

German Implementation of the Cross-Border Distribution of Funds Directive: New Pre-Marketing Rules for EU and Non-EU Managers

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The German Ministry of Finance has published the long-awaited ministerial draft of the act implementing (among other things) the Cross-border Distribution of Funds Directive 2019/1160 (the “Directive”). The act is referred to as the Act to Promote Germany as a Fund Jurisdiction (the “Act”) and includes some changes to improve the regulatory framework for German funds and German fund managers. As to non-EU funds, the Act also provides rules with respect to pre-marketing in implementation of the Directive, making non-EU funds and managers subject to the same rules regarding pre-marketing as EU funds, to the extent marketed in Germany.

Background

As discussed in our previous [update](#), the Directive was adopted to amend, among other things, the Directive 2011/61/EU on Alternative Investment Fund Managers (“AIFMD”) to create an EEA-wide approach to pre-marketing. It remains in the remit of the German legislator to decide how pre-marketing is applied in respect of retail investors and non-EU AIFMs under the statement in the recital of the Directive that EU AIFMs may not in any way be disadvantaged vis-a-vis non-EU AIFMs.

What Is Pre-Marketing?

“Pre-marketing” refers to distribution-related activities that can be conducted without having obtained marketing approval. This occurs when an authorised EU AIFM or non-EU AIFM or a third party on the AIFM’s behalf directly or indirectly makes information or communication regarding investment strategies or concepts available to German professional and semi-professional investors or EEA professional investors to determine if there is an interest in an AIF (or a compartment of an AIF) that is not yet established or that is established but has not yet obtained the marketing passport or approval, which does not constitute an offer or placement of the AIF’s interests with the prospective investor.

The information that may be provided in the course of permitted pre-marketing must not:

- enable investors to acquire interests or shares of an AIF (hence no subscription documents or anything that amounts to subscription forms or similar documents (whether in draft or a final form) may be shared); or
- amount to final constitutional documents, final mandatory disclosures under Article 23 AIFMD or final offering documents of an AIF that is not yet “established”.

If draft fund documents are provided, they must not contain “sufficient information” to allow investors to make an investment decision. Hence, there should be clear language that the drafts are subject to negotiation and amendment. We hope that BaFin will accept that, with respect to private funds, when fund documentation is typically negotiated by investors and is only final on admission of the investors, any prior drafts provided will not include “sufficient information”—even if in principle all information is included but subject to final negotiation and acceptance by both sides.

The definition makes clear that the German legislator only allows pre-marketing to semi-professional and professional investors and not retail investors in Germany.

Pre-Marketing Notification

German and non-EU AIFMs and EU AIFMs marketing non-EU AIFs¹ will be required to document their pre-marketing efforts and notify BaFin no later than two weeks after the pre-marketing has started, including a list of relevant AIFs, the relevant time period and a brief summary of the AIF’s investment strategy.

One important change is that if pre-marketing is conducted by a third party on behalf of an AIFM (which appears to include affiliates of the AIFM), the third party requires an EU authorisation either as an investment firm, credit institution, AIFM or UCITS management company or tied agent status within the meaning of MiFID. This is quite an important change, as it seems that pre-marketing (and also marketing) must be conducted either by the AIFM itself or an authorised licensed EU firm, irrespective of whether such activity constitutes a MIFID regulated activity or not.

¹ According to the Directive EU AIFMs marketing EU AIFs will have the same obligation towards their home state regulator.

Reverse Solicitation

AIFMs must ensure that, after pre-marketing by the AIFM, investors who have been approached during pre-marketing do not subscribe to the AIF for 18 months after the beginning of pre-marketing unless and until the relevant marketing passport (or, in the case of investors in the AIFM's home Member State, regulatory approval to market the relevant AIF) has been obtained. Unfortunately, the wording is not absolutely clear and could be read in a way that investors approached during pre-marketing may not subscribe before the passport or approval is obtained, irrespective of the 18-month period, and all investors that subscribe to the fund, approached or not, within 18 months after the beginning of pre-marketing are deemed to have subscribed because of pre-marketing. The latter reading would preclude any genuine reverse solicitation for 18 months after the beginning of pre-marketing.

