

## Frequently asked questions about delegation pursuant to section 36 of the German Investment Code (Kapitalgesetzbuch – KAGB)

Ref. no.

WA 41-Wp 2137-2013/0036

Date:

10 July 2013, amended on 15 November 2017.

This document answers frequently asked questions about delegation pursuant to section 36 of the KAGB of 4 July 2013 (FAQs). The catalogue of FAQs is to be updated on an ongoing basis and further questions will be added as necessary.

On this page:

1. Activities pursuant to point 2 of Annex I of the AIFM Directive
2. Activities of an externally managed investment company
3. Materiality
4. Delegation of risk management
5. Application for authorisation
6. Notification of delegation
7. Notification of changes
8. Functions delegated before 22 July 2013
9. Objective grounds of justification
10. Evidence for objective grounds of justification
11. Letter-box entities
12. Advisory models
13. Difference between delegation and external management
14. Complete delegation of portfolio management for tangible assets
15. Delegation vs. provision of services with respect to tangible assets

### [1. Activities pursuant to point 2 of Annex I of the AIFM Directive](#)

If the functions specified in point 2 of Annex I of the AIFM Directive are carried out by a third party (e.g. administration, activities related to the assets of AIFs, such as facilities management and real estate administration), is this to be deemed delegation on the part of the asset manager?

Although the wording of point 2a of Annex I of the AIFM Directive is such that an asset manager does not necessarily need to perform the functions specified therein itself,

administrative activities are to be regarded as functions for which responsibility ultimately lies with the asset manager. If these functions are carried out by a third party, this is to be seen as either delegation on the part of the asset manager or merely the procurement of external services (see also no. 15 of these FAQs (delegation vs. provision of services with respect to tangible assets)). In both cases, the asset manager remains responsible for these functions being fulfilled properly by the third party.

This view is supported not only by section 1 (19) no. 24 of the KAGB, according to which collective portfolio management also includes administrative activities, but also section 216 (7) of the KAGB (Article 19(10) of the AIFM Directive), according to which the asset manager remains responsible for valuation (see also point 2(iii) of Annex I of the AIFM Directive). Furthermore, section 17 (3) of the KAGB (Article 5(1) of the AIFM Directive) provides that the asset manager is responsible for ensuring compliance with all requirements of the law (see point 2(iv) of Annex I of the AIFM Directive). Regulation (EU) No. 231/2013 (AIFM Regulation) also sets out extensive organisational requirements and assigns functions to the asset manager, including administrative activities. In particular, the activity of regulatory compliance monitoring specified in point 2(a)(iv) of Annex I also shows that administrative activities are necessarily functions for which responsibility ultimately lies with the asset manager. This is because it is the asset manager which is authorised or registered; it is subject to supervision. This also means that the responsibility for regulatory compliance ultimately lies solely with the asset manager.

The European Commission has also made it clear that the asset manager is responsible even where the functions are carried out by a third party (European Commission Q&A on the AIFM Directive, ID 1158 and ID 1159).

It is ultimately only possible for the asset manager to have this responsibility if the functions ultimately lie within the sphere of responsibility of the asset manager. The European Securities and Markets Authority (ESMA) also reaches this assessment in its discussion paper on "Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM" of 23 February 2012 (Ref. ESMA/2012/117) in section III, no. 10. Finally, this evaluation is also supported by reasons of investor protection: if the responsibility for the administrative functions did not ultimately lie with the asset manager, and instead the responsibility for the provision thereof ultimately lay with a third party, the investor would have no contractual claim against the third party, as the investment contract would be concluded only between the asset manager and the investor.

The same considerations apply to the activities specified in point 2(c) of Annex I of the AIFM Directive relating to the management of assets.

BaFin continues to stand by its interpretation of the law that when investment units are marketed by intermediaries, this, as a rule, is not deemed to be delegation.

## 2. Activities of an externally managed investment company

Are externally managed investment companies permitted to perform the activities pursuant to point 2 of Annex I of the AIFM Directive?

