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Investor Oversight or Undue Influence?

Reassessing BaFin's Stance on AIFM Portfolio Control

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Abstract: This article critically examines the March 2025 Draft Position Letter issued by BaFin on investor involvement in AIF portfolio decisions. While reaffirming the AIFM's exclusive mandate under the AIFMD, BaFin's strict stance on veto rights, LPAC involvement, and investor oversight diverges from more pragmatic regulatory approaches in other EU jurisdictions. Drawing on legal obligations under Articles 12 and 57 of the AIFMD and AIFMR, and contrasting interpretations by regulators such as the CSSF, this paper argues for a proportionate balance between investor protection and fund manager autonomy. The analysis underscores the need for regulatory alignment that recognises legitimate governance rights without undermining the structural integrity of the AIFM model.

KEY WORDS: AIFM DIRECTIVE · REGULATORY DIVERGENCE · AIFM DISCRETION · INVESTOR INFLUENCE · INVESTOR PROTECTION · LPAC RIGHTS · VETO MECHANISMS · PORTFOLIO MANAGEMENT OVERSIGHT · FIDUCIARY DUTIES · RECORD-KEEPING OBLIGATIONS · JOINT VENTURE VS AIF QUALIFICATION · CAPTIVE FUNDS · DAY-TO-DAY DISCRETION · GOVERNANCE RIGHTS IN AIFS

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Introduction

(1) The role of investors in the investment and divestment decisions of alternative investment funds (the "**AIFs**")[1] has long been a subject of fluidity and regulatory interpretation. While investors provide the capital necessary for these funds to operate, the regulatory framework governing AIFs establishes clear boundaries to ensure that investment decisions remain within the control of the alternative investment fund manager (the "**AIFM**"). The AIFM Directive[2] enshrines the principle that AIFMs must exercise independent discretion over portfolio management, free from undue external influence. However, the extent to which investors can intervene in investment decision-making – whether through limited partner advisory committees (the "**LPACs**"), veto rights, recommendations, or otherwise – remains a complex and evolving issue.

(2) The *Bundesanstalt für Finanzdienstleistungsaufsicht* (the "**BaFin**"), Germany's financial supervisory authority, published a draft position on the matter on 14 March 2025 inviting stakeholders to submit their comments on the draft until 31 March 2025.[3] A number of actors

[1] See Article 4(1)(a) of the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (the "**AIFM Directive**"), *OJ L 174*, 1 July 2011, p. 1 – 73; for a consolidated version please see: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:02011L0061-20250117 (last accessed on 27 June 2025) defines AIFs as "*collective investment undertakings, including investment compartments thereof, which: (a) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (b) do not require authorisation pursuant to Article 5 of Directive 2009/65/EC [i.e., that are not UCITS]*".

[2] See Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010; *OJ L 174*, 1 July 2011, p. 1 – 73; for its coordinated version see: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02011L0061-20250117 (last accessed on 28 June 2025).

[3] See BaFin draft position paper on "Influence on Investment Funds: Guidance Clarifies Investor Involvement" (*Einflussnahme auf Investmentvermögen: Merkblatt konkretisiert Möglichkeiten von Anlegerinnen und Anlegern*) (the "**Draft Position Letter**");

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have published comments on the matter.[4] The Draft Position Letter reveals some important details which may be seen as diverging from the one applied by some other regulators, such as the Luxembourg *Commission de Surveillance du Secteur Financier* (the "**CSSF**").

(3) While BaFin's Draft Position Letter reinforces the principle that AIFMs must retain independent decision-making authority, its strict limitations on investor involvement raise concerns about practical implications for fund governance, regulatory divergence within the EU, and potential constraints on institutional investors.

(4) This paper examines the legal, practical, and cross-border implications of BaFin's proposed framework. It contrasts BaFin's interpretation with the more balanced and market-sensitive approaches of other regulators and assesses whether BaFin's stance aligns with the broader objectives of the AIFM Directive. Through an analysis of the AIFM's statutory duties under Articles 12 and 57 of the AIFM Directive and the AIFMR, and a closer look at industry practice regarding investor governance rights, this paper argues for a more proportionate and principles-based regulatory position – one that upholds investor protection without undermining market functionality.

(A) Exclusive Management Authority of the AIFM over Investment Decisions

(5) One of the fundamental responsibilities of an AIFM is to carry out the portfolio management for the AIFs it manages. This obligation stems from the AIFM Directive,[5] which mandates that an AIFM must undertake at least either portfolio management or risk management as a core function.[6] The ability to perform portfolio management is also a key requirement for obtaining an authorisation as an AIFM.[7]

(6) While the AIFM Directive does not provide a precise definition of portfolio management, it is generally understood to encompass namely the binding decisions taken in relation to acquisition and disposal of assets for the AIF. This process is essential in ensuring that the AIF's investment strategy is implemented in a structured and professional manner.

