Time's Up for Reverse Solicitation? Case Study: MONACO

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Introduction: Reverse Solicitation as a sales practice is under increasing scrutiny by country regulators and the European Securities and Markets Authority (ESMA). In December 2021 the new Chair of ESMA, Verena Ross, wrote to the European Commission regarding reverse solicitation in the contest of the Cross Border Distribution of Funds regime ("CBDF"). The letter was issued following a previous 2021 request for evidence from the European Commission on the levels of the use of Reverse Solicitation in the EU.

ESMA has conducted surveys of several National Competent Authorities ("NCAs") about their knowledge of the prevalence and use of Reverse Solicitation by Alternative Investment Fund Managers (AIFM)s and Asset Managers. Many NCAs suspect that Reverse Solicitation is being "over-used" (abused) as a sales practice to circumvent EU rules on AIFM/AIF passporting under AIFMD or notifications under NPPR, UCITS passporting requirements and/or to circumvent MiFID-II licensing rules for the promotion of funds in the EU, especially in light of Brexit. This article will focus on the use of Reverse Solicitation for Alternative Investment Funds ("AIFs").

So Reverse Solicitation as a sales practice is in the Regulator's crosshairs.

While the Principality of Monaco is a third country with respect to the European Union (EU), it is still an important example of how Reverse Solicitation, which was a previously "tolerated sales practice" with investors in Monaco, is now prohibited and how the Monaco Regulator, the "*Commission de Contrôle des Activités Financières*" (Financial Activities Supervisory Commission) ("CCAF") has addressed Reverse Solicitation through legislation.

In this SRMO News article, we analyse Monaco as our Reverse Solicitation Case Study for legal & compliance insight into Reverse Solicitation. The Monaco legal perspective is provided by expert Monaco Counsel Geoffroy Michaux, and marketing compliance commentary is from Global Sales Compliance Ltd.®, cross-border marketing compliance consultants.

Monaco Legal Perspective: AML Monaco Advisory

Because the Principality of Monaco is not a member of the European Union (EU), EU regulations do not apply in Monaco and Monaco is under no general obligation to transpose EU Directives into Monegasque legal order. However, under a Monetary Agreement between the European Union and the Principality of Monaco of Nov. 29, 2011 (the "***Monetary Agreement***"), the Principality of Monaco shall, pursuant to art. 9 of the Monetary Agreement :

[1]Accord Monétaire entre la Principauté de Monaco et l'Union Européenne - Annexed to Sovereign Ordinance n° 3.559 of 5 December 2011, as amended pursuant to Sovereign Ordinance n° 8.600 dated April 1st, 2021.

a. *apply all appropriate EU legal acts or rules listed in Annex A relevant to the application of Article 11(2), including those which are directly applied by the French Republic or those measures taken by the French Republic for the transposition of the relevant legal acts or rules in accordance with the modalities set out in Articles 11(2) and 11(3);*

b. *adopt measures to comply with the legal acts or rules listed in Annex B, which are either directly applied or transposed by the Member States, in accordance with the modalities set out in Articles 11(4), 11(5), and 11(6) of this Agreement, in the following fields:*

– *banking and financial legislation, as well as the prevention of money laundering in the domains and in accordance with the modalities set out in Article 11[…]*

Relating to financial products and their distribution, and within the framework of the Monetary Agreement, EU Directive 2011/61(AIFM) and 2014/65 (MiFID II) have only been incorporated into the Monegasque legal order in 2021 .

Therefore, and until recently, neither the concept of "marketing" or "pre-marketing" of financial products in the Principality of Monaco, nor the relating practices, including their distribution products, were specifically addressed under Monegasque law.

Prior to that, the only applicable piece of legislation applicable to financial activities in Monaco in general, was Law n°1,338 , under which the exercise of any financial activity in the Principality (as defined in the said law) is subject to obtaining a license from the local regulator (CCAF).

Accordingly, foreign managers were not allowed to directly market their products to any investors in Monaco. Only duly authorized and CCAF-licensed entities could distribute financial products in Monaco, within the framework of a "distribution agreement".

However, applicable regulations did not formally forbid informing potential investors residing in Monaco in response to an unsolicited approach from that investor (the so-called Reverse Solicitation), and practice had it that reverse solicitation was tolerated provided that :

- the unsolicited approach was not a recurrent scheme;
- the fund manager was at all times able to prove that the initial solicitation was initiated by the investor;
- meetings and/or transactions took place outside Monaco;
- the fund manager had no physical or legal presence in Monaco.

