

# CLIENT UPDATE

## GERMAN INSURERS AND PENSION FUNDS MAY EFFECTIVELY BE BANNED FROM INVESTING IN NON-EEA PRIVATE FUNDS

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The German Ministry of Finance (the “**Ministry**”) currently is conducting a consultation process on its recently issued draft of a regulation amending the German Investment Regulation (*Anlageverordnung*) and the German Pension Fund Capital Investment Regulation (*Pensionsfonds-Kapitalanlageverordnung*) (the “**Draft Regulation**”). The purpose of the Draft Regulation is to adapt the capital investment rules applicable to insurance companies and certain retirement schemes to the regulatory framework under the AIFM Directive, as transposed into the German Capital Investment Act (*Kapitalanlagegesetzbuch* - KAGB). Unfortunately, the Draft Regulation, if enacted as currently drafted, among other things would effectively ban German insurers and pension funds from investing in private equity, real estate and debt funds managed by (most) non-EEA fund managers. We are working with clients and other industry participants to convince the Ministry to eliminate the most troubling provisions of the Draft Regulation.

### WHAT THE DRAFT REGULATION WOULD DO

*Private Equity Funds.* The Draft Regulation would only permit German insurers and pension funds to invest in private equity funds managed by non-German fund managers if those fund managers (i) are domiciled in an EEA state or a full member state of the OECD, (ii) are subject to public supervision to protect investors and (iii) hold

a license “within the meaning” of the licensing provision of the German Capital Investment Act. It is the licensing requirement that presents serious concerns. Even if one interprets this requirement as permitting private equity investments with fund managers holding a license that is “comparable” to a German license (which the explanatory notes to the draft suggest was intended, although the Draft Regulation itself does not state this), there is no guidance as to whether the regulatory regime of any other jurisdiction (within or outside the EEA) is “comparable” for that purpose. It will almost certainly be the case that Germany would consider a fund manager authorized in another EEA state under the AIFM Directive as being subject to “comparable” regulation. However, it is not clear which non-EEA regulatory regimes, if any, the German regulators would consider “comparable” for these purposes. For example, the Draft Regulation does not contain guidance as to whether a US fund manager that is registered as an investment adviser under the US Investment Advisers Act of 1940 would be considered subject to “comparable” regulation.

We are concerned that German insurance companies and pension funds will be unwilling to determine themselves which countries have “comparable” regulation of fund managers, for fear of being second-guessed by the German authorities. If so, the Draft Regulation would severely limit – indeed, effectively would ban – investments by such insurers and pension plans in private equity funds managed by US (and other non-EEA) alternative investment fund managers until such time as such fund managers are permitted to obtain authorization as an AIFM (within the meaning of the AIFM Directive), which will not be until the end of 2015 (at the earliest).<sup>1</sup>

*Other Types of Private Investment Funds.* The Draft Regulation would impose even greater restrictions on investments by German insurers and pension funds in other types of private investment funds, including real estate and debt funds. In the case of real estate and debt funds, the Draft Regulation requires both that the fund itself be organized under the laws of an EEA state and that the fund manager is domiciled in the EEA. There is no allowance for fund managers domiciled in an OECD member state outside the EEA, even where such a fund manager obtains authorization as an AIFM (once possible).

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<sup>1</sup> The Draft Regulation does include a “basket” that allows for an aggregate of “non-conforming” investments of up to 5% of an insurance company’s guarantee assets (*Sicherungsvermögen*) and other restricted assets (*gebundenes Vermögen*). However, this basket is unlikely to alleviate materially the concerns presented by the “comparable license” requirement, because insurance companies with active asset management programs generally use such fallback basket for asset classes other than private equity.

## **EFFORTS TO IMPROVE THE DRAFT REGULATION ARE COMING**

The Ministry is currently accepting comments on the Draft Regulation. We are assisting clients and other industry participants in their efforts to demonstrate to the Ministry that the Draft Regulation should be amended in a number of respects because it (i) violates the spirit of the decision only to introduce authorization for non-EEA alternative investment fund managers under the AIFM Directive at the end of 2015 (at the earliest), (ii) limits market access and is *de facto* discriminatory, (iii) represents a step back from previous decisions to expand opportunities for investment in non-EEA private funds and (iv) will deny German insurance companies and pension plans the benefits of investing with US (and other non-EEA) alternative investment fund managers.

The consultation process will end on June 27, 2014. We will keep you updated on its outcome. Should you have any questions or concerns in the meantime, please do not hesitate to contact us. We would be happy to discuss this with you further.

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Please do not hesitate to contact us with any questions.

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