Dechert LLP

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Germany's New Rules Tough on Foreign Funds

By Madison Marriage

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The German regulator's take on implementation of the Alternative Investment Fund Managers directive could push foreign firms out of the German fund market.

In July, the German ministry of finance published a draft act to implement the AIFM directive into German law, replacing the German Investment Act with the German Investment Code, which comprises the future legal framework for all investment funds in Germany.

A recent report issued by Dechert, a UK law firm, indicates that the draft Act, to gear the country up for implementation of the AIFM directive by next July, risks forcing fund companies out of Germany.

The new German Investment Code is stricter than the AIFM directive and will make doing business in Germany harder for domestic and foreign asset managers, according to the authors of the report.

"On several points the [German ministry of finance] has gone beyond the mandatory minimum requirements of the AIFM [directive] and imposed a more stringent legal framework on the German investment fund sector than that stipulated by the European legislator," the report's authors, Angelo Lercara and Martin Hüwel, write.

According to Mr. Lercara, a partner at Dechert's Munich practice, these rules will eradicate Germany's private placement regime sooner than is necessary, preventing providers of vehicles that are not registered with the German regulator from distributing funds. Fund houses have only one year to register their privately placed funds with the German regulator, which represents a significant cost burden, he says. "Fund providers will have to ask whether they are willing and able to fulfil the requirements of the AIFM directive.

"Registration [with the German regulators] is an option, but in many cases it is not, either because [the requirements] are too burdensome or because [fund firms] do not have enough [German] investors," Mr. Lercara says.

"This will definitely push some providers out of Germany," he adds.

Under the AIFM directive, private placement regimes can continue until 2018, allowing fund groups in most other European jurisdictions an extra five years to choose whether to register with local authorities.

Hedge funds, private equity funds and commodity funds can currently be distributed to institutional and retail investors in Germany under private placement rules.

"In the future no fund will be privately placed, [which] will have a huge impact, in particular on foreign fund providers," he says. Mr. Lercara adds the rule changes "will affect a lot of foreign fund providers" as they currently use the private placement regime when looking for "easy market entry in Germany".

This is because private placement offers "an easy way to gauge the German market," he says.

Fund groups that decide they cannot or will not meet the registration requirements within the time frame face a number of questions over what to do with assets from existing German investors. Mr. Lercara says German investors might be forced to redeem from these fund houses.

Alternatively, all marketing activity for these funds in Germany will cease and the funds will stop accepting further investment from German clients.

Managers of alternative investment funds will "either have to go through full registration or nothing at all", Mr. Lercara says.

Mr. Lercara says managers of real estate funds, private equity funds and closed-ended funds are likely to suffer the most.

However, he says these rule changes will create a "more transparent" environment for investors, who will feel "more comfortable" making investment decisions. He is, nonetheless, dismayed by additional rules requiring domestic fund groups to notify BaFin, the German regulator, prior to marketing alternative investment funds.

Marketing rules have also changed for foreign alternative investment fund management companies, which from next year will need a reliable, suitable representative with a registered office in Germany "[who is] able to exercise the compliance function for management and marketing activities", says Mr. Lercara.