Via e-mail: juergen.tietze@bmf.bund.de

German Federal Ministry of Finance
Mr. Jürgen Tietze
Unit VII B 4 – Insurance Industry
11016 Berlin
Germany

June 27, 2014

Reference Number: VII B 4 – WK 8113/11/10001-01
Doc: 2014/0467249

Dear Mr. Tietze:

The Private Equity Growth Capital Council (the "PEGCC") respectfully submits this letter to express our concerns regarding the formal draft (*Referentenentwurf*) of a Regulation (the "Draft Regulation") amending the German Investment Regulation (*Anlageverordnung*) and the German Pension Fund Capital Investment Regulation (*Pensionsfonds-Kapitalanlageverordnung*). We are deeply concerned that the Draft Regulation, if adopted as now written and without further guidance, would materially and adversely affect our members who are located outside of the European Economic Area ("EEA"), as well as German insurance companies and German pension funds, by severely limiting the ability of those insurance companies and pension funds to invest in private equity funds managed by US (and other non-EEA) alternative investment fund managers.

I. Who We Are

The PEGCC, based in Washington, DC, is an advocacy, communications and research organization established to develop, analyze and distribute information about the private equity and growth capital (together, "private equity") industry and its contributions to the US and global economy. Our members represent a broad cross-section of the private equity industry in the United States, and include many of the world's largest and best known private equity firms, as well as leading small and medium-sized private equity firms.

Our members are united by their commitment to growing and strengthening the businesses in which they invest. Many of our members invest in Germany and market their funds to sophisticated professional investors in Germany, including German insurance companies and pension funds. For further information please see www.pegcc.org.

In our letters dated April 7 and May 5, 2014, we expressed concerns about a preliminary version of the Draft Regulation. We are grateful for being given the opportunity now to comment formally on the Draft Regulation.

The PEGCC believes that the Draft Regulation will have significant negative effects, which we discuss below. The PEGCC respectfully requests that the German Federal Ministry of Finance take into account these concerns, and adopt our recommendations below, to ameliorate these negative effects. German insurance companies should retain full flexibility in choosing between investments with EEA, US and, where appropriate, other non-EEA (OECD domiciled) alternative investment fund managers without having to rely on the fallback basket under the opening clause.

To simplify our discussion below, where we refer to the "Revised Investment Regulation" we mean the German Investment Regulation if it were amended by the Draft Regulation, and accordingly we refer in the discussion below only to German insurance companies and not to German pension plans. The same considerations, concerns and requests outlined below, however, also generally apply with respect to the German Pension Fund Capital Investment Regulation if it were amended by the Draft Regulation.

II. Application to Private Equity Funds

Our understanding is that, pursuant to the Revised Investment Regulation, German insurance companies would only be permitted to invest their restricted assets (*gebundenes Vermögen*) in private equity funds as follows:

First, Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation would permit German insurance companies to invest their restricted assets in private equity funds managed by (*i*) domestic alternative investment fund managers licensed pursuant to Sec. 20 para. 1 of the German Capital Investment Act (*Kapitalanlagegesetzbuch* or "KAGB") or (*ii*) foreign alternative investment fund managers that (*a*) are domiciled in another state of the EEA or a full member state of the OECD, (*b*) are subject to public supervision to protect investors and (*c*) hold a license within the meaning of Sec. 20 para. 1 KAGB. In case of private equity fund of funds, the aforementioned requirements apply to the manager of each underlying target fund.

Second, the so-called "opening clause" in Sec. 2 para. 2 of the Revised Investment Regulation would permit an insurer to invest its restricted assets in investments that (*i*) are not referred to in, and do not meet the requirements of, Sec. 2 para. 1 of the Revised Investment Regulation (including private equity funds managed by alternative investment fund managers that do not meet the requirements of Sec. 2 para. 1 no. 13 lit. b), or (*ii*) exceed the limits specified in Sec. 3 para. 2 nos. 1 to 3 and Sec. 3 paras. 3 to 5 of the Revised Investment Regulation. All such "non-conforming" investments by a German insurance company under the opening clause taken together generally must not exceed 5% of that company's guarantee assets (*Sicherungsvermögen*) and that company's other restricted assets (*cf.* Sec. 3 para. 2 no. 4 of the Revised Investment Regulation).

