Universal Banks and Investment Companies in Germany

Theodor Baums

UNIVERSAL BANKS AND INVESTMENT COMPANIES IN GERMANY

Theodor Baums*

I. Introduction

Universal banking means that banks are permitted to offer all of the various kinds of financial services. This includes classical banking activities like the credit and deposit business, as well as investment services, placement and brokerage of securities, and even insurance activities, trading in real estate and others. German universal banks also hold stock in nonfinancial firms and offer to vote their clients' shares in other firms.[1] This paper deals with universal banks and their role in the investment business, more specifically, their links with investment companies and their various roles as shareholders and providers of financial services to such companies. Banks and investment companies have, as financial intermediaries, one trait in common: they both transform capital of investors (depositors and shareholders of investment funds, respectively) into funds (loans and equity or debt securities, respectively) that are channeled to other firms. So why should a regulation forbid to combine these transformation tasks in one institution or group, and why should the law not allow banks to establish investment companies and provide all kinds of financial services to them in addition to their banking services? German banking and investment company law have answered these questions in the affirmative. This paper argues that the existing regulation is not a sound and recommendable one.

The paper is organized as follows: Sections II - V identify four areas where the combination of banking and investment might either harm the shareholders of the investment funds and/or negatively affect other constituencies such as the shareholders of the banking institution. These sections will at the same time explore whether there are institutional or regulatory provisions in place or market forces at work that adequately protect investors and the other constituencies in question. Concluding remarks follow (VI.).

II. Banks as Shareholders and Trustees

This section deals with the principal-agent relationship between investors and investment companies and the concurrent roles of banks as shareholders in investment companies and as trustees of the investors under German law.

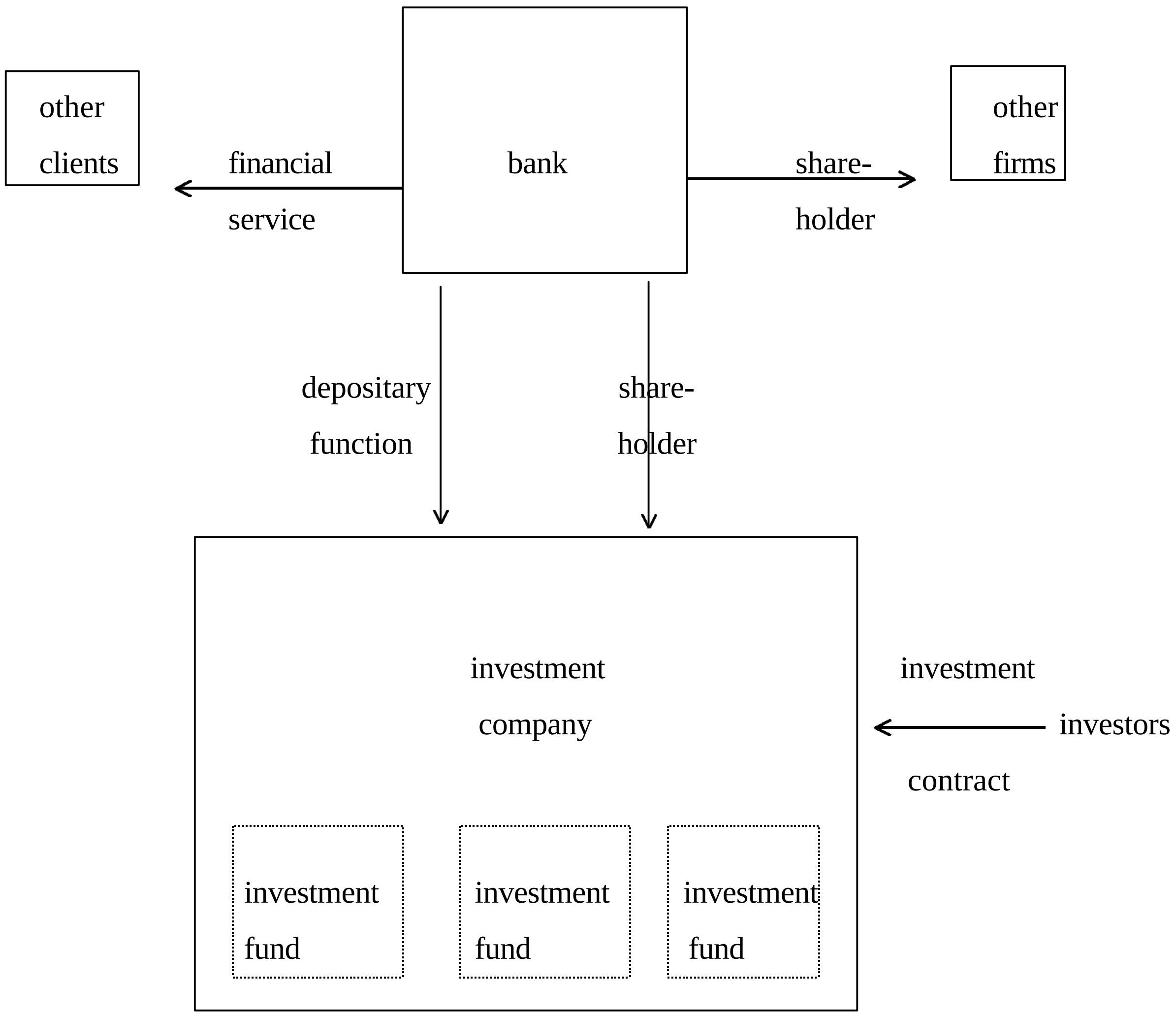
1. The separation between shareholders and investors under German law

One basic structural difference between a mutual fund under the U.S. Investment Company Act of 1940 and an investment company under German law is crucial for understanding of the role of the banks both as shareholders and providers of various kinds of services to investment companies: contrary to a U.S.-style mutual fund, German investors are not shareholders of the investment company. The shareholder(s) of an investment company and the "shareholders" of the investment funds that are set up and run by such a company have to be clearly distinguished. German investment companies are corporations[2] whose shares are mostly[3] held either by one single bank or a majority of their shares is held by one or several banks. The "shareholders" of the funds, or investors, however, are not shareholders of the investment company. Rather, the investment fund is a pool of assets (securities, real estate) financed by the investors and administered, similar in form to a trust, by the investment company. The investment fund is, other than the administering investment company, not a legal entity. Each of the investors is linked with the investment company by an indenture that spells out the fundamental investment policies and the management fees that are paid to the company, and describes the rights of the investor vis-à-vis the company and the interest he holds in the fund.

2. Contractual vs. corporate governance structure

As a consequence, the governance structure and governance problems of American-style mutual funds and German-style investment funds look quite different.

Figure 1


other
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When an investment company is organized as a corporation with its investors as its shareholders, management is obliged to pursue solely and exclusively the investors' interests. Of course, even in such a setting there will be monitoring problems and specific costs for the investor-shareholders because of the separation of ownership and management,[4] problems that will be exacerbated to the extent that the shares are widely distributed among small shareholders.[5] But the duties of the board and management vis-à-vis the investor-shareholders are clear and undivided.

That is not the case in a structure where the investors and the shareholders of an investment company are different groups. On the one hand such an investment company is obliged to pursue the investors' interests, on the other hand management must maximize the value of shareholder's shares and follow their instructions.[6] Being parties to an investment contract rather than shareholders, investors cannot give such instructions to the investment company or its management, cannot vote on corporate or investment matters or even dismiss management if they are dissatisfied. There are then only two ways left to protect the interests of the investors in such a setting:

First, investors could be given an exit option: the right to a repurchase of the investment certificates by the company. Investors could then "exit" rather than vote[7] if they are dissatisfied with management. Given the costs that are connected with monitoring by voting - information gathering, costs of collective action, costs because of remaining agency problems - the exit option seems to be a superior solution. German investment law provides for such a right of exit.[8]

However, exit comes at a cost and might not be a realistic option under specific circumstances. Following the "Wall Street Rule" and choosing another investment imposes transaction costs on the investor. There may also be barriers to exit because of high loads or fees.[9] And the exit option will only be exercised if the investor has information about bad performance of the fund compared to its competitors or to a benchmark. There is, however, no useful and reliable assessment of the value of investment certificates and the performance of the funds so far. German investment securities are not listed on a stock exchange. Their value is not assessed by the market. They are bought and sold on the basis of a valuation by the depositary bank (which is identical with the parent bank). This valuation does, at least to a certain extent, say something about the past performance of the fund and the quality of the funds' management and its decisions. This information, however, is "hidden": the investor does not know whether the price development of his share follows the market, or whether his fund has out- or underperformed the market in the past[10]. Most "performance comparisons" for publicly held funds ("Publikumsfonds") reported in the media are simply based on a comparison of the developments of the prices of the various shares fixed by the deposit banks;[11] sometimes the riskiness of a share is also calculated.[12]

A mere exit option has still another shortcoming. If investment certificates are dispersed and widely held, and if there is no voting mechanism with a majority rule, then it will be almost impossible to change the conditions of the investment contract, adopt a new policy, alter the administration fees, and so on. Adaptation to new circumstances is made impossible. In such a system investment companies will anticipate this and offer conditions from the beginning (like broad phrasing of permissible investment policies etc.) that might be disadvantageous to the investors, at least as long as competitive forces and the development of informational intermediaries do not exclude this.
Consequently, German investment law does not rely exclusively on the exit option. The Investment Company Act permits the investment company itself to make one-sided alterations to the indenture where necessary,[13] provided that the alteration complies with any applicable mandatory provisions of the law[14], the Federal Banking Supervisory Authority[15] finds that the interests of the investors have been sufficiently preserved, and the alteration is published. To the problems of monitoring the investment company's management and controlling whether it complies with the provisions of the contract, acts with due loyalty and care, and performs well, the Investment Company Act has found a special solution: It does not - as one might expect - consider the links of the management and the investment company with its owners (mostly a bank) as a possible source of conflicts of interests vis-à-vis the investors. On the contrary, the Investment Company Act even puts the bank and the company's supervisory board into action as a means of monitoring management in lieu and on behalf of the investors as the following section will show.

3. Supervisory boards and owner-banks as trustees

The managers of an investment company are appointed and dismissed by the shareholding institution (bank or other).[16] The same is true for the members of the supervisory board to the extent that they are not elected by the employees of the company.[17] The supervisory board must monitor management and must be asked for its consent to defined major transactions.[18] In order to make sure that the interests of the investors are preserved, the Investment Company Act provides that the "personality and expert knowledge" of the members of the supervisory board guarantee that the interests of the investors be ensured.[19] That does not, however, preclude - according to the opinion of legal commentators and the practice of the Federal Banking Supervisory Authority - a member of the supervisory board of an investment company which is a subsidiary of a bank from serving on the management board of the owner-bank at the same time[20]. Hence, in practice, the majority of the members of the "Aufsichtsrat" of an investment company will be managers of the owner-bank(s) at the same time.[21]

The model contract for so-called "Spezialfonds" (a special form which is available for institutional investors only) provides for an additional investment advisory council ("Anlageausschuß") where at least some of the members are appointed by the investors themselves.[22] But the model contract for retail or public investment funds ("Publikums-fonds") does not provide such a representation of the investors' interests.[23]

Apart from these attempts to promote and enforce investor-orientated policy and behavior by the fund's management, the Investment Company Act provides particular investor protection by conferring special tasks in this regard upon a depositary bank. This depositary bank must not only keep a fund's securities in safe custody, cash in dividends, etc., but is also vested with specific powers to protect the investors' interests. It must, inter alia, guarantee that the investment company does not overcharge the fund with unjustified fees and expenses.[24] It has the right to assert claims on behalf of the investors by legal action.[25] In case of insolvency of the investment company it has the right to cancel the investment contract between the investors and the company.[26] Under certain circumstances it has the right and the duty to liquidate the fund.[27] In fulfilling these tasks it must act independently and only in the interest of the investors.[28] Neither the Investment Company Act nor the Banking Supervisory Authority, however, exclude a parent bank that owns an investment company from serving itself as the investment company's depositary institution at the same time. Hence that is always the regular case in practice.[29] I need not explain further that the idea of allowing the owner of a company to serve also as the overseer of the company on behalf of the company's counterparties is flawed.[30] It is as flawed as the complementary provision of the Investment Company Act that the (subsidiary) company oversee its (parent) depositary bank's fulfillment of its tasks.[31]

The initial idea behind the provision that the parent bank act as trustee on behalf of the investors was probably to profit from the bank's reputation. The next section deals with the question whether this and/or more vigorous competition will provide for effective control of the investment company on behalf of the investors.

4. Reputation and performance measurement as substitutes?

It has already been mentioned that there is still no satisfactory and reliable performance measurement of the German "Publikumsfonds", nor any continuous performance information for the investing public.[32] Hence there have been always considerable informational problems for the investors before the conclusion of an investment contract. For new independent investment companies it would therefore have been particularly difficult to build up a reputation as good performers on their own. In order to offset this the established banks lent and still do lend their own reputation to their affiliated investment companies. A similar consideration applies to problems that might arise after the conclusion of an investment contract: the reputation of the banks was and still is considered as a certain guarantee against detrimental actions of an incompetent, low-performing or even criminal management.