(7) The responsibility for portfolio management can either be exercised directly by the AIFM's internal team or outsourced to an authorised external portfolio manager.[8] However, this role cannot be undertaken by the AIF itself (unless the AIF is an internally-managed AIF/AIFM).[9]

(8) That said, does that mean that investors should not be allowed to exert direct control or influence over portfolio management decisions?

(9) BaFin expressed in the Draft Position Paper that investors' direct control over portfolio management decisions would undermine the principle of delegated management, which is a cornerstone of AIFM/AIF structures. Indeed, the regulator's view is that the final decision on the acquisition and disposal of assets must always remain with the AIFM or its designated portfolio

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https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Meldung/2025/meldung_2025_03_14_Merkblatt_Einflussnahme_Investmentvermoegen.html (last accessed on 28 June 2025).

[4] See namely Michelle Kos-Kogos & David Peroz, *Update Aufsichtsrecht – Einflussnahme von Anlegern auf Investmentvermögen und der Entwurf des BaFin-Merkblatts*, 1 April 2025; https://www.pe-magazin.de/update-aufsichtsrecht-einflussnahme-von-anlegern-auf-investmentvermoegen-und-der-entwurf-des-bafin-merkblatts/ (last accessed on 28 June 2025); Bundesverband Investment und Asset Management e.V., *BVI-Stellungnahme zum Entwurf des BaFin-Merkblatts zur Einflussnahme von Anlegern auf Investments und Desinvestments von Investmentvermögen*, 7 April 2025; https://www.bvi.de/fileadmin/user_upload/250407_BVI_Stellungnahme_BaFin-Merkblatt_Anlegereinfluss.pdf (last accessed on 28 June 2025); Bundesverband Alternative Investments e.V., *BAI-Stellungnahme zum Entwurf eines Merkblatts zur Einflussnahme von Anlegern auf Investments und Desinvestments von Investmentvermögen*, 31 May 2025; https://www.bvai.de/fileadmin/Recht/Stellungnahmen/BAI_Stellungnahme_BaFin_Merkblatt_Anlegereinfluss_30_03_25.pdf (last accessed on 28 June 2025).

[5] See Article 8(5) of the AIFM Directive, read in conjunction with the definition of "managing AIFs" as found under Article 4(1)(w) of the AIFM Directive.
[6] See namely Article 82 of the AIFMR.
[7] See Article 8(5) of the AIFM Directive.
[8] See Article 20 of the AIFM Directive.
[9] See point **(25)** for more information on the matter.

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manager without a veto right being granted to investors (other than in typical scenarios).[10] Should investors exert such influence on the AIFM on portfolio management matters, this would – in the BaFin's view – constitute an undue regulatory intervention, challenging the integrity of the AIFM/AIF's governance framework.

(10) In the author's view, BaFin takes an exceptionally strict stance in limiting investor involvement, stating that investors may not exert meaningful yet reasonable influence over investment and divestment decisions with very limited exceptions. While regulatory caution is warranted to protect the AIFM's independence, this approach fails to consider market realities and one of the two core principles underlining the AIFM Directive, *i.e.*, protection against systemic risks and improved investor protection. Many sophisticated investors, such as institutional pension funds and insurance companies, *should still be able to expect* – some 14 years after the publication of the AIFM Directive – a degree of oversight and control over portfolio decisions, particularly in tailored fund structures like captive funds. BaFin's outright prohibition of investor influence could, in the author's view, have significant consequences. First, it may deter international institutional capital from being invested in AIFs managed by German-regulated AIFMs, potentially making these managers less competitive compared to those established in other EU jurisdictions. Second, it could compel German institutional investors allocating capital to AIFs managed by EU-regulated AIFMs to forgo governance rights that they have carefully negotiated in the interest of all AIF investors, thereby limiting their ability to safeguard investment oversight and risk management as currently contemplated.

