

Marketing of AIF by non-EU AIFM / Third Country Managers in Germany after 21 July 2013

The new German Capital Investment Act (*Kapitalanlagegesetzbuch*, KAGB) coming into force on 22 July 2013 provides for the implementation of the AIFM-Directive ("**AIFMD**") and a number of modifications to the regime of marketing and distribution of units in funds in Germany. This client briefing has a special focus on marketing of EU and non-EU Alternative Investment Funds ("**AIF**") by non-EU Alternative Investment Fund Managers / Third Country Managers ("**non-EU AIFM**") in Germany after 21 July 2013.

On 16 May 2013, the First Chamber of the German Federal Parliament (*Bundestag*) adopted the AIFM Implementation Act (*AIFMD-Umsetzungsgesetz*) that provides for the replacement of the German Investment Act (*Investmentgesetz*, InvG) by the KAGB. On 7 June 2013, the AIFM Implementation Act was on the agenda of the Second Parliamentary Chamber, the Federal Council (*Bundesrat*). The Federal Council raised no objections and, as a result, the AIFM Implementation Act will soon be signed into law by the Federal President (*Bundespräsident*) and published in the Federal Gazette (*Bundesgesetzblatt*). It is planned that the AIFMD Implementation Act and accordingly the German Capital Investment Act will come into force on 22 July 2013.

The below gives an overview of the notification procedure as well as the requirements set out by the KAGB for non-EU AIFM intending to distribute units in EU AIF or non-EU AIF managed by themselves towards professional and/or semi-professional investors (definition of terms in Annex A) in Germany. The KAGB distinguishes between three categories of AIF, domestic (German) AIF, EU AIF and non-EU AIF (= Third country AIF). For the purpose of this client briefing, the term AIF only refers to EU AIF and to non-EU AIF, but not to domestic (German) AIF.

Section 330 of the KAGB provides for the provisions corresponding to Article 42 of the AIFMD (Conditions for the marketing in Member States without a passport of AIFs managed by a non-EU AIFM).

A German peculiarity is that the German legislator took the opportunity of the AIFMD implementation to terminate the private placement regime in Germany, *i.e.*, to terminate licence free marketing and distribution of units in funds to professional investors. (For more detail please refer to our May 2013 Client Briefing "Marketing AIF in Germany"). As a consequence, after 21 July 2013 marketing and distribution of units in funds to professional investors in Germany will become an activity subject to licensing, if no exception (grandfathering rules, grace period) applies.

After July 2015 the EU "licence" (passport) for non-EU AIFM according to the regime in Articles 37 and 39, 40 of the AIFMD will be required by the KAGB. Until then (July 2015) the following Article 42 of the AIFMD-based national procedures must be followed to obtain a licence under German law. Please note that Germany did not opt for an implementation of the AIFMD with both national and EU regimes being available at the same time in the period between 2015 (date according to Article 67

para 6 of the AIFMD) and 2018 (date according to Article 68 para 6 of the AIFMD). In Germany, the AIFMD implementation will be completed in July 2015 with the EU-passport regime being the sole authorisation recognised by the KAGB.

A. Requirements for distribution to professional and semi-professional investors

1.1 Distribution to professional investors only

If a non-EU AIFM intends to distribute units of a non-EU AIF or an EU AIF managed by itself, **only** to professional investors (definition of term in Annex A) in Germany, the following prerequisites must be met:

- I. Adequate cooperation agreements between the German regulator, the Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "BaFin") and the home state authority of the non-EU AIFM and, as the case may be, the home state authority of the AIF are to be entered into;
- II. neither the home state of the non-EU AIFM nor the home state of the non-EU AIF are on the Financial Action Task Force (FATF) blacklist of Non-Cooperative Countries or Territories;
- III. appropriate measures to prevent marketing of the AIF to retail investors have been implemented (e.g. disclaimer on website not sufficient); and
- IV. the non-EU AIFM complies with certain information duties towards BaFin:
 1. The non-EU AIFM has to provide the following information for each of its managed domestic AIF and EU AIF as well as for each AIF being marketed in an EU or EEA country:
 - a) the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature;
 - b) any new arrangements for managing the liquidity of the AIF;
 - c) the current risk profile of the AIF and the risk management systems employed by the non-EU AIFM to manage the market risk, liquidity risk, counterparty risk and other risks including operational risk;
 - d) information on the main categories of assets in which the AIF invested; and
 - e) the results of certain stress tests related to risk and liquidity management.
 2. BaFin may request the following additional information from the non-EU AIFM:
 - a) Annual report of its managed domestic AIF and EU AIF as well as for each AIF being marketed in an EU or EEA country;
 - b) a detailed list for the end of each quarter of all AIFs which the non-EU AIFM manages;
 3. non-EU AIFM managing at least one AIF, which employs leverage on a substantial basis, has to provide BaFin with the following for each of its managed AIF:

