COUNTRY REPORT GERMANY 2008

1. Economic and Financial Background

Table 1: Key economic and financial indicators		
	2006	**2008-06**
Population (million)	82.4	82.3
GDP (EUR billions)	2,302.7	2,423.8
Real GDP growth (%)	2.5	2.5
Inflation rate (%)	1.7	2.3
Unemployment rate (%)	9.6	8.3
Stock market capitalization (EUR billions)	1,242	1,440
Stock market capitalization (% of GDP)	53.9	59.4
Bond market capitalization (EUR billions)	3,044.1	3,130.7
Bond market capitalization (% of GDP)	132.2	129.2
Household gross savings ratio (%)	10.6	10.9
Household financial wealth (EUR billions)	4,529	4,564
Average per capita financial wealth (EUR)	51,699.03	55,450.79

2. Key Trends in Flows and Assets under Management

2.1. Fact and Figures of the German Fund Industry

Table 2: Net assets by the fund industry in Germany (EUR billions)					
	2004	**2005**	**2006**	**2007**	**2008-06-30**
Home-domiciled UCITS	224.6996	262.3653	271.5519	266.0639	230.5738
Home-domiciled non-UCITS	630.3464	704.8197	741.8806	775.8066	747.5427
Funds domiciled abroad and promoted by national providers	176.6937	237.2708	268.5523	322.5664	299.6795
Total AuM	1,031.7397	1,204.4558	1,281.9848	1,364.4369	1,277.796

Total net assets exhibited the most pronounced relative reduction within the present decade: as by mid 2008, they have decreased by 6.8 percent within the last 12 months which is even a little bit more than what has been observed between 2001 and 2002. Once again, home domiciled UCITS have been much more affected by this negative development (-18.1 percent) than home domiciled non-UCITS (-3.9 percent) or round-trip funds (-4.0 percent). These outflows are, however, neither attributable to deliberate decisions of German investors, nor to worse performance of home domiciled UCITS compared to products based in Luxemburg or Ireland. The reason for this development is rather that the asset classes recently in favour of German investors like guaranteed or capital protected funds as well as funds of funds are either exclusively or predominantly represented by round-trip funds. This bias in domicile is the result of history in terms of German investment companies having preferred Luxembourg and Ireland in the past when launching new and innovative investment funds. The importance of an attractive composition of the fund universe by asset classes and product lines is also reflected by considerable losses experienced by foreign funds domiciled abroad and promoted by foreign providers (not shown in table 2). Their net assets (the past focus of which has been more on classic products like pure equity and bond funds) went down from EUR bn 65.029 as by 30th of June, 2007, to EUR bn 58.310 by mid 2008 which means a decrease by 10.3 percent.

Due to the recent improvements of regulatory framework by the German authorities, the numbers of fund launches within and outside Germany are currently in the process of levelling. Thus, we may expect equalization in the allocation of fund domiciles in the future. Notwithstanding this trend, net assets of home domiciled UCITS have dropped below the line at year-end of 2004.

Table 3: Net sales of investment funds in Germany (EUR millions)					
	2004	**2005**	**2006**	**2007**	**2008-06-30**
Home-domiciled UCITS	-6,555.3	10,147.8	-6,245.5	-13,443.0	-7,261.4
Home-domiciled non-UCITS	20,822.5	37,325.6	41,153.3	34,669.2	11,934.1
Foreign domiciled funds promoted by national providers in your country	10,646.8	40,245.9	30,193.5	45,907.0	19,201.8
Total net sales	24,914.0	87,719.3	65,101.3	67,133.2	23,874.5
Foreign-domiciled funds promoted by foreign providers in your country	n/a	n/a	3,037.0	-7,949.0	3,392.2

Annotation:
Whereas in the past funds of funds have been excluded from the tables on assets and net sales within our country reports, they are now part of the German investment market sums presented by BVI statistics. Starting in 2007, we have adopted statistic approaches used in most other European countries which include funds of funds. In order to preserve data comparability, we have updated the time series back to 2004. That is why the current numbers deviate from those reported in the years before.

Comments:
Taking into account negative performance displayed by most of the leading peer groups within the last 12 months, it becomes clear that even significant net sales must have failed to prevent net assets from shrinking and, consequently, funds with net redemptions had to face truly hard circumstances. From that perspective, it is no surprise that home domiciled UCITS with net redemptions of EUR bn -15.1 have suffered the most dramatic crash. This holds true not only for comparison between fund groups broken down by domiciles and providers, but also in a historic dimension within home based UCITS. Never before have these products shown such extreme outflows. Most alarming, the outflows appeared quite steadily all over the period, interrupted by a negligible recovery in Q4 of 2007 (EUR bn 0.542). Strong outflows took place in the remaining period: EUR bn -8.385 in Q3 (2007), EUR bn -5.243 in Q1 (2008), and EUR bn -2.018 in Q2 (2008). Foreign funds of foreign origin exhibited a similar pattern (EUR bn -2.568 in Q3, -2.380 in Q4), yet seem to manage the critical situation a little bit better since the beginning of 2008 (EUR bn 1.355 in Q1, and EUR bn 2.037 in Q2).