III. Application to Real Estate and Debt Funds

The Revised Investment Regulation imposes even greater restrictions on investments by German insurers in real estate and debt funds.

German insurance companies would only be permitted to invest their restricted assets in non-German real estate funds and other non-German funds not pursuing a real estate, private equity or UCITS strategy (for example, closed-end debt funds), if such funds (*i*) are organized under the laws of another state of the EEA and (*ii*) the fund managers are also domiciled in the EEA. The above-mentioned 5% basket applies. As in the case of private equity fund managers, the managers of such other private investment funds must be subject to public supervision to protect investors and hold a license within the meaning of Sec. 20 para. 1 KAGB. (*cf.* Sec. 2 para. 1 no. 14 lit. c and no. 17 of the Revised Investment Regulation).

IV. Our Concerns and Requests with Respect to Private Equity Funds

As discussed in our earlier letters, the new requirement in Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation that fund managers domiciled in another state of the EEA or a full member state of the OECD must "hold a license within the meaning of Sec. 20 para. 1 KAGB" presents several serious concerns:

First, this new requirement is a change that would limit – and until the end of 2015 at the earliest – effectively ban investments by German insurance companies in private equity funds managed by US (and other non-EEA) alternative investment fund managers. The fallback basket under the opening clause does not alleviate this concern since insurance companies with active asset management programs generally use such fallback basket for asset classes other than private equity.

The PEGCC fails to see the benefits to German insurers of the new requirement, particularly when weighed against the following costs and concerns: this new requirement (*a*) violates the spirit of the decision only to introduce authorization for non-EEA alternative investment fund managers under the Alternative Investment Fund Managers Directive ("AIFMD") at the end of 2015 (at the earliest), (*b*) limits market access and is *de facto* discriminatory, (*c*) represents a step back from previous decisions to expand opportunities for investment in private equity, *(d)* will deny German insurance companies the benefits of investing with US (and other non-EEA) private equity firms and (*e*) in any event is likely to be superseded by Solvency II in 2016.

Second, even if one accepts that it is appropriate to adopt this disruptive and harmful requirement at this time, it is flawed as drafted because, on a literal reading, it would only permit investment by German insurance companies in a private equity fund managed by an alternative investment fund manager that holds a German license within the meaning of Sec. 20 para. 1 KAGB. This result was not intended by those who prepared the Draft Regulation, according to the explanatory notes.

Third, even if one interprets this new requirement as permitting investment in fund managers with licenses that are "comparable" to a German license, the requirement fails to provide guidance as to whether the regulatory regime of any other jurisdiction (within or outside the EEA) is "comparable" for this purpose.

1. Unclear Benefits and Clear Negative Consequences

The license requirement of Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation, read literally, effectively bans investment by German insurance companies in private equity funds managed by non-German alternative investment fund managers, with no discernible benefit to German investors and with clear negative consequences for our members and for the German insurance industry.

The investment strategy of many German insurers has long included investing in private equity funds. Investment in German, other European and non-European funds plays an important role in diversifying insurers' assets, thereby enhancing the safety of insurers' asset portfolios in the interests of policy holders. Private equity investments also offer very attractive returns to investors, returns that are indispensable, especially in the current low-interest rate environment. The license requirement of Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation could lead to the undesirable result of preventing German insurers from investing in some of the most attractive and well-established funds. The German insurance industry would sustain a severe competitive disadvantage, if other European and non-European competitors could invest with greater flexibility in private equity funds.

Even if the new license requirement is read broadly (as the explanatory notes suggest and as we recommend in Section IV.2 below) ─ to permit investment by German insurers in funds managed by OECD-domiciled alternative investment fund managers subject to "comparable" regulation ─ the uncertainty around how to satisfy this comparability requirement very likely will make it impossible for German insurance companies to continue to invest in private equity funds managed by US (and other non-EEA) alternative investment fund managers until the end of 2015 (at the earliest), when such managers are permitted to obtain authorization as an AIFM (within the meaning of the AIFMD).

