

Are Infrastructure Funds Becoming More Attractive for German Pension Investors?

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On 6 February 2025, an Ordinance to Amend the German Investment Ordinance took effect, freeing up space for infrastructure investments in German pension investors' portfolios.

The Investment Ordinance applies to German sub-threshold insurance undertakings exempt from Solvency II, to certain German pension schemes (*Versorgungskassen*) and to German professional pension schemes (*Versorgungswerke*). Solvency II insurance undertakings that apply the Investment Ordinance on a voluntary basis to comply with their investment and risk management obligations under the "prudent person principle" may also be affected.

The changes follow two goals: (1) to provide pension providers with the ability to make more investments with a strong return and (2) to make German pension money available for infrastructure investments, especially for renewable energy.

INFRASTRUCTURE BASKET IN THE INVESTMENT ORDINANCE

The newly introduced infrastructure basket intends to increase investments of German pension investors into infrastructure.

Investors subject to the Investment Ordinance can, subject to an escape basket, invest only in 18 different asset classes, each subject to specific requirements applicable to such asset class. The Investment Ordinance applies diversification requirements to each class of investment. Infrastructure funds are currently acquired as private equity funds under sec. 2 para. 1 no. 13 lit. b) or as alternative funds under sec. 2 para. 1 no. 17 of the Investment Ordinance. Pension schemes can allocate up to 15% of their "guarantee" assets in private equity funds and up to 7.5% in alternative funds. Additionally, investments in both private equity and alternative funds count towards the "risk capital" diversification quota of up to 35% of the investor's guarantee assets. Guarantee assets are a pool of assets serving as a legally mandated reserve to satisfy future obligations to policyholders and pensioners.

The amendment to the Investment Ordinance introduces a new basket for infrastructure investments in which pension schemes can invest up to 5% of their guarantee assets. Direct and indirect investments financing infrastructure assets and infrastructure companies for the purpose of constructing, expanding, renovating, maintaining, making available, holding, operating or managing infrastructure for in total up to 5% of the guarantee assets may not be counted towards the respective applicable diversification quotas.

In practice, this means each relevant investment in infrastructure must still comply with the requirements of one of the 18 available asset classes. The infrastructure basket does not create a new asset class of investments in addition to the 18 asset classes that were already eligible investments so far. What the infrastructure basket does is create more space for infrastructure investments. It allows German pension investors to make those investments for the purpose of financing infrastructure outside the existing diversification quotas as long as they in total do not exceed 5% of the guarantee assets. So, eligible infrastructure investments no longer have to compete with other investments for space in the relevant diversification quotas. The new 5% infrastructure basket is, contrary to the other diversification quotas, not mandatory but optional. The investor can choose whether to allocate an eligible investment to this basket or to use the diversification quota otherwise applicable to the relevant asset class.

This should also be available to investment funds making relevant infrastructure investments. The question of how to deal with infrastructure or other funds with an investment strategy that also permits investments other than infrastructure investments described above remains unresolved. It remains to be seen if the German Financial Supervisory Authority (“BaFin”) will make those funds eligible by allowing a portion of the fund to invest in non-compliant investments or ineligible by requiring the fund to invest only in eligible investments. Alternatively, BaFin may take a look-through approach to allow a pro rata allocation to the infrastructure basket based on the fund’s portfolio composition, which would require additional disclosure from the fund manager.

The Investment Ordinance is further amended to state that according to Sec. 2 para. 1 no. 13 lit. b) of the Investment Ordinance, private equity funds can acquire investments in infrastructure project entities. This is, however, according to the legislator, simply an explicit codification of existing practice.

RISK CAPITAL QUOTA

Additionally, the amendment to the Investment Ordinance expands the risk capital diversification quota from 35% to 40% of the guarantee assets. The quota covers, among other things, investments in listed and unlisted equity; subordinated loans; profit participation rights; private equity, alternative and hedge funds; and certain corporate loans.

ISSUER QUOTAS

The Investment Ordinance addresses counterparty risk by setting limits for the portion of the guarantee assets that a pension investor can invest with one counterparty. Pension investors can, for instance, only invest up to 1% of the guarantee assets in a single private equity or alternative fund. The Investment Ordinance does allow for an “escape basket” of up to 5% of the guarantee assets, which can be increased to up to 10% with BaFin’s approval. Previously, the escape basket was only available for investments that did not fall into one of the eligible 18 asset classes or exceeded the applicable diversification quota. In the future, the escape basket will also be available for investments exceeding the applicable issuer quota.

FUTURE CHANGES ENVISAGED UNDER THE DRAFT ZUFING II

On 15 January 2025, the government draft of the Second Financing the Future Act (Zukunftsfinanzierungsgesetz – “**ZuFinG II**”) was published. It contains further envisaged changes relevant for investments by German pension and insurance investors.

Real Estate Quota

The ZuFinG II envisages adding infrastructure project entities as eligible asset for German real estate retail funds, provided the infrastructure project entities’ purpose is limited to acquiring, constructing, managing or holding installations to produce, transform, transport or store renewable energies or heat derived from renewable energies as well as transport or store waste heat. This will also benefit German pension and insurance investors because it will also apply for German and EU real estate funds that are eligible under the Pension Fund Supervisory and Investment Ordinance’s real estate quota and that may then make the same types of infrastructure investments.

According to the explanatory notes to the draft ZuFinG II, the legislator intends to enable real estate funds to invest in such infrastructure projects that are built on real property that is only leased by the infrastructure project entity. To prevent German real estate retail funds from becoming, contrary to their name, infrastructure funds, those investments are limited to 15% of the retail fund's value. However, when deciding whether to allocate a fund to the real estate quota under the Insurance Ordinance, German retail real estate funds are typically only used as a reference point for eligible investments without taking on the investment limits. Should the ZuFinG II be adopted, it would remain to be seen whether BaFin will issue guidance in that regard.

Special AIF (Spezial-AIF mit festen Anlagebedingungen)

Another proposed change under the draft ZuFinG II that affects German open-ended special AIFs with fixed investment terms ("**Special AIF**") also indirectly impacts pension and insurance investors. Those investors often use Special AIFs as captive investment vehicles and have to choose investments not only considering their own investment restrictions but also the investment restrictions of their Special AIFs. At present, Special AIFs are only permitted to invest in open-ended domestic and foreign investment funds, which, on its face, precludes all closed-ended funds. Acquiring such funds as unlisted undertakings would cause tax complications. To invest in closed-ended funds, Special AIFs are, therefore, forced to assess whether the closed-ended fund meets all criteria to qualify as "securities" as defined in the UCITS Directive. This procedure is seen with skepticism by the industry. Should the ZuFinG II come into effect as envisaged, this exercise would fall away in the future, and it would be a big step forward towards achieving more legal certainty for investors using these German investment structures.

NEXT STEPS

To specify the requirements established in the Investment Ordinance, BaFin has published the Capital Investment Circular (currently: Circular 11/2017 (VA)) setting out BaFin's administrative practice interpreting the rules. BaFin has stated they would update the Circular in a timely manner after publication of the amended Investment Ordinance. It remains to be seen how BaFin might specify the application of the new infrastructure basket or if additional requirements will be established.

The draft ZuFinG II was originally envisaged to take effect in Q 2 of 2025. However, it remains to be seen how the collapse of the governing coalition and the upcoming general elections will affect the draft laws.

Please do not hesitate to contact us with any questions.



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