

# Integration and competitiveness of the EU fund market



## Wolf Klinz

MEP, Committee on Economic and Monetary Affairs,  
European Parliament

### Increasing the competitiveness of the EU investment fund market

Europe has significantly more investment funds than the United States of America. However, these funds are smaller and as a result more expensive and less competitive than their American competitors. What is more, the EU investment fund market is still predominantly organised as a national market: 70 % of all assets under management are held by investment funds registered for sale only in their domestic market. Only 37 % of UCITS and about 3 % of AIFs are registered for sale in more than three Member States.

The new legislative measures on facilitating the cross-border distribution of collective investment funds will significantly improve the integration and competitiveness of the EU fund sector. They will reduce fragmentation in the financial market in the EU and therefore improve its shock absorbing capacity through more private risk sharing.

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*"The EU needs to do more to fully integrate its capital markets into a single European capital market. The lack of such is not only hampering growth prospects for EU companies, it also falls short of cushioning shocks in case of crisis."*

- WOLF KLINZ

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Key areas identified for action included procedures for meeting marketing requirements by national authorities, transparency on fees set by such authorities, the possibility to 'pre-market' across borders alternative investment funds, and the possibility to denotify marketing activities for AIFs and UCITS.

A key new provision quickly agreed on was to prohibit Member States from requiring a physical presence on their territory of such funds intending to market there. When



>>> it comes to pre-marketing, the European institutions managed to agree on a targeted approach by focusing on the main political goal: to make pre-marketing possible but keep reverse solicitation from happening. This was achieved, while simplifying the conditions for pre-marketing and limiting the administrative burden for the investment undertakings.

Concerning the provisions on the possibility for AIFMs and UCITS managers to cease marketing a fund, which has previously been active in a particular host Member, we were also able to achieve significant simplifications. The continuation of marketing will no longer be mandatory if it is not economically sensible from the point of view of the investment undertaking. At the same time it has been ensured that the investors remain very well protected. They will be offered a repurchase offer free of any charges and if they choose to remain invested, the financial undertaking must continue to fulfil the disclosure and reporting requirements as laid down in Union law.

The cooperation among the political groups and the European institutions was excellent throughout the legislative process. The European Parliament would have preferred to achieve more on limiting the fees supervisory authorities can charge, in particular in host Member States, in relation to the ending of cross border activities of fund managers by ensuring that those fees are consistent with the actual costs incurred by the competent authorities. Nevertheless, thanks to the agreed reforms, investors will be able to profit from strengthened investor protections clauses, reduced fees, and better access to more and larger funds.

From the point of view of the European Parliament, additional action is still needed when it comes to the pre-marketing of UCITS, by introducing as soon as possible the same conditions for UCITS as now agreed for AIFs. However, the job is not finished there. The EU needs to do more to fully integrate its capital markets into a single European capital market. The lack of such is not only hampering growth prospects for EU companies, it also falls short of cushioning shocks in case of crisis.

In contrast to the United States where almost 75 % of shocks are absorbed by private risk sharing due to more integrated capital markets, only 20 % of such shocks can be smoothed through cross-border risk sharing in the EU. Hence, the need for the use of taxpayer's money from public budgets in case of crisis is much higher in the EU. We therefore need to redouble our effort to build the functioning Capital Markets Union across the EU-27. And we must ensure our priorities evolve in tandem with political, economic and technological developments. ●



## Felicia Stanescu

Head of Policy Definition and Coordination,  
DG for Financial Stability, Financial Services  
and Capital Markets Union,  
European Commission

### Regulatory developments in the EU fund sector

A well-functioning internal market for investment funds is an integral part of a CMU. The growth of the European asset management sector has been significant over the last years reaching a total of € 9.7 trillion of AUM in UCITS and over € 4.9 trillion in alternative investment funds. Looking ahead, despite being increasingly organised on a pan-European basis the EU fund industry continues to face challenges in terms of integration and

competitiveness, including fragmentation, transparency and fees.

