



Snapshot Spezialfonds

THE GERMAN MARKET FOR SPEZIALFONDS AT A GLANCE

Spezialfonds are a core element of old-age provision in Germany

Spezialfonds are a remarkable success story and a key feature of the German fund market: they serve as the transmission belt for the investment of retirement capital in Germany. At the end of June 2021, fund companies managed assets of EUR 2,114 billion for institutional investors in Spezialfonds. This represents over 60 percent of total fund assets (of EUR 3,471 billion). Open-ended securities funds, including many balanced funds, contribute with EUR 1,952 billion the major part. Open-ended real estate funds account for another EUR 125 billion. Money market funds and

closed-ended products play only a minor role. Over the last ten years, overall assets managed by Spezialfonds have grown by an average of 9.8 percent per year. The corresponding figure for retail funds was 7.6 percent. A special element of the Spezialfonds business is the steady inflow of new money, even during difficult market phases. Net inflow has amounted to at least EUR 30 billion in each six-month period for the last ten years. Spezialfonds even recorded inflows in the market turmoil of 2008 and 2011, as well as during the Corona crisis in March



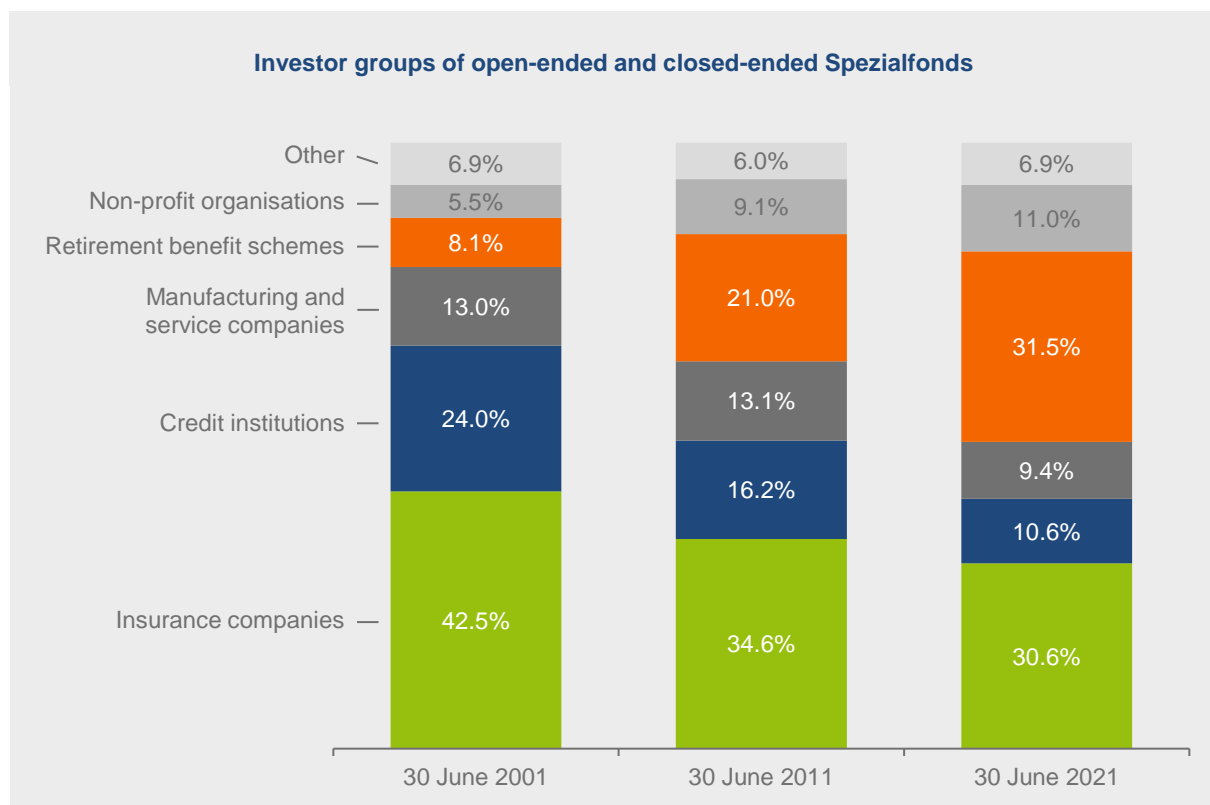
2020. The reason for this is the stable supply of pension contributions and insurance premiums to institutional investors – as well as the particularly long investment horizon of many investors in Spezialfonds (such as insurance companies).

Formally, Spezialfonds are "alternative investment funds" (AIF) for institutional investors. Under EU law, they therefore fall into a collective category of the most diverse types of funds. This obscures their nature as a mostly conservative standard solution for institutional investors. Their huge success over the past decades is based on three main reasons.

