect to marketing rules” to be a central issue relating to the use of the EU passport.⁷⁷ But the ESMA and the Commission have provided no substantive guidance for defining this term, so we must look elsewhere for clues on how to interpret “marketing.” Similar EU financial law and the Member States’ various approaches to defining the scope of “marketing” provide a good starting point.

⁷⁰ See *id.* at recital 4 (explaining that the Directive applies to fund managers “performing management and/or marketing activities within the Union”) (emphasis added). See also Emily Kehoe, *Hedge Fund “Regulation” for Systemic Risk: Largely Impossible*, 14 J. BUS. & SEC. L. 35, 50 (2013) (“Non-EU [fund managers] that manage assets located outside of the EU are only exempted from the complex AIFMD requirements if they do not market [their funds] to EU investors”).

⁷¹ AIFMD, *supra* note 3, arts. 45(6)–(8). Competent authorities can request any information, carry out on-site inspections, request the freezing of assets, withdraw the authorization granted to a fund manager or depositary, or adopt any type of measure to ensure that fund managers or depositaries remain in compliance with the applicable requirements of the Directive. *Id.* at art. 46(2).

⁷² Jeremy C. Jennings-Mares et al., *The European Alternative Investment Fund Managers Directive—A Non-EU Fund Manager’s Perspective*, 2013 WL 7143854, at *3 (2013).

⁷³ AIFMD, *supra* note 3, at recital 70.

⁷⁴ Sagan, *supra* note 1, at 513.

⁷⁵ See *id.* at 513.

⁷⁶ See *supra* Section I (defining “regulatory arbitrage” in the context of this Comment).

⁷⁷ ESMA’s Opinion to the European Parliament, Council and Commission and Responses to the Call for Evidence on the Functioning of the AIFMD EU Passport and of the National Private Placement Regimes, ESMA/2015/1235, 16 (July 30, 2015).

For instance, the Markets in Financial Instruments Directive and the AIFMD have similar constructions and purposes.⁷⁸ The Markets in Financial Instruments Directive regulates investment companies and purports to reduce the systemic risk created by their activities.⁷⁹ Additionally, like the AIFMD, it aims to harmonize the implementation and enforcement of its rules across the EU. The Markets in Financial Instruments Directive is relevant in defining “marketing” because it similarly regulates “marketing communication[s],” which it defines as information addressed by the investment firm to the investor that pertains to the services it offers and fees it charges.⁸⁰ It further states that such communications must be “fair, clear and not misleading” and must also be “clearly identifiable.”⁸¹

The Markets in Financial Instruments Directive standard is helpful in considering interpretations of marketing under the AIFMD for two reasons. First, it emphasizes the importance of honest and clear communications to investors. This protects investors from false promises and deceptive advertising in communications promoting funds. Second, it is important that marketing communications with respect to the Directive are “clearly identifiable” so that they can be easily distinguished by relevant stakeholders from other types of communications, as marketing communications distributed in the EU subject fund managers to the Directive’s burdensome rules.

As discussed earlier, Member States have interpreted and implemented “marketing” differently. For example, the French and British Competent Authorities define marketing contrarily.⁸² The French Monetary and Financial Code defines marketing broadly as “any unsolicited contact made, through whatever means, with a given individual or legal entity with a view to obtaining agreement.”⁸³ The United Kingdom (U.K.) has taken a narrower approach to interpreting marketing, providing in its implementing regulations that an offering or placement occurs when a person seeks to raise capital by making a unit or share of a fund available for purchase by a potential investor.⁸⁴ The U.K.’s definition emphasizes the offer of sale itself as marketing, which suggests that mere

⁷⁸ See generally Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU (recast), 2014 O.J. (L 173) 349 [hereinafter MiFID II].

⁷⁹ See Dirk A. Zetzsche & Thomas F. Marte, *AIFMD versus MiFIDII/MiFIR: Similarities and Differences*, in *THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE*, *supra* note 4, at 119, 120.

⁸⁰ MiFID II, *supra* note 78, at art. 24(3), (4).

⁸¹ *Id.* at art. 24(3).

⁸² See AIFMD 2014 Update, *supra* note 41, at 5.

⁸³ Zetzsche & Marte, *supra* note 15, at 431, 444 (citing French Monetary and Financial Code, Art. L. 341-1).

⁸⁴ *Id.* (citing Financial Conduct Authority, Perimeter Guidance (“PERG”) 8.37.5).

promotions of financial services and other marketing materials may not fall under the Directive.⁸⁵

These definitions of “marketing” are consistent in holding that marketing occurs in the wake of some form of unsolicited persuasion with the intent to obtain an investment.⁸⁶ However, they differ in what types of activities are deemed solicitations and thus fall under the definition of marketing. This Comment will address this gap by suggesting a broad and narrow interpretation of marketing under the Directive, and articulating the types of promotions and activities that fall within the scope of each.⁸⁷ These interpretations offer greater specificity and clarity than the Directive’s vague language, as well as that of the French and British definitions.

Similar to France’s interpretation, this Comment will define the broad interpretation of “marketing” to include any form of unsolicited contact with intent to make a sale. This interpretation includes materials distributed or made accessible to EU investors that promote a fund or fund manager. It also includes communications that discuss specific investment services and directly or indirectly connect those to a fund manager or any of the funds that he or she manages. Communications do not fall under the definition of “marketing” if they simply explain related investment services or the characteristics of different types of funds generally, as long as they do not solicit investments or identify a fund manager or his or her managed funds.⁸⁸

Similar to Britain’s interpretation, this Comment will define the narrow interpretation of “marketing” such that it emphasizes the actual offer of sale and allows for limited distribution of marketing materials. This narrower interpretation limits “marketing” to promotional materials or activities that expressly provide an offer of sale or that clearly have the characteristics of one. Promotions that have the characteristics of an offer of sale include those that encourage investors to contact a fund manager or other fund representative to inquire about or invest in a fund. In contrast, promotions that provide information only about investment

⁸⁵ *Id.* (noting a potential distinction made by the U.K. authority between “financial promotions” and “marketing”). *See also* AIFMD 2014 Update, *supra* note 41, at 5 (indicating that the U.K.’s narrow interpretation may be beneficial in that it could allow a non-EU fund manager to engage in some general “pre-marketing” activity without having to notify the U.K. regulatory authority).

