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Value Is in the Eye of the UCITS Holder

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ICI research shows a steady decline in the cost of investing in Undertakings for the Collective Investment in Transferable Securities (UCITS). European regulators are looking beyond just declining cost, however, by requiring UCITS managers to justify the value of these funds to investors. But how do investors assess value relative to cost, and what is the role of regulators?

Is There a Difference Between Cost and Value?

Yes—a big difference. Investors value UCITS that allow them to pursue their desired investment outcomes—regular income, capital growth, or both. Investors incur costs when using the services of a UCITS manager—professional management of a portfolio, access to a wide array of different global investment options, and the benefits of regulation and oversight—in pursuit of those investment outcomes.

That seems straightforward. But how do investors assess whether a UCITS will enable them to achieve their desired investment outcomes and whether the cost and quality of the UCITS manager's services will match their expectations? In other words, how do investors assess value?

There is no simple answer. Investors seek differing investment outcomes and assess the value of a UCITS based on its usefulness in achieving their particular outcomes. UCITS managers offer a wide range of UCITS with different approaches—such as providing asset allocation, index tracking, or active management—that appeal to different investors. But, with such a broad choice, value can be hard to define.

One simple, seemingly objective approach would equate low cost with high value. But such an assessment is badly flawed on two counts. First, it overlooks the many differences among investors—the investment outcomes they seek, the types of service they desire, and the goals they seek to fulfill, including, for some, achieving environmental, social, or governance (ESG) outcomes. Second, it fails to take into account the multitude of different ways UCITS managers seek to meet investor outcomes and objectives. Investors need to assess value on a more thorough basis that considers the UCITS' cost and performance and the UCITS manager's services.

Elements of Value: Cost

UCITS enable investors to access a wide array of global investment options. Investors pay UCITS managers a fee that is dependent on the asset class, management technique of the UCITS manager, and a range of other factors. For instance, actively managed UCITS are generally more costly than index tracking funds—investors pay average ongoing charges for actively managed equity UCITS of 1.36 percent compared with 0.28 percent for index tracking equity UCITS. The higher fees charged by active managers reflect the additional significant research about individual stocks or bonds, market sectors, or geographic regions for active UCITS—offering investors the chance to earn superior returns or to meet other investment objectives such as limiting downside risk, managing volatility, under- or overweighting various sectors, or altering asset allocations in response to market conditions. These characteristics tend to make active management more costly than management of an index tracking UCITS.

Investors assess the appropriateness of fees based on the UCITS manager's approach to achieving their desired investment outcomes—the target level of investment return—and the risk of not doing so.

Regulators have recently sharpened their focus on assessing whether UCITS managers are levying "undue" costs on investors that are inconsistent with, or prohibitive to, a UCITS achieving its stated outcomes and objectives. For instance, regulators are examining how UCITS managers ensure that they have their clients' best interest at heart and that costs and charges are reasonable and disclosed in a transparent and non-complex manner.

Elements of Value: Investment Performance

UCITS investors anticipate favorable future investment performance in line with their desired investment outcomes. Investor expectations are based on an assessment of the UCITS' investment objectives and investment horizon against desired investment outcomes, in either absolute or relative returns, and the UCITS manager's approach to achieving these outcomes. Regulators are examining more closely how the performance of UCITS matches investor expectations.

Elements of Value: Services

UCITS investors evaluate the services offered by a UCITS manager based on both “hard” and “soft” factors. The first includes the nature and quality of a UCITS manager’s investment approach; its organization, governance, and systems; its client engagement (e.g., reporting, customer service, complaints record); and other factors such as achieving sustainability-related investment outcomes. The second includes corporate brand, culture, and corporate values. Investors use a range of reference points when making this evaluation, including information from regulators, financial advisers, fund managers, and the media.

How Can Investors Be Supported When Assessing Value?

All investors need clear and correct information on costs, performance, and service to assess the value of a fund and understand how this fits with their expectations and intended outcomes. UCITS managers can provide this substantive information and regulators can support its clear and consistent disclosure to investors. Regulatory changes in the European Union, including MiFID II, have fostered simpler and more transparent fee disclosure, but further steps are necessary to ensure more harmonized and useful disclosure.

Some investors may benefit from professional financial advice to build a portfolio of UCITS to pursue their desired investment outcomes. Regulators should assess the distribution of UCITS to better understand investor choice, including the role and activities of intermediaries in fostering competition, delivering choice, and supporting investors in seeking out funds that provide the greatest value.

No single UCITS ticks all the boxes for all investors. Regulators should not favor one investment product over another—on the basis of cost or other metrics—or pass judgment on which UCITS provide the greatest value. Such an approach risks reducing choice, eroding efficient capital allocation and price discovery, and degrading competition and innovation. Instead, the market at large—with its myriad investors evaluating value with distinct outcomes in mind—is best placed to determine which UCITS best fit the bill.

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