It must not be ignored, however, that the parent bank stands on the side of the investors' counterparties. In the principal-agent relationship between investors and investment company the depositary bank belongs to the agent's side if it is affiliated with the investment company as its parent. There is a natural conflict of interests between the parent bank and the investors. The parent bank cannot credibly serve as an independent monitor of its investment company's management on behalf of the investors in such instances in which the interests of the bank and the investors might diverge. The reputation of the bank may not necessarily be impaired by actions against the interests of the investors because, perhaps the investors will not detect such an action. Investors will therefore react negatively to their partial lack of efficient control.

An improvement of the measurement of the (past) performance of the funds' managers certainly will provide for more vigorous competition and put a tighter rein on investment companies and their managers. But good performance in the past is not a guarantee against agency problems that might arise once the investment contract is concluded.

To sum up, a change in the existing regulation, e.g., to take the position of trustee of the investors away from parent banks of investment companies and to provide for more effective and flexible control of the investment companies on behalf of the investors, is not superfluous because the parent bank's reputation might be at stake, and it will not be made unnecessary by market forces unleashed by increased competition.

5. Publicly held funds and the collective action problem

Any proposals for how to shape the "principal-agent" relationship between the investors and the investment company and its parent bank must consider the "market split," the difference between publicly held funds ("Publikumsfonds") and the special funds ("Spezialfonds"). Spezialfonds are reserved to institutional investors and may have no more than ten shareholders.[33] Agency problems and most of the problems discussed later in this paper will be less severe in Spezialfonds as their investors usually are sophisticated investors with large or even single shareholdings.[34] One characteristic trait of these Spezialfonds is that typically there will be an advisory board established that consists of representatives of the investor(s) and has a decisive influence on investment decisions.[35] There is also a separate private performance measurement company that sells its services almost exclusively to Spezialfonds and their investors[36] whereas performance measurement of the Publikumsfonds is much less developed.[37] This structure means, however, that in fact there exist two different markets for investment certificates: one market where certificates are sold to institutional investors only, and where private investors - the public - do not have access. Beside this market there exists a second and smaller(!)[38] market for investment shares in "Publikumsfonds". More than 80% of these shares are held by private investors, less than 20% by institutions (insurance companies, banks and others).[39] The consequence of this split into two different markets with two different groups of investors is that the institutional investors do not stand by to protect the interests of the small investors who otherwise could "free-ride" on the discipline imposed by the institutions.

III. Affiliated transactions

1. Scope

The role of universal banks in German investment company law and practice is not confined to positions as owners of such companies. They also serve, as has been shown, as trustees of the investors. In addition they offer and sell all kinds of financial services to investment companies:

- They keep the funds’ securities and other assets in safe custody and administer them (cash-in dividends; deliver the assets to the purchaser in the event of a sale etc.);[40]

- They sell and purchase the funds’ assets (securities) on behalf of the investment company with the right of adopting these transactions for themselves;[41]

- They sell and repurchase the investment certificates to and from the investors on behalf of the investment company;[42]

- As German investment certificates are not listed and traded on an exchange, the depositary banks are obliged to calculate and fix the sale and repurchase price of these securities daily;[43]

- They distribute dividends to the investors;[44]

- They pay administration fees to the investment companies.[45]

2. Conflicts of interest and regulatory provisions

Given the fact that the predominant owner-bank will be chosen as depositary bank by its investment company's management, there seems to be considerable potential for conflicts of interest and abuse of the investors unless market forces or legal provisions prevent it.[46] There is, for instance, incentive for "churning" if the bank receives a brokerage fee and this practice is not limited by, e.g., an appropriate provision in the investment contract. The fact that investment securities are not listed and traded on an exchange forces the consumers to buy them through the banks, thus guaranteeing fees to the banks[47]. At the same time this system forgoes the chance to let the market rather than one single interested institution assess the value of the investment product.

Finally - connected with this - there is an incentive to ask for non-competitive high fees for the bank's services to the investment company. As a subsidiary, the investment company and its management are not free to choose another institution as depositary. Factually, the depositary bank and the investment company have an exclusive commitment. The Investment Company Act tries to counterbalance the investment company's lack of freedom of action by requiring that the terms and conditions of the investment contract be approved by the Banking Supervisory Authority.[48] This approval must be refused if the contract does not fix the methods, the (maximum) amount, and the calculation of the depositary bank's fees.[49] But that will, of course, provide only for a certain disclosure[50] of the fees that the bank charges, not for competitive prices.

To conclude, there is no pressure on a parent bank's fees from the side of its counterparty, the investment company, because of their common ownership.

That needs not to mean, however, that business links between a parent bank and its subsidiary investment company should be cut completely. Rather, one could argue that the bank and its investment company should be considered as one entity. This entity produces and sells its products, i.e. shares in investment funds, to the public. Whether or not the bank overcharges its subsidiary does not matter as long as there is effective *intergroup* competition in the market for investment securities. If that is the case, a regulation should not try to enforce independence of a subsidiary by prohibiting its parent bank from offering financial services to the subsidiary. There is no reason to prescribe for (financial) firms how they should be organized and whether they should produce products completely intra-group or buy parts of it in the market.

The problem with this argument, however, is that it does not take into consideration the complexity of the investment product, the limited information available to the investors, and the investors' limited rationality. If the amount of the fees charged by the depositary bank is not fixed precisely before an investment contract is concluded, the investment fund may be charged uncompetitive high prices later. Even if a maximum amount is agreed upon and disclosed in the investment contract (usually: in of the "value" at the end of each month, as calculated by the depositary bank), a comparison with other investment products and their various specific traits by the single investor is very difficult (and costly). An integration of future fees that could possibly be charged into the current share prices by the market could be a true and satisfactory substitute for a prohibition of affiliated transactions between a parent bank and its affiliated investment company. Another way would be to establish outside boards with truly independent representatives of the investors and have the investment fund managers to ask the board for its consent to transactions with the parent bank.

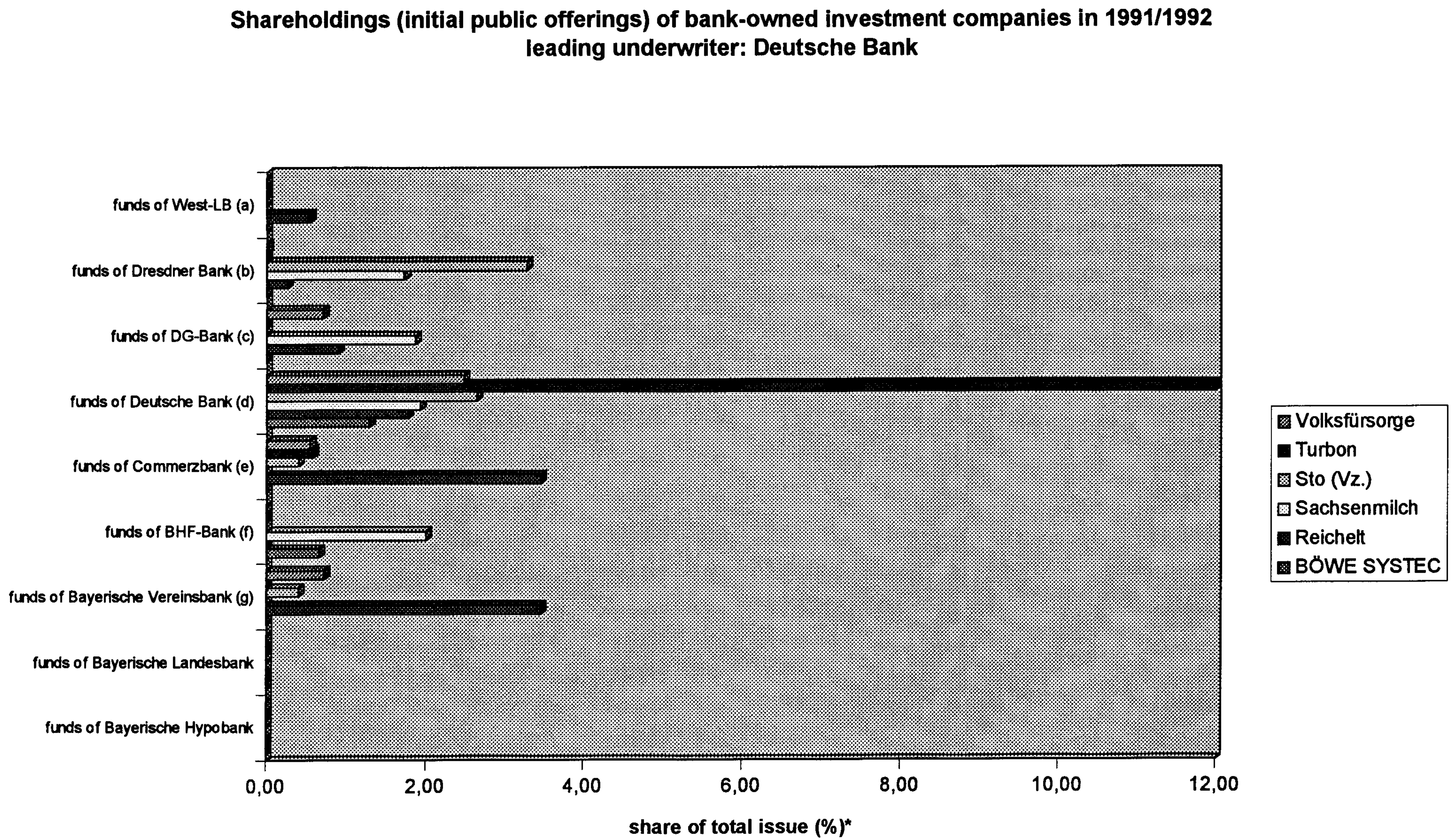
IV. Other business interests of the parent bank

Apart from the banks' direct business links with their affiliated investment companies, the banks also have links with third parties that might detrimentally influence a fund's policy and its investors. There might, for instance, be incentive to ask the fund managers to support a debtor firm of the bank by, say, acquiring its securities or by buying real estate from it. The following section tries to track the coordination of a fund's investment policies with its owner-bank's interests in two instances: first, the owner-bank is underwriter of a share issue (1.); second, the owner-bank holds shares of another firm on its own account (2.). Does this influence the subsidiary fund's investment policy, and if so, how?

1. Underwriting and investment policy

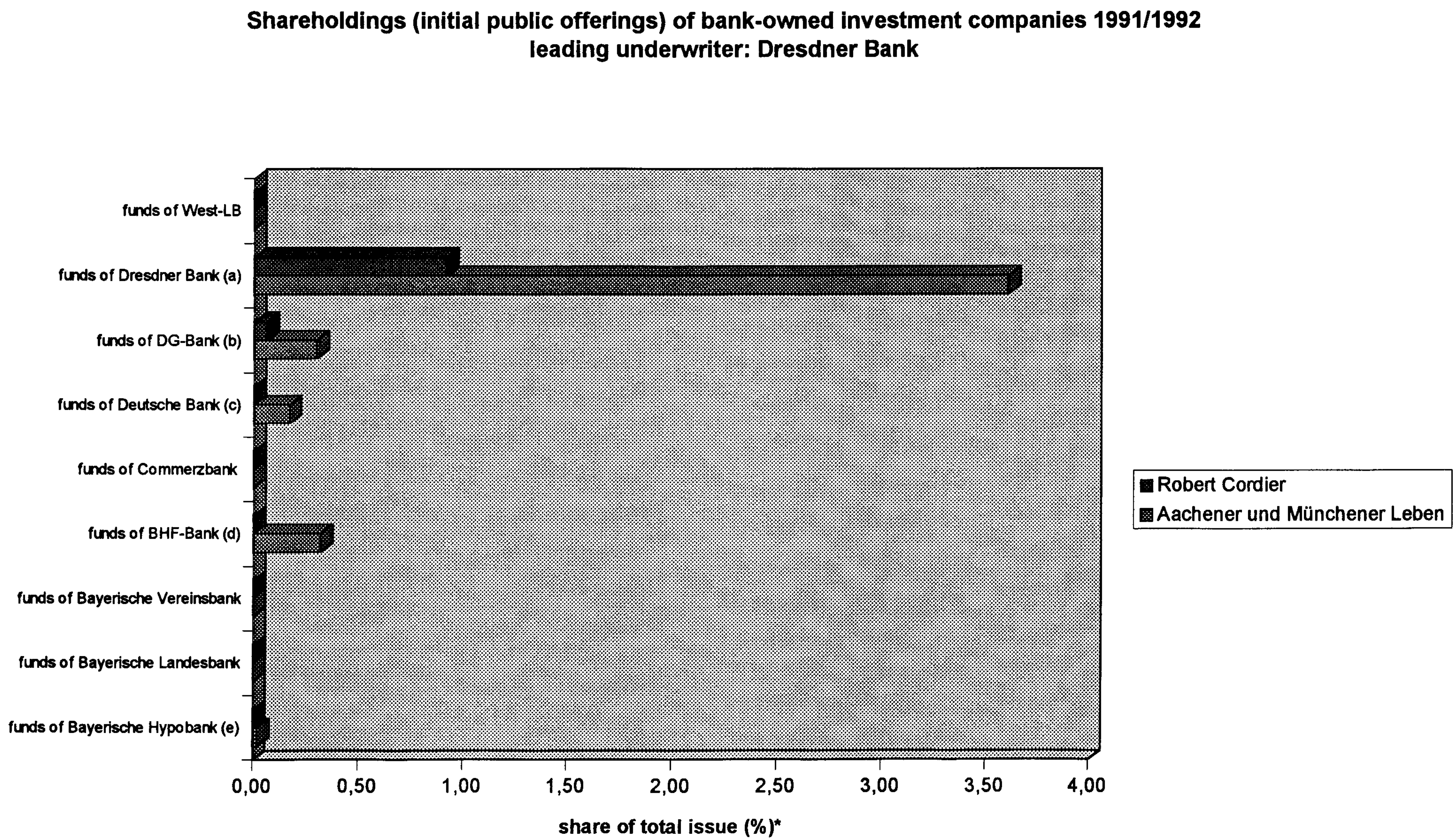
The following figures show initial public offerings of shares in 1991 and 1992, their principal underwriters, and the extent to which their investment company subsidiaries ("Publikumsfonds") bought these shares in the following period.