Therefore, the new license requirement of Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation would violate the spirit of the decision to introduce authorization for non-EEA alternative investment fund managers under the AIFMD only at the end of 2015 (at the earliest).

In addition, the new license requirement would limit market access and is *de facto* discriminatory against US (and other non-EEA) private equity firms. The license requirement would run counter to commitments made by G20 leaders to an open global economic system and could violate the principle of non-discriminatory treatment of US companies under the Treaty of Friendship, Commerce and Navigation between the United States of America and the Federal Republic of Germany dated October 29, 1954.

Furthermore, the new license requirement represents a step back with respect to the German insurers' ability to invest in private equity outside the EEA. Prior to 2008, investments in private equity funds located outside the EEA were considered as non-conforming investments. The Investment Regulation was then amended to treat investments in private equity funds outside the EEA as conforming investments, as long as the foreign fund manager had its seat in a full member state of the OECD.

In view of all these concerns, we are troubled and, frankly, mystified as to why the German Federal Ministry of Finance is adding the license requirement of Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation at this time, particularly since it appears that this requirement will be superseded by Solvency II in 2016.

We respectfully request that the license requirement in Sec. 2 para. 1 no. 13 lit. b be deleted from the Revised Investment Regulation.

2. Drafting More Restrictive Than Intended

Sec. 20 para. 1 sentence 1 KAGB states that a capital investment company (*Kapitalverwaltungsgesellschaft*) must have a written license from the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin*) for its business operations. Sec. 17 para. 1 sentence 1 KAGB defines a capital investment company by reference, among other things, to its statutory seat and center of business operations in Germany. This means that an alternative investment fund manager domiciled outside of Germany (even where domiciled elsewhere in the EEA) cannot hold a license within the meaning of Sec. 20 para. 1 KAGB.

However, the explanatory comments to the Draft Regulation explain what is actually intended: the fund manager must hold a license that is “comparable” to a license within the meaning of Sec. 20 para. 1 KAGB. We believe that market participants would be well served if the text of the Revised Investment Regulation were modified to reflect the actual intent as described in the explanatory comments.

If the German Federal Ministry of Finance decides (notwithstanding the concerns raised in Section IV.1 above) to retain the license requirement of Sec. 2 para. 1 no. 13 lit. b, the PEGCC respectfully requests that the text be modified to make clear the intent that “comparable” licenses are sufficient for this purpose, *i.e.*, that alternative investment fund managers domiciled in another state of the EEA or a full member state of the OECD must hold a license within the meaning of Sec. 20 para. 1 KAGB, or have been authorized as an AIFM (within the meaning of the AIFMD) pursuant to local law in another EEA state, or be domiciled in and subject to regulation in an OECD member state that provides comparable protection of investors.

3. Comparability Guidance Necessary

If the German Federal Ministry of Finance decides (notwithstanding the concerns raised in Section IV.1 above) to retain the license requirement of Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation, but makes it clear that “comparable” licenses are sufficient (as we request in Section IV.2 above), we submit that further guidance is required as to comparability.

a) *Non-German EEA Fund Managers.* We believe that an authorization as an AIFM (within the meaning of the AIFMD) in another EEA state should be, and was intended to be, regarded as “comparable.” However, the Revised Investment Regulation does not state this.

We believe that market participants would benefit if the text of the Revised Investment Regulation were modified to make this clear, or if the BaFin would provide guidance to make this clear, at the time the Revised Investment Regulation takes effect.

b) *US and Other Non-EEA Fund Managers.* Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation is also problematic for US (and other non-EEA) alternative investment fund managers, even if the changes requested in Section IV.2 above are adopted. This is because, in the absence of appropriate guidance, it would be very difficult for a German insurance company to determine (without fear of being second guessed by the German Federal Ministry of Finance or the BaFin) whether or not any non-EEA regulatory regime for fund managers is "comparable."