No. When an investment stock corporation with variable capital appoints an external asset manager, this external asset manager is responsible, pursuant to section 112 (1) of the KAGB, for performing general administrative activities and investing and managing the investment stock corporation's assets. Pursuant to sections 125 (2), 129 (1), 142,

144, 150 (2) and 154 (1) of the KAGB, the same also applies to investment stock corporations with fixed capital and to open- and closed-ended investment limited partnerships. An externally managed investment company thus no longer performs any activities, apart from the activities of the governing bodies prescribed by law. The collective management of the investment fund is the sole responsibility of the appointed asset manager which is accountable for it. It is also not permitted for the functions to be "insourced" to the investment company. This finding is also justified for reasons of investor protection. An externally managed investment company is a fund vehicle and not at the same time an operational company (which performs the management). The investor should therefore, similarly to an investor in a common fund, not be exposed to any operational risk.

### 3. Materiality

Do the provisions of section 36 of the KAGB in principle apply to all cases of delegation?

Section 16 of the German Investment Act (Investmentgesetz – InvG) did not use the term "material delegation" (wesentliche Auslagerung) either. However, only the transfer of functions which are material – to conducting the operations – was deemed to be delegation within the meaning of section 16. The concept of "materiality" is no longer used in section 36 of the KAGB. The EU provisions mean a tightening of the delegation regulations with respect to previous administrative practice, as the focus is no longer on the transfer of functions which are material to conducting the operations. Ultimately, however, it will continue to be the case that not every procurement of external services will be classified as delegation within the meaning of section 36 of the KAGB.

Under recital 82 of the AIFM Regulation, the delegation limitations and requirements are to apply to the management functions set out in Annex I of the AIFM Directive. By contrast, supporting tasks like administrative or technical functions assisting the management tasks, such as logistical support in the form of cleaning, catering and procurement of basic services or products, should not be deemed to constitute delegation. Other examples given are buying standard software 'off-the-shelf' and relying on software providers for ad hoc operational assistance in relation to off-the-shelf systems or providing human resources support such as sourcing of temporary employees or processing of payroll. However, the statement in the recital regarding off-the-shelf standard software also, in turn, means that relying on service providers in relation to the operation of software which is not off-the-shelf cannot in principle be exempted from the requirements for delegation. Here, a case-by-case evaluation of the asset manager is necessary.

### 4. Delegation of risk management

Is it still possible to delegate risk management to companies without authorisation under the KAGB?

Yes. There is the possibility for BaFin to grant authorisation.

### 5. Application for authorisation

What are the requirements for the application for authorisation for the delegation of portfolio and risk management pursuant to section 36 (1) no. 3 of the KAGB? What are the requirements for authorisation?

The requirements for authorisation correspond to the requirements specified in section 36 of the KAGB and in Articles 75 to 82 of the AIFM Regulation (e.g. the delegate must have at its disposal sufficient resources for the delegated functions and the managers must be reliable and have sufficient experience).

To demonstrate that these requirements have been met, a written application for authorisation is to be submitted. The delegation agreement is also to be submitted, and the documentation necessary for assessing the reliability and suitability of the managers is to be attached (cf. the relevant documentation according to the Guidance notice on the authorisation procedure for a German AIFM under section 22 of the KAGB of 22 March 2013).

## 6. Notification of delegation

What information needs to be provided with the notification of delegation pursuant to section 36 (2) of the KAGB? Do the delegation agreements also need to be submitted? When does the notification need to be submitted?

The delegate must be clearly named in the notification. In particular, this includes naming the legal person and stating the registered office thereof. In addition, the delegated function/activity must be described and the investment fund(s) (where relevant, for fund-specific delegation) and the specific assets (where relevant, for object-specific delegation; e.g. the management of real estate) must be stated. The date on which the delegation takes effect is also to be stated, and the objective reasons for the delegation pursuant to the first sentence of Article 76(1) of the AIFM Regulation are to be stated and explained.

