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Kapitalbeteiligungsgesellschaften

## Press Releases

# Clear framework conditions for private equity in Germany □ BVK makes a submission for the 2009-2013 legislative period

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The German Private Equity and Venture Capital Association (BVK) today released its recommendation for the improvement of framework for private equity, and thus for the finance opportunities for small and medium enterprises (SMEs) during the upcoming legislative period. Germany is the largest national economy in Europe, but if one measures its private-equity investments compared to its economic power, it is one of Europe's stragglers. Not least, this is due to the fact that compared to other countries, the general framework for the private equity sector are essentially undefined in Germany. In its "Recommendation for the creation of a capital market framework for the regulation of private equity in Germany during the legislative period 2009-2013", the BVK shows how Germany could re-establish itself as internationally competitive. "In international competition, private equity can strengthen German businesses not only with capital, but also with know-how", says Dr Hanns Ostmeier, President of the BVK. He adds, "It is important that private equity firms also find a stable legal environment in Germany - this is where the next federal government should begin". Georg Fahrenschon, Bavarian State Minister for Finance, singled out the positive role of private equity, and confirmed that "the general framework for the establishment and development of innovative businesses, and their financing through private equity can still be clearly improved. The union [the CDU and CSU parties, collectively] has adopted a passage concerning private equity into its government programme, for this reason."

The attempt to advance the general framework with the law for the modernization of general conditions for equity investment (MoRaKG) and the introduction of the venture capital investment law (WKBG) must be seen as unsuccessful. Essential elements of the WKBG have been stopped by Brussels, which has prompted EU state aid proceeding which could last for years. The law also addressed only one market segment, that of venture capital. A new approach, comprising a comprehensive concept for the regulation of private equity is needed, which contains both taxation and regulatory aspects, and which regulates the various levels of the private equity model. Furthermore, the introduction of a capital market framework for private equity with consistent regulation should be carried out while looking ahead to the current EU intentions in this area. Currently, Europe-wide regulation of all alternative investment fund managers (AIFMs) is being prepared in Brussels, which must be implemented in law at the national level by 2010 or 2011. The creation of a capital market framework for private equity in Germany, in line with the BVK's recommendation, would prepare for this step and represent a basis for the implementation of the EU directive.

Contents of the BVK's recommendation: Private equity, comprising the areas of venture capital, growth financing and buy-outs, is an autonomous segment of the capital market, but still lacks a discrete legal framework. Every segment of the capital market requires rules, which must be set up and kept to, in order to safeguard its continuing function. This also applies to private equity. The integrated BVK concept provides regulatory law and tax rules for private equity funds, their management firms and involved investors. All funds operating in the private equity segment in Germany and all forms of financing companies with private equity or private equity-like funds are covered. In order to prevent abuse of private equity-specific regulations by other types of funds, the BVK recommendation provides for a clear distinction between private equity funds, and other capital-market segments and corporate structures.

Private equity funds are organised by management firms, which is why the capital-market framework provides activity and approval regulations for them. Compliance with these regulations is to be enforced by a regulatory body with the required powers and the authority to impose sanctions. This will force



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management firms to comply with a licence requirement with recognition of the so-called "EU-Passport". The purpose of this is to ensure that access to private equity from abroad is not limited, and that management firms from non-EU countries have access to the German capital market on the one hand, and, on the other hand, that the regulation of their activities in Germany by German authorities is safeguarded. The activities of the management firms must be transparent for fund investors, which is why the capital market framework is to contain consistent principles for reporting and evaluation, as well as a code of conduct and corporate governance guidelines. The BVK has possessed wide-ranging, internationally-recognised principles for many years, in the form of its professional standards and its code of conduct.

The determining parts of a future capital market framework are tax regulations which orientate themselves using the internationally recognised standards for private equity funds which are already used in many European countries, as well as regulations which already exist for other capital market participants in Germany. The key point is the legal regulation of the tax transparency of the funds, that is, no taxation of the revenue which accrues at the fund level, only taxation of the fund's investors. This has already been codified for share equity and real-estate funds in Germany. Tax transparency does not mean tax freedom; the funds themselves are not taxed, but the fund investors certainly are. These will be taxed as if they had directly invested in the target companies. Without this tax transparency, large international investors such as pension funds will not invest in German-based private equity funds. Tax losses due to these legal regulations are not a matter of concern, as this step merely serves to legally codify pre-existing German administration practice. However, only legally fixed regulations are considered sufficiently binding at the international level. An increase in German-based funds due to a more binding regulatory framework would then make it more attractive for funds based in non-EU states such as Switzerland, or Luxembourg or Great Britain to settle here. The administration of these funds would bring back many highly-qualified jobs (solicitors, auditors, tax advisers, administrative assistants) to Germany. These jobs have been lost to the traditional fund centres such as London over the past several years.

Aside from tax transparency, the administration of regulated private equity funds should be free of VAT, in line with the regulations which now exist in France and Italy, and which are based on EU law. The fund initiators' share of earnings (carried interest) of these funds should be subject to a withholding tax. These are both important elements in order to make German private equity funds attractive for international investors, and to channel capital into the national economy.