



March 6, 2015

Good things come to those who wait?

http://docs.bepartners.pro/news/2015-03-06_bgbl_anlv.pdf

Today the amendments of the Regulation on the Investment of Restricted Assets of Insurance Undertakings („Investment Regulation“) have been published in the Federal Law Gazette (“Bundesgesetzblatt“). The amendments were necessary to match the Investment Regulation with the new fund regulation which came into effect following the transposition of the AIFM Directive.

Ten months before Solvency II comes into force, the German government decided upon the amendments of the Investment Regulation. Since the legislative process was delayed several times, we expected more fundamental changes of the Investment Regulation. However, the changes against the draft law dated May 23, 2014 only relate to regulated private equity funds and a specific type of open-ended funds.

For the larger German insurance companies, the Insurance Regulation applies only until the end of 2015. For small insurance companies, pension funds and professional pension schemes, the Insurance Regulation will presumably continue to apply to their investments.

The amendments of the Investment Regulation come into effect on March 7, 2015. As already provided in the earlier drafts of the law, investments purchased prior to the aforementioned date are grandfathered.

1. Real estate quota: one size fits all

Under the amended Investment Regulation, the requirements for real estate funds are merged in a single item of the so-called catalogue of eligible investments according to section 2 (1) of the Investment Regulation (the „Catalogue“), i.e. number 14 c). From now on, open-ended as well as closed-ended real estate funds can qualify as investments which are eligible for the real estate quota.

The management company (i.e., the AIFM) must be fully licensed. Unlike for private equity funds, a registration of a real estate fund's management company under the de minimis rule is not sufficient. The same is true for the location: real estate funds (EEA only) are subject to stricter requirements than private equity funds (EEA plus OECD).

1.1 EEA location

The seat of foreign real estate funds and their relevant management company must be within the EEA. Funds which are domiciled in OECD full member states are not eligible as a real estate investment. Therefore, US funds are excluded from the real estate quota; they need to go for the characterization as real estate private equity fund in no. 13. Master feeder structure are not helpful since the master or target fund must meet the same requirements, i.e. it must be domiciled in the EEA.

1.2 Eligible assets of a real estate fund

A real estate fund under no. 14 c) may (directly or indirectly via target funds) exclusively invest in

- real property (assets enumerated in section 231 (1) no. 1 to 6 of the Investment Code); and
- real estate companies according to section 235 (1) of the Investment Code (i.e., SPVs with a strictly limited purpose).

Hence, the investment universe of a fund qualifying for the real quota continues to be a small one. Therefore, real estate funds pursuing an entrepreneurial strategy (real estate private equity) are eligible only via the participation quota.

1.3 Leverage

No. 14 c) does not include any provisions relating to leverage. Presumably, the federal insurance supervisory authority (the „BaFin“) will determine a limitation. Until the amendment, German real estate funds had to observe a threshold of 50 % loan-to-value of the real properties; for foreign funds, the BaFin accepted 60 % loan-to-value of the real properties.

1.4 Fund of funds, transferability

If a German insurance company invests into real properties indirectly via a fund of funds, the target funds must also meet the requirements pursuant to no. 14 c). In addition, the units or shares in the fund must be freely transferable. According to the legislative history, the free transferability requirement also applies to open-ended funds even if they provide for a frequent (i.e., at least semi-annual) redemption right.



2. Participation quota

Participations can be allocated to the participation quota if the requirements of no. 13 of the Catalogue are met. Following the amendment of the Investment Regulation, no. 13 is now divided into no. 13 a) and no. 13 b). For participations under no. 13 a) the requirements remain same, with one exception: no. 13 a) applies only to structures which are not subject to any regulation. The wording has not been modified, therefore the BaFin's interpretation regarding the requirements of the former no. 13 should continue to apply. Hence, foreign funds which are outside the scope of any regulation can be eligible under no. 13 a), this does include foreign real estate private equity funds under the same rules as under the old law.

No. 13 b) relates to regulated private equity fund structures. German funds are eligible if they are structured as closed-ended funds which are open to professional and semi-professional investors. Retail funds are not allowed. Under the Investment Regulation, a fund is deemed to be closed-ended if the units or shares can not be redeemed at least annually. The management company must be fully licensed or registered under the *de minimis* rule.

No. 13 b) covers the funds which are, due to a regulation, not covered by no. 13 a). Due to the AIFM Directive, fund managers domiciled in the EEA are regulated anyway.

