

## Ongoing UCITS Fees Are Falling

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By Giles Swan and James Duvall

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UCITS are an example of EU financial innovation and a global success story. With €10.1 trillion in total net assets, UCITS help global investors save for financial goals, including retirement, education, and housing.

Like any investment vehicle, UCITS are not free: investors pay ongoing charges that cover a host of services. There is good news, as average ongoing charges have steadily declined. [A recent report](#) by the Investment Company Institute, which represents regulated funds globally, demonstrates this decline and highlights trends in the ongoing charges of UCITS.

The publication shows that average ongoing charges for both equity and fixed-income UCITS fell by about 20 basis points between 2013 and 2018. For equity UCITS, excluding exchange-traded funds (ETFs), the asset-weighted average ongoing charge fell to 129 basis points in 2018 from 149 basis points in 2013, while asset-weighted average ongoing charges for fixed-income UCITS fell to 79 basis points percent from 98 basis points.

An asset-weighted average—which gives more weight to the ongoing charges of funds with more assets—is the preferred measure for summarising ongoing charges. This is in contrast to the average, which over emphasises the ongoing charges of UCITS in which investors hold fewer euros.

ICI's report shows that many factors are driving this downward trend, including that investors are concentrating assets in lower-cost UCITS as higher-cost UCITS are closing.

Two other factors could accelerate this trend:

- Greater understanding of UCITS costs and charges
- Economies of scale

## Greater Understanding

Regulatory changes, including MiFID II, have fostered simpler and more transparent disclosure of costs and charges. EU policymakers continue to discuss how they can improve investors' understanding of what distribution costs encompass and how they pay for them. This is an important dialogue as there is no one-size-fits-all model covering fund distribution and financial advice charges.

For example, in the United States, mutual fund investors are choosing to pay for distribution and advice separately rather than through the fund. According to ICI research, 71 percent of US mutual funds' total net assets in 2018 were in no-load share classes where any payments for a financial professional's services are separate from sales commissions, or loads, paid through the fund. In addition, the vast majority of net assets in no-load share classes in the United States do not include distribution costs in their charges.

By contrast, UCITS retail investors predominantly pay for distribution and advice through ongoing charges that bundle the cost. At least half of the net assets in retail UCITS share classes are in bundled share classes. In recent years, in response to regulatory developments, UCITS have made available retail share classes that unbundle the cost of advice. These generally have lower ongoing charges than bundled share classes. If retail UCITS investors continue to shift towards unbundled share classes, one would expect, all else being equal, average ongoing charges of UCITS funds should continue to decline.

While there is no one-size-fits-all approach for how retail investors should pay for distribution and advice, they should understand the total cost of a UCITS. Ensuring that fee disclosures are as easy to understand as possible empowers investors to choose the payment method that is best suited for them. Greater transparency around costs also fosters competition, which tends to push charges downward.

## Economies of Scale

Economies of scale are another factor influencing ongoing costs. As funds grow larger, they can spread costs that are relatively fixed—such as transfer agency fees, accounting and audit fees, and depositary fees—across a larger base of assets. That means they contribute less to ongoing charges measured as a percentage of assets as a fund grows.

ICI research shows that at year-end 2018, the average size of a US mutual fund was €1.66 billion compared with €284 million for the average UCITS.

Given the scale of the average US mutual fund, it is not surprising that their average ongoing charges are lower than for UCITS—55 basis points for a US equity mutual fund compared with 129 basis points for an equity UCITS. The US retirement system allows mutual funds to achieve such scale.

Cross-border UCITS, which account for about two-thirds of UCITS assets, gain economies of scale by selling into, and gathering assets from, multiple countries. But such funds face hurdles in gaining economies of scale. Cross-border UCITS incur costs to research, understand, and comply with the marketing rules in each state where they are distributed. In addition, regulators may charge fees for processing and maintaining required marketing notifications.

Recently, the European Commission has focused on reducing these barriers. For example, a new law provides flexibility for a UCITS to determine whether to establish local investor facilities in each jurisdiction in which it is available for sale. These physical business presence requirements can be costly, especially for smaller funds, and any effort to help reduce these fixed costs will allow funds to achieve greater economies of scale and thus reductions in their ongoing charges.

As the distribution and regulatory landscape has evolved and UCITS investors have gravitated towards lower-cost products, UCITS ongoing charges have steadily declined. Continuing to improve investors' understanding of costs and charges and fostering greater economies of scale could further reduce UCITS ongoing charges. That would significantly benefit UCITS investors around the world.

*Giles Swan is director of global funds policy at ICI Global. James Duvall is an associate economist at ICI.*

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