

Fund Management

Contributing editors

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**GETTING THE
DEAL THROUGH**

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Fund management

1 How is fund management regulated in your jurisdiction? Which authorities have primary responsibility for regulating funds, fund managers and those marketing funds?

Fund management is regulated in Germany by the German Capital Investment Act (KAGB). The KAGB implements the EU Undertakings for Collective Investments in Transferable Securities (UCITS) Directive (2009/65/EC) and the Alternative Investment Fund Managers Directive (AIFMD).

Responsible for regulating funds, fund managers and those marketing funds is the Federal Financial Supervisory Authority (BaFin).

2 Is fund administration regulated in your jurisdiction?

Fund administration is not per se regulated in Germany. The regulation rather depends on whether the specific services fall within a specifically regulated environment.

As a general rule, general assistance in fund administration is not regulated, such as the preparation of reports or distribution notices.

Certain administrative services are regulated by professional services laws. Before offering bookkeeping services on the market, a minimum of three years' professional experience is required. Trade settlement is typically licensable as the financial service of the execution of orders on behalf of clients or the banking activity of trading on behalf of others.

3 What is the authorisation or licensing process for funds? What are the key requirements that apply to managers and operators of investment funds in your jurisdiction?

Regulation of funds is primarily exercised through regulation of managers. It requires that the manager is either fully licensed or registered with BaFin under the KAGB. If a fund is internally managed, then the fund itself needs a licence or registration.

Registered managers: registration process

Availability

The registration process is only available to certain small or medium-sized managers. The most important category of these small to medium-sized managers are known as 'sub-threshold managers' under the AIFMD/KAGB. In practice, most German fund managers fall within this category.

Sub-threshold managers under the KAGB are managers with assets under management of not more than €100 million (in the case of leverage) or not more than €500 million (no leverage) and who only manage special alternative investment funds (special AIFs). Special AIFs are AIFs whose interests or shares may only be acquired according to the fund documents by professional investors or semi-professional investors (ie, non-retail funds).

Professional investors are defined in the AIFMD and the Markets in Financial Instruments Directive (MiFID). A semi-professional investor is a person who:

- commits to invest at least €200,000;
- confirms in writing that he or she is aware of the risks; and
- has the expertise, experience and knowledge to participate in the investment opportunity. This must be assessed and confirmed by the manager.

In addition, senior management, risk-takers and other staff of the manager within the meaning of article 13 AIFMD are considered semi-professional. A person with a minimum commitment of €10 million is considered semi-professional as well.

Besides the requirements mentioned above, special AIFs managed by sub-threshold managers are in principle not regulated.

Registration procedure

The registration procedure is comparatively simple. It requires the submission of an informal registration request together with certain 'corporate' documents on the manager and the managed funds (such as the fund's limited partnership agreement (LPA) and the manager's articles of association). In addition to being a special AIF, the fund may not require the investors to additionally pay in capital beyond the investor's original commitment.

Ongoing issues

An advantage of the registration is that only few provisions of the KAGB apply to a 'registered-only' manager, mainly the provisions on the registration requirements, ongoing-reporting requirements and the general supervisory powers of BaFin. However, fund-specific requirements do not apply to 'registered-only' managers and their funds. In particular, the depositary requirements and marketing requirements as well as the additional requirements of the KAGB for fully licensed managers do not apply.

On the downside, the registration restricts the manager to the type of funds and investors for which the registration was obtained (ie, only special AIFs and professional or semi-professional investors). Furthermore, a registered manager does not benefit from the European marketing passport under the AIFMD. A registered manager can, however, opt in to become a fully licensed manager.

Fully licensed manager: licensing process

Availability

Fund managers who do not qualify for a registration or who opt out of a registration must apply for a full fund-management licence with BaFin under the KAGB.

A full fund-management licence opens the door for a manager to market funds to retail investors as well as to the marketing passport under the AIFMD or UCITS Directive. Retail investors are investors who are neither professional nor semi-professional investors.

Licensing procedure

The licensing procedure is a fully fledged authorisation process with requirements equivalent to the requirements for granting permission under article 8 AIFMD or article 6 of the UCITS Directive. The licensing procedure checks requirements, such as sufficient initial capital or own funds, sufficiently good repute of the directors and shareholders, and organisational structure of the manager.

