BAI Newsletter – February 2019

Editorial article of Frank Dornseifer, Managing Director, BAI e.V., Bonn

Dear Ladies and Gentlemen, dear members,

2019 – start to a volatile year!

A new year is something one likes to start in confidence with regard to what is coming; Sometimes it is accompanied by the relief that the old year is over. Some of you may have fared this way professionally. After all, 2018 was a disastrous year for the German and European stock markets. It was marked, among other things, by various trade disputes instigated by the US. Not only has there been conflict with China and the EU, but the grotesque struggle for an exit agreement between the European Union and the United Kingdom has further increased tensions. Additionally, the Italian Government and its budgets have once again called the stability of the European Union into question.

So, let us avoid looking into the rear-view mirror and instead raise our glasses to a better year 2019! Unfortunately, with regard to Brexit, we have continued on the path we set out on last year. The painstakingly negotiated treaty will be scrapped in Britain's House of Commons and is now to be renegotiated. Meanwhile the date for Brexit edges closer and closer. The government and the House of Commons have lost enough credibility on the other side of the English Channel, we should therefore keep calm on this side of the Channel and insist on the fact that no further negotiations are on the table. At least until consequences have been felt in the Kingdom first hand.

The European Securities Supervisors and the British FCA, who have signed a Memorandum of Understanding, a basic requirement for cross border services in the financial sector after a hard Brexit, have now shown that it can be done pragmatically. This would enable, for example, outsourcing to and from the UK. An important and positive signal for the financial industry!

In big politics, on the other hand, it is interesting to observe how much German politicians too suddenly ensnare the British financial sector, especially banks. It was proudly announced that more than 40 financial service providers would probably relocate to Germany or set up branches here. One may rejoice in this increase in financial literacy in Germany, but one may also ask oneself what German policy is currently doing for the domestic financial sector, for example in order to strengthen its competitiveness globally. And one may probably also ask why German politics has frightened away German fund companies through inconsistent legislation and gold plating for years, instead of remembering that Germany creates more value(s) as a production location for funds than when Germany is simply degraded to a sales market? After this disservice, British banks, whose role in the concert of the financial sector will tend to decline in the coming years, should now strengthen Germany as a financial centre, while the increasingly important asset management sector operates mainly from abroad? The Brexit brings forth strange fruit!

And what else – economically – does 2019 have to offer? Globally, the signs in terms of economic development at renowned economic research institutions such as ZEW or ifo are rather negative. The trade war between the US and China continues to send its greetings, and there are question marks over whether tax reform in the US will really drive growth and new investment as clearly as planned. According to the prognosis of the Munich-based ifo Institute, the global economy will continue to grow overall in 2019, albeit with a flattening trend. For the years 2019 and 2020, the ifo Institute forecasts global GDP growth of 2.9% and 2.8% respectively. However, the possible escalation of trade wars remains a major factor of uncertainty. Other analyses suggest a stagflationary environment with slowing global growth. At the same time, key interest rates in the US could rise to a new high of 3% and further appreciate the US dollar.

Of course, Europe will not be spared the uncertainties of the global economy. As the ZEW states in its survey, with the uncertainties in the course of 2018, expectations about Europe's economic development have also declined significantly. However, there are also reasons for uncertainties in 2019 within Europe, not only because of the Brexit, but also, for example, because of the Yellow West movement, which poses a danger not to be underestimated for the stability of France but also of the EU. Especially against the background of the European elections, such movements are a clear factor of uncertainty for the economic development of Europe.

After all, as can be seen from the ZEW Financial Market Report, economic expectations in Germany are currently clouding over. This is due, among other things, to the aforementioned uncertainties regarding international trade conflicts and the possibility of a hard Brexit. The ifo Institute expects the German economy to continue to weaken in 2019. The structural difficulties in the labour market and the weak automotive industry are cited as reasons for this. The Bundesbank, on the other hand, assumes that the economic boom will continue as the difficulties of the automotive industry will soon be overcome. The Bundesbank is forecasting real GDP growth (adjusted for calendar effects) of around 1.5%.

In the end, the low interest rate environment – unfortunately – remains a reliable constant. On the 13 December 2018, the ECB decided to discontinue net bond purchases under the Asset Purchase Programme (APP). However, by reinvesting maturing securities, the portfolio is to be kept constant at around EUR 2.6 trillion, according to the Bundesbank. A change in monetary policy is not expected before mid-2019. Here, however, a personnel issue is already casting shadows.

Of course, 2019 also has a lot to offer in political and regulatory terms: The Brexit date of 29 March is on everyone's agenda anyway. Between the 23rd and the 26th of May, one week after the BAI Alternative Investors Conference, the new European Parliament will be elected. On October 31st, not only the term of office of ECB President Draghi will end, but also that of EU Commission President Juncker. Both successors have special challenges ahead of them. Brussels will not only decide how to proceed with the capital market union. Rather, it is a matter of a fundamental decision pointing the way to the future of Europe: at any rate, the EU is currently more fragile than stable! On 12 December, the ECB will hold its first monetary policy meeting under Mr Draghi's successor. It will be interesting to see whether anything will be done to tighten the interest rate screw beforehand.

