Financial Services Industry
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FSI Investment Management Newsletter 1/2014
Current Regulatory Developments

This newsletter provides an overview of selected practice-relevant aspects of the implementation of the AIFMD (Act Implementing the Alternative Investment Fund Managers Directive) in Germany through the German Investment Code (KAGB), as well as other topics.

In particular, we address the following:

1. Act on the Adjustment of Laws regarding the Financial Market (FinMarktAnpG) and other current developments involving investment management companies (KVG)
2. Outsourcing
3. Consequences of the CRD IV (including the CRR) for KVGs
4. Leverage
5. Amendments in the area of open real estate funds
6. German AIFM Taxation Adjustment Act (AIFM-Steueranpassungsgesetz)

1. FinMarktAnpG – Draft – and other current developments involving KVGs

1.1. FinMarktAnpG

The draft of an act to adjust laws regarding the financial market (FinMarktAnpG) in the version dated 4 March 2014 was distributed to the associations for consultation with a request for feedback within one week. The act's objective is to rectify incorrect references and information as well as to make editorial modifications to individual provisions for the purpose of alignment with EU terminology. In addition, new EU requirements are to be implemented.

After the EU Commission clarified in its FAQ dated 27 March 2013 (ID 1144) that alternative investment fund managers (AIFM) can only receive an EU passport for collective portfolio management or the sale of managed alternative investment funds (AIF), but not for the other approved main and supplementary activities performed, such as individual portfolio management, investment advisory services, fund-related custody business and acquisition services, the French and British supervisory authorities voiced their opposition to this position. On 12 February 2014, the British Financial Conduct Authority (FCA) published the reference that the European negotiations on revising the Markets in Financial Instruments Directive (MiFID, which was implemented in Germany through the Securities Trading Act (WpHG)) also included an agreement to the effect that the above-stated MiFID-relevant services performed by an AIFM should also be able eligible to receive an EU passport. For this purpose, the AIFM Directive is to be supplemented in Articles 4 and 33 with corresponding clarification. The FCA assumes that applications for cross-border performance of MiFID services in the member states should also be accepted before implementation of the legal amendments. In anticipation of the pending EU legislation and also within the framework of the planned FinMarktAnpG, this issue is now to be addressed in Germany with a modification of the regulations on cross-border services and the establishment of EU branches in §§ 52 and 54 KAGB.

The second material legal change is related to the difference between open and closed funds. In the still current version of the KAGB, this difference is based on a related regulation proposal from the European Securities and Markets Authority (ESMA). According to this, in addition to undertakings for collective investment in transferable securities (UCITS), all AIFs are to be treated as investment funds if their shares – regardless of minimum holding periods and the option of suspending the redemption of shares – may be redeemed by investors at least once per year. Closed funds are all other AIFs according to §1 Para. 5 KAGB. The EU commission did not, however, agree with the ESMA's regulation proposal. It insisted that all AIFs were to be treated as open funds, which grant redemption rights before initiation of the liquidation phase, even if this is conducted less than once per year. The EU Parliament approval was postponed, but can be assumed. The respective adjustment in the KAGB takes places through inclusion of a reference to the EU regulation.

Due to the fact that the classification of AIFs as open or closed in Germany is linked to numerous legal consequences, including with regard to permissible investments, it was also necessary to establish rules for exceptions and transitional rules based on the modification of the classification criteria. The draft of the EU Directive provides for a special transitional regulation, according to which funds with shares that can first be redeemed after a minimum five-year waiting period are also subject to the transitional provision for fully invested closed funds or funds with expired subscription periods. In Germany, such closed funds are being defined separately for the purpose of the transitional regulations. KVGs that are only subject to registration obligations based on the scope of the AIFs managed exclusively in the form of special funds, or KVGs that are not subject to all obligations as per the KAGB based on the minor scope of special and mutual funds managed, must comply with the regulations for open funds with regard to the frequency of assessment and share value calculation as far as the affected funds at least provide for share redemption. The permission of asset conditions and the approval for sale of funds that were established before the FinMarktAnpG entered into force and were considered closed under the older version of the law, shall now be deemed open and expire six months after the law takes effect. This means that KVGs have exactly this amount of time to make the necessary adjustments to by-laws or asset conditions so that these funds may continue to be considered closed within the meaning of the legal amendment. The sales documentation must include references to the required adjustments.