⁸⁶ Zetzsche & Marte, *supra* note 15, at 431, 444.

⁸⁷ Both interpretations implicitly assume that *indirect* solicitations where the fund manager has a formal or informal agreement with an intermediary to solicit EU investors will be subject to the same standards as *direct* solicitations, with respect to what constitutes a marketing communication. *See* AIFMD, *supra* note 3, art. 4(1)(x) (defining “marketing” to include “direct or *indirect* offering[s] or placements[s]”) (emphasis added).

⁸⁸ This exception is based on Rule 135a regarding “generic advertising” of the SEC’s general rules and regulations for the Securities Act of 1933. 17 C.F.R. 230.135a.

services offered by the fund and name the fund or fund manager are permitted, as long as the promotional material contains a reasonably visible disclaimer that the fund or fund manager is not compliant with the Directive.⁸⁹

1. Cost-benefit analysis for the broad interpretation of marketing.

a) *Benefits*. Under the broad interpretation, “marketing” encompasses a larger variety of activities. Unlike the narrow interpretation, the broad version not only prohibits promotional materials that solicit investments, but also those that directly or indirectly identify fund managers or their managed funds.

One benefit of the broad interpretation is that because a wider range of promotional materials would fall within the Directive’s scope, the Directive will regulate more fund manager activities. This result aligns with the Directive’s policy objectives because it increases uniformity, or harmonization, and better protects EU investors by subjecting more fund managers to the Directive’s highly transparent and risk mitigating requirements, particularly if they solicit EU investors. These measures may also reduce systemic risk, another central goal of the Directive. Moreover, the more uniform compliance will generate cost efficiencies through greater predictability and certainty with respect to the law.

A related benefit is less circumvention by fund managers who market or manage funds in the EU. The broad scope of marketing will encourage more funds to comply with the Directive instead of attempting to circumvent it, especially if they want to actively participate in the EU market. This is because fund managers will face a greater risk of being subject to the Directive’s requirements due to the larger range of activities that constitute marketing than under the narrow interpretation. If a Competent Authority determines that a fund manager engaged in marketing, they could impose liability if the fund manager did not meet the law’s strict standards. Moreover, fund managers who do comply will have an advantage in light of their ability to identify themselves and their funds in communications, and to directly solicit investors.

A final potential benefit is that the broad interpretation may allow relatively easy and low cost enforcement. As this rule is broad and encompassing, it affords limited exceptions that could lead to disputes, which will reduce administrative and other social costs. This effect will be even greater if funds that wish to avoid compliance choose to exit the market over risking circumvention, as a higher proportion of funds in the EU market will be in compliance with the Directive.

⁸⁹ This is a crucial distinction from the broad interpretation, as it implies that promotions like billboards, television advertisements, and internet advertisements are not included within the meaning of “marketing” as long as they do not clearly invite or encourage investment and they contain a disclaimer.

b) *Costs*. Although the broad interpretation will increase compliance and may reduce enforcement expenses, it is associated with some important private and social costs. If some fund managers exit the EU market due to the high burdens of compliance and risks of liability under the broad interpretation of “marketing,”⁹⁰ fewer active funds will remain in the EU market. Fewer funds will cause a decline in competition and will reduce investment options for EU investors in the alternative investment funds market.

Another cost of the broad interpretation is that investors will bear much of the increased compliance costs imposed on fund managers. Fund managers who must comply with the Directive because of the broad scope of marketing will be subject to a variety of structural and financial requirements, rigid corporate governance requirements, periodic asset valuations, and transparency requirements.⁹¹ With less disposable capital, fund managers will pass these costs on to investors in the form of higher fees and lower returns.⁹²

Finally, two social costs associated with the broad interpretation include a decrease in innovation and negative liquidity effects. As previously discussed, the expansive reach of “marketing” under the broad interpretation will cause more funds to be subject to the Directive. The increased compliance costs spread over a larger number of fund managers will likely reduce available capital for investment in the European market, which could undermine financial innovation.⁹³ Furthermore, if fund managers have lower investable capital, this may result in negative liquidity effects by decreasing the amount of cash that fund managers invest in equity and bond markets. However, the extent of this effect depends on the number of additional funds subject to the Directive under the broad interpretation and the costs that compliance imposes upon them.

Based on the preceding analysis, the broad interpretation of marketing will better encourage compliance with the Directive, promote uniform application of the law, and increase transparency. It is also likely to reduce enforcement costs. However, it will reduce investor choice in the fund market, diminish investment returns, and negatively impact innovation and liquidity in the funds market.

2. Cost-benefit analysis for the narrow interpretation of marketing.

a) *Benefits*. The narrow interpretation of marketing allows fund managers to market their funds through promotional materials and activities if they do not

⁹⁰ See Sagan, *supra* note 1, at 513–14.

⁹¹ Kehoe, *supra* note 70, at 50.

⁹² See Peter McGowan & Kimberly Everitt, *New Requirements Imposed on the European Alternative Investment Funds Industry*, 14 BUS. L. INT'L 105, 110 (2013) (noting how the costs of new leverage requirements under the Directive “are likely to be borne ultimately by the [fund] and its investors”).