For example, the regulatory regime for alternative investment fund managers in the United States imposes comprehensive, detailed and vigorous oversight of alternative investment fund managers, as explained in detail in our letter dated May 5, 2014. US regulation of fund managers is much more than "mere" registration, and covers the same areas of concern addressed by the German licensing scheme. Accordingly, we believe that registration and regulation of a US alternative investment fund manager as an investment adviser under the US Investment Advisers Act of 1940, as amended (the "Advisers Act"), should be considered "comparable" for purposes of the comparable licensing requirement of the Revised Investment Regulation. However, because the US approach differs in its details and structure from the German licensing requirements, we fear that German insurance companies very likely will be unwilling to conclude on their own that Advisers Act registration and regulation is "comparable."

Therefore, if the license requirement in Sec. 2 para. 1 no. 13 lit. b is not deleted from the Revised Investment Regulation (as requested in Section IV.1 above), but is expanded to cover "comparable" licenses (as requested in Section IV.2 above), the PEGCC respectfully requests that the BaFin provide guidance, at the time that the Revised Investment Regulation takes effect, that registration and regulation of a US alternative investment fund manager as an investment adviser under the Advisers Act is "comparable" for purpose of Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation. We respectfully request that the BaFin make such a finding, and similar findings of comparability where appropriate with respect to other non-EEA alternative investment fund managers, at least on a transitional basis until such time as US and other non-EEA alternative investment fund managers are permitted to be authorized in the EEA states generally, or at a minimum in Germany and the United Kingdom under the AIFMD (with an appropriate additional grace period of 90 days).

This kind of guidance or transitional relief avoids the worst market access concerns discussed above. In making this request, we ask the German Federal Ministry of Finance to take note of the fact that US and other regulators have used the type of transitional relief that we are asking the BaFin to provide, in order to avoid market disruptions and discriminatory impacts caused by the timing of regulatory transitions.[1]

---

[1] One prominent recent example involves the US Commodity Futures Trading Commission's ("CFTC") application of capital, margin and other requirements to dealers and major participants in the US swaps and derivatives markets per Title VII of the Dodd-Frank Wall Street Reform and Consumer

4. Fund of Funds Requirements Unduly Restrictive

The requirement that every fund in which a fund of funds invests must meet the test described above would limit diversification unduly. If the licensing requirement is maintained, the PEGCC respectfully requests that a fund of funds be permitted to invest a reasonable portion of its capital in funds that are managed by an alternative investment fund manager that is not subject to "comparable" regulation.

V. Our Concerns and Requests with Respect to Real Estate and Debt Funds

The Revised Investment Regulation imposes even greater restrictions on investments by German insurers in real estate and debt funds. Since the Revised Investment 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, German insurance companies are generally precluded from investing with fund managers domiciled (in a full member state of the OECD) outside the EEA. This holds true even where such a fund manager obtains authorization as an AIFM (once possible).

In other words, the Revised Investment Regulation would permanently ban investments by German insurance companies in funds organized under non-EEA laws and/or managed by US (or other non-EEA) alternative investment fund managers.

Therefore, we respectfully request that Sec. 2 para. 1 no. 14 lit. c and no. 17 of the Revised Investment Regulation be amended to permit investments by German insurance companies in funds organized under the laws of a full member state of the OECD and managed by fund managers domiciled in an OECD member state. Additionally, for the reasons set out in detail in Section IV above, the license requirement should be deleted. If this is not acceptable, the respective paragraphs should be amended according to the aforementioned alternative proposal for private equity funds.

