

Germany

Regulation

HEDGE FUNDS 2009

Hedge fund managers/advisors

Regulation

Authorization requirements and process

There are two types of hedge funds which are required to authorize under the Investment Act: funds with additional risk (henceforth single hedge funds) and fund-of-funds with additional risks (henceforth fund of hedge funds). Both types of hedge funds can be issued by investment management companies or investment stock corporations.

Investment management companies and investment stock corporations must obtain a written license from the BaFin prior to the commencement of their business. In the case of investment management companies the BaFin may connect the license to ancillary conditions. The license to an investment stock corporation may not be issued unless certain conditions set forth in the Investment Act are satisfied.

There are no authorization requirements for hedge fund advisors.

Typical timescale to receive approval

The typical timescale for the approval of a new hedge fund manager in Germany is three months.

Regulatory capital requirements

There are no specific capital requirements for hedge fund managers, only the usual requirements for investment management companies or investment stock corporations apply.

Investment management companies must have an initial start-up capital of at least EUR 3 million. If the value of the funds exceeds EUR 1,125 billion, the investment management company must provide additional equity capital amounting to at least 0.02 percent of the amount by which the value of the

fund exceeds EUR 1,125 billion. The required total amount of initial and additional equity capital may not exceed EUR 10 million. Under certain circumstances these expanded capital requirements may be substituted by a guarantee, issued by credit institution, with respect to the same amount. Any assets the investment management company administers on behalf of a third party are not included.

Notwithstanding these equity capital requirements, the investment management company must at all times maintain equity capital which equals at least one-quarter of its costs as shown under general management expenditures, depreciation of tangible assets and amortization of intangible assets in the income statement for the most recent annual financial year.

For hedge funds in the form of an investment stock corporation the initial capital must be at least EUR 300,000.

There are no capital requirements for the advisor of single hedge funds or funds of hedge funds.

Significant restrictions on marketing to investors

There is a general prohibition on the marketing of onshore and offshore single hedge funds to the public. This prohibition applies to the marketing of the units of single hedge funds as well as for the shares of investment stock corporations.

Fund of hedge funds may be publicly marketed, but any advertising for funds of hedge funds and for units in foreign funds which are subject to comparable requirements must contain a reference to the special risks related to an investment in these funds. In addition the usual marketing provisions for funds apply.

Hedge fund structures

Regulation

Authorization requirements

Single hedge funds are investment funds which observe the principle of risk diversification, but are otherwise only subject to minor restrictions in their selection of assets. The fund rules must provide either the possibility of leverage through unrestricted borrowing or by the use of derivatives or the possibility of short sales.

Fund of hedge funds must invest in units of target funds. Target funds are single hedge funds, investment stock corporations whose articles of

association provide for similar forms of investment like hedge funds or foreign investment funds which are subject to requirements on the investment policy that are comparable to single hedge funds. Leverage and short sale transactions are not allowed for fund of hedge funds.

The rules for single hedge funds or fund of hedge funds may provide that the pricing and the redemption of the units shall only be performed on specific redemption dates, but at least once in every quarter. Notice of the redemption shall be given by an irrevocable redemption declaration not more than 40 calendar days in the case of single hedge funds or not more than 100 calendar days in the case of a fund of hedge funds prior to the relevant redemption date.

Investment management companies and investment stock corporations must have their registered offices and their headquarters in a jurisdiction governed by the Investment Act.

Restrictions on types of investments, concentration levels, and the manner in which hedge funds can invest and/or strategies

Single hedge funds have to follow the principle of risk diversification and pursue either leverage or short sale strategies.

Apart from this, single hedge funds are free from many investment restrictions which apply to other investment funds. Nevertheless they cannot invest more than 30 percent of their assets in companies which have not been admitted to a stock exchange or are not included in an organized market. Single hedge funds cannot invest in real estate, property companies or commodities other than precious metals.

Fund of hedge funds may only invest in target funds. Target funds are single hedge funds, investment stock corporations whose articles of association provide for similar forms of investments like hedge funds or foreign investment funds which are subject to requirements on the investment policy that are comparable to single hedge funds. Leverage and short sales transactions are not allowed for fund of hedge funds.

Furthermore fund of hedge funds may invest no more than 49 percent of their assets in bank cash balances, money market instruments and money market funds which may invest only in cash balances and money market instruments. The sale of currency futures contracts and put option rights on currencies or currency futures contracts for the purpose of hedging against exchange rate risk is permissible.

Foreign target funds may be acquired provided that the assets of the foreign fund have been entrusted to a depositary bank or another comparable organization for safe-keeping.

Fund of hedge funds may invest up to 20 percent of their assets in any single target fund, but may acquire all of the issued units of a target fund. It may not invest in more than two target funds from the same issuer or the same fund manager and may not invest in target funds which themselves invest in target funds. Investments in foreign target funds from states which are not cooperating in the fight against money laundering within the meaning of international agreements are prohibited.

Rules regarding the publishing of the accounts and prospectuses

The fund rules for single hedge funds and fund of hedge funds have to fulfill the usual information requirements specified by the Investment Act. In the case of fund of hedge funds further information has to be provided, such as, on the principles for selecting target funds, the investment strategies pursued by the target funds and the scale on which the target funds may borrow, use derivatives, or execute short sales.

The prospectus for a fund of hedge funds must contain additional information compared to the usual prospectus, such as, the principles for selecting target funds or the amount up to which units of foreign target funds not subject to supervision may be acquired. In addition, the prospectus must include a warning for the possible total loss of the invested capital in a prominent position.

Fund of hedge funds must provide the public only with a comprehensive prospectus including the fund rules.

Time-scale of establishment of a hedge fund

The typical timescale for the establishment of a hedge fund including regulatory approval in Germany is one month.

Investors

Regulation

Restrictions on which type of investors can invest in a hedge fund and/or the minimum/maximum number of investors in a hedge fund

There are no restrictions on the type and the minimum or maximum number of investors which can invest in a single hedge fund or fund of hedge funds.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we

endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.