⁹³ See Zetzsche, *supra* note 4, at 1, 11–12.

have the characteristics of an offer of sale and do not clearly evidence an intent to obtain one, as long as they also contain a disclaimer of non-compliance with the Directive.

One benefit of the narrow interpretation is that it protects investors by creating a diversification effect with respect to regulatory regimes. Holding all fund managers and funds active in Europe subject to a single unified regime creates a form of systemic risk,⁹⁴ as problems with the Directive's interpretation, administration, and enforcement could substantially impact the market. For example, the Directive concentrates liability for certain types of fund losses on EU credit institutions, which creates the risk of bank runs if a fund's losses are significant and the credit institution overseeing it is of systemic importance.⁹⁵ Investors could reduce the systemic risk associated with this regime if they can invest in funds subject to various regulatory infrastructures.

A second benefit is that this interpretation may reduce private costs for EU investors. Imagine that an investor contacts a third-country fund manager who distributes promotions that do not fall within the narrow interpretation of marketing because they do not have the characteristics of an offer of sale. To meet the requirements under this definition of marketing, the promotions contain a disclaimer of non-compliance with the Directive. This investor could presumably negotiate for a discounted fee or higher-value service because of the risks the investor faces without the strong protections of the Directive. Moreover, EU professional investors are sophisticated and could appreciate these risks, and also identify when they are present on account of the non-compliance disclaimer.⁹⁶

Finally, under the narrow interpretation, third-country fund managers will be less likely to exit the EU market because of the risks of liability than they would under the broad interpretation. Fund managers not registered under the Directive could not only maintain relationships with existing investors but could also identify the nature of the investment services they offer in promotional materials. This would allow them to continue expanding their investor base in the EU market without having to comply with the Directive. More funds active in the EU will give investors more choices and the ability to more efficiently allocate their capital to funds that produce higher returns. Furthermore, third-country funds that would otherwise have exited the EU market can instead continue to provide it with liquidity and competition.

b) *Costs.* An important cost of the narrow interpretation of marketing is that it creates a greater risk of circumvention than the broad version. One problem with circumvention is that it undermines the Directive's goal of risk management

⁹⁴ Kehoe, *supra* note 70, at 63 (arguing that the Directive's rigid approach to hedge fund regulation "will actually contribute to the creation of systemic risk in the hedge fund industry").

⁹⁵ *See id.* at 63–64.

⁹⁶ *See* AIFMD, *supra* note 3, art. 4(1) (defining "professional investors").

at both the investor and systemic levels. At the investor level, the more flexible rules on promotional materials and other communications with current clients about new services create informational asymmetries. While circumventing fund managers must make required disclosures according to the rules of their home country's regulatory regime, they may choose not to release some of the information regarding their risk exposures that fund managers subject to the Directive must disclose. Accordingly, EU investors might lack relevant information in making an investment decision.

In terms of systemic risk, circumvention would allow fund managers to avoid the Directive's highly transparent regulatory regime with its strong limits on leverage and substantial liquidity requirements. Consequently, fund managers might engage in more speculative investing that increases systemic risk, particularly if their home country regulations are more lenient.

Another cost associated with circumvention is that it may create competitive disparities. The narrow interpretation may put EU fund managers at a competitive disadvantage on their own home turf because some of their third-country based competitors face lower regulatory costs and burdens by being subject only to their home jurisdiction's regulatory requirements.⁹⁷ This problem could become worse if circumventing fund managers establish more subsidiaries in the EU and expand their activities so as to take advantage of this regulatory discrepancy.⁹⁸ However, the negative effects of circumvention would be lower if the third-countries where such fund managers are based have similarly strict regulatory regimes.

It is not yet clear whether third-countries admitted to the passport regime will have regulatory frameworks similar to the Directive, and for those that do not, whether their agreements with EU authorities will efficiently close the gaps in substantive legal rules and their enforcement.⁹⁹ The comprehensive analysis that the ESMA is undertaking to determine which third-countries should be admitted to the passport regime should help minimize discrepancies between the regulatory frameworks of admitted countries and the Directive.¹⁰⁰ However, the laws and

⁹⁷ This will only be an issue where the home jurisdiction of circumventing third-country fund managers has a more lenient regulatory regime than the Directive.

⁹⁸ Although third-country fund managers that manage assets in the EU will not be exempted from the Directive, they could likely continue to manage assets in their home third-countries and simply establish subsidiaries in the EU for promotional purposes.

⁹⁹ See ESMA's Advice, *supra* note 11, at 10.

¹⁰⁰ See *id.* at 7–11 (setting out the following criteria upon which the ESMA is analyzing third-countries for potential admission to the passport regime: (1) experiences with existing agreements between EU and third-country Competent Authorities under the national private placement regime; (2) the extent of investor protection; (3) differences in the regulatory environment and potential for regulatory arbitrage; (4) obstacles to competition; and (5) systemic risk associated with the third-country's legal regime).

enforcement capacities of third-countries may differ, and the many rigid corporate governance requirements, leverage limits, liquidity requirements, periodic asset valuations, and transparency requirements of the Directive suggest that it may impose substantially higher costs than the regulatory regimes of the admitted countries.¹⁰¹

A third cost is that the narrow interpretation may undermine the standard set forth in the Markets in Financial Instruments Directive, an EU directive that closely parallels the AIFMD.¹⁰² As discussed above, this directive holds that marketing communications should be “fair, clear and not misleading” and also “clearly identifiable.”¹⁰³ Although fund managers cannot use promotional materials that directly solicit investors under the narrow interpretation, they can still discuss the investment services offered by their funds, and may be able to include basic performance metrics. These materials might attract and mislead investors, particularly if the fund exaggerates strong performance metrics or fails to disclose important risks. Moreover, they may be difficult to distinguish from communications that solicit investors and subject a fund or fund manager to the Directive from those that do not. The uncertainty in determining which communications fall within the definition of marketing will likely result in administrative costs and potentially significant error costs for fund managers that incorrectly believe their communications do not constitute marketing.¹⁰⁴

The narrow interpretation provides a beneficial diversification effect by spreading risk across multiple regulatory regimes. It also reduces private costs and is less likely to drive third-country fund managers out of the EU market than the broad interpretation. Yet, this approach increases risk for fund investors and may result in a net increase in systemic risk. It is also less compatible with the definition of “marketing communications” in the Markets in Financial Instruments Directive, and the uncertainty of which communications constitute marketing may result in higher administrative costs than under the broad interpretation.