Consistent net inflows can be reported in case of funds domiciled abroad and promoted by national providers: EUR bn 6.148 in Q3, EUR bn 5.976 in Q4, EUR bn 15.334 in Q1, and EUR bn 4.094 in Q2. For home domiciled non-UCITS, figures were positive throughout all of the quarters, yet not as evenly spread. For most part (EUR bn 11.934 out of EUR bn 13.629 in total), net inflows took place in the first half of 2008, whereas second half of 2007 was quite poor, especially Q4 (EUR bn 0.139).

There is but a limited impact of the liquidity crisis as far as visible from investment fund statistics up to the second quarter 2008. Undoubtedly, the net redemptions observed in several asset classes, sectors or investment funds have been temporarily enforced by the market crunch and in some rare cases might have been induced by the crisis. However, considering the impact of domicile highlighted above and the fact that net redemptions appeared all over the equity, bond, and money market funds universe instead of stroking specific peer groups, we may well assume a general retreat from clear-cut traditional asset classes as opposed to the avoidance of selected peer groups. This finding is supported by the fact that funds of funds and balanced funds as categories typically comprising new product ideas (total and absolute return approaches in a broader sense) have still gained inflows, even in home domiciled UCITS (see tables 4 and 5 for further details).

2.2 Key Trends in the UCITS Market

Table 4: UCITS assets by fund type (EUR billions)

	2004	2005	2006	2007	2008-06-30
Equity	97.9	120.4	129.5	130.4	104.3
Bond	70.8	78.5	69.7	62.9	57.8
Balanced	14.2	18.9	22.3	27.2	27.7
Money Market	32.5	31.9	32.7	27.5	23.4
Fund of Funds	7.4	10.8	13.1	13.3	14.8
Other	1.9	1.9	4.2	4.7	2.6
Total	224.7	262.4	271.6	266.1	230.6
of which					
➢ **Guaranteed**	0.0	0.0	0.0	0.0	0.0
➢ **ETFs**	6.9	12.6	17.6	19.9	16.3
➢ **Absolute return**	1.0	1.5	1.2	4.0	5.8
➢ **SRI**	0.8	0.9	1.9	2.4	2.3

Table 5: Net sales of UCITS by fund type (EUR millions)

	2004	2005	2006	2007	2008-half-year
Equity	-2,238	-900	-7,061	-7,315	-4,197
Bond	2,371	6,626	-1,609	-5,701	-5,555
Balanced	-128	3,404	587	3,298	3,633
Money Market	-6,674	-630	393	-4,477	-4,090
Fund of Funds	516	1,797	1,812	36	2,797
Other	-403	-149	-368	716	150
Total	-6,555	10,148	-6,245	-13,443	-7,261
of which					
➢ **Guaranteed**	0.0	0.0	0.0	0.0	0,0
➢ **ETFs**	2,459	4,008	3,218	1,333	-2,329
➢ **Absolute return**	270	394	-203	1,220	783
➢ **SRI**	39	72	671	334	18
Total gross sales	n/a	n/a	n/a	n/a	n/a

The market-driven negative performance of equity funds (e.g. -21.5 percent in equity funds “Germany”, -20 percent in equity funds “international”, -23,5 percent in equity funds “Europe”) and net redemptions of EUR bn -5.696 have melted off the net assets of equity funds by nearly a quarter (EUR bn 104.3 compared to EUR bn 138.3 by mid 2007). Regarding money market funds, a likewise combination of negative performance (e.g. -7.1 percent in money market funds “international”) and net outflows (EUR bn -10.494) has taken place, resulting in a drop of net assets of home based money market funds in total by 31.1 percent. In terms of absolute numbers, net redemptions have also been significant for bond funds (EUR bn -8.563 throughout the relevant 12 month period). The reduction in net assets, however, was less remarkable due to relatively or absolutely better performances (e.g. 1.1 percent in bond funds “Euro” from 30th of June, 2007, to 30th of June, 2008). Balanced funds and funds of funds succeeded in increasing their net assets, supported by strong inflows. Both coming from weak numbers in Q3 2007, they increased their net inflows in Q2 2008 up to EUR bn 2.191 in balanced funds and EUR bn 2.248 in funds of funds.

Exchange traded funds, generally a market segment of growing importance, have been affected by the bad performance of equity markets which has led to a decline of their net assets by 14.6 percent. Absolute return funds have now reached net assets of EUR bn 5.8 (compared to EUR bn 3.2 one year before) marking a relatively sharp growth. These figures must be interpreted cautiously due to the absolutely low base and possible systematic effects like inconstant reporting of respective features. Nevertheless, as may be expected from the recent trends in investor's behaviour and public discussion, absolute return funds and funds with focus on socially responsible investments are products of increasing attractiveness.