Ongoing issues

The licensing of the manager results in the manager being subject to the entirety of the KAGB. This means, in particular, the following:

- the required appointment of a depositary for the funds;
- access to setting up contractual funds;

- adherence to the corporate governance rules for funds set up as investment corporations or investment limited partnerships (investment KGs);
- adherence to the fund-related requirements of the KAGB;
- adherence to the marketing rules of the KAGB;
- access to the marketing passport under the AIFMD/UCITS Directive;
- access to the managing passport under the AIFMD/UCITS Directive; and
- adherence to the reporting requirements of the KAGB.

4 What is the territorial scope of fund regulation? Can an overseas manager perform management activities or provide services to clients in your jurisdiction without authorisation?

EU fund managers

EU fund managers are allowed to perform fund management services under the passport regime of the AIFMD or UCITS Directive. In addition, EU fund managers may use the EU passport regime to provide other services and ancillary services (such as investment advice or discretionary individual portfolio management).

Non-EU managers

Non-EU managers are currently not allowed to perform fund management services in Germany. This will change with regard to AIFMs in those countries for which the passporting regime under the AIFMD for third-country managers will eventually become effective.

Non-EU managers can provide regulated services outside of fund management (such as investment advice or discretionary individual portfolio management) but only if there is an existing relationship with a German client or if the relationship is established at the initiative of the German client.

5 Is the acquisition of a controlling or non-controlling stake in a fund manager in your jurisdiction subject to prior authorisation by the regulator?

The acquisition of a material stake in a UCITS management company requires prior clearance by BaFin. The threshold for a material stake is 10 per cent of the capital or voting rights of the management company. The threshold also applies in the case of an indirect acquisition (eg, through acquiring a controlling stake in a financial holding company).

There is no prior clearance procedure with BaFin for the acquisition of a material stake in an AIFM. However, BaFin can take measures if shareholders with a material stake are not of sufficiently good repute or are otherwise not reliable enough to hold a stake in an AIFM.

6 Are there any regulatory restrictions on the structuring of the fund manager's compensation and profit-sharing arrangements?

Germany follows the remuneration requirements of the European Securities and Markets Authority (ESMA) Guidelines on Sound Remuneration under the UCITS Directive and under the AIFMD.

Fund marketing

7 Does the marketing of investment funds in your jurisdiction require authorisation?

Overview

The marketing of investment funds requires an authorisation by BaFin or at least a European marketing passport under the AIFMD or under the UCITS Directive. A private placement regime is no longer available in Germany.

The only exception available applies to German-registered sub-threshold managers (see question 3). German-registered sub-threshold managers can market their funds using the private placement exemption available under the German implementation of the EU Prospectus Directive or, as applicable, the private placement exemption available under the Asset Investment Law.

The German funds marketing regime distinguishes between domestic funds, EU funds and non-EU funds as well as between domestic fund managers, EU fund managers and non-EU fund managers. It further distinguishes between UCITS and AIFs as well as – with regard

to AIFs – whether the funds are marketed to professional investors, semi-professional investors or retail investors.

Marketing of UCITS

With regard to the marketing, in Germany, of non-German UCITS, Germany follows the passporting regime of the UCITS Directive. In addition to the standard notification procedure, the marketing of UCITS must comply with the German implementation of the UCITS passporting rules (articles 91 to 95 of the Directive). For instance, there must be a financial institution in Germany for making payments to unitholders, repurchasing or redeeming units and for making available the information that UCITS are required to provide under Chapter IX of the Directive.

UCITS can be marketed under the passport to professional, semi-professional and retail investors.

Marketing of EU AIFs by EU AIFMs

With regard to the marketing of non-German EU AIFs by EU AIFMs, the AIFMD marketing passport of article 32 AIFMD is available. The AIFMD marketing passport allows for the marketing of EU AIFs to professional and semi-professional investors in Germany.

Marketing of non-EU AIFs or EU AIFs by non-EU AIFMs

With regard to the marketing of non-EU AIFs managed by non-EU AIFMs, Germany allows for marketing under the regime of article 42 AIFMD to professional investors. The same regime applies to the marketing of EU AIFs managed by non-EU AIFMs to professional investors. Germany also applies the article 42 AIFMD regime to non-EU sub-threshold managers.

Germany has implemented the article 42 regime in a rather cumbersome way. Compared with some other EU member states, the process is a bit lengthy and costly. BaFin has at least two months (in some cases even longer) for review once the filed documents are complete and BaFin currently charges a fee of €6,582. The set of documents to be submitted to BaFin is rather extensive and includes the private placement memorandum (PPM), the fund LPA and certain constitutional documents.