(B) Organisational and Fiduciary Obligations of the AIFM

a) The Fiduciary Standard under Article 12 of the AIFM Directive

(11) Article 12 of the AIFM Directive establishes the fiduciary duty of AIFMs to act in the best interests of AIFs and their investors. This duty is fundamental to ensuring that investment decisions are made with integrity, transparency, and a clear focus on investor protection. Unlike mere regulatory compliance, fiduciary responsibility under Article 12 imposes a higher standard of care on AIFMs, requiring them to prioritise investor interests over their own commercial objectives and to ensure that all investment and divestment decisions align with the AIF's stated strategy and risk profile. As part of this obligation, AIFMs must implement effective risk management procedures, prevent conflicts of interest, and exercise due diligence in portfolio selection and monitoring. Failure to uphold these responsibilities could lead to regulatory scrutiny and potential legal liability, making adherence to Article 12 a cornerstone of sound fund management and investor confidence.

(12) One of the key aspects of Article 12 is its emphasis on acting in the best interests of investors, a duty that extends beyond mere compliance with legal requirements to encompass broader principles of fairness and investor protection. This obligation requires AIFMs to prioritise investor interests when making investment and divestment decisions, structuring transactions, and allocating costs. It also necessitates a robust risk management framework to ensure that investments are selected and managed in a way that aligns with the AIF's stated strategy and risk profile. Any action that places the AIFM's interests – or those of a particular subset of investors – ahead of the collective interests of the AIF's investors would constitute a breach of this fiduciary duty.

(13) Another critical component of an AIFM's fiduciary duty under Article 12 is the prevention and management of conflicts of interest. The AIFM Directive requires AIFMs to establish and implement policies designed to identify, mitigate, and, where necessary, disclose conflicts that may arise in the course of managing an AIF. This is particularly relevant in cases where the AIFM has deeper relationships with particular investors that could influence decision-making to the detriment of other investors. Where conflicts cannot be effectively managed, the AIFM is required to act in a manner that demonstrably protects all investors' interests, including declining to proceed with transactions that would create a material conflict.

(14) The principle of acting in the best interests of investors also includes the AIFM's duty to exercise due diligence in investment selection and monitoring. AIFMs are expected to conduct thorough research, assess risks, and ensure that investments are made in accordance with the AIF's

[10] See points **(27)** *et seq*. for more information on the matter.

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objectives. This duty extends to divestment decisions, requiring AIFMs to determine the optimal timing and method of disposal in a manner that maximises value for investors. Any failure to perform this duty diligently – such as engaging in transactions that lack commercial justification or are driven by external pressures – would constitute a breach of fiduciary responsibility.

b) Record-Keeping and Documentation Requirements under the AIFMR

(15) Article 57 of the AIFMR[11] explicitly states that AIFMs must:

- establish, implement and maintain decision-making procedures and an organisational structure which specifies reporting lines and allocates functions and responsibilities clearly and in a documented manner;[12] and
- maintain adequate and orderly records of their business and internal organisation.[13]

(16) Furthermore, Article 64(1) of the AIFMR provides that AIFMs must promptly create and maintain a record for each portfolio transaction related to the AIFs they manage, ensuring that the information is detailed enough to allow for the reconstruction of the order, the executed transaction, or the agreement. Such records must be retained for a period of five (5) years.[14]

(17) Complying with said provisions requires AIFMs to document the various stages of their portfolio management activities. Investment decision-making must be clearly recorded, from the initial screening and risk assessment to final execution and monitoring. Investment logs must be maintained to provide a chronological record of all transactions, specifying namely the rationale behind investment or divestment decision. Due diligence reports are required for asset selection, detailing financial analysis, legal risks, and potential exposures. These reports must demonstrate that investments align with the AIF's strategy and risk parameters and that adequate risk controls are in place. Additionally, AIFMs must maintain records of portfolio valuations, outlining the methodologies used to assess asset values and any adjustments made in accordance with market conditions.

(18) Finally, when the AIFM appoints a portfolio manager to perform the portfolio management function in relation to an AIF, the delegation must be structured in a way that allows competent authorities to conduct supervisory reviews effectively.[15]

c) The New Documentation Obligations Under the Draft Position Letter

(19) To ensure that BaFin and auditors can verify that BaFin-regulated AIFMs complied with the investment / divestment decision process as further described below,[16] BaFin required that said AIFMs (and portfolio managers appointed by them) *document all forms of investor involvement in the decision-making process*. This "investor involvement" notion encompasses not only direct instructions (such as a veto) from investors but also investment recommendations and suggestions. Additionally, records must be kept of all investment committee meetings, ensuring that discussions, deliberations, and any input from investors are properly recorded. These record-keeping requirements shall in principle become applicable after the consultation period concludes and BaFin finalises its position letter, taking into account the case being the feedback received.[17]

(20) While regulatory transparency is crucial, the level of documentation required under the Draft Position Letter appears excessive and operationally burdensome, compounding its already far-reaching negative impact on institutional capital – arguably the most concerning consequence

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[11] See Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision; *OJ L 83*, 22 March 2013, p. 1 – 95; for its coordinated version see: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0231 (last accessed on 28 June 2025).
[12] See Article 57(1)(a) of the AIFMR.
[13] See Article 57(1)(e) of the AIFMR.
[14] See Article 66(1) of the AIFMR.
[15] See namely Articles 75(e), 78 and 79 of the AIFMR.
[16] See points **(23)** *et seq*. for more information on the matter.
[17] See point IV of the Draft Position Letter.

