

# Insight: Capital Markets

July 2013

## AIFMD in Germany Strategies for non-EU AIFMs Marketing Alternative Investment Funds

### Summary

- In conjunction with the implementation of the European Directive on Alternative Investment Fund Managers (2011/61/EU) (the "Directive" or "AIFMD") the German legislature decided to abolish the private placement regime in Germany, i.e., to terminate unregulated marketing and distribution of alternative investment funds ("AIFs").
- As a result, from 22 July 2013 onwards, any kind of marketing or distribution of units in AIFs in Germany will be subject to governmental approval by BaFin, the German Financial Supervisory Authority.
- In addition, although the Directive provides for an EU passport regime that allows AIF managers ("AIFMs") to submit to regulation in one European jurisdiction while being permitted to market their AIFs throughout the EU (the "EU Passport Regime"), between 22 July 2013 and July 2015 (at the earliest), only EU-domiciled AIFMs (EU-AIFMs) marketing EU-domiciled AIFs (EU-AIFs) are eligible for the EU Passport Regime.
- Therefore, during this 1st transitional period, non-EU AIFMs wishing to place AIFs (whether or not domiciled in the EU) in Germany, or EU-AIFMs wishing to place non-EU AIFs in Germany will need to comply with domestic requirements set out in Germany's newly introduced Capital Investment Act (Kapitalanlagegesetzbuch or "KAGB") (the "National Regime").
- Non-EU AIFMs that are marketing EU-AIFs may also choose to re-domicile to a European jurisdiction and make use of the EU Passport Regime.
- Unlike some other European jurisdictions, Germany chose not to extend its National Regime in parallel with the full implementation of the EU Passport Regime during the 2nd transitional period between July 2015 (at the earliest) and July 2018 (at the earliest). Therefore, as of July 2015 (at the earliest), the EU Passport Regime will be the sole authorisation recognised by the KAGB for all AIFMs and AIFs, regardless of where they are domiciled.



**Jan-Holger Arndt**  
Partner, Düsseldorf/Germany

+ 49 211 49195 342  
jarndt@whitecase.com

**Stuart Willey**  
Partner, London

+ 44 20 7532 1508  
swilley@whitecase.com

**Sharon Hartline**  
Partner, Hong Kong

+ 852 2822 8733  
shartline@whitecase.com

**Mara Topping**  
Partner, Washington, DC

+ 1 202 626 3663  
mtopping@whitecase.com

**Monica K. Arora**  
Partner, New York

+ 65 6347 1362  
monica.arora@whitecase.com

**Emily Low**  
Local Partner, Singapore

+ 1 212 819 8668  
emlow@whitecase.com

- Along with the new regulations in the KAGB, the German legislature has also introduced a new category of investors – semi-professional investors – who are to a certain degree treated the same as (MIFID) professional investors. This has the potential to expand the base of investors to which authorized AIFMs may market in Germany, but it remains to be seen whether non-EU AIFMs will comply with the additional requirements to market to semi-professional investors, or whether they will pass up the opportunity.

### Background

Historically, the private placement of AIFs in European marketplaces has offered AIFMs relief from otherwise burdensome regulations that accompany public offerings. The implementation of the Directive in European member states as of July 22, 2013 – please see our prior update on AIFMD from June 2013 ([click here](#)) – will fundamentally change the regulatory considerations underlying such a private placement strategy.

AIFMs, and in particular non-EU AIFMs, should be aware of the changes that will accompany AIFMD and should evaluate whether a private placement strategy in Europe continues to be in their best interest.

Although the Directive is intended to harmonize the regulatory framework for AIFMs and for the placement of AIFs throughout the European Union and further member states of the European Economic Area, there will still be variation in the regulatory environment because:

- The Directive will only take effect through the local implementing legislation in each EU member state, which will be applied and interpreted by national regulatory bodies and courts of each EU member state respectively,
- There are various provisions in the Directive that allow member states to impose stricter rules than proscribed in the Directive, and
- The scope of the Directive is limited, allowing member states to implement varying regulation of areas not covered by the Directive. For example, the Directive

only addresses the placement of funds to Professional Investors (as defined in MIFID – see below), and the Directive does not regulate the AIFs as such, but rather the managers of the AIFs.