VI. Summary of Our Requests

1. For all the reasons discussed above, the PEGCC respectfully requests that Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation be amended as follows:

Protection Act. In implementing these standards, the CFTC established a substituted compliance regime, whereby EU (and other non-US) firms may comply with EU (or other non-US) regulations rather than US regulatory requirements, provided that the non-US regulations are "comparable to and as comprehensive as" the corresponding Title VII requirements. Further, and most importantly, in connection with implementation of this substituted compliance regime, the CFTC granted non-US (including EU) firms temporary relief from certain requirements to provide additional time for (*i*) the CFTC to review certain substituted compliance requests from parties located in the EU and other non-US jurisdictions and (*ii*) non-US regulators to finalize certain regulations. While this temporary relief has expired, the CFTC has since approved comparability determinations permitting substituted compliance by swap dealers and major swap participants located in certain non-U.S. jurisdictions (including the EU). Indeed, several German financial institutions are registered as swap dealers with the CFTC and, prior to the issuance of the CFTC's comparability determinations for the EU (on which they currently rely), benefitted directly from the CFTC's temporary relief described above.

- Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation should require only that an alternative investment fund manager is domiciled in the EEA or a full member state of the OECD and is subject to effective public supervision to protect investors.

  The requirement of that a fund manager domiciled in another state of the EEA or a full member state of the OECD must "hold a license within the meaning of Sec. 20 para. 1 KAGB" should be deleted.

- Alternatively, if the above is not acceptable to the German Federal Ministry of Finance, Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation should be amended to replace the requirement that fund managers domiciled in the EEA or a full member state of the OECD must "hold a license within the meaning of Sec. 20 para. 1 KAGB" with the following language, or other language to this effect: "in the case of a fund manager domiciled in another EEA state, have obtained an authorization under the provision of national law implementing Article 6 para. 1 of the AIFMD; and in the case of a fund manager domiciled in another full member state of the OECD, be subject to regulation comparable to the regulation applicable to domestic fund managers holding a license pursuant to Sec. 20 para. 1 KAGB."

- In addition, the BaFin should be instructed to provide guidance to investors, in an update of the BaFin Investment Regulation Circular at the time the Revised Investment Regulation takes effect, as to which non-EEA regulatory regimes are considered comparable for purposes of the Revised Investment Regulation, including guidance that registration and regulation of a US fund manager under the Advisers Act is comparable for this purpose.[2]

2. The requirement that every fund in which a fund of funds invests must meet the test described above would limit diversification unduly. If the licensing requirement is maintained, the PEGCC respectfully requests that a fund of funds be permitted to invest a reasonable portion of its capital in funds that are managed by an alternative investment fund manager that is not subject to "comparable" regulation.

3. The PEGCC respectfully requests that Sec. 2 para. 1 no. 14 lit. c and no. 17 of the Revised Investment Regulation be amended to permit investments by German insurance companies in funds organized under the laws of a full member state of the OECD and managed by fund managers domiciled in an OECD member state.

---

[2] We have assumed in this letter that SEC oversight of US alternative investment fund managers would be considered "effective public supervision for the protection of investors" for purposes of Sec. 2 para. 1 no. 13 lit. b of the Revised Investment Regulation. If you do not agree with this assumption, we respectfully request that the BaFin should be instructed to provide guidance to investors, in an update of the BaFin Investment Regulation Circular at the time that the Revised Investment Regulation takes effect, that registration and regulation of a US fund manager under the Advisers Act is "effective public supervision for the protection of investors" for this purpose.

Additionally, the license requirement should be deleted. If this is not acceptable, the respective paragraphs should be amended according to the aforementioned alternative proposal for private equity funds.

* * *

The PEGCC believes that it is important to create a true "level playing field" in connection with the proposed amendments to the German Investment Regulation and the German Pension Fund Capital Investment Regulation. Therefore, we request that the German Federal Ministry of Finance make the necessary amendments to ensure that German insurance companies and German pension funds can continue to invest in US private equity and other alternative investment funds. Taking these steps would avoid market disruption and would be in line with similar actions taken by US regulators to ensure that German market participants benefit from equality of competitive opportunity and access to US financial markets.

The PEGCC appreciates the opportunity to submit this letter. We hope you find it helpful, and we would be pleased to answer any questions that you might have.

Respectfully submitted,

Steve Judge
President and CEO
Private Equity Growth Capital Council