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of the proposed framework[18] AIFMs would need to track and justify even minor investor interactions to prove they have not been unduly influenced, potentially leading to unnecessary compliance costs and administrative inefficiencies. This obligation would extend beyond German-regulated AIFMs to also affect German-regulated investors, who would be required to maintain records of their influence on investment / divestment decisions, even when investing in AIFs managed by non-German-regulated AIFMs.

(21) Furthermore, where portfolio management is outsourced to an external foreign portfolio manager, German-regulated AIFMs will have to ensure that the outsourcing arrangement includes a contractual obligation for the external manager to maintain proper documentation in this respect as well. This would *de facto* require all German-regulated AIFMs to amend their existing portfolio management agreements to align with this new regulatory position.

(22) BaFin went on to say that the documentation requirement would also apply to all forms of investor influence, "*irrespective of whether such influence is legally permissible*". If, at the very least, the limit was drawn at "*unless such influence is legally permissible as per applicable law and regulatory practice in the jurisdiction of the AIF and the AIFM*" rather than imposing an absolute requirement to document all forms of investor influence irrespective of their regulatory standing, the Draft Position Letter would be considerably more balanced. This modification would (i) recognise that certain forms of investor influence are expressly permitted under the AIFM Directive, the AIFMR and ESMA, (ii) ensure that German-regulated AIFMs are not required to document investor interactions that are entirely lawful and consistent with local rules and regulations – particularly considering that the AIFM Directive imposes obligation on AIFMs, not AIF investors, and that BaFin should not, in the author's view, shift any part of the regulatory burden onto investors, and (iii) reduce unnecessary compliance costs and legal uncertainties.[19]

(C) Regulatory Limits on Investor Influence in Portfolio Decision-Making

(23) The extent to which AIF investors may influence investment and divestment decisions within the fund itself (either through an LPAC decision or otherwise) requires careful regulatory consideration.

a) Direct Investor Instructions and the AIFM's Exclusive Mandate

(24) One key restriction concerns direct investor instructions regarding specific investments or divestments. Investors cannot indeed direct the AIFM or its portfolio manager to buy or sell particular assets, as the authority to make such decisions must remain solely with the manager. This principle is rooted in the fundamental requirement that an AIFM must exercise independent discretion over investment decisions to ensure proper risk management and investor protection under the AIFM Directive framework. Allowing investors to dictate individual transactions would undermine the core governance principle that AIFMs are responsible for executing the AIF's investment strategy in the best interests of all investors.

(25) This position is further reinforced by ESMA's position on the role of the AIFM and the AIF in relation to investment decisions, and more particularly in relation to externally-managed AIFs.[20] ESMA explicitly states that an externally-managed AIF [whether through its general partner/board or its general meeting of shareholders/LPAC] cannot itself perform the investment

[18] See point **(10)** for more information on the matter.

[19] Also see Caroline Herkströter, Ute Brunner-Reumann and Sabine Kimmich, *Anleger-Einfluss auf Investmententscheidungen von KVGen – BaFin konsultiert neues Merkblatt zu den Grenzen der Zulässigkeit*, 17 March 2025, where the authors expressed concern that BaFin's proposed documentation requirement for all forms of investor influence on investment decisions is too far-reaching and may impose disproportionate administrative burdens on capital management companies and their asset managers. While they acknowledge the intent to promote transparency and proper governance, they argue that the obligation should be limited to clear and targeted communications aimed at influencing specific decisions, rather than encompassing every discussion that might touch on investment matters. They also caution against excessive formality, such as requiring investors to countersign meeting minutes, and urge that the final guidance strike a more practical balance that does not hinder effective collaboration between institutional investors and fund managers; https://www.dlapiper.com/de-de/insights/publications/2025/03/anleger-einfluss-auf-investmententscheidungen-von-kvgen-bafin-konsultiert-neues (last accessed on 28 June 2025).

