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Ongoing Charges for UCITS in the European Union

KEY FINDINGS

- » **Average ongoing charges for equity and fixed-income UCITS have declined since 2013.** In 2018, average ongoing charges for equity UCITS were 1.29 percent, down from 1.49 percent in 2013. Average ongoing charges for fixed-income UCITS declined to 0.79 percent in 2018 from 0.98 percent in 2013. Average ongoing charges for mixed UCITS have remained relatively stable—1.43 percent in 2018 compared with 1.45 percent in 2013.
- » **Investors tend to concentrate their assets in lower-cost UCITS.** In 2018, the simple average ongoing charge for all equity UCITS was 1.51 percent compared with an asset-weighted average of 1.29 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 that investors tend to concentrate their holdings in lower-cost funds.
- » **Retail investors still pay for the cost of distribution even when it is not included in the total ongoing charge.** Direct comparisons of average ongoing charges between UCITS share classes that “bundle” distribution in the ongoing charge with those that “unbundle” distribution from the ongoing charge can be misleading. In unbundled share classes, retail investors typically pay distribution costs directly out of pocket.
- » **Average ongoing charges for actively managed and index tracking equity UCITS have fallen since 2013.** In 2018, the average ongoing charge of actively managed equity UCITS fell to 1.39 percent, down from 1.56 percent in 2013. Average index tracking equity ongoing charges declined to 0.28 percent in 2018 from 0.40 percent in 2013.
- » **Cross-border UCITS provide European investors with a much larger range of investment options, but such funds often incur additional marketing or registration costs.** In 2018, the average estimated fixed cost for cross-border equity funds was 22 percent of the total ongoing charge compared with 15 percent for single country funds.

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The following methodology, unless otherwise specified, apply to all data in this report: (1) UCITS that invest primarily in other funds are excluded from the data to avoid double counting, (2) UCITS not domiciled in the European Union, in addition to the United Kingdom and the Netherlands, are excluded, (3) UCITS primarily intended for sale in the United Kingdom and the Netherlands are excluded from data for ongoing charges, and (4) euros and percentages may not add to the totals presented because of rounding. In addition, for simplicity, this report will sometimes use *funds* to refer to collective investment schemes established and authorized under the UCITS framework.

Introduction

The UCITS¹ Directive has become a global success story since it was first adopted in 1985. Although down from 2017 as stock markets around the world weakened, net assets in UCITS domiciled in the European Union were €8.7 trillion at year-end 2018 (Figure 1).² Investments in these funds are held by investors from Europe and other jurisdictions worldwide.³

UCITS provide many important advantages to European investors, including professional management services, access to global markets, the benefit of regulation and supervisory oversight, and access to a wide array of investment options via "passporting." For example, investors in equity UCITS had access to more than 110 different investment objectives with €3.2 trillion in net assets at year-end 2018.

UCITS investors incur ongoing charges that cover a host of services, including portfolio management, administration, compliance costs, accounting

services, legal costs, and payments to distributors.

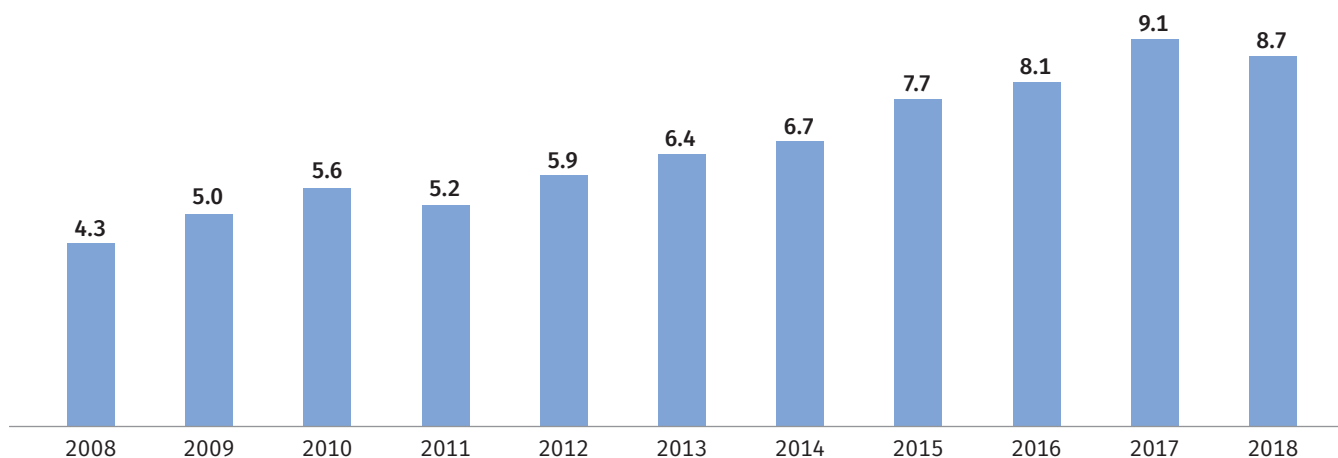
The total cost of these charges is disclosed to investors through either the total expense ratio (TER), often found in a UCITS' annual report and other marketing documents, or the ongoing charges figure (OCF), found in the Key Investor Information Document (KIID). Ongoing charges among UCITS vary, and these differences depend on a variety of factors. Because ongoing charges are paid from fund assets, investors pay for the investment-related services associated with them indirectly.

The way in which fund costs are disclosed to investors has changed as regulation, industry practice, and the distribution landscape have evolved.⁴ This report describes historic and current approaches to the disclosure of costs and charges by UCITS and the recent trend in average ongoing charges paid by investors.

FIGURE 1

Net Assets of UCITS in the European Union Were €8.7 Trillion in 2018

Trillions of euros, year-end



Note: Data include UCITS domiciled in the United Kingdom and the Netherlands (representing 13 percent of net assets at year-end 2018). Data also include exchange-traded funds and UCITS that invest primarily in other funds.

Source: European Fund and Asset Management Association (EFAMA) 2019a

Evolution of UCITS Cost Disclosure

Regulatory requirements for disclosure of UCITS costs and charges have evolved through successive iterations of the UCITS Directive. And with each new iteration, regulators continue to take a close look at fee disclosure in an effort to provide investors with the most relevant information on the ongoing charges and one-off costs they might incur.⁵

In 1985, the original UCITS Directive⁶ did not prescribe an EU-wide approach to disclosing costs and charges. Instead, it required regulation or fund rules set by individual Member States to outline the remuneration and the expenditure that a management company is allowed to charge and the method of calculation of such remuneration.⁷ Approaches at the time typically required disclosure in marketing materials of some form of annual management charge (AMC), generally representing the cost of investment management services, such as staff salaries, payments for research conducted by third parties, and payments to distributors for their services (Figure 2).

In 2002, the UCITS III Directive⁸ introduced a requirement to provide investors with a simplified prospectus before subscription. UCITS III required that the simplified prospectus contain a breakdown of certain costs and charges, distinguishing between those paid for by investors and those paid for by the fund or management company.⁹

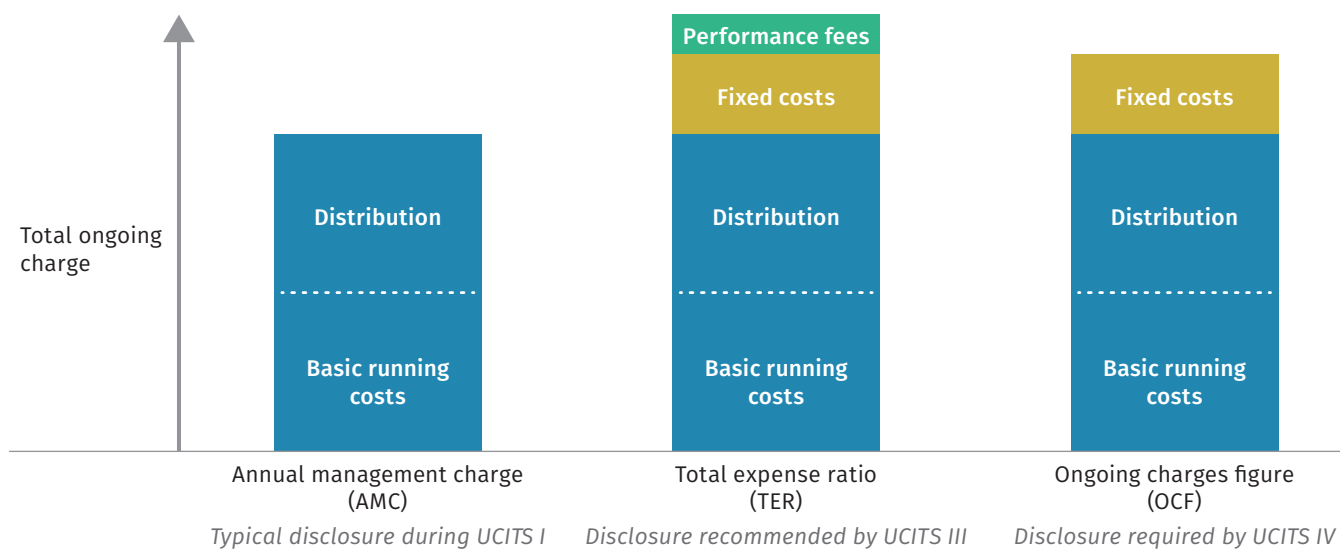
In 2004, the European Commission recommended that the TER¹⁰ should be included in the simplified prospectus as an indicator of a UCITS' total operating costs. In addition to management fees, the TER includes a number of fixed costs incurred by the fund. Depositary fees, legal fees, transfer agent fees, and audit fees, among others, represent a few of the fixed costs borne by the fund. Additionally, the TER includes any performance-related fees when the fund outperforms certain benchmarks (Figure 2).¹¹ At the same time, the European Commission also recommended the disclosure of other costs such as transaction costs and entry or exit costs, when deemed available by the fund's home regulator, and the existence of fee-sharing agreements and soft commissions.¹²

In 2009, the UCITS IV Directive¹³ replaced the simplified prospectus with a requirement to provide investors with the KIID, before subscription. UCITS IV required the disclosure of an OCF in the KIID, representing all annual charges and other payments taken from the assets of the UCITS over the defined period, based on the figures from the preceding year.¹⁴ To support the implementation of UCITS IV, the Committee of European Securities Regulators (CESR) produced guidelines on the calculation methodology for the OCF and the approach to transitioning from the simplified prospectus to the KIID.¹⁵ The OCF includes nearly the same costs found in the TER—the explicit exclusion of performance fees is the main exception (Figure 2).