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- a) The total amount of leverage employed, as well as a breakdown by type of leverage, distinguishing between leverage due to borrowing or securities lending, and leverage arising through the use of derivatives or in any other way;
 - b) the extent of the re-utilisation of assets of the AIF in connection with the employment of leverage; and
 - c) the identity of the five largest financial donors, of which loans or securities loans were taken out, and the extent of such loans or securities loans;
4. BaFin may, regularly or *ad-hoc*, specify additional or *ad-hoc* reporting requirements for AIFM, provided this is required for the effective monitoring of systemic risk or when BaFin is requested by the European Securities and Markets Authority (ESMA) to impose such additional reporting requirements.

V. If the AIF qualifies as a private equity fund the non-EU AIFM adheres to the special requirements of the KAGB for private equity funds:

1. The AIFM investing for an AIF may only invest in assets with a so-called fair value that can be determined;
2. the AIFM is obliged to inform BaFin if the proportion of the voting rights of the non-listed company which is held by the AIF, changes due to purchase, sale or holding of shares of the concerned non-listed company with regard to the thresholds of 10%, 20%, 30%, 50% or 75% being reached, exceeded or undercut;
3. should the AIF alone or jointly with another AIF obtain control of a non-listed company, then the AIFM is obliged to also inform the non-listed company and its shareholders (should their identity and address be known). Exercising control in terms of the private equity provisions of the KAGB means to obtain more than 50% of the voting rights of the company in question; and
4. the reporting requirements according to items IV. 3. and IV. 4. above must be complied with at the latest within 10 working days after the relevant threshold has been reached.

The private equity provisions of the KAGB do not apply with respect to (i) exercising control over non-listed small and medium-sized companies (SME) pursuant to article 2 para 2 of the annex to the Commission Recommendation 2003/361/EC dated 6 May 2003 or (ii) with respect to a special purpose company for acquiring, holding or managing real estate.

VI. The AIFM has appointed one or more depositories for the AIF, who take over responsibilities in accordance with Article 21 paras 7 to 9 of the AIFMD.

The depository

1. ensures that the AIF's cash flows are properly monitored, and shall in particular ensure that all payments made by or on behalf of investors upon the subscription of units or shares of an AIF have been received and that all cash of the AIF has been booked in separated cash accounts;
2. ensures that the assets of the AIF or the AIFM acting on behalf of the AIF shall be entrusted with the depository for safe-keeping as follows:
 - a) for financial instruments that can be held in safe custody;

(i) The depositary shall hold all financial instruments that can be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary in safe custody; and

(ii) for that purpose, the depositary shall ensure that all those financial instruments that can be registered in a financial instruments account opened in the depositary's books are registered in the depositary's books within segregated accounts opened in the name of the AIF or the AIFM acting on behalf of the AIF, so that they can be clearly identified as belonging to the AIF in accordance with the applicable law at all times;

b) for other assets:

(i) The depositary shall verify the ownership of the AIF or the AIFM acting on behalf of the AIF of such assets and shall maintain a record of those assets for which it is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership of such assets;

(ii) the assessment of whether the AIF or the AIFM acting on behalf of the AIF holds the ownership shall be based on information or documents provided by the AIF or the AIFM and, where available, on external evidence; and

(iii) the depositary shall keep its records up-to-date;

3. ensures that the sale, issue, re-purchase, redemption and cancellation of units or shares of the AIF are carried out in accordance with the applicable national law and the AIF rules or instruments of incorporation;
4. ensures that the value of the units or shares of the AIF is calculated in accordance with the applicable national law, the AIF rules or instruments of incorporation and the procedures laid down in Article 19 of the AIFMD;
5. carries out the instructions of the AIFM, unless they conflict with the applicable national law or the AIF rules or instruments of incorporation;
6. ensures that in transactions involving the AIF's assets any consideration is remitted to the AIF within the usual time limits; and
7. ensures that an AIF's income is applied in accordance with the applicable national law and the AIF rules or instruments of incorporation.

VII. The information duties pursuant Article 23 of the AIFMD, i.e the latest financial statements and an appropriate document containing all necessary information mentioned in Article 23 para 1 of the AIFMD and information on a potential limitation of liability of the depositary vis-à-vis potential investors are fulfilled.