[20] See "Section VIII: Delegation" of ESMA's questions and Answers – Application of the AIFMD, ESMA 34-32-352, 14 June 2023; https://www.esma.europa.eu/sites/default/files/library/esma34-32-352_qa_aifmd.pdf (last accessed on 28 June 2025).

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management functions set out in Annex I of the AIFM Directive. Instead, where an AIF appoints an external AIFM, the responsibility for providing these functions rests solely with the external AIFM. While the AIFM may delegate certain functions to third parties under Article 20 of the AIFM Directive, the AIF itself does not qualify as a "third party" and cannot assume the role of a portfolio manager.

(26) This clarification underscores a crucial regulatory distinction: the AIF, as a collective investment vehicle and irrespective of the body corporate(s) involved, must remain separate from the decision-making authority vested in the external AIFM. Allowing the AIF or its investors to *positively make* investment / divestment decisions would undermine this separation and effectively render the AIF self-managed, which is not permissible under the AIFM Directive unless it qualifies as an internally-managed AIF under Article 5(1)(b) thereof. That said, a positive investment or divestment decision is fundamentally different from an oversight or control right, such as a veto decision made by an LPAC, which is inherently restrictive in nature.

b) Veto Rights and Pre-Approval Mechanisms

(27) Irrespective of our last remark above, according to BaFin, investor veto rights or approval requirements for individual investments are generally not permissible. It maintains that if investors were able to block or refuse consent for specific transactions, the final decision would no longer rest with the AIFM or its portfolio manager but rather with those investors exercising veto power. However, certain exceptions accepted by BaFin have emerged in practice, particularly concerning transactions that fall outside the scope of the investment strategy outlined in the AIF's private placement memorandum or limited partnership agreement. Investment decisions that deviate from the pre-agreed strategy, especially those exceeding concentration or allocation limits, represent a material shift in the risk exposure accepted by investors at the time of their commitment. Such deviations, if left unchecked, could expose investors to risks they did not originally consent to, necessitating additional oversight.

(i) The Expanding Role of LPACs in Investment Governance

a. BaFin Recognised Scope of LPAC Intervention

(28) In this context, the evolving role of LPACs in AIFs reflects a broader market trend towards greater investor oversight in circumstances that materially affect the risk profile of the AIF. In particular, LPACs are increasingly empowered to grant pre-approval for investments that exceed concentration or allocation limits – such as geographical restrictions – or that fall outside the AIF's defined investment focus.[21] This development is not only commercially justifiable but also legally sound, as it aligns with core principles of the AIFM Directive.

(29) From a legal standpoint, LPAC pre-approval in these scenarios is justified under Article 23(1)(a) and (b) of the AIFM Directive. These provisions mandate that investors must receive clear and comprehensive disclosures on the investment strategy, objectives, and risk profile of the AIF *prior to* making a commitment. Where an AIFM seeks to undertake an investment that represents a deviation from these pre-agreed parameters, it constitutes a contractual departure from the risk exposure initially accepted by investors. Given that investors have committed capital based on specific risk assumptions, any significant change to these parameters rightfully warrants LPAC scrutiny to ensure transparency and continued investor alignment.

(30) Beyond the contractual justification, the requirement for LPAC pre-approval also finds legal support under Article 12(1)(b) and (e) of the AIFM Directive, which places a fundamental obligation on AIFMs to act in the best interests of the AIF and its investors. An AIFM's discretion in making investment decisions is therefore not absolute; it must be exercised within the framework of fiduciary duties and investor protection principles embedded in the AIFM Directive. Where an investment strays beyond concentration limits or falls outside the AIF's stated investment focus, it carries the potential for increased risk exposure, unforeseen liquidity constraints, or conflicts with investor expectations. Requiring LPAC approval in such cases ensures that these risks are properly assessed and mitigated in a manner that safeguards investor interests, reinforcing the AIFM Directive's overarching investor protection framework.

[21] See Robert Seber, The Case for Independent LPAC Members, *Private Equity Law Report*, Mergermarket Limited, 3 October 2024; https://media.velaw.com/wp-content/uploads/2019/11/07132556/The-Case-for-Independent-LPAC-Members.pdf (last accessed on 3 October 2024).

