

# The German Master- KVG & popular fund structures

A guide for institutional investors

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# The Master-KVG structure

## Why choose a Master-KVG structure?

As an institutional investor, you may wish to optimise your investment structure with the ultimate goal to achieve greater efficiency. The Master-KVG structure allows institutional investors to manage their assets centrally, streamlining operations and reducing administrative burdens. By opting for a Master-KVG structure, institutional investors may benefit from:



### Increased investment security

- The assets are managed by a regulated capital management company (*Kapitalverwaltungsgesellschaft* – **KVG**) that is supervised by the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – **BaFin**).
- The KVG is legally required to act solely in the interest of the investor.
- The assets are kept safe with a separate custodian, that reviews the compliance of investment activities solely in the interest of the investor.
- Mandatory annual audits are conducted by independent auditors and investors can agree further or own monitoring rights.



### Decide the fund structure and team

- Investors can select, appoint, dismiss and / or replace the KVG based on their own criteria.
- Investors can select the fund structure and shape the fund rules and investment strategy of the fund together with the KVG.
- The KVG is responsible for establishing the respective fund vehicle and, after the fund's launch, takes on the ultimate responsibility for portfolio management, risk management, and administrative activities. This relieves the investor of these duties. At the same time, the investor has a say in the process: both the fund's establishment and its subsequent management are based on the fund's investment conditions, which the investor can set together with the KVG.
- Usually, at the investor's request, a specialised and experienced third-party service provider is engaged for portfolio management. The investor can recommend or specify a portfolio manager to the KVG, who is also regulated by BaFin. The portfolio manager's strategy and authority are defined by the fund rules.

# The Master-KVG structure



## Maintain control over assets

- Investment decisions are made by the KVG / appointed third party portfolio manager based on the fund rules and investment strategy agreed with the investor.
- Investors may be granted veto rights or approval requirements regarding the general investment strategy and further influence the investment decisions through investment ideas and recommendations. For details on permissible investor influence, please read our [client briefing](#) on BaFin's recent consultation on this topic.
- Investors' assets are kept separately from assets of the KVG and the custodian and are not liable for their potential liabilities. The assets are thus protected in the event of their insolvency.
- Investors are kept up-to-date on the investments by regular reporting, which can be tailored to investors' needs.



## Increased cost efficiency

- Save costs through leveraging on research, know-how and expertise of the KVG and / or the portfolio manager.
- Benefit from the KVG and portfolio manager's legal obligation to execute transactions in the best interest of the investors.
- Take advantage from reduced transaction costs for KVGs and portfolio managers, who benefit from special market conditions, compared to investors' direct investments.
- The fund accounting managed by the KVG for all transactions related to the fund provides significant efficiency benefits for the investor. The investor only needs to account for the fund's shares or units, rather than the entire fund portfolio, thereby reducing their workload.
- Increase cost transparency, improve and centralise valuation and performance measurement, enhanced process security and reduced administrative and coordination efforts.

# The Master-KVG structure

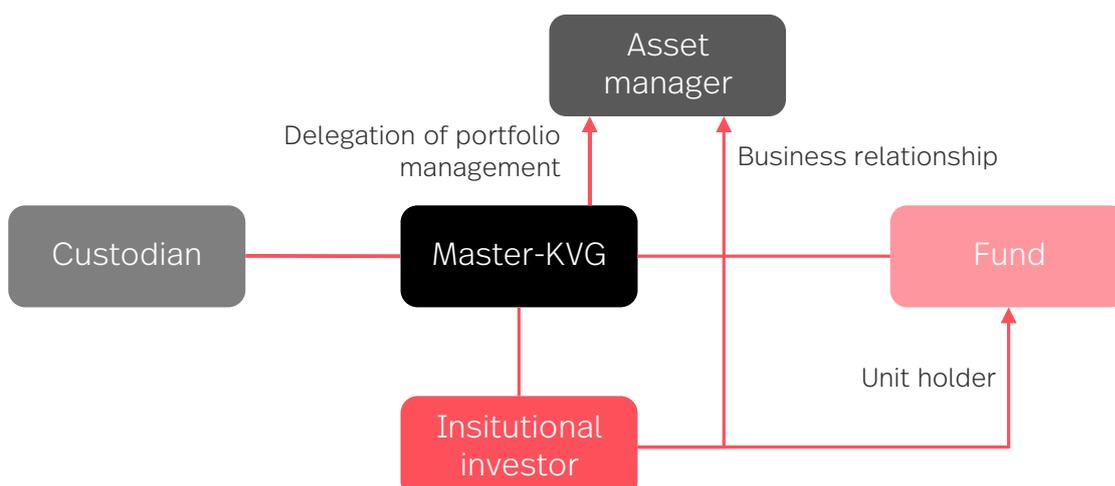
## How does it work?