This "loophole" practice raised a very high degree of uncertainty and risk for both CCAF-licensed entities, and non-Monegasque managers and financial entities, and the Monegasque financial sector had requested clarification on this practice from CCAF for a very long time.

It has finally been heard through the enactment of law 1.515 dated December 23, 2021, which modified law 1.338 as at January 7, 2022, in the perspective of

[2]Sovereign Ordinance No. 8.600 of April 1st, 2021
[3]Law 1.338 of September 7, 2007 on Financial activities.
[4]Art. 29 of Law 1.338 as modified pursuant to art. 27 of Law 1.529 of July 29, 2022

the adhesion process of the CCAF to the International Organization of Securities Commissions (IOSCO).

Under the new law "Non-licensed companies are prohibited under the present law from canvassing, whether based on ***active or reverse solicitation***, in order to offer, financial services or financial products, regardless of the place and medium used."

This new piece of legislation raised many questions from CCAF-licensed entities, local legal practitioners and foreign managers and financial entities as to the actual intention of the legislator to fully forbid the marketing and distribution of financial products to all Monaco-based individual and entities as no exceptions were included in law 1.515.

Law 1.529 of July 29, 2022 clarified this matter establishing a number of exceptions , for (i) institutional investors, (ii) CCAF-licensed entities and (iii) clients of such licensed entities provided that such canvassing is conducted through such CCAF-licensed entities. Also, the prohibition does not apply to events organized in the Principality gathering professionals from the banking and financial sectors, subject to prior notification to the CCAF.

On the contrary, Law 1.529 establishes a clear prohibition of unrequested solicitation, carried out remotely, by any non-CCAF-licensed entity with a view to offer, regardless of the place or the means used, services, financial instruments or products, to people domiciled in the Principality, except when the person domiciled in Monaco is a client of such entity.

Finally, Article 29 of Law n°1529 creates an Article 29-2 in Law n°1338 prohibiting CCAF-licensed companies from carrying out unrequested solicitation at the investor's domicile, residence, or place of work, with a view to offering services, financial instruments or products to people domiciled in the Principality.

Marketing Compliance Perspective: Global Sales Compliance Ltd®

For the past two decades, GSC Ltd. has investigated the sales practice of Reverse Solicitation with our legal Counsel network, including Monaco. We have queried over 50 law firms in 50 jurisdictions about whether AIFMs and Asset Managers can utilise the sales practice of Reverse Solicitation as a regulatory carve-out, waiver or exemption from local country fund marketing and licensing laws with respect to the cross-border solicitation of funds and/or financial services.

Reverse Solicitation is a sales practice whereby the investor requests information about an AIFM/Asset Manager's fund at their own initiative, under the assumption that there was no prior contact (or initiative) made by the AIFM/Asset Manager and/or no contact was made by any third party to result in the investor's unsolicited request for information on the fund from the AIFM/Asset Manager.

Let's examine Regulator intent: Reverse Solicitation as a sales practice was intended by some Regulators to be a regulatory carve-out or waiver from local country fund marketing and/or licensing requirements. In applying these regulatory waivers, some Regulators were trying to be "helpful" to the industry to acknowledge that indeed, in some cases, there truly are instances of unsolicited,

inbound enquiries about AIFM/Asset Manager funds from potential investors.

Some country regulators acknowledge the sales practice of Reverse Solicitation as a market practice that is exempt from their local fund marketing and licensing rules; however, the regulators that do accept Reverse Solicitation apply several "***substance tests***" to determine whether this sales practice qualifies as a potential regulatory waiver.

Our Counsels confirm that in order to confirm regulatory carve-outs or waivers from fund marketing and licensing regulations, some NCAs apply the "***initiative test***": who (which party) contacted whom first about the AIFM/Asset Manager and its funds? Other law firm feedback is that Regulators apply the "***legitimacy test***": AIFM/Asset Manager's files should not contain numerous client letters to "prove" Reverse Solicitation; otherwise, regulators will "look through" this sales practice and may conclude that proactive solicitation took place in that jurisdiction, potentially in breach of local country marketing rules.

From our regulatory investigations with law firms around the world and for the sake of completeness, many Regulators do not accept the sales practice of Reverse Solicitation as a regulatory carve-out, waiver or exemption from their local regulations concerning fund marketing and licensing rules. Notable examples of Regulators in this category include the US Securities & Exchange Commission (SEC) and Japan's Financial Services Authority (FSA); meaning, these Regulators do not accept Reverse Solicitation as a waiver of their rules and regulations.