The new law also includes another adjustment related to the closed funds sector. To date, § 263 stated that the net asset value is the reference figure to be used to calculate the asset limit for accessing credit by mutual funds. Against the background of the closed fund business model, it was asserted that this was too restrictive. BaFin initially held firm to the literal interpretation of the law; however, it explained in the email dated 18 November 2013 to the German Federal Association of Investment and Asset Management (BVI) that the (gross) value of the assets held by the fund should be used as the reference figure in the future instead of the net asset value. The law now reflects this interpretation of the BaFin in a clear manner, establishing legal certainty.

1.2. Additional current developments involving KVGs

On 17 February 2014, the ESMA published an FAQ regarding the application of the AIFM Directive, which is to be successively supplemented. The initial publication on the supplement addresses the first-time application of the regulations for remuneration. According to this, the regulations are to be generally applied as soon as the KVG has received its licence. Provided that variable remuneration is to be paid, the regulations shall become applicable at the earliest, however, for bonuses based on the first full financial year after the licence has been issued. For example, if a KVG calculates employee bonuses based on the financial year, which happens to be the same as the calendar year, and it receives its licence in 2014, then the employee performance in 2015 is first relevant for calculating the bonus according to the new regulations. If the licence is issued after 31 December 2014 for a KVG that has been in operation prior to 22 July 2013, then the year 2015 is also to be used as the basis for calculating bonuses according to the new regulations.

In the case of outsourcing, the ESMA clarifies that the remuneration rules are only to be applied to employees in outsourcing companies that exercise influence on the risk profile of the funds managed by the outsourcing company. Only these employees should be subject in general to appropriate contractual arrangements in order to prevent acts of circumvention. If the outsourcing company is subject to the CRD regulations, the ESMA views these regulations as equivalent to the regulations applicable for AIFMs, so that no further regulation is required. A prerequisite is, however, that the CRD regulations are also applicable to the relevant employees in the outsourcing company.

On 26 March 2014, a further supplement of the FAQ was published, in which the ESMA addresses questions regarding regular fund reporting, among other issues. In addition, the ESMA clarified that pension transactions are considered a type of financing. The German legislator held a differing view on this matter to date (see reasons for amendment of § 57 of the German Investment Act (InvG) by the Act to Implement the Revision of the UCITS Directive); this interpretation will have be adjusted in the future.

2. Outsourcing

2.1. The concept of outsourcing activities and outsourcing-relevant duties of a KVG

Under supervisory law, outsourcing is considered the procurement of third-party services, under which the third party is granted considerable decision-taking authority with regard to the performance of services; however, responsibility to other third parties is retained by the outsourcing company. BaFin uses and will continue to use this definition in the future when assessing issues of delimitation, in particular with regard to purely advisory or support services (investment advisory services, research, among others). With regard to supervisory law, outsourced activities are only relevant if they are significant to the performance of the respective services and ancillary services of the KVG, so that the supervisory practices should not change despite the modified wording of the law.

Portfolio management and risk management in this context are considered to be core functions for a KVG's collective asset management within the meaning of § 36 KAVG. In addition to these functions, all administrative activities listed in Annex I No. 2 AIFMD and the activities related to the asset values of the AIF are to be considered part of the management function and thus as duties that are to be performed within the framework of the collective asset management. If external service providers or third-party companies (partially) perform these services, this is considered (partial) outsourcing. In contrast, supporting activities that facilitate the performance of the stipulated management functions, such as facility or fleet management, will continue to be considered non-relevant with regard to outsourcing within the meaning of the KAGB. It is still not clear in this context, however, if and to what extent sales is also to be classified as an outsourcing-relevant activity. There are rumours on the market that BaFin does not intend to handle sales as an act of outsourcing, but an official statement has not yet been issued.

The BaFin did inform the relevant associations in a statement from 7 March 2014 that in anticipation of the depository circular, it views the acceptance and processing of customer transactions in investment units as part of the technical processing and not as an outsourcing issue. The industry breathed a sigh of relief at this because, if otherwise, not only would the contracts have to be adjusted with the custodian, but the custodian would also have to adhere to the rules regarding the segregation solution, i.e. the issue and redemption of share certificates would have had to be separated in organisational terms from the respective control functions.