2.3. Key Trends in Other Nationally Regulated Funds

Table 6: Assets of other nationally regulated funds (EUR billions)

	2004	2005	2006	2007	2008-06-30
Real estate	87.191	85.129	75.545	83.426	87.160
➢ **Open-ended funds**	87.191	85.129	75.545	83.426	87.160
➢ **Closed-ended funds**	n/a	n/a	n/a	n/a	n/a
➢ **REITS**	n/a	n/a	n/a	n/a	n/a
Alternative management	0.096	0.564	1.090	0.763	0.593
➢ **Hedge funds**	0.044	0.232	0.718	0.434	0.264
➢ **Funds of hedge funds**	0.052	0.332	0.371	0.329	0.329
Special funds	543.059	619.127	665.246	691.618	659.790
Other	n/a	n/a	n/a	n/a	n/a
Total	630.346	704.820	741.881	775.807	747.543

Table 7: Net Sales of other nationally regulated funds (EUR millions)

	2004	2005	2006	2007	2008-half-year
Real estate	3,058.4	-3,428.4	-7,395.5	6,680.0	4,074.0
➢ **Open-ended funds**	3,058.4	-3,428.4	-7,395.5	6,680.0	4,074.0
➢ **Closed-ended funds**	n/a	n/a	n/a	n/a	n/a
➢ **REITS**	n/a	n/a	n/a	n/a	n/a
Alternative management	94.7	456.0	509.6	-341.0	-155.3
➢ **Hedge funds**	42.7	178.9	476.9	-285.2	-156.6
➢ **Funds of hedge funds**	52.0	277.1	32.7	-55.7	1.3
Special funds	17,669.4	40,298.0	48,039.2	28,330.2	8,015.4
Other	0.0	0.0	0.0	0.0	0.0
Total	20,822.5	37,325.6	41,153.3	34,669.2	11,934.1

Within non-UCITS, property funds have once more represented an element of stability, both in terms of performance (5.2 percent) as well as net sales. With the exception of Q4 2007 (EUR bn -0.631), they exhibited continuous net inflows amounting to EUR bn 5.326 in total throughout the 12 month interval, having now nearly reached their peak in net assets at the end of 2004 (EUR bn 87.191 compared to EUR bn 87.160 by mid 2008). Special Funds (held exclusively by institutional investors) as by far the largest part of home domiciled non-UCITS have also not been able to avoid losses in net assets (-5.2 percent). Having seen massive inflows throughout the whole decade, they seem to have entered a phase of consolidation. The net sales figures became somewhat encouraging in Q1 and Q2 of 2008 (EUR bn 3.705, EUR bn 4.310, respectively) which is, nevertheless, far below the level of net sales experienced in the years before. In the second half of 2007, net sales were almost disappointing with EUR bn -0.249 in Q3 and EUR bn 0.796 in Q4. As regards net assets and net sales, hedge funds become more and more a niche business barely worth mentioning.

3. Trends in the Number of Funds

Table 8: Number of funds					
	2004	**2005**	**2006**	**2007**	**2008-06-30**
Home-domiciled UCITS	1,224	1,270	1,415	1,741	1,876
➢ **Funds**	1,224	1,269	1,407	1,681	1,798
➢ **Units**	12	12	16	57	82
➢ **Classes**	12	13	24	117	160
Home-domiciled non-UCITS	4,901	4,690	4,417	4,246	4,325
Foreign funds registered for sales	5,181	5,596	6,397	7,457	7,758
➢ **By national promoters**	1,467	1,527	1,601	2,139	2,309
➢ **By foreign promoters**	3,714	4,069	4,796	5,318	5,449
Fund Launches	465	622	695	845	405
Fund Liquidations	809	770	798	707	385
Fund Mergers (of which UCITS)	40 (0)	127 (1)	217 (9)	122 (20)	60 (18)
Average fund size (median)					
➢ **Equity**	38.6	53.0	51.6	47.4	35.8
➢ **Bond**	70.5	72.4	52.7	53.3	50.8
➢ **Balanced**	35.2	44.7	40.0	26.1	19.6
➢ **Money market**	182.6	142.0	111.2	75.1	58.0
➢ **Real estate**	1,893.0	1,651.0	1,288.8	1,698.2	1,774.5
➢ **Special**	43.8	51.0	55.7	57.3	55,6
Number of unit holders	14.4	15.1	15.8	16.0	16.0

Numbers of funds refer to home domiciled investment funds unless otherwise specified. Number of unit holders in million.

