What's going on in the investment fund industry in the Netherlands?

Three highlights

Introduction

The investment fund industry in the Netherlands is highly dictated by the two European giants that regulate this sector: the Undertakings for Collective Investment in Transferable Securities Directive (UCITS Directive) and the Alternative Investment Fund Managers Directive (AIFM Directive). Whereas these directives are aimed at a European level playing field, in daily practice the differences between implementation and application amongst EU Member States are striking. This means that the investment fund sector in the Netherlands has to deal with its own specifics and developments. Where the past years were – from a financial regulatory point of view - dominated by the implementation of the AIFM Directive (in July 2013) and licensing of fund managers in connection therewith, we see an increasing interest in UCITS funds recently.

We highlight three topics of specific interest at this moment for non-Dutch fund managers.

1. Dutch sub-threshold regime open to other Member States?

The AIFM Directive provides for an exemption from full supervision under the AIFM Directive for fund managers managing limited assets. If a number of conditions have been met, the AIFM Directive requires these 'small managers' to register only with the competent supervisory authority in the country of establishment. Except for this registration provision, the AIFM Directive does not apply. This exemption is available to fund managers whose managed assets – to put it briefly – at the aggregated level do not exceed EUR 500 million, or in case of leveraged or open-end funds, EUR 100 million. In addition, the manager must offer units of participation in the managed AIFs to (i) exclusively professional investors, (ii) less than 150 individuals, (iii) with a minimum equivalent value of EUR 100,000 or (iv) with a minimum nominal value of EUR 100,000. This one regime is known under several names. In the Netherlands, reference is often made to (a) the 'de minimis exemption' (referring to the thresholds for the managed assets), (b) the 'light regime' (referring to the fact that a small number of obligations apply) or (c) the registration regime (referring to the obligation to register with the competent Dutch regulator, the Netherlands Authority for the Financial Markets (AFM)). Internationally, this regime is often designated as the 'small managers regime', the 'sub-threshold regime' or the 'Article 3 (2) exemption'.

Rosemarijn Labeur

Rosemarijn Labeur is a financial regulatory lawyer since 2005 and heads the Investment Management Team of Finnius since mid-2015. She has extensive experience in the field of Dutch financial regulatory law, with particular emphasis on the regulation of investment funds (AIFMD, UCITS) and investment services such as investment advice (MiFID II). Rosemarijn is a committed lawyer with a pragmatic approach.

Rosemarijn is one of the teachers of the Grotius specialisation course 'Securities Law'. She is part of the editorial office of a Dutch professional journal on financial regulatory law (Tijdschrift voor Financieel Recht), in which journal she also frequently publishes on several topics. Rosemarijn is a fellow of the Institute for Financial Law of the University of Nijmegen.

Chambers Europe has consistently mentioned Rosemarijn since 2015 and has since 2017 singled out Rosemarijn as one of the leading individuals within the category Investment Funds.

Tim de Wit

Tim is a financial regulatory lawyer since 2011, joined Finnius in 2015 and is partner in the firm since 2021. Tim focuses on investment funds and investment services, and advises asset managers on the AIFMD, UCITS, MiFID II, sustainability requirements (SFDR and Taxonomy Regulation) and information requirements (prospectus, PRIIPS and marketing). He also has broad knowledge and expertise in the field of FinTech (including asset management, payments (PSD2) and e-money) and AML/CFT. His goal is to translate complex financial regulatory requirements into practice.

In his daily practice, Tim advises on the scope and impact of financial regulatory requirements. He also assists market parties in their contacts with the AFM, such as in connection with a license application or with AFM investigations.

Tim is recommended in The Legal 500 as a "Rising Star" and is listed as "Rising Stars" by Expert Guides, both in the Investment Funds category.

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The sub-threshold exemption is optional for Member States: they may decide for themselves whether or not to transpose this exemption to their national laws and may also decide to attach more stringent conditions to the exemption. In the Netherlands, the sub-threshold regime is at this moment open available to fund managers with their corporate seats in the Netherlands (Dutch managers). This means that a small fund manager established and registered under the sub-threshold regime in an EU Member State, such as Luxembourg, cannot also operate under the sub-threshold regime in the Netherlands. Reaching out to investors established in the Netherlands by a non-Dutch fund manager is only possible on the basis of a full license within the meaning of the AIFM Directive. Such full license can be used to approach investors in other Member States upon completion of a relatively simple notification procedure (known as 'passporting'). For specific types of investment funds, i.e. the Venture Capital Funds and Social Entrepreneurship Funds, it is – in principle – possible for a registered manager to obtain a passport at fund level (known as the EuVECA label and EuSEF label). These 'fund-labels' currently provide an alternative to the cumbersome full licensing route.

