

Capitalising on crypto allocation in alternative investment funds

German Fund Location Act

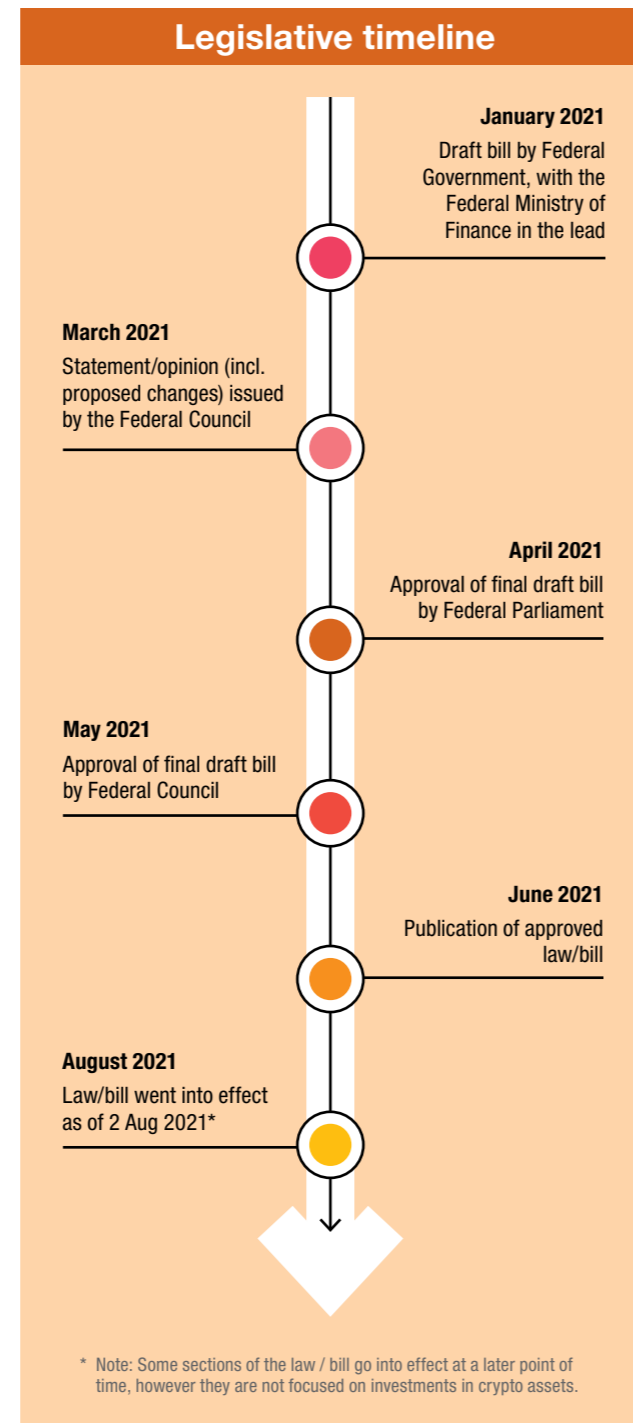


Regulatory changes allow funds to invest in crypto

The new Fund Location Act allows so-called German 'special funds' to allocate a significant part of their portfolios to crypto assets

Executive summary

- Since 2 August 2021 an approved regulatory change allows German domestic special funds ('Spezialfonds') to invest up to 20 % of their portfolios into crypto assets.
- The Fund Location Act ('Fondsstandortgesetz') by the Federal Ministry of Finance is relevant for all German domestic special funds offered by wealth and institutional investment fund managers.
- With a current Assets under Management (AuM) value of approx. EUR 3,200bn (27 % of the AuM of the EU), Germany is by far the biggest funds market within the EU¹. Given that the open-end domestic special funds represents an AuM of approx. EUR 1,900bn², this regulatory change impacts a large proportion of the existing AuM, and if all such funds allocated the full 20 % into crypto assets, approx. EUR 380bn would move into the crypto market.
- Allocating a proportion of a fund is a more straightforward way of offering clients exposure to crypto-assets compared to establishing custodial services and requisite ability to hold and trade crypto-assets on an individual basis.
- Offering these products can lead to a significant competitive advantage, especially given the market demand for clients and investors to gain exposure to crypto-assets, the relative ease with which they could do so, and the inherently diversified nature of such funds.
- Whilst there are operational complexities to including crypto-assets within funds, these are not unsurmountable in a relatively short timeframe, particularly when the fund issuer is willing to enter into a partnership with an established custodian of crypto-assets.



Main legislation impacted by the Fund Location Act

- German investment code ('KAGB', Kapitalanlagegesetzbuch)
- Income tax law ('EStG', Einkommensteuergesetz)
- Investment tax law ('InvStG', Investmentsteuergesetz)



Legislation FAQ

Q: Which legislation is changing?

A: The Fund Location Act introduces amendments to more than a dozen German laws, with the majority of changes applying to the German Investment Code ('KAGB').

