

YPOG Briefing:

BaFin update: Consultation on the influence of investors in investment funds

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On March 14, 2025, the German Federal Financial Supervisory Authority (BaFin) published a draft guidance notice for consultation on the subject of the influence of investors in investment funds permitted under supervisory law. The guidance notice explains whether and to what extent the investors of an investment fund, which may also include banks and insurers supervised by BaFin, may influence the investment decisions of an alternative investment fund manager (AIFM) for the account of the investment fund.

BaFin will accept comments to the consultation until March 31, 2025.

This briefing provides an overview of important statements in the guidance notice and our assessment of them. As the guidance notice is currently being consulted, there may (and in our view must) be changes in the course of the further procedure.

Important statements of the guidance notice

Self-management vs. third-party management

BaFin concludes from the statutory responsibility of the AIFM to comply with the provisions of the German Investment Code (KAGB) that a 'third-party management' (*Fremdverwaltung*) of the investment fund by an AIFM is required. In contrast, management of the investment funds by the investors instead of the AIFM would constitute 'self-management' (*Eigenverwaltung*), which is not permitted under supervisory law.

Investors exceed the permissible limit of self-management if they exert excessive influence on the AIFM's investment and divestment decisions on behalf of investment funds.

These explanations apply to both sub-threshold and fully-licensed AIFMs.

In our view, the use of the terms third-party management and self-management in connection with regulatory responsibility for an investment fund has been discussed in the recent past primarily in the context of two issues, both of which, however, revolve around the interpretation of the term 'investment fund':

- **Differentiation between AIFs and investment clubs:** There is already a similar discussion on the question of whether a collective investment undertaking should be classified as an **investment fund** under the KAGB or as an investment club not subject to the KAGB. According to the European Securities and Markets Authority (ESMA), the rejection of qualification as an investment fund depends crucially on whether the investors as a group have day-to-day discretion or control over operational issues relating to the daily management of the assets of the undertaking. However, the BaFin guidance notice now consulted on the influence of investors in

investment funds **expressly does not address this distinction**, but deals solely with the regulatory permissibility of investor influence in investment funds.

In our opinion, there may nevertheless be a certain correlation between BaFin's new guidance notice and ESMA's already known distinction between investment funds and investment clubs. This is because in the past, BaFin has based the distinction stipulated by ESMA on whether all operational decisions regarding the acquisition, holding and disposal of investments are made by the partners' meeting and not originally by the management. This establishes a link to the excessive influence of investors on investment and divestment decisions that BaFin has now criticized. It therefore remains to be seen to what extent the new interpretation of self-management will influence the distinction between an investment club and an investment fund.

Nevertheless, there may be constellations in which a collective investment undertaking qualifies as an investment fund and the investors in this investment fund are granted certain opportunities to exert influence in the limited partnership agreement of the investment fund or in side letters, which would now have to be scrutinized in light of the new guidance notice.

- **Scope of application of the German Investment Tax Act (GITA):** The distinction between third-party management and self-management has also attracted some public attention in tax law. In the course of investigations into 'millionaire funds', there was a fierce debate as to whether third-party management is a defining characteristic of an investment fund and therefore a mandatory requirement for the scope of application of the GITA to be opened up. The discussion was given new impetus by two tax court rulings that deal with this question and the criteria for the necessary third-party management. As with the regulatory distinction between an investment club and an AIF, the discussion revolves around the concept of investment funds and is not directly influenced by the subject matter of the draft guidance notice.

Final decision by the AIFM or portfolio manager

Due to the particular importance of portfolio management for the remit of an AIFM, BaFin considers the performance of portfolio management by investors to be inadmissible. BaFin emphasizes that the provision of portfolio management by the AIFM is a basis for the granting of a license under the KAGB. The issue raised by BaFin is therefore of direct relevance to the existence of the license itself.

BaFin defines portfolio management within the meaning of the KAGB in particular as the acquisition and disposal of assets for the account of the investor collective and thus the investment funds. This definition by BaFin focuses on investment and divestment decisions, but is not limited to this.

BaFin concludes from all of this that **the final decision** on which assets are acquired or sold for an investment fund must be made by the AIFM or its (commissioned) portfolio managers and not by the investors. If this line is crossed, this constitutes undue influence by investors under supervisory law.

BaFin illustrates this demarcation using the following examples:

Instructions from investors in relation to individual assets

Instructions from investors to the AIFM or portfolio managers are inadmissible, as the final decision in this respect no longer lies with the AIFM or the portfolio managers. In our opinion, this is understandable.

Veto and consent rights by investors

It is incomprehensible that BaFin equates veto rights and consent rights by investors in relation to individual assets in its legal assessment and regards both mechanisms as an expression of an inadmissible final decision-making power of investors.