Once more, the number of home domiciled UCITS rose significantly by 372 (24.7 percent) to 1,876 between mid 2007 and mid 2008, marking a new peak and enforcing a trend (3.8 percent in 2005, 11.4 percent in 2006, and 23.0 percent in 2007) that started at the end of 2004 when the retail investment market had left the phase of stagnation and consolidation after its decline at the beginning of the decade. The increase in the number of home domiciled UCITS is an outcome of both, absolutely less liquidations and absolutely more fund launches in 2007 than in 2006. It seems that this process is continuing in the first half of 2008. Funds of funds have even topped the average by growing more than a third which may be a consequence of upcoming changes in capital gains tax regime announced for 2009. Balanced funds in a broader sense (including products rapidly reallocating between equities, bonds and other instruments) contributed significantly to this development, accompanied by CPPI and related protection systems in the context of absolute/total-return approaches, life cycle funds and the so-called “Super-UCITS”. To say it more generally: funds with flexible and/or hybrid benchmarks to handle moving target situations have experienced the strongest growth.

Foreign funds promoted by national providers as well as such promoted by foreign providers have also reached new all time peaks. Their growth was significant (14.7 percent and 11.2 percent, respectively), yet, most remarkably, remained behind the figures of home domiciled UCITS. This is a clear indication that German investment companies do not any longer prefer foreign domiciles across the board when it comes to new product launches.

Launches of funds comprising several share classes have been approved by the German investment law a few years ago. Up to 2005, this structure wasn’t of any relevance, and it has to be said that – from investors’ point of view and in terms of database handling and distribution activities – each ISIN is being categorized as a fund. In a more formal approach, we could state that there were 1,876 ISINs by the mid of 2008 including 82 units (compartments) and covering 160 share classes in total. Thus, there would have been 1,876 minus 160 = 1,716 “single funds” and 82 “complex funds” equivalent to 1,798 funds in terms of what is meant by this term outside Germany.

As repeatedly lined out in preceding issues of the Germany Country Report, Special Funds are more and more organized in the model of so-called "Master Funds". This development leads to a reduced number of funds (ISINs), concurrently increasing the number of segments below the ISIN level. This trend has weakened in 2007 and seems to have come to an end signalizing that the market-wide process of re-organizing in terms of Master constructions has been accomplished. It started in early 2003 (5,325 Special Funds by the end of 2002), and has now settled down at a level of 4,262 (compared to 4,256 by mid 2007). This means a reduction by more than 1,000 funds within five and a half years (20.0 percent).

Hedge funds are present at a constant number of about 20 funds, yet have lost net assets due to significant redemptions. Property funds have taken advantage in terms of growing net assets and satisfying, rather continuous net sales. The number of funds, however, remains at constant and reflects something like a current repletion of this market segment.

4. Household Savings Allocation

Table 9: Main assets of households (EUR billions)

	2003	2004	2005	2006	2007
Currency & Deposits	1,407	1,456	1,493	1,537	1,623
Debt securities	387	428	321	361	331
Quoted shares	263	276	320	368	393
Life & Pension funds	1,219	1,277	1,294	1,359	1,426
Investment funds	465	461	513	514	545
➢ **Direct ownership**	n/a	n/a	n/a	n/a	n/a
➢ **Via life ins. policies**	n/a	n/a	n/a	n/a	n/a
Other	167	188	268	272	246
Total financial assets	3,908	4,086	4,209	4,412	4,564
Non financial assets					
Total net wealth	3,908	4,086	4,209	4,412	4,564

Table 10: Net asset acquisition by households (EUR millions)

	2003	2004	2005	2006	2007
Currency & Deposits	57,800	48,900	44,000	43,500	85,600
Debt securities	19,200	35,600	16,700	37,100	-42,100
Quoted shares	-20,000	-6,500	-4,000	-5,000	-16,500
Life & Pension funds	55,000	59,500	66,600	65,300	64,600
Investment funds	27,500	-6,200	17,700	-7,000	25,500
Other	3,200	3,200	-3,300	-1,900	-1,900
Total financial assets	142,700	134,500	137,700	132,000	115,200

As can be expected from the basic economic data listed in table 9, there are no significant shifts in the proportions of categories between years. For 2007, they are 35.6 percent as regards currency and deposits, 7.3 percent as for debt securities, 8.6 percent as for quoted shares, 31.2 percent as for life and pension funds, 11.9 percent as for investment funds, and 5.4 percent as for "other".

The between-year-differences (end of 2007 compared with the end of 2006 instead of mid year each because data are published by the authorities in calendar year intervals only) may be roughly explained by the corresponding net sales. The only exception are quoted shares which have displayed net asset growth of 6.8 percent (EUR bn 25) in spite of negative sales balance (EUR bn -16.5). This is due to the favourable stock market conditions up to the end of 2006 and before the crunch within the first half of 2008. As regards debt securities, the poor development was driven by net sales as well as by price losses caused by increasing interest rates. Investment funds exhibited a growth of their net assets by 6.0 percent (second place behind quoted shares). In absolute numbers, the increase amounts to EUR bn 31.0, thus indicating some performance based influences as the contribution of net acquisition was EUR bn 25.5. Within the investment fund sector, equity funds, property funds, and, to some extent, balanced funds have been the main components of this performance based effect.