If portfolio management or risk management is delegated to a delegate established outside Germany, an explanation of whether the delegate is authorised or registered for the purposes of investment management and whether it is subject to supervision is to be provided, taking into account the provisions of Article 78 of the AIFM Regulation. In such cases, the asset manager is to state the competent supervisory authority and the respective authorisation or registration number of the delegate. If the foreign competent supervisory authority does not grant such authorisation or registration numbers, the asset manager may prove the authorisation or registration of the delegate by other appropriate means.

Moreover, if the asset manager delegates portfolio management or risk management to a company established within Germany or outside Germany, it must set out whether and how the requirements under section 36 (3) no. 2 of the KAGB are met. Under these provisions, portfolio management and risk management may not be delegated to another company whose interests could conflict with those of the asset manager or the investment fund's investors, unless the company a) functionally and hierarchically separates its functions in the portfolio management or risk management from the other functions it performs that have the potential to result in conflicts of interest and b) properly investigates, controls and monitors the potential conflicts of interest and discloses them to the investment fund's investors. In particular, the asset manager is to declare or demonstrate as part of its notification of delegation that there are no conflicts of interest or, if there are conflicts of interest, how these are controlled.

Delegation agreements do not need to be submitted with notifications pursuant to section 36 (2) of the KAGB. However, BaFin reserves the right to request these at a later time. Although the asset manager must be able to show at any time on request that the requirements of section 36 of the KAGB and Articles 75 to 82 of the AIFM Regulation

have been met, it is not necessary to enclose further documentation about this (e.g. regarding the reliability or suitability of the managers) with the notification at this stage. However, BaFin may request further documentation at any time.

The notification is to be submitted to BaFin before, and at the latest one day before, the delegation agreement comes into force. However, if BaFin establishes, after the delegation arrangement comes into force, that the details of the asset manager were not accurate, or that the requirements for delegation were not fulfilled for other reasons, it will address the delegation ex-post and require that the asset manager reverse the delegation or fulfil the legal requirements by delegating the functions to another, suitable provider.

## 7. Notification of changes

Is it necessary to notify BaFin of all changes to delegation agreements? Does the one-month time limit pursuant to section 34 (2) of the KAGB apply here?

No, it is not necessary to notify BaFin of every change in a delegation agreement pursuant to section 34 (1) of the KAGB. A notification is only required for material changes which could also compromise the requirements for authorisation (e.g. which could potentially lead to categorisation as a letter-box entity), with the result that BaFin may reject such changes pursuant to section 34 (2) of the KAGB. Such material changes therefore cannot come into force until at least one month after the corresponding notification pursuant to section 34 of the KAGB.

Changes to the necessary details regarding the notification of delegation as listed in the answer to question 6 (in particular the delegate and the function) may be seen as a new delegation arrangement and are thus to be notified to BaFin pursuant to section 36 (2) of the KAGB, with an explanation of the change and a reference to the original notification. This also applies to sub-delegation pursuant to section 36 (6) no. 2 of the KAGB.

## 8. Functions delegated before 22 July 2013

Are delegation agreements which were already in place assumed to be authorised? Is it necessary for new authorisation to be granted for existing delegation arrangements? What is the time limit for submitting this type of application for authorisation?

Authorisation is not assumed for delegation agreements which were already in place. The specific requirements of the AIFM Regulation regarding letter-box entities alone provide a reason why such authorisation cannot be assumed.

The required applications for authorisation for existing delegation arrangements are to be submitted together with the application for authorisation.

The time limit under section 36 (1) sentence 2 of the KAGB does not affect the time limit under section 22 (2) of the KAGB.

## 9. Objective grounds of justification

Can achieving economic advantages through delegation or making use of specific technical knowledge constitute an objective ground of justification within the meaning of section 36 (1) no. 1 of the KAGB?