Almost half of all UCITS funds are offered only in the Member States where they are based and more than 90% of all AIFs are only offered in one Member State. The bulk of the cross-border supply of funds are directed to Member States with large markets to the detriment of investors in smaller Member States. This has negative implications on the choice for investors, competition, level of fees and net returns. The EU investment fund sector remains highly fragmented, and EU funds tend on average to be smaller in size than their US peers.

Transparency is an essential component for a more efficient EU asset management industry. Pre-contractual disclosure requirements and reporting to investors tend to increase transparency at every level for products and distributors. Getting a broader picture of the performance and cost of retail >>>

>>> investment contributes to better interpretation of the product information and facilitates investment decision. And it increases competitive pressure so that investors are offered the products that best fit their needs.

The proposal on the cross-border distribution of collective investment funds presented by the Commission, and recently agreed at political level by the European Parliament and the Council, aims to reduce differences across Member States, increase transparency, reduce costs for funds and improve cross-border functioning of the market.

The Commission has also started its review of AIFMD. The review is seeking to identify areas for potential improvements, and if warranted, propose legislative amendments. At this stage, the

Commission collects and analyses empirical evidence and will decide on launching a public consultation in the coming months.

*"Commission is a consistent advocate of policy actions to improve the operation of EU funds sector."*

- FELICIA STANESCU

This will be an important and complex policy work, and while it is premature to comment on the scope or precise timing of the evaluation, the Commission services will continue to openly and constructively engage with the stakeholders.

The Commission is a consistent advocate of policy actions to improve the operation of EU funds sector. Important EU financial services legislation has already been put in place. Some important initiatives, like a Proposal for a cross-border distribution of funds, a Proposal for a pan-European personal pension product (PEPP) and Sustainable Finance proposals - are well-advanced. The Commission will continue to execute its CMU-related actions and remains true to its mandate of promoting a single market for investment funds and ensuring fair, well-informed and transparent outcomes for investors. ●

Contributors: Ivan Kuznetsov and other colleagues of the Asset Management Unit of DG FISMA



## Jarkko Syyrilä

Head of Public Affairs, Nordea Asset and Wealth Management

### Stability of the EU regulatory framework is key for global competitiveness

The European asset management industry has seen a remarkable growth since the financial crisis. According to EFAMA statistics, the total assets under management in investment funds and discretionary mandates grew from EUR 10.8 trillion at the bottom of the crisis in 2008 to a record high of EUR 25.2 trillion in 2017. This is a strong sign of investors' trust in our industry.

A strong regulatory framework built especially around the 1985 UCITS Directive and its' later amendments has been a key cornerstone for the success of UCITS becoming the global gold-standard for investment funds. European asset managers compete strongly in the global market with the UCITS fund as a flagship product of the export capability of European financial services.

Since the financial crisis many EU regulatory measures have been adopted impacting also indirectly asset managers, most prominently MiFID II which is having key impact on distribution models and where the jury is still out on the long-term effects. Same goes for much of the EU legislation across all financial services, it is quite new, and needs time to take effect and markets to adapt before we can see its real impact.

For the new EU Commission and Parliament agenda there is no need for a regulatory overhaul in asset management. The most important regulatory measure needed for the competitiveness of the European asset management industry now is stability of the regulatory framework. The key safeguards to protect investors and integrity of the markets are in place. The vast amount of recent regulation needs time to bed down and careful assessment of the impacts. Targeted adjustments can be done, but mostly the way forward should be using tools of supervisory convergence coordinated by ESMA to achieve even better integration of the European fund market. Accordingly, the planned reviews of the UCITS and AIFMD should be evidence-based, carefully targeted and

aimed only at addressing material issues that cannot otherwise be addressed through supervisory convergence or Level 2 regulatory harmonisation.

PRIPs was meant to provide a key information document for retail investors on all savings products whether a securities/ banking/ insurance product, but is largely considered a failure by both the industry and consumer bodies. Performance scenarios and transaction cost calculations are misleading to clients. The new Commission together with the ESAs will need to review the PRIPs regulation thoroughly. It should not be extended to UCITS funds before the problems have been fixed. The PRIPs regulation as it stands is a reputational risk for the whole industry.