Most recently, two other regulatory changes have been introduced that affect how UCITS costs and charges are disclosed. One is the recast Markets in Financial Instruments Directive (MiFID II), which had an implementation date of January 3, 2018. The other is the Packaged Retail and Insurance-Based Investment Products (PRIIPS) regulation that will replace the UCITS KIID with a Key Information Document (KID) beginning December 31, 2021.¹⁶

MiFID II requires distributors of UCITS to provide retail and institutional investors with ex-ante and ex-post disclosures on costs and charges. Ex-ante disclosures are provided to clients before they invest and represent

FIGURE 2
Elements of Ongoing Charges Incurred for Investing in UCITS



Descriptions of costs

basic running costs. Fees that include staff salaries, research costs, and other similar essential operating costs.

distribution. Fees paid by the fund to the distributor for their services, sometimes referred to as *trailer fees* or *retrocessions*. Some EU countries prohibit such fees for new/existing subscriptions.

fixed costs. Fees relatively fixed in euro terms—includes fees such as administrator fees, depositary fees, audit fees, transfer agent fees, legal fees, and regulatory fees.

performance fees. Fees related to fund performance that are explicitly *included* in the TER, but explicitly *excluded* from the OCF.

Source: Investment Company Institute

the costs and charges that investors can expect to pay. Personalized ex-post disclosures are provided annually to investors and detail the costs and charges paid on their investments in the past year. Ex-ante and ex-post disclosures for UCITS include one-off charges (e.g., entry and exit costs), ongoing charges, transaction costs, and incidental costs (e.g., performance fees).¹⁷

The PRIIPS regulation will require UCITS to provide retail investors with the KID,¹⁸ which is different from the KIID required by UCITS IV. The European Commission is reviewing the application of the PRIIPS KID to UCITS.¹⁹ With regard to the costs and charges disclosure requirement, the primary difference between the two documents is that the KID requires transaction costs to be explicitly stated.

Other Costs Investors May Pay for Investing in UCITS

Outside of ongoing charges, investors may pay one-off costs—entry, exit, and switching costs—when purchasing or selling shares or units of a UCITS.²⁰ One-off costs are calculated as a percentage of the sales or offering price of a fund share class and taken directly from the investment amount. Investors also indirectly pay transaction costs, which the fund may naturally incur when it trades its underlying assets.²¹

Entry costs are paid by investors at the time of share purchase (or on subsequent share purchases) to compensate financial professionals for assistance. These costs are reported as some maximum value, as advisers or distributors often waive all or a portion of the entry cost for investors that meet certain criteria (such as meeting a minimum initial investment threshold). In 2018, maximum entry costs were most commonly set to 3 percent or 5 percent, and about 60 percent of UCITS share classes reserved the option to charge an entry cost.²²

Exit costs are paid by investors upon sale of their investments.²³ These costs are also reported as some maximum value, as advisers often waive these costs if an investor has remained in the fund for some

minimum length of time. In 2018, maximum exit costs were most commonly set to 1 percent or 2 percent, and about 11 percent of share classes reserved the option to charge an exit cost.²⁴

Switching costs may be charged when an investor wants to move their assets from one fund's share class to another fund's share class run by the same asset manager. These costs are also reported as some maximum value and may be waived. In 2018, maximum switching costs were most commonly set to 1 percent, and about 18 percent of share classes reserved the option to charge a switching cost.²⁵

Transaction costs may be incurred by UCITS from the purchase or sale of their investments. Some examples of such costs include explicit costs, like exchange fees and transactions taxes, and implicit costs around the market impact—the amount the price of a security may change when making a large trade—of buying and selling securities.²⁶ These costs affect the return an investor receives and are paid indirectly. According to recently available data, the median transaction cost was 0.15 percent of a fund's net assets.^{27, 28}

UCITS Share Classes

Share classes are an efficient mechanism through which a UCITS can provide different features to investors based on their preferences.²⁹ For instance, a UCITS can offer share classes based on whether the income generated by the fund's portfolio investments is reinvested (often identified as "accumulation" shares) or distributed to the investor (often identified as "income" or "distributed" shares). Also, many UCITS offer share classes denominated in various currencies to appeal to local preferences of investors in different countries. Some UCITS offer share classes that hedge against certain factors, such as currency risk or interest rate risk.³⁰ Some of these types of share classes require different levels of management than others (e.g., hedging can be costly), and therefore the management fee may be different between share classes. The average UCITS had seven share classes in 2018, with some funds having 50 share classes or more.³¹

More importantly, UCITS also use multiple categories of share classes with different costs and charges to appeal to specific types of investors (such as retail and institutional investors). For example, ongoing charges may differ between UCITS share classes to define how an investor will pay for distribution (e.g., commission payments to an investment professional for advice).

Distribution costs may be *bundled*, meaning they are included in the ongoing charge of the share class (Figure 3). Bundled share classes are traditionally offered to retail investors with small accounts, and ongoing charges sometimes differ in these share classes based on whether an entry cost is charged. For investors who rely heavily on the advice of their investment professionals, bundled share classes can offer a cost-effective way to pay for those services.

Distribution costs also may be *unbundled*,³² meaning that the ongoing charge is devoid of commissions and investors pay for advice through an asset-based

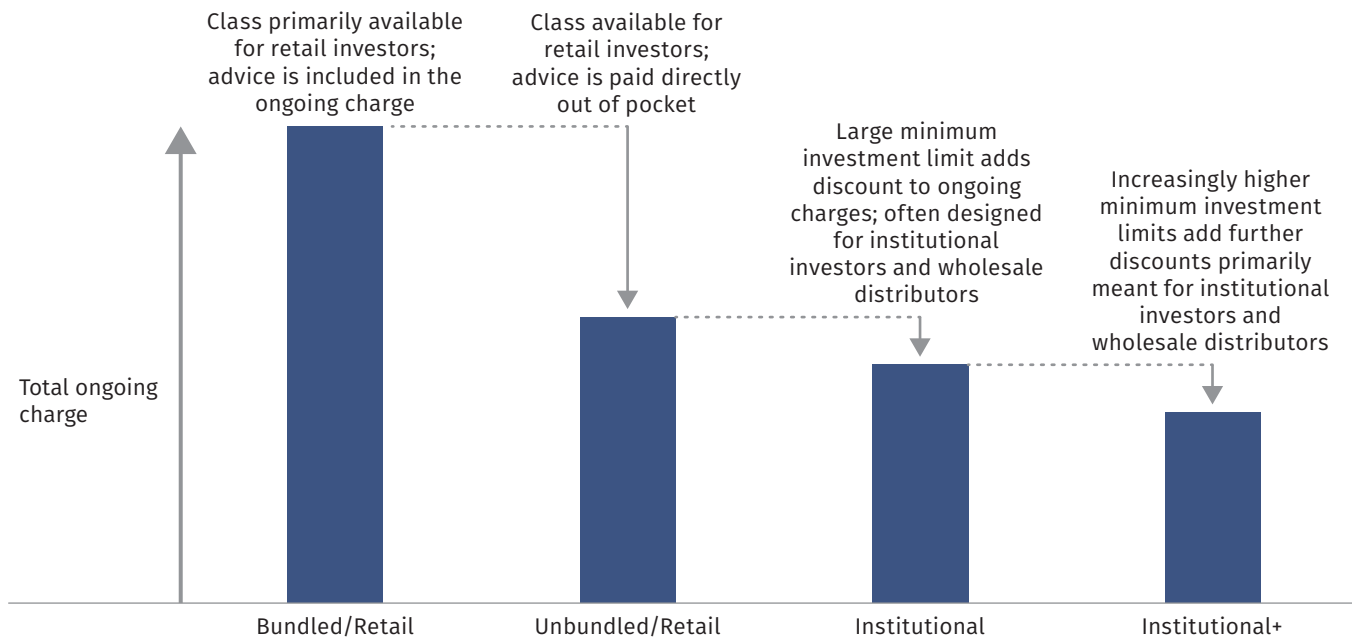
fee that comes directly out of the investor's pocket (Figure 3). Unbundled share classes were traditionally offered to institutional investors or retail investors with large account balances (e.g., high net worth individuals). However, many UCITS now offer at least one unbundled share class intended for retail investors with small accounts, or those who contact or meet with their investment professionals on a limited basis.

The number of unbundled share class offerings for retail investors has increased in recent years, as regulators and policymakers have encouraged advisers to move toward fee-based advice. The UK's Retail Distribution Review (RDR) and the Netherlands' Authority for Financial Markets (AFM) banned intermediary commission payments—both with implementation dates of January 1, 2013—from being included in the ongoing charge. Under certain circumstances, MiFID II banned intermediary commission payments for UCITS as of January 3, 2018.³³ UCITS have adapted to these rules in different ways. Some have added new unbundled share classes specifically for new retail investors, while others simply waived or removed the minimum investment limits on their preexisting unbundled or institutional share classes.