¹⁰¹ Kehoe, *supra* note 70, at 50–53. *See also id.* at 38–39 (contrasting the Securities and Exchange Commission’s focus on information gathering with the Directive’s efforts to reduce systemic risk through an “attempt to dismantle the hedge fund industry,” but acknowledging that the Securities and Exchange Commission may be stepping up its enforcement efforts against hedge funds).

¹⁰² *See Zetzsche & Marte, supra* note 79, at 119, 119–25.

¹⁰³ *See MiFID II, supra* note 78, art. 24(3).

¹⁰⁴ *Cf.* A. A. Sommer Jr., *Who’s “In Control”? – S.E.C.*, 21 *BUS. L.* 559, 563 (1966) (noting the importance of determining the meaning of a “controlling person” in United States securities law and that the lack of clarity has led to the development of “imprecise limits” through the “painstaking process of rule, interpretation, judicial decision and ad hoc determinations in ‘no action letters’”). *See also id.* (observing that this uncertainty is potentially very costly for persons who incorrectly determine that they do not fall within the definition of “controlling person”).

3. Preferred interpretation and empirical questions.

Based on the preceding cost-benefit analysis, it appears that the broad interpretation better serves the Directive's policy objectives of risk management and harmonization. The more expansive scope of "marketing" will provide a more level playing field and encourage third-country fund managers that are active in the EU to comply with the Directive's requirements given the higher liability risk. Moreover, the high transparency and liquidity requirements and the restrictions on leverage will apply to more funds than under the narrow interpretation, providing investors with greater protection. Although this approach will likely cause some fund managers to leave the EU market, many third-country funds more active in the EU market will likely remain. In contrast, the narrow interpretation protects investors through regulatory diversification, reduces financial costs for investors, and may have positive liquidity and competition effects. Yet, its greater opportunities for circumvention undermine the Directive's objectives of risk management and harmonization.

Although the broad interpretation seems to better serve the Directive's policy objectives, it is important to recognize its potentially significant costs. These costs include the enforcement burdens of monitoring the additional activities that subject a fund manager to the Directive, higher fees and lower returns for investors, and less market liquidity and financial innovation. Though the narrow interpretation would result in circumvention costs and more significant line-drawing problems with regards to what constitutes a "marketing" communication, the overall costs of the broad interpretation may be higher if compliance costs are substantial.

While it is important that the Commission's approach support the Directive's policy goals, the Commission should weigh these goals against the relevant costs. Moreover, the Commission and ESMA should investigate the following empirical questions before the Commission sets forth a legislative act that interprets or clarifies the Directive's language regarding the meaning of "marketing."

First, the Commission should consider whether greater overall compliance with the Directive would in fact better protect EU investors than corresponding laws in other countries. If the countries admitted to the third-country passport system have strong regulatory regimes in place that provide many of the same protections as the Directive, then achieving a higher level of overall compliance and avoiding circumvention is not as important. In that case, the narrower interpretation's lower economic costs favor adopting that approach.

Relatedly, it would be useful to know whether the Directive imposes significantly higher burdens on third-country funds than their home regulators do, particularly for those that join the third-country passport system. If it does not, then the increase in compliance obligations may not be as costly as assumed in the

preceding cost-benefit analysis, and using the broad interpretation will allow for more uniformity while also keeping the increased costs to fund managers to a reasonable level. However, if compliance costs are high, then the narrow interpretation may be preferred since its relative benefits for innovation, liquidity, and consumer choice are more likely to outweigh the costs of undermining the Directive's policy goals of harmonization and risk management.

B. The Equivalence Requirement

The second vague provision of the Directive analyzed in this Comment is the “equivalence requirement.”¹⁰⁵ This rule is significant in light of the expansion of the passport regime to include third-countries because it provides an exemption from compliance with the Directive where a legal rule in a third-country directly conflicts with a provision of the Directive and certain conditions are met.¹⁰⁶

A third-country fund manager that markets funds using the passport system (after it is expanded to cover third-countries) must fully comply with the Directive, except for Chapter VI, which concerns fund managers managing specific types of funds.¹⁰⁷ However, this compliance requirement does not apply in circumstances where a provision of the Directive is “incompatible with compliance with the law to which the non-EU [fund manager] and/or the non-EU [fund] marketed in the Union is subject” *and* the fund manager can demonstrate that: (a) it is impossible for it to comply with both laws; (b) “the law to which the non-EU [fund manager] and/or non-EU [fund] is subject provides for an equivalent rule having the same regulatory purpose and offering the same level of protection to the investors of the relevant [fund];” and (c) the non-EU fund manager and/or the non-EU fund complies with the equivalent rule indicated in point (b).¹⁰⁸ This exception is known as an “equivalence requirement.”¹⁰⁹

While there is no clear authoritative guidance on the equivalence requirement as applied to the authorization of third-country fund managers under the passport system, Article 21(6)(b) offers some insights because it incorporates a similar equivalence requirement concerning the regulation and supervision of depositaries.¹¹⁰ This Article provides that depositaries in third-countries must be

¹⁰⁵ See AIFMD, *supra* note 3.