Figure 2:



* Maximum amount between two semiannual reports.
(a) WestKA (share of West-LB 100%).
(b) DIT (share of Dresdner Bank 100%); dbi (share of Dresdner Bank 100%); HMIT (share of Dresdner Bank 35%).
(c) DEVIF (share of DG-Bank 63%); Union-Investment (share of DG-Bank < 69,16%).
(d) DWS (share of Deutsche Bank 92,5%); DVG (share of Deutsche Bank 100%); DEGEF (share of Deutsche Bank 100%).
(e) ADIG (share of Commerzbank 39,5%); Commerzinvest (share of Commerzbank 100%).
(f) Frankfurt-Trust (share of BHF-Bank 100%).
(g) ADIG (share of Bayerische Vereinsbank 39,6%); BKG (share of Bayerische Vereinsbank 100%); NORDINVEST (share of Bayerische Vereinsbank 100%).

Figure 3:



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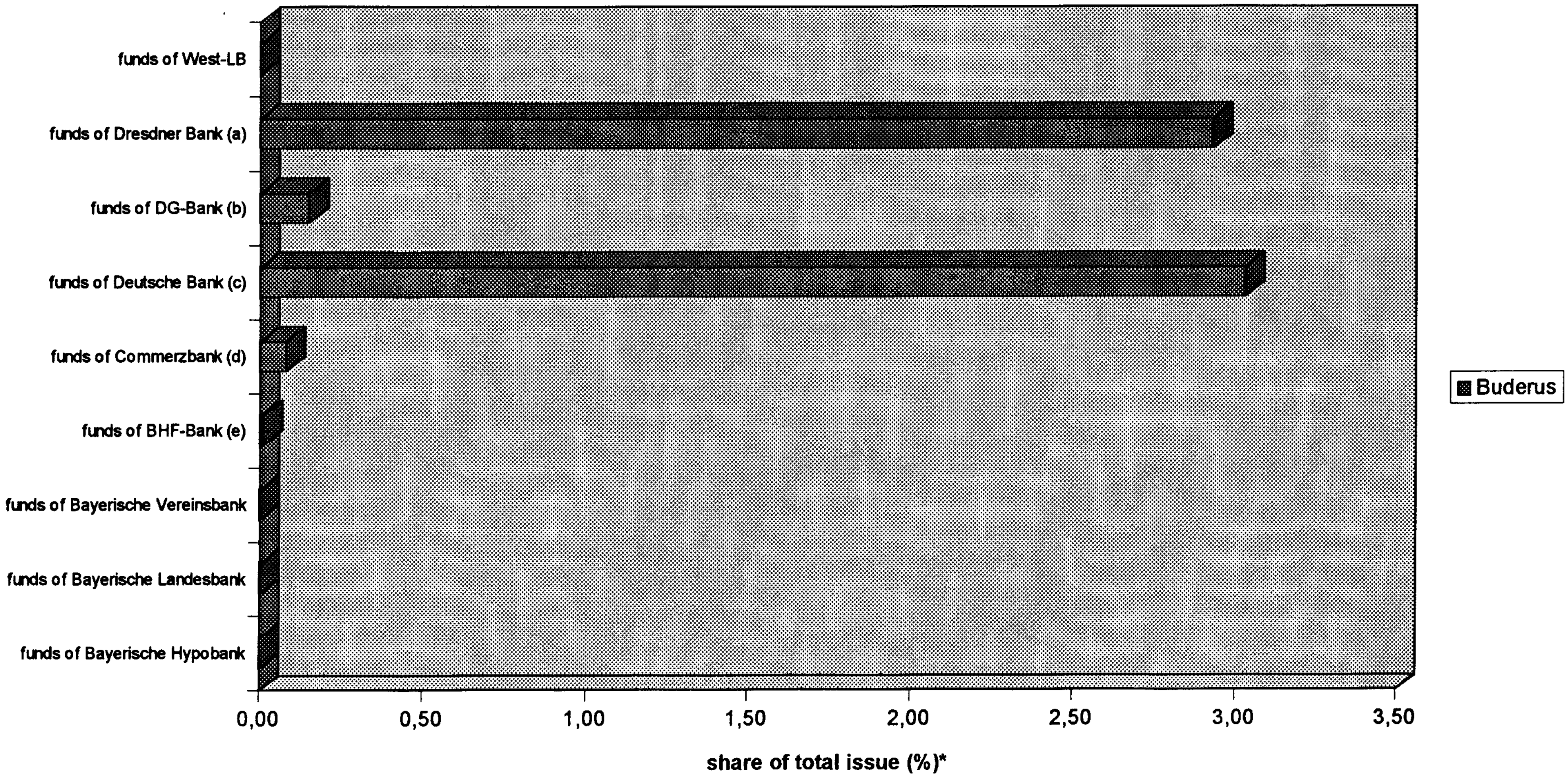
(e) HYPO Capital Management (share of Bayerische Hypobank 100%); Allfonds (share of Bayerische Hypobank 100%).

Figure 4:

Shareholdings (initial public offerings) of bank-owned investment companies in 1991/1992 leading underwriter: Deutsche Bank and Dresdner Bank



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(e) Frankfurt-Trust (share of BHF-Bank 100%).

Figure 5:

Shareholdings (initial public offerings) of bank-owned investment companies in 1991/1992
leading underwriter: Commerzbank

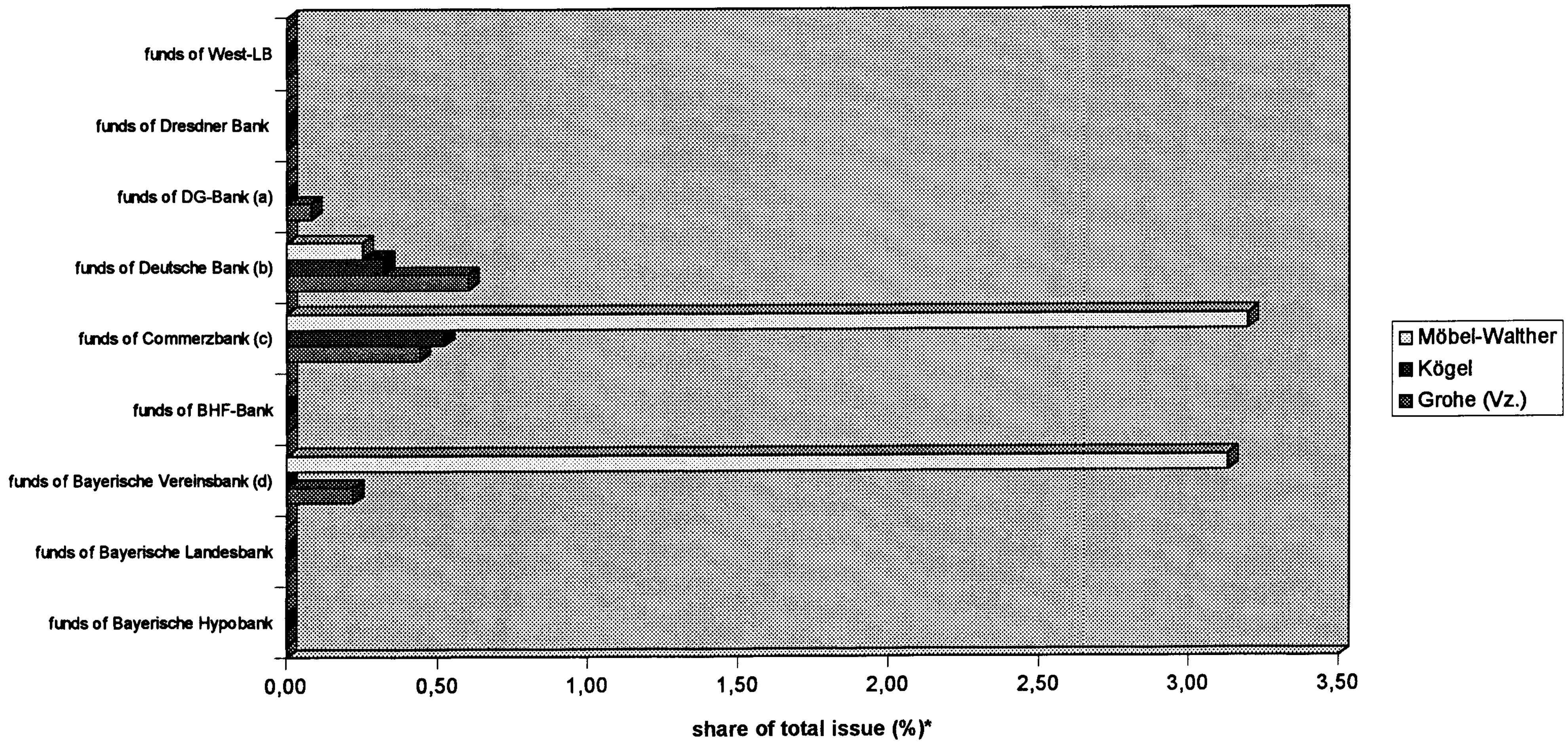

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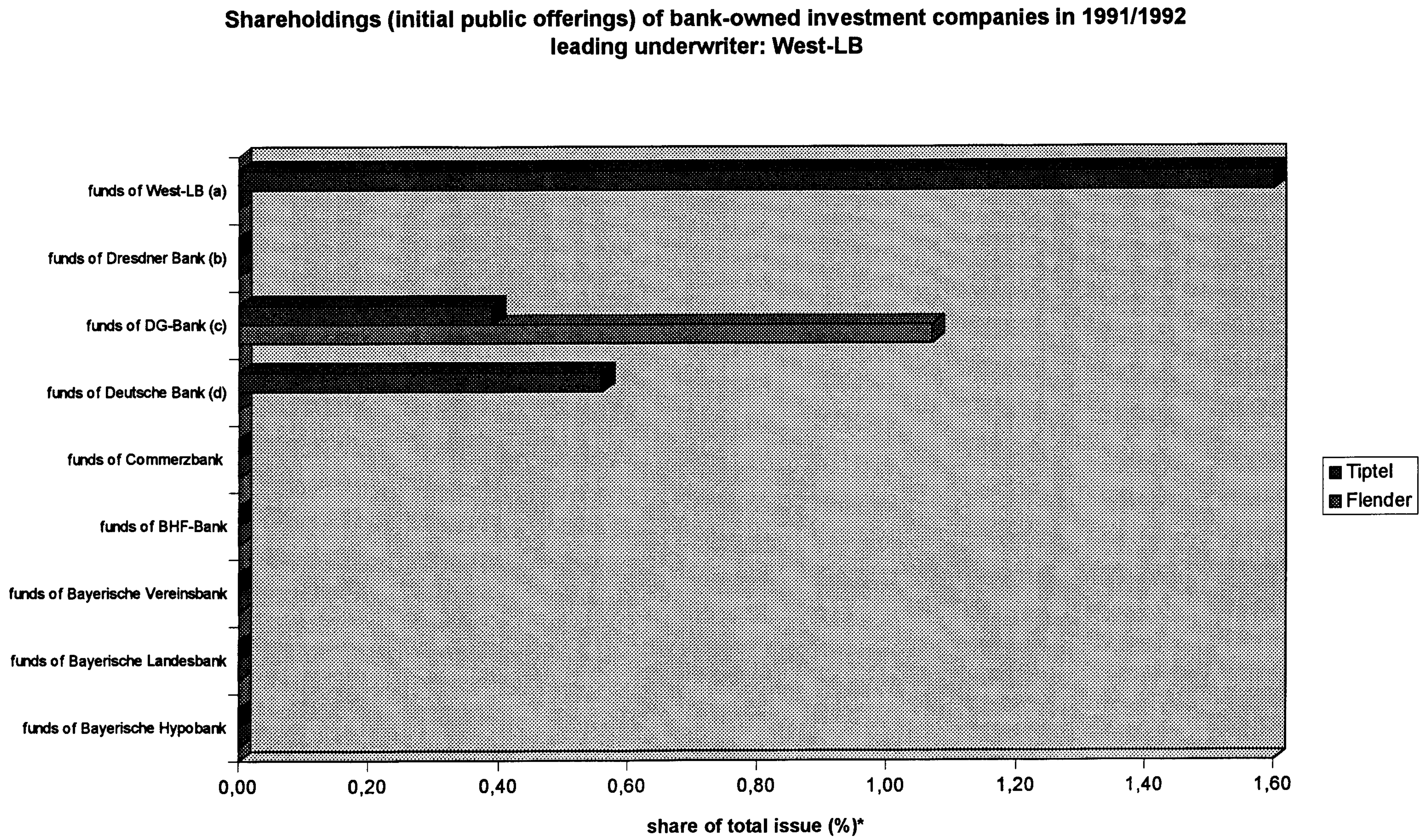
Figure 6:



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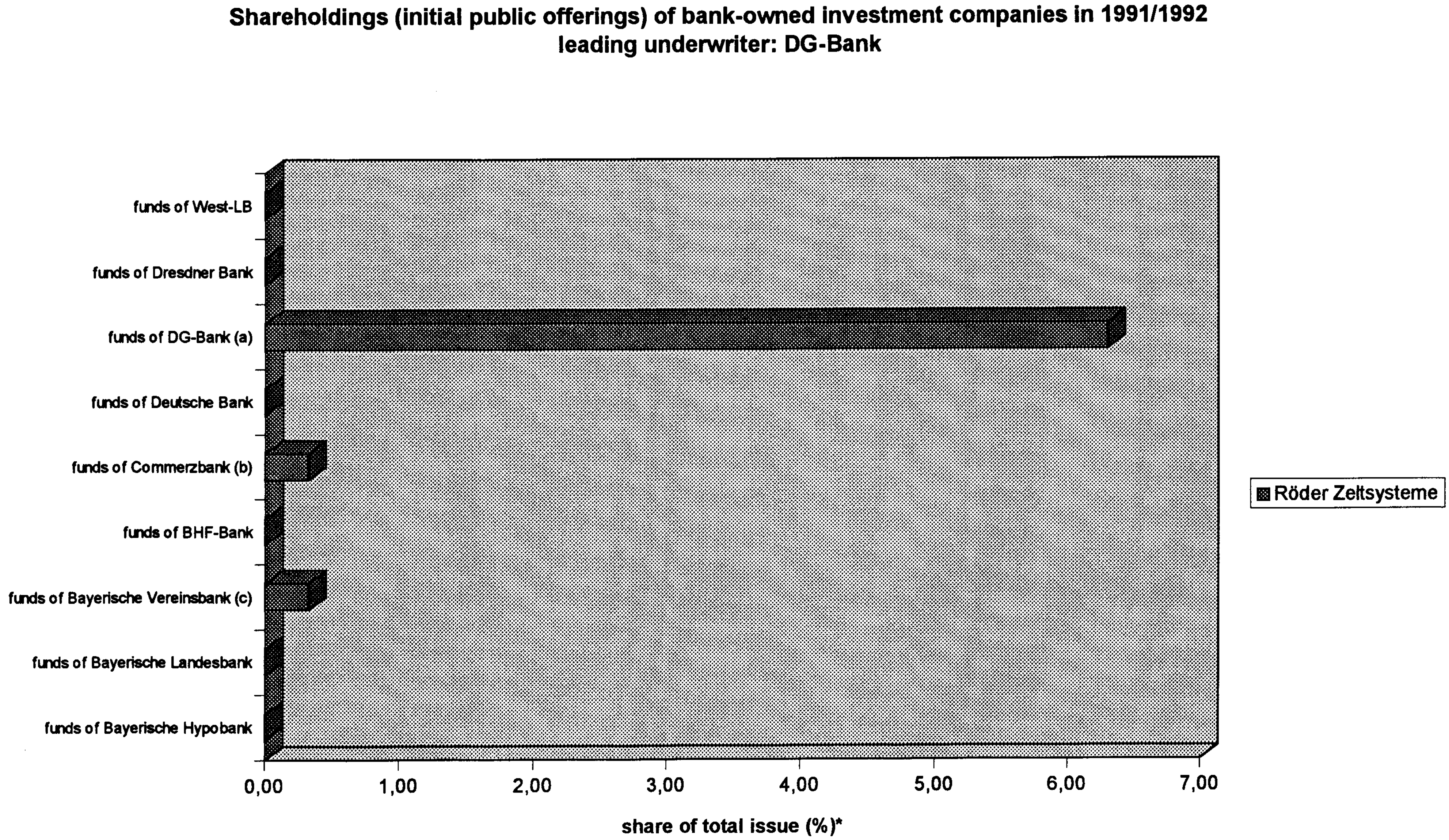

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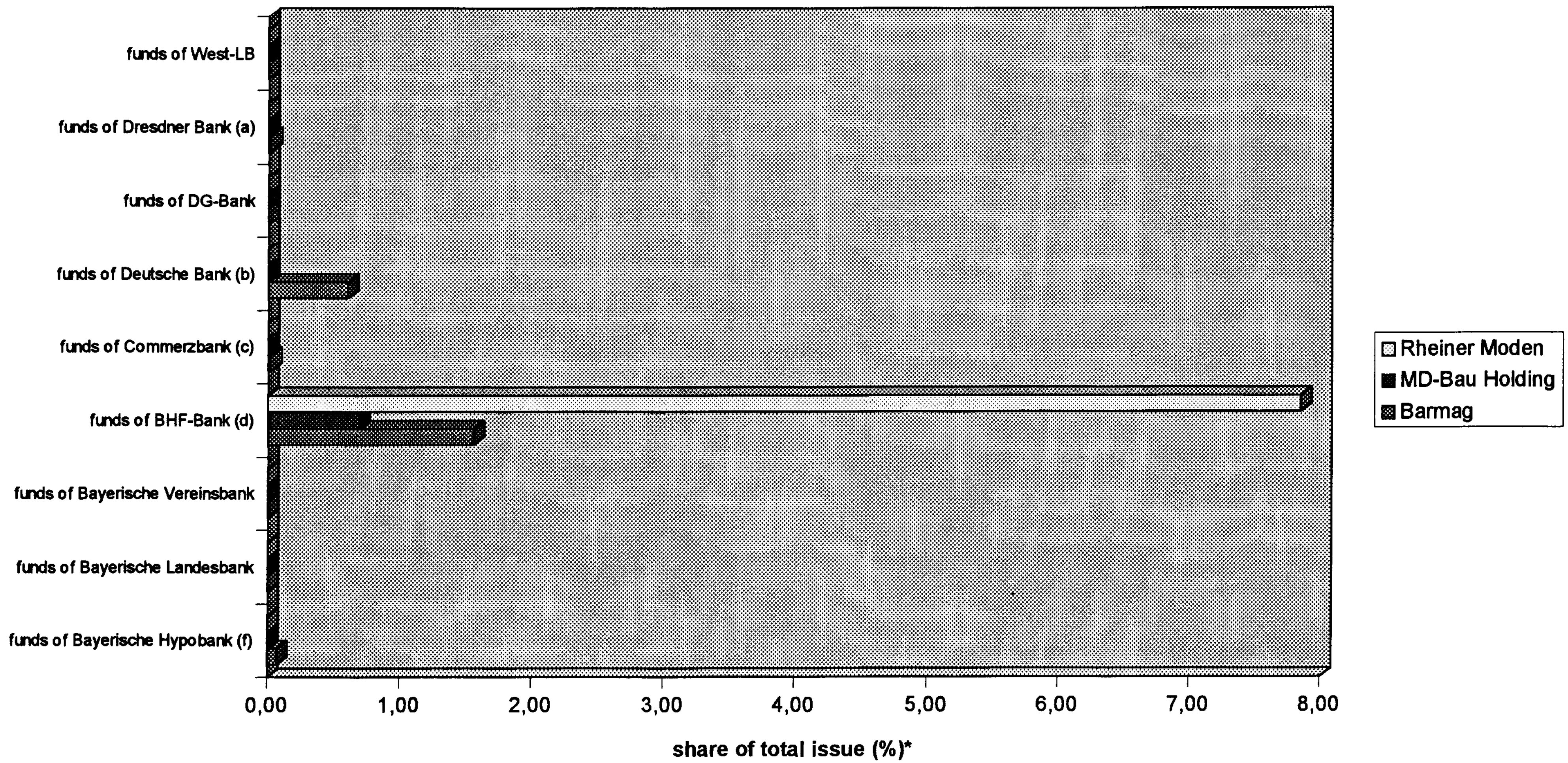
Figure 8:

Shareholdings (initial public offerings) of bank-owned investment companies in 1991/1992
leading underwriter: BHF-Bank



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(d) Frankfurt-Trust(share of BHF-Bank 100%).

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Figure 9:

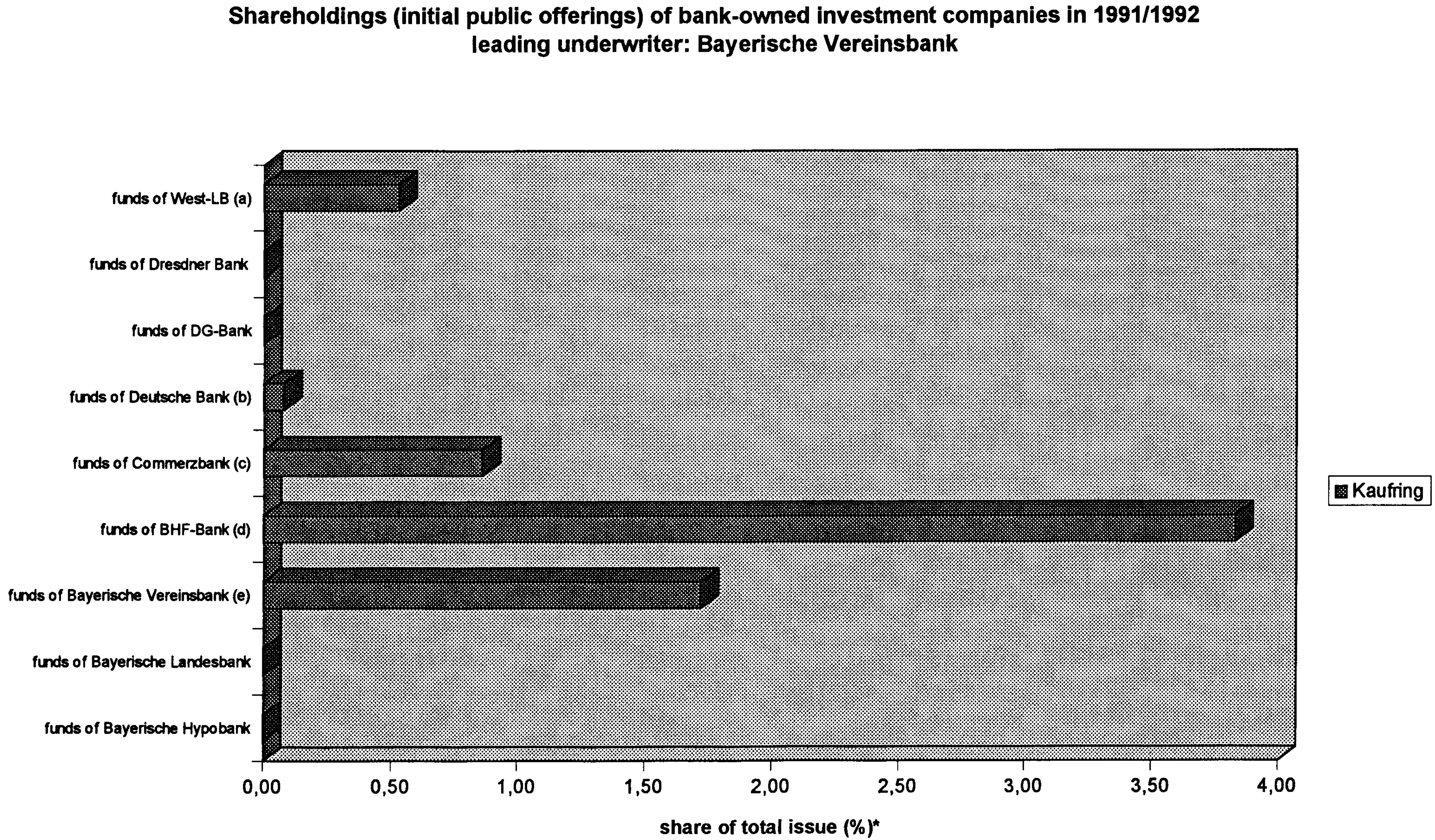

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Figure 10:

Shareholdings (initial public offerings) of bank-owned investment companies in 1991/1992 leading underwriter: Bayerische Landesbank