1.2 Additional requirements for marketing to semi-professional investors

If the AIF shall not only be marketed to professional investors but also to semi-professional investors (definition of terms in Annex A) certain, additional requirements must be fulfilled:

- I. The non-EU AIFM wholly complies with the provisions of the AIFMD as stated in the KAGB (e.g. organisational measures, capital requirements, compliance); and

- II. the management of the AIF by the non-EU AIFM wholly complies with the provisions of the AIFMD as stated in the KAGB (e.g. investors information, rules of conduct).

1.3 Master - Feeder structures

In Master-Feeder structures under section 330 of the KAGB the requirements summarised above also apply to the Master-AIF and its AIFM.

B. Notification procedure

2.1 Filing a formal notification

The AIFM has to file a formal notification with BaFin. The following documents are to be included in the notification file:

- I. Notification letter;
- II. the following up to date information/documents:
 - 1. Business plan, containing information regarding the notified AIF and its registered office;
 - 2. investment conditions, the articles of incorporation and the partnership agreement of the notified AIF respectively;
 - 3. name of the depositary of the notified AIF;
 - 4. description of the notified AIF and any information on the AIF available to the investor;
 - 5. information concerning the registered office of the Master-AIF and its management company, in case the notified AIF is a Feeder-AIF;
 - 6. information on the arrangements that have been taken to prevent units or shares of the AIF to be marketed to private investors, particularly if the AIFM engages an independent company for the provision of investment services for the notified AIF; and
 - 7. further information enumerated in detail in section 307 of the KAGB;
- III. further documents and information:
 - 1. Material information concerning the
 - a) AIFM and its committees; and on the
 - b) depositary or trustee being responsible for the safe-keeping of the assets of the AIF;
 - 2. statement of non-EU AIFM committing itself
 - a) to submit the AIF's audited annual report to BaFin, six months after the end of each fiscal year at the latest;
 - b) to inform BaFin of all material changes; and

- c) to provide information and submit documents to BaFin, at its request, and to comply with the notification and information duties regarding the management of the AIF;
3. if also distributing to semi-professional investors, the following information in relation to non-EU AIFM must be submitted:
- a) adequate proof of the fulfilment of the capital requirements necessary for business operations;
 - b) names of the managers;
 - c) information for assessing the reliability of the managers;
 - d) information for the assessment of the professional competence of the managers;
 - e) the names of the shareholders of a qualified participation in the AIFM, information to assess their reliability and the extent of their respective participation;
 - f) information concerning facts indicating a close link between the AIFM and other individuals or legal entities;
 - g) a business plan, containing, *inter alia*, information on how the AIFM will comply with its responsibilities under the KAGB;
 - h) information on the remuneration policy and remuneration practices; and
 - i) information in relation to the outsourcing arrangements;
4. proof of payment of the fee for the notification; as well as
5. additional requirements in case of Feeder-AIF (further information can be provided upon request).

Documents in a foreign language must be translated either into German or provided in English.

2.2 Approval Period

The approval procedure may take between 2 and 4 months if distribution is limited to professional investors or between 4 and 8 months if distribution is also intended to semi-professional investors depending on whether Master-Feeder structures are involved.

If the non-EU AIFM has applied for the licence to distribute units in another AIF earlier, it might be possible to refer to some of the documents filed in this earlier notification procedure.

Annex A: Definition of the terms professional investors and semi-professional investors

Professional investors within the meaning of the KAGB are either investors who are, according to Annex II of the MiFID (Directive 2004/39/EC), (i) considered to be professional customers, or (ii) investors who, upon request may be treated as professional customers.

Contacts



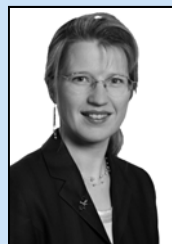
Dr. Sven Zeller
Partner

T: +49 69 7199 1280
E: sven.zeller
@cliffordchance.com



Dr. Gregor Evenkamp
Partner

T: +49 69 7199 3158
E: gregor.evenkamp
@cliffordchance.com



Dr. Alexandra M. Uhl
Counsel

T: +49 69 7199 3154
E: alexandra.uhl
@cliffordchance.com



Stefan C. Koch, LL.M.
Senior Associate

T: +49 69 7199 3164
E: stefan.koch
@cliffordchance.com



Lars H. P. Thiessen,
Maitre en droit
Senior Associate

T: +49 69 7199 3192
E: lars.thiessen
@cliffordchance.com



Andrea A. Stockhorst
Associate

T: +49 69 7199 3126
E: andrea.stockhorst
@cliffordchance.com



Kirill Schitomirski
Associate

T: +49 69 7199 3179
E: kirill.schitomirski
@cliffordchance.com

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