Q: What exactly is a German special fund, to which the act applies?

A: A special fund is any financial investment management company not meeting the criteria as defined in the UCITS directive ('OGAW'). Special funds are less strictly regulated and allow investments in more types of assets (such as real estate, precious metals, etc.). However, only semi-professional and professional investors may invest.

Q: What is considered to be a semi-professional or professional investor?

A: These types of investors are defined in the German Investment Code ('KAGB'). Generally, semi-professional investors are required to invest at least EUR 200,000. Professional investors are typically large corporations, insurances, pensions funds and the like.

Q: How does Germany define crypto assets?

A: The German Banking Act ('KWG') defines crypto assets as a digital representation of a value that has not been emitted / issued by a central bank or a public authority/ institution (or guaranteed thereby), but is being accepted by natural or juristic persons as a medium / means of exchange, payment or investment (based on an agreement or practice) and can be electronically stored, transferred and exchanged.

Q: Are all crypto assets included by the act and are there any investment restrictions?

A: Generally all crypto-assets are included, provided that their current market value can be determined. However, the crypto-assets may only take up a maximum of 20 % of the special fund's value.

¹ www.bvi.de/ueber-die-branche/deutschland-groesster-fondsamt-der-eu/

² www.bvi.de/fileadmin/user_upload/Statistik/Investmentstatistik_2103_Gesamtmarkt_DE.pdf

Benefits of offering exposure to crypto assets for clients

Clients are increasingly demanding exposure to crypto-assets, and there is an opportunity to gain wallet share and first-mover advantage

Benefits

- **Competitive advantage:** First-mover advantage and potential USP; Easy way to offer crypto exposure without direct custodian management; Simple access to broad variety of new investment opportunities.
- **Strong returns:** As of 11 October 2021, the Bloomberg Galaxy Crypto Index (benchmark designed to measure the performance of the largest cryptocurrencies traded in USD) grew by 486.95 % over the past 12 months, against 24.25 % (S&P 500), 15.47 % (DAX) and -8.72 % (gold).
- **Diversification:** Typically, crypto assets do not strongly correlate to traditional asset classes (such as the stock markets or real estate) and are well-suited for diversification.
- **Portfolio management:** Portfolio allocation can be adjusted 24/7, as there are no market hours for most crypto assets.
- **Compliance:** Substantial progress in the regulatory environment, continuously eliminating related uncertainties.



Sizing the market opportunity for crypto

Significant amounts of wealth are moving into crypto-assets, as confidence in this burgeoning asset class grows

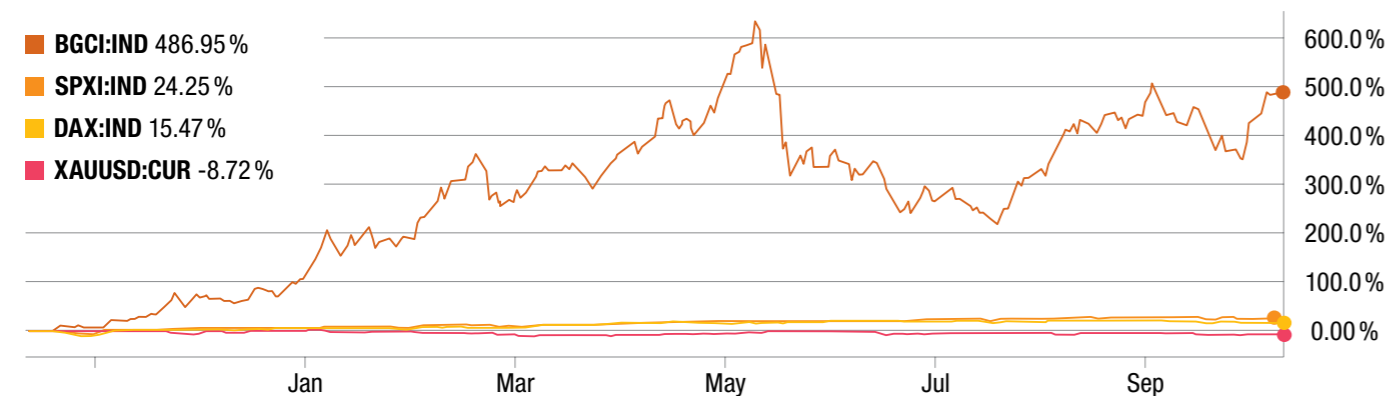
PwC insight

A joint report between PwC and the Alternative Investment Management Association (AIMA) on the global crypto hedge landscape demonstrates an increasingly mature crypto industry, increasing allocations of wealth, and substantial returns over previous years.