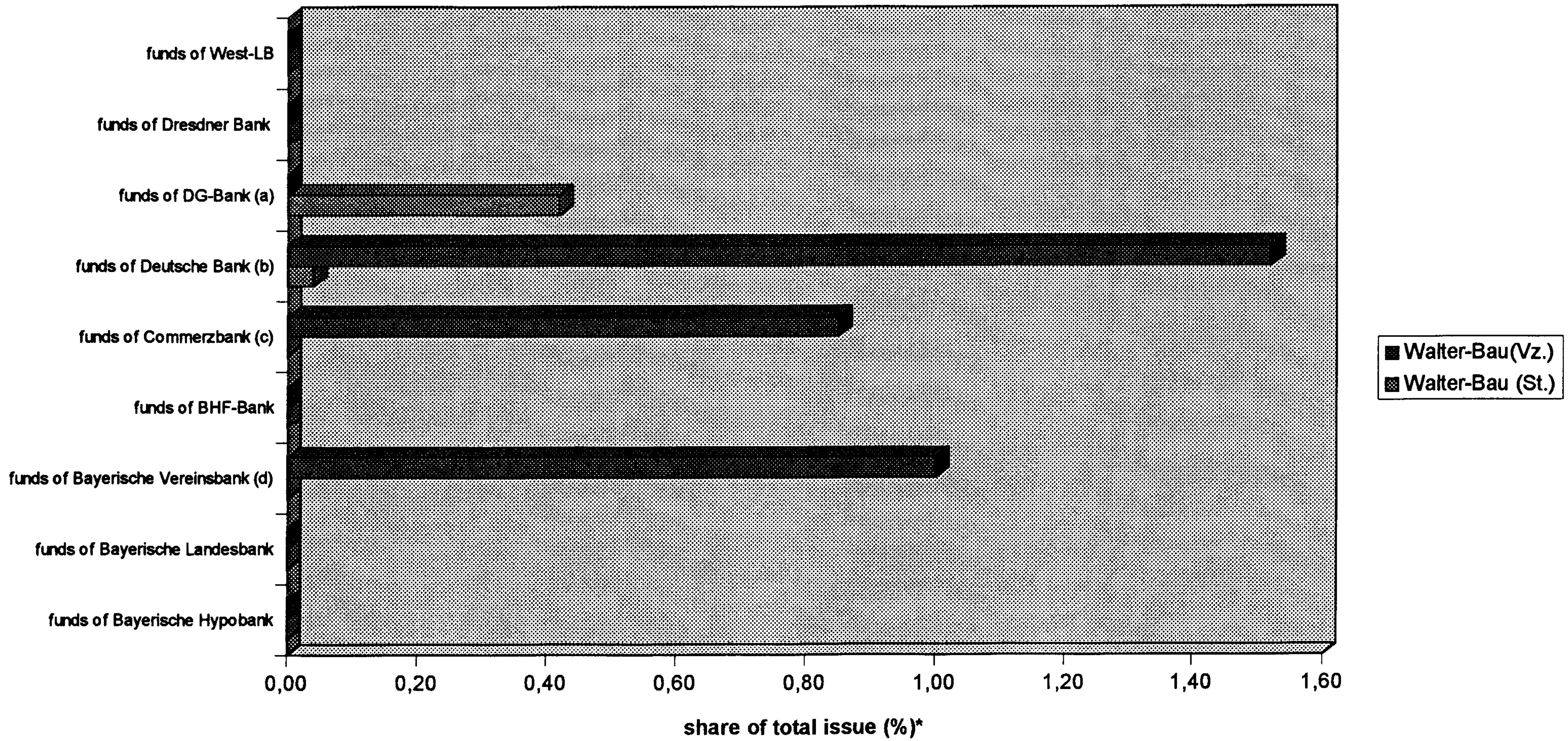

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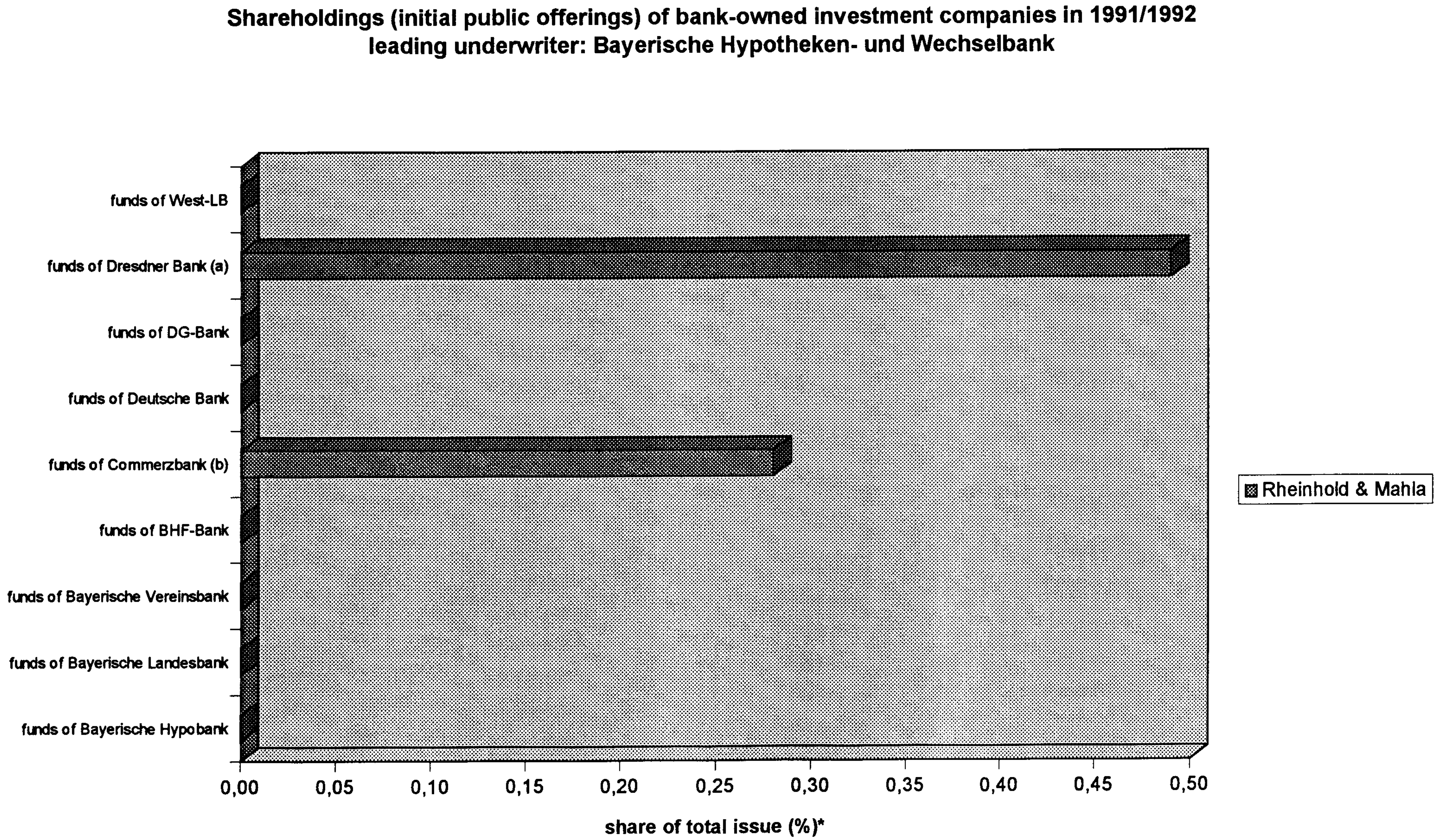
Figure 11:



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So far these figures do not give more than a first impression. They will have to be extended over several years, will have to include other banks and their subsidiaries as well, and will have to integrate bond issues and stock issues of already listed companies.

Interestingly, figures 2-9 show one investment pattern: in all cases where the parent bank was principal underwriter, its subsidiary investment funds bought more shares of the new issue than other funds. That, of course, does not yet say anything about the quality of this investment decision. The subsidiary may have profitted from better information on the firm and its outlook ("good decision"). Or the parent bank may have "dumped its trash" on its subsidiary or simply used its subsidiary to support the market for these securities ("bad decision"). It is hard to find out whether the investment decisions of the subsidiaries' fund managers were good or bad given that the available data are not sufficient to fix the purchase and selling dates exactly and check the development of the price movement around these dates.

In any event, the mere possibility of "dumping the trash" might deter investors or lead to additional risk premiums if there are neither appropriate regulatory nor market forces at work.

The above figures certainly prove that there is no industry-wide policy for investment companies not to invest in securities where the parent bank has acted as underwriter. Of course the investment bank, its managers, as well as the depositary bank would breach their legal duties if they acted against the interests of the investors.[51] Both the investment company and the depositary bank could sue each other on behalf of the investors.[52] The investors could sue both companies in such a case,[53] and the Banking Supervisory Authority could act as well. There are, however, practical problems in implementing these sanctions: first, it is difficult to discover any connection between underwriting and investment decision and, second, even if the stock price had crashed before and after the purchase, the question has to be answered whether the investment decision was beyond any reasonable business judgement.

Here again the question arises whether such practices should be forbidden completely or whether market forces can and do restrain such practices. As prices are fixed by the parent (depositary) bank[54] and not by the market (an exchange), the cost of a possible later "bad decision" is not integrated into the price the investor pays. Therefore investors could be damaged ex post if they are not aware of this from the beginning and refrain from buying shares in such funds. If a valuation by the market (an exchange) did exist, investment firms could deliberately adopt a policy not to invest in securities that are underwritten by the parent bank. One could even imagine a binding disclosure rule obligating an investment fund to disclose the fund's investment policy in this respect. A legal prohibition would be unnecessary then, provided that this investment security is listed on an exchange and valued by the market. An alternative would be to establish outside boards with independent representatives of the investors who would have to decide on such transactions.

2. Shareholdings of banks and investment policy

Similar considerations apply as we turn to shareholding by the parent banks on their own accounts, and its possible influence on investment decisions of their subsidiaries. There are three principal incentives for a bank to ask its subsidiary's management to invest in shares of a firm in which the parent bank holds a stake itself. The first reason is related to the underwriting case: the parent bank might wish to get rid of a part of its own shares. In this case, since there is exactly the same demand for the amount of shares that the bank offers, the share price will not drop. Another reason is that the parent bank might want to increase its influence on the firm without expending its own capital. Finally, a bank might not want to reach or exceed certain thresholds (e.g., 20%, 25% or 50%) because holdings above these thresholds will trigger certain duties or have other unwanted consequences.[55] The second and the last case presuppose, of course, that a parent bank is able to command the votes of the shares that are held in an investment fund. The Investment Company Act provides that the fund managers "shall" themselves vote the shares held by the fund in regular cases.[56] According to the legal literature this does not, however, prohibit management from giving the depositary bank a proxy by which the bank can vote these shares without having to disclose whose stock it votes.[57] That is also what happens in practice.[58]

Table 1 shows the shareholdings of banks and their investment fund subsidiaries in selected stock corporations in 1994.

Table 1 **Shareholdings of banks and their investment fund subsidiaries („Publikumsfonds“) in selected stock corporations in 1994**

			ADIG(a)		DWS (b)		DIT
name of stock corporation	shares held by Bayerische Vereinsbank (%)	shares held by Commerzbank (%)	shares held by investment company in percent*	shares held by Deutsche Bank (%)	shares held by investment company in percent*	shares held by Dresdner Bank (%)	shares held by investment company in percent*
Aktienbrauerei Kaufbeuren AG	75,70%		0,00		0,00		0,00
Allgäuer Brauhaus AG	39,20%		0,00		0,00		0,00
Bausparkasse Mainz AG			0,00		0,00		0,00
Bilfinger + Berger BauAG			(0,71)		0,00	25,10%	1,71(1,76)
Brau und Brunnen AG			(0,24)		0,00	25,60%	0,55(0,61)
Daimler-Benz AG			0,50(0,55)	28,19%	0,89(1,15)		0,69(0,77)
DBV Holding AG		48,30%	1,63(2,04)		0,17(0,17)		0,61(0,64)
Globale Krankenversicherungs-AG			0,00		0,00		0,00
Hasen-Bräu AG	77,30%		0,00		0,00		0,00
Heidelberger Zement AG			0,00		0,13(0,34)	20,90%	0,09(0,75)
Philipp Holzmann AG			(0,09)	30,03%	1,41(1,52)		0,79(0,92)
Horten AG			0,63(1,40)	25,08%	1,27(1,35)		0,43(0,46)
Hutschenreuther AG			0,00	25,09%	0,00		0,00
Karstadt AG		25,00%	0,63(1,35)	25,08%	1,21(1,78)		2,01(2,54)
Kautex Werke AG		40,00%	0,00		0,00		0,00
Klöckner-Humboldt-Deutz AG			0,00	41,13%	0,30(0,87)		1,67(2,06)
Neue Baumwoll-Spinnerei und Weberei Hof AG	42,40%		0,00		0,00		0,00
NINO AG			0,00	23,93%	0,00		0,00
Voigtländische Baumwollspinnerei AG	38,70%		0,00		0,00		0,00
Vereinigte Schmiergel- und Maschinen-Fabriken AG			0,00		0,00	25,10%	0,00
Hans Wiebe Textil AG		20,90%	0,00		0,00		0,00

(a) ADIG = Allgemeine Deutsche Investment Gesellschaft mbH;
Investment company subsidiary of Bayerische Vereinsbank (39,6%), Commerzbank (39,3%).
(b) DWS = Deutsche Gesellschaft für Wertpapiersparen mbH;
Investment company subsidiary of Deutsche Bank (93%).
(c) DIT = Deutscher Investment-Trust Gesellschaft für Wertpapieranlagen mbH:
Investment company subsidiary of Dresdner Bank (100%).

* numbers in parentheses show the maximum amount (%) held in the period between two semiannual reports

Here again this picture is only preliminary. To get a more reliable overview it will be necessary to look at several years, and, most importantly, to include the holdings of the so-called special funds ("Spezialfonds") that are reserved for institutional investors. Another serious drawback of this overview is that it is not yet possible to include holdings of banks below the threshold of 20% as there are no reliable data so far.[59] Nevertheless the table shows that in two cases (DBV Holding AG and Karstadt AG) the holdings of a bank (Commerzbank) and its investment subsidiary (ADIG) surmounted the critical threshold of 25%. - The wish of a parent bank to increase its own voting power with the help of the holdings of its subsidiary investment fund is apparently limited to these cases given that the holdings of the funds make up only very small percentages. Finally, the table of course says nothing about whether the shares held by the funds have been purchased from their parent banks. Here again one needs the exact purchase dates, which are unknown.