*"The vast amount of recent regulation needs time to bed down and careful assessment of the impacts."*

- JARKKO SYRILÄ

Key focus area in the new Commission's mandate will certainly continue to be sustainable finance regulation. Nordea Asset Management has already for many years had a strong emphasis on ESG and we are fully prepared to play our part and serving our customers when regulatory change brings sustainable finance more and more to the mainstream of asset management. ●



## Dennis Gepp

Senior Vice President, Managing Director and Chief Investment Officer, Cash, Federated Investors (UK) LLP

### How should Brexit impact the competitiveness of the EU fund sector?

Hard Brexit, Soft Brexit, Delayed Brexit, No Brexit; the one thing that will remain a constant after 29 March 2019 is that the global financial markets will continue to evolve and a significant role remains to be played by both the United Kingdom and the remaining 27 members of the European Union to ensure that the EU fund industry remains the global

standard. Despite over two years trying to work towards a sensible and workable result, much uncertainty remains in the EU Financial Services sector with respect to Brexit. There has been progress. MoUs have been agreed and temporary permissions regimes put in place – but is it enough? The powers that be in both the UK and EU need to embrace that the model for providing best-in-class financial products in the most cost-effective manner to benefit all European Investors remains a model where there is a free flow of knowledge, services, and funds between the UK and the EU post Brexit. France, Ireland and Luxembourg are without question the leading fund domiciles in Europe. Also, without question is the fact that the UK is the leading domicile for portfolio management and that other EU jurisdictions have taken the lead in servicing the funds industry.

The current EU model of funds domiciled in one jurisdiction, serviced in another and managed in yet another has developed over many years and has made the EU Funds industry the global standard. It encourages the selection of the best of the best regardless of geographic constraints. That standard is under a constant barrage of attacks by regulatory proposals aimed specifically at imposing enhanced restrictions on UK fund managers from providing their services to EU funds, when everyone either knows or should know that the financial services regulatory framework in the UK is equivalent in every way and will continue to be so post-Brexit. Under the fiction of ensuring that there is no extreme regulatory divergence post-Brexit, increased substance demands for

entities operating in the financial services sector have been put in place; potential restrictions on delegations are being put in place, and even individual NCAs are being subjected to enhanced regulatory scrutiny. The net effect of relentless regulatory initiatives (not designed with investor protection in-mind) is that the costs, needlessly redundant costs, of providing a diverse range of world class investment management products in Europe continues to rise, and in a global environment where spreads between products is narrowing, this is not a trajectory that will end well for investors in Europe who want access to a wide range of products, managed by the best portfolio managers, at a globally competitive price.

*“Without question is the fact that the UK is the leading domicile for portfolio management.”*

- DENNIS GEPP

Certainly, the EU will need to monitor the UK financial regulatory framework to ensure it remains equivalent – but the Day 1 assumption, without question, needs to be IT IS, just as similar determinations have been made for many other third-country regulatory regimes. Monitoring, post-Brexit, to ensure equivalence is very different than operating under an ill-advised assumption that the regulatory frameworks will materially diverge, and to further assume that any future variance is material. ●

## Jean-Paul Servais

Chairman, Financial Services and Markets Authority, Belgium (FSMA)

### The integration of the EU fund sector: going the extra mile

Fostering the participation of retail investors in EU capital markets is a key theme of the Capital Markets Union (CMU).

Recent EU policy initiatives have aimed at closely integrating the EU fund sector. Cross-border distribution should

eliminate unjustified (regulatory) barriers in order to support fund managers in engaging more in cross-border distribution of their funds. The PRIIPs Regulation should improve the quality and comparability of information on the key features of investment (in particular on risk, performance and costs). The PEPP should establish a single market for personal pensions, allowing for the creation of pan-European personal pension products and enhancing the portability of such products.

The EU policy initiatives have delivered positive results in terms of the integration and competitiveness of the EU fund sector. Taking the example of the Belgian fund market, the number of foreign EU funds offered to the >>>





>>> Belgian retail investor has more than doubled since the financial crisis. For every Belgian fund, 5 foreign EU funds are now being offered to the public.

