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by Angelo Lercara and Robert Eberius

Dechert LLP

9 November 2011

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The implementing provisions for the Alternative Investment Fund Managers Directive (AIFMD) are now about to be elaborated by the European Securities and Markets Authority (ESMA).

Due to the particular structure of the German fund market it will be of utmost importance for German fund managers that the provisions ensure a feasible and competitive framework. More than 80 percent of open-ended investment funds domiciled in Germany, with currently about 900 billion euros of assets under management, will fall under the new EU framework. The biggest impact will be expected for the private equity and closed-end fund sector. These investment vehicles are not currently regulated by any financial supervisory authority in Germany, although prospectuses of closed-end funds aiming at a public offering must be approved by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht or BaFin) (see also below).

German so-called special funds (Spezial-Sondervermögen) will also fall under the new framework. These are funds which are managed by German investment management companies, for which only corporate investors are eligible, and are often established for a small group of investors or even only one investor. Real estate funds will also fall under the new framework. Both are currently subject to a rigorous framework of provision of the German investment act and are already regulated by BaFin; they will now fall under the new AIFMD framework.

The fact that the AIFMD excludes investment vehicles with only one investor has generally been seen as helpful for German special funds, although there has recently been some uncertainty about whether this could turn out to be a disadvantage. The administrative practice of BaFin states that the investment regulation of a special fund must allow the possibility of at least one further investor being admitted. If this requirement is not fulfilled the fund will not be considered to be an investment fund and will also not be subject to the investment tax act and its advantageous taxation rules. It is therefore very important for ESMA to accept that a special fund which provides for the possibility of admitting a further investor in its fund rules should still be considered to be a fund with only one investor for AIFMD purposes.

The Act Amending the Law on Investment Intermediaries and Capital Investments

Introduction

The German government has published a draft law which targets the so far largely unregulated closed-end fund industry in Germany. The Act Amending the Law on Investment Intermediaries and Capital

Investments (*Gesetzesentwurf zur Novellierung des Finanzanlagevermittler- und Vermögensanlagerechts*), which is currently under consideration by the financial committee of the German parliament (*Bundestag*), would introduce a new act, the German Capital Investment Act (*Vermögensanlagegesetz*, the Act), as well as various amendments to existing capital markets-related laws, including the Banking Act (*Kreditwesengesetz*), the Securities Trading Act (*Wertpapierhandelsgesetz*), the Trade Law (*Gewerbeordnung*), and the Investment Act (*Investmentgesetz*). The basic goal of the new Act, as stated in the statutory explanation, is to align the regulatory framework of the so-called "grey capital markets" with that of the securities market as it is currently regulated.

The provisions of the Act would only apply to so-called "capital investments" (*Vermögensanlagen*), most notably closed-end funds, if they are publicly distributed, and none of the exemptions provided in s 2 of the Act are applicable. These exemptions include, *inter alia*, private placements, sales to qualified investors and distributions of shares exceeding a minimum value of 200,000 euros.

Most of the Act's provisions are directed at persons or entities that publicly offer or provide capital investments (*Anbieter*, the issuer).

The provisions of the Act are expected to enter into force in stages, starting at the beginning of 2012. On the effective date, specific German federal departments will be authorised to issue statutory regulation on details of the Capital Investment Act and the changes to the Trade Law. Six months later the Capital Investment Act will enter into force in full. Another seven months after that, the amendments to the Trade Law will come into force.

A grandfathering clause in s 32 of the Act governs, *inter alia*, existing sales prospectuses and claims relating to prospectus liability. A sales prospectus published before the Act comes into effect as a whole would still be governed by the current Sales Prospectus Act (*Verkaufsprospektgesetz*), which will be replaced by the Act. A claim relating to prospectus liability would be governed by the current regulation if the claim originates before the coming into effect of the Act as a whole.

Balancing the Regulatory Frameworks for Investment Intermediaries

Currently, capital investments do not qualify as "financial instruments" and accordingly do not fall within the scope of the Banking Act or the Securities Trading Act. The Act changes the legal definition of financial instruments so that capital investments will now be subject to those laws, which require intermediaries, as a rule, to hold a licence in accordance with s 32 of the Banking Act. This would mean, for example, that intermediaries with respect to capital investments, who already qualify as investment service firms (i.e., entities and persons that are subject to licensing requirements under the Banking Act), would be subject to the conduct of business rules as set forth in s31 of the Securities Trading Act.