Share classes primarily intended for institutional investors generally have substantial minimum investment amounts such as €100,000 or €1 million (Figure 3). Further, some UCITS offer multiple share classes with increasingly higher minimum investment limits (e.g., €5 million, €10 million, or even €100 million), but progressively lower ongoing charges (referred to as institutional+ share classes in Figure 3). Some institutional+ share classes also are meant for very specific types of accounts, such as those that are distributed through wholesalers (e.g., packaged with other investment products) or those that combine the accounts of a large number of individual retail investors.

FIGURE 3

Ongoing Charges Are Different for Various Types of UCITS Investors



Source: Investment Company Institute

UCITS Investors Are Concentrated in Lower-Cost Funds

On an asset-weighted basis,³⁴ average ongoing charges paid by investors in equity and fixed-income UCITS have decreased since 2013 (Figure 4).^{35, 36} In 2013, asset-weighted average ongoing charges for equity funds were 1.49 percent, or €1.49 for every €100 in assets. By 2018, the asset-weighted average had fallen to 1.29 percent.³⁷ Asset-weighted average ongoing charges also declined for fixed-income funds, falling from 0.98 percent in 2013 to 0.79 percent in 2018. Average ongoing charges for mixed funds remained relatively stable over this same period—1.45 percent in 2013 compared with 1.43 percent in 2018.³⁸

In each year from 2013 to 2018, the asset-weighted average ongoing charges for equity, fixed income, and mixed funds were below their respective simple averages, illustrating that investors tend to concentrate their assets in lower-cost funds. For example, the simple average ongoing charge for equity funds was 1.51 percent in 2018 compared with an asset-weighted average of 1.29 percent. For fixed income funds, the simple average was 1.04 percent compared with an asset-weighted average of 0.79 percent; and for mixed funds, the simple average was 1.51 percent compared with an asset-weighted average of 1.43 percent.

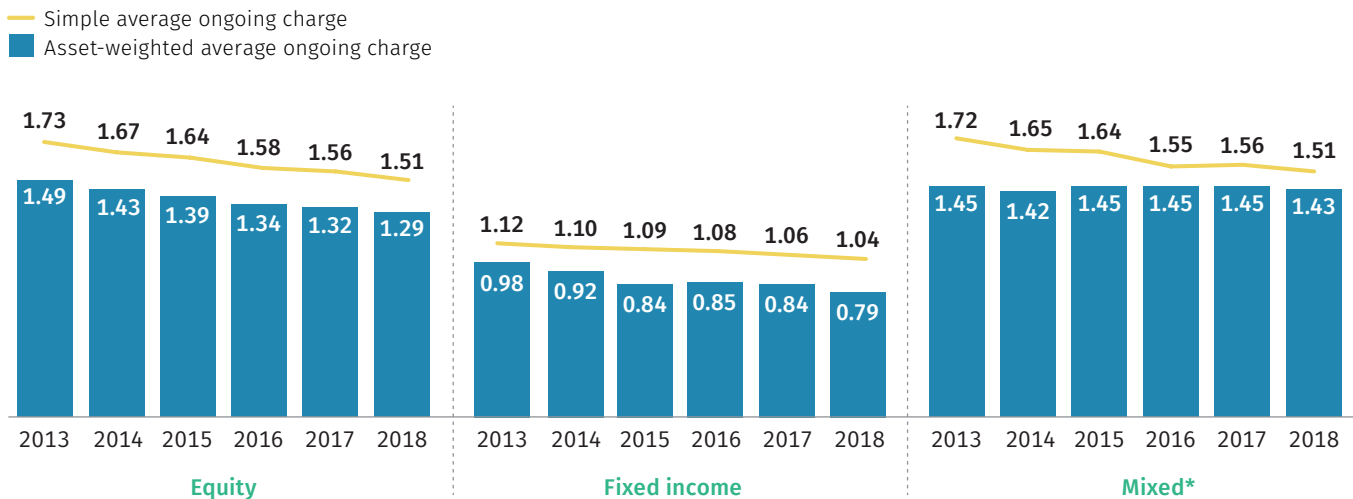
Fundamentally, asset-weighted average ongoing charges of UCITS may fall in any given year for a variety of reasons:

- » Ongoing charges of individual funds may have fallen
- » Assets may have shifted to lower-cost funds
- » New, lower-cost funds may have entered the market
- » Higher-cost funds may have left the market

To determine which reason (or combination of reasons) it was, the change from 2013 to 2018 in the asset-weighted average ongoing charges for equity and

fixed-income UCITS can be broken down into two components. The first component measures how much the asset-weighted average ongoing charge declined because the ongoing charges of individual funds fell. This component is determined by calculating what the asset-weighted ongoing charge would be hypothetically if funds' net assets were held constant and ongoing charges allowed to change as they actually did from 2013 to 2018. Asset-weighted average ongoing charges for equity funds fell 20 basis points from 2013 to 2018. Thirty-five percent (or 7 basis points) of this decrease was because the ongoing charges of individual equity funds declined (Figure 5).

FIGURE 4
Investors in UCITS Pay Below-Average Ongoing Charges
 Percent



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

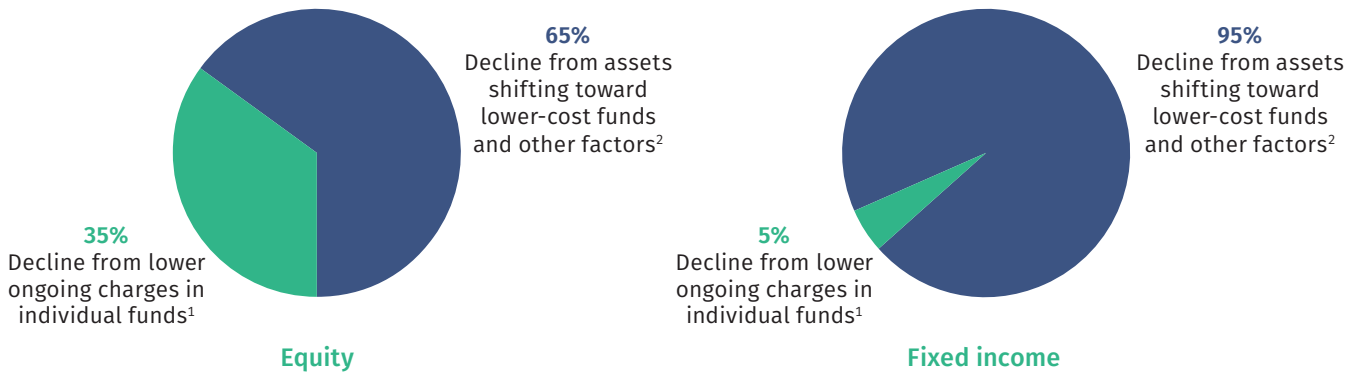
Note: Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

FIGURE 5

Analysis of the Decline in Average Ongoing Charges Between 2013 and 2018

Percentage of total decline



¹ Tabulations are based on a consistent sample; that is, a share class must have existed in each year from 2013 to 2018.

² Other factors include the opening of new lower-cost funds and the closing of older higher-cost funds.

Note: Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

The second component is the difference between the change in the average ongoing charges from 2013 to 2018 and the first component. It accounts for all other factors that could have affected the asset-weighted average ongoing charge, including assets shifting toward lower-cost funds, lower-cost funds entering the business, or higher-cost funds closing. This component accounted for 65 percent (or 13 basis points) of the decrease in average ongoing charges for equity UCITS from 2013 to 2018 and 95 percent (or 18 basis points) of the decrease for fixed-income UCITS.

One way to gauge whether assets are shifting to lower-cost funds is to examine the concentration of assets in low-cost UCITS over time. Figure 6 shows the percentage of assets in equity and fixed-income UCITS with ongoing charges in the lowest quartile of all equity and fixed-income funds from 2013 to 2018. The share of assets among funds with the lowest quartile of ongoing charges has been generally increasing since 2013. In 2018, 33 percent of the net assets in equity funds were in those among the lowest quartile of ongoing charges,

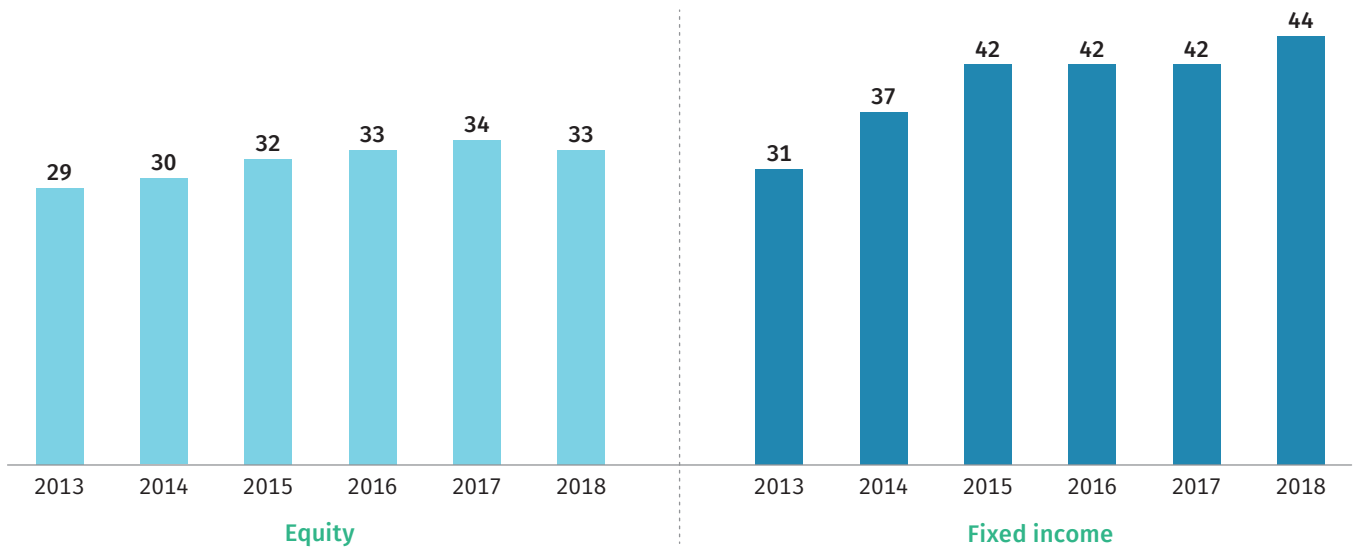
up from 29 percent in 2013. For fixed-income UCITS, 44 percent of assets in 2018 were in funds among the lowest quartile of ongoing charges, up from 31 percent in 2013.

