The Single Market for Investment Funds:
Market Integration and the „End User" Perspective

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1. Do we have an integrated market for investment funds?

In an integrated single market for investment funds:

- only quality, brand, service, performance etc would guide investors' decisions when buying funds, but not the domicile.
- fund production would be organised in a pan European style. Each part of the value chain would be located by the fund manager where the best conditions prevail – regardless of where the point of distribution or the domicile of the management company is.

We should not underestimate the progress that has been achieved under the EU Investment Directive. We have an effective mechanism of passporting and mutual recognition of EU funds. We do count more than 20,000 cross-border registrations of UCITS. In more than half of the EU member countries the number of registered foreign UCITS exceeds the number of domestic funds.

However it appears that – despite these achievements - the market is rather fragmented than integrated.

- The ratio of fund assets placed cross-border is estimated to be 10 – 15 %, the ratio of new saving inflows into cross-border funds to be 20 – 25 % annually. Effective flows do not go in cross-border registered funds.
- 30,000 funds indicate that economies of scale and scope are not yet exploited.

Does the consumer benefit from the single market for investment funds?

Market integration is not a purpose in itself but a means to generate more benefits for consumers, in particular:

- more choice
- value (better overall returns on the money invested)
- lower fees

Due to the lack of market integration, it is questionable whether significant additional benefits for the customer have already been achieved.

Certainly the large number of cross-border fund registrations has increased choice. "Value for money" requires more than choice – namely that the customer is competent to select products that fit to his needs and perform better than others. It is not easy to measure whether this is the case or not. There are indications, however, that quality of product choice remains moderate. Lack of market transparency (in the sense of true comparability of products and predictability of returns) and qualified investment advice may be the main reasons for this.

Fund fees show no downward trend. The single market has not yet delivered efficiency gains in production; moreover the increase of fund registrations has increased the competition for place in distributors' shelves, a factor that forces fund managers to raise the level of retrocessions passed to the distribution side.

What are the main impediments for true market integration?

The large number of cross border registrations taking place indicates that the main progress is not to be expected in this area. Obviously we have to take a closer look at the way products are marketed, in particular transparency and advice, and the way the manufacturing is organised.

However also cultural factors, trust and familiarity create a "home bias" in customer choice and make integration slower than it could be. These "natural barriers" have, of course, to be respected. In practice it is difficult to clearly distinguish between the cultural bias and lack of quality in the marketing process.

What has to be done?

There is no reason to underestimate the progress achieved so far. The robust registration mechanism should be regarded as an "asset". However, in order to reach a significant degree of market integration, a determined further step is required over the next years.

I would define four areas where work has to be done (regardless whether this may be UCITS or beyond UCITS):

1. Further streamlining of the fund registration mechanism.

Cross-border fund registrations remain the backbone of the single market for investment funds. Although the process works, further improvements are attainable. The most imperative step is to realize a single registration – in other words, a home country passport for a management company should mean that no further product passport or product registrations in host countries are required.

2. Extension of the area of harmonized product

The ambition should be that all retail product types in Europe can be marketed cross-border within the UCITS framework. Despite the broader definition of products and instruments under UCITS III, this is currently not the case. Important products that are not covered today are e.g. real estate funds and (funds of) hedge funds. It appears that the product definition of UCITS has to be reconsidered in order to get more flexibility to adopt additional product types.

3. Improving the efficiency of product manufacturing

The single market so far has not led to significant efficiency gains. The European market place still seems fragmented. Of course, efficiency gains should be created by the market forces. However, the regulatory framework should encourage this process and take away any hurdles that might exist for competition to work. The possibility for cross-border sourcing of back-office and depositary services is one example for this. Pooling techniques to facilitate a more efficient management of assets of different vehicles is another one. The possibility to merge funds cross-border is a third one.

4. Facilitate customer choice

UCITS require high disclosure standards for products, including the Total Expense Ratio (TER) which is part of the simplified prospectus. However, transparency (of products) does not necessarily mean comparability (across products). In this area there is still much room for improvement, in particular comparison of product performance and quality of advice. The approach under MiFiD to define standards and requirements for good advice is welcomed by the fund industry. Transparency standards is an area where the industry and service providers are called to work.

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