¹⁰⁶ See *id.*, art. 37(2).

¹⁰⁷ Zetzsche & Marte, *supra* note 15, at 431, 470 (citing AIFMD, art. 37(2)).

¹⁰⁸ AIFMD, *supra* note 3, art. 37(2).

¹⁰⁹ Zetzsche & Marte, *supra* note 15, at 431, 471.

¹¹⁰ AIFMD, *supra* note 3, art. 21(6)(b). See also *id.* at art. 21(7)–(10) (noting that a “depository” is responsible for monitoring a fund’s cash flows, acting on behalf of the fund and fund manager, safe-keeping financial assets, performing calculations required under the Directive, and carrying out the instructions of the fund manager unless they conflict with applicable national law).

subject to regulations and supervision that “have the same effect as Union law and are effectively enforced.”¹¹¹ In the Primary Directive Regulation, the Commission clarified and supplemented this depositary equivalence requirement.¹¹² The Primary Directive Regulation holds that a third-country law preempts a Directive requirement if, among other things, the depositary is subject to ongoing supervision by an authority with adequate resources to fulfill its tasks and the “law of the third country provides for the application of sufficiently dissuasive enforcement actions in the event of breach by the depositary.”¹¹³

However, there is no guarantee that the same criteria will apply to equivalence provisions regarding the authorization of third-country fund managers to market or manage funds in the EU under the third-country passport regime.¹¹⁴ In fact, the differences in the language of the Article 21(6)(b) equivalence provision and the one under Article 37(2) suggest that they should not be interpreted or applied identically. As stated previously, Article 21(6)(b) requires that third-country fund managers and funds be subject to regulations and supervision in their home country that “have the same effect as Union law and are effectively enforced.”¹¹⁵ In contrast, Article 37(2) requires that the conflicting third-country law provide “an equivalent rule having the same regulatory purpose and offering the same level of protection to the investors of the relevant [fund].”¹¹⁶

Thus, unlike Article 21(6)(b), Article 37(2) emphasizes the purpose behind the conflicting rule and does not contemplate effects beyond those related to the level of protection that investors receive. Moreover, Article 37(2) applies to “the investors of the relevant [fund]” and not just “EU investors.”¹¹⁷ This suggests that the conflicting third-country rule must provide the “same level of protection” as the corresponding Directive rule for *both* EU and third-country investors, and that the effects of the rule should not be assessed beyond any relevant funds.¹¹⁸ Accordingly, this Comment will incorporate these implications as assumptions of how the Article 37(2) equivalence requirement should be read for both of the interpretations that are evaluated below.

Equivalence is “best understood as implying a holistic test with benchmarks that focus on high comparability between regulatory and supervisory outcomes,

¹¹¹ *Id.* at 21(6)(b).

¹¹² Primary Directive Regulation, *supra* note 29, art. 84.

¹¹³ *Id.* at art. 84(f).

¹¹⁴ Zetsche & Marte, *supra* note 15, at 431, 471. *See also* AIFMD, *supra* note 3, art. 37(1).

¹¹⁵ AIFMD, *supra* note 3, art. 21(6)(b).

¹¹⁶ *Id.* at art. 37(2)(b).

¹¹⁷ *Id.* at art. 37(2).

¹¹⁸ *Compare id.* (“the same level of protection to *the investors* of the relevant AIF”) *with id.* at art. 37(3) (“between the *EU investors* of the relevant AIF . . .”) (emphasis added).

rather than rigid line-by-line examinations of similarities and differences, and a quest for exact mirroring of practices and philosophies.”¹¹⁹ Inherent in this view are the concepts of *cost equivalence* and *functional equivalence*.¹²⁰

“Cost equivalence” requires that the costs imposed on financial intermediaries by the laws and supervisory practices of the Member State hosting funds and fund managers be comparable to the costs imposed on intermediaries by the third-country fund manager’s home country legal regime.¹²¹ In contrast, “functional equivalence,” an outcome-based approach, requires that the rules of two countries produce similar results.¹²² The functional approach holds that the formal similarity or dissimilarity of rules and standards between the third-country and Member State host country are not critical, as different methods may achieve the same level of regulatory protection.¹²³

This Comment will propose and evaluate two interpretations of the language in the equivalence requirement under Article 37(2) of the Directive that reflect the principles of cost and functional equivalence, respectively. As discussed above, each will assume that this equivalence requirement applies to both EU and third-country investors of any funds, and that any effects beyond these investors or funds falls outside the scope of this rule. Additionally, under both interpretations, this Comment will infer the word “same” in Article 37(2)(b) to mean “substantially similar.”¹²⁴ These interpretations of Article 37(2) differ based on how they define “impossible” and what they consider to constitute “the same level of protection to the investors of the relevant [fund].”¹²⁵

The first interpretation is the “cost equivalence” approach. For Article 37(2) to be satisfied, this approach requires that a fund manager and fund be subject to substantially similar *costs and burdens* under a third-country’s laws as apply under the Directive. Under this reading, the language “impossible to combine such compliance” means that a fund manager cannot possibly comply with both a provision of the Directive and a binding legal rule in the fund manager’s home country concurrently (a phenomenon this Comment refers to as “objective

¹¹⁹ Zetzsche & Marte, *supra* note 15, at 431, 472 (citing EILÍS FERRAN & LOOK CHAN HO, CORPORATE FINANCE LAW 417 (2d ed. 2014)).

¹²⁰ These two concepts contrast with *formal equivalence*, which requires that the rules of the third-country and Member State not only produce similar results, but that they also are characterized by substantially similar form and substance. *Id.* at 472.

