

A large, abstract graphic of a network or sphere made of interconnected blue nodes and lines, positioned in the upper right background. The nodes are 3D cubes, and the lines are thin, glowing blue tubes. The overall structure is a complex, interconnected web.

Germany

Regulation

FUNDS AND FUND MANAGEMENT 2009

2.0 Regulation

On 28 December 2007, the last amendment to the German Investment Act (Investmentgesetz, InvG) has been come into force. With this amendment, the German legislator had implemented the commission directive 2007/16/EC of 19 March 2007 and had also introduced two new fund types which should allow more innovative investment products also in Germany.

Although there are still some unclear interpretations of the Investgesetz the new regulations has been widely accepted by the industry. Especially the new fund type, Sonstiges Sondervermögen, has often been launched in the last year. The investment companies are now waiting for a FAQ regarding eligible assets for UCITS which the German regulator, the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin), will issue in the next months. These FAQ will reflect the actual administration practice of the BaFin.

2.1 Type of funds

The Investment Act distinguishes between funds that are compliant with the UCITS Directive as implemented into German law (UCITS funds) and other types of funds (non-UCITS funds).

UCITS

UCITS are organized as open-ended investment funds (Investmentfonds) with no legal personality, the assets of which are owned either by the management company on behalf of the unitholders or by the unitholders as co-owners. The fund rules must contain the selected type of ownership.

In principle, UCITS funds may invest into every asset class foreseen by the UCITS Directive and the Eligible Assets Directive. Further restrictions may be incorporated in the fund rules.

Non-UCITS funds

Institutional investors frequently invest in institutional funds (Spezialfonds). An institutional fund may only be held by institutional investors. Investors are mainly insurance companies, pension funds, but also large corporations and banks. Basically, institutional funds may invest in the same assets as UCITS funds in Germany. But upon approval by the investors, institutional funds may also deviate from certain restrictions of UCITS funds and can mix all asset classes of the Investment Act.

Investment stock corporations may only be established in the legal form of a stock corporation (Aktiengesellschaft, AG). Investment stock corporations issue voting (Unternehmensaktien) and non-voting shares (Anlageaktien). The voting shares have to be held by the management of the investment stock corporation. They grant voting rights at the shareholders' meeting. In contrast, non-voting shares do not grant any voting rights. Investment stock corporations can be established as consistent with the UCITS regulations, if the charter codifies that the investment stock corporation may only invest in assets compliant with the UCITS directive. In the case of an institutional stock corporation, the investment shares may only be held by institutional investors.

Real estate funds (Immobilienfonds) mainly invest in residential and commercial property. The management company must establish a board of at least three autonomous experts for the appraisal of the property.

Hedge funds can be issued as single hedge funds (Sondervermögen mit zusätzlichen Risiken) or fund of hedge funds (Dach-Sondervermögen mit zusätzlichen Risiken). Single hedge funds are characterized by the use of leverage and short sales according to § 112 (1) of the Investment Act. Units in single hedge funds may not be publicly offered to private individuals. Fund of hedge funds may only invest in German single hedge funds, investment stock corporations whose statutes provide for a similar form of investment, or foreign investment funds which are subject to requirements with respect to investment policies that are comparable to those of German single hedge funds. No leverage and short sale transactions may be executed for fund of hedge funds.

Infrastructure funds were created to allow for investments in public-private-partnerships (PPPs), although they may also invest in property, securities, money market instruments, or deposits. In contrast to other fund types, the net asset value of infrastructure funds must only be reported at specific dates, at least once a month.

The most flexible funds type is the new category of miscellaneous funds (Sonstige Sondervermögen) which may invest in UCITS compliant assets as well as in private equity or precious metals. One special kind of miscellaneous funds are microfinance funds which mainly invest in loans receivables of microfinance institutions as defined by § 90h (7) of the Investment Act.

2.2 Laws

Investment funds in Germany operate under the provisions of the Investment Act, which regulates among other things the activities of domestic fund management companies, the investments eligible for domestic funds and the public distribution of units in foreign funds in Germany.

