

PRE-MARKETING

The Bundesverband Alternative Investments e.V. (BAI) is the cross-asset class and cross-product lobby for Alternative Investments in Germany.

(Status of the information: 07 July 2021)

What is pre-marketing?

Until now, the launch and distribution of alternative investment funds as well as pre-marketing measures - i.e. the dissemination of information about funds in advance of a marketing authorisation - have been handled legally differently in the EU member states. In order to create a level playing field for cross-border distribution and to remove existing obstacles, the EU Directive 2019/1160 amending the OGAW Directive and the AIFM Directive as well as the Regulation (EU) 2019/1156 were adopted in June 2019.

According to the new and EU-uniform **definition**, pre-marketing is, in short, "the direct or indirect provision of information on investment strategies or investment concepts to potential professional investors resident in the EU in order to test their interest in a fund that has not yet been launched or for which there is not yet a marketing notification in the respective member state".¹ Furthermore, the German definition according to section 1 (19) no. 29a KAGB-E also covers semi-professional investors.

From when are the new changes valid?

The EU Regulation 2019/1156 is directly applicable from 02 August 2021 and the EU Directive 2019/1160 is to be transposed into national law by 02 August 2021. In order to implement the directive, the Fondsstandortgesetz ("FoStoG") was subsequently adopted in Germany, which entered into force on 01 July 2021.

Current status quo in Germany:

Currently, only distribution, i.e. the active offering and placement of investment assets (cf. section 293 (1) sentence 1 KAGB), but not pre-marketing, is regulated in Germany. Distribution is governed by the KAGB and the requirements of BaFin pursuant to the "FAQ Vertrieb" (Frequently Asked Questions on the Distribution and Acquisition of Investment Assets under the KAGB, reference WA 41-Wp 2137-2013/0293). If there is a fully negotiated and thus offer-ready contract or if investment assets already exist, the contact with potential investors qualifies as "distribution" and a distribution notification procedure must be carried out.

As a rule, these prerequisites are not yet present in the creation phase or in the context of the initial contact with the potential investor ("testing the waters"), so that the AIFM are only in the - as yet unregulated - area of pre-marketing. Since marketing activities are characterised by active action, merely responding to an investor's order (so-called reverse solicitation) does not constitute marketing either. Similarly, brokerage by a third party not commissioned by the AIFM does not constitute marketing.

¹ Art. 15 (EU) No 2019/1156

Furthermore, it is currently still possible for investors to sign the AIFM's contractual documents directly after negotiations have been concluded. According to the new legal situation, a marketing notification procedure - which was previously unnecessary - must be carried out beforehand.

What are the main changes in the context of pre-marketing?

What additional notification and documentation requirements will there be in the context of pre-marketing?

According to the new EU-uniform definition of pre-marketing, virtually every dialogue of the fund manager with a potential professional or semi-professional investor about a future fund qualifies as pre-marketing. The classification of the activity as pre-marketing also results in new **notification and documentation obligations**:

The AIF management company must informally notify BaFin or its competent national authority in writing or electronically of the start of pre-marketing within two weeks.² This notification must contain the following information:

- the member states as well as the period in which the pre-marketing takes place or has taken place;
- a brief description of pre-marketing, including information on investment strategies;
- where applicable, a list of the AIFs which are the subject of pre-marketing.

An official template for the notification of pre-marketing does not yet exist. The notification obligation of pre-marketing activities applies to domestic as well as EU and non-EU AIFMs, provided they conduct pre-marketing within Germany.³

Furthermore, the AIFM shall ensure that all pre-marketing activities are adequately documented. The FoStoG does not specify what requirements are to be placed on the documentation obligation. We recommend documenting, among other things:

- the date of the pre-marketing,
- Name and address of the potential investor,
- whether the information was provided directly by the AIF management company or indirectly through intermediaries,
- a brief summary of the content of the information.

The competent authority of the home member state of the AIFM shall subsequently inform the competent authorities of the Member States where pre-marketing is or has been carried out.

