INVESTMENT COMPANY INSTITUTE

The Asset Management Industry SERVING INDIVIDUAL INVESTORS

ICI VIEWPOINTS

June 8, 2023

Cost Benchmarks in the EU's Retail Investment Strategy Will Stifle Innovation

Cost Benchmarks in the EU's Retail Investment Strategy Will Stifle Innovation

A look at the EU's Retail Investment Strategy

By Matthew Mohlenkamp and James Duvall
The recently released EU Retail Investment Strategy (RIS) aims to advance the Capital Markets Union (CMU) and empower retail investor participation in the capital markets, including through UCITS and similar products, with a package of proposed legislative changes. ICI Global strongly supports efforts to open opportunities for investors to benefit from capital market investment returns, and any new legislation must be grounded in a firm understanding of the facts so that the resulting reforms empower retail investors.

Unfortunately, the European Commission's proposed legislation regarding "value for money" includes a mandate that the European Supervisory Authorities construct cost benchmarks against which approximately 30,000 UCITS would need to be evaluated. Any deviation from the relevant benchmark would introduce a presumption that costs and charges are too high and require a manager to suspend new subscriptions until they have justified the cost deviation.

This cost benchmark is bad policy. Cost benchmarks will reduce product diversity and stifle future innovation, leading to negative consequences for European investors.

For example, in a previous *Research Perspective* ICI highlighted the empirical evidence that average ongoing charges for UCITS have already been falling steadily since 2013. In 2021, the average ongoing charge for equity UCITS had decreased 19 percent from its level in 2013, and the average ongoing charge for fixed-income UCITS was 31 percent lower. These changes are mainly attributable to assets shifting to lower-cost funds, lower-cost funds entering the market, and higher-cost funds exiting the market.

Figure 1: Average Ongoing Charges for UCITS Have Decreased
Percent

Note: Data include both actively managed and index-tracking UCITS funds. Data exclude exchange-traded funds.

Source: Investment Company Institute calculations of Morningstar Direct data. See *ICI Research Perspective*, "Ongoing Charges for UCITS in the European Union, 2021."

In 2021, the simple average ongoing charge for all equity UCITS was 1.42 percent, compared with an asset-weighted average of 1.21 percent. The simple average ongoing charge, which measures the average ongoing charge of all UCITS offered for sale, can overstate what investors actually paid because it fails to reflect the fact that investors have grown increasingly aware of the costs they pay to invest in UCITS, and net assets have therefore become more concentrated in lower-cost funds over time.

Another vital benefit of retail investors' access to a wide variety of UCITS is the range of diversification opportunities available—and it is important to note that UCITS' ongoing charges differ based on their investment objectives. For example, fixed-income funds tend to have lower ongoing charges than equity funds, and sector-specific or small-cap equity funds tend to have higher ongoing charges than large-cap equity funds. These differences are natural and can reflect the higher costs needed to effectively manage certain types of investments, and spreading assets among a range of different markets or strategies is an important part of building a diversified portfolio. Variations within investment objectives can also be affected by fund size because larger funds are able to distribute their fixed costs over a wider base of assets.

Figure 2: UCITS Ongoing Charges Vary Across Investment Objectives
Percent, 2021

*Mixed funds invest in a combination of equity and fixed-income securities.

Note: Each share class is weighted equally for the median, 10th, and 90th percentiles. Data exclude exchange-traded funds.

Source: Investment Company Institute calculations of Morningstar Direct data. See *ICI Research Perspective*, "Ongoing Charges for UCITS in the European Union, 2021."

A Holistic Approach to Value for Money Is Needed

Cost is only one element of any assessment of value, which also includes factors such as investment performance, diversification, the investment objectives of the retail investor, and the services provided to the investor. The cost itself is the result of many factors that affect a fund's ongoing charge, including the fund's investment strategy, asset class, and geographic focus.

Given these nuances, it would be extremely difficult to construct adequately granular and fully representative benchmarks across the full range of potential funds, strategies, and investor preferences. Any such benchmark would be a blunt tool that instead limits choice and innovation.

ICI Global supports transparency on costs and charges, including by distributors, and we welcome a dialogue on transparency through the RIS. As EU policymakers move forward with consideration of the RIS, they must ensure that any proposals can be implemented in a way that is fair, balanced, and proportionate, and which improves rather than impairs the experiences and choices for retail investors.