- **Total AuM:** AuM of global crypto hedge funds increased to USD 3.8bn in 2020 (from USD 2bn 2019)
- **Fund size:** Average AuM I 2020 increased from USD 12.8m in 2019 to USD 42.8m in 2020. The percentage of funds with an AuM over USD 20m increased to 46 % (from 35 % in 2019).
- **Investor type:** Vast majority of investors in crypto hedge funds are either high-net worth individuals (54 %) or family offices (30 %).
- **Performance:** The median crypto hedge fund returned +128 % in 2020 (vs +30 % in 2019).
- **Fees:** Average management fees were stable at 2.3 %, but average performance fees increased from 21.1 % to 22.5 %.
- **Allocation:** Most crypto hedge funds trade Bitcoin 'BTC' (92 %), followed by Ethereum 'ETH' (67 %), Litecoin 'LTC' (34 %), Chainlink 'LINK' (30 %), Polkadot 'DOT' (28 %) and Aave 'AAVE' (27 %).



BGCI:IND Bloomberg Galaxy Crypto Index **3,033.07 USD**



Source: <https://www.bloomberg.com/quote/BGCI:IND>, retrieved on 11 October 2021







Managing the business transformation

Offering crypto exposure via fund issuance is operationally less difficult than providing full custodial services, but requires careful implementation

Implementation considerations

Offering a fund, including an allocation to crypto-assets, can be achieved using a number of go-to-market strategies and/or partnering models. The right option for an organisation will depend on the crypto-maturity, risk appetite, existing skills and capabilities, as well as considering plans to offer services such as custody, payments or lending in future.

 Business strategy	What is the right 'go-to-market option'?
	What positioning is needed to perform now and in the future?
 Partnerships	Do we want to partner with an established crypto operator?
	What is the right partnering model?
	How do we select a suitable partner?
 Target Operating Model	What is the right Target Operating Model based on our go-to-market and approach to partnership?
 Crypto allocation	What is the right allocation for crypto-assets?
	What crypto-assets should be included within any allocation model? (incl. understanding of blockchain and digital assets)?
 Capabilities (technical and talent)	Do we have the right talent to serve our customers?
	Do we have the right talent to deliver and operate the new business?
	What infrastructure changes are required to meet the crypto opportunity?

PwC as the industry leader and a reliable partner for you

Our involvement within the industry and credentials from recent and current transformation programmes



Transformation and go-to-market

Unparalleled experience defining and delivering go-to-market strategies and supporting the business transformation of high profile clients



Industry expertise

Expertise and proven blockchain track record across industries at your disposal. We have advised clients in financial services, retail, energy, real estate and more



Technology know-how

State-of-the-art platforms developed in-house for blockchain, incl. forensics and assurance

- Blockchain Facts, a fundamental data aggregation solution
- Crypto Audit tool, an application to facilitate auditing of crypto assets



Incubators

A partner or founding member of the top incubators that have kickstarted nearly 100 blockchain start-ups so far in the Swiss Crypto Valley, including **Trust Square, Crypto Valley Labs, F10** and **Chainwork**



Partnerships and memberships

Partnered and delivered projects with the leading financial services private blockchain consortiums

- R3 and Hyperledger membership
- Digital Asset Holdings partnership

Also co-founded the **Crypto Valley Association** in 2017:

- Strategic partnership with Blockchain [X]
- Contributor to the Capital Markets and Technology Association



Blockchain audit/assurance

Well positioned to increase trust in the blockchain ecosystem by providing audit and other assurance services. We provide such services to crypto custodians, private banks and ICOs, such as:

- Tezos
- Swiss Crypto Vault
- Custodigit
- SEBA Bank
- Swissquote



Selected credentials



Building a global payment network

Supported a high-profile, global payment network in developing their go-to-market, target operating model, and building their operations in their pursuit of a FINMA application and subsequent pivot to the US



Growing Switzerland's largest cryptocurrency custody provider

Partnering the most well-established crypto-custodian in Switzerland to build its banking operations and products, support its international expansion and enhance its risk, compliance and operational resilience



Licensing The World's First Crypto Bank

Enabled a first-mover crypto bank to be awarded a banking and securities licence from FINMA, a significant milestone towards the institutionalisation of the digital asset economy



Your contacts at PwC

We would be happy to support you in understanding and benefiting from these regulatory changes and the crypto-related transformation



Patrick Akiki
Partner
+41 79 708 11 07
akiki.patrick@pwc.ch

- Patrick is the Financial Services Management Consulting Lead at PwC in Switzerland
- Global relationship partner for high-profile crypto payment networks
- Extensive experience working with GSIBs and Insurance/Re-Insurance companies in New York, Switzerland, London and France on transformation projects
- Spent more than 4 years working at PwC's offices in New York supporting our global clients, mainly regarding risk, regulatory and technology projects



Mark Hussey
Director
+41 79 549 07 59
mark.hussey@pwc.ch

- Director Financial Services Consulting specialising in digital transformation
- Coin, token and DLT lead, having supported crypto companies throughout their strategic definition, go-to-market approach and implementing the core aspects of operations
- Experienced in defining target operating models – both at an organisational level (crypto payment network) and functional level
- Seasoned project manager, having led multiple business transformation programmes with a focus on IB