If BaFin were to base its administrative practice on this in future, this would be a new development for the fund world. Up to now, in our view, investor committees with veto rights or consent rights have also been permissible from BaFin's perspective.

The new administrative practice would also contradict its administrative practice on the scope of decision-making for financial portfolio managers under the German Banking Act or the German Investment Firm Act. This is because, according to previous administrative practice for financial portfolio managers, clients of a financial portfolio manager can certainly require co-decision powers, provided these are limited to veto rights. In the case of a veto right, the financial portfolio manager can make a legally binding investment decision as long as and insofar as the client does not expressly exercise their right to object. In contrast, the consent right alone is regarded as detrimental to the financial portfolio manager's scope for decision-making. This is because, in the case of a consent right, an investment decision could only be effectively implemented after the client has expressly consented.

The version of the new guidance notice currently being consulted could, incomprehensibly, also lead to restrictions on the involvement of an investor committee (Limited Partner Advisory Committee, LPAC), insofar as this committee decides on the contractual permissibility of the investment in cases of conflicts of interest. As a body for deciding on conflicts of interest and thus as a legally appropriate means for an AIFM to meet its own requirements for conflict of interest management, such a restriction would be neither expedient nor legally justified.

In our opinion, it should not be lost sight of in the discussion that, irrespective of the investors' co-decision powers, it is ultimately always the AIFM itself that would make a corresponding investment decision. For example, if investors give their consent, the AIFM can adopt and implement the investment decision, but is not obliged to do so.

However, BaFin at least correctly recognizes that veto rights or consent rights by investors in investor committees are permissible if they relate to the abstract determination of the investment strategy within the framework of the contractually agreed investment guidelines, *e.g.*, in connection with the question of whether or not a special fund should be able to invest in certain types of securities, regions, sectors, etc. The associated influence on the strategic orientation of the investment fund leaves the final decision-making authority with the AIFM or the portfolio manager.

'Investment ideas' or 'recommendations' from investors

In BaFin's opinion, non-binding investment ideas or recommendations from investors are permissible, as the ultimate decision-making authority of the AIFM or the portfolio manager is not called into question here either. This seems reasonable to us.

However, BaFin makes an important restriction by requiring that such an idea or recommendation must not in fact constitute an indirect instruction. The presence of an indirect instruction should be evaluated based on the specific circumstances of each case:

- **No own research or material assessment:** In BaFin's opinion, indications of an indirect instruction would be if the AIFM carries out all investor recommendations 1:1 without conducting

its own research or material assessment of the opportunities and risks of the investment or disinvestment and formally limits its review to acquisition criteria or an investment limit check. Such a constellation is rare in practice, as an asset manager cannot escape liability simply by pointing to ideas or recommendations received. Moreover, we understand BaFin's statements such that the AIFM may certainly use documents already prepared by the investor from a due diligence in order to carry out its own material assessment of the opportunities and risks and, if necessary, request further documents.

- **No own initiative for investment decisions:** BaFin also considers it an indication of self-management if the initiative for the acquisition or disposal of assets rarely or never comes from the AIFM, but essentially and continuously from the investors. We consider this generalized statement to be problematic. On the one hand, single-asset AIFs are common on the market, where, in the opinion of BaFin, the involvement of investors would therefore be – unconvincingly – detrimental across the board. Secondly, the initiative is not to be equated with the investment and divestment decision, which is the central task of portfolio management. According to BaFin's understanding of portfolio management, only the latter forms the central component of portfolio management. The initiative itself does not constitute 'excessive influence' of the investors on the investment and divestment decisions, as BaFin cites for the distinction between third-party and self-management explained at the beginning.

Documentation

BaFin requires that the AIFM and the portfolio manager document any form of influence exerted by investors on investment decisions for the account of investment funds from the publication of the guidance notice on the BaFin website. This is intended to ensure traceability for BaFin and the auditor. At the same time, it is intended to create awareness of the issue and increase the inhibition threshold for unauthorized transactions.

Irrespective of their admissibility under supervisory law, instructions, the exercise of veto rights and consent rights and the submission of investment recommendations or investment ideas by investors must therefore be documented and investment committee meetings must be minuted.

These obligations must also be taken into account in the event of outsourcing.

Participation of supervised investors

BaFin expects the supervised investors, e.g. banks and insurance companies, to cooperate accordingly in the documentation by the AIFM with regard to the scope of influence.

What happens next?

Market participants still have until March 31, 2025, to submit their comments on the consultation. We are happy to receive and process any feedback. Individual statements made by BaFin in the guidance notice may still change as a result of the comments.

Nevertheless, market participants are well advised to identify the potentially problematic constellations of investor influence now. In future, greater attention should also be paid to the appropriate level of documentation, both in their own processes and in outsourced portfolio management processes.