In our opinion, real estate private equity funds can qualify for the participation quota pursuant to no. 13 b) under the amended Investment Regulation. The only requirement relating to the investment portfolio is that such funds invest in participations within the meaning of section 261 (1) no. 4 of the Investment Code. According to the legislative history, the scope of eligible investments is intended to be same as under the previous no. 13. Therefore, a real estate fund which is not eligible for the real estate quota due to its entrepreneurial strategy can qualify as a real estate private equity fund.

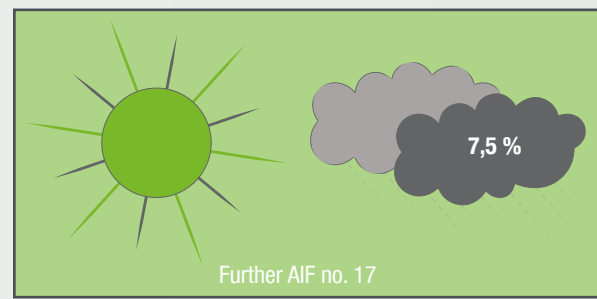
The investment universe of no. 13 also includes equity-like instruments and so-called other instruments for the purpose of company financing. Liquid investments are limited to small amounts. Derivatives must be used for hedging purposes only.

Funds which provide debt financing to companies or infrastructure projects can be qualified under no. 13 b). On the other hand, according to the legislative history, the legislator intended pure loan funds being allocated to no. 17 of the Catalogue (and therefore subject such funds to a new 7.5 % quota for alternative investments). Therefore, it is necessary to distinguish between the financing of companies and infrastructure undertaken by a private equity fund and the mere holding of loans. In order to qualify for no. 13, the investment and monitoring processes of a loan fund must be similar to the processes undertaken by a bank (i.e., purchasing loans on a secondary market would not be sufficient).

Foreign funds are eligible if they are domiciled in the EEA or an OECD full membership state. Also the fund's management company (i.e., the AIFM) must have its seat in the EEA or an OECD full membership state. In addition, the management company must be subject to public supervision to protect the investors and it must be licensed or registered (such license or registration must be comparable to the AIFM license or registration according to the AIFM Directive).

Unlike real estate funds, the target funds of a private equity fund of funds must not fulfill the requirements pursuant to no. 13 b). However, the BaFin intends to address scenarios which lead to circumvention of the Investment Regulation at a later date.

Units or shares in the fund must be freely transferable.



3. A rising star: no. 17

Any funds which do not qualify as private equity funds, real estate funds or securitites funds (i.e., funds which do not fall under no. 13 b), no. 14 c), no. 15 or no. 16) are qualified for an insurance company's restricted assets under no. 17, provided that the requirements are met. Said requirements are the same as they apply to real estate funds: EEA funds which are managed by a fully licensed EEA management company, public supervision for the protection of investors, free transferability of the interests.

However, investments in funds under the amended no. 17 are subject to a strict limitation. Only 7.5 % (compared to 15 % in no. 13 and 25 % in no. 14 c) of each of the guaranteed assets and of the other restricted assets may be invested in such funds.

4. Funds under the previous no. 13 are grandfathered

Interests in private equity funds and other funds under no. 13 which were subscribed prior to the amendment of the Investment Regulation can be held until maturity. Outstanding commitments of the insurance company can be drawn down, however, a new subscription would terminate the grandfathering.



5. Conclusion



Although the amendment of the Investment Regulation has taken a long time, it has not opened new paths to profitable investments. The flexibility with regard to private equity is welcome. More flexibility with regard to real estate (e.g., an opening of the Investment Regulation for OECD funds) would have been even more welcome. At least the leeway provided by the introduction of the alternative fund according to the new no. 17 is helpful. For the larger German insurance companies, the Investment Regulation will become history in less than ten months.

be in touch: If you have any questions, please do not hesitate to contact us!



Dr. Carsten Bödecker
Partner . Steuerberater . Rechtsanwalt
Tel. +49 211 946847-51
Fax +49 211 946847-01
carsten.boedecker@bepartners.pro



Carsten Ernst
Partner . Steuerberater
Tel. +49 211 946847-52
Fax +49 211 946847-01
carsten.ernst@bepartners.pro



Harald Kuhn
Partner . Rechtsanwalt
Tel. +49 211 946847-54
Fax +49 211 946847-01
harald.kuhn@bepartners.pro



Alexander Skowronek
Steuerberater . Rechtsanwalt
Tel. +49 211 946847-62
Fax +49 211 946847-01
alexander.skowronek@bepartners.pro