5. Regulatory and taxation issues

5.1 Eligible assets for UCITS

In Germany the European Commission Directive on clarification of certain definitions of eligible assets (2007/16/EC) has been implemented by the Amendment Act to the Investment Act (Investmentänderungsgesetz – InvÄndG) which became effective in December 2007. Together, UCITS III and the Commission Directive on eligible assets are a major step towards more innovation in fund design, paving the way for new, competitive products. In addition to providing explanatory notes on units of closed-ended funds, money market instruments and derivatives, the provisions set forth in the InvÄndG also clarify the requirements for structured products as eligible investments for German UCITS.

The amended definitions of eligible assets are to a large extent capable of eliminating uncertainties in terms of eligible investments under the UCITS Directive. Due to these uncertainties resulting in diverging interpretations by the regulatory authorities, the European Single Market has already shown signs of competitive distortion and supervisory arbitrage.

5.2 Pensions

In 2007 net sales of the so-called “Riester” pensions based on investment fund saving plans kept growing by an impressive rate. The total number of these plans rose by more than 56 percent from 1.23 million at the end of 2006 to 1.92 million at the end of 2007. The increase of about 690,000 contracts was the highest total increase in numbers since the introduction of the “Riester” pension in 2002. The first half of 2008 showed another increase to 2.12 million contracts. “Riester” pension is a third pillar pension product enjoying state funding through matching state contributions and tax benefits.

Within the area of the so-called “Rürup” pensions, a funded first pillar pension product for individuals outside the state pension scheme, BVI was successful in obtaining a circular from the Federal Ministry of Finance which extends to investment fund products for the “Rürup” pensions, giving the local tax authorities instructions how to handle these products and making sure that respective contributions are tax deductible. In December 2007 the first “Rürup” pension product based directly on investment funds has been introduced in the German market, followed by a second one to be launched by 2008/10.

To support its initiative of extending second pillar occupational pensions to investment fund products, BVI has worked out a draft for the necessary changes to labour and tax law which is currently being verified by an independent consulting company with the aim of ensuring compliance with the principles of the German occupational pension regulation.

Regarding implementation of the European “Institutions for Occupational Retirement Provision (IORP) Directive one can summarize that it did not have noticeable implications on asset managers in terms of changes in the demand for asset management services. In Germany, occupational pensions are still a pure insurance business, and the investment industry is the first choice for insurance companies with demand for asset management services for IORPs. Nevertheless, BVI’s core objective for the future of occupational provisions in Germany is the extension of occupational pensions to investment fund saving plans.

5.3 Other regulatory developments

The regulation of funds and investment management companies in Germany has seen some changes following the enactment of the InvÄndG. The objective of the new legislation has been deregulation and implementation of the EU Directive 2007/16/EU on eligible assets.

Under InvÄndG, the German Investment Act (Investmentgesetz – InvG) has been reverted to the mandatory harmonization level of the UCITS Directive. Investment companies have forfeited their status as credit institutions. The reporting requirements of § 10 InvG have been scrapped and statutory deadlines introduced for the approval of funds. Rules intended primarily to protect private investors have been abolished in the area of Special Funds reserved for institutional investors. Infrastructure Funds ("ÖPP" or private-public-partnership funds) and Other Funds with flexible investment regulations (Sonstige Sondervermögen) have been introduced in order to stimulate product innovation. Infrastructure Funds may invest in so called public to private companies or partnerships. Public to private companies or partnerships are also a permitted asset for non-German investment funds with comparable features to German Infrastructure Funds. The new investment fund type of Other Funds is very flexible with respect to its investment policy. A German Other Fund may invest up to 20 percent of its NAV in unlisted shares or interests and up to 30 percent of its NAV in precious metals, derivatives and non-securitized loans. These fund types are not subject to any issuer-related investment limitations. The unit redemptions for such funds may be limited to at minimum six-monthly intervals, but must be allowed at least once a year.

The EU Transparency Directive 2004/109/EC as well as the Implementing Directive 2007/14/EC have been implemented during 2007. Several pieces of existing national legislation have been amended. Provisions relevant for notifications of major shareholdings are to be found in §§ 21-30 of the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG). Conditions of exemption from the aggregation duty for fund management companies and asset managers are dealt with in § 32 InvG and in a new Implementing Ordinance (Transparenzrichtlinie-Durchführungsverordnung).

There has been gold-plating insofar as the German law provides for a 3 percent threshold for notification of holdings in shares. With the adoption of "Risikobegrenzungsgesetz" (cf. 9.1 below), the German Parliament has recently approved further amendments to the notification rules requiring in particular aggregation of holdings in shares and financial instruments for the purpose of determining the notification thresholds.

5.4 Tax rules and Taxation of Savings Directive

5.4.1 New tax rules with impact on fund management

2009 will see a new tax regime, the so called "Abgeltungsteuer", coming into force which will affect the taxation of German retail fund investors according to the Investment Tax Act.