What would be the appropriate reactions should further empirical research prove that holding companies influence their investment company subsidiaries in all three instances mentioned above?

Appropriate rules should be made to forbid the use of a subsidiary's holdings to circumvent laws tied to certain shareholding thresholds.

Buying shares from a parent company and exercising voting rights in the interest of the parent company may damage the investors. As this cannot be perceived before the conclusion of the investment contract, and monitoring of management by the investors or by the depositary banks on behalf of the investors does not work, only three approaches remain. The law could forbid buying shares from a holding company and voting stock in firms in which other affiliated companies together hold a controlling block. Another way would be to establish outside boards with independent representatives of the investors on it who have to be asked for their consent in such cases. Finally, one could leave it to the market to react. If a valuation of investment securities by the market (an exchange) did exist, investment firms could deliberately adopt a policy not to buy or vote shares in the interest of an affiliated company. Thus legal prohibition would be unneccessary if the investment security is listed on the exchange.

V. Interests of the parent bank's management

Managements pursue their own interests. One of these interests is to protect themselves against control. Control may be exerted by various stakeholders and in different ways. One is control by the shareholders through voting. Can investment funds serve as a means to protect the parent bank's management against control by its shareholders? This issue concerns predominantly those banks that are organized as stock corporations whose shares are widely distributed among small shareholders. The following section will first try to explain the corporate governance structure in such banks in a bit more detail (1.), then look at the evidence (2.), and finally seek appropriate regulation (3.).

1. Corporate governance in large banks

Control in large stock corporations with widely distributed shares suffers from collective action problems. The German answer to these problems was to allow banks to vote their clients' stock as proxies and thus take advantage of scale economies.[60] A bank may also use proxies to vote those of its own shares that are held by customers of the bank provided that these clients have specifically instructed the bank how to vote.[61] Hence in 1992, Deutsche Bank's management voted about 32% of all shares present at its own shareholders' meeting by proxies; Dresdner Bank's management more than 44%, and Commerzbank's management more than 18% as table 2 below shows. Although the shareholders who are asked for a proxy and an instruction tend to follow the recommendations of management in most cases, control still remains in the shareholders' hands. A way for management out of that would be to repurchase its own stock and vote it at the shareholders' meetings. This way, however, is barred under German law; the management of a company may not vote the company's own stock.[62]

Another way could be to let the managers of a subsidiary investment company vote the funds' shares in the parent bank. Neither the Investment Company Act nor the Stock Corporation Act prohibits an investment company from voting shares in its parent bank's general meeting. This is apparently another case where strict rules can be circumvented by inserting an investment company.

Yet still another way for management to control voting might be of interest here. As table 2 below shows, banks also vote shares in their competitors' general meetings to a large extent. Hence managements of these banks can either support or punish each other to a certain extent. This means that there is a strong disincentive working against monitoring and controlling the other banks' managements. This structure creates an implicit management coalition against tight control by the shareholders of such banks. Here again the shares held by a subsidiary investment company might contribute to the proxy holdings of the parent bank itself and help to protect the parent bank's management further against effective control by its shareholders.

2. *Investment funds and shares in parent banks*

Is there evidence of the use of investment funds' assets in the interests of the parent banks' managements?

Table 2 displays the voting rights exercised by the five largest private banks at their own and their competitors shareholders' meetings in 1992.

Table 2: Voting rights[a] of the five largest stock corporation banks at their shareholders' meetings in 1992

no.	bank	Deutsche Bank	Dresdner Bank	Commerz-bank	Bayr. Vereinsb.	Bayr. Hypo	all
9	Deutsche Bank	<u>32,07</u>	14,14	3,03	2,75	2,83	54,82
11	Dresdner Bank	4,72	<u>44,19</u>	4,75	5,45	5,04	64,15
13	Commerzbank	13,43	16,35	<u>18,49</u>	3,78	3,65	55,70
15	Bayr. Vereinsb.	8,80	10,28	3,42	<u>32,19</u>	3,42	58,11
18	Bayr. Hypo.	5,90	10,19	5,72	10,74	<u>23,87</u>	56,42

a includes depositary voting rights and shares held by subsidiary investment funds/% of all shares represented at the meeting.

Source: Baums/Fraune, Institutionelle Anleger und Publikumsgesellschaft, Die Aktiengesellschaft 3/1995, at p. 106.

The table proves that managements of this top group together exercise the majority of the votes present at the meetings. The numbers include depositary voting rights that are exercised by a proxy given to the bank's managements and shares held by subsidiary investment funds.

Table 3 shows the percentage of shares that were voted by banks at the 1992 shareholders' meetings of the 24 largest widely held stock corporations. These include the 3 biggest German banks: Deutsche Bank, Dresdner Bank and Commerzbank. At Deutsche Bank's meeting, more than 82% of all shares present were voted by (all[63]) banks, at Dresdner Bank more than 83%, and at Commerzbank more than 81%. The corporations may not vote their own shares.[64] At Deutsche Bank's meeting, of the 82% more than 12% were held by subsidiary investment companies (including Deutsche Bank's investment companies); at Dresdner Bank 7,72%, and at Commerzbank 15,84%. These shares were voted exactly in line with the shares voted by proxies and the proposals of the bank's managements.[65]

Table 3: Voting rights[a] exercised by banks in general meetings of the 24 largest widely held stock corporations in 1992

no.	firm	own shares of banks	subsidiary investment funds' shares	proxy votes	total
1	Siemens		9,87	85,61	95,48
2	Volkswagen		8,89	35,16	44,05
3	Hoechst		10,74	87,72	98,46
4	BASF	0,09	13,61	81,01	94,71
5	Bayer		11,23	80,09	91,32
6	Thyssen	6,77	3,62	34,98	45,37
7	VEBA		12,62	78,23	90,85
8	Mannesmann		7,76	90,35	98,11
9	Deutsche Bank		12,41	82,32	94,73
10	MAN	8,67	12,69	26,84	48,20
11	Dresdner Bank		7,72	83,54	91,26
12	Preussag	40,65	4,51	54,30	99,46
13	Commerzbank		15,84	81,71	97,55
14	VIAG	10,92	7,43	30,75	49,10
15	Bayr. Vereinsbank		11,54	73,15	84,69
16	Degussa	13,65	8,65	38,35	60,65
17	AGIV	61,19	15,80	22,10	99,09
18	Bayr. Hypo	0,05	10,69	81,38	92,12
19	Linde	33,29	14,68	51,10	99,07
20	Deutsche Babcock	3,22	11,27	76,09	90,58
21	Schering		19,71	74,79	94,50
22	KHD	59,56	3,37	35,03	97,96
23	Bremer Vulkan		4,43	57,10	61,53
24	Strabag	74,45	3,62	21,21	99,28
average		13,02	10,11	60,95	84,09

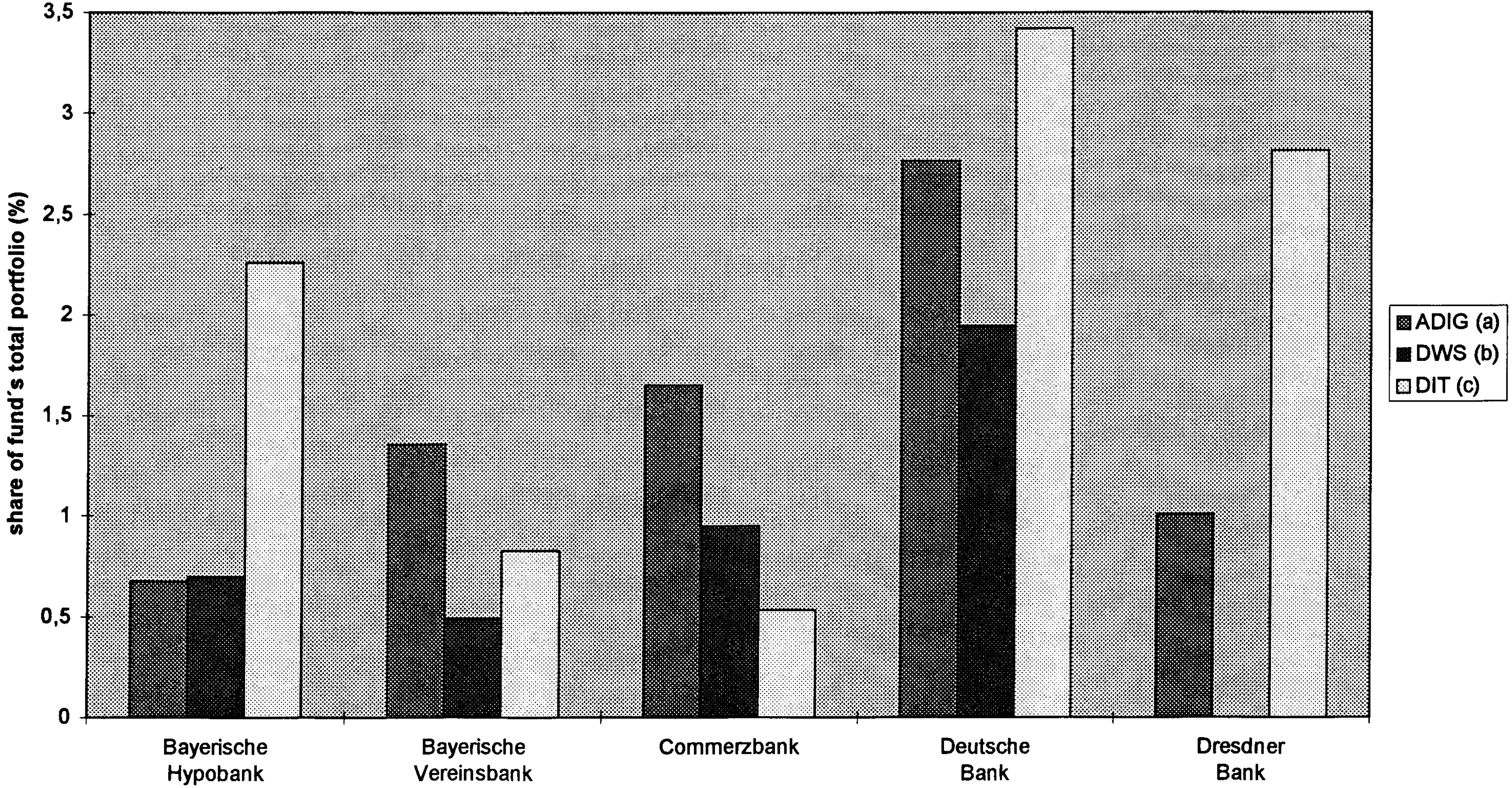
a includes shares on own account, depositary voting rights as proxies and shares held by subsidiary investment funds/% of all shares present at the meeting.

Source: Baums/Fraune, Institutionelle Anleger und Publikumsgesellschaft, Die Aktiengesellschaft 3/1995, at p. 103.

Figure 12 breaks these numbers down and shows (only) the shareholdings of subsidiary "Publikumsfonds" in the big five private banks. Although these shareholdings in their parent banks sum up to considerable amounts compared to the overall investments of such companies (cf. fig. 12), they remain small in size compared to the parent bank's own share capital as shown in figure 13. Figure 12 is also interesting in that it shows no general investment pattern of each subsidiary investing the highest amount in its parent bank's stock. Here again one will also have to look at the holdings of the "Spezialfonds" too as these obviously[66] hold the bulk of the parent bank's shares compared to the holdings of the "Publikumsfonds". "Spezialfonds" are a form of investment fund that is available for institutional investors only (including the parent banks themselves) as compared to the "Publikumsfonds" with widely dispersed investors.