The limitation of the Dutch sub-threshold regime to Dutch fund managers detract from a level playing field for small EU managers. Of course, we see parties trying to structure around this limitation by establishing a formal corporate managing entity in the Netherlands. We believe this circumvention is tricky, as in order to characterise as a Dutch manager, the portfolio and risk management in respect of the fund must be performed by an entity established and operated in the Netherlands; a letter box entity cannot be considered to be the true manager of a fund. Therefore, small managers that are just established in the Netherlands for tax purposes or other structuring means, are strictly speaking not eligible for the sub-threshold regime. The question is how strict the AFM will act upon fund managers that resemble letterbox entities. It seems that the AFM shares market criticism that the restriction of the sub-threshold regime to Dutch managers is too disturbing, especially because several other Member States do not apply a similar nationalistic provision. Early 2020, the AFM requested the Dutch legislator to open up the Dutch sub-threshold regime to other small fund managers established in the EU. This request goes hand in hand with the suggestion to no longer allow small managers to rely on the sub threshold regime if they restrict their offer to less than 150 persons. That would mean that the Dutch sub-threshold regime would no longer be available to reach out to true retail investors, but that a minimum investment of EUR 100,000 in a fund would be required. In a recent proposal for a legislative change, the Dutch legislator has only partly incorporated this request of the AFM, i.e. for non-Dutch EU fund managers that only offer their funds to, in short, institutional investors (i.e. professional investors within the meaning of the AIFMD). This is much to our surprise. In our experience, a substantial number of small managers focusses on the group of semi-professional investors (comprising, for example, high net worth individuals). Investment fund managers targeting the institutional market are often licensed within the meaning of the AIFM Directive. Not only because their assets under management exceed the thresholds of the registration regime, but sometimes also because institutional investors expect this from these managers. A European passport can be obtained with the license. Access to the Dutch small managers regime is therefore not relevant to that group. The intended adjustment of the registration regime therefore does not make a sufficient contribution to a level playing field for small managers. We therefore hope that the legislator will in the final version of the proposed amendment of the Dutch sub-threshold regime fall back on what the AFM proposed and will open up this regime for a broader group to non-Dutch small managers to procure a better level playing field.

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If the sub-threshold regime would be broadened for the benefit of other small EU-managers in the broader sense as proposed by the AFM, this will be a huge relief for that market segment. However, be aware that participation in the sub-threshold regime does not mean that small fund managers do not have to concern themselves with compliance with supervisory laws and regulations. On the contrary: our experience is that the registration regime is not so light as many fund managers might hope. In recent years, the AFM has become increasingly aware of this and has drawn particular attention to compliance by exempt managers with the Money Laundering and Terrorist Financing (Prevention), the Sanctions Act 1977, the PRIIPs Regulation and the Unfair Commercial Practices. Furthermore, small fund managers must register with the AFM and annually report their financial data to DNB.

Nevertheless, the sub-threshold regime is a popular gateway to the Dutch capital: to this date, approximately 1050 funds managed by small fund managers are included in the public register maintained by the AFM. One can imagine the expansion of this register once, or if, the Dutch sub-threshold regime will be opened up to other EU small managers.

1. Dutch licensed fund managers are not for rent

Obtaining a licence as a manager of a UCITS or an alternative investment fund in the Netherlands is a time-consuming and cumbersome process which entails, amongst other requirements; (i) provision of an organisational handbook which contains a detailed description of the governance structure, business and organisation of the fund manager; (ii) provision of policies and procedures safeguarding compliance with the legal requirements; (iii) testing of procedures in respect of executive board members and non-executive board members of the fund manager and in respect of executive board members of the shareholders of the fund manager; (iv) selection and engagement of a depositary; and (v) preparation of an information memorandum that needs to meet the legal requirements. In our experience, it takes about at least four to six months to prepare the licence application package, and approximately nine months for the AFM to decide on the package. The AFM-levy for the application is charged on the basis of hours spent on the application, with a maximum amount of EUR 100,000. On average, the AFM handling levy will be around EUR 50,000. In addition to this levy, the AFM charges a fee between EUR 700–3,600 for each person that is subject to a testing procedure as referred to above. The specific amount for the testing of a person depends on the type of testing they are subject to, given their role in connection to the fund manager. A licensed manager is subject to ongoing supervision by the Dutch regulators (AFM and the Dutch Central Bank (DNB, De Nederlandsche Bank). An important advantage of the licence from a legal perspective is that the licence may be passported to other EU Member States, which means that EU investors may also invest in the AIF.