There are also some additional requirements (gold-plating) not readily discernible from the reading of article 42 AIFMD. For instance, Germany also applies the article 42 regime to non-EU sub-threshold managers.

To ensure that the article 42 requirement of cooperation agreements between the relevant competent authorities is effective, BaFin requires as part of the marketing authorisation procedure an express declaration from the non-EU AIFM that:

- the non-EU AIFM is registered with the competent authority with which BaFin has entered into a cooperation agreement or that the non-EU AIFM is registered in another register to which the competent authority has access; and
- the competent authority has information rights in relation to the non-EU AIFM.

Most importantly, Germany introduced the additional requirement of a 'depository-lite'. The AIFM must appoint a depository who performs the three depository functions of article 21(7) to 21(9) AIFMD, namely, cash monitoring, safekeeping of assets and a general oversight over the AIFM and the AIF. The depository can be located outside of Germany. The final draft of the depository agreement together with a depository confirmation must be submitted to BaFin.

The article 42 regime is also available for marketing to semi-professional investors. However, in such case, the non-EU AIFM and the management of the AIF must fully comply with the AIFMD.

EU sub-threshold AIFMs

EU sub-threshold AIFMs may use a simplified marketing notification procedure with BaFin. This notification procedure requires, among others, a confirmation of the registration status of the AIFM in its home member state and reciprocity. 'Reciprocity' means that the home member state must allow the marketing of AIFs managed by a German sub-threshold manager without imposing stricter requirements than Germany. Such reciprocity is currently recognised for instance with regard to the UK and Luxembourg, but not with regard to Austria, Denmark, France and the Netherlands.

Marketing of EU AIFs or non-EU AIFs to retail investors

The AIFMD deals only with the marketing of AIFs to professional investors. With regard to non-professional investors, the member states of the EU are free to impose stricter requirements (article 43, paragraph 2 AIFMD). Germany therefore introduced a strict retail marketing regime for EU and non-EU AIFs. The regime is based on the retail marketing regime of German AIFs. It requires full AIFMD compliance as well as full compliance with the German Products Regulation. Because of these high requirements, marketing an AIF to retail investors only makes sense if the relevant AIF is already set up with German retail investors in mind. A 're-tailoring' of an existing AIF is cost-prohibitive.

8 What marketing activities require authorisation?

Definition of marketing and pre-marketing

The key trigger of an authorisation is the term 'marketing'. 'Marketing' means the direct or indirect offering or placement of units or shares in an investment fund.

Marketing must therefore relate to units or shares in an investment fund. BaFin concludes that marketing in particular takes place with regard to a fund if:

- the fund has been established (ie, first closing with investors); or
- the terms of the fund are ready to be sent for acceptance to investors.

Consequently, there is no marketing if the fund has not yet had a closing with investors and only incomplete fund terms are distributed. This means that in practice marketing might start rather early in the investor relationship process.

However, marketing must also include an offering or placement. The term 'offering' includes offers to subscribe as well as the sending out of invitations to potential investors to make an offer to subscribe. The 'placement' alternative is in practice already included in the offering mechanism. Therefore, in our view marketing can only occur if the investor has a legal basis for a subscription or for making an offer to subscribe. Accordingly, an activity should still be pre-marketing (even if the investment fund has had a closing with certain investors) if: (i) the investor has no access to the final documents (PPM, LPA and subscription documents); and (ii) it is made clear that the fund manager is not currently seeking subscriptions and that offers to subscribe will only be possible after BaFin marketing approval on the basis of the final documents (eg, in a disclaimer in the documents).

Reverse solicitation

Germany recognises a reverse solicitation concept, albeit in a rather strict form. It requires that the offer or placement is genuinely initiated by the investor. In addition, the prospective investor must be a professional or semi-professional investor. The exact scope of the reverse solicitation concept as understood by BaFin is still not clear.

If the investor is a retail investor, the requirements on reverse solicitation are even less clear. In general, reverse solicitation will not work with regard to retail investors and the fund manager would be subject to the more cumbersome retail marketing regime in Germany.

In any case of reverse solicitation, the fund manager should have documentary evidence of how the relationship with the investor started and seek a confirmation from the investor that the contact has been initiated solely by the investor. In our experience, the requirements for reverse solicitation will be fulfilled only in limited instances.