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.*

¹²⁴ This accords with the understanding of equivalence requirements set forth by Eilís Ferran and Look Chan Ho, discussed above. *See supra* note 120. It avoids the need for “formal equivalence” of Member State and third-country rules in terms of virtually identical language or form.

¹²⁵ AIFMD, *supra* note 3, art. 37(2).

impossibility”).¹²⁶ Additionally, this interpretation will find the requirement for an “equivalent rule . . . offering the same level of protection to the investors of the relevant [fund]” to be met if the *costs and burdens* imposed on fund managers and funds complying with each set of laws is substantially similar.¹²⁷

The second interpretation is the “functional equivalence” approach. This approach is outcome-based and requires that a third-country rule conflicting with the Directive produce substantially similar *results*. Under this reading, the language “impossible to combine such compliance” includes within its scope situations in which it would be *extremely difficult* for a fund manager to comply with a Directive provision and third-country legal rule simultaneously (“subjective impossibility”).¹²⁸ Furthermore, this approach finds the requirement for an “equivalent rule . . . offering the same level of protection to the investors of the relevant [fund]” met if the conflicting rule produces substantially similar *results* with respect to the level of protection for fund investors.

1. Cost-benefit analysis for the cost equivalence approach.

a) *Benefits*. The first benefit afforded by the cost equivalence approach is one that also supported the broad interpretation of marketing, namely that it minimizes circumvention. The literal reading of “impossible” as objective impossibility will prohibit a fund manager from obtaining an exemption from compliance with a Directive provision under Article 37(2) in all but the few cases in which the fund manager cannot possibly comply with a rule in its home jurisdiction that is incompatible with the Directive.¹²⁹ Moreover, even if compliance with both rules is impossible, the exemption can apply only if the costs and burdens imposed by the third-country rule are substantially similar to those under the Directive and the fund manager complies with this rule. Accordingly, this interpretation prevents fund managers from abusing this rule to circumvent (but not violate) the Directive. The reduction in circumvention has the same benefits discussed in the analysis of marketing above, including providing investors with the significant protections of the Directive and making it easier for

¹²⁶ The strict requirement of compliance if at all possible minimizes the number of instances in which a fund manager can circumvent a provision of the Directive, thereby limiting circumstances in which the fund manager or fund is subject to different costs or burdens under a third-country’s laws.

¹²⁷ See AIFMD, *supra* note 3, art. 37(2)(b).

¹²⁸ The use of “extremely difficult” in place of “impossible” fits with the functional equivalence approach because it will only allow non-compliance where a fund or fund manager faces very substantial burdens in complying with both laws. Article 37(2)(b) would still require that the third-country rule provide substantially similar results with respect to the protection of investors.

¹²⁹ See AIFMD, *supra* note 3, art. 37(2).

them to compare funds, as well as promoting uniformity in the Directive's application.

A second benefit of the cost equivalence approach is that by focusing on the costs and burdens imposed by the conflicting third-country rule, it helps prevent funds and fund managers subject to a third country's regulatory regime from obtaining an unfair competitive advantage over their EU-based competitors.¹³⁰ This interpretation will not allow fund managers to engage in regulatory arbitrage by taking advantage of incompatible provisions in a third-country's laws to obtain exemptions under Article 37(2) that will reduce their incurred costs.¹³¹ As a result, fund managers will not be able to leverage these cost savings to improve operations, cover expenses, or charge lower fees than their competitors that are subject to the full requirements of the Directive.

A third benefit is that the interpretation of impossible as objectively impossible is more consistent with the plain language of the Directive than interpreting it to mean "extremely difficult." In common usage, the word "impossible" generally refers to something "incapable of being or of occurring."¹³² This understanding of impossible supports apparent legislative intent since EU legislators elected to use prohibitive language instead of more lenient language. Unfortunately, it does not appear that EU law or the literature provides clear guidance on how to interpret "impossible" in the context of the Directive.¹³³

A final benefit is that the cost equivalence approach provides a clear bright-line rule with few exceptions. "Impossible" under this approach is a strict standard and is easier to apply than "extremely difficult," as the latter could apply to various situations where a fund manager incurs high costs or burdens from complying with conflicting rules. Moreover, it is not too difficult to determine whether costs and burdens imposed by regulations are substantially similar under the Directive and a third-country's legal regime by comparing the language and scope of relevant law, as well as enforcement efforts. Consequently, the cost equivalence

¹³⁰ Zetzsche & Marte, *supra* note 15, at 431, 472.

¹³¹ See *supra* Section I (defining "regulatory arbitrage" in the context of this Comment).

¹³² *Impossible*, MERRIAM-WEBSTER ONLINE DICTIONARY. <http://www.merriam-webster.com/dictionary/impossible> (last visited Apr. 16, 2016).

¹³³ The use of alternate constructions of the word "impossible" in various EU laws, as identified in the literature and case law, highlights the uncertainty of the term's meaning. See, for example, Mihail Danov & Florian Becker *Introduction*, to CROSS-BORDER EU COMPETITION LAW ACTIONS, 1, 8 (Mihail Danov, Florian Becker & Paul Beaumont, eds. 2013) (noting that Member States must not make "practically impossible" or "excessively difficult" the exercise of rights granted under EU law. See also Opinion of A.G. Wahl, Case C-527/12, European Commission v. Federal Republic of Germany (2014), ECLI:EU:C:2014:90, 8-9, 17 (describing EU case law on the defense of "absolute impossibility," which requires a person to show (1) the occurrence of an event that the person could not influence and (2) the exercise of all reasonable efforts to avoid its consequences, and also referring to this as "objectively impossible").

approach offers relatively low administrative and enforcement costs, along with high transparency.

b) *Costs*. An important cost of the cost equivalence approach is that, like many bright-line rules, it is over-inclusive. The strict and unforgiving interpretation of “impossible” as objective impossibility will require compliance with the Directive even where it is possible but extremely costly or burdensome. This may at times put third-country fund managers between the proverbial “rock and a hard place,” as they will have to choose whether to subject themselves to liability and potential loss of the privilege to market funds in the EU, or to bear a burden that may competitively disadvantage them in all of their active markets. In addition, this approach could be over-inclusive if conflicting rules in the Directive and third-countries generally achieve the same empirical results by imposing different regulatory hurdles. The cost equivalence approach compares only the costs and burdens imposed, so it would not take into account these divergent means of achieving the same ends.

