

## Guest Viewpoint: Dan Waters, ICI Global

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By Dan Waters

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*'Easier, cheaper fund distribution would help build stronger capital markets.'*

Europe is facing two related and urgent needs: bolstering economic growth and providing its citizens with efficient, lower-cost vehicles for savings and investment. One way to address both problems is to eliminate unjustified barriers to cross-border investment and develop more effective ways for citizens to save for crucial financial goals, including retirement. Improving how investment funds are distributed across European borders will help Europe's investors and economies alike.

The current barriers to fund distribution are especially harmful to UCITS funds. UCITS is a fund framework so successful it has become a global investment vehicle used in markets far outside Europe, such as Asia-Pacific and Latin America. But under current regulations, selling a fund from one European country to investors in another can be a difficult proposition.

Why? Because fund managers face a patchwork of differing, difficult-to-navigate approval processes for marketing funds. These webs of rules have fostered fragmented fund distribution and prevented the UCITS structure from fulfilling its intended role as a fund passport for all of the European Union (EU).

Member states have inconsistent and varying marketing rules for funds. National authorities often add on extra regulations (gold plating), while wrapping their approval processes in bureaucratic red tape and imposing layers of disparate tax rules. Despite decades of legal and social change designed to make it easier for Europeans to move and work across borders, citizens still cannot make use of pan-European vehicles to save and invest efficiently.

The list of countries that have thrown up barriers to UCITS domiciled outside their borders is lengthy. This is a widespread problem.

Indeed, the obstacles have become so evident that the European Commission has taken the bold and critical step of targeting them in its newly-issued consultation on cross-border fund distribution. We applaud the Commission for its forward-looking, specific report.

The barriers the Commission has identified are bad for the economy and for investors. They lead to inefficient markets that create a drag on returns.

Investors also need more opportunities. In Europe, investors commonly express cultural preferences for funds managed in their home country. While to some extent understandable, domestic regulations that go beyond rules at the EU-level to hamper cross-border fund distribution unhelpfully amplify and reinforce this bias, discouraging investors from exploring opportunities presented by funds from elsewhere in Europe.

If the EU eliminated such unjustified market frictions and opened the door to additional choice and administrative efficiencies, savers could greatly benefit. Competition in a vastly expanded market would promote greater innovation, more service and lower fees.

Cross-border barriers to investment also carry many ill effects for Europe's tepid economy. Despite a host of interventions, Europe is still—six years on from the financial crisis—struggling to recover fully. One missing ingredient in Europe's efforts to restore economic vigour is capital formation from investment.

Easier, cheaper fund distribution would help by building stronger capital markets, supporting investors and improving financing for the economy. With expanded capital market opportunities, fund markets will grow, which—in turn—injects more capital into the broader economy. This is a virtuous circle of growth.

Why is it important to establish a better balance between these two forms of financing? Because well-developed capital markets:

- Efficiently intermediate and distribute risk in the system;
- Enhance economic stability by providing real-time feedback on the prospects of companies and governments; and
- Encourage economic flexibility by fostering risk-taking and entrepreneurship.

One system to examine for lessons is the US, which for two centuries has operated a vibrant, resilient dual system of bank and capital market financing. Today, the US capital markets' financing for businesses, governments, and households is more than twice the financing provided through bank loans (combining shares and debt, 73 percent versus 27 percent).

Who provides this capital? In the US, retail investors provide significantly more long-term capital than do their counterparts in the EU.

The picture is quite different in the EU, where outstanding loans are almost equal to the issuance of equities and debt securities.

EU citizens are much more likely to keep their holdings in cash and deposits: households keep two-fifths of their financial assets in banks, and only one-twelfth of their wealth in fund structures.

The US numbers are markedly different: American households hold about one-eighth of their financial assets in bank deposits, while keeping nearly one-quarter of their financial assets in investment funds.

This large pool of stable investment has contributed enormously to the success and resilience of the US economy. Redirecting just some of the assets held by European households from banks into the markets could create a much larger potential source of financing for businesses in the EU. Commissioner Jonathan Hill's estimates are that an additional €90bn of funding would have been injected into the euro-zone between 2008 and 2013, if a similarly strong dual system of finance had existed.

In addition, to removing unnecessary cross-border barriers to fund distribution, the EU should go further, by creating a Pan-European Personal Pension Product (PEPP). A well-designed PEPP would create economies of scale through cross-border pooling and management of assets. It also would encourage additional direct investment into the European market by attracting retail investors looking to save for the long-term. And it would better accommodate the needs of an increasingly mobile European workforce. Over time, a flourishing PEPP market could play an important role in the diversification of funding of the European economy that the Capital Markets Union seeks to achieve.

In Europe, what might help tear down the savings barriers?

- Harmonise UCITS marketing rules to eliminate duplication, divergence, and conflict among various member state requirements. Further, create a pan-European regime for private placement;
- Remove member state rules that impede UCITS market access by cross-border funds. For example, develop expedited procedures for minor changes or for UCITS that are 'clones' of existing authorised UCITS;
- Harmonise electronic transmission and filing processes to enable the single-market UCITS passport to be obtained through a single home member state filing, akin to the Markets in Financial Instruments Directive (MIFID) services passport;
- Improve and standardise tax treaty benefits across the EU, including for investment funds.

The time is now for creation of a single, pan-European marketing regime for UCITS. Facilitating more efficient cross-border distribution should increase competition, lower costs, and spur fund managers to innovate and find ways to offer superior services and products – all to the benefit of investors. We applaud the Commission's effort to deepen Europe's single market for funds, and welcome the dialogue that will follow in pursuit of this idea.

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