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## BAFIN Updates Its Guidance on Investment Advice – Implications for Investment Funds, AIFMs & German Capital Management Companies

On 10 February 2025, BAFIN published an updated version of its notice on the guidance on investment advice (the “**Notice**”).<sup>1</sup> In this newsletter, we will briefly explain what constitutes investment advice under European supervisory law, what clarifications BAFIN has made in its notice and, in particular, the implications for investment funds, AIFMs and German capital management companies (Kapitalverwaltungsgesellschaft – KVG).

### 1. European Legal Requirements

Investment advice is defined in *EU Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (“MiFID II Directive”)*. Article 4(1)(4) states: “‘investment advice’ means the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments”.

The term “financial instruments” is defined in Annex I Section C of the MiFID II Directive. Under this definition,

- transferable securities;
- money-market instruments;
- units in collective investment undertakings;
- options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or income, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;
- options, futures, swaps, forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event;

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<sup>1</sup> [https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb\\_250210\\_anlageberatung.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb_250210_anlageberatung.html) (German version)



- options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled;
- options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned herein and not being for commercial purposes, which have the characteristics of other derivative financial instruments;
- derivative instruments for the transfer of credit risk as well as financial contracts for differences;
- options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event, as well as
- any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned herein, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, OTF, or an MTF;
- emission allowances consisting of any units recognised for compliance with the requirements of Directive 2003/87/EC (Emissions Trading Scheme);

are financial instruments as defined in the MiFID II Directive. It also covers instruments issued using distributed ledger technology.

## 2. Legal Implementation in Germany

### a. Definition of “Investment Advice”

Section 1(1a) sentence 2 no. 1a of the *German Banking Law* (Gesetz über das Kreditwesen – KWG) defines the financial service of investment advice as the:

*“provision of personal recommendations to clients or their representatives relating to transactions in specific financial instruments, provided that the recommendation is based on an evaluation of the investor’s personal circumstances or is presented as suitable for the investor and is not disclosed exclusively through information dissemination channels or to the public (investment advice)”.*

This definition can also be found in identical wording in Section 2(2) no. 4 of the *German Law on the Supervision of Securities Institutions* (Gesetz zur Beaufsichtigung von Wertpapierinstituten – WpIG).<sup>2</sup> At first glance, the German and European definitions appear to deviate from each other. However, the German definition only contains clarifications that correspond to other requirements of the MiFID Directive, so that there is no deviating interpretation of the term “investment advice”.

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<sup>2</sup> As the regulatory content is identical in both laws, we do not make a distinction between the German Banking Law and the German Law on the Supervision of Securities Institutions below.

#### b. Definition of “Financial Instruments”

In contrast, the definitions of the term “*financial instruments*” in German law differ from the definition in Annex I Section C of the MiFID Directive. In addition to the requirements of the MiFID II Directive, the German definition also includes or specifies:

- shares in domestic or foreign legal entities, partnerships with legal capacity and other companies, insofar as they are comparable to shares, as well as depository receipts representing shares comparable to shares;
- investments as defined in Section 1(2) of the German Investment Law (Vermögensanlagegesetz), which include, among other things, shares that grant a participation in the earnings of a company, shares in assets that the issuer or a third party holds or manages in its own name for the account of a third party (fiduciary assets), profit-participating loans, subordinated loans, profit participation rights and registered bonds;
- debt instruments, in particular profit participation certificates, bearer bonds, bonds payable to order and rights comparable to these debt instruments, which, by their nature, are negotiable on the capital markets, with the exception of payment instruments, as well as depository receipts representing these debt instruments; and
- other rights that entitle the holder to acquire or dispose of rights as defined in points 1 and 3 or result in a cash payment that is determined on the basis of such rights, currencies, interest rates or other income, commodities, indices or measures.

The German law is particularly relevant for alternative investment funds as it addresses traditional assets in this area in more detail, including shares in legal entities, profit-participating or subordinated loans, profit participation rights and debt instruments such as bearer bonds.

#### c. Recommendation

From BAFIN’s point of view, a “recommendation” implies that the investor is advised to take a certain action – this includes in particular the purchase, sale, subscription, exchange, repurchase or takeover of a certain financial instrument, but also the holding of a certain financial instrument as well as the exercise or non-exercise of a right associated with a certain financial instrument regarding the purchase, sale, subscription, exchange or repurchase of a financial instrument – that is deemed to be in their best interest, rather than simply being provided with information without specific suggestions for action.

This is always the case under the so-called investment adviser model between the investment adviser and the AIFM or the German capital management company (KVG).

#### d. Recommendation to a Client

The investment adviser's recommendation must be addressed to a client. This includes natural and legal persons. AIFMs and German capital management companies can also be clients in this context.<sup>3</sup> This also covers triangular relationships, e.g. between an investment adviser and an asset manager in relation to a portfolio that the asset manager manages for a client of the asset manager.

#### e. Personal Recommendation

The recommendation is classified as "personal" if it is either based on an evaluation of the investor's personal circumstances or is at least deemed suitable for the investor. In the investment adviser model, this is already laid down in the investment adviser agreement and is therefore inherent in the relationship between an AIFM/a German capital management company and an investment adviser. BAFIN expressly states that "*a recommendation made to a capital management company is also a personal recommendation within the meaning described if the adviser takes into account the previous asset composition or the investment strategy pursued by the company or conveys an impression to that effect*".<sup>4</sup>

#### f. Authorization Requirement

If the investment advisory activities described above are provided on a professional basis or to an extent that objectively requires a commercially organized business operation (Section 32(1) sentence 1 in conjunction with Section 1(1a) sentence 1 of the German Banking Law or Section 15(1) of the German Law on the Supervision of Securities Institutions in conjunction with Section 2(1) of the German Law on the Supervision of Securities Institutions, the investment advice is subject to authorization. Investment advice to AIFMs/German capital management companies is provided in all cases known to us with the intention of making a profit and also to an extent that "cannot be provided from the comfort of your sofa". Therefore, it must be assumed and should always be part of the initial and ongoing due diligence of the investment adviser that its activities require official approval (MiFID license).

#### g. Exception with Regard to Advice Given on Investment Fund Shares

If the professional investment advice is limited to advisory services with regard to investments in regulated investment funds, such advice is not subject to authorization. BAFIN justifies this exemption by the fact that investment funds are more standardized than other securities – which seems more than questionable in the case of alternative investment funds – and the institutions or companies for which the advisory services are carried out in this case (Management Companies / AIFM) are also subject to supervision. In any case, this exception does not apply to the so-called investment adviser model, unless the investment adviser exclusively advises a fund of funds with regard to investments in other regulated investment funds.

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<sup>3</sup> End of section 3 of the Notice.

<sup>4</sup> End of section 4 of the Notice; recommendations to the public or through so-called information dissemination channels are not considered personal recommendations.

### 3. Summary

If an AIFM/a German capital management company appoints an investment adviser to assist in the management of an investment fund, the investment adviser's license must be part of the initial and ongoing due diligence process. From the perspective of the MiFID Directive and the German Banking Law/German Law on the Supervision of Securities Institutions, investment advice for an investment fund regarding purchase and sale recommendations for financial instruments are considered regulated activities. The primary consideration at this stage is whether the investment strategy, and therefore the type of relevant financial instruments, align with the definition set forth by the MiFID Directive or the German Banking Law/German Law on the Supervision of Securities Institutions.

We are happy to answer any questions you may have:

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