² Section 306b (3) KAGB-E

³ Section 306b (4) KAGB-E

Can an AIFM continue to promote its services and products without this being classified as pre-marketing?

As a rule, the mere general advertising of one's own services without a concrete reference to the product of the AIF management company does not qualify as pre-marketing. Therefore, no notification to the competent authority is required in this respect. However, the border to pre-marketing will be fluid. It will have to be assessed differently from case to case whether the general advertising of own products falls under the "provision of information on investment strategies or investment concepts to potential investors in order to test their interest in a fund that has not yet been launched" and thus possibly already constitutes pre-marketing.

What are the consequences of violations of the documentation and notification requirements?

Violations of documentation and notification obligations constitute **administrative offences** pursuant to section 340 para. 2 no. 79c and no. 79d KAGB-E, which may be punished by a fine of up to €200,000 and a fine of twice the economic advantage derived from the violation.⁴

Moreover, a violation could result in the nullity of the subscription under civil law pursuant to § 134 BGB, provided that the documentation and notification obligations qualify as a statutory prohibition within the meaning of § 134 BGB. However, this is contradicted by the fact that the pre-marketing regulations are only directed against the circumstances of the conclusion of the subscription, but not against the content of the legal transaction - the subscription - as such.

What information towards the potential investor is permissible in the area of pre-marketing?

Pursuant to section 306b (1) KAGB-E, no documents or information may be provided to professional or semi-professional investors in the context of pre-marketing which:

- sufficient to enable investors to commit to the acquisition of units or shares of a particular AIF;
- Drawing forms or comparable documents, whether in draft or final form;
- Constitutive documents, prospectuses or offering documents of an AIF not yet authorised in final form.

Insofar as this information is communicated to the investor, it is no longer pre-marketing but already a distribution activity, so that a distribution notification procedure is required.

Where information is nevertheless provided in draft prospectuses or offering documents, it must not be so extensive as to be sufficient for investors to make an investment decision. Consequently, the documents shall contain a disclaimer that it is not an offer or invitation to subscribe for units or shares of an AIF and that the information set out therein should not be

⁴ Section 340 (7) sentence 1 no. 3, sentence 2 KAGB

relied upon as binding. AIFMs should ensure that fund units or shares can only be acquired through authorised marketing.

What should be considered when involving third parties in pre-marketing?

It should also be noted that **third parties** who are involved in pre-marketing or who conduct such pre-marketing on behalf of an AIF management company must fulfil the requirements of a contractually bound intermediary within the meaning of Section 2 (10) KWG or must themselves be a regulated company. These can be:

- Investment services company
- Credit institutions
- UCITS management companies
- AIF management companies

Accordingly, it is no longer sufficient to merely fulfil the requirements of the Trade Regulation Act. The circle of third parties who may carry out pre-marketing for the AIF-KVG is thus considerably restricted.

What are the obligations of the AIFM before and during the marketing of AIFs? Is reverse solicitation still possible?

In the future, it will no longer be possible to sign the corresponding documents directly after the contract negotiations have been concluded. If an investor wishes to acquire fund units, a **sales notification procedure** must first be carried out with the competent authority.

In the future, **reverse solicitation** will not offer a way out of the distribution notification obligation. From the beginning of pre-marketing, this is generally excluded during a blocking period of 18 months. Every subscription of a fund unit within this period - also on the initiative of the investor - will in future be deemed to be a sales result pursuant to section 306b (2) KAGB-E, so that even then the sales notification procedure must first be carried out.

It is unclear whether these restrictions within the lock-up period only apply to investors contacted in the course of pre-marketing, to all investors in a member state where pre-marketing was carried out or even to all investors throughout the EU.

In the end, reverse solicitation will hardly be possible with the new legal regulations.

For the process this means:

1. Within two weeks, the competent national authority must be notified informally in writing of the start of pre-marketing. In addition, the pre-marketing activities must be documented.
2. After the contract negotiations have been concluded, a distribution notification procedure is necessary.
3. After sending the complete documents, BaFin has a processing period of 20 working days to approve the distribution.

