

Brexit: Grandfathering for German regulated investors

March 15, 2019

With the expiry of March 29, 2019 the United Kingdom of Great Britain and Northern Ireland's membership of the EU will expire unless the EU and the United Kingdom agree on an extension of this deadline. After leaving the EU, or, if applicable, after expiry of a transitional period, the United Kingdom shall be treated as a third country also for the purposes of financial markets law. This affects, among other things, the eligibility of British investment funds for German regulated investors. By the Act on Tax Implications of the Brexit (Brexit-Steuerbegleitgesetz), there is now grandfathering for such investments in British funds.

Direct investments: Seat or location in the EEA or the OECD

For German occupational pension schemes and certain insurance companies not covered by Solvency II, the Investment Regulation regulates how the guarantee assets of these investors must be invested. Many pension schemes for the liberal professions and other institutions for retirement income must also comply with the provisions of the Investment Regulation when investing their assets.

Section 2(1) of the Investment Regulation contains an enumeration and description of the assets that may be acquired and held as guarantee assets. Directly held loans, securities and interests in companies must (among other criteria) originate from an issuer which has its seat in an EEA country or a full member state of the OECD. The same applies to real estate investments: a direct real estate investment requires that the property is located in an EEA country or a full member state of the OECD. In the case of listed assets, what matters is not the issuer's seat but trading on a stock exchange or admission or inclusion in another organized market.



Documents to beinformed:

- [beinformed](#) dated March 6, 2015
- [Government draft of Act on Tax implications of the Brexit \(in German\)](#)
- [Resolution of the German parliament \(in German\)](#)

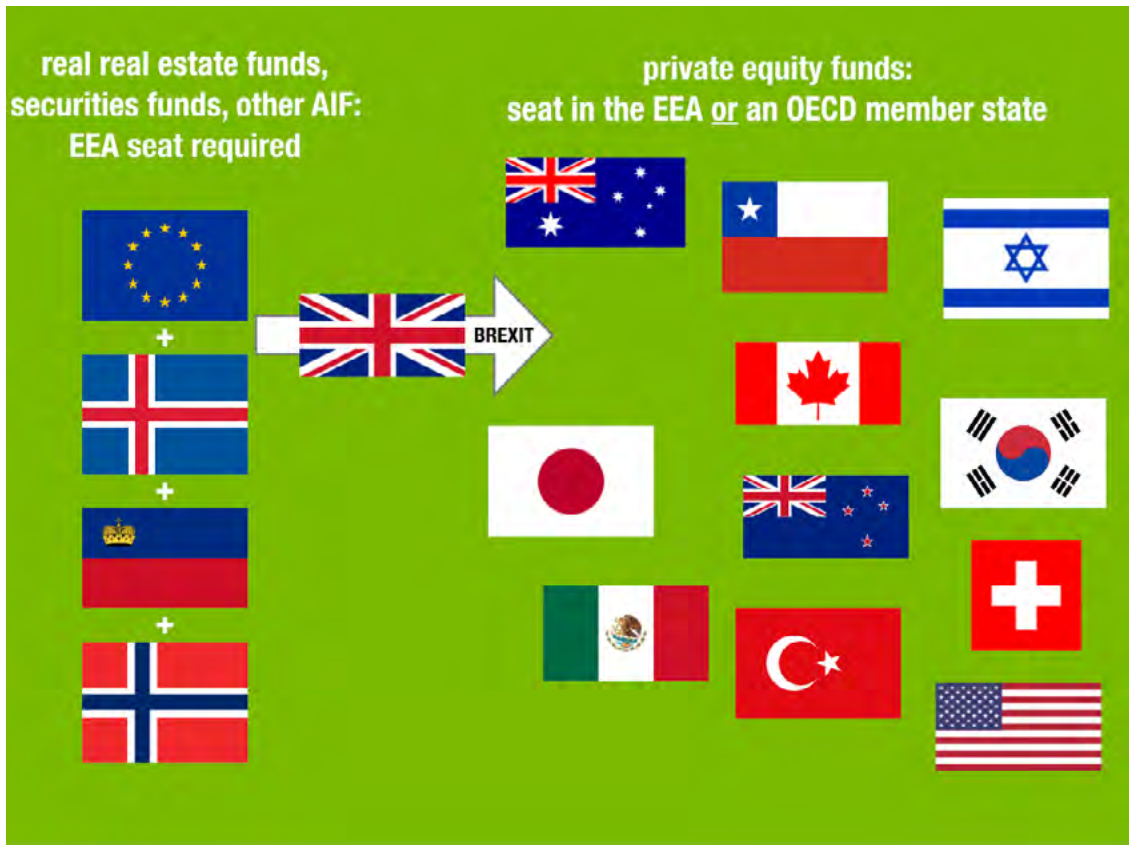
Stricter requirements for indirect investments via funds