Based on two decades of compliance advisory experience, in practice our best guess is that true, legitimate unsolicited reverse enquiries from investors about an AIFM/Asset Manager's fund without any prior contact by the AIFM/Asset Manager or other third party to the investor are ***rare*** according to the original intent of the regulator. Even sales teams tell us they must make outreach to the investor first in order to "generate" a so-called "Reverse Solicitation" request from the investor about the AIFM/Asset Manager's AIF.

So, some industry players have taken what was intended by regulators to be a sales practice relevant for a "one-off" instance of regulatory carve outs/waivers and are abusing this practice by conducting proactive, ongoing AIF solicitation in breach of AIF marketing regulations and licensing rules and calling it" Reverse Solicitation". Regulators across the EU are now waking up to this potential regulatory abuse (and some may say, regulatory manipulation) and one regulator in particular, Monaco's CCAF, has put an end to it through a legislative response.

In Monaco the big business opportunity for AIFM/Asset Managers has always been to target Monaco Family Offices, Private Wealth Management channels and high net worth individuals for the marketing of their AIFs. While Reverse Solicitation was a tolerated sales practice in Monaco until recently, CCAF has finally regulated – and limited – this practice under Monaco's regulations.

This sales practice has been used for many years and might have gotten out of hand to some extent, with AIFM/Asset Managers proactively soliciting Monaco's Family Office clients and high net worth

individuals about their AIFs, trying to operate under the mirage of a "regulatory waiver" called Reverse Solicitation. Perhaps this cross-border practice which was previously tolerated by CCAF rose to a higher, more dangerous level putting Monaco's Private Wealth Management industry at risk. Could CCAF's move to limit Reverse Solicitation be a protectionist move for Monaco's cottage industry (the golden egg), the Private Wealth Management/Family Office and high net worth individual investors?

Summary

The sales practice of Reverse Solicitation as a regulatory carve-out (exemption) was intended by regulators to apply in limited circumstances and meeting certain compliance substance tests including the "initiative test" and "legitimacy test".

Some EU regulators are becoming increasingly aware that this sales practice is being overused by some financial industry players and suspect that their use of reverse solicitation is an excuse for non-compliance with EU Directives.

Even though Monaco is not an EU member state, its regulator realised that the Reverse Solicitation "loophole" needed to be closed and further legislative clarification was needed in respect of foreign fund managers soliciting investors in the Principality of Monaco under the guise of "Reverse Solicitation".

Could other National Competent Authorities ("NCAs") follow CCAF's approach with a firmer legislative response to the overuse by some industry players of Reverse Solicitation as a way to circumvent national (country) regulations?

We are monitoring it.

Author Bios

Geoffroy Michaux is a managing partner at AML Monaco Advisory, in Monaco and founder and partner of GPM-Avocats in Paris (France). Geoffroy advises HNWI and Family offices on structuring asset-protection organizations, and conducting financial investments, as well as fund managers on all sorts of Monegasque matters (setting-up and structuring local structures – relationships with the local regulator – distribution schemes etc.).

Geoffroy is a Cornell Law School and a Sorbonne Graduate, and is admitted to the bar in Madrid, New York, Geneva and Paris. He has over 15 years of practice with leading law firms in various jurisdictions (Cuatrecasas in Barcelona, Winston & Strawn in France, Lenz & Staehelin in Switzerland and Gordon S. Blair in Monaco) relating to private-clients investment schemes and investment regulation.

Cathy Brand is founder and CEO of Global Sales Compliance Ltd.® and Sales Road Maps Online Ltd.®. and is the industry's leading expert in cross-border marketing compliance with over two decades of experience dedicated to cross-border financial product & services regulations. Working with our valued legal Counsel partner network, GSC Ltd. provides bespoke compliance advice to AIFMs, Asset Managers, Global Financial Institutions and broker-dealers on compliance with country marketing regulations for the cross-border promotion of AIFs, asset management funds and the provision of financial services in over 70 countries worldwide.

Cathy's 30+ year career includes varied roles at Citigroup, UBS, Zurich Insurance, a US Family Office and development of SRMO, the industry's innovative RegTech solution for cross-border AIF marketing compliance. Cathy received her MBA in International Finance from the George Washington University (Washington, D.C. USA) and BBA in International Business from the University of Georgia, USA.