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.
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 seg-
ments, on the other hand, is usually outsourced to in-
dividually mandated managers. Master-KVGs facili-
tate cooperation with providers specialising in certain
asset classes as well as foreign investment manag-
ers. 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 invest-
ment 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 re-
spected. In the traditional version, the law specifies a
catalogue of allowed investment objects (including se-
curities, real estate, and corporate investments) and
investment limits. Historically, Spezialfonds held al-
most 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 Spezial-
fonds 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 equi-
ties is around 15 percent and is slowly increasing. Es-
specially shares from advanced economies are in-
cluded 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 pri-
ivate equity, are of great interest to institutional inves-
tors – but so far only make up a small part of total as-
sets. Furthermore, according to a survey of BVI mem-
bers 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 portfo-
lio 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 in-
vestments and retail funds. Despite strong growth,
new investor groups and the challenges posed by the
zero interest rate environment, their character re-
ains conservative.

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

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1 See Art. 111 (1) Delegated Regulation (EU) No.
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