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(31) The principle of "investor best interest", as enshrined in the AIFM Directive, underscores why LPAC pre-approval is not only a governance safeguard but a regulatory necessity in these situations. It ensures that AIFMs remain accountable to their investors and that any such changes to investment risks are subject to an additional layer of oversight. This evolution of LPAC authority reflects a natural alignment between market practice and regulatory intent, reinforcing the role of LPACs as an essential mechanism for balancing fund manager discretion with investor protection.

b. A Call for Regulatory Recognition of Ex-Ante LPAC Oversight

(32) The industry already acknowledges the *ex-ante* intervention rights of the management body of an AIF, including through the exercise of a veto power.[22] These mechanisms ensure that the AIFM operates within its regulatory obligations and in the best interests of the AIF and its investors. This framework allows for effective preemptive control over the AIFM's actions – in line with the principle that "prevention is better than cure" (*mieux vaut prévenir que guérir*) – to anticipate and mitigate risks before they materialise, rather than addressing the consequences after the fact.

(33) In the context of an LPAC veto right beyond that described under points **(28)** *et seq.*, while acknowledging that the AIFM retains full responsibility for portfolio and risk management, exceptional circumstances may justify intervention by the LPAC, particularly for instance when indications tend to show that the AIFM would have gaps I the conduct of its due diligence on a targeted asset. In such cases, an LPAC veto right *ex-ante* serves as a critical safeguard to ensure that investor capital is deployed prudently. If the AIFM fails to adequately assess risks, conduct thorough due diligence, or adhere to the AIF's investment policy, the LPAC's ability to block an investment until these gaps are addressed is not undue interference but rather an essential investor protection mechanism which is and remains at the genesis of the AIFM Directive. After all, it is the investors' capital at stake, and they should not bear the risk of inadequately vetted transactions.

(34) Such a mechanism aligns with the industry's broader recognition that AIFs' governance bodies and LPACs must have the ability to pre-emptively act to protect investors *ex-ante* and not only through damages claimed *ex-post* against the AIFM. Given this industry-wide recognition of *ex-ante* intervention rights and the fundamental role of investor protection within the AIFM Directive, it is essential that BaFin takes these considerations into account and reassesses its position. The ability of governance bodies and LPACs to intervene before risks materialise is not a deviation from regulatory principles but a reinforcement of them, ensuring that investor capital is safeguarded through proactive oversight rather than relying solely on remedial measures after harm has occurred. BaFin should, therefore, acknowledge the legitimacy and necessity of LPAC veto rights in specific circumstances, including where there are indications of inadequate due diligence by the AIFM, and amend its stance accordingly to reflect both market realities and investor protection imperatives.

(ii) Diverging Regulatory Interpretations Across Jurisdictions

a. CSSF and ESMA Perspectives on Veto Rights and AIF Qualification

(35) In a recent case which related to whether an undertaking did qualify as an AIF, the CSSF took the position that the vehicle indeed did despite investor intervention at many levels including in divestment decisions which it could veto.[23]

(36) This case is cited mainly for the purpose of describing that in the view (in this case) of the CSSF, and despite other additional elements, the blocking power given to a sole investor in a "captive fund" on divestment decisions did make a fund a joint venture but an AIF.

(37) "Captive funds" are common place in the industry. They are typically established by corporations, financial institutions, family offices, or insurance companies to manage and invest

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[22] For more information on the matter see Ezechiel Havrenne, *Luxembourg SICARs, SIFs and RAIFs: A Review of the statutory seat/registered office and the real seat/central administration notions in light of AIFMD-related considerations*, JurisNews | Investment Management, Larcier, Vol. 11, n° 3-4, p. 221.

[23] The BaFin clarified that its position did not address the AIF definition as per § 1(1) KAGB or whether excessive investor influence results in a structure that no longer qualifies as an investment fund under § 1(1) KAGB. This being said, by doing so, the guidance creates potential additional gaps.

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their own capital. Some of these investors resolve to have one of them manage said investment structure whilst others appoint a third-party manager who will co-invest alongside said investor(s). These structures still seem to raise questions at times about whether they should be classified as AIFs or fall outside the AIFM Directive framework altogether.

(38) The case reviewed by the CSSF concerned a captive fund set-up as a Luxembourg special limited partnership (*société en commandite spéciale*) serving the interests of a single investor. Said investor was granted on the basis of the fund documentation control rights which – in the view of the fund's manager – fell squarely within the day-to-day discretion or control definition given by ESMA.[24]

(39) Under the ESMA Guidelines,[25] an undertaking is not considered an AIF – but rather a joint venture – if its investors collectively exercise day-to-day discretion or control over the management of its assets. "Day-to-day discretion" refers to investors having a direct influence on the operational management of the undertaking beyond what is typically expected in standard governance roles, such as board appointments, M&A decisions, liquidation matters or account approvals. In practice, this means that any compelling involvement by investors in decisions related to the selection, acquisition, disposal or ongoing management of assets would constitute day-to-day discretion or control – regardless of whether such rights or powers are actually exercised.