2.2. Notification of outsourcing and operationalisation of the letter-box criteria

A new factor in comparison to the InvG is that the KVG must notify BaFin before the respective outsourcing agreement takes effect. This also applies to each sub-outsourcing of activities by the contracted company. According to the BaFin circular dated 10 July 2013, the following information must be included in each individual notification of future outsourcing:

- Clear designation of the outsourcing company, including legal form and registered office;
- Description of activity(ies) to be outsourced;
- Period of outsourcing;
- Presentation of the objective reasons for outsourcing (based on the respective specific outsourcing as well as the overall outsourcing structure).

The relevant outsourcing agreements must be submitted, but only on request. Significant changes to the outsourcing agreements are also to be submitted to BaFin. In individual cases, particularly with regard to extensive enhancement of the outsourcing, BaFin is entitled to consider such to be a new act of outsourcing, which would then require a new submission of full notification to BaFin.

In addition to the current applicable prohibition stated in the regulation (EU) 231/2013, other qualitative regulations were also formulated, according to which activities may not be outsourced to an extent that may result in the KVG no longer being considered the management company; if this is the case, the KVG would be considered a letter-box entity. With regard to the operationalisation of the letter-box criteria, an initial outline can be deduced from current management practice. BaFin demands that the outsourced (partial) areas of the portfolio or risk management do not quantitatively exceed the portfolio management and risk management structures provided for at the KVG. An "offsetting" of portfolio and risk management activities with administrative activities (middle and back office functions) that are retained by the KVG (this also applies to the reverse situation) is not recognised by the supervisory authority in this context. Either the portfolio or the risk management or individual activities within the portfolio and/or risk management can be outsourced. This is all contingent on an assessment and conclusive argumentation based on the respective structure in each individual case of outsourcing.

In view of all requirements applicable to cases of outsourcing, such as the outsourcing of middle and back office functions, the following criteria must continue to be fulfilled:

- In-house specialised knowledge and resources must be available
- KVG must be able to conduct effective monitoring of the outsourced areas
- Management authority remains with the KVG
- The rights to inspect documents at the service providers, access rights as well as rights to issue instructions to the service providers must be ensured

In our opinion, when justifying the outsourcing structure, it is important that the argumentation for (partial) outsourcing of portfolio and risk management in the industry is consistently plausible. This especially applies to the definition of activities relevant to portfolio and risk management. In this context, it should be made clear that the portfolio manager consistently takes into consideration the risks associated with the decisions regarding the assets – and thus manages portfolio risk – but that by means of limits (or the conscious waiver of such) and risk controlling, the risk management/controlling function is to be understood as an independent function with respective influence on the risk profile of the investment assets. In our view, the increased formal requirements regarding notification and justification can be implemented under consideration of the existing reference points, particularly because BaFin has let it be known that they assume that the currently approved KVGs will most likely not be considered letter-box entities.

3. Consequences of the CRD IV (including the CRR) for KVGs

The regulations of Basel III, which was published by the members of the Basel Committee on Banking Supervision of the Bank for International Settlements (BIS) on 16 December 2010, are implemented in the European Union through the amended EU Capital Requirements Directive (CRD IV) and the associated new Capital Requirements Regulation (CRR). These were published in June 2013 in the Official Journal of the European Union and have been applicable since 1 January 2014. CRD IV and CRR establish the European legal framework for the approval or the operation of banks and financial service institutions. These entities must fulfil, in particular with regard to the CRR, the stipulated requirements for solvency and liquidity as well as reporting requirements, such as in view of large exposures. This also applies if they invest in investment assets.

In this way, the amended regulatory standard directly affects the business of KVGs if institutions invest in the investment funds of the KVG. In Germany, the regulations of the CRD IV has been transposed into German law through amendments to the German Banking Act (KWG) as well as through adjustments to regulations that supplement the KWG, i.e. the German Solvency Regulation (SolvV), the German Regulation governing large loan exposures and million loans (GroMiKV) and the German Minimum Requirements for Risk Management (MaRisk). The CRR is also a directly applicable law in Germany and does not require transposition into national legislation.

A new factor regarding the notification of appropriate own funds is based on the introduction of the exposure classes “defaulted exposures”, “past due exposures”, and “institutions and companies with short-term credit assessments” as well as the mandatory consideration of the Credit Value Adjustments (CVA Charge) for derivatives that are traded OTC.