Further improving integration and competitiveness will first require adjustments to recent policy initiatives so as to improve their efficiency. For example, and with regard to PRIIPs, we are hopeful that the amendments of the level 2 legislation will lead to the publication of Key Information Documents that really permit a comparison among products. In order to improve the rules in credible way, it is important to take sufficient time to prepare the amendments thoroughly, given the technicality of the issues to be addressed and the need for consumer testing.

The remaining global challenges, however, go beyond transnational integration. EU policy initiatives should focus on the “last mile”, the final leg of the distribution phase that delivers the fund to retail end-users. For example, the closed architecture of distribution and intermediation channels could be a barrier to integration and competitiveness.

On the path towards integration, we should not forget to put the interest of the consumer at the forefront. The “one size fits all” approach has its limits when it comes to distributing products to consumers. We have to strike a balance between transnational integration and more diversified approaches to investors.

*“On the path towards integration, we should not forget to put the interest of the consumer at the forefront.”*

- JEAN-PAUL SERVAIS

In fact, retail investor participation is built on confidence and protection. More specifically, for investors a “good” product means, inter alia, that clear information is given to investors and that the target group understands and can accept the characteristics and risks of the products. For the supervision of these items, proximity of the supervisor constitutes an advantage.

Ex-ante supervision of distribution can substantially improve consumer confidence in products and increase their participation in long-term investment. To this end, it is key for the host NCA to be able to acquire all necessary information and intervene promptly to ensure consumer protection. The Belgian

experience since the financial crisis shows that the supervision of the product distribution played a key role in restoring trust in financial products. ●



## Frédéric Bompaire

Head of Public Affairs, Finance and Strategy, Amundi Asset Management

### Competition and competitiveness for the benefit of investors

The first competition for funds is to be found in the possibility for an investor to either run his money directly or delegate it through a mandate or via a fund. The key factors for promoting funds relate to the collective character of funds that allows cost sharing and economies of scale and enables to seize investment opportunities not directly accessible for smaller portfolios. Funds are very attractive also as they transfer the burden of accounting on the fund's administrator with the investor booking one single entry from the subscription to the redemption of the fund. Most important is the opportunity to benefit from the expertise of professional asset and risk managers that take investment decisions and monitor risk for the best interest of the end investors.

Several criteria evidence the highly competitive environment of the fund industry in Europe. First, the number of management companies. Each year the number of new creations and withdrawals proves that free access to the activity is

granted: it is one pillar of the definition of a free competitive world. It is important to keep this fluidity whilst ensuring investors' protection and requiring that management companies have an appropriate internal organization and sufficient resources. Second, the number of funds in Europe shows an extensive choice is available for investors. On the one hand it guarantees that there is no substitutability issue in the fund industry, but on the other hand it limits economies of scale for units' holders. Third, the trend towards lower management fees that is apparent in the EU over the last years is another indication of competition among asset managers.

*“Several criteria evidence the highly competitive environment of the fund industry in Europe.”*

- FRÉDÉRIC BOMPAIRE

Conversely, impediments reduce the competition and, hence, the competitiveness of the industry to the detriment of investors. We shall mention three examples. Retail distribution is not unified in the EU. We do not argue against the power of National Competent Authorities to supervise all documentation aimed at retail clients. We understand the requirement that it should be translated in the national language as a prerequisite for local distribution. However, we feel less comfortable when NCAs ask for information that is not foreseen in the UCITS and AIFMD directives or when they do not interpret them in the same manner; for example, the calculation of market exposure with the commitment methodology under UCITS Directive is not similar in all EU Member States. The second example is tax. Tax is a national prerogative, but when it creates an obligation for fund managers to calculate specific coupon rate for the holders of one Member State it could amount to anti-competitive manoeuvres. The last example is about comparability. The EU regulation considers transparency as a key factor for the development of competition. However, when we look at costs it is misleading to compare data: some funds will show a very low level of fees but those will not include the distribution costs that the investor will pay in some other way; the same applies with transaction costs that can be negative under the PRIIPs calculation methodology and that are meaningless if not linked to the turnover and the performance of the fund. ●