But until then there is still some time left. Until then, the regulatory agenda will include a large number of projects and legislative procedures, such as the EU Commission's Sustainable Finance Initiative, the revision of the AIFM Directive, the Solvency Review, the new Investment Firm Review, the amendment of the PRIIPS Regulation, the reform of the European supervisory authorities (ESA Review), and many other - more or less interesting - issues.

In short: if you believed or hoped at the beginning of the year that you could sail in calmer waters in 2019, put on your life jacket. 2019 will be stormy and the markets will remain volatile. But this is precisely where there should also be opportunities for the alternative investment industry, right?

BAI Alternative Investor Conference on the 14th and 15th of May at Kap Europa in Frankfurt

Of course, all of you have already noted down this year's date for the industry conference on the topic of alternative investments in Germany and have also taken a closer look at the agenda. The AIC is and remains our anchor event, which is now taking place for the 12th time. Once again, with the participation of many institutional investors, we have set up a top-class programme: scientific key-notes, specialist lectures, break-out sessions and, of course, an attractive supporting programme with investor dinner, investor workshop, etc. This year, for the first time, we expect significantly more than 500 participants; By the way, we already have more than 60 registrations only from institutional investors! Those who do not come this year will not only miss important impulses for institutional capital investment in the coming years, but will also miss the opportunity for professional and personal exchange with the AI sector! And if you bring your boxing gloves, you are welcome to exchange ideas with Henry Maske at the get-together on the first day of the conference!

Reconstitution of BAI specialist committees has begun

There has been a very strong response to the survey of member companies' interests in continuing to participate in the BAI expert committees, and fortunately many members have registered who now wish to participate in the committees for the first time. There were around 30 reports each for the existing expert committees on fund and market regulation, investor supervision law and investment taxation, so that in future we will have expert committees with a broad-based structure across the entire value chain. At the same time, we have received a number of suggestions for special topics, new committees, etc., which we are of course happy to take up and which are now being incorporated into further planning for implementation.

The first telephone conferences were already scheduled for the three committees at the end of February: in the expert committee on fund and market regulation, e.g. on the directive on cross-border fund distribution, on which agreement was recently reached in the trilogue, and the AIFMD review; in the expert committee on investor supervision, e.g. on the new Solvency Implementing Regulation on unrated debt and unlisted or long-term equities and the recently started Solvency review; in the expert committee on investment taxation, e.g. on the so-called DAC-6 Directive on the introduction of a reporting obligation for cross-border tax arrangements and its national implementation and another upcoming consultation on the German investment taxation circular.

If you still wish to register for the committee work, please contact dornseifer@bvai.de.

Of course, we will also report regularly on the committee work and the further planning in the BAI infomails or in the closed member and investor area, where we already published the members' list of all committees.

Special Focus Private Equity

Private equity remains a sought-after asset class, as recently confirmed by surveys conducted by the Institutional Investor Institute or the data provider preqin. As part of the programme planning for the BAI Alternative Investor Conference, institutional investors also confirmed their continued willingness to invest. At the same time, they expressed concerns about investment opportunities and rising asset prices in the private equity segment. In addition, risk management, in particular portfolio monitoring down to the operational company level, and performance measurement and comparability for PE funds were cited as special challenges. For BAI, this is a welcome occasion not only to place private equity as a central topic on the agenda of this year's AIC, but also to dedicate the current focus on this topic on the BAI homepage and this newsletter itself.

In this context, we must not forget to mention that the long-awaited new Solvency II Implementing Ordinance, which contains new, improved rules for capital adequacy requirements under Solvency II and thus takes up our petition from last year in a thoroughly gratifying way, will be published shortly. So-called long-term equities are subject to an SCR of 22%, so that relevant insurers that do not have an internal model can, under appropriate conditions, make their PE allocation more efficient in addition to the category of unlisted equities.

I hope your curiosity about the topic of private equity has been awakened. Look forward to the following, very informative articles in this newsletter on private equity:

- Challenges and management approach of growth-oriented private equity investors in an environment of rising fund volumes, by Wolfgang Pietzsch and Philipp Lattermann, ARDIAN Germany GmbH
- Successful positioning of co-investments via market cycles, by Oliver Schumann, Capital Dynamics GmbH
- Empower Due Diligence by Digitalization of Investment Work Flows: Empirical Study on North American Private Equity, von Jinfang Shi und Dr. Daniel Schmidt, CEPRES
- A New Era in Private Markets: Secondaries and Co-Investments, by Richard Hope, Hamilton Lane
- Prospectus liability - BGH judgment reduces risks for funds, by Dr. Joachim Mogck, P+P Pöllath + Partners
- Emerging Markets Perspectives: The Rise of the Asian Consumer Weichou Su, StepStone Group
- Special Situation Investments - Strategies for Quality Improvement in Private Equity Portfolios of Institutional Investors, by Dr. Peter Laib, María Sanz García, Dr. Matthias Unser, YIELCO Investments AG

I wish you an informative and entertaining read

Frank Dornseifer