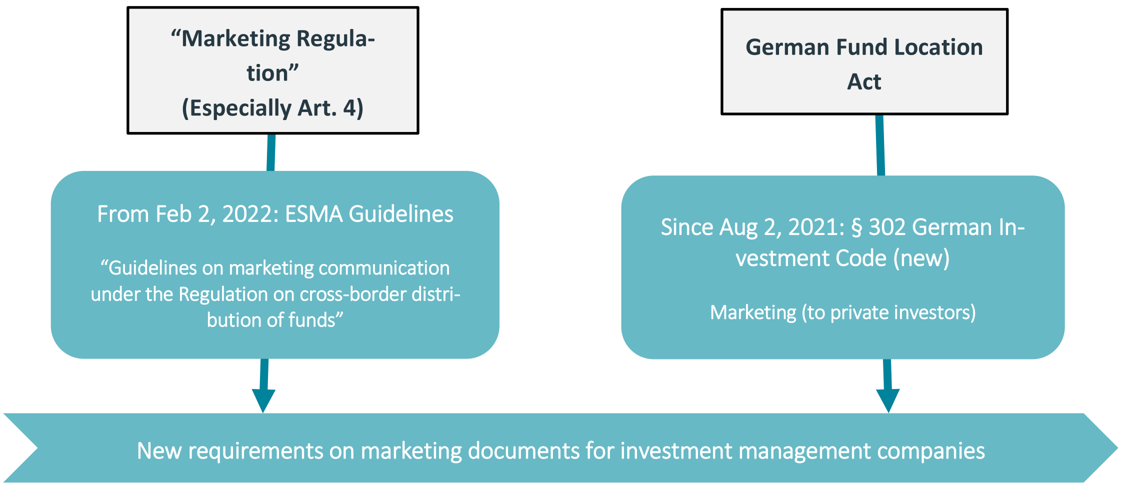
New marketing rules for investment management companies

UNDER THE EU'S MARKETING REGULATION AND GERMANY'S NEW FUND LOCATION ACT, INVESTMENT MANAGEMENT COMPANIES WILL HAVE TO COMPLY WITH MANY ADDITIONAL RULES IN THE FUTURE WHICH HAD EXCLUSIVELY APPLIED TO EXTERNAL DISTRIBUTORS PREVIOUSLY



Executive summary

- Under Regulation (EU) 2019/1156[1] ("**Marketing Regulation**") - which has been fundamentally valid in its entirety and directly applicable since August 2, 2021 - and Directive (EU) 2019/1160 amending the UCITS and AIFM Directives[2]- which was largely implemented into German law via the Fund Location Act as per August 2, 2021 - the cross-border distribution of investment funds will be facilitated further and currently existing restrictions will be removed, at least in part. Against this background, UCITS and AIFM companies should review their sales activities and processes, and redefine them as necessary. With a view to the introduction of pre-marketing, AIFMs may particularly need to revise their operational processes, renew contracts with sales agents, and rethink the selection of their distribution partners and

[1] Regulation (EU) 2019/1156 of the European Parliament and of the Council of June 20, 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013, and (EU) No 1286/2014.

[2] Directive (EU) 2019/1160 of the European Parliament and of the Council of June 20, 2019 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings.

target markets. Moreover, new rules regarding uniform investor protection need to be met, especially in marketing.

- On August 2, 2021, ESMA also officially published the "Guidelines on marketing communication under the Regulation on the cross-border marketing of funds" (hereinafter **"ESMA Guidelines"**) in all official EU languages[3]. These guidelines provide details on the requirements for marketing communication under Art. 4 (1) Marketing Regulation and define uniform principles which must be met starting **Feb 2, 2022**. Accordingly, marketing communication directed at investors will have to be identified as such in the future and describe an investment's risks and rewards with equal levels of clarity. Additionally, all information must be fair, clear, and not misleading.

- Some of the provisions of the Marketing Regulation regarding private investors have also been directly implemented into German national law via the **Fund Location Act**, which was published on June 10, 2021 and largely went into effect as per **August 2, 2021**.

- The addressees of these new rules are UCITS management companies, AIFMs, EuVECA managers, and EuSEF managers.

- The new marketing rules will **become effective in stages**. While the abstract rules under the Marketing Regulation became applicable as per August 2, 2021, the detailed ESMA Guidelines on their construction will not become effective on February 2, 2022. It can be assumed that no audits of marketing communication will take place based on the detailed ESMA Guidelines before February 2, 2022. However, under certain circumstances, it can make sense to carry out a transition now.

1. Legal foundations

The Marketing Regulation (Regulation (EU) 2019/1156), which became effective on August 1, 2019 and became fully applicable - in particular with regard to Art. 4 - as per August 2, 2021, serves to establish uniform rules on the publication of national requirements on distribution, marketing communication, and common principles for fees and charges to be paid by investment managers in connection with their cross-border distribution activities.