Figure 12

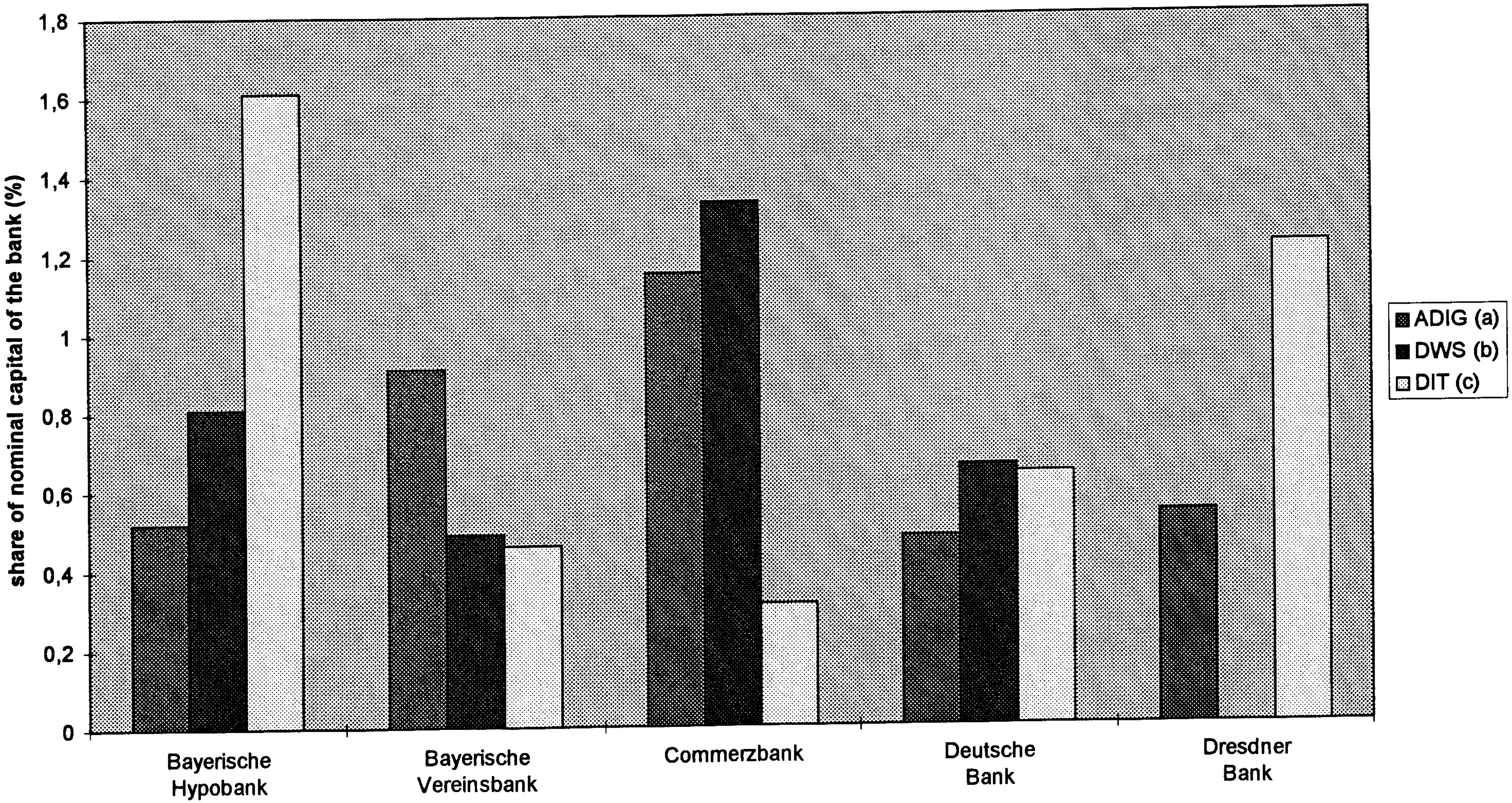
Shareholdings of bank-owned investment companies ("Publikumsfonds") in large German banks in 1994



Note:
(a) ADIG = Allgemeine Deutsche Investment Gesellschaft mbH;
Investment company subsidiary of Bayerische Vereinsbank (39,6%), Commerzbank (39,3%).
(b) DWS = Deutsche Gesellschaft für Wertpapiersparen mbH;
Investment company subsidiary of Deutsche Bank (93%).
(c) DIT = Deutscher Investment-Trust Gesellschaft für Wertpapieranlagen mbH;
Investment company subsidiary of Dresdner Bank (100%).

Figure 13

Shareholdings of bank-owned investment companies ("Publikumsfonds") in large German banks in 1994



Note:
(a) ADIG = Allgemeine Deutsche Investment Gesellschaft mbH;
Investment company subsidiary of Bayerische Vereinsbank (39,6%), Commerzbank (39,3%).
(b) DWS = Deutsche Gesellschaft für Wertpapiersparen mbH;
Investment company subsidiary of Deutsche Bank (93%).
(c) DIT = Deutscher Investment-Trust Gesellschaft für Wertpapieranlagen mbH;
Investment company subsidiary of Dresdner Bank (100%).

Table 4 breaks down the aggregated data from figure 12 into the holdings of the single subsidiary "Publikumsfonds". As the dates of the general meetings of the parent banks do not coincide with the dates when the reports of their subsidiary investment funds are published, one cannot rely on the amount of shareholdings at these publication dates. Hence the table shows also the maximum amount of the parent bank's shares held by the respective fund during two reporting dates.

Table 4 **Shareholdings of bank-owned investment companies („Publikumsfonds“) in large German banks in 1994**

name of investment company shareheld by parent bank (%)	name of parent bank	name of investment fund	portfolio company: Bayerische Hypobank AG (shareholders´ meeting 5/10/94) share of nominal capital (%) by (date)	maximum share of capital (%) during period	share of fund`s total portfolio
Deutsche Gesellschaft für Wertpapiersparen mbH (DWS) (93%)	Deutsche Bank	DWS-Deutschland	0,25(9/30/94)	0,47(10/1/93-9/30/94)	0,91
		Investa	0,45(9/30/94)	0,94(10/1/93-9/30/94)	1,85
		Provesta	0,05(9/30/94)	0,10(10/1/93-9/30/94)	0,67
		Eurovesta	0(9/30/94)	0(10/1/93-9/30/94)	0,00
		Intervest	0,01(9/30/94)	0,01(10/1/93-9/30/94)	0,14
		Akkumula	0,05(9/30/94)	0,05(10/1/93-9/30/94)	0,62
All			0,81(9/30/94)	1,62(10/1/93-9/30/94)	
Deutscher Investment-Trust Gesellschaft für Wertpapieranlagen mbH (100%)	Dresdner Bank	Concentra	0,82(6/30/94)	0,82(1/1/94-6/30/94)	4,26
		DIT-Fonds für Vermögensbildung	0,28(6/30/94)	0,28(1/1/94-6/30/94)	1,82
		Thesaurus	0,32(6/30/94)	0,33(1/1/94-6/30/94)	4,36
		Industria	0,06(6/30/94)	0,06(1/1/94-6/30/94)	0,80
		Interglobal	0(6/30/94)	0(1/1/94-6/30/94)	0,00
		DIT-Wachstumsfonds	0,11(6/30/94)	0,16(1/1/94-6/30/94)	4,15
		DIT-Kapital Plus	0,01(6/30/94)	0,01(1/1/94-6/30/94)	0,44
All			1,61(6/30/94)	1,66(1/1/94-6/30/94)	
ADIG Allgemeine Deutsche Investment-Gesellschaft mbH (39,6%; 39,3%)	Bayerische Vereinsbank Commerzbank	Adifonds	0,14(6/30/94)	0,15(7/1/93-6/30/94)	1,26
		Adireth	0(6/30/94)	0(7/1/94-6/30/94)	0,00
		Adiverba	0,23(6/30/94)	0,37(7/1/93-6/30/94)	1,68
		Fondak	0,09(6/30/94)	0,09(7/1/93-6/30/94)	0,94
		Fondis	0(6/30/94)	0,04(7/1/93-6/30/94)	0,00
		Fondra	0,02(6/30/94)	0,10(7/1/93-6/30/94)	0,52
		Plusfonds	0,03(6/30/94)	0,08(7/1/93-6/30/94)	1,00
		Fondiropa	0(6/30/94)	0(7/1/93-6/30/94)	0,00
All			0,52(6/30/94)	0,83(7/1/93-6/30/94)	

Source : Annual and semiannual reports of investment companies

Table 4 (continued) **Shareholdings of bank-owned investment companies („Publikumsfonds") in large German banks in 1994**

	portfolio company: Bayerische Vereinsbank AG (shareholders´ meeting 5/6/94)			portfolio company: Commerzbank AG (shareholders´ meeting 5/27/94)		
name of investment fund	share of nominal capital (%) by (date)	maximum share of capital (%) during period	share of fund`s total portfolio	share of nominal capital (%) by (date)	maximum share of capital (%) during period	share of fund`s total portfolio
DWS-Deutschland	0,12(9/30/94)	0,29(10/1/93-9/30/94)	0,46	0,54(9/30/94)	0,80(10/1/93-9/30/94)	2,17
Investa	0,27(9/30/94)	0,41(10/1/93-9/30/94)	1,21	0,79(9/30/94)	1,01(10/1/93-9/30/94)	3,54
Provesta	0,05(9/30/94)	0,12(10/1/93-9/30/94)	0,74	0(9/30/94)	0(10/1/93-9/30/94)	0,00
Eurovesta	0,05(9/30/94)	0,07(10/1/93-9/30/94)	0,55	0(9/30/94)	0(10/1/93-9/30/94)	0,00
Intervest	0(9/30/94)	0(10/1/93-9/30/94)	0,00	0(9/30/94)	0(10/1/93-9/30/94)	0,00
Akkumula	0(9/30/94)	0(10/1/93-9/30/94)	0,00	0(9/30/94)	0(10/1/93-9/30/94)	0,00
All	0,49(9/30/94)	0,89(10/1/93-9/30/94)		1,33(9/30/94)	1,81(10/1/93-9/30/94)	
Concentra	0,29(6/30/94)	0,29(1/1/94-6/30/94)	1,55	0,09(6/30/94)	0,45(1/1/94-6/30/94)	0,49
DIT-Fonds für Vermögensbildung	0(6/30/94)	0(1/1/94-6/30/94)	0,00	0,28(6/30/94)	0,38(1/1/94-6/30/94)	1,90
Thesaurus	0,10(6/30/94)	0,12(1/1/94-6/30/94)	1,46	0(6/30/94)	0(1/1/94-6/30/94)	0,00
Industria	0(6/30/94)	0(1/1/94-6/30/94)	0,00	0(6/30/94)	0(1/1/94-6/30/94)	0,00
Interglobal	0(6/30/94)	0,01(1/1/94-6/30/94)	0,00	0(6/30/94)	0(1/1/94-6/30/94)	0,00
DIT-Wachstumsfonds	0,07(6/30/94)	0,07(1/1/94-6/30/94)	2,78	0,03(6/30/94)	0,07(1/1/94-6/30/94)	1,35
DIT-Kapital Plus	0(6/30/94)	0(1/1/94-6/30/94)	0,00	0(6/30/94)	0(1/1/94-6/30/94)	0,00
All	0,46(6/30/94)	0,49(1/1/94-6/30/94)		0,31(6/30/94)	0,45(1/1/94-6/30/94)	
Adifonds	0,32(6/30/94)	0,33(7/1/93-6/30/94)	2,97	0,31(6/30/94)	0,36(7/1/93-6/30/94)	2,91
Adireth	0(6/30/94)	0(7/1/94-6/30/94)	0,00	0,03(6/30/94)	0,03(7/1/94-6/30/94)	0,25
Adiverba	0,24(6/30/94)	0,43(7/1/93-6/30/94)	1,79	0,41(6/30/94)	0,59(7/1/93-6/30/94)	3,14
Fondak	0,20(6/30/94)	0,35(7/1/93-6/30/94)	2,21	0,24(6/30/94)	0,43(7/1/93-6/30/94)	2,57
Fondis	0,04(6/30/94)	0,06(7/1/93-6/30/94)	0,51	0,04(6/30/94)	0,06(7/1/93-6/30/94)	0,49
Fondra	0,06(6/30/94)	0,20(7/1/93-6/30/94)	1,61	0,07(6/30/94)	0,21(7/1/93-6/30/94)	1,82
Plusfonds	0,03(6/30/94)	0,08(7/1/93-6/30/94)	1,11	0,03(6/30/94)	0,08(7/1/93-6/30/94)	1,31
Fondiropa	0,01(6/30/94)	0,03(7/1/93-6/30/94)	0,64	0,01(6/30/94)	0,03(7/1/93-6/30/94)	0,72
All	0,91(6/30/94)	1,47(7/1/93-6/30/94)		1,15(6/30/94)	1,79(7/1/93-6/30/94)	