The institutional investor may establish multiple funds or fund segments for different asset classes and elect its preferred asset manager for each asset class. Legally, the funds will be administered by a single Master-KVG who will delegate the portfolio management to the different asset managers but remains fully responsible.

In sum, the Master-KVG structure involves a minimum of five parties:

- the **institutional investor**.
- the **Master-KVG** – a regulated capital management company authorised and supervised by BaFin. From a legal perspective, the Master-KVG is the manager of the fund and has ultimate responsibility for the portfolio management, risk management and administrative services.
- the **custodian** – a regulated entity appointed by the Master-KVG for safekeeping of the assets. The custodian also has several monitoring and controlling rights and obligations with respect to the supervision of the portfolio management and is involved in technical matters of trading and settlement.
- one or more **portfolio or asset manager(s)** – a regulated, specialised legal entity responsible for the portfolio management of the fund. In practice, the investor will select the asset manager, who is then appointed by the Master-KVG on the basis of a delegation agreement (known as the „investment management agreement“).
- the **investment fund** – typically a contractual fund with no legal personality. In such case the Master-KVG acts for the (joint) account of the investors of the fund and the asset manager acts on behalf of the Master-KVG. The fund may, however, also be structured in a corporate form and / or may have segments. Investors may also decide to establish multiple funds with the same Master-KVG, appointing specialised asset managers for each of the funds and / or their segments.

For further details, please also read our [client briefing](#) on the German Master-KVG model.



# German fund structures typically chosen by institutional investors

## Overview

German investment law provides for various fund types. For example, funds can be:

- UCITS within the meaning of Directive 2009/65/EG, i.e. highly regulated public funds, or AIF, which are any funds that do not qualify as UCITS;
- special-AIF which are eligible for (semi-)professional clients only;
- open- or closed-ended, depending on whether investors may return their shares or fund;
- structured as contractual funds without own legal personality, or in corporate form (e.g. an investment stock company or limited partnership);
- so called “Chapter 2” or “Chapter 3” funds that are subject to specific tax laws or limited partnerships that are subject to normal taxation rules.

When choosing the right fund structure, it thus is essential to first determine the specific needs of the institutional investor. Key decisive criteria typically are the **type of assets** to be managed, the envisaged **investment strategy**, **tax** matters and overall expected **costs**.

## Popular structures

Institutional investors often seek flexibility in their investment strategy and prefer to keep their portfolio exclusive. As a result, they typically opt for a special-AIF, which is only eligible for (semi-)professional investors rather than a UCITS or other public funds. They also often desire the flexibility to withdraw capital from the fund, making closed-ended fund types unsuitable. Under the German Capital Investment Code (*Kapitalanlagegesetzbuch* – **KAGB**), there are three types of funds that are open-ended special-AIFs:

- the general open-ended domestic special AIF under sec. 282 KAGB (**282 Funds**);
- hedge funds under sec. 283 KAGB; and
- the open-ended domestic special AIF with fixed investment conditions under sec. 284 KAGB (**284 Funds**).

A hedge fund structure is usually inappropriate unless the investment strategy involves high leverage or short selling. Therefore, the choice of fund structure is typically narrowed down to the 282 Funds and 284 Funds which are outlined in more detail on the next pages.

# The 282 Fund at one glance

The 282 Fund offers a very flexible structure, allowing for a wide range of investment opportunities without significant restrictions on the types of assets that can be held.

## Legal Form

The 282 Fund can be established as a contractual fund with no legal personality (*Sondervermögen*) or as a body corporate (in the form of an investment stock company with variable capital or a limited liability company). This overview is focused on the contractual form, which is more commonly used as it does not require the relatively burdensome establishment of a new company. The fund can be segmented, allowing different portfolio managers to manage different segments, and assets can be freely moved between segments. While the fund must be notified to BaFin, there is no approval requirement.

## Ownership structure

The assets within the 282 Fund can be held either in the ownership of the Master-KVG as trustee for the investors ("trust solution") or jointly by the investors ("co-ownership solution"). In both scenarios, the 282 Fund's assets are kept separate from assets of the KVG. Usually, the co-ownership solution is preferred for maintaining existing ownership structures.

## Open fund

The 282 Fund is considered "open" because investors have the right to redeem their shares, providing liquidity and flexibility.

## No asset restrictions

There are no specific restrictions on the types of assets that can be held, as long as their market value can be determined. There also are no restrictions on the use of derivatives within the 282 Fund. The fund must, however, adhere to the principle of risk diversification, typically requiring investment in at least four different assets with varying risks. Moreover, the fund must manage its assets to ensure liquidity for redemptions. The 282 Fund must not grant loans.