If an intermediary sells units in capital investments only, it would be exempted from complying with the rules as set out in the Banking Act and the Securities Trading Act, but would still require a licence pursuant to the Trade Law. This requirement is currently laid down in s34c and will in future be set out in s 34f of the Trade Law. The Act would add a new s 34g, preparing the ground for a statutory regulation

that would include business conduct rules which would essentially be analogous to the regulations in s31 of the Securities Trading Act. These rules will apply to those investment intermediaries who do not require a licence according to s 32 of the Banking Act.

In accordance with the abovementioned transition period, investment service firms would need to implement the business conduct rules six months after the effective date of the Act Amending the Law on Investment Intermediaries and Capital Investments, whereas investment intermediaries who only fall within the scope of the Trade Law would have another seven months to adjust to the new regulations.

New Information Requirements for Issuers

Issuers of capital investments such as closed-end funds will have to comply with new information provision rules. The relevant sections of the Act are essentially based on the analogous provisions of the Sales Prospectus Act. The obligation to issue a sales prospectus will be laid down in s6 of the Act; rules related to content of sales prospectuses and the conditions of its release will be set out in ss7?12.

New rules would include, *inter alia*, the obligation for issuers to place a notice in the sales prospectus which makes it clear that there is a time limit on prospectus liability claims. Issuers would also be required to state the total amount of commissions paid and summarise the material risks related to capital investments. Further, a statutory regulation would identify those documents that have to be attached to the sales prospectus. In addition to requirements as to the content, provisions are also included regarding formatting issues (i.e., requiring that certain information be highlighted).

When publishing a sales prospectus, issuers would be required to provide a capital investment information sheet, which would basically conform with the key investor information documents for UCITS. It may not be longer than three A4 pages, must contain key investor information regarding the capital investment and is intended to enable investors to compare capital investments more easily. The Act specifies the minimum key investor information to be provided, including, *inter alia*, the type of investment, investment strategy and policies, information on material risks and information on costs and commissions. More detailed requirements may be laid down in a statutory regulation in the future. It is likely, however, to be rather difficult to summarise complex risk and fund structure-related information in an easy-to-understand manner within the maximum length of the document.

As a change from the current regulation, the issuer would be obliged to send both the sales prospectus and the key information sheet on demand to investors free of charge.

Significance of BaFin to Issuers of Capital Investment

BaFin looks set to increase in importance. This is not only due to the new definition of financial instruments, which incorporates capital investments, but also because the new regulation is explicitly directed at capital investments. In contrast to the current regulation, the sales prospectus will be subject to a review by BaFin regarding comprehensibility and coherence. Although BaFin will not make any determination regarding the accuracy of the information set out in the sales prospectus, this document may not be made public until approved by BaFin.

Amendments to Liability Regulation

The Act also contains amendments to the prospectus liability regulation, which essentially would be transferred from the Sales Prospectus Act to the Act. Basically, longer limitation periods will apply. In

contrast to the current regulation, it will be possible to assert a prospectus liability claim up to two years after the first public offering of the capital investment has taken place (the limit was previously six months).

Act to Strengthen Investor Protection and to Improve the Operability of the Capital Market

The Act to Strengthen Investor Protection and to Improve the Operability of the Capital Market came into effect April 8, 2011 and contains, *inter alia*, important amendments to the regulatory framework of investment funds, especially with regard to real estate funds. Due to the recent financial turmoil, several real estate funds had to suspense redemption and liquidate their assets because fund shares could not be redeemed in time, i.e., on a daily basis as the former regulation required. To deal with this problem, the provisions on such suspensions and redemptions have been revised.

Fund issuers may now choose to set specific dates at which fund units can be redeemed, which has to be at least once a year. In addition, this act established a minimum lock-up period of 24 months after purchase of the units, as well as a notice period for the intent to redeem of 12 months. Small investors may redeem fund units with an aggregate value of 30,000 euros every six months regardless of the lock-up period.