The entry of lower-cost funds and the exit of higher-cost funds (through liquidation or merging) likely also has contributed to the downward pressure on asset-weighted average ongoing charges for equity and fixed-income UCITS. Since 2013, simple average ongoing charges for newly opened funds and fund share classes have trended down (Figure 7). As distributors adapted to the MiFID II rules, some UCITS created new unbundled share classes for retail clients, which naturally had lower ongoing charges (see Figure 3). Additionally, new index tracking UCITS, which generally have lower ongoing charges, have opened to meet increased demand for index funds (see page 16). At the same time, simple average ongoing charges for funds liquidating or merging were higher than those of newly opened funds in the same year.

FIGURE 6

Investors Are Increasingly Concentrating Their Assets in Lower-Cost UCITS

Percentage of UCITS net assets with ongoing charges in the lowest quartile



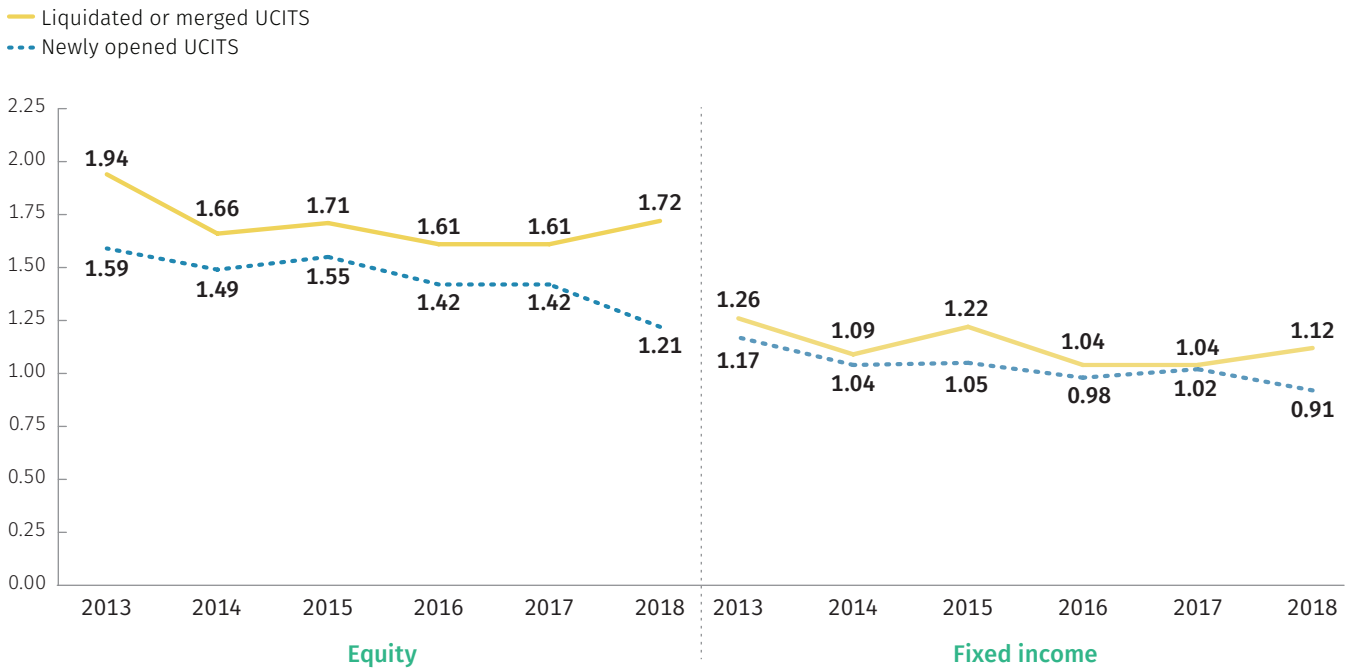
Note: Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

FIGURE 7

Simple Average Ongoing Charges of Newly Opened UCITS Are Decreasing

Percent



Note: Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

Ongoing Charges Vary Across UCITS

Like prices of most goods and services, ongoing charges of individual UCITS vary considerably across the array of available products. Outside of distribution structures (or compensation arrangements), there are many factors that affect the ongoing charge of a UCITS share class, including investment objective, fund assets, cross-border availability, and whether the fund is actively managed or tracks an index.

UCITS Investment Objectives

Ongoing charges for UCITS differ based on their investment objectives (Figure 8).^{39, 40} For example, fixed-income funds tend to have lower ongoing charges than equity funds. And among equity funds, ongoing charges tend to be higher for funds that invest in a given sector—such as healthcare or real estate—

or those that invest in mid- and small-cap stocks, because such funds tend to cost more to manage. Additionally, ongoing charges can vary considerably even within a particular investment objective. For example, 10 percent of emerging market fixed-income funds have an ongoing charge of 0.56 percent or less, while another 10 percent have ongoing charges of 2.11 percent or more. This variation reflects, among other things, the fact that portfolios of emerging market securities can be substantially different from one another. Some funds might invest solely in one emerging market economy, while others may spread out their investments across many countries. This distinction is important because investing in certain countries can cost more to manage, as information may be less readily available or access to certain markets might be difficult (or costly) to obtain.

FIGURE 8

UCITS Ongoing Charges Vary Across Investment Objectives Percent, 2018

Investment objective	10th percentile	Median	90th percentile	Asset-weighted average	Simple average
Equity	0.55	1.49	2.49	1.29	1.51
Europe equity large-cap	0.49	1.40	2.35	1.27	1.41
Europe equity mid/small-cap	0.78	1.60	2.61	1.55	1.64
US equity large-cap	0.42	1.25	2.38	1.03	1.39
Global equity large-cap	0.46	1.33	2.34	1.23	1.41
Sector equity	0.83	1.73	2.63	1.62	1.66
Fixed income	0.35	0.92	1.82	0.79	1.04
Europe fixed income	0.25	0.74	1.51	0.61	0.84
US fixed income	0.40	0.91	1.92	0.72	1.05
Global fixed income	0.41	0.91	1.76	0.91	1.01
Emerging market fixed income	0.56	1.21	2.11	0.99	1.29
Mixed*	0.74	1.51	2.30	1.43	1.51
Money market	0.06	0.20	0.59	0.17	0.27
Memo:					
Index equity	0.06	0.30	0.70	0.28	0.36

* 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 tabulations of Morningstar Direct data

Funds of Funds and Synthetic Ongoing Charges

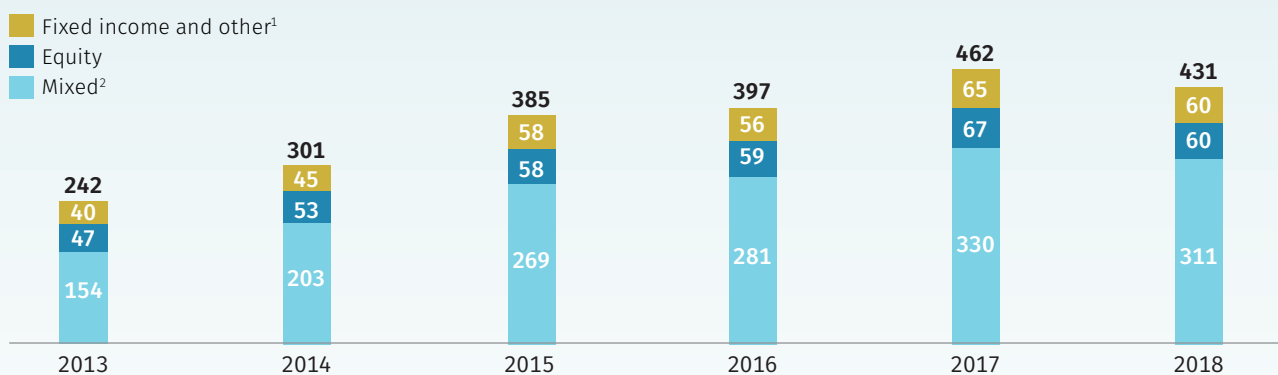
UCITS funds of funds are UCITS that invest primarily in other funds. Net assets in funds of funds nearly doubled from €242 billion in 2013 to €431 billion in 2018 even though the number of funds decreased from 2,676 to 2,521 over the same period (Figure 9). The majority of net assets in funds of funds, €311 billion, were in mixed funds in 2018.

Ongoing charges for UCITS funds of funds are commonly referred to as “synthetic” ongoing charges and are made up of the ongoing charge of the fund itself (as defined in Figure 3) plus the ongoing charges of the underlying funds (proportional to the assets invested in those funds).⁴¹ In 2018, the asset-weighted average synthetic ongoing charge for UCITS funds of funds was 1.71 percent compared with 1.78 percent in 2017 (Figure 10).

FIGURE 9

Net Assets of UCITS Funds of Funds Are Mostly in Mixed Funds

Billions of euros, year-end



Number of UCITS funds of funds

2,676 2,608 2,599 2,599 2,561 2,521

¹ Categories of other UCITS include alternatives, miscellaneous, money market, convertibles, property, and commodities.

² Mixed funds invest in a combination of equity and fixed-income securities.