9 What is the territorial scope of your regulation? May an overseas entity perform fund marketing activities in your jurisdiction without authorisation?

The German marketing regime described above applies to any inbound marketing in Germany.

10 If a local entity must be involved in the fund marketing process, how is this rule satisfied in practice?

A local entity must only be involved with regard to UCITS (paying and information agent) and in the case of marketing AIFs to retail investors (paying agent and representative of AIFM). The position of the local entity is usually performed by a German credit institution.

11 What restrictions are there on intermediaries earning commission payments in relation to their marketing activities in your jurisdiction?

Germany follows the MiFID inducement rules on commission payments received by intermediaries. In practice, this means that such commissions need to be disclosed to the prospective client. Note, however, that with regard to cross-border services without a German branch, the supervision of the German MiFID rules of good conduct is primarily with the home country regulator.

Retail funds

12 What are the main legal vehicles used to set up a retail fund? How are they formed?

The fund-related requirements of the KAGB distinguish between UCITS, special AIFs and public AIFs. UCITS are UCITS funds within the meaning of the UCITS Directive. Retail funds are UCITS funds and public AIFs. Public AIFs are AIFs that can be subscribed by retail investors (as well as professional and semi-professional investors). Retail investors are investors who are neither professional nor semi-professional investors (see question 3).

Arrangements and vehicles for open-ended funds

For open-ended funds, the contractual fund and the investment corporation with variable capital structures are available. They can have different classes of units or shares. They can also establish sub-funds (umbrella structure).

The open investment limited partnership structure is only available to semi-professional or professional investors.

The contractual fund is established by the fund manager on a contractual basis with the investor. The contractual fund is a pool of assets separated by statute and contract from the (other) assets of the fund manager. The investment guidelines for contractual funds set out the details of the contractual relationship between the fund manager and the investors, in particular the applicable investment restrictions. The investment guidelines of retail funds require the approval of BaFin.

Investment corporations and the investment limited partnerships are basically corporations and limited partnerships with some modifications for investment law. They are established in accordance with the applicable procedures for establishing corporations and partnerships (with some modifications because of investment law). In addition to the articles of incorporation or the LPA, separate investment guidelines are necessary.

Vehicles for closed-ended funds

For closed-ended funds, the only available vehicles for retail funds are the investment corporation with fixed capital and the closed-ended investment limited partnership.

Both vehicles can issue different classes of shares or interests, but they cannot establish sub-funds (no umbrella).

In addition to the articles of incorporation and the LPA, separate investment guidelines are necessary.

13 What are the key laws and other sets of rules that govern retail funds?

The main law governing retail funds is the KAGB. The KAGB is supplemented by several ordinances (the Derivative Ordinance, the Organisational and Rules of Conduct Ordinance and the Mediation Ordinance). In addition, the AIFMD Level II Regulation applies to retail AIFs.

This set of laws is supplemented by self-regulatory standards, mainly the Rules of Good Conduct issued by the German Investment Funds Association and the Association's sample investment guidelines.

14 Must retail funds be authorised or licensed to be established or marketed in your jurisdiction?

The investment guidelines of retail funds as well as the marketing of retail funds each need BaFin approval. In addition, BaFin has to approve the selection of the depositary for the respective fund. The approvals are usually obtained in parallel with each other.

15 Who can market retail funds? To whom can they be marketed?

Retail funds can be marketed to any investor in Germany (regardless of whether the investor is professional, semi-professional or retail).

Retail funds can be marketed only by three categories of 'marketers':

- the fund manager itself can always market its 'own' funds. If the fund manager is fully licensed (ie, not only registered as a sub-threshold manager) the fund manager may also market investment funds of other managers;
- in addition to fund managers, MiFID firms are entitled to market investment funds (provided they have a MiFID licence or passport for investment advice and the transmission or receipt of orders); and
- Germany also allows the marketing of retail funds by firms or individuals with a financial intermediary licence under the German Commerce Act (GewO). The financial intermediary licence is a non-MiFID licence and based on the optional exemption from MiFID in article 3 MiFID.

16 Are there any special requirements that apply to managers or operators of retail funds?

The special requirements on retail funds are not the requirements applicable to managers. The manager requirements of retail funds are broadly similar to the requirements on managers of non-retail funds. The main differences between retail and non-retail funds are in stricter statutory investment guidelines (product regulation) and stricter marketing rules.