With regard to current income of a fund, the general system of taxation will remain, but a new flat rate of 25 percent will be applicable. In particular, interests and dividends, whether distributed or accumulated at the end of the fund's business year (deemed distributed income), will be subject to a tax rate of 25 percent. Moreover, due to reduction of the corporate tax rate from 25 to 15 percent, the 50 percent exemption on dividends for private investors (Halbeinkünfteverfahren) will be abolished.

Capital gains from the disposal of fund units, which are currently tax free after a holding period of one year, will be subject to taxation at a flat rate of 25 percent irrespectively of the holding period. Consequently, any capital gains realized by the fund and distributed to private investors will also be taxable. Although the taxation of accumulated realized capital gains from the disposal of equity and plain vanilla debt securities at the fund level will be deferred until disposal of fund units, capital gains resulting from the disposal of certain debt certificates will be deemed distributed at the end of a fund's business year.

Notwithstanding these developments, BVI continues to argue that fund saving plans which are used for old age provision should be treated like comparable insurance pension products, i.e. the taxation of notional distributed income should be abolished and special capital gains taxation rules for long-term investments should be introduced.

Following the "Abbey National" jurisdiction of the European Court of Justice (ECJ), the Court's findings have been transformed into German VAT guidelines. Fees for services by the depositary bank have been deemed fully VAT taxable in the past. Under the new rules, fees that are paid for other functions than safekeeping and control (administrative management) should be exempted from VAT if the criteria set forth by the ECJ for management services provided by a third party manager are met. In addition, VAT rules for tax exemption of the fund management are now also applicable to German corporate SICAV funds (and not only for the German contractual type funds) which become more and more popular in Germany. Due to the transposition of the "Volker Ludwig" jurisdiction of the ECJ, multiple level distribution services have been exempted from VAT tax as well.

5.4.2 Changes/adaptations of guidelines regarding the Taxation of Savings Directive

Concerning practical application of the Taxation of Savings Directive, two major changes occurred in 2007:

- **Joint accounts are not longer treated as paying agents on receipt:**
  Accounts with more than one holder ("joint accounts") where at least one holder is not resident for tax purposes in Germany had been treated as paying agents on receipt. According to the new guidelines, "joint accounts" shall only be treated as paying agent on receipt in case not all members of an organization (e.g. partnership, investment-club etc.) are also account holder. Otherwise, the paying agents have to provide information on interest payments for each non-resident account holder. With regard to the exchange of information on the amount of interest payment, the paying agent may report for each non-resident account holder:
  - the full amount of the interest payment or
  - per-capita amount of the interest payment or
  - a partial amount according to an individual distribution key (partial amount has to be at least 1 percent of the full amount).

- **Asset test for calculating 15 and 40 percent thresholds is now applicable in any case:**
  Until the recent change of the guidelines, an asset test had not been permitted if the fund's investment policy allowed a cash-position up to 50 percent of the NAV which is typical for German funds. This was the reason to treat equity funds as funds within the scope of the EU Savings Directive.

5.4.3. Impact of the EU Savings Directive on fund sales

There is no evidence that the current omission of unit-linked life insurance and structured bonds at EU level leads to distortions of competition in the financial market. In fact, it is rather the different tax treatment of these products under the German tax law which causes distortions in practice.

6. Governance

6.1. Corporate Governance

In order to support its members in exercising investors' rights, BVI, assisted by IVOX, provides a "general assembly service" preprocessing the agendas of general assemblies of the most important German and European listed companies. The service informs on key data and topics and analyzes materials provided by the issuers. The overall goal of the initiative is to assist BVI members in efficiently and autonomously exercising voting rights. Consequently, the service does not provide recommendations for particular voting behavior.

6.2. Fund Governance

The revision of the German Investment Act which came into force at the end of 2007 has introduced several new requirements affecting the governance of management companies. Under the new regime, the management company's supervisory board has to comprise at least one member independent from its shareholders, affiliates and business partners. Fund managers are also subject to more detailed risk management and internal control requirements. In particular, they must establish adequate procedures in order to ensure that investors' interests are not harmed by high transaction costs caused by a exceptionally high turnover rate or significant redemptions of units.

BVI works on further guidance to these new rules in its Code of Conduct ("Wohlverhaltensregeln") which altogether is currently being adapted to the revised legal framework. On this basis, the BVI Code of Conduct is supposed to be given a binding status by the German supervisor BaFin. The association strongly supports this initiative.

7. Trends in product development

7.1 Socially Responsible Investing (SRI) Funds

SRI funds are a relatively new phenomenon in the German market experiencing rapid growth in the last few years. Starting with Euro bn 0.9 in 2005, assets of SRI funds grew up to Euro bn 2.4 until the end of 2007 and experienced only a slight decline by mid 2008 (Euro bn 2.3). The increase is especially attributable to a high level of sales (1 bn Euro in the period between 2005 and 2007). SRI funds are not a separate fund type in legal terms. For statistic purposes, funds with the focus on sustainable, ethical or charitable investments form the category of SRI funds.