Note: Data include UCITS funds of funds domiciled in the United Kingdom and the Netherlands (representing 12 percent of net assets in 2018). Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

FIGURE 10

Average Synthetic Ongoing Charges for UCITS Funds of Funds

Percent

Year	Asset-weighted average	Simple average	Median
2017	1.78	2.00	1.91
2018	1.71	1.88	1.81

Note: Data reported in this figure rely solely on the OCF as reported in the Key Investor Information Document (KIID). Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

Fund Size

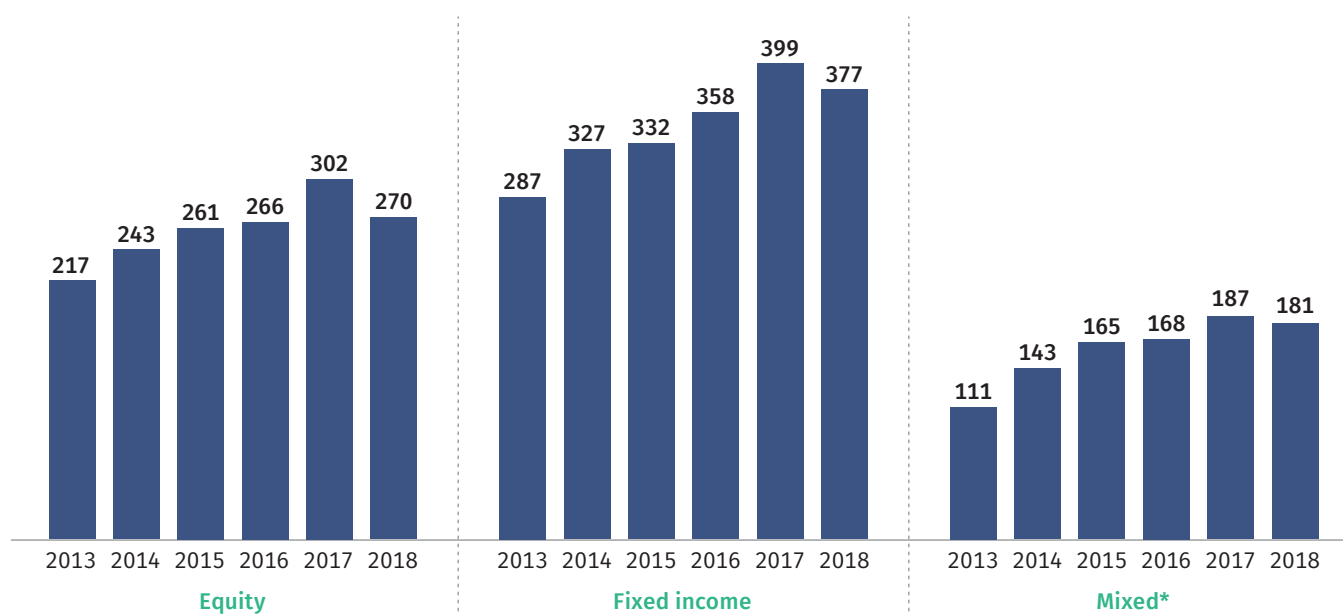
The amount of net assets in a fund is another important element that affects ongoing charges because of economies of scale. Some fund costs—such as transfer agency fees, accounting and audit fees, and depository fees—are relatively fixed in euro terms, regardless of fund size. Growth in a fund’s net assets places downward pressure on average ongoing charges as

fixed costs become an increasingly smaller share of net assets. The average size of equity, fixed-income, and mixed UCITS in 2018 were all higher than in 2013—this growth in assets likely explains some of the decline in average ongoing charges over the period (Figure 11). In 2018, the average size of equity funds was €270 million compared with €217 million in 2013.

FIGURE 11

Average Net Assets of UCITS Have Generally Increased Since 2013

Millions of euros, year-end



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

Note: Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

Cross-Border Distribution

The growth of UCITS in the European Union owes much of its success to the passport arrangement it grants to funds, meaning that a UCITS established in one country can be sold cross-border into one or more other countries.⁴² Indeed, net assets of cross-border funds domiciled in the European Union have grown from €1.7 trillion in 2008 to €5.1 trillion by year-end 2018 (Figure 12),⁴³ 83 percent of which was domiciled in Luxembourg and Ireland. Cross-border funds also have been approved for sale in jurisdictions outside of Europe with a large degree of success—nearly 16 percent of UCITS’ net assets reportedly come from outside Europe, mostly in Asia and Latin America.⁴⁴

An important distinction from cross-border funds are “round-trip” funds—UCITS that are domiciled in one country but primarily intended for sale in only one

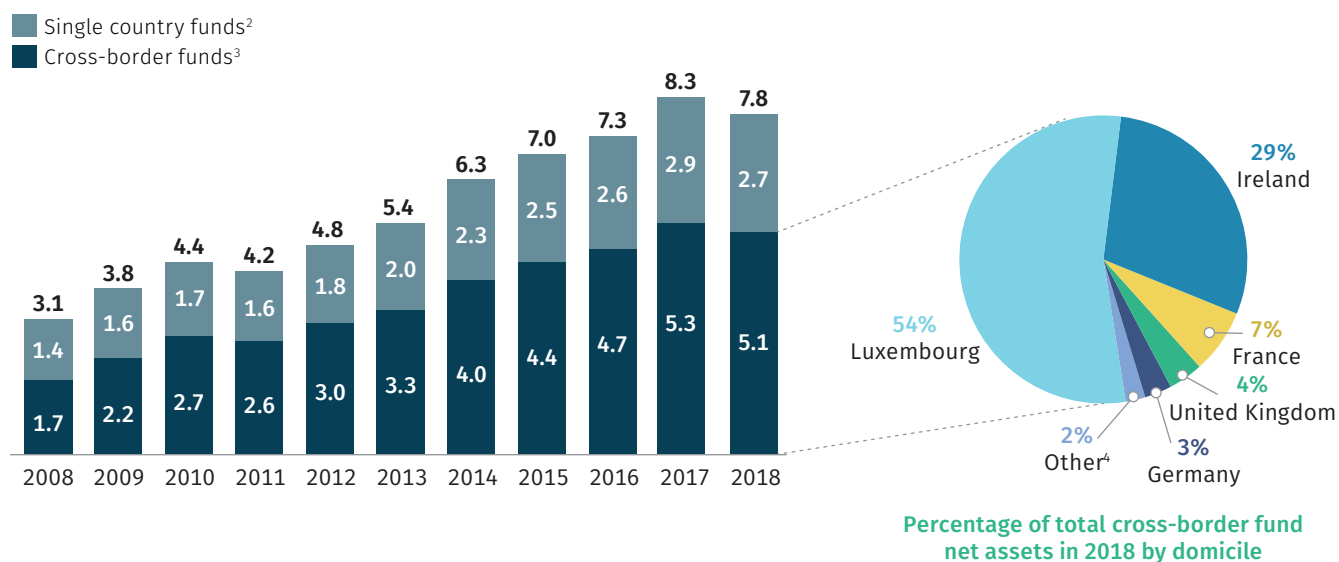
other country.⁴⁵ For example, as Luxembourg grew in popularity as a prominent cross-border fund domicile, asset managers in some countries domiciled their funds in Luxembourg with the sole intent to sell those funds in their home country.⁴⁶ This report treats round-trip funds as single country funds because they are only intended to be sold in one country. Round-trip funds were about 28 percent of the €2.7 trillion in net assets of single country funds in 2018.

The availability of cross-border funds in Europe has many benefits for investors. For one, cross-border funds provide European investors with additional options over other investment products in their home countries, which helps foster competition. Additionally, being available for sale in multiple countries gives cross-border funds access to more investors—allowing cross-border funds to gain economies of scale.

FIGURE 12

Cross-Border Funds Represent Nearly Two-Thirds of Total UCITS Net Assets

Total UCITS net assets in trillions of euros,¹ year-end



¹ Total UCITS net assets reported by Morningstar in this figure are less than those reported to EFAMA by its member countries and shown in Figure 1. Part of the difference is attributable to the exclusion of UCITS that invest primarily in other funds in the Morningstar data. While UCITS net assets in Morningstar data are still lower than those reported by EFAMA after this adjustment, Morningstar has more detail on cross-border availability for individual funds, which is necessary for ICI’s identification of cross-border funds.

² Single country funds include funds registered and available for sale in one country. Single country funds also include round-trip funds—funds domiciled in one country but primarily intended for sale in a different country.

³ Cross-border funds are defined as funds registered and available for sale in three or more countries.

⁴ Other includes Sweden, Belgium, Austria, Finland, Denmark, the Netherlands, Malta, Estonia, Lithuania, Slovenia, and Latvia.

Note: Data include UCITS domiciled in the United Kingdom and the Netherlands (representing 13 percent of net assets in 2018). Data also include exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

Nevertheless, ongoing charges in cross-border funds tend to be higher than for single country funds because average fixed costs in cross-border funds tend to be larger. For example, most countries in Europe impose local requirements on the marketing of cross-border funds, thereby incurring costs for funds in each country in which they are registered and available for sale.⁴⁷ There are also additional administration costs to cover the complexity of offering different share classes in different countries, which are often in different currencies.⁴⁸ Some efforts have been made to converge or remove local requirements imposed on cross-border funds by European countries. However, some European countries are seeking to maintain or even strengthen the requirements they impose.