With respect to the investment in derivatives funds have to apply the Derivative Regulation (Derivateverordnung, DerivateV) which contains further rules for the design of the risk management system, the assessment of market risk, the design of stress tests or the investment in structured products.

Further regulations and clarifications are published in circulars by the BaFin.

2.3 Managers, trustees, and custodians

Fund management companies must be established in the form of a stock corporation (Aktiengesellschaft, AG) or a limited liability company (Gesellschaft mit beschränkter Haftung, GmbH).

Since 28 December 2007, management companies no longer qualify as credit institutions. The applicable provisions of banking regulation were directly included in the Investment Act. Therefore, banking regulation does not apply to investment management companies any more unless stated otherwise in the Investment Act.

The safe-keeping and custody of the fund assets has to be performed by a depositary bank, which has to be appointed by the investment management company. The depositary bank may be a German bank or a German branch of a bank having its registered office in a Member State of the EU or EEA.

An investment management company must have initial start-up capital of at least EUR 300,000. If the assets under management exceed EUR 1.125 billion, the investment management company must provide additional equity capital equal to at least 0.02 percent of the amount by which the assets under management exceed EUR 1.125 billion. However, the required total amount of initial start-up and additional equity capital may not exceed EUR 10 billion.

Investment stock corporations must also have initial start-up capital of at least EUR 300,000. Within six months after the enrolment of the investment stock corporation in the commercial register, the capitalization has to be at least EUR 1.25 billion. Investment stock corporations may issue and redeem shares within the boundaries of a minimum and maximum capitalization which have to be fixed in the rules.

2.4 Investment restrictions

Investment restrictions vary according to the type of fund under consideration.

UCITS

The assets open to UCITS funds comprise securities, money market instruments, cash deposits, units of funds and derivatives. A UCITS fund may not invest more than 5 percent of its NAV in securities and money market instruments of the same issuer. The fund may invest a maximum of 10 percent of its NAV in assets of a single issuer if the fund rules allow for this possibility. In respect of bonds and promissory notes issued by the Federal Republic of Germany, a German state, the EU or Member States of the EU or EEA an issuer limit of 35 percent of the NAV applies.

Derivatives on underlyings specified in § 51 (1) of the Investment Act may be used by UCITS funds for investment purposes provided that their usage does not increase the potential market risk by more than twice. Furthermore, the extent to which derivatives may be used is determined by whether the fund is managed under the simplified (einfacher Ansatz) or qualified approach (qualifizierter Ansatz) as detailed in the Derivative Regulation. The simplified approach is only suitable for funds that restrict the use of derivatives to certain basic instruments. All other UCITS funds have to be managed under the qualified approach. The qualified approach provides for the calculation of the value at risk to measure market risk exposure.

Non-UCITS funds

As mentioned before (see section regarding UCITS), institutional funds may deviate from the investment restrictions for UCITS funds with approval of the investors.

Real estate funds may invest up to 49 percent of its NAV in assets other than property. The value of one single property must not exceed 15 percent of the NAV of the real estate funds at the time of purchase. The total value of properties with individual values exceeding 10 percent of the NAV may only account for at most 50 percent of the NAV. The currency risk of real estate funds may amount at most to 30 percent of the NAV.

Hedge funds have to act on the principle of risk diversification but are otherwise not subject to any restrictions in the investment strategies they pursue.

Infrastructure funds must invest at least 10 percent of their NAV in money market instruments, deposits and units of investment funds which are only invested in deposits and money market instruments. At most, 20 percent of the NAV may be invested in securities listed on a stock exchange in the EU or

EEA. Infrastructure Funds may invest up to 30 percent of their NAV in property which serve to fulfill public duties. The investment in PPPs must at least amount to 60 percent, but may not exceed 80 percent of the NAV. The value of a single PPP investment may not exceed 10 percent of NAV.