Yes, both can constitute an objective reason for delegation within the meaning of section 36 (1) no. 1 of the KAGB. Objective reasons are listed in Article 76(1) of the AIFM Regulation: optimising of business functions and processes, cost saving, expertise of the delegate in administration or in specific markets or investments, access of the delegate to global trading capabilities.

## 10. Evidence for objective grounds of justification

Does the evidence for objective grounds of justification pursuant to section 36 (1) no. 1 of the KAGB in conjunction with Article 76 of the AIFM Regulation relate to the entire delegation structure of the company or to individual delegation arrangements of the individual AIF?

Both. The objective reasons are to be explained in the notification for the individual delegation arrangement (see also the explanation relating to question 6). However, the asset manager must also justify the objective reason in relation to the entire delegation structure in their explanation.

In addition, the entire delegation structure of the asset manager is part of the auditor's examination of the delegation arrangement pursuant to sections 38 (3) and 121 (3) of the KAGB, in conjunction with sections 148 (1) and 136 (3) as well as in conjunction with section 159 of the KAGB. The auditor's report is therefore to contain details of the extent to which the delegation structure satisfies Article 76 of the AIFM Regulation.

Furthermore, the asset manager must be able, at any time, to explain the entire delegation structure to BaFin and provide evidence of the extent to which this is justified by objective reasons pursuant to Article 76 of the AIFM Regulation (see also Article 76(2) of the AIFM Regulation, according to which further explanations and documentation regarding the entire structure must be provided to BaFin upon its request).

## 11. Letter-box entities

Can portfolio management and/or risk management be fully delegated? Is it sufficient if the asset manager only performs administrative activities (which are also part of collective management)? When risk management is fully delegated, is it acceptable for some parts of portfolio management such as defining and monitoring the investment strategy to be kept in-house?

The assessment of whether the company is a letter-box entity is determined by Article 82 of the AIFM Regulation. Pursuant to Article 82(1)(d) of the AIFM Regulation, quantitative and qualitative criteria apply with regard to the delegation of portfolio management and risk management. In principle, it is possible for either portfolio management or risk management to be delegated. It is also possible to delegate parts of each. However, it is not permitted for both functions to be fully delegated, with the result that the asset manager, for example, simply performs administrative activities for all investment funds. Although these administrative activities are also core functions and part of the collective portfolio management (see also the explanation under question 1), the assessment pursuant to Article 82(1)(d) of the AIFM Regulation, from a quantitative point of view as well, exclusively relates to the investment management functions, i.e. portfolio management and risk management (see point 1 of Annex I of the AIFM Directive). Administrative activities cannot compensate for the delegated portfolio and risk management, and cannot be used for quantitative assessment under Article 82(1)(d) of the AIFM Regulation.

In addition, the delegated investment management functions must not significantly exceed the retained portfolio management and risk management functions from a quantitative point of view. This assessment regarding the extent to which the delegated investment management functions exceed the retained portfolio management and risk management functions is to be carried out at fund level.<sup>1</sup> The different requirements for portfolio management and risk management for certain fund types and categories are also to be included in the assessment.

## 12. Advisory models

Are advisory models still permissible? When are the boundaries of mere advice exceeded? Is it sufficient for the asset manager just to make the investment decisions?

Yes, see the statements in point 10 item 1 of the KAMaRisk, which state that it is not considered delegation within the meaning of section 36 of the KAGB to accept information or recommendations of third parties in relation to assets as are necessary for the company's investment decisions provided that the qualified investment decision by the asset manager is based on its own analysis of the investment for the investment fund. However, it is not sufficient for the investment recommendation to be simply subjected to a formal verification, e.g. to confirm that it is within investment thresholds, and for the company to otherwise implement the recommendation without carrying out its own assessment of the investment.

## 13. Difference between delegation and external management

How is delegation differentiated from external management? If authorisation is required even in cases where only portfolio management or risk management is provided, does this mean that a portfolio manager can be subject to an authorisation requirement?