With regard to KVG reporting duties within the context of solvency notifications, the regulatory standard also provides for reviewing target funds held in fund of funds in the future.

The requirements applicable to reporting equity capital deduction items as well as reporting the liquidity figures “Liquidity Coverage Ratio (LCR)” as well as “Net Stable Funding Ratio (NSFR)” were not required in this form to date under the older version of the KWG. These new liquidity figures should serve as indicators of sufficient existing liquidity for the institutions. During the calculation, investment assets can be taken into consideration if they fulfil the relevant CRR requirements, according to which funds themselves must be invested in liquid assets; even in this case, the limit is set at EUR 500 million per institution. On 20 December 2013, the European Banking Authority (EBA) published definitions of high and extremely high liquid assets in a Regulatory Technical Standard (RTS).

The reporting of asset values, which represent the equity of institutions, serves to enable the investing institutions to determine their equity capital deductions items (classified according to hard core capital, additional core capital and supplementary capital) in compliance with the requirements of the CRR (Article 36 et seq.). With regard to managed funds, this means that KVGs must identify direct, indirect and synthetic investments of the investment assets in companies operating in the financial sector and issue reports on such to the investors if such are institutions.

Table 1 summarises the relevant reporting dates.

	Reporting frequency	First reporting date
Solvency figures	Quarterly	First reporting date: 31 March 2014 Reporting date: 30 May 2014
Regulation governing large exposures and million loans	Monthly	First reporting date: 31 March 2014 Reporting date: 30 May 2014
Equity capital deduction items	Quarterly	First reporting date: 31 March 2014Reporting date: 30 May 2014
Liquidity figures	Monthly	First reporting date: 31 March 2014Reporting date: 30 April 2014

The regulations of the CRD and CRR result in various additional requirements regarding customer reporting for KVGs. The responsible departments are required to align existing specialised concepts for reporting according to CRR/SolvV or GroMiKV with the new regulations and, if necessary, to create new specialised concepts for liquidity reporting and the calculation of the equity capital deduction items. In this context, the requirements are especially based on the implementation of new regulations into IT frameworks, the revision of master data storage and the amendment of existing processes for customer reporting in general.

4. Leverage

Leverage is any method applied by the KVG to increase the level of investment in the investment portfolio that it manages through borrowing of cash or securities, leverage embedded in derivative positions, or by any other means.

With regard to UCITS, the obligation to calculate leverage is derived from the German Derivative Regulation (DerivateV) in the version dated 22 July 2013 and depends on the selected method of calculating market risk potential.

If the simplified method is applied, the level of investment of the investment assets is to be calculated, which can be increased to more than 100% by means of leverage. With regard to the simplified method, the UCITS is not required to conduct additional leverage calculation in addition to the calculation of the level of investment under possible consideration of hedging transactions as per §§ 15 et seq. DerivateV.

During application of the qualified method, the leverage of investment assets must be monitored in each case in addition to calculating the potential risk amount as per §§ 8 through 14 DerivateV. This is based on the fact that through the use of the value-at-risk method in certain circumstances, or under application of specific asset strategies, it is possible that investment assets show a high leverage ratio despite compliance with market risk limits.

For UCITS, the method for calculating leverage generally remains at the discretion of the KVG; the explanations to §§ 35 and 36 DerivateV require, however, that the UCITS, which calculates its market risk potential according to the qualified approach, publish the expected leverage on the basis of ESMA guidelines 10-788. In this context, leverage is to be consistently calculated as a ratio of the global exposure of the UCITS and its net asset value ([attributable amount +NAV]/NAV). When calculating the attributable amount, the focus should be on a gross calculation ("sum of notionals" as per ESMA guidelines). In addition, the calculation of the leverage amount can be conducted on the basis of the regulation regarding the simplified method as per §§ 15 et seq., i.e. under consideration of hedging transactions (net perspective).

Unlike leverage calculation for UCITS, Articles 6 through 11 of the Regulation (EU) 231/2013 (AIFM Level 2 Regulation) are applicable to AIFs. The AIFM Level 2 Regulation applies in this context also to German open mutual AIFs subject to the DerivateV and German open special AIFs with fixed asset conditions regardless of the application of the simple or qualified method for calculating market risk.