First, Spezialfonds are well-established investment vehicles for many institutional investor groups. The first products were launched as early as the 1960s to provide insurance companies with a professionally managed option for investing their capital – in addition to direct investments. Today, insurers hold shares in Spezialfonds worth EUR 647 billion. This corresponds to 31 percent of the total market volume. In recent years, however, especially life insurance policies have become less important. This is due to the low interest rate environment and the loss of preferential tax treatment for insurance products held at least twelve years

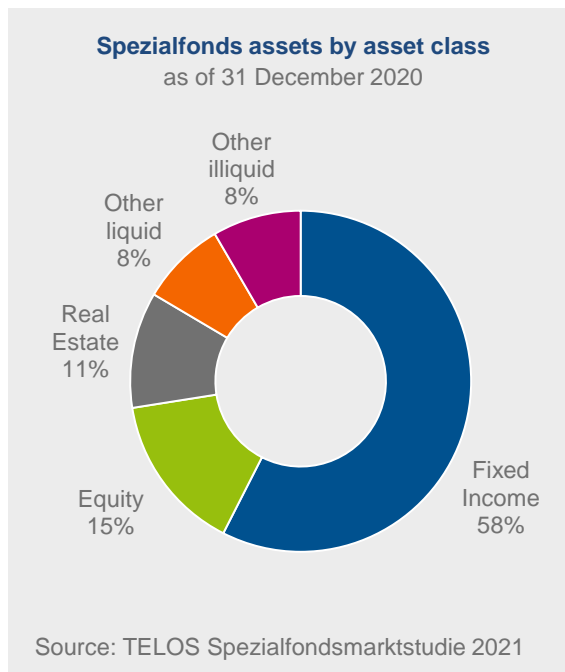
in 2005. In the 1990s, Spezialfonds were opened to additional institutional investor groups and the catalogue of investable asset classes was expanded. As a result, many banks began to use Spezialfonds in the management of their own portfolios. After the financial crisis, however, banks lost importance as an investor group again. Today, they account for about ten percent of the assets. In recent years, the use of Spezialfonds by retirement benefit schemes (e.g. pension funds) has grown considerably. With assets of over EUR 665 billion at the end of June 2021, they have surpassed insurance companies to become the largest investor group. One important factor was the introduction of a legal right to use deferred compensation in 2001. Now, all employees in Germany have access to some form of a corporate pension plan. This has boosted the importance of pension funds considerably. The growth of this investor group is also due to the good development of the labour market and the typically higher proportion of shares in their portfolio.

The second success factor of Spezialfonds is the strong specialisation along the value chain. For about ten years, so-called master investment management companies (Master-KVGs) have accounted for around 70 percent of total assets. Their role is to combine



different asset classes as “segments” in one fund. On the one hand, this allows to incorporate many different regulatory requirements of individual investor groups into a uniform reporting system. On average, a master fund today contains more than four segments. This considerably simplifies tax and accounting procedures as well as performance measurement for institutional investors. The portfolio management of individual segments, on the other hand, is usually outsourced to individually mandated managers. Master-KVGs facilitate cooperation with providers specialising in certain asset classes as well as foreign investment managers. At the end of June 2021, assets of around EUR 500 billion were managed abroad. According to a BVI survey, the most important management locations for Spezialfonds mandates outside Germany are the United Kingdom and the USA. One consequence of the high degree of specialisation, resulting in strong competition between providers, and the high investment sums are very low costs, which often amount to only a few basis points.

Third, Spezialfonds are less restrictive in terms of the investment universe than retail funds. Two versions are legally possible. One of them is a relatively new version with a very flexible investment universe, as long as the principle of risk diversification is respected. In the traditional version, the law specifies a catalogue of allowed investment objects (including securities, real estate, and corporate investments) and investment limits. Historically, Spezialfonds held almost exclusively bonds. This has changed somewhat in the context of the low interest rate environment. Nevertheless, Spezialfonds invest conservatively, as their investors often have to meet payout obligations to pension recipients or insurance customers. Bonds continued to account for 58 per cent of all Spezialfonds investments at the end of 2020, according to a TELOS survey. The majority of these are government bonds and covered bonds, which can be considered as particularly low-risk instruments. The share of equities is around 15 percent and is slowly increasing. Especially shares from advanced economies are included in the portfolios. Real estate is the third largest asset class with a share of eleven percent. Properties in Germany (80 percent of all properties) and from the office and retail sectors form the basis of real estate



funds. According to the survey, other illiquid asset classes, for example infrastructure investments or private equity, are of great interest to institutional investors – but so far only make up a small part of total assets. Furthermore, according to a survey of BVI members in 2020, only 0.6 per cent of Spezialfonds, which together managed EUR 13.9 billion, used “leverage on a substantial basis”¹. This also demonstrates the overall risk-averse investment strategy.

Overall, Spezialfonds are an established, core portfolio component for institutional investors, especially in the segment of old-age provision. Due to the well-established and highly efficient processes and their flexible design, they are often preferred over direct investments and retail funds. Despite strong growth, new investor groups and the challenges posed by the zero interest rate environment, their character remains conservative.

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¹ See Art. 111 (1) Delegated Regulation (EU) No. 231/2013