In other words, while it is helpful to understand the Directive itself, AIFMs will only gain a precise understanding of their regulatory obligations in each European member state by understanding each state's national implementing legislation.

In this memo, we focus on some of the most important peculiarities of Germany's AIFMD implementing legislation, the KAGB. The KAGB distinguishes between three categories of AIFs: Domestic (German) AIFs, EU AIFs and non-EU AIFs. For the purpose of this memo, the term AIF only refers to EU AIF and non-EU AIF.

### Germany Abandons its Private Placement Regime

Effective July 22, 2013, Germany's private placement regime will no longer exist and the placement method (publicly placed or privately offered) will no longer be a relevant criterion in determining the regulatory obligations of AIFMs.

As of July 22, 2013 any placement of an AIF, whether public or private, will require prior notification of and authorization by the competent German governmental authority, BaFin. The authorities will require an information package, the contents of which are set out in detail in the KAGB. Upon receipt of a complete information package, BaFin will decide whether to authorize placement of an AIF. The authorization period is two months if placement is limited to Professional Investors and four months if the AIFM intends for placement to Semi-Professional Investors. With regard to a Feeder-AIF, these authorization periods are doubled to up to four months for placement to Professional Investors and up to eight months for placement to Semi-Professional Investors.

AIFMs that have commenced private placement prior to July 22, 2013 will be permitted to continue placement throughout the notification and authorization period. The law is silent on

how quickly notification should be initiated by such an AIFM while private placement continues, but it would be prudent to provide the required information to BaFin in due course after the July 22, 2013 transition date. In any event, the permission to privately place such grandfathered AIFs will continue only for one year, until July 22, 2014, unless authorization for placement has been granted under the new regime in the interim.

Other EU member states, notably the UK, have announced an intention to maintain their private placement regimes until 2015 or even 2018. However, the current AIFMD phased implementation plan calls for an end to unregulated private placements in all EU member states by the summer/autumn of 2018. Germany's AIFMD implementing legislation may thus be considered an early implementation of the final phase of AIFMD, with other European jurisdictions to follow either immediately, in 2015, or in 2018.

Even during the transitional phases between July 2013 and July 2018 (at the earliest) when some EU member states will maintain their current private placement regimes, AIFMD imposes certain minimum disclosure, reporting, and regulatory filing, both before and after placement of the fund interest in all EU member states. These requirements (the "AIFMD Minimum Requirements") are described in detail in our prior update on AIFMD in June ([click here](#)). While the continued availability of private placement regimes in certain European jurisdictions during the transitional phases is leading some AIFMs to consider abandoning placement in Germany altogether, given the unavoidable AIFMD Minimum Requirements, the additional regulatory requirements of placement in Germany may

### Germany's KAGB Regulates Three Categories of Investors

The KAGB regulates marketing to three categories of investors:

- Professional Investors: Pursuant to the Directive, KAGB regulates AIFMs marketing AIFs to professional investors, which encompasses those investors

listed in Annex II of the Directive 2004/39/EC ("MIFID") (attached hereto as Annex 1).

- **Semi-Professional Investors:** KAGB goes beyond the Directive and establishes a new category of investors, the Semi-Professional Investors, who are, to a large extent, treated the same as the MIFID Professional Investors. By establishing this additional category, the KAGB substantially expands the investor base to which AIFs may be marketed by non-EU AIFMs, and reflects a pro-market philosophy from a German Legislature that has traditionally been viewed as over-restrictive. The definition of a Semi-Professional Investor is set out in detail in Annex 2 hereto.
- **Retail Investors:** Finally, as permitted (but not mandated) by the Directive, the KAGB includes not only regulation of AIFMs marketing AIFs to retail investors, but also regulation of the AIFs themselves that are marketed to such investors. The retail investor category includes all investors that fall outside the definition of professional and Semi-Professional Investors.