According to the AIFM Level 2 Regulation, the leverage of an AIF must be calculated according to the gross method (Article 7) as well as the commitment method (Article 8). The gross method shall serve to provide information about the global risk of an AIF, while the commitment method shall consider the hedging and netting arrangements used by the KVG with its risk-reducing effects. In comparison to UCITS, which apply the qualified method, the gross leverage as well as the net leverage must be calculated for AIFs.

When comparing the regulation on leverage calculating for UCITS and AIFs, it is clear that the methods for calculating gross leverage differ for UCITS (sum of notionals) and AIFs (methods as per Article 7 AIFM Level 2 Regulation). For example, for UCITS the attributable amounts of the derivatives as well as the market values (as part of NAV) are included in the leverage calculation, which is not the case for AIFs. Furthermore, existing loan commitments for AIFs as per Article 7 AIFM Level 2 Regulation are generally included as absolute amounts in the leverage calculation and thus have a leverage increasing impact.

With regard to leverage under consideration of loans, an aggravating factor is that the higher amount from the loan and the associated acquired asset is to be recognised, which requires a plausible allocation of the asset to the loan. In the material asset loan area, this requirement can be complied with in general; in the securities fund business, a reasonable implementation is faced with considerable practice-related obstacles.

In view of disclosure requirements for UCITS and AIFs, the following shall apply: The sales prospectus of a UCITS must include information on the anticipated scope of leverage if the qualified method is applied. UCITS as well as other open mutual investment assets must also present the maximum scope of leverage; a relevant presentation for special AIFs is to be conducted in the investor information document. For domestic UCITS, the information on maximum leverage can be substituted by the information on the maximum market risk potential, if applicable supplemented by information on the expected leverage. In a UCITS annual report, in which the qualified approach is applied, the used leverage is also to be presented.

5. Amendments in the area of open real estate funds

With the announcement and entry into force of the KAGB as well as the capital asset accounting and assessment regulation (KARBV), changes enter into effect for the accounting procedures for real estate special investment funds (in the future: real estate special investments in the form of open mutual AIFs or special AIFs with investments in such investment assets).

With regard to the information to be presented regarding real estate, shares in real estate companies and other investment assets connected to the special investment fund, for instance the size, type or location of a property, such was taken in full from the InvG and assumed by the Investment Accounting and Assessment Regulation (InvRBV). The regulations on incidental acquisition costs of assets remain unchanged. A new factor for special investment funds is that a so-called activity report is to be included in the annual reports.

In comparison to the InvRBV, the KARBV includes several new elements that are not applicable to real estate special investment funds. One of the new components is the overview of assets, which replaces the summarised list of assets. Furthermore, an exhibit to the annual report must be prepared that must include not only explanatory accounting information but also further information about the special investment fund. This includes information about derivative classification, explanations on overall employee remuneration as well as on management and employees whose activities are directly related to the risk profile of the fund, or with regard to mutual investment funds, about significant changes in the information included sales prospectus during the current financial year. With regard to special investment funds, information must be included at least on assets difficult to liquidate, changes in the liquidity management, the current risk profile and changes to the related risk management system. Assets difficult to liquidate only include, however, real estate or real estate companies if special rules apply to such or to the fund, for example with regard to a suspension of share redemption. When leverage is used, additional information must be included in the annual report according to § 30 Para. 2 KAGB. In the overview of assets, a specific provision for the classification of asset and debt positions of real estate special investment funds was included for the first time. This largely corresponds with the BVI template used to date. A considerable change was made to the profit and loss statement. The earnings not realised in the financial year are now to be included in the calculation of the annual result; this is also based on the EU Directive (231/2013) from Article 103 et seq., which is directly applicable. In addition, the principle of specific identification is to be applied when calculating the realised results from sales and liquidation of real estate and real estate companies.

Based on the conversion of the profit and loss statement, with regard to the structure of the cash flow statement, only the realised result may be included in the distribution calculation; this corresponds with the notion that the unrealised result should not be available for distributions (§ 162 Para. 2 No. 6 KAGB). The abbreviated statement of developments as per the KARBV represents a subsequent change to the profit and loss statement. A minor simplification regarding other disclosures states that only transaction costs must be disclosed for mutual special investment funds.