17 What are the investment and borrowing restrictions on retail funds?

Germany offers different types of retail funds (eg, UCITS, real estate funds, fund-of-funds, hedge funds and closed-ended funds). The fund types are based on the UCITS investment and borrowing restrictions as the default rules. The investment and borrowing restrictions are then modified to fit each fund type. For instance, real estate funds may only invest in real estate, but can also invest up to 49 per cent of the net asset value in money-market instruments or investment funds. The borrowing limits are increased for real estate funds from the UCITS' short-term borrowing of 10 per cent of the net asset value to a long-term borrowing for investment of 30 per cent of the net asset value.

18 What is the tax treatment of retail funds? Are exemptions available?

The German Investment Tax Act generally applies to UCITS and AIFs – both retail AIFs and special AIFs (see also question 29).

Current law (in force until 31 December 2017)

The German Investment Tax Act was revised in 2016 and most of the changes will take effect as of 1 January 2018. Currently, and in force until 31 December 2017, the law distinguishes between two different categories of funds for tax purposes. Such categories are tax-specific and do not mirror the regulatory categories of funds.

Qualifying funds

Certain funds fall under the category of 'qualifying funds' (investment funds). This category is applicable only to certain open-ended funds (UCITS and AIFs) that meet specific product regulation requirements under German tax law. In practice, this will mostly be the case for German open-ended retail funds and certain German special AIFs. Many foreign funds are not likely to be able to meet the German tax product requirements, unless they were specifically set up to be marketed to German investors (in practice mainly Luxembourg and to a lesser degree Irish UCITS products).

The taxation of qualifying funds and their investors is based on the principle of 'restricted transparency'. Accordingly, qualifying funds themselves are treated as corporate income tax subjects for German tax purposes, but benefit from a personal tax exemption (also applicable for German trade tax purposes), effectively avoiding taxes at fund level. German investors in qualifying funds are subject to German income or corporate tax on certain distributions, as well as retained income of the fund and capital gains upon a transfer of fund units. Certain exemptions are available (fund privilege) that make an investment in a qualifying fund more attractive from a tax perspective than a direct holding of the underlying assets by the investors.

Non-qualifying funds

All other funds that do not meet the requirements of qualifying funds, namely, that do not comply with the German product regulation for tax purposes, fall under the second category of non-qualifying funds. This second category captures closed-ended funds (in particular private equity funds and other closed-ended AIFs) as well as certain open-ended funds. The tax treatment of non-qualifying funds depends on their legal form (partnership or corporation).

Non-qualifying partnerships

For non-qualifying funds in the form of a partnership (a German KG or foreign limited partnership), the general rules of German taxation of partnerships apply. A partnership is generally tax-transparent for German tax purposes, namely, not subject to German income tax or local trade tax. This is only fully the case if the partnership is not considered to be in a trade or business owing to its structure ('deemed business' concept) or because of its activities. Depending on the relevant asset class, there are specific criteria developed by courts and in decrees of the German tax authorities to distinguish business activities from mere asset-management activities (eg, with respect to private equity funds, real estate and traded securities). In practice, this distinction is inherently factual in nature depending on all facts and circumstances. If the partnership is transparent, the allocable share of the partnership's income is (only) taxed at the level of the investors, which are taxable in Germany in accordance with the general rules of German taxation.

Non-qualifying corporations and contractual-type funds

For non-qualifying funds in a legal form other than a partnership, a specific tax regime is applicable. This regime not only covers funds in the form of a corporation (eg, a German stock corporation, Luxembourg SA/SCA SICAV or Irish PLC), but also funds of the contractual type (eg, a German *Sondervermögen*, Luxembourg *fonds commun de placement*, French FCPI/FCPR or Italian *fondo chiuso*).

Domestic non-qualifying funds other than partnerships are subject to German corporate income tax and German local trade tax. A foreign non-qualifying fund can only be subject to German taxation to the extent that it incurs German-source income. Investors in such a 'corporate' non-qualifying fund do not qualify for the partial income taxation or the tax exemption for dividends and capital gains, unless the income of the fund is subject to tax (in a sufficient degree; at least 15 per cent if based in a non-EU state) at the fund level. In the case of foreign 'corporate' non-qualifying funds, the German tax laws for controlled foreign corporations may also be applicable in certain circumstances.