The losses that third-country fund managers may suffer in the event of a conflict that can only be overcome by costly action would generate several undesirable outcomes. First, the higher costs incurred by these funds would reduce their available capital for investments, which would consequently decrease their returns. Fund managers might need to charge higher fees or cut some of their offered investment services to avoid financial distress. Second, the lower profitability may cause some fund managers to exit the EU market if the burden that Article 37(2) imposes is costly enough to exceed the benefits of continuing to market funds in the EU. Third, fund managers facing the lose-lose dilemma described above may make financially unsound and socially suboptimal decisions, such as firing well-performing employees and funneling investment funds or proceeds into compliance and risk management, instead of investing productively.

Lastly, the cost equivalence approach does not accurately reflect reality. Countries other than the EU have also responded to the recent global economic crises with legislation and regulations to address the risks of alternative investment funds. However, their frameworks differ significantly, and it is highly unlikely that many third countries will pursue the objectives of promoting uniformity, protecting investors, or reducing systemic risk by imposing the same kinds of costs and burdens that the Directive does.¹³⁴ Consequently, there may be few cases in which a conflicting third-country rule creates substantially similar costs and burdens, which could render the exemption empty in practice.

As this analysis has demonstrated, the benefits of the cost equivalence approach are that it minimizes circumvention, limits the ability of third-country fund managers to obtain competitive advantages over fund managers based in the

¹³⁴ See generally Kehoe, *supra* note 70 (distinguishing the approaches of regulation in the United States and under the Directive).

EU, that it is more consistent with the common usage of the term “impossible,” and that it offers a bright-line rule that minimizes administrative and enforcement costs. On the other hand, the costs are that it may be over-inclusive and unduly burdensome on third-country fund managers, it would reduce returns for investors and result in suboptimal decision-making, and that it does not comport with the reality that the regulatory regimes of other countries have not adopted the same methods for accomplishing the same policy goals.

2. Cost-benefit analysis for the functional equivalence approach.

a) *Benefits*. Unlike the cost equivalence approach, the functional equivalence approach is not a bright-line rule, but rather a more flexible standard that incorporates a degree of equity. It does so by allowing third-country fund managers to avoid compliance where there is a direct conflict of rules and where compliance would be highly prejudicial to the fund manager by forcing higher regulatory costs on it than its competition faces. In particular, by broadening the scope of “impossible” to include “extremely difficult,” the subjective impossibility view allows a fund manager to avoid complying with a rule in the Directive if it would be extremely costly or burdensome to comply with both laws simultaneously. For example, if the applicable third-country law prohibited disclosure of certain sensitive information for national security reasons, but this information was incorporated into information that had to be disclosed under the Directive, a fund manager might meet the “impossibility” prong of Article 37(2) by showing that separating such information would be extremely costly or burdensome.

A second benefit of the functional equivalence approach is that it aligns with equivalence requirements in related EU financial law. Equivalence requirements run throughout pan-European market infrastructure regulations, such as regulations for credit rating agencies and central securities depositaries.¹³⁵ These regulations generally hold that, with respect to an equivalence requirement, a “proportionate, outcomes-based approach should be taken.”¹³⁶ Moreover, “it should be sufficient that the third-country regulatory regime achieve the same objectives and effects in practice.”¹³⁷ This language strongly accords with the

¹³⁵ Zetzsche & Marte, *supra* note 15, at 431, 475.

¹³⁶ Parliament and Council Regulation 909/2014 of the European Parliament and of the Council of 23 July 2014 on Improving Securities Settlement in the European Union and on Central Securities Depositories and Amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, 2014 O.J. (L 257) 14, recital 75.

¹³⁷ Parliament and Council Regulation 462/2013 of the European Parliament and of the Council of 21 May 2013 Amending Regulation (EC) No 1060/2009 on Credit Rating Agencies, 2013 O.J. (L 146) 10, recital 48.

functional equivalence approach, which is outcome-based and focused on the effective results of the conflicting rules.

A final benefit is that, not only does this approach better reflect the reality of different regulatory regimes using different methods to obtain the same ends, it also follows more directly from the language in Article 37(2)(b). This Article requires that if two rules conflict, the third-country law must provide for “an equivalent rule having the same regulatory purpose and offering the same level of protection to the investors of the relevant [fund].”¹³⁸ A third-country rule offering the same level of protection in its results but not its means appears to effectively meet this requirement, which suggests that the regulatory obstacles necessary to achieve those results are immaterial.

b) *Costs*. The functional equivalence approach will provide more opportunities to circumvent the Directive than the cost equivalence interpretation. Because “impossible” implies “extremely difficult” under this approach, fund managers could invoke Article 37(2) more often. Furthermore, fund managers will have more leeway to argue that they would face high costs or burdens in complying with both the Directive and a conflicting third-country rule, whether or not these costs are actually substantial. With respect to Article 37(2)(b), fund managers could also point to self-serving data that suggests that the empirical results of the rules are substantially similar. This approach could be costly if fund managers can invoke this exemption frequently enough to obtain a competitive advantage over EU-based fund managers who must comply with the applicable rule.