The 2007 review of the German Investment Act has introduced Micro Finance Funds as a particular type of Other Funds. Micro Finance Funds may invest up to 75 percent of the funds assets in non-securitized loans issued by so-called micro-finance institutes which have to fulfill certain conditions in order to qualify for investment. As yet, no Micro Finance Fund has been launched in the German market.

7.2 Sophisticated UCITS III Funds

There is no formal categorization of UCITS III funds as to their sophistication level under the German law. However, in order to evaluate market risk of each fund investing in derivative instruments, the management company must apply either the “simplified” or the “qualified” method under the Ordinance on Derivatives (Derivateverordnung). In general, the market exposure of derivatives shall be managed according to the "qualified approach" (Value at Risk). Use of a "simplified approach" is only allowed if the fund limits itself to investing in certain basic types of derivatives or combinations of securities so that all market risks can be captured with adequate precision.

As a result, nearly all German investment managers applying derivative techniques have adopted the qualified method for assessing the market risk. It is, however, impossible to provide more precise data due to the absence of a relevant section in the BVI statistics.

8. Fund Standards and Distribution

8.1. Fund Standards

BVI attended several major projects to standardize key processes along the transaction chain of cross border and domestic securities trading, trade matching and trade settlement. With these initiatives BVI is spearheading the straight-through-processing efforts within the German asset management industry in order to enhance efficiency and operational safety.

In 2007 one could see a wider market penetration of ISO-20022 standard within the German asset management community. BVI supports and assists WM Daten to implement a website which contains European Funds Passport data. Moreover, BVI attends the work of the International Standardization Organization ISO.

BVI supports FundsXML, a standard for the data exchange of investment information as well as for reporting purposes. The updated version 1.2.1 has been finalized in cooperation with the Austrian investment association VÖIG and with Dutch support. Furthermore, BVI enhanced efforts to automate parts of the reporting of portfolio transitions.

The BVI Rating-/Ranking-Transparency Standards were updated in 2007 by using a more specified and detailed questionnaire.

8.2 Distribution

In Germany the implementation of the European “Markets in Financial Instruments Directive” (MiFID) has been conducted via an omnibus bill (Finanzmarktrichtlinie-Umsetzungsgesetz – FRUG) amending several pieces of existing legislation. The new provisions came into force well timed on 1 November 2007.

Up to now, the impact of MiFID implementation on distribution of fund units has been fairly limited. This is certainly due to the fact that the German legislator has confined itself to mostly verbatim transposing EU provisions into national law, leaving in many cases a broad scope for interpretation. In addition, the option available under Article 3 MiFID has been exploited in order to exempt IFAs distributing investment funds without investment firm status from the scope of MiFID provisions.

Regardless of MiFID, disclosure of monetary benefits, in particular of retrocessions received by distributors from fund management companies has been prompted by a ruling of the German Federal Court of Justice (Bundesgerichtshof) in December 2006. On grounds of this high court decision, the German banks consider themselves legally bound to inform their clients about the level of retrocession payments expected with regard to the client order. The disclosure takes place in percentage terms before the conclusion of a contract. In case of tiered commissions, either the highest possible or the effectively reached rate are being disclosed towards the client. However, the first approach has recently been challenged by the courts.

9. Other activities of the association

9.1 Focus of domestic lobbying activities

In 2007 the German government has approached the idea of increasing the employees’ participation in the growth on their companies’ assets. The political parties preferred either direct participation models by means of employee shares or creation of a public fund, the Deutschlandfonds, providing capital to scheme participants. Voluntary employers' contributions for their employees to such participation schemes would benefit from matching state contributions. The model of the Deutschlandfonds has been withdrawn in early 2008 and was replaced by a new type of (private) investment fund with a large proportion of assets to be invested in private equity of employers who offer participation in the underlying schemes. BVI has serious doubts about the feasibility of the proposed fund solution and lobbies in favour of more conventional fund products to be included into participation models. Legislation is scheduled to be finalized by the end of 2008.

The summer of 2007 has seen another governmental initiative, the so-called Risk Limitation Act (Risikobegrenzungsgesetz) representing a set of measures to prevent “economically undesirable activities of occupational investors”. The legislative proposal has aimed, inter alia, at broadening the definition of “acting in concert”, requiring disclosure of investment objectives and source of invested assets at the holding level of 10 percent and vesting issuers with a right to require the identification of ultimate shareholders. In the course of legislative proceedings, BVI has undertaken great efforts in order to limit the regulatory burden for investment companies to a reasonable minimum. The amended draft of Risikobegrenzungsgesetz was adopted in August 2008.