For taxation of compensation of fund managers, see question 29.

Revised law

On 1 January 2018, the new rules under the revised Investment Tax Act become effective. The scope of application has been slightly reduced as partnerships will no longer be covered. Instead, the general rules of German taxation for partnerships are applicable (ie, resulting in the same treatment as currently is the case for 'non-qualifying partnerships'). Thus, only funds in the form of a corporation or of a contractual type are now covered by the new law. Also covered are certain other entities that do not qualify as 'investment funds' under the KAGB (in particular 'single-investor funds'). One major conceptual change is that the principle of 'restricted transparency' has been replaced by a newly introduced opaque tax regime where there are two levels of taxation: the fund and the investors. This new tax regime was designed for retail funds, but it is applicable to all investment funds (including non-retail funds) that do not satisfy the specific criteria for specialised investment funds under the new law (see also question 29).

Under the opaque regime, the fund is now subject to taxation in respect of certain domestic German income (in particular dividends and real estate income, but not capital gains from the sale of securities unrelated to real estate and unrelated to a permanent establishment in Germany) at fund level (15 per cent tax rate (ie, German corporate tax)). The exemption for dividends (section 8b of the German Corporation Tax Act) is not applicable at the level of the fund even if the relevant threshold (ie, 10 per cent) is exceeded. In addition, German trade tax may be triggered at the level of the fund, if it is engaged in trade or business in Germany (subject to a potential exemption if the fund does not engage in 'active entrepreneurial management' in relation to its assets).

At the investor level, there is a lump-sum taxation (which is designed for the needs of retail funds with a large number of investors, but applicable to all funds covered). Distributions from the fund, predetermined tax bases and capital gains realised upon sale or redemption of the fund interests, are covered, in particular. For individual investors, the actual rate of investor level taxation will depend on whether the investor holds the fund interests as part of their 'non-business' or 'business' assets. For corporate investors, the full amount of such items is subject to corporation tax. In addition, German trade tax may be triggered.

The partial income taxation and the exemption pursuant to section 8b of the German Corporation Tax Act do not apply.

19 Must the portfolio of assets of a retail fund be held by a separate local custodian? What regulations are in place to protect the fund's assets?

Germany requires a depository or custodian for both UCITS and AIFs. The rules for custodians for AIFs are an implementation of the rules of article 21 AIFMD. Germany made use of the option in article 21(3) AIFMD to provide for a special custodian for private equity funds. The requirements for UCITS custodians are based on the UCITS Directive.

A custodian is not required for funds managed by AIFMs who are only registered with BaFin (in particular, sub-threshold managers; see question 3).

There are rules in place to protect a fund's assets from liability incurred by the manager or by the activities of managing the fund (in case of an internally managed fund). For instance, a manager can, as a basic rule, not directly act on behalf of a contractual fund. Any arrangement a manager enters into on account of a contractual fund is binding only on the manager. The contractual fund will then indemnify the manager, but only to the extent allowed by law and the rules of the contractual fund. The contractual fund is therefore protected from claims of third parties unrelated to the management of the contractual fund. In the case of an internally managed investment KG, the KG must have two types of assets: administrative assets and investment assets. The investment assets are financed by the capital of the investors and are used for making investments. The administrative assets serve to finance the general operations of the investment KG. The administrative assets may not be financed by the investors' capital.

20 What are the main governance requirements for a retail fund formed in your jurisdiction?

The governance requirements distinguish between the fund vehicle and the fund manager.

With regard to a manager, several governance requirements apply. An (external) manager can only be set up in a corporate or corporate-like legal form (AG, GmbH and GmbH & Co KG). As a result, the basic governance rules of the respective legal form apply (such as registration requirements and rules for shareholders' meetings). To adapt these governance rules to a fund management environment, the KAGB supplements these rules with specific requirements. For instance, the manager must have at least two executive directors (officers) of good repute and with sufficient knowledge. In addition, there must be a supervisory board. Further, the KAGB requires a manager to obey several duties of good conduct, such as a duty of care, a duty to act in the best interests of the funds and the investors, a duty to avoid conflicts of interest and a duty to treat investors fairly. These duties are reinforced by organisational requirements on the manager, such as a duty to have adequate risk management or rules for personal transactions of employees in place.

The governance requirements applicable to the fund manager are the main governance protection rules applicable to contractual funds.