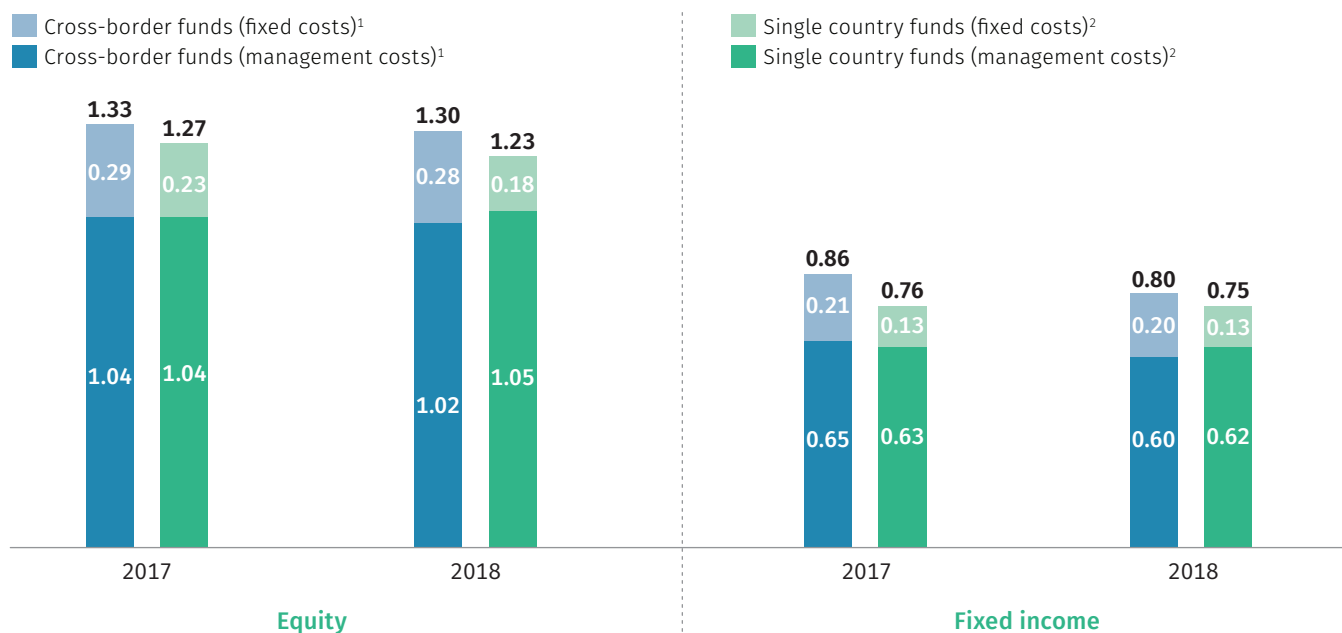
Average ongoing charges for cross-border equity UCITS were 1.30 percent in 2018, down 3 basis points from

1.33 percent in 2017; and average ongoing charges for single country equity funds were 1.23 percent in 2018, down from 1.27 percent in 2017 (Figure 13). Also, for both equity and fixed-income UCITS, fixed costs for cross-border funds were larger than single country funds both as a percentage of assets and as a share of the ongoing charge. In 2018, fixed costs for cross-border equity funds were 0.28 percent, or 22 percent of the total average ongoing charge, compared with fixed costs for single country equity funds of 0.18 percent, or 15 percent of the total average ongoing charge. This difference is similar for fixed-income funds, where 25 percent of the total ongoing charge (or 0.20 percent) was from fixed costs in cross-border funds compared with 17 percent of the total ongoing charge (or 0.13 percent) for single country funds.⁴⁹

FIGURE 13

Fixed Costs Tend to Be Larger for Cross-Border Funds

Percent



¹ Cross-border funds are defined as funds registered and available for sale in three or more countries.

² Single country funds include funds registered and available for sale in one country. Single country funds also include round-trip funds—funds domiciled in one country but primarily intended for sale in a different country.

Note: Fixed costs are estimated as the difference between the asset-weighted average ongoing charge and the asset-weighted average management cost. Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

Index Trackers

Index trackers generally seek to replicate the return on a specified index. Under this approach, portfolio managers buy and hold all, or a representative sample of, the securities in their target indexes. This approach to portfolio management is a primary reason that index tracking UCITS tend to have below-average ongoing charges. By contrast, under an active management approach, managers have more discretion to increase or reduce exposure to sectors or securities within their funds' investment mandates. Active managers may also undertake significant research about stocks or bonds, market sectors, or geographic regions. This approach offers investors the chance to earn superior returns, or to meet other investment objectives such as limiting

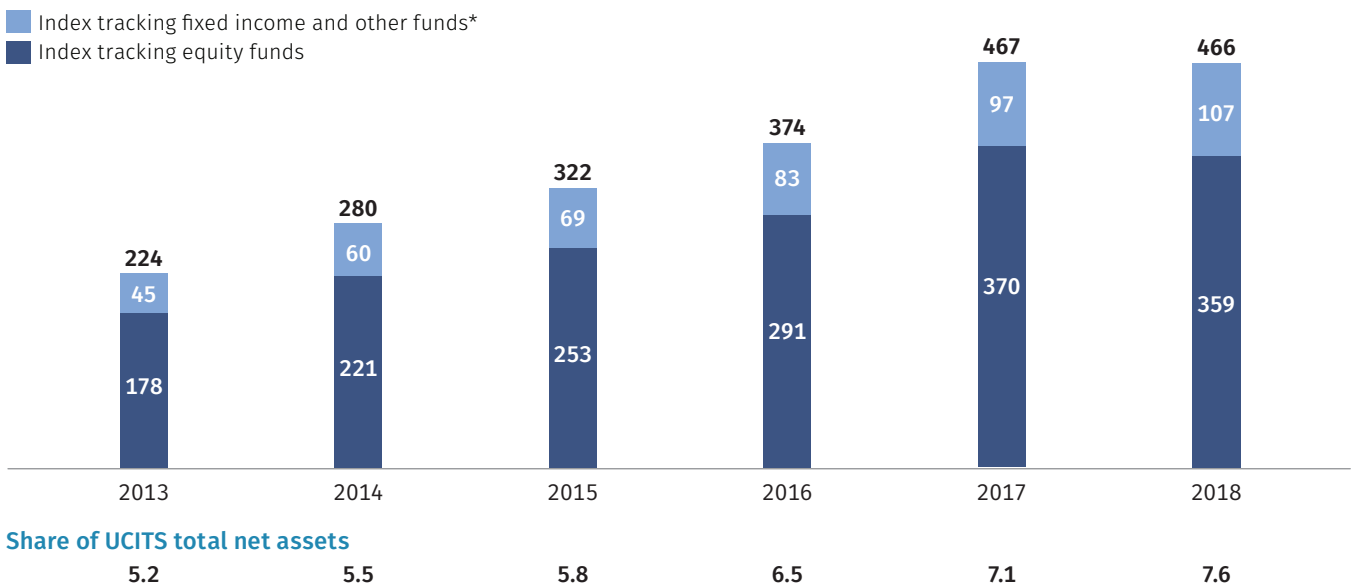
downside risk, managing volatility, under- or over-weighting various sectors, and altering asset allocations in response to market conditions. These characteristics tend to make active management more costly than management of an index tracking fund.

Growth in index tracking funds also has contributed to the decline in asset-weighted average ongoing charges for equity and fixed-income funds. Since year-end 2013, net assets in index tracking funds have more than doubled from €224 billion to €466 billion (Figure 14). However, net assets in index trackers are still relatively small when compared to net assets for all funds, representing 7.6 percent of UCITS net assets at year-end 2018.

FIGURE 14

Net Assets in Index Tracking UCITS Have More Than Doubled Since 2013

Billions of euros, year-end



* Fixed income and other includes fixed income, mixed, alternatives, convertibles, miscellaneous, commodities, property, and unclassified.

Note: Data include index tracking UCITS domiciled in the United Kingdom and the Netherlands (representing 40 percent of net assets in 2018). Data exclude money market funds and exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

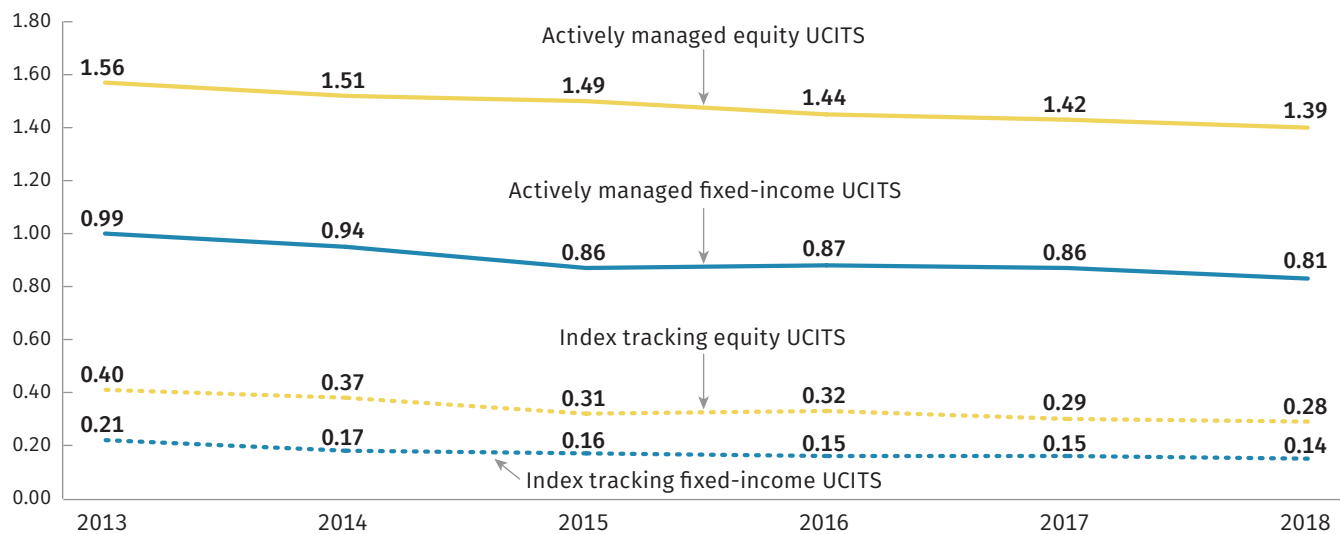
Index tracking funds tend to have below-average ongoing charges for a couple of reasons. For one, their general approach to replicating the return on a target index lends itself to being less costly. This is because portfolios of index tracking funds tend not to change frequently, and therefore have lower turnover rates. Also, index tracking funds are larger on average than actively managed funds, which, through economies of scale, helps reduce ongoing charges. In 2018, the average size of an index tracking equity fund (€519 million) was more than twice the average size of an actively managed equity fund (€259 million).