For indirect investments via investment funds, the seat of the fund vehicle as well as its management company is decisive. Apart from private equity funds and private equity funds of funds, the requirements are stricter here: real estate funds, securities funds and other alternative investment funds (AIF) must be domiciled in an EEA state, as must their management companies. The seat in a full



member state of the OECD is not sufficient for such funds. Only for private equity funds and private equity funds of funds it is sufficient if the fund and the management company have their seat in an EEA state or a full member state of the OECD.

For real estate funds, securities funds and other AIFs, the end of the United Kingdom's membership of the EU therefore means that funds and their management companies domiciled in the United Kingdom could no longer be held as guarantee assets of German pension schemes and insurers under section 2(1) of the Investment Regulation.



Protection of existing investments

For the existing investments in British funds made prior to the Brexit, the German legislator now created a grandfathering rule. Der Federal Council (the second chamber of the German parliament) today approved the Act on Tax Implications of the Brexit. Article 13 of said Act adds a new paragraph to the Investment Regulation. According to said new paragraph, investments which no longer fulfil the requirements for the respective investment form pursuant to § 2 (1) of the Investment Regulation because the United Kingdom is no longer a state of the EEA may continue to be allocated to the respective investment form pursuant to section 2(1) of the Investment Regulation.

The grandfathering rule is a key date rule. It applies to investments made before the date on which the United Kingdom ceases to be a member state of the European Union. The key date is March 29, 2019 in the case of a „hard Brexit“, otherwise it will be a later date which will result from the agreement to be concluded between the EU and the United Kingdom. Investments made before this key date may remain in the guarantee assets and be allocated to the respective investment form in accordance with section 2(1) of the Investment Regulation.



Capital calls may be served

In our opinion, it is possible to pay in capital which was committed by investors prior to the key date but is drawn after the key date. Otherwise, the new grandfathering rule would not be effective for many blind-pool-funds because all the funds which use the commitment and drawdown mechanism would have to be withdrawn from the investor's guarantee fund irrespective of the grandfathering. Capital calls have also been handled in the same way by the legislator in the past: With regard to the grandfathering rule for private equity funds under the Regulation Amending the Investment Regulation dated March 3, 2015, the legislator expressly stated in the explanatory memorandum that it was possible to call capital which was committed prior to the entry into force of that version of the Investment Regulation (please see our beinformed dated March 6, 2015).

Private equity funds: no comparability test required due to grandfathering

For investments in private equity funds and private equity funds of funds, the consequences of Brexit are less serious at first sight, as British funds remain eligible for the guarantee assets due to the OECD membership of the United Kingdom. However, the general assumption that there is equivalent authorization and public oversight to protect investors over the (UK) management company due to harmonization through the AIFM Directive is no longer applicable. In future, British private equity funds and private equity funds of funds will therefore have to undergo a comparability test. In our opinion, this is not necessary for existing investments as they are protected under the new grandfathering rule (section 6(4) of the Investment Regulation).

Conclusion

The legislator made the right arrangements in good time to protect existing investments in British funds. He should also have made it clear that capital calls may continue to be served but we have no reasonable doubt about this in light of the statements made in the past about earlier grandfathering rules.

The grandfathering rule will enter into force on March 29, 2019.

We are happy to assist you with any questions you may have regarding the impact of Brexit on your investment portfolio.

 **in touch: Any questions? Please do not hesitate to contact us!**



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