Letter from Germany

Despite feeling the aftershocks of the US sub prime market crisis, the future looks bright for asset management in Germany. Independent asset management consultant Markus Hill surveys the landscape ahead, and identifies the main causes for hope.

The US sub prime market crisis has, of course, had repercussions in Germany. The markets are shaky and nobody knows for sure where the trip will end – at least in the coming months or years. The first ABS funds have already temporarily suspended their repurchasing agreements or announced such steps.

However, asset management should actually be a long-term business. Despite the highly "dynamic" nature of the present asset management field in Germany, the picture of the market here could hardly be brighter. At least structurally, everything points to more growth: rules and regulations are being altered, the product management departments of domestic capital investment companies are anything but sluggish, and foreign investors value Germany as a highly attractive market. At the present, it is a top investment goal for many private equity investors. At the worst, short to mid-term turbulences (DAX 5000?) could dampen spirits to an extent. However, the investment years 2000 to 2007 have shown that an asset management doomsday no longer seems imminent.

The investment years 2000 to 2007 have shown that an asset management doomsday no longer seems imminent.

The following points give cause for hope. Which are the important points of discussion now for the German fund industry?

Withholding tax, MiFID

New slogans – news at all costs! The fund industry is famous for its pro-cyclical tendencies. The taxation issue is an old favourite as a German marketing instrument. In the long term, this has often turned out "questionable" results at best. Focussing on taxation has hardly made things easier for private investors interested in serious long-term asset management.

What has changed in the tax regulations for asset management? One vital point: starting 2009, interest, dividends, and profits will be taxed 25% across the board. The fund industry marketing machinery is going into high gear. Funds of funds or super funds (UCITS III, "asset management strategies") and the German private label fund industry (for example, Universal Investment, Hauck & Aufhäuser) are fortunately getting their own special economic development program. In addition to this, topics such as fund policies and a Luxembourg special fund solution (SIF – "specialized investment funds") – falsely marketed as a "private investors fund", are being debated. The MiFID regulation, which comes into effect at the end of the year, could lead to better quality in general financial management. Stricter documentation rules, improved cost transparency for financial products which are, for instance, marketed by independent asset managers, could benefit consumers.

Of course, the fund and certificate industry is not entirely enthusiastic about this "transparency development". However, it may be that well-qualified agents and salesmen form a good basis for the constantly growing market of fund products.

Product policy

In Germany, as elsewhere, fund launching is a pro-cyclical business. Like the withholding tax (Abgeltungssteuer), the industry tends to stress subjects which seem to offer marketing stimuli like environmental protection funds, nature preservation funds, and 130-30 funds (see DWS for example). Themes such as multi-asset-class strategy, absolute return, and alternative investments accompany these intense debates. The structure of fees (portfolio and management fees) of these future products offers a growing range of sales opportunities. Here again we see that the retail and press sectors are usually lagging behind new developments. Super funds (UCITS III) have been on the German market since 2004, and a track record is just building up. As one variation of these super funds, more and more 130-30 funds have been launched. For anyone who has been observing the institutional investing sector, this is all old stuff. Nevertheless, the press and public relations sector is humming.

The hedge fund sector could also profit from developments in the UCITS III area. At present it is one of the obstacles to a free expansion of the retail and institutional hedge fund business, as many of these are sold only privately. The use of UCITS III regulations could possibly be to develop new products ("hedge funds lite"). A point worth considering – a partially limited asset management policy (strategy, process) versus easier market accessibility. Germany is becoming increasingly more attractive as compared to Luxembourg ("backlash").

Institutional and retail business meet fund boutiques

Mutual funds and fund boutiques have been becoming more attractive for institutional investors in Germany and German-speaking areas for some time now. This trend has become stronger and will continue to grow. The institutional investment sector is a highly competitive field due to high publicity exposure through the press, rating and ranking agencies, etc. These elements are generally lacking in the special fund sector. The transparency on the mutual fund sector facilitates market access for large and small fund boutiques. Foreign and domestic fund boutiques profit from this trend (see Tiberius Asset Management, Comgest). Core-Satellite strategies, style investing, and Exchange Traded Funds are hotly debated subjects among institutional investors. Without exaggeration, one might say that foreign and domestic fund boutiques are healthy competition for old established German capital investment companies. Journalists show a lively interest in the growing number of changes of portfolio managers from the large companies to fund boutiques.

Without exaggeration, one might say that foreign and domestic fund boutiques are healthy competition for old established German capital investment companies.

Consultants, marketing, and sales

Consultants play a strong role in German asset management, with Anglo-Saxon countries still in the lead. One interesting development is the fact that consultants in Germany cannot get around dealing more and more with mutual funds. The first nationwide consultant study (TELOS/Markus Hill) could already document this trend. The next specialized study project (2. Edition!) by FAROS Consulting on the same subject is in the making. Many institutional investors are now making use of the product Master-Segment Funds (for example EnBW, one of Germany's largest energy suppliers). Firms such as Feri, Mercer, and Fondsconsult have for a long time worked intensively on the subject of multi-management. Controversies arise when discussing the fine line separating consultant and fund manager functions as seen by the experts of the media. A further trend is appearing: "Modularising the Fund Industry" (by Murat Ünal) or the breaking up of value growth lines into modules.

Germany is gradually developing its own class of sales and marketing consultants. Marketing entrance errors committed by numerous foreign managers and consultants in the past, such as "hit and run" strategies, lack of local support, and lack of coordination between the product being offered and customer target group calls for this highly interesting trend for professionals in the field. The need is there, as shown by "roadshow organizers" like Citywire who are increasing their efforts in Germany.

Markus Hill is an independent asset management consultant. His professional background includes, among others, the SEB Bank and Credit Suisse Management. His activities include management of mandates (for example: Arcturus/BG Funds) in the areas of sales, marketing, and public relations. He is also active in the areas selecting themes in the special areas of target funds with a multi-management aspect based on special tasks with special themes of fund boutiques and mutual funds for institutional investors. He is further actively engaged in the cooperation with the market-leading Private Label Funds Master KAG in Germany (Universal Investment). He is an initiator of such authoritative studies on the first all-German Consultant Questionnnaire by RCP-Telos etc. Various publications here and abroad underscore his wide-ranging activities as branch networker.