

Made and Regulated in Germany

The German InvestmentAG is a fund platform for international fund promoters.

Frankfurt/M. (Germany), 8 February 2011

For many years, the only alternative for structuring regulated investment funds provided for under German investment law was a contractual mutual investment fund (*Sondervermögen*) issued by an investment management company (*Kapitalanlagegesellschaft* – “KAG”). This limitation has long separated Germany from international practice. In other countries with active fund industries, such as the U.S., Ireland, Luxembourg and the United Kingdom, the contractual type investment fund is largely unknown or is of secondary importance. Internationally, the most common form of a regulated investment fund has been the investment company with variable capital. Consequently, it is not surprising that, beginning in the early 1990s, international fund promoters seeking to launch investment fund products on the German market have favoured the standard international fund form of a corporation over the atypical German *Sondervermögen*. These primarily U.S., French and British fund companies began to set up fund platforms in Luxembourg and Ireland that are legally organised as investment companies with variable capital (SICAV or ICVC). Today there are more than 1,500 SICAVs in Luxembourg alone with a total of about EUR 1.200 trillion in assets under management.

1. The background for the new German InvestmentAG

At the end of the 1990s, the German fund industry realised that more than EUR 700 billion of German assets were invested in Luxembourg and Irish investment funds. One factor was that foreign fund companies found the German contractual type investment fund system incomprehensible and to some extent too complex. Fund promoters also considered the conditions in other European fund industry countries to be more favourable in some respects. For this reason, they typically chose a non German fund form, even if the fund aimed exclusively for distribution in Germany. In order to close the gap with Luxembourg and Ireland, the largest competitors in the field of regulated investment funds, in 2004 the German legislature decided to give the asset management industry an alternative to the *Sondervermögen* in the organisation of open-ended investment funds. This new form of investment fund is the investment stock corporation (InvAG – “InvestmentAG”), a German investment company with variable capital. However, by the end of 2007, only a few InvestmentAGs had been established. Promoters were unenthusiastic about the legal framework established for InvestmentAGs and shunned the new fund form. At the end of 2007, the German legislature reacted by passing revised provisions, which are now generating increased interest in the InvestmentAG as a fund platform.

2. The InvestmentAG is an internationally competitive fund vehicle

The new regulations governing the InvestmentAG have initiated considerable interest since the amendment came into effect at the end of 2007. The InvestmentAG is now a fund

vehicle that is the full equal not only of the *Sondervermögen*, but also of the fund forms it was modelled on, the Luxembourg SICAV and the Irish ICVC. German and international investment companies quickly established more than 20 InvestmentAGs. In total, more than 50 funds with various investment strategies were launched under the umbrella of InvestmentAGs. A few months ago, for example, iShares (DE) I InvestmentAG, an InvestmentAG established by BlackRock, launched iShares DJ STOXX Global Select Dividend 100 (DE) as a UCITS fund.

Due to the 2007 reforms, under German investment law an InvestmentAG can now designate a KAG as management company. On the basis of a management company agreement, the management company provides all administration and asset management services for the fund launched by an InvestmentAG. In Luxembourg, approximately 90% of all SICAVs have currently appointed a management company. What lies behind this seemingly odd third-party administration concept, and what are its benefits? In Luxembourg and Ireland, a large number of SICAVs and ICVCs have been launched by asset management boutiques or by foreign investment companies in cooperation with local management companies. Both the fund boutiques and the foreign fund promoters were in search of their own internationally recognised platform for the investment funds they planned to manage and to distribute globally. Because of the corporate structure, they viewed the SICAV and ICVC as providing more advantages than the German *Sondervermögen*. This was because an investment company with variable capital not only offers the opportunity to transfer asset management to the promoter on the basis of an asset management outsourcing, it also gives asset managers the opportunity to manage such fund vehicles by acting as a member of the management board.

3. Made and Regulated in Germany – a sign of quality for funds

As a result, the German InvestmentAG now offers unique benefits over established international funds. With an InvestmentAG, the fund promoter can exercise direct influence on the investment policy of the company as a member of the board and as the sole shareholder with voting rights. With the introduction of two new share types, the so called entrepreneur shares with voting rights at general meetings intended for the promoter of the InvestmentAG and the non-voting investor shares intended for the actual investors, the fund promoter has the opportunity, as the sole shareholder with voting rights, both to set the investment policy for the fund and to take all other business decisions. The promoter retains permanent corporate control of the InvestmentAG. This is not the case with the Luxembourg SICAV and the Irish ICVC; with both of these fund forms there is the risk of a hostile takeover by investors or competitors. This scenario was rendered impossible by the two new share types that the German legislature introduced for the InvestmentAG.

In addition to its structural advantages, the InvestmentAG also offers the "Made and Regulated in Germany" seal of quality. The financial crisis has increased awareness among both private and institutional investors for the regulation of investment funds and the various national standards, even within the European Union. German and international investors make their investment decisions not only on the basis of a fund's investment strategy, but also with regard to the level of supervision to which it is subject and thus the level of protection offered to its investor. In this respect, Germany continues to enjoy an excellent reputation. "Made and Regulated in Germany" makes a great selling point for a fund company, both on the German fund market and in the international fund arena.

4. Advantages over SICAV and ICVC

The German InvestmentAG offers a number of advantages over the Luxembourg SICAV and the Irish ICVC, in both the mutual fund and specialised fund segments. Only mutual funds or specialised funds can be launched under the umbrella of a SICAV, while under the umbrella of an InvestmentAG, UCITS Funds, Mixed Funds (*Gemischte Sondervermögen*), less regulated so called Other Funds (*Sonstige Sondervermögen*), specialised funds and Hedge Funds can be launched simultaneously. In addition, an InvestmentAG can name a different custodian for each sub fund. This gives the promoter greater leeway in organising the launch of different fund concepts under the umbrella of the same fund vehicle. In addition to these general advantages, the new German specialised fund regime provides increased flexibility. For example, the launch of specialised sub funds under the umbrella of an InvestmentAG does not require the approval of the German Federal Financial Supervisory Authority (BaFin). In addition, a special sub fund of this type does not require the preparation of a prospectus. The situation is different for Luxembourg specialised funds (SIF), which are subject to a licensing procedure and are also required to prepare a prospectus. These time-consuming and costly steps are not required for specialised funds under the umbrella of an InvestmentAG.

5. Summary

The German InvestmentAG is an internationally competitive vehicle for regulated investment funds. The legal framework of the new Investment Act offers to international fund promoters as well as institutional investors advantages in terms of governance that are unsurpassed in the European Union. Several German and international fund promoters had been waiting for the reforms and established InvestmentAGs immediately after the Act entered into force. The German investment market now provides the flexibility that had been missing and also offers fund promoters increased opportunities for influence. This allows fund promoters to take advantage of the "Made and Regulated in Germany" label to gain market share both in Germany and internationally.

Author:

WTS LEGAL Asset Management
(Carsten Fischer / Robert Welzel)
Taunusanlage 19
60325 Frankfurt am Main
Germany
www.wts.de