The assessment of whether the responsibility for a collective portfolio management activity lies with an external management company or whether it is carried out via delegation depends on who bears the responsibility to third parties for the activity. If portfolio management is provided by means of delegation, this does not trigger an authorisation requirement for the collective portfolio management because the responsibility to third parties still lies with the delegating company.

## 14. Complete delegation of portfolio management for tangible assets

Is it also possible to fully delegate portfolio management with respect to real estate funds such that investment decisions are also made by a third party?

Portfolio management can also be delegated with respect to real estate funds, and investment decisions on the purchase and sale of real estate can also be made by a delegate. In this respect, it is now also permitted to delegate investment discretion, as a core competence of the asset manager. Investment discretion here means the power to take binding investment decisions regarding the purchase or sale of real estate as part of the management of the fund, but does not refer to the ability to dispose of the real estate or conclude purchase contracts. In such cases of delegation, the competence of the delegate is of particular importance. The suitability of the delegate, if it does not have appropriate authorisation itself, is examined by BaFin in the authorisation procedure. In particular, this must include an assessment of the scope of the delegation arrangement

---

<sup>1</sup> ESMA Q&A on the application of the AIFMD, Section VIII: Delegation, Q&A no. 1 (ESMA34-32-352).



and the risk it presents to the asset manager and the real estate fund. Due to the significance of a decision on the purchase/sale of property or tangible assets, the legislative intent underlying section 36 (1) no. 3 of the KAGB sets out the authorisation of an extensive delegation arrangement to a delegate which is not authorised as an exception to the rules.

The provisions regarding letter-box entities must also be taken into account.

## 15. Delegation vs. provision of services with respect to tangible assets

Are certain services with respect to the assets of the AIF (e.g. property management in real estate funds) to be classified as delegation? Is the use of a service provider for letting to be classified as delegation of the portfolio management?

In the management of certain assets, in particular real estate or other tangible assets, individual activities connected with these assets which do not include any discretion regarding the purchase or sale of the assets, e.g. facility management and other management activities, are not to be seen as part of the portfolio management. This follows from Annex I of Directive 2011/61/EU, which specifies portfolio management in section 1, and demarcates the other activities, named in section 2(c), from it. When these activities are transferred, it is therefore not necessary for the other requirements of section 36 (1) no. 3 of the KAGB to be fulfilled. However, according to recital 82 of the AIFM Regulation, the limitations and requirements for delegation in principle are to apply to all management functions set out in Annex I of the AIFM Directive. These management functions, which as such are normally to be classified as delegation arrangements when they are transferred, thus also include the management activities, such as facility management, listed in section 2(c) of Annex I. However, it is to be taken into account here whether the company uses the services of a service provider on a single occasion or to a limited extent for support (e.g. small repairs) or delegates facility management on an ongoing basis. In cases of a commission on a single occasion, this can then be deemed simply procurement of external services and not delegation.

However, regardless of the duration of the service relationship set out contractually, a simple procurement of external services is usually ruled out in cases where the contracting party is granted a material discretionary scope with regard to the provision of the services. In this case, it can always be assumed that this would be deemed delegation.

The respective activities may then also be considered to be portfolio management, with the result that the transfer thereof must also satisfy the requirements of section 36 (1) no. 3 of the KAGB. This might be the case for activities involving a broad decision-making power regarding an asset with potentially extensive economic consequences for the fund (e.g. in the case of letting or renovation of property). If decisions about this regarding an asset are still made by the asset manager after the asset manager itself has carried out a thorough examination (e.g. decisions about the specific leasing arrangement following advice from service providers, decisions about a renovation measure following a suggestion from architects or planners), this can fall under procurement of other external services and not delegation (similarly to the assessment of investment advice, see question 13). This reasoning can also be applied in relation to decisions regarding such arrangements or the purchase or sale of other tangible assets (e.g. ships).

A similar line of reasoning applies to the use of service providers for advice about the financing of tangible assets. In cases where the company itself still carries out a thorough



examination and makes the final decision, this does not need to be deemed delegation of portfolio management.