4. Only with approval may the AIFM begin marketing and subscription to the corresponding fund units is possible.

What documents are necessary for a distribution notification procedure?

Necessary documents for the application are - for example according to § 321 KAGB - among others:

- the business plan with details of the notified AIF and its registered office,
- the Terms of Investment and the Memorandum and Articles of Association of the AIF,
- the name of the depositary of the AIF,
- a description of the AIF and all information available to investors about the AIF,
- (if relevant: details of the domicile of the master AIF and its KVG),
- Information on precautions taken against distribution to retail investors,
- Information documents pursuant to section 307 (1) KAGB as counterpart to the sales prospectus (indication of information intended to inform the investor about the product, including the annual report).⁵

If the marketing notification is incorrect or incomplete, the AIFM must submit the missing information and documents within six months. BaFin then has another 20 working days to check. If the six-month period has expired, the AIFM must submit a new marketing notification to BaFin. Significant changes after the marketing authorisation has been granted must also be notified to BaFin.

In what form must the documents be submitted to BaFin?

In future, all notifications and submission obligations to BaFin under the KAGB are to be made electronically in accordance with section 7b KAGB-E. This is accompanied by the new principle that BaFin will mainly communicate electronically.

As the digital reporting platform has yet to be set up, this change will not come into force until 01 April 2023.⁶

Cessation of the marketing of AIF

There are also changes and a uniform EU regulation of the prerequisite for the cessation of distribution activities and deactivation of the distribution passport. It should be noted that for the period of 36 months pursuant to section 331a (5) KAGB-E, no pre-marketing may be carried out for the previously marketed funds or funds with a comparable investment strategy.

⁵https://www.bafin.de/SharedDocs/Downloads/DE/Veranstaltung/dl_200228_Seminar_KAGB_Vortrag_8_Vertrieb.pdf?__blob=publicationFile&v=5

⁶ Art. 19 para. 2 FoStoG

However, this only applies to the member state in which the marketing of the AIF is to be revoked.

Do the new rules also apply to non-EU AIFs?

The EU Regulation and the Directive do not apply to **non-EU domiciled AIFs**. On the other hand, according to the recitals of EU Directive 2019/1160, EU AIFMs that are obliged to comply with Directive 2011/61/EU and in particular with the rules on pre-marketing should not be disadvantaged in any way compared to non-EU AIFMs. However, under the German FoStoG, the new rules also apply to non-EU AIFs pursuant to section 306b (4) KAGB, provided that they conduct pre-marketing in Germany.

Conclusion

Finally, the new FoStoG still leaves some important questions open for AIFM: For example, it is not clear how to deal with the circumstance that a new fund does not yet have a competent AIFM and who is responsible for the pre-marketing notification and the documentation requirements in this case. Furthermore, it is not clear from the wording of the law which requirements must be complied with for the documentation of the pre-marketing. It is also questionable whether pre-marketing may still be carried out in a member state if the marketing authorisation has already been applied for or granted in another member state.

According to the new FoStoG, compliance with the notification and documentation requirements of pre-marketing and the marketing authorisation of the AIF is relevant for AIFM, as violations constitute an administrative offence and could also have civil law consequences. Thus, the EU legal requirements represent a considerable tightening of the requirements compared to the current regulations. Furthermore, reverse solicitation is excluded during the 18-month blocking period and it is thus already common practice to apply for a marketing authorisation earlier than before. This will mean more time and bureaucracy.

Note: BaFin has already announced that it will not issue any guidelines on the new regulations. The European Securities and Markets Authority (ESMA) ⁷published its report on "Marketing requirements and marketing communications under the Regulation on cross-border distribution of funds" on 30 June 2021, which, however, does not refer to pre-marketing.

⁷https://www.esma.europa.eu/sites/default/files/library/esma_34-45-1219_-_report_on_national_rules_governing_marketing.pdf