(40) In the case at hand, no capital was allowed to be raised from other investors without the single investor's consent.[26] The only other investor in the undertaking was the fund manager in line with the skin-in-the-game principle and who invested 1% to 2% of the total amount in the undertaking. The captive fund was also a single asset fund.

(41) Such extraordinary rights (including a veto right on divestment decisions) had been given to the single investor in compliance with Article 320-4 of the Company Law, which states that "*<u>do not constitute management acts</u> for which the limited partner incurs unlimited and joint liability towards third parties: the exercise of partner prerogatives, <u>advice and recommendations given to</u> the special limited partnership, to its affiliated entities, or to <u>their managers</u>, <u>control and supervision acts</u>, the granting of loans, guarantees, or collateral, or any other assistance to the special limited partnership or its affiliated entities, <u>as well as authorisations given to managers in cases provided for in the partnership agreement for acts exceeding their powers</u>*" (emphasis added).[27]

(42) Given these restrictions, the board of the captive fund's manager took the position that the undertaking did not qualify as an AIF but rather as a joint venture, namely based on the fact that the investor exercised a level of control over management matters that would typically be incompatible with the definition of an AIF. Indeed, the presence of veto rights on divestments (together with other elements) suggested that the investor exerted control akin to that of a direct owner rather than a passive participant in an AIF.[28]

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[24] See ESMA's Final report – Guidelines on key concepts of the AIFMD, ESMA/2013/600, 24 May 2013 (the "**ESMA Guidelines**"); https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-600_final_report_on_guidelines_on_key_concepts_of_the_aifmd_0.pdf#:~:text=ii,or%20control%20should%2C%20for%20an (last accessed on 28 June 2025).

[25] See also PERG 16.1 as published by the UK's Financial Conduct Authority where the UK regulator adopted a similar approach on the matter as the one taken by ESMA; https://www.handbook.fca.org.uk/handbook/PERG/16/?view=chapter (last accessed on 28 June 2025).

[26] Furthermore, the investor was the one who spontaneously sought to establish a relationship with the manager to entrust part of its assets and therefore no capital was raised within the meaning of the AIFM Directive and the ESMA Guidelines.

[27] It is noteworthy that the law establishing special limited partnerships also served to implement the AIFM Directive into Luxembourg law. It is also important to note that the Luxembourg legislator recognised in the framework of limited liability of LPs that those acts, including acts of control, are not – from a Company Act standpoint, to be regarded as "management acts". This distinction ensures that limited partners can exercise a degree of oversight and provide support without jeopardising their limited liability status.

[28] See also Andreas Böhme, *Eigenverwaltung von Immobilienfonds – BaFin konsultiert Merkblatt zur Einflussnahme durch Investoren auf Anlageentscheidungen*, 28 June 2025, where the author noted that in practice – particularly in closed-end real estate funds – investors often have meaningful participation rights, especially regarding fundamental decisions such as the sale of the fund's only asset. He questions whether these rights might be at odds with the draft guidance and highlights potential conflicts with German company law,

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(43) The CSSF's position in this case underscores a significant divergence in regulatory interpretation regarding the extent to which an investor or an LPAC may exercise veto rights over investment or divestment decisions without this having any impact on the undertaking qualifying as an AIF. By determining that the fund in question qualified as an AIF, the CSSF effectively concluded that such control mechanisms do not, in and of themselves, constitute day-to-day discretion or control within the meaning of the AIFM Directive.

b. Lessons from Regulatory Divergence for Cross-Border Structuring

(44) At the same time, the divergence between regulatory approaches highlights the importance of jurisdictional considerations in fund structuring. While BaFin appears to take a stricter approach to investor influence, the CSSF's position suggests a more nuanced view that accommodates certain governance rights – such as veto power over divestments – without necessarily undermining the AIFM's regulatory standing.

(45) This difference in interpretation reinforces the need for fund managers and investors to carefully assess how governance rights are structured within fund documentation depending on the jurisdiction where the AIF is structured and the AIFM is located.

c) Investor Input and the Fine Line Between Recommendation and Control

(46) BaFin recognises that while AIF investors may provide investment ideas or recommendations, these must remain strictly non-binding to preserve the AIFM's autonomy in managing the AIF. The underlying regulatory concern is that if an AIFM simply executes investor suggestions without exercising independent judgement, the AIFM's role as the rightful decision-maker in investment and divestment matters is effectively eroded which could potentially lead to "letter-box entity" considerations under Article 82 of the AIFMR.