On a positive note, the explanatory notes to the Act confirm the current view in the market that advertising the capabilities of the AIFM without advertising a specific AIF ("brand" marketing) is allowed, does not constitute pre-marketing and, therefore, does not preclude reverse solicitation.

De-Notification

AIFMs can de-notify marketing of AIFs to BaFin (or, in case of EU-AIFMs marketing EU-AIFs, towards the home state regulator). De-notifying open-ended AIFs regarding marketing in Germany requires an offer to redeem the interests of German investors free of deductions. That does not apply to closed-ended funds. The AIFM may not then pre-market the relevant AIFs or AIFs with "comparable investment strategies or concepts" during the period of 36 months after de-notification.

AIFMs must continue to comply with mandatory disclosure and reporting obligations towards investors. Non-EU AIFMs and EU-AIFMs de-notifying non-EU AIFs towards BaFin must also continue with mandatory notifications, disclosures and reporting towards BaFin as long as they retain a German investor.

Consequences for Non-EU AIFMs

The Act has the potential to impact the marketing activities of non-EU AIFMs. It does not come as a surprise that non-EU AIFMs will have to comply with the same rules as

EU AIFMs because of the Directive's stipulation that EU AIFMs may not be disadvantaged.

Nevertheless, the prohibition on pre-marketing AIFs with "comparable investment strategies or concepts" for 36 months after de-notifying an AIF impacts non-EU AIFMs more severely than it impacts EU AIFMs. EU AIFMs are subject to AIFMD because they manage EU AIFs and will continue to be subject to AIFMD after de-notification of a fund. Non-EU AIFMs, on the contrary, only submit to AIFMD when filing the marketing notification with one or more EU regulators. In practice non-EU AIFMs rely more on pre-marketing to gauge interest in their AIFs before filing in any member state. They also need to de-notify when their marketing efforts were in vain, because otherwise they would continue to have regulatory obligations towards a multitude of EU regulators without any connection to the European Union. The Act could mean that non-EU AIFMs should abstain from making de-notifications in respect of a particular fund (and hence continue to fulfil reporting and depositary requirements, even if no German investor has been admitted to the fund). Otherwise, non-EU AIFMs may be barred from any further pre-marketing of AIFs with "comparable investment strategies or concepts" for three years.

Other Aspects of the Act

Several measures are taken to promote Germany as a fund jurisdiction, also by broadening the spectrum of available German fund vehicles for sponsors, for example:

- **Open-ended retail infrastructure funds:** An open-ended fund vehicle for retail investors will be created to invest in infrastructure project companies. The fund vehicle will not be a legal entity but a contractual arrangement creating a separated pool of ring-fenced assets (*Sondervermögen*). Because the open-ended fund invests in illiquid assets, the applicable provisions will lean to a large extent on the provisions applicable to open-ended retail real estate funds.
- **Closed-ended Special AIFs:** The Act will provide an additional legal form for special AIFs as well. So far all closed-ended German funds had to be set up as a limited partnership or, rarely, as a stock company. Closed-ended special funds will have the option to choose the form of the above-described contractual arrangement (*Sondervermögen*).
- **VAT on management fee:** A major drawback of Germany as a fund jurisdiction for, for instance, private equity funds has been the application of VAT on fund management services provided by the AIFM to the fund. Management of "risk

capital funds” (*Wagniskapitalfonds*) will be exempt from VAT. The term is commonly used in the context of venture capital funds but is not defined by law and hence leaves room for interpretation, with the exact scope remaining unclear.

- **Electronic communication with BaFin:** So far BaFin still heavily relies on paperwork in its administrative proceedings. The Act will replace this with electronic communication, which will hopefully simplify registrations, notifications and other proceedings, especially in an international context.

Next Steps

The consultation remains open until 16 December 2020. The replies will feed into the governmental draft that will be consulted before it is submitted to the federal assembly (*Bundestag*) for debate.

The Act will apply beginning with the day after its promulgation. The VAT exemption applies from 1 July 2021 and the electronic communication with BaFin from 1 April 2023, as it will require extensive preparations.

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