The Regulation specifies, inter alia, that AIFMs, EuVECA managers, EuSEF managers, and UCITS management companies must ensure that marketing communication directed at investors be identifiable as such, describe with a comparable level of clarity the risks and rewards associated with the acquisition of units or shares, and that any information contained in marketing documents be fair, clear, and not misleading.

In the future, investment management companies will be responsible for ensuring that all marketing materials comply with the requirements of the Marketing Regulation and the ESMA Guidelines, even if they are not themselves the publishers of the materials or do not themselves address investors or distribute fund units. The ESMA's aim was to create a regulatory standard comparable to Art. 44 MIFID-DD. Accordingly, the requirements on marketing materials are being standardised overall.

With the ESMA Guidelines (Final Report of May 27, 2021), the ESMA has now **specified concrete requirements** for marketing communication. They govern the requirements for marketing communication while also accounting for the online aspects of such marketing communication. These ESMA Guidelines will apply as per February 2, 2022[4].

Additionally, **§ 302 German Investment Code (new)**, ("Kapitalanlagegesetzbuch" or "KAGB" amended by the Fund Location Act published on June 10, 2021) supplements the requirements under Art. 4 Marketing

[3] https://www.esma.europa.eu/system/files_force/library/esma34-45-1272_guidelines_on_marketing_communications_de.pdf?download=1.

[4] The Guidelines will enter force 6 months after the date of their publication on the ESMA's website in all official EU languages. They were published on August 2, 2021.

Regulation for private investors and the distribution of UCITS. It became effective on August 2, 2021, too.

2. Examination standard: Marketing communication

Marketing communication are all messages which have a marketing objective, and therefore all messages that advertise a UCITS or AIF (investment fund), irrespective of the medium, including

- printed documents on paper or information provided in electronic form,
- press articles, press releases, interviews, advertisements,
- documents made available on the internet or on websites, video presentations, live presentations, radio news,
- fact sheets.

This also explicitly covers messages disseminated on social media (e.g. social networks such as Twitter, LinkedIn, Facebook, or discussion forums) if, for example, such messages relate to the characteristics of an investment fund, including its name.

Also affected are marketing communication that **are individually** addressed to (potential) investors, as well as documents or presentations made available on the websites of investment management companies or at other places (fund manager's registered office, office of distribution agent, etc.).

Likewise, in scope here are communications that **advertise an investment fund** and are addressed to (potential) investors who are located in the investment management company's member state of origin or in a host member state.

Messages which describe the characteristics of an investment fund and are sent by an investment management company **to distribution agents**, and are ultimately addressed to (potential) investors, even if these communications were not intended to be passed on to (potential) investors, are also deemed to be marketing communication.

Furthermore, communications originating **from a third party** and used by an investment management company for marketing purposes also fall within scope.

Examples of marketing materials include term sheets, pitch books with reference to specific investment assets, fund presentations, messages on blogs and social media, as well as all documents or information with reference to an investment asset that are addressed to (potential) investors.

Documents required under law and by regulation ("fund documentation"), by contrast, **are not seen as marketing communication**, e.g. sales prospectus, significant product information or KIID/KID, annual / semi-annual reports, or the investment fund's founding documents. Marketing communication also are not pure **corporate communications** distributed by a fund manager which describe activities or recent market developments and make no reference to a specific investment fund or fund group (unless the fund manager's activities are limited to one investment fund or a small number of investment funds implicitly named in such corporate communication). **Short messages distributed online** e.g. via social media platforms, which merely contain a link to a website that does carry marketing communication yet does not itself contain **information about a specific investment fund or group of investment funds** likewise are not deemed to be marketing communication.

3. Content requirements for the design of marketing communication

Marketing communication, which initially - depending on the product category - require a corresponding distribution authorisation or notification, must (a) be identified as such (Chapter 4 of the ESMA Guidelines); (b) highlight risks and opportunities equally (Chapters 5 and 6 of the ESMA Guidelines); and (c) be fair, clear, and not misleading, irrespective of target investor type (Chapter 6 of the ESMA Guidelines).

a) Identification as marketing communication (Chapter 4 of the ESMA Guidelines)

Marketing communication (including spoken/oral representations) must be identified as such. They must point out that:

- The document / information is exclusively for marketing purposes (e.g. via a highlighted designation as "marketing communication", "marketing message" or "marketing material" on the front page),
- It is not a contractually binding document and does not represent information required under law, and
- The document / information is not sufficient as a basis for making an investment decision.

Furthermore, extensive legal references mustn't be included.