In view of the above, a frequently asked question by fund managers in need for a license under either the UCITS Directive or the AIFM Directive, is whether they could make use of the services of a third party license-holder in the Netherlands when managing their fund(s). In Luxembourg and Ireland, commercial fund managing platforms are available that operate 'rent-a-manco' models. This model refers to a set-up whereby a licensed fund manager offers the opportunity to third parties that initiate an investment fund (the fund sponsor), to perform the portfolio management of such fund as delegated investment manager, while the AIFM performs the risk management and is legally responsible for the portfolio management of the fund in question. The Dutch regulator, the AFM, takes a critical approach towards this business model as it strictly adheres to the delegation rules set forth under the UCITS Directive and the AIFM Directive. Its key concerns in respect of platforms are substance of the licensed entity and the control of that entity over the core activities in respect of the fund: portfolio management. Therefore, structures in which a fund sponsor and a licensed fund manager cooperate are in the Netherlands only possible under very strict conditions. There are no signs that this is about to change. However, it might be that the request of ESMA in its recommendations to the European Commission about the revision of the AIFMD (in its letter dated 18 August 2020) may lead to a little more harmonization of views of Member States on AIFMD platforms. There is a small chance that the AFM will on the longer term loosen its strict views on such platform models. However, we do not keep our hopes up too much in this respect.

1. Brexit, Dutch NPPR and reverse solicitation

Now Brexit with a deal without much use for the financial sector is a matter of fact, the use of the third country regime for non-EU alternative investment managers (AIFMs) that wish to offer or manage alternative investment funds (AIFs) will likely reach a new peak this year. UK AIFMs have now transformed from EU fund managers to third country fund managers and will for market access in the EU be dependent on the National Private Placement Regimes (NPPRs) that are available on a country-by-country basis.

For the Dutch NPPR for AIFMs, the following conditions apply in accordance with Article 42 AIFM Directive:

(i) the AIF may only be offered to professional investors within the meaning of the AIFM Directive;
(ii) the country in which the non-EEA AIF or non-EEA AIFM is established may not be listed as FATF non-cooperative;
(iii) the Dutch regulator (AFM) and the supervisory authority of the home Member State of the non-EU AIFM must have concluded a cooperation agreement for the exchange of supervisory information
(iv) an attestation notice of the AIFM's home state regulator confirming that the regulator is able to effectively comply with the cooperation agreement must be submitted with the notification form. This attestation notice is form free. However, this means that there must be some sort of supervision of the non-EEA AIFM in the home State and that the non-EEA AIFM must be able to provide evidence of such supervision with its notification to the AFM.

Furthermore, certain ongoing transparency requirements (AIFMD prospectus requirement, regulatory reporting) still apply to non-EU AIFMs that are active under the NPPR referred to above. Also, asset stripping rules may apply, depending on the type of AIF that is managed.

The NPPR is a commonly used way of market entry for non-EU fund managers targeting institutional investors, such as Dutch pension funds. A disadvantage of the NPPR is that it only caters for accessibility for third country AIFMs to the institutional market. Selling funds to high net worth investors or retail investors is out of reach under the NPPR. For non-EU AIFMs that are established and duly licensed in Jersey, Guernsey, Hong Kong (with restrictions) or the US (with restrictions) and that wish to manage an AIF in the Netherlands which is also aimed at retail investors, the so-called "designated state exception" is available. This means that these AIFMs may operate in the Netherlands on the basis of the home country license. However, these AIFMs still need to register with the AFM and to comply with the Dutch rules of conduct. It is yet a question whether the UK will also become a designated state (as appointed as such by the Dutch legislator).

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We see in practice that many third country fund managers inquire about the option to rely on reverse solicitation when getting in touch with non-Dutch investors. We note that relying on reverse solicitation is a risky option and will only work in incidental cases with specific circumstances. Basing a marketing or private placement strategy on reverse solicitation is in our view a contradictio in terminis.

The application of the principle of reverse solicitation may need to be stretched to solve the situations that will arise for UK fund managers with non-institutional Dutch investors as participants in closed end funds. In that case, argument can in our view be made that the participants can retain their interest in such fund on the basis of the concept of reverse solicitation, provided that (i) such existing participations will be informed about the new regulatory status (unregulated in the EU) and (ii) all possibilities to offer the participations an exit are explored and explained and, where feasible, offered to the participant. The line of reasoning under this reverse solicitation concept could in this case be, in short, that (i) the existing participant relationship has been established legitimately in the past, where possible supported by the additional argument that (ii) the client requires continuation of the participation after Brexit if it did not decide to make use of an exit option. However, we note that the AFM did not express any views on this issue yet and is generally reluctant to accept reverse solicitation as a solution, especially where the retail market is concerned. This probably explains why the AFM recently emphasised, in its recommendations on AIFM Directive improvements to the European Commission, that the work on the Third Country passport will be re-started. That passport will enable third country managers to freely circulate their funds throughout the EU on a cross border basis. We agree with the AFM that this is key to procure that the European capital markets remain open and attractive for foreign investment.