## Requirements for Distribution to Professional Investors in Germany (Notification Procedure with BaFin)

If a non-EU AIFM intends to distribute units of an AIF to Professional Investors in Germany, it must meet the following requirements:

- i. An adequate cooperation agreement between the German regulator, BaFin, and the home state authority of the non-EU AIFM and, as the case may be, the home state authority of the AIF (if located elsewhere) must exist;
- ii. Neither the home state of the non-EU AIFM nor the home state of the non-EU AIF may be on the Financial Action Task Force (FATF) blacklist of Non-Cooperative Countries or Territories;
- iii. Appropriate measures must have been implemented to prevent marketing of the AIF to retail investors;

iv. The AIFM must have appointed a depository for the AIF, who will take over responsibilities in accordance with AIFMD.

v. The non-EU AIFM must comply with certain BaFin regulatory filing duties, and must provide BaFin with certain additional information at BaFin's request. If leverage is employed by the AIF, certain further information must be provided. BaFin may, regularly or on an ad-hoc basis, specify additional reporting requirements for the AIFM, provided that such reporting is required for BaFin to effectively monitor systemic risk, or provided that such information is required by the European Securities and Markets Authority (ESMA).

vi. Every investor interested in acquiring a unit in an AIF must be provided with certain information regarding the AIF and the AIFM prior to entering into the contract and on a continuing basis.

vii. If the AIF qualifies as a private equity fund the non-EU AIFM must adhere to the specific requirements of the KAGB for private equity funds. The private equity provisions of the KAGB do not apply with respect to (i) exercising control over non-listed small and medium-sized companies or (ii) special purpose companies designed to acquire, hold or manage real estate.

## Additional Requirements for Distribution to Semi-Professional Investors in Germany

Beyond the requirements for non-EU AIFMs intending to distribute units of an AIF to Professional Investors in Germany, non-EU AIFMs intending to distribute to Semi-Professional Investors must also meet the following requirements:

- i. The non-EU AIFM must wholly comply with the provisions of the AIFMD as stated in the KAGB (e.g. organizational measures, capital requirements, compliance); and
- ii. The AIF's management by the non-EU AIFM must wholly comply with the provisions of the AIFMD as stated in the KAGB (e.g. investors information, rules of conduct).

It remains to be seen whether non-EU AIFMs will be prepared to comply with these additional requirements, or whether they will pass up this opportunity to broaden their investor base.

In Master-Feeder structures, the requirements summarised above also apply to the Master-AIF and its AIFM.

## Germany Transitions to the Passporting Regime

Rather than having each member state independently regulate AIFMs that market within their jurisdiction, the Directive provides for a pan-European marketing passport whereby AIFMs are regulated only by the member state in which they are domiciled (either directly or by reference) and such AIFMs are permitted to market throughout Europe. EU-AIFMs marketing EU-AIFs will benefit from such passporting as of July 22, 2013 and non-EU AIFMs will be eligible for passporting two years later, as of July 22, 2015 (at the earliest), if such non-EU AIFMs are compliant with AIFMD.

The staggered availability of passporting, in conjunction with the imminent abolishment of Germany's private placement regime, gives rise to different strategic considerations for non-EU AIFMs. EU-AIFMs may utilize the passporting system from July 2013 onwards to market EU-AIFs into Germany. In contrast, non-EU AIFMs face a 2-year transition period regarding the marketing of their AIFs (whether domiciled in the EU or elsewhere) in which they may: (a) cherry-pick among other European jurisdictions with private placement markets that will remain open and (i) opt not to market into Germany, or (ii) go through the notification procedure with BaFin to market into Germany, as set out hereinabove, or (b) convert to an EU-AIFM by re-domiciling to Germany or another European jurisdiction and take advantage of the EU Passport Regime that is available to EU-AIFMs marketing EU-AIFs from July 2013 onwards. Note that re-domiciling and taking advantage of the EU Passport Regime would work only for those managers with EU-AIFs; the passport system will only be available for non-EU AIFs as of July 2015 (at the earliest).

# ANNEX 1

## Professional Investors for the Purpose of this Directive

A Professional Investor is a client who possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs. In order to be considered a professional investor, the client must comply with the following criteria:

### I. Categories of investors who are considered to be professionals

The following should all be regarded as professionals in all investment services and activities and financial instruments for the purposes of the Directive.