Miscellaneous funds may invest at most 30 percent of their NAV in units of other miscellaneous funds and single hedge funds or their foreign counterparts. The total amount invested in non-listed shares may not exceed 20 percent and the amount for a single stock has to be less than 5 percent of the NAV.

Microfinance funds may invest up to 75 percent of the NAV in loans receivable of microfinance institutions defined in the Investment Act, but only up to 10 percent in loans receivable of the same microfinance company.

2.5 Securities lending

Funds (UCITS and non-UCITS) may lend securities of up to 15 percent of their NAV for a fixed period of time. Securities lending to a single borrower must not exceed 10 percent of the NAV of the fund.

2.6 Borrowing

According to § 53 of the Investment Act, a UCITS fund is allowed to raise short-term loans up to an amount of 10 percent of its NAV if this is laid down in the fund rules and the conditions of the loan are in line with market practice.

Institutional funds may raise loans of up to 30 percent of their NAV.

In addition to the limit of 10 percent, real estate funds may only raise loans up to an amount of 50 percent of the value of their property.

Single hedge funds in the Investment Act are characterized by the possibility of unlimited borrowing. For fund of hedge funds the usual limit of 10 percent applies according to § 113 of the Investment Act.

Miscellaneous funds may raise loans up to an amount of 20 percent of the NAV.

2.7 Accounts and prospectuses

For every fund audited, annual reports have to be issued within four months following the end of the financial year. Semi-annual reports which need not to be audited have to be published within two months after the end of period. The dissolution report has to be released within three months after the dissolution date.

According to § 42 (1) of the Investment Act, funds with the exception of institutional funds have to publish a prospectus. The prospectuses for real estate, infrastructure, and other funds have to contain in addition to the general information more detailed specifications dependent on the fund type. The prospectus has to be filed with the BaFin immediately after its first usage.

UCITS funds also have to publish a simplified prospectus whose contents is determined by § 42 (2) of the Investment Act.

2.8 Supervision

The supervisory authority for German and foreign investment funds (if admitted for public distribution) is the BaFin.

The costs of the BaFin are charged to the supervised entities. For German investment management companies, the fee depends primarily on the volume of funds under management.

2.9 Fund ownership

There are no restrictions with regard to the percentage of units which may be held by any one person or group of persons. Institutional funds and investment stock corporations may only be held by institutional investors.

2.10 Fund structure

The Investment Act allows for the introduction of different unit classes within a single fund. The unit classes may convey different rights regarding the use of income, charges and management fees. The Unit Class Regulation (Anteilklassenverordnung, AntKIV) comprises specific regulation regarding the accounting treatment, the accounting methods, and the valuation of the unit classes.

2.11 Stock exchange

Since 2000, actively and passively managed index funds may be quoted on German stock exchanges on a special market segment called Exchange Traded Funds. In May 2006 the German Stock Exchange (Deutsche Börse) introduced a new market segment for trading actively managed non-index funds called Funds Trading (Fondshandel). The majority of German open-ended investment funds can be traded on this market segment.

2.12 Bank secrecy

There are anti-money laundering laws in Germany.

2.13 Fund set-up

The time to set-up a UCITS fund has been drastically reduced by the possibility of the BaFin to approve model clauses in advance.

2.14 Foreign funds

The marketing of foreign funds is regulated by the Investment Act. Public distribution is only allowed if the BaFin does not prohibit the distribution within three months after the application for public distribution has been filed. In the case of funds governed by the UCITS Directive the BaFin has only two months following notification to prohibit public distribution.

2.15 Use of the internet

The BaFin has clarified under which conditions it considers the marketing of foreign funds to constitute a public distribution in Germany, which would require prior notification to the German regulator.

Internet sites in a foreign language that do not contain any information specifically directed at German investors (such as, no German addresses, specific information, or disclaimers) are not considered a public offering in Germany.

By contrast, internet sites in German language will generally be considered a public offering in Germany. Exceptions might apply for sites which due to their content are only directed towards investors in other German speaking countries.

Unsolicited e-mail to recipients in Germany qualifies as public offering regardless of language or content.

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