Significant changes which impact the financial reporting could result from the new valuation requirements for real estate and real estate companies held by real estate special investment funds. Particularly noteworthy in this context are the elimination of the obligatory committee of experts and the introduction of a EUR 50.0 million limit; for amounts above this limit, two external and independent valuers must conduct the purchase valuation for purchases of real estate and real estate companies. For amounts up to EUR 50.0 million, the valuation must be conducted by only one independent evaluator. Real estate companies shall continue to be valued by an auditor. Furthermore, property visits are now mandatory for purchase valuations and subsequent valuations.

The ongoing valuation of the real estate held by mutual investment funds shall be conducted by two independent evaluators. It is unclear in this context as to which value is to be applied if the valuation results from both evaluators are not identical. BaFin views such procedures as particularly appropriate if based on an arithmetic mean; various other procedures, such as selecting the value which is closest to the previous value, were rejected by BaFin. In any case, the approach is to be clearly stipulated in the valuation guidelines of the investment company.

Special funds may continue to deviate from the rules applicable to mutual investment funds if the investors agree to such.

With regard to the special provisions for investments in real estate according to the KARBV, it should be emphasised that specific procedures for valuing real estate are stipulated for the first time. The preferred procedure for application is the earnings capacity value method, but other methods may also be applied in individual cases. The KVG must justify the selection of the procedure applied and align its selection with the procedure recognised on the respective real estate market. If the valuation method as per the Real Estate Valuation Regulation (ImmoWertV), which is highly popular with real estate investment funds, continues to be applied, particularly for foreign properties, remains to be seen. The special requirements for valuing investments in real estate companies were largely taken from the Investment Accounting and Valuation Regulation (InvRBV).

A particular challenge for the KVG will be the future valuation of real estate that must be fixed within the framework of a valuation guideline. In addition, the preparation of activity reports for special AIFs, the change to the profit and loss statement as well as further disclosure obligations in the annual report are the significant new factors that must be taken into account.

6. AIFM Taxation Adjustment Act

On its second attempt, the AIFM Taxation Adjustment Act (AIFM-StAnpG) took effect on 24 December 2013, the day after announcement in the German Federal Law Gazette (BGB 1 I, S. 4318). The act corresponds with the changes of the InvStG in the version agreed upon by the conciliation committee in the summer of 2013 before the failure of the legislative procedure in the last legislative period.

6.1. Modified scope of application

The InvStG is applicable for all UTICS funds and AIFs within the meaning of § 1 Paras. 2 and 3 KAGB as well as the shares in these investment funds. Investment funds are entities for mutual investment, which pool capital from a number of investors in order to invest this capital according to a fixed investment strategy to the benefit of the investors and which are not companies operating outside of the financial sector. Companies, institutions or organisation that are not subject to the KAGB according to § Para.1 and 2 KAGB are exceptions to this rule (e.g. holding companies, institutions for occupational pension schemes, securitisation special purpose entities), as are venture capital companies within the meaning of § 1a Para. 1 of the German Holding Companies Act (UBGG) and public sector capital investment companies.

The principle of investment fund management in its current form of restricted tax transparency remains generally intact for investment funds, whereas changes will be made in subareas. Investment funds exist only when the modified requirements of § 1 Para. 1b InvStG are fulfilled. In any other case, the investment funds are considered investment companies, for which the management scheme for business partnerships or capital investment companies applies depending on the legal form of the fund.

6.2. Investment funds

By decoupling the definitions from supervisory law (KAGB), the InsStG establishes its own scope of application. UCITS and AIFs are considered investment funds if they cumulatively fulfil the following requirements (§ 1 Para. 1b InvStG):

- The UCITS, AIF or the AIF manager is subject to supervision of assets used for the collective investment of capital in its country of residence.
- The investors are entitled to exercise the right of redemption of their stocks or shares at least once per year.
- The objective business purpose is limited to the investment and management of its resources for joint account of the holders of the stocks or shares; active commercial management of the assets (not including real estate) as well as a commercial influence on the portfolio companies is excluded.
- The assets are invested directly or indirectly according to the principle of risk spreading (more than three assets with different asset risks) and at least 90% in suitable assets.
- The catalogue of suitable assets was expanded.
- Not more than 20% of assets may be placed in investments in non-listed corporate enterprises and company holdings which were acquired before 28 November 2013. Real estate funds may be held in real estate investment companies up to 100% of the value.
- The amount of the investment must amount to less than 10% of the capital of a corporate enterprise. This limit does not apply to investments in real estate companies, PPP project companies and EEG companies. Real estate funds may be invested in real estate companies up to 100% of the value.
- A loan may only be taken out over the short term and for not more than 30% of the value of the investment fund. Real estate investment funds may take out short-term loans in an amount up to 10% of the value of the investment fund and also loans up to an amount of 30% of the market value of the real estate held in the investment fund.
- The investment terms and conditions must be documented in the investment terms and conditions.