A second and related cost of the functional equivalence approach is that “extremely difficult” is a less clear standard, and thus will likely result in higher administration and enforcement costs. It will be difficult for authorities to establish what conduct falls within this line, which may cause more adjudication in gray areas and the court expenses, lawyer fees, and procedural battles associated with it. Moreover, judges who lack expertise in financial matters may find themselves at the mercy of sophisticated fund managers who vigorously argue that the exemption applies.

A third cost is that comparing the empirical results of two conflicting rules is a more costly and difficult exercise than comparing the costs and burdens that they impose on funds and fund managers. Authorities will need to acquire sufficient empirical data, but they may not have the infrastructure to do so for some rules that conflict with the Directive. As a result, governments and, ultimately, taxpayers will pay for data collection efforts and the resources required for its analysis. This problem may be exacerbated if various countries analyze and compare results differently, creating competitive disparities and facilitating regulatory arbitrage. In particular, third-country fund managers could invoke the

¹³⁸ AIFMD, *supra* note 3, art. 37(2)(b).

Article 37(2) exemption more often if their home jurisdiction compared results more broadly. Accordingly, this interpretation might create some of the same inefficiencies and costs that currently characterize the divergent national private placement regimes as compared with a uniform passport system.¹³⁹

The above analysis shows that the benefits of the functional equivalence interpretation include that it is less apt to unfairly prejudice third-country fund managers, it aligns with equivalence requirements in related EU financial law, and it is more compatible with the language in Article 37(2)(b). Costs of this approach are that it allows fund managers more frequent access to the exemption and thus reduces the extent of their compliance with it, the “extremely difficult” standard is hard to apply and will impose significant administrative and enforcement costs, and comparing the results of two conflicting rules will be more challenging than comparing the costs and burdens they impose.

3. Preferred interpretation and empirical questions.

The cost-benefit analysis suggests that from both a policy and a cost and efficiency standpoint, the cost equivalence approach is the better choice. It is a bright-line rule that reduces administrative and enforcement costs and facilitates a more uniform application of the Directive. Furthermore, by promoting uniform application of the Directive and higher compliance, this approach will better serve the Directive’s goals of harmonization and investor protection. However, the cost equivalence approach may lead to undesirable outcomes for third-country fund managers if they must comply with both a third-country law and the Directive, despite incurring extremely high costs in doing so.

To reduce the harsh and more restrictive nature of the cost equivalence approach, the Commission might instead interpret “impossible” to mean “extremely difficult.” The relaxation of that standard would help balance the potential over-inclusiveness of the requirement that a conflicting third-country rule impose the same costs and burdens on fund managers, as discussed above.

The functional equivalence approach better aligns with other equivalence requirements in EU financial law and reflects the reality that different countries have unique approaches to achieve the same objectives. However, this approach is more costly, and divergent application of it may create competitive disparities and opportunities for regulatory arbitrage. Also, the costs of comparing the empirical results of many potentially conflicting rules would probably be significant, and investors and taxpayers would likely absorb these costs. Lastly, the “extremely difficult” standard is unclear and would promote litigation and self-serving testimony, which less financially sophisticated judges could find difficult to identify.

¹³⁹ See *supra* Section II. See also Directive on Alternative Investment Fund Managers (“AIFMD”): Frequently Asked Questions, *supra* note 7, at 3.

Although the cost-benefit analysis favored the cost equivalence view, two important factors could influence whether this is indeed the preferred approach. First, if countries admitted to the third-country passport system have regulatory regimes that impose similar costs and burdens as the Directive, then the cost equivalence approach may be better since it can still reasonably, though less effectively, compare how effective investor protection measures are. On the other hand, if the burdens they impose to achieve similar outcomes diverge significantly, the functional equivalence approach may be best. Second, if the Commission clarifies how the functional equivalence approach should be applied in practice so that authorities can apply it more uniformly, then the functional approach may be preferred, provided that it is not defined so narrowly as to facilitate circumvention.

With respect to the interpretation of “impossible,” the ESMA should collect and analyze data on how the Article 37(2) exemption applies to countries that the agency recommends for admission to the third-country passport system. In particular, it should seek to determine whether there will be many direct rule conflicts and whether compliance with both conflicting rules in those contexts would be impossible or even extremely difficult. If there are more potential conflicts, it would be preferable to interpret “impossible” as subjective impossibility because the objective impossibility view would impose substantial costs on third-country fund managers that would likely place them at a significant competitive disadvantage relative to their EU peers, or even prohibit them from marketing or managing their funds in the EU altogether.

V. CONCLUSION

The Alternative Investment Fund Managers Directive introduces the novelty of a pan-European passport regime for third-country fund managers. If the Commission implements it after carefully considering the implications of relevant data collected and analyzed by the ESMA, then the legislative act it enacts may well promote the Directive’s goals of harmonization and risk management. One of the crucial challenges in implementing this expanded passport system is establishing clear interpretations of vague provisions of the Directive that will promote the Directive’s policy objectives, align with the Directive’s language and implementing legislative acts, maintain consistency with EU financial law, and minimize private and social costs.

This Comment provided a systemic cost-benefit analysis framework for the interpretation of vague provisions of the Directive and applied it to the definition of “marketing” and the “equivalence requirement,” endeavoring to identify which of two interpretations was preferred for each of these provisions. Furthermore, it discussed important costs and benefits that may apply to the interpretation of other vague provisions. Ultimately, the ideal interpretation for each of these provisions will depend on the answers to relevant empirical questions, which can

best be investigated by the ESMA. The Commission should carefully consider the policy implications and economic consequences of these interpretations in light of this data as it prepares to implement the third-country passport system.