While index tracking funds generally have lower ongoing charges than actively managed funds, it is important to note that decreases in ongoing charges of both index tracking and actively managed funds have contributed to the overall decline in UCITS ongoing charges. From 2013 to 2018, average ongoing charges for index tracking equity funds fell from 0.40 percent to 0.28 percent, while the average ongoing charge for actively managed equity funds fell from 1.56 percent to 1.39 percent (Figure 15). Over the same period, average ongoing charges for index tracking fixed-income funds fell from 0.21 percent to 0.14 percent, and the average ongoing charge for actively managed fixed-income funds fell from 0.99 percent to 0.81 percent.

FIGURE 15

Ongoing Charges for Actively Managed and Index Tracking UCITS Have Fallen

Percent



Note: Data exclude exchange-traded funds.

Source: Investment Company Institute tabulations of Morningstar Direct data

UCITS Exchange-Traded Funds

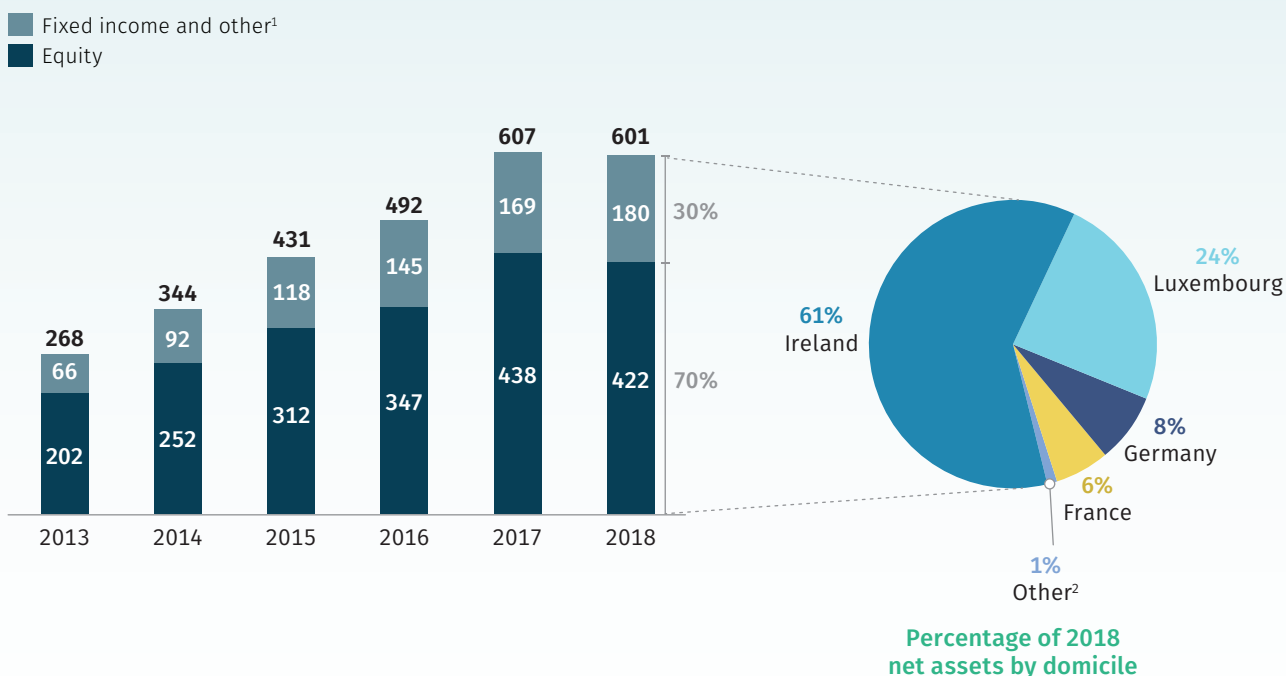
UCITS exchange-traded funds (ETFs) have become increasingly popular with investors. Authorized under UCITS, this segment of the EU fund industry enjoys many of the same benefits as its other open-end peers—such as passporting across EU Member States, for example. By the end of 2018,

net assets in UCITS ETFs reached €601 billion, more than double their level at year-end 2013 (Figure 16). Equity ETFs represented 70 percent of the net assets of UCITS ETFs at year-end 2018, and the majority (61 percent) of UCITS ETF net assets were domiciled in Ireland.

FIGURE 16

UCITS ETFs Are Growing Quickly

Net assets in billions of euros, year-end



¹ Fixed income and other includes fixed income, mixed, alternatives, commodities, convertibles, money market funds, miscellaneous, and unclassified.

² Other includes Sweden, the Netherlands, Spain, Finland, the United Kingdom, and Greece.

Note: Data include a small number of actively managed exchange-traded funds, representing 1.6 percent of net assets or less in any given year. Data also include exchange-traded funds domiciled in the United Kingdom and the Netherlands (representing 0.3 percent of net assets in 2018).

Source: Investment Company Institute tabulations of Morningstar Direct data

UCITS Exchange-Traded Funds CONTINUED

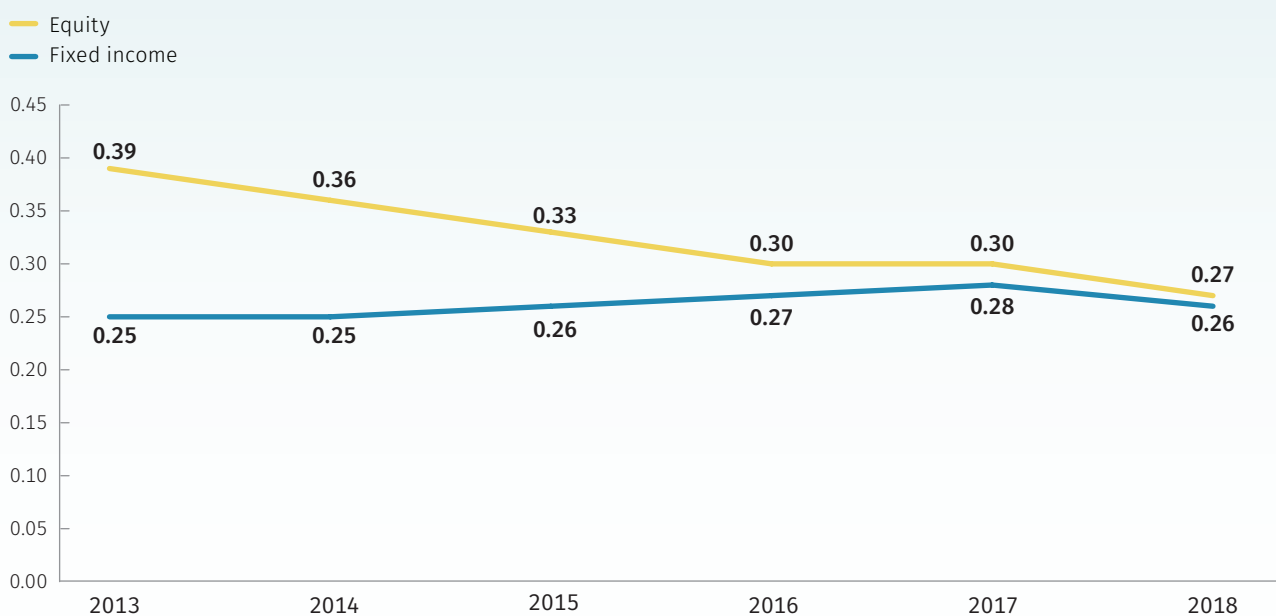
The vast majority of UCITS ETFs are indexed to a specific benchmark, and thus require lower management costs (and thereby lower ongoing charges) to operate when compared to actively managed funds. Actively managed UCITS ETFs represented only 1.6 percent of net assets or less

in any given year between 2013 and 2018. Average ongoing charges for equity UCITS ETFs fell from 0.39 percent in 2013 to 0.27 percent in 2018, and average ongoing charges for fixed-income UCITS ETFs rose slightly from 0.25 percent to 0.26 percent over the same period (Figure 17).

FIGURE 17

Ongoing Charges for Equity and Fixed-Income UCITS ETFs

Percent



Note: Data include a small number of actively managed exchange-traded funds, representing 1.6 percent of net assets or less in any given year.

Source: Investment Company Institute tabulations of Morningstar Direct data

Conclusion

Since its inception in 1985, the UCITS Directive has undergone numerous changes affecting the way funds disclose costs and charges to investors. These changes have been designed to make the fees that investors pay for their investments as transparent as possible, especially with regard to how investors pay for distribution. During this time, UCITS have introduced new unbundled share classes—which exclude commission payments for advice—that distributors have made readily available to retail investors. These unbundled share classes have lower ongoing charges, but it is important to note that investors who use these share classes and receive advice typically pay for that advice directly out of pocket.

Ongoing charges for equity and fixed-income UCITS have trended down since 2013. Although part of the decrease is a result of declining ongoing charges as UCITS realize economies of scale, most of the downward pressure has come from assets shifting to lower-cost funds, lower-cost funds entering the business, and higher-cost funds closing. Two important factors driving the decline in UCITS' ongoing charges are the increasing number of unbundled share classes that have been made available to investors to cater to new regulations and the increasing popularity of index tracking funds—both of which tend to have lower-than-average ongoing charges.