For a fund set up as an investment corporation with fixed or variable capital (investment AG) or an investment KG, the fundamental layer of governance is based on the governance of the legal forms these funds are based on (eg, with regard to registration requirements). In addition, the KAGB sets out funds-specific requirements, such as the appointment of at least two executive directors.

21 What are the periodic reporting requirements for retail funds?

A manager must report annually. Semi-annual reports are required for contractual funds and investment AGs with variable capital.

22 Can the manager or operator place any restrictions on the issue, transfer and redemption of interests in retail funds?

A manager can restrict the issue, transfer and redemption of interests if there is a basis in the fund's investment guidelines. For instance, investment guidelines typically empower the manager to suspend redemption in extraordinary circumstances.

Non-retail pooled funds

23 What are the main legal vehicles used to set up a non-retail fund? How are they formed?

With regard to vehicles used for non-retail funds (ie, professional or semi-professional investors only), Germany distinguishes between funds managed by fully licensed managers and funds managed by registered managers (sub-threshold managers). Non-retail funds are typically called special AIFs (see question 3).

In the case of a fully licensed manager, the following types are available: contractual fund, investment KG and investment AG. In our experience, the contractual fund is the most common vehicle used for non-retail investors by fully licensed managers.

In the case of a registered manager, the vehicle of choice is a simple limited partnership with a company with limited liability (GmbH) as the only general partner (GmbH & Co KG). However the legal forms of an investment KG or an investment AG are also available.

24 What are the key laws and other sets of rules that govern non-retail funds?

With regard to fully licensed managers managing non-retail funds, the same key rules apply to managers managing retail funds (see question 13).

Managers who are only registered benefit from a very light regulation. Besides the requirements mentioned in question 3, non-retail funds managed by sub-threshold managers are in principle not regulated.

25 Must non-retail funds be authorised or licensed to be established or marketed in your jurisdiction?

In contrast to retail funds, the investment guidelines of non-retail funds only need to be submitted to BaFin without BaFin having to approve the guidelines. The investment guidelines of non-retail funds can either mirror the investment guidelines of retail funds or can be freely specified as long as a fair market value of the assets can be determined. The marketing of non-retail funds requires BaFin approval.

In the case of registered managers, no investment guidelines are necessary and they do not need to be submitted to BaFin. BaFin has established in its practice a requirement to submit a commercial register excerpt of the fund once the fund is established. Once the manager is registered, the marketing of a fund does not need BaFin approval (on the assumption that the marketing takes place within the private placement regime of the German prospectus laws; see question 7).

26 Who can market non-retail funds? To whom can they be marketed?

Non-retail funds can in general be marketed by the same players as retail funds (see question 15). An exception applies to funds managed by registered managers. Such funds cannot be marketed by firms with a financial intermediary licence under the GewO.

Non-retail funds may only be marketed to professional or semi-professional investors (for the definition, see question 3).

27 Do investor-protection rules restrict ownership in non-retail funds to certain classes of investor?

Only professional or semi-professional investors may invest in non-retail funds.

28 Are there any special requirements that apply to managers or operators of non-retail funds?

The distinction between retail and non-retail is in stricter investment guidelines and stricter marketing rules, at least with regard to funds managed by fully licensed managers.

With regard to registered managers, only a regulatory-lite regime applies (see question 3).

29 What is the tax treatment of non-retail funds? Are any exemptions available?

Current non-retail fund taxation (in force until 31 December 2017)

The tax treatment of retail funds (see question 18) is generally also applicable to non-retail funds. As the prior revision of the German Investment Tax Act became effective in late 2013, certain grandfathering rules are applicable (only until 31 December 2017) for those funds existing prior to the enactment of the 2013 revision. German special tax rules (including certain exemptions) apply at the level of the investors, depending on the tax status of the investor (eg, taxable corporation, insurance company and tax-exempt institution).

Revised law (in force from 1 January 2018)

As noted in question 18, the German Investment Tax Act was revised in 2016 and the new rules will become effective on 1 January 2018. As noted, funds in the form of a partnership are now outside the scope of the AIF (ie, in effect, no change compared to the current law for most non-retail AIFs as they are often structured as limited partnerships). Thus, the new law only applies to non-retail funds if they are structured in a corporate or contractual form. Under the new law, there is an option for certain qualifying specialised investment funds to opt out of the new 'opaque regime' and, instead, to apply the 'restricted transparency regime' (ie, the tax regime for investment funds under the law currently in force until the end of 2017 (see question 18)).