Also new is that a marketing communication additionally must include a clearly visible disclaimer. The ESMA Guidelines cite the following formulation as an example:

"This is a marketing communication. Please refer to the [prospectus of the [UCITS/ AIF/EuSEF/EuVECA] / Information document of the [AIF/EuSEF/EuVECA] and to the [KIID/KID] (delete as applicable)] before making any final investment decision."

The disclaimer may also be replaced, where appropriate, by a shorter notice such as *"marketing communication"* or *"#Marketing Communication"* to identify the marketing purpose if the length or format of the marketing communication makes the disclaimer named above appear disproportionate.

b) Risks and opportunities (Chapters 5 and 6 of the ESMA Guidelines)

If rewards are going to be addressed, then there needs to be a balanced presentation of rewards and risks. Rewards must not be mentioned without also mentioning the risks. Accordingly, as soon as marketing communication include a product's potential reward, any risks must always be mentioned as well in an **equally prominent manner** (in terms of presentation and format). The objective is to prevent risks from being concealed or softened.

There must be balance in the extent, type, and accuracy of the presentation (including font type, font size, prominence of the text passage) of rewards and risks **(in line with the principle of proportionality and in a balanced manner)**. The more in-depth and comprehensively rewards are highlighted, the more in-depth and comprehensively risks must be addressed. Rewards must not be over-emphasised, and risks must not be under-emphasised.

c) Fair, clear, and not misleading (Chapter 6 of the ESMA Guidelines)

Marketing communication must be honest (i.e. objectively accurate), unambiguous (clear and understandable), and not misleading (i.e. not causing misconceptions).

Information in marketing communication must not contradict, supplement, or soften fund documentation.
Short marketing communication, such as messages on social media, should be as neutral as possible and indicate where further information can be reviewed (e.g. via link). When providing information on past performance, source and reference period must be stated in a clear manner.

When an investment is being **compared to another investment**, then:

- the comparison (e.g. a comparison of the real estate market with the development of bond yields) must be meaningful,
- the significant characteristics of the products being compared must be matched in an adequate manner,
- the comparison must be balanced, i.e. it must not serve solely to discredit other regulated products.
- sources of information, material facts, and hypotheses used for the comparison must be indicated.

A further new addition is the possibility to show a **ranking**. However, a ranking may only be based on a representative selection of investment funds which are similar in terms of investment policy and risk/return profile. The presentation of a ranking must also include reference to the relevant period (at least 12 months or a multiple thereof) and the risk classification of the investment assets.

- the ranking must be limited to investment funds characterised by a similar investment policy and a similar risk and return profile based on the summarising risk indicator in the KID or the synthetic risk and return indicator in the KID. Otherwise, relevant explanations of the differences between the investment funds should be presented.

With regard to **performance** information in marketing materials, it should be noted that information on the reference period and the reference source must be provided and reference periods comprise a full 12 months or multiples thereof in each case. A footnote will not suffice to this end. There are detailed requirements for the presentation of reference information for the past and the future. Additionally, a disclaimer is required which states that past performance, simulations, or forecasts are not a reliable indicator for future performance:

"Past performance does not predict future returns."

A disclaimer should also be put in front of the presentation of expected future performance based on current or historical data:

"The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies, and/or current market conditions and are not an exact indicator. How much you actually receive depends on how the market performs and how long you hold the investment/product."

It is also necessary to indicate that future performance is subject to individual tax rates, which may change in the future, and also to indicate the potential for financial loss. Expected future performance must also be based on realistic assumptions supported by objective data. However, future performance should only be indicated if it is also mentioned in sales documents.
Expected future performance may only be indicated per investment fund and not by using aggregated figures. The reference period for expected future performance should be consistent with the recommended investment horizon. In the case of an ETF, the regulated markets on which the investment fund is traded must be indicated and expected future performance must be based on the investment fund's NAV. If open to retail investors, the illiquid nature of the investment must also be mentioned, as applicable[5].

d) Sustainability-related aspects

Another new development is that marketing communication must include sustainability-related aspects. Information on the sustainability-related aspects of the advertised investment fund should not go beyond the extent to which the investment strategy integrates sustainability-related features or objectives (for example: if the investment fund's strategy of primarily centres around performance, then sustainability aspects should not comprise the primary information in the marketing communication).

It is necessary to indicate that a decision to invest should also take into account the other characteristics and objectives of the investment fund as described in the prospectus or informational documents. A link to the website which provides sustainability information in line with the

[5] ESMA Guidelines, point 6.2, no. 38

Sustainability-Related Disclosures Regulation can be included. The goal here is to avoid what is known as "greenwashing".

e) Other requirements

With regard to private investors, §. 302 par. 2 German Investment Code now requires a reference to the prospectus and the key investor information of an AIF as well as to where (including link), how, and in which language this information can be obtained (see Art. 4 (2) in conjunction with (5) Marketing Regulation).