Source : Annual and semiannual reports of investment companies

Table 4 (continued) **Shareholdings of bank-owned investment companies („Publikumsfonds“) in large German banks in 1994**

	portfolio company: Deutsche Bank AG (shareholders´ meeting 5/19/94)			portfolio company: Dresdner Bank AG (shareholders´ meeting 5/20/94)		
name of investment fund	share of nominal capital (%) by (date)	maximum share of capital (%) during period	share of fund`s total portfolio	share of nominal capital (%) by (date)	maximum share of capital (%) during period	share of fund`s total portfolio
DWS-Deutschland	0,33(9/30/94)	0,41(10/1/93-9/30/94)	**4,83**	0(9/30/94)	0,21(10/1/93-9/30/94)	0,00
Investa	0,27(9/30/94)	0,53(10/1/93-9/30/94)	**4,40**	0(9/30/94)	0,18(10/1/93-9/30/94)	0,00
Provesta	0(9/30/94)	0(10/1/93-9/30/94)	0,00	0(9/30/94)	0(10/1/93-9/30/94)	0,00
Eurovesta	0,02(9/30/94)	0,02(10/1/93-9/30/94)	**0,95**	0(9/30/94)	0,02(10/1/93-9/30/94)	0,00
Intervest	0,02(9/30/94)	0,02(10/1/93-9/30/94)	**0,71**	0(9/30/94)	0(10/1/93-9/30/94)	0,00
Akkumula	0,02(9/30/94)	0,02(10/1/93-9/30/94)	**0,79**	0(9/30/94)	0(10/1/93-9/30/94)	0,00
All	0,66(9/30/94)	1,01(10/1/93-9/30/94)		0(9/30/94)	0,42(10/1/93-9/30/94)	
Concentra	0,25(6/30/94)	0,44(1/1/94-6/30/94)	4,68	0,54(6/30/94)	0,54(1/1/94-6/30/94)	**4,84**
DIT-Fonds für Vermögensbildung	0,22(6/30/94)	0,23(1/1/94-6/30/94)	**4,99**	0,37(6/30/94)	0,37(1/1/94-6/30/94)	4,12
Thesaurus	0,10(6/30/94)	0,17(1/1/94-6/30/94)	**4,76**	0,19(6/30/94)	0,21(1/1/94-6/30/94)	4,51
Industria	0,02(6/30/94)	0,04(1/1/94-6/30/94)	0,90	0,05(6/30/94)	0,06(1/1/94-6/30/94)	**1,02**
Interglobal	0(6/30/94)	0(1/1/94-6/30/94)	**1,75**	0(6/30/94)	0(1/1/94-6/30/94)	0,00
DIT-Wachstumsfonds	0,05(6/30/94)	0,07(1/1/94-6/30/94)	**6,85**	0,07(6/30/94)	0,07(1/1/94-6/30/94)	4,71
DIT-Kapital Plus	0(6/30/94)	0(1/1/94-6/30/94)	0,00	0,01(6/30/94)	0,01(1/1/94-6/30/94)	**0,52**
All	0,64(6/30/94)	0,95(1/1/94-6/30/94)		1,22(6/30/94)	1,26(1/1/94-6/30/94)	
Adifonds	0,14(6/30/94)	0,20(7/1/93-6/30/94)	**4,52**	0,07(6/30/94)	0,16(7/1/93-6/30/94)	1,14
Adireth	0,03(6/30/94)	0,03(7/1/94-6/30/94)	**0,68**	0,03(6/30/94)	0,03(7/1/94-6/30/94)	0,37
Adiverba	0,05(6/30/94)	0,13(7/1/93-6/30/94)	1,39	0,36(6/30/94)	0,37(7/1/93-6/30/94)	**4,46**
Fondak	0,15(6/30/94)	0,17(7/1/93-6/30/94)	**5,57**	0,06(6/30/94)	0,10(7/1/93-6/30/94)	1,06
Fondis	0,03(6/30/94)	0,03(7/1/93-6/30/94)	**1,22**	0(6/30/94)	0(7/1/93-6/30/94)	0,00
Fondra	0,04(6/30/94)	0,05(7/1/93-6/30/94)	**3,82**	0,01(6/30/94)	0,10(7/1/93-6/30/94)	0,52
Plusfonds	0,02(6/30/94)	0,05(7/1/93-6/30/94)	**3,02**	0(6/30/94)	0,01(7/1/93-6/30/94)	0,00
Fondiropa	0,01(6/30/94)	0,01(7/1/93-6/30/94)	**1,90**	0,01(6/30/94)	0,02(7/1/93-6/30/94)	0,52
All	0,48(6/30/94)	0,68(7/1/93-6/30/94)		0,54(6/30/94)	0,80(7/1/93-6/30/94)	

Source : Annual and semiannual reports of investment companies

To sum up: subsidiary investment funds, publicly held funds as well as special funds, hold shares in their parent banks to a considerable extent. These shares are either voted by the fund managers themselves, or - predominantly - fund managers give a proxy to an employee of the parent bank to vote these shares. In any event shares are voted according to the proposals of the parent bank's management. Subsidiary investment companies' shares do also serve as a means to hold managements of other competing banks in check in order not to leave their shareholdings and proxies too much room for control.

3. Regulatory reactions

The issue discussed in this section IV, like those discussed in the previous sections, concerns not only the interests of the investors in an investment fund but also and predominantly the interests of shareholders of the parent bank. The corporate governance problems there should be solved by a regulation that forbids credit institutions to vote as proxies except they have been given explicit instructions.[67] A subsidiary investment company should also be forbidden to vote stock of a parent corporation.

V. Concluding remarks

The previous sections have analyzed one aspect of "universal banking", the combination of banking and investment companies in one group. Four instances have been identified where such a combination will affect either the investors or other constituencies such as the shareholders of the banking institutions negatively if there are not appropriate legal and regulatory provisions in place and/or market forces at work that exclude or diminish such detrimental effects. It has also been argued that the legal and regulatory provisions of German banking and investment company law are insufficient or even flawed. This, however, has only been partially proved empirically so far. Further research will be necessary.

Only recently the Social Democratic Party has introduced a bill that would, inter alia, bar banks from founding and holding stock in investment companies.[68] The regulation of banking and the investment sector in the U.S. was held up as an example. I personally do not think that the plan to cut any equity links between banks and investment companies is a convincing and sufficient solution, as my remarks have shown. But the existing regulation needs to be amended in various respects.

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[1] For a detailed description of the German universal banking system see *Baums/Gruson*, Brooklyn J Int'l Law 19 (1993), p. 101 ff.; on mutual funds in Germany (in English) *Fabozzi/Modigliani/Ferri*, Foundations of Financial Markets and Institutions (1994), at p. 156 f. with further references.

[2] Mainly in the form of a "Gesellschaft mit beschränkter Haftung" ("corporation with limited liability").

[3] By numbers as well as by the size of the portfolios of the bank-owned investment companies compared to all others. For a list of the investment companies cf. Investment 94, Daten, Fakten, Entwicklungen. BVI Bundesverband Deutscher Investment-Gesellschaften e.V. (ed.), Frankfurt 1994, p. 96 ff.; for a list of their owners Commerzbank (ed.), wer gehört zu wem, 18. ed. 1994. Cf. also the lists in *Noll*, Investmentfonds, in: *Oberender* (ed.), Marktökonomie, 1989, p. 359, 386, and in *Roggenbuck*, Begrenzung des Anteilsbesitzes von Kreditinstituten an Nichtbanken, 1992, pp. 359 ff. For an (older) analysis of the market structure and the concentration ratio cf. Hartmann, Ökonomie des Investmentsparens, 1990, p. 122 ff.

[4] Cf. *Jensen/Meckling*, "Theory of the Firm: Managerial Behavior, Agency costs and Ownership Structure", Journal of Financial Economics (1976), p. 305 ff.

[5] Cf. *Olson*, The Logic of Collective Action. Public Goods and the Theory of Groups (1965).

[6] § 37 GmbHG (Limited Liability Companies Act). § 10 (1) (2) KAGG (Gesetz über Kapitalanlagegesellschaften - Investment Company Act) tries to limit this dependence from the owner-bank(s) of the investment company by stating that the investment company, in fulfilling its tasks, must act independently and exclusively in the interest of the investors.

[7] Cf. *Hirschman*, Exit, Voice, and Loyalty (1970).

[8] § 11 (2) KAGG.

[9] Issue fees normally range between 3%-5%. German investment companies do not charge explicit repurchase fees.

[10] For details of "performance measurement" cf., e.g., Association for Investment Management and Research, Performance Presentation Standards (1993); *Kaserer/Pfau*, Performance deutscher Aktienfonds, Die Bank 10 (1993), p. 596 ff. with further references.

[11] Cf., for instance, "Das Wertpapier" 3/95 of Jan 27, 1995 at p. 29 ff. The risk of a fund is symbolized by a smiling, a sullen or a balanced face in this list.

[12] E. g., manager magazin 3/1995, at p. 122 ff.

13 §§ 15 (2), 53 b KAGG; for more details see *Beckmann*, in: *Beckmann/ Scholtz* (eds.), Investment. Ergänzbares Handbuch für das gesamte Investmentwesen (loose-leaf ed., May 1994), 425 § 15 at p. 7 f. with further references.

14 Especially: the Investment Company Act. The conditions of the investment contract are also subject to control under the Standard Form Contract Act (Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen; cf. § 23 (3) of the Act). There have been, however, no decisions on this so far.

15 Bundesaufsichtsamt für das Kreditwesen, Berlin.

16 § 46 Nr. 5 GmbHG (n. 6, supra).

17 On the German dual boards system (management board and supervisory board) and the codetermination regime cf., e. g., *Baums*, Takeovers vs. Institutions in Corporate Governance in Germany, in: *Prentice/Holland* (eds.), Contemporary Issues in Corporate Governance, 1993, at p. 151, 153 f. with further references.

18 § 3 KAGG (Investment Company Act) and § 111 AktG (Stock Corporation Act).

19 § 4 KAGG. This rule does not apply to members that are elected by the employees.

20 Cf. *Beckmann* (supra n. 13), at 425 § 4 p. 1 f.

21 As this can be easily verified by looking into the annual reports of the investment companies and their owner-banks (cf. § 285 Nr. 10 HGB-Commercial Code) I omit a lengthy statistical survey here.

22 Cf. *Päsler*, Handbuch des Investmentsparens, 1991, at p. 301.

23 *Päsler*, op. cit., at p. 269 ff.; cf. also *Laux/Päsler*, Wertpapier-Investmentfonds, 1992, at p. 45.

24 § 12 c (1) KAGG.

25 § 12 c (2) KAGG.

26 § 13 (4) KAGG.

27 § 14 KAGG.

28 § 12 (2) KAGG.

29 Cf. the references supra n. 3.

30 Detailed and early criticism in *G.H. Roth*, Das Treuhandmodell des Investmentrechts, 1972, at p. 156 ff.; see also *Thiel*, Der Schutz der Anleger von Wertpapierfonds im deutschen und amerikanischen Recht, 1982, passim, with further references.

31 § 12 c (1) (2); § 12 c (3); § 13 (1) KAGG.

32 Cf. supra footnotes 10-12.

33 § 1 (2) KAGG.

[34] For a detailed analysis of the development, assets and structure of ownership cf. Deutsche Bundesbank, Monatsbericht Oktober 1994, at p. 49 ff. and *Kandlbinder*, Zeitschrift für das gesamte Kreditwesen, 1994, at p. 786 ff.

[35] See also Bundesbank, supra n. 34, at p. 55 footnote 3.

[36] DPG Deutsche Performancemessungs-Gesellschaft für Wertpapierportfolios, Frankfurt/Main.

[37] Cf. supra at footnotes 10-12.

[38] By end of Nov., 1994, there were 540 German Publikumsfonds with some 200 bn DM assets as compared to 2,467 Spezialfonds with about 258 bn DM assets; cf. Deutsche Bundesbank, Kapitalmarktstatistik, Jan. 1995, at p. 52, 53.

[39] Cf. Bundesbank, supra n. 34, at p. 56.

[40] §§ 12 (1), 12 a (1) KAGG.

[41] § 400 HGB (Commercial Code).

[42] § 12 (1) KAGG.

[43] § 21 (2) KAGG.

[44] § 21 a (2) KAGG.

[45] § 12 c (1) KAGG.

[46] Cf. *Thiel*, supra n. 30, at p. 74 ff. with further references.

[47] Cf. *Sieper*, Zunehmender Einsatz von Fonds bei der Anlageberatung, Zeitschrift für das gesamte Kreditwesen 1994, at p. 367.

[48] § 15 (2) KAGG.

[49] § 15 (3) (e) KAGG.

[50] The model investment contract between the investment company and the investors sets out the maximum amount of the depositary bank’s fee as a of the fund's value at the end of each month, which is calculated by the bank itself; cf. *Päsler*, op. cit. (supra n. 22), at p. 279.

[51] §§ 10 (1), 12 (2) KAGG.

[52] § 12 c (2), 12 c (3) KAGG.

[53] § 12 c (2) (3) and § 12 c (3) (2) KAGG.

[54] Supra n. 43.

[55] 20%: A corporation has to inform the public about a holding of 20% or more in its annual report (since the beginning of 1995 holdings above 5% have to be disclosed); 25%: The merger control rules may apply; > 25%: the holding company has to give the other corporation due notice of its stake and can block changes of bylaws and other important decisions at general meetings; 50%: The combination may be subject to merger control: > 50%: The holding company

commands the majority of votes and can take all conclusions at general meetings except those which require a super-majority.

56 § 10 (1) (3) KAGG.

57 *Beckmann*, op. cit. (supra n. 13), 425 § 10, at p. 9 f. with further references; critical *Thiel*, op. cit. (supra n. 30), at p. 69 f.

58 In 1992, 58% of the shares (in 24 publicly held large corporations) that were held by investment companies and represented at the general meetings of these corporations were voted by the depositary banks; *Baums/Fraune*, Institutionelle Anleger und Publikumsgesellschaft. Eine empirische Untersuchung. Die Aktiengesellschaft 1995, at p. 97 (108).

59 Cf. n. 53.

60 For a detailed description and assessment see *Baums/v. Randow*, Shareholder Voting and Corporate Governance: The German Experience and a New Approach. Universität Osnabrück Working Paper 3/94; to be published in: Aoki (ed.), Corporate Governance in Transitional Economies, World Bank, Washington D.C. (1995).

61 § 135 (1) (2) AktG (Stock Corporation Act).

62 § 71 b AktG (Stock Corporation Act).

63 As compared to table 3 where only the voting rights of the big five are shown.

64 Cf. n. 62, supra.

65 *Baums/Fraune*, op. cit. (supra n. 58), 97 (107 pp) and tables 17 and 18.

66 Cf. table 3 column 4 (shares of all subsidiary funds) with the holdings of the subsidiary "Publikumsfonds" in figure 12.

67 Shares not represented by a credit institution or other proxy with explicit instructions would be voted by "voting mandataries"; cf. *Baums/v. Randow*, op. cit. (supra n. 60); cf. also the recent draft legislation of the Social Democratic Party, Bundestagsdrucksache 13/367.

68 Supra note (n. 67).