Following the announcement in the government program, the German Ministry of Finance has conducted an intensive evaluation process concerning the governance structure of the federal supervisory authority BaFin. The finally adopted governance model introduced a new board of directors comprising the president, three chief executive directors for securities, banking and insurance supervision each, and one director responsible for cross-sector issues as well as internal administration. The internal restructuring of BaFin has no direct regulatory impact on the financial industry.

9.2 Sponsorship

BVI being the German partner of the international Carbon Disclosure Project (CDP) since 2006 has produced the second country report for Germany in 2007. CDP is a common initiative of institutional investors in the field of climate change providing the investment community with information on the corporations' greenhouse gas emissions and climate change management strategies. On a global basis about 2,400 of the world largest quoted companies by market capitalization (including the FT 500 companies) are requested to disclose their carbon emissions. For Germany the 200 biggest German quoted companies were asked to fill out the questionnaire. The objective of the initiative is to sensitize institutional investors to consider aspects of climate change in their asset allocations. BVI’s engagement continues in 2008.

9.3 Seminars, workshops and business education

2007 has seen another increase in the seminars and workshops organized by BVI as a part of the association’s membership service. The 38 “members only”-events were attended by over 2,800 participants (versus 2,200 in 2006). They covered a wide range of subjects from seminars for beginners (labelled “Investment Funds in a Day”), conferences on specific legal developments to the annual get-together event for the industry, the two-day Asset Management-Konferenz (AMK). In its third year the AMK was visited by more than 350 representatives of BVI members. The “Deutscher Investment Hochschultag”, organized together with the Chair of Investment, Portfolio Management and Pension Finance at the University of Frankfurt, Prof. Raimond Maurer, had its 5-year-jubilee. Bringing together latest scientific research and CEOs from BVI members commenting on it attracted 250 visitors in 2007.

The new occupational image “investment specialist” (“Investmentfondskaufmann”) initiated by BVI is already well established and being taught both in Frankfurt and Munich. Currently some 150 young people a year pick up this career. In 2006 Frankfurt Chamber of Commerce introduced the so-called Investment-Fachwirt or Bachelor of Investment (CCI) as the next stage of professional training and the first courses started in Frankfurt. One year later Trier has been established as an additional location, attracting students from Luxembourg financial institutions who are looking for ways to improve their career chances. The Investment-Fachwirt has been developed by BVI and the services sector trade union. Its main target groups are investment specialists or people with a professional background in an investment company of at least five years. In a two year-course they will pick up general skills consisting of a deeper knowledge of economics and legal aspects of the fund business and will then choose to specialize either in the field of portfolio management, marketing and distribution or fund controlling and risk management.

9.4 Surveys

In 2007 a basic BVI study on distribution of retail funds (“Grundlagenstudie: Vertrieb von Publikumsfonds 2007”) has been conducted by a management consultant. 47 companies, both BVI members and other market participants, responded to detailed questions about strategy and brand management, distribution, customer relationship management, market and competitors as well as product management.

9.5 Publications

Since 2002 BVI issues a regular biweekly newsletter informing BVI members about latest developments relevant to the investment industry. The BVI newsletter comprises information on political issues at national and international level, legal, tax and pension news, media coverage and changes to upper management and has developed over years to form a major information medium for the German investment community.

BVI offers information materials about investment funds for different target groups. The following items are currently in great demand:

- **„Me and my fund“** – standard brochure for retail investors containing easily understandable basic information about investment funds,
- **“Riester-Rente with investment funds”** – publication addressing essential questions with regard to state-funded third pillar retirement provisions called “Riester-Rente” and illustrating potential returns of fund based Riester solutions,
- **BVI fact book** with detailed information about latest developments concerning the German investment industry for retail and institutional investors,
- **Tax brochure** providing annual information on taxation of fund investment profits for retail and institutional investors.
- **CD-ROM: „Investmentfonds – saustark!“** – an interactive presentation with basic information about investment funds as well as calculation programs for savings plans and withdrawal plans.
- **BVI teaching aids „Hoch im Kurs“,** consisting of a pupil magazine, a teacher brochure with more background information and suggestions for instruction as well as a corresponding webpage www.Hoch-im-Kurs.de. Last year, this media package received Comenius EDU Media Award in the category of economic and commercial education.

Comprehensive information on investment funds in general, the current status and framework of the German investment industry as well as on organization and activities of BVI can also be found on BVI’s webpage (**www.bvi.de**).

9.6 BVI membership structure

As an additional category, the “information membership” has proven to be very attractive to new members. After only four years, their number crossed the magic threshold of 100 in early 2008 and reached 110 in summer 2008. The benefits comprise, among others, access to selected areas of the BVI extranet (including statistical data), the fortnightly BVI newsletter and the possibility to attend the BVI seminars and workshops. “Informationsmitglieder” come from different companies ranging from software and IT service providers to lawyers, depository banks and accountants.

The number of regular BVI members comprising investment companies and asset managers has grown by 12 since the beginning of 2007. Currently, BVI represents 92 regular members.