Notes

- ¹ UCITS, or undertakings for collective investment in transferrable securities, are collective investment schemes established and authorized under a harmonized EU legal framework, currently EU Directive 2014/91/EU, as amended (UCITS V), under which a UCITS established and authorized in one Member State can be sold cross-border into other Member States without a requirement for an additional full registration (often referred to as the UCITS “passport”). Since it was first adopted in 1985, the UCITS Directive has been modified several times to take into account developments in financial markets.
- ² Total UCITS net assets in the European Union have risen since year-end 2018 and total €9.5 trillion as of June 30, 2019. See European Fund and Asset Management Association (EFAMA) 2019b.
- ³ In European Distribution Dynamics 2019, by Cerulli Associates, survey results indicated that 15.8 percent of cross-border UCITS assets in 2018 were from jurisdictions outside Europe (7.6 percent from Asia, 4.3 percent from Latin America, 1.3 percent from the Middle East and Africa, and 2.6 percent from elsewhere).
- ⁴ The recast Markets in Financial Instruments Directive (MiFID II) 2014/65/EU entered into force on July 2, 2014, with an implementation date of January 3, 2018, banning commissions paid to or by investment firms under certain instances (Article 24(9)), see <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN>. The European Commission (EC) issued a mandate to European Supervisory Authorities (ESAs) on October 13, 2017, to “issue recurrent reports on the cost and past performance of the main categories of retail investment, insurance and pension products” (see European Commission 2017). The first report, “Performance and Costs of Retail Investment Products in the EU,” was released by the European Securities and Markets Authority (ESMA) on January 10, 2019. See European Securities and Markets Authority 2019.
- ⁵ For a brief outline of the different ways in which regulators continued to examine costs and charges in 2017, see chapter 4 of KPMG International 2018.
- ⁶ See Council Directive 85/611/EEC of December 20, 1985, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS I Directive), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A31985L0611>.
- ⁷ See Article 43, UCITS I Directive.
- ⁸ See Directive 2001/107/EC of the European Parliament and of the Council of January 21, 2002, amending Council Directive 85/611/EEC on the coordination of laws, regulations, and administrative provisions relating to UCITS with a view to regulating management companies and simplified prospectuses (UCITS III), available at <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001L0107:EN:HTML>.
- ⁹ See Article 52(b)(6.1) and amendments to Annex I, Schedule C, UCITS III.
- ¹⁰ See Commission Recommendation of April 27, 2004, on some contents of the simplified prospectus as provided for in Schedule C of Annex I to Council Directive 85/611/EEC (Simplified Prospectus Regulation), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004H0384&from=EN>.
- ¹¹ The use of performance fees in UCITS is relatively uncommon. According to data from Morningstar Direct, an estimated 14 percent of UCITS, representing about 15 percent of net assets, charged a performance fee in 2018.
- ¹² Following a 2005 survey, the Committee of European Securities Regulators (CESR) concluded that while the Commission’s recommendations had generally been implemented satisfactorily across Member States, the level of implementation on disclosure of costs and fees had not been as effectively achieved—particularly regarding fee-sharing arrangements and soft commissions. See the CESR press release at www.esma.europa.eu/sites/default/files/library/2015/11/05_435.pdf.
- ¹³ See Directive 2009/65/EC of the European Parliament and of the Council of July 13, 2009, on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS IV), available at <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32009L0065>.
- ¹⁴ See Section 3, Commission Regulation (EU) No 583/2010 of July 1, 2010, implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website (KIID Regulation), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32010R0583>.
- ¹⁵ See Committee of European Securities Regulators 2010a and 2010b.
- ¹⁶ The PRIIPS Regulation initially envisioned that the KID would apply to UCITS from December 31, 2018. Following the extension of the application date of the PRIIPS Regulation by one year and a subsequent extension of the application date of the KID through the cross-border distribution of fund regulation, the KID is envisioned to apply to UCITS from December 31, 2021 (see Article 17 of Regulation 2019/1156 amending Article 32(1) of Regulation 1286/2014).
- ¹⁷ For more information on how investment firms are recommended to follow MiFID II reporting guidelines, see The Investing and Saving Alliance 2017.
- ¹⁸ See Regulation (EU) No 1286/2014 of the European Parliament and of the Council of November 26, 2014, on Key Information Documents (KIDs) for Packaged Retail and Insurance-Based Investment Products (PRIIPs) at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1286&from=EN>.
- ¹⁹ See footnote 3 of European Fund and Asset Management Association 2018.
- ²⁰ This report will refer to “shares” or “units” of UCITS as simply “shares” of UCITS; as used in this paper, the term also includes investment into units of fund vehicles such as unit trusts.
- ²¹ For the purposes of this report, performance fees are not considered in this section since they are included in the TER.
- ²² Information derived from Investment Company Institute tabulations of data from Morningstar Direct.
- ²³ In this context, exit costs exclude any costs that are applied to a fund redemption intended to correct for the effects of dilution (such as through anti-dilution levies or swing pricing).
- ²⁴ Information derived from Investment Company Institute tabulations of data from Morningstar Direct.
- ²⁵ Information derived from Investment Company Institute tabulations of data from Morningstar Direct.

- ²⁶ It is important to note that transaction costs reported using the MiFID II methodology may be zero or negative. For more information on MiFID II reporting guidelines, see page 9 of J.P. Morgan Asset Management 2018.
- ²⁷ Use of Morningstar data requires the following disclaimer: © 2019 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.
- ²⁸ Data are as reported in Morningstar Direct's MiFID II view as of July 2019. The field used for this statistic was "transaction fee actual," which is reported as an annual figure as required by the MiFID II reporting standards for ex-post costs and charges. Share classes where this field was missing were excluded from the calculation. The vast majority of the most recently reported transaction fees of UCITS spanned the period of June 2018 through June 2019.
- ²⁹ The types of UCITS share classes discussed in this section are not meant to be an exhaustive list. For guidance on factors ESMA believes UCITS should consider when setting up new share classes, see European Securities and Markets Authority 2017.
- ³⁰ ESMA has issued its opinion on the compatibility of such hedging arrangements with the requirement for a UCITS to have a common investment objective. See European Securities and Markets Authority 2017.
- ³¹ Information derived from Investment Company Institute tabulations of data from Morningstar Direct.
- ³² The terms *bundled* and *unbundled* are loosely based on Morningstar's nomenclature for share classes in which payment for advice is either internalized (bundled) or externalized (unbundled).
- ³³ See note 4.
- ³⁴ ICI uses asset-weighted averages to summarize the ongoing charges that shareholders pay through UCITS. In this context, asset-weighted averages are preferable to simple averages, which would overstate the ongoing charges of UCITS in which investors hold few euros. ICI weights the ongoing charge of each fund share class by its year-end total net assets.
- ³⁵ Throughout this report, the ongoing charge is represented by the TER in Morningstar Direct. For share classes where Morningstar does not report a TER, the OCF is used if available. Because the only major difference between the TER and OCF is the inclusion of performance fees in the TER, and the number of funds that charge performance fees is relatively small (see note 11), ICI finds that this methodology is appropriate. The use of the TER to analyze costs paid by UCITS investors is consistent with analysis done by others. See Cerulli Associates 2011 and European Securities and Markets Authority 2019.
- ³⁶ In this analysis, ICI excluded ongoing charges of UCITS share classes domiciled or primarily intended for sale in the United Kingdom and the Netherlands. These share classes were excluded to minimize, as much as possible, any influence of the effects of either the RDR or AFM ban on intermediary commission payments, both of which had an implementation date of January 1, 2013. An in-depth analysis of UK costs and charges by ICI can be found at Investment Company Institute 2017.
- ³⁷ In this report, the average coverage—represented as the percentage of UCITS net assets where either the TER or the OCF is reported—between 2013 and 2018 is 61 percent. Data coverage for 2017 and 2018 is lower when compared with data coverage between 2013 and 2016. For UCITS still active in 2017 or 2018, if the ongoing charge is non-missing for the prior year and missing in the current year, then the ongoing charge is carried forward at the same level to the current year. Reported results are robust to this assumption as there are minimal differences between the reported results and the results in which the missing ongoing charges are not replaced with the prior year's ongoing charge.
- ³⁸ Mixed funds invest in a combination of equities and fixed-income securities.
- ³⁹ See note 27.
- ⁴⁰ Investment objectives for Figure 8 in this report are based on Morningstar's *global broad category group* (equity, fixed income, mixed, and money market), *global category* (Europe equity large-cap, Europe equity mid/small-cap, US equity large-cap, global equity-large cap, Europe fixed income, US fixed income, global fixed income, emerging market fixed income), and *Morningstar category* (aggregation of various sector equity categories) data fields.
- ⁴¹ Simple average, median, and asset-weighted average synthetic ongoing charges are calculated using the OCF reported in the KIID in the Morningstar database. While the rest of the ongoing charges in this report rely on the TER, Morningstar 2016 comments that TERs for UCITS funds of funds are inaccurate when compared to the OCF. Therefore, the OCFs are taken from KIIDs, as generally reported for fiscal years 2017 and 2018 by Morningstar. See note 27.
- ⁴² See note 1.
- ⁴³ In this report, cross-border UCITS are defined as funds registered and available for sale in three or more countries.
- ⁴⁴ See note 3 and Cerulli Associates 2019.
- ⁴⁵ In some instances, the manager of a round-trip fund may be domiciled or established in the country in which it is primarily distributed.
- ⁴⁶ See Lipper Fund Marketing Information 2010.
- ⁴⁷ For a description of regulatory fees charged by EEA Member States, see Annex 11 of European Commission 2018.
- ⁴⁸ See Deloitte Touche Tohmatsu Limited 2016.
- ⁴⁹ Addressing fixed costs that act as a barrier to entry in establishing cross-border UCITS is currently a policy objective for the EC. It hopes to achieve this goal by taking a close look at marketing requirements, regulatory fees, administrative requirements, and notification requirements for which cross-border UCITS are currently responsible. See European Commission 2018.

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