(47) Several factors can indicate that an investor's recommendation has crossed the line into undue influence, thereby breaching regulatory requirements. One key red flag is if the AIFM or its portfolio manager consistently follows investor suggestions without conducting independent research or performing its own due diligence. In such cases, the AIFM may be seen as merely executing investor preferences rather than making discretionary investment decisions based on the fund's strategy and risk management policies. Another indicator is if investment and divestment decisions are based solely on formal criteria or investor-imposed limitations, rather than being subject to substantive evaluation by the AIFM. If the AIFM does not perform its own market analysis, risk assessment, or financial modelling to validate investor suggestions, it raises concerns that the AIFM is not exercising the independent decision-making authority required under the AIFM Directive.

(48) An even stronger indication of undue investor influence arises when investment and divestment initiatives predominantly originate from investors rather than from the AIFM. If the AIFM rarely initiates transactions or if its investment activity is largely reactive to investor-driven proposals, it suggests that the investors are in effect directing the AIFM's decision-making rather than providing non-binding recommendations. This dynamic could challenge the AIFM's regulatory status and may lead authorities like BaFin to question whether the AIF is being managed in compliance with the AIFM Directive.

(49) BaFin's guidance on this topic, and to which the author can subscribe, underscores the need for clear governance protocols, ensuring that while investors may provide input, the AIFM retains discretion in deciding whether to act upon such recommendations. AIFMs must also document their investment decision-making processes, demonstrating that all investment ideas – whether originating from investors or otherwise – are subject to an independent review process before execution. This regulatory expectation aligns with broader principles of investor protection, ensuring that AIFMs remain accountable for the AIF's performance.

(D) Cross-Border Consequences for German-Regulated Investors

(50) Draft Position Letter imposes strict regulatory expectations on German supervised institutions, such as banks and insurance companies, when they act as investors in AIFs. Given their status

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where shareholder consent may be legally required in certain cases (e.g., §116 HGB or §179a AktG); https://www.kslaw.com/news-and-insights/self-administration-of-real-estate-funds?locale=de (last accessed on 28 June 2025).

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as regulated entities, these investors are required to uphold high standards of governance and transparency in their investment activities, including their interactions with German or foreign AIFMs. One key aspect of this obligation is their expected cooperation in the documentation process (including LPAC minutes) to prove that they have not exercised undue influence within the AIF (including foreign AIFs).

(51) BaFin's regulatory expectation on German-regulated investors seems overbearing, particularly when investing in foreign AIFs managed by foreign EU-based AIFMs. Given that BaFin requires German banks, insurance companies, and other supervised institutions to comply with its standards when acting as investors in AIFs, these institutions may face restrictions on their ability to exert oversight rights currently theirs over the management of foreign AIFs in ways that would otherwise be permissible under the regulatory framework of the AIFM's home jurisdiction.[29] As a result, they may have to relinquish current rights and be barred from participating in certain governance arrangements for future AIFs.

Conclusion

(52) BaFin's Draft Position Letter seeks to reaffirm the regulatory principle that AIFMs must retain exclusive responsibility for managing the assets of an AIF. While this objective is consistent with the core tenets of the AIFM Directive, the approach adopted by BaFin risks overshooting the mark. By drawing rigid lines around permissible investor involvement and imposing exhaustive documentation requirements that apply even to lawfully permitted forms of influence, BaFin may inadvertently stifle the very investor protection and governance standards that the AIFM Directive was designed to promote.

(53) The consequences of this approach are not merely theoretical. German AIFMs may find themselves burdened with complex compliance obligations that reduce operational efficiency and global competitiveness. At the same time, German institutional investors could face restrictions when participating in non-German AIFs, potentially requiring them to waive governance rights that are standard and accepted elsewhere in the EU. In a landscape where cross-border investment is the norm and investor sophistication is growing, a more calibrated regulatory response is needed.

(54) This paper calls for the industry to continue the dialogue with BaFin and invite the regulator to reconsider its stance and align its supervisory approach more closely with the proportionality and flexibility embedded in the AIFM Directive. Regulatory integrity can and should be preserved without disregarding market practice, investor expectations, or the realities of modern fund governance. A recognition that certain forms of investor involvement – particularly those that are pre-agreed, risk-focused, and legally permissible – are not only acceptable but beneficial, would go a long way in reconciling regulatory objectives with the evolving dynamics of the European fund industry.

[29] See point **(10)** for more information on the matter.