Moreover, § 302 para. 3 German Investment Code specifies that private investors will need to be informed in the future about where and in which language a summary of investor rights can be obtained, as well as a corresponding link (see Art. 4 (3) in conjunction with Art. 4 (2), (5) (for AIFs) Marketing Regulation).

An investment management company must also indicate that it may decide to retract distribution.

4. Pre-screening of marketing communication

In the future, supervisory authorities can request that marketing communication be submitted to them in advance for review. However, this is not a prerequisite for distribution and also is not part of the notification procedure[6].

5. Facilities for retail investors

In each Member State where a product is distributed, investment management companies of retail AIFs must have facilities in place to process requests for subscription, payment, repurchase, or redemption. However, a local physical presence or the appointment of a third party is no longer required to such end, § 306 a German Investment Code.

6. Summary

Overall, the new provisions described here do contribute to aligning the regulatory framework pertaining to marketing measures for investment management companies with the framework pertaining to distribution. The corresponding standard for regulated securities services companies is yielded from § 63 para. 6 German Securities Trading Act, in German "Wertpapierhandelsgesetz" or "WpHG" in conjunction with Art. 44 Delegated Regulation (EU) 2017/565 ("MiFID II DR"), and the corresponding standard for financial investment intermediaries is yielded from § 14 German Financial Investment Intermediaries Ordinance ("FinVermV", in its German abbreviation) in conjunction with Art. 44 MiFID II DR. For further construction, the extensive instructions issued by Germany's Federal Financial Supervisory Authority within its Minimum Requirements on the Compliance Function and Further Obligations Regarding Conduct, Organisation, and Transparency also need to be met (see "BT3 Requirements for fair, unambiguous, and non-misleading information pursuant to § 63 para. 6 German Securities Trading Act").

It remains to be seen whether the German legislature will extend the requirements for private investors under § 302 German Investment Code to all other investor types in the future.

[6] Art. 7 (1) Marketing Regulation and Art. 7 (3) Marketing Regulation for AIF management companies when marketing to retail investors.

The market is faced with non-negligible implementation issues in view of the **staggered applicability** of (1) the initially abstract provisions of the Marketing Regulation as per August 2, 2021 and (2) the detailed ESMA Guidelines regarding their interpretation as per February 2, 2022. To cite one example: Since the detailed ESMA Guidelines - whose publication is explicitly ordered by Art. 4 (6) Marketing Regulation - will not apply until February 2, it can be assumed that audits of marketing communication will only be taking place after February 2, 2022, at least with respect to the detailed requirements in the ESMA Guidelines, e.g. within the context of an annual audit. Nevertheless, it may be advisable to prepare corresponding documents at this point in time or to align them with the guidelines now available in order to make use of the time frame in the second half of 2021 accordingly, or if it is already clear now that corresponding documents are going to be used beyond February 2, 2022.

Robert Kramer
Lawyer
Office Munich
robert.kramer@gsk.de

Ralf Brenner
Lawyer
Office Munich
ralf.brenner@gsk.de

Lisa Baumann
Lawyer
Office Munich
lisa.baumann@gsk.de

GSK STOCKMANN

Copyright

Disclaimer

This client briefing exclusively contains general information which is not suitable to be used in the specific circumstances of a certain situation. It is not the purpose of the client briefing to serve as the basis of a commercial or other decision of whatever nature. The client briefing does not qualify as advice or a binding offer to provide advice or information and it is not suitable as a substitute for personal advice. Any decision taken on the basis of the content of this client briefing or of parts thereof is at the exclusive risk of the user.

GSK Stockmann as well as the partners and employees mentioned in this client briefing do not give any guarantee nor do GSK Stockmann or any of its partners or employees assume any liability for whatever reason regarding the content of this client briefing. For that reason we recommend you to request personal advice.

www.gsk.de

GSK Stockmann

BERLIN
Mohrenstrasse 42
10117 Berlin
T +49 30 203907-0
F +49 30 203907-44
berlin@gsk.de

HEIDELBERG
Mittermaierstrasse 31
69115 Heidelberg
T +49 6221 4566-0
F +49 6221 4566-44
heidelberg@gsk.de

FRANKFURT / M.
Taunusanlage 21
60325 Frankfurt am Main
T +49 69 710003-0
F +49 69 710003-144
frankfurt@gsk.de

MUNICH
Karl-Scharnagl-Ring 8
80539 Munich
T +49 89 288174-0
F +49 89 288174-44
muenchen@gsk.de

HAMBURG
Neuer Wall 69
20354 Hamburg
T +49 40 369703-0
F +49 40 369703-44
hamburg@gsk.de

LUXEMBOURG
GSK Stockmann SA
44, Avenue John F. Kennedy
L-1855 Luxembourg
T +352 271802-00
F +352 271802-11
luxembourg@gsk-lux.com