Specialised investment funds may only have a maximum of 100 investors (as is currently the case). Unlike the current law, there is a look-through approach with respect to partnerships as investors (ie, each partner of such partnership is counted as one investor of the fund). However, individuals may now invest directly in a specialised investment fund, provided that they hold such fund interests as part of their 'business assets' (previously, only indirect participations of investors were possible).

To qualify as a specialised investment fund, a fund must satisfy certain criteria with respect to regulation, redemption rights, eligible assets and investment restrictions. These are substantially similar to the criteria under the current law (although certain changes with respect to the definition of 'securities' apply).

Fund manager taxation

A 40 per cent exemption from German income tax applies to the carried interest received by managers of a private equity fund structured as a partnership (including limited partnerships) if certain cumulative criteria are fulfilled (in particular, the fund must qualify for asset management status and the carried interest must be paid only after the investors have had all their invested capital paid back). Otherwise, such income is fully taxable at normal German income tax rates. These rules are generally not affected by the revision of the German Investment Tax Act.

Update and trends

The German regulator BaFin is currently requesting comments on an interpretative letter with regard to the German Insurance Ordinance. The Insurance Ordinance is relevant for investments by non-Solvency II investors, such as local pension funds. The proposed BaFin interpretations will – if enacted in its current form – severely restrict investments in non-EU (managed) private equity and debt funds.

Regarding the issue of VAT on management fees, the reform of the Investment Tax Act has not yet included the anticipated improvement of the VAT situation for AIFs. However, there is still hope in the market that German VAT rules will be revised to expand the VAT exemption to AIFs (which is currently not the case in contrast to many EU member states) in order to reflect a court decision of the European Court of Justice in December 2015. Additional pressure on the legislature could come from new court litigation initiated by fund managers. In general, it remains true that the tax landscape is complex and subject to constant change.

30 Must the portfolio of assets of a non-retail fund be held by a separate local custodian? What regulations are in place to protect the fund's assets?

A separate custodian is necessary if the non-retail fund is managed by a fully licensed manager. A custodian is not necessary in case of a registered manager.

31 What are the main governance requirements for a non-retail fund formed in your jurisdiction?

The governance requirements with regard to non-retail funds managed by fully licensed managers are similar to retail funds (see question 20).

There are no special requirements on the governance of non-retail funds managed by registered managers.

32 What are the periodic reporting requirements for non-retail funds?

A manager must report annually.

Separately managed accounts

33 How are separately managed accounts typically structured in your jurisdiction?

Managed accounts are often structured as contractual funds provided by a fully licensed manager as the investment platform. The portfolio management is then typically delegated to a specialised portfolio manager.

34 What are the key legal issues to be determined when structuring a separately managed account?

Managing a separate account is usually deemed discretionary portfolio management in Germany. As a result, the MiFID rules of conduct apply.

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If a sub-delegation structure is used for the managed account, the sub-delegation must comply with delegation rules of the KAGB. This means that effectively the rules of conduct under the KAGB and the other provisions of the KAGB also apply to the delegate manager.

35 Is the management or marketing of separately managed accounts regulated in your jurisdiction?

Managing a separate account is usually deemed discretionary portfolio management in Germany and therefore regulated under the German MiFID implementation. If the account is managed in the form of a contractual fund, the manager must be a fully licensed manager under the KAGB (see question 3).

General

36 Are there proposals for further regulation of funds, fund managers or marketers of funds in your jurisdiction?

Germany currently implements the MiFID II. MiFID II will have an impact on marketers of funds. MiFID II's product governance rules will likely also have an impact on fund managers that use placement agents in Germany.

37 Outline any specific requirements for stock-exchange listing of retail and non-retail funds.

The specific requirements for stock-exchange listing of funds depend on each exchange. For instance, there are exchanges that allow for the trading of closed-ended funds whereas other exchanges permit only open-ended funds.

38 Is it possible to redomicile an overseas vehicle in your jurisdiction?

This is currently not possible in the context of funds.

39 Are there any special rules relating to the ability of foreign investors to invest in funds established or managed in your jurisdiction or domestic investors to invest in funds established or managed abroad?

There are, in general, no special rules applicable. However, certain investors, such as German insurance companies, are restricted to a certain extent by regulatory law to invest in overseas or offshore vehicles.