(1) Entities which are required to be authorised or regulated to operate in the financial markets. The list below should be understood as including all authorised entities carrying out the characteristic activities of the entities mentioned: entities authorised by a Member State under a Directive, entities authorised or regulated by a Member State without reference to a Directive, and entities authorised or regulated by a non-Member State:

- (a) Credit institutions
- (b) Investment firms
- (c) Other authorised or regulated financial institutions
- (d) Insurance companies
- (e) Collective investment schemes and management companies of such schemes
- (f) Pension funds and management companies of such funds
- (g) Commodity and commodity derivatives dealers
- (h) Locals
- (i) Other institutional investors

(2) Large undertakings meeting two of the following size requirements on a company basis:

- Balance sheet total: EUR 20 000 000,
- Net turnover: EUR 40 000 000,
- Own funds: EUR 2 000 000.

(3) National and regional governments, public bodies that manage public debt, Central Banks, international and supranational institutions such as the World Bank, the IMF, the ECB, the EIB and other similar international organisations.

(4) Other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions.

The entities mentioned above are considered to be professionals. They must, however, be allowed to request non-professional treatment and investment firms may agree to provide a higher level of protection. Where the client of an investment firm is an undertaking referred to above, the investment firm must inform such client prior to any provision of services that, on the basis of the information available to the firm, the client is deemed to be a professional client, and will be treated as such unless the firm and the client agree otherwise. The firm must also inform the client that it may request a variation of the terms of the agreement in order to secure a higher degree of protection.

It is the responsibility of the client, considered to be a professional investor, to ask for a higher level of protection when it deems it is unable to properly assess or manage the risks involved.

---

This higher level of protection will be provided when a client who is considered to be a professional enters into a written agreement with the investment firm to the effect that it shall not be treated as a professional for the purposes of the applicable conduct of business regime. Such agreement should specify whether this applies to one or more particular services or transactions, or to one or more types of product or transaction.

## **II. Clients who may be treated as professionals on request**

### **II.1. Identification criteria**

Clients other than those mentioned in section I, including public sector bodies and private individual investors, may also be allowed to waive some of the protections afforded by the conduct of business rules.

Investment firms should therefore be allowed to treat any of the above clients as professionals provided the relevant criteria and procedure mentioned below are fulfilled. These clients should not, however, be presumed to possess market knowledge and experience comparable to that of the client categories listed in section I.

Any such waiver of the protection afforded by the standard conduct of business regime shall be considered valid only if an adequate assessment of the expertise, experience and knowledge of the client, undertaken by the investment firm, gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved.

The fitness test applied to managers and directors of entities licensed under Directives in the financial field could be regarded as an example of the assessment of expertise and knowledge. In the case of small entities, the person subject to the above assessment should be the person authorised to carry out transactions on behalf of the entity.

In the course of the above assessment, as a minimum, two of the following criteria should be satisfied:

- The client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters,
- The size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500 000,
- The client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

### **II.2. Procedure**

The clients defined above may waive the benefit of the detailed rules of conduct only where the following procedure is followed:

- They must state in writing to the investment firm that they wish to be treated as a professional client, either generally or in respect of a particular investment service or transaction, or type of transaction or product,
- The investment firm must give them a clear written warning of the protections and investor compensation rights they may lose,
- They must state in writing, in a separate document from the contract, that they are aware of the consequences of losing such protections.

Before deciding to accept any request for waiver, investment firms must be required to take all reasonable steps to ensure that the client requesting to be treated as a professional investor meets the relevant requirements stated in Section II.1 above.

However, if clients have already been categorised as professionals under parameters and procedures similar to those above, it is not intended that their relationships with investment firms should be affected by any new rules adopted pursuant to this Annex.

Firms must implement appropriate written internal policies and procedures to categorise clients. Professional clients are responsible for keeping the firm informed about any change, which could affect their current categorisation. Should the investment firm become aware however that the client no longer fulfills the initial conditions that made him eligible for a professional treatment, the investment firm must take appropriate action.