## Leverage

There are no statutory limits on leverage, but it should not be used "to a significant extent" to avoid classification as a hedge fund.

## Taxation

282 Funds are usually so-called Chapter 2 Funds, which are opaque and are taxable only with certain German source income. Taxable investors in such Chapter 2 Funds may benefit from partial tax exemptions if the 282 Fund qualifies as an equity, mixed or real estate fund. Portfolio management fees are VAT-exempt when charged to the 282 Fund.

# The 284 Fund at one glance

The 284 Fund is less flexible but more structured than the 282 Fund and offers investor security through a higher level of regulation.

## Legal Form and ownership structure

Like the 282 Fund, the 284 Fund can be established as a contractual fund (*Sondervermögen*) or as a body corporate (in the form of an investment stock company with variable capital or a limited liability company) and allows for segmentation. The fund must be notified to BaFin, however, there is no approval requirement.

The assets within the 284 Fund can be held either in the ownership of the Master-KVG ("trust solution") or jointly by the investors (co-ownership solution). The latter is preferred for maintaining existing ownership structures.

The 284 Fund is considered "open" because investors have the right to redeem their shares, providing liquidity and flexibility.

## Investment restrictions

Like the 282 Fund, the 284 Fund must adhere to the principle of risk diversification, requiring investment in more than three different assets. Moreover, assets must be managed to ensure liquidity for redemptions, which may impact the investment strategy.

In addition, the 284 Fund is subject to certain investment restrictions. However, under certain circumstances, the law allows for deviations – a practice often utilised by market participants. In such case, only limited restrictions apply to the portfolio's composition and weighting. These include, in particular:

- The 284 Fund may invest only in eligible assets listed in sec. 284(2) no. 2 KAGB, including but not limited to securities, money market instruments, derivatives bank deposits, real estate, participations in real estate property companies and other company participations, funds, precious metals and non-securitized loan receivables.
- A maximum of 20% of the fund's assets can be invested in non-listed shares or company participations.
- A maximum of 20% can be invested in cryptocurrencies.
- Short selling and granting loans is not permitted.
- When investing in derivatives, the market risk potential of the 284 Fund must not exceed double the net asset value, effectively limiting leverage to 200%.

## Leverage

Credit can be used only short-term and up to 30% of the 284 Fund's value, with no significant leverage allowed.

## Taxation

284 Funds are usually so-called Chapter 2 Funds, which are opaque and are taxable only with certain German source income. Taxable investors in such Chapter 2 Funds may benefit from partial tax exemptions if the 284 Fund qualifies as an equity, mixed or real estate fund. However, a 284 Fund may also qualify as a so-called Chapter 3 Fund which is semi-transparent. Portfolio management fees are VAT-exempt when charged to the 284 Fund.

## How we can help

### Unlocking investment potential with Simmons & Simmons

In the ever-evolving world of institutional investment, efficient asset structuring is crucial. At Simmons & Simmons, we are well-versed in the intricacies and opportunities associated with establishing a German Master-KVG structure. Our extensive experience advising Master-KVGs, external portfolio managers, and institutional investors gives us a comprehensive understanding of the structure from all business perspectives.

### Comprehensive end-to-end support

From the initial structuring and regulatory approval to ongoing compliance and operational management, Simmons & Simmons provides comprehensive support throughout the entire process. Our multidisciplinary team works collaboratively to tackle legal, tax, and operational challenges, ensuring you receive a holistic service tailored to your specific needs.

### Expert guidance every step of the way

Our dedicated team of legal experts is committed to guiding you through each phase of setting up your Master-KVG structure. We offer a range of legal assistance, including:

- **Reviewing existing Investment Structures:** We assess your current setup to identify deficiencies and areas for improvement.
- **Determining Optimal Target Structures:** Our team helps you define the most effective structure to meet your investment goals.
- **Addressing Tax Implications:** We provide insights into the tax considerations relevant to your structure.
- **Selecting the Right Master-KVG:** We assist in choosing a Master-KVG that aligns with your strategic objectives.
- **Onboarding External Portfolio Managers and Service Providers:** We facilitate the integration of key partners into your new structure.
- **Transferring Assets:** Our team ensures a smooth transition of assets to the new structure.
- **Conducting Due Diligence for New Investments:** We perform thorough due diligence to support informed investment decisions.

## How we can help

### Why choose Simmons & Simmons?

With a proven track record and a commitment to excellence, Simmons & Simmons is your trusted partner in unlocking the full potential of your investments. Our tailored solutions and innovative strategies ensure that your Master-KVG structure is not only compliant but also optimised for success.

### Get in touch



To discover how Simmons & Simmons can assist you in setting up a German Master-KVG structure, please contact our team. We look forward to partnering with you on this journey.



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