If amendments are made to the investment terms and conditions so that they no longer correspond with the stipulated requirements, or in the event of significant infringements of the investment conditions, the financial authority must assess such. For a period of three years after incontestability of the finding, the fund shall be considered a capital investment company with significant tax-related disadvantages for the investors.

6.3. Investment companies

Management according to the limited transparency principle is not applicable to investment companies. Furthermore, the management of these funds is subject to Value Added Tax.

For partnership-investment companies, i.e. investment limited partnerships or funds with a similar foreign legal form, which do not fulfil the investment fund criteria, the general tax law regulations for business partnerships and their investors according to § 18 InvStG shall apply. The income of partnership-investment companies is to be determined in a uniform and separate way and are allocated to the investors pro rata for their income or corporation tax assessment. Depending on the domestic structure and activities, trade tax may also be applied to funds, which can be decreased or offset against trade income at the investor level.

Investment forms that are not an investment fund or a partnership-investment company, are considered capital investment companies (§ 19 Para. 1 InvStG). These are subject to corporate and trade tax and to unrestricted tax liability for domestic earnings or restricted tax liability for foreign funds. The lumpsum tax for investors in capital investment companies as proposed by the German Bundesrat did not become law; however, the investment privilege for operating investors is only to be applied to distributions or sales profits if the fund is subject to income tax for corporate entities in its country of residence (for third-party countries, at least 15%) and is not subjectively exempt from such. It should be noted that not only funds of the company-type but also funds of the contract-type (e.g. FCP, CCF) may fall into the category of the capital investment company.

In addition, with regard to partnership investment and capital investment companies, the applicability of additional taxation (§§ 7 et seq. AStG) is to be examined. If applicable, appropriate tax declarations are to be prepared in such case.

6.4. Other changes

Pension pooling/investment-limited partnership

The open investment-limited partnership was introduced as a third form of an open investment fund. As an investment fund, it is exempt from trade tax under the law and does not establish a domestic business premise for its investors.

The main objective of introducing an open investment-limited partnership is to create a transparent investment tool for DBA purposes that offers domestic pension scheme institutions the opportunity to enable them to fully or partially reduce or refund foreign source taxes. German pension and retirement scheme institutions should compare the advantages of this structure to schemes currently used.

Deduction of advertising costs

For fund financial years that begin after 31 December 2013, indirect advertising costs are to be allocated pro rata to ordinary income as well as extraordinary income. The conversion results in the need for adjustments regarding the determination of tax bases for German investors. For mutual investment funds, it would appear that the financial authority will grant an extension of the transition period in the form of a rule of non-objection.

Distribution sequence

Distributions made after 23 August 2014 are to be primarily taken from earnings from the current and past fund financial years. Only after they have been fully distributed can capital be paid out.

6.5. Application provisions

The regulations of the AIFM-StANpG are generally to be applied as at 24 December 2013. The transition regulations state that investment assets which were founded by 23 December 2013 shall be considered investment funds until the end of the financial year that ends after 22 July 2016, as far as they continue to fulfil the previous requirements of an investment asset according to InvStG (older version).

The regulations of InvStG in the version applicable on 21 July 2013 shall continue to apply for the period form 22 July 2013 to 24 December 2013.

6.6. Need for action

For UCITS funds, there is generally no need for action with regard to the applicable tax scheme because they generally fulfil the requirements of the modified investment fund definition. In this respect, the tax bases as per § 5 InvStG should continue to be acknowledged and announced. A need for action exists, however, in view of any necessary adjustments to fund documentation as well as the analysis of investments, in particular with regard to the placement of share profit and intransparent fund earnings.

With regard to investments in newly established funds as well as, in particular, for foreign funds after expiration of the transition period, the resulting tax consequences for German investors and which taxation rules are applicable must be examined.

In addition, there are enhanced monitoring requirements with regard to the prevention of significant infringements of the investment fund requirements in the future (in particular the compilation of fund portfolios), in order to prevent tax disadvantages for German investors.

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