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Cross-border distribution of funds in Europe: identify the real barriers and enhance investors' confidence

The European Capital Markets Union action plan set forth the possibility that obstacles to cross-border investment of European investment funds persist. These obstacles are caused by national law or government practices. To assess their extent, the European Commission has made public a consultation on the cross-border distribution of investment funds, primarily addressed to managers, distributors, and European investors. The aim is to gather their opinion on the reality of barriers to entry that may hamper the distribution of European funds in other countries (distribution costs, fees and taxes, administrative measures, etc.). This position paper is a reasoned response to this consultation.

The European passport is dynamic, and working efficiently

Passports seem to be widely used within the European Area

The first observation is that the European passport mechanism, already well known to professionals, is widely requested by European funds. PwC emphasized that 74,000 European passports were distributed in late 2014 (both UCITS and AIFs), a number driven notably by the large number funds from Ireland and Luxembourg and distributed in other European countries[(1)]. These numbers highlight the success of the passport mechanism in terms of cross-border marketing of funds.

Most European countries are clearly quite open to funds coming from other countries in Europe, which often make up more than half of the funds offered in their territory (Italy: 89%, Germany: 88%, Spain: 81%, Belgium: 74%, Ireland: 43%, and Luxembourg: 13%)[(2)] . In France, the number of European funds obtaining a passport is rising steadily, currently at more than 800 AIFs and 6,700 UCITS in 2015, or 42% of funds marketed in France. While French management companies also export their products to other European countries (634 passports for marketing UCITS and AIF products in 2015), they do so in lesser proportions, with greater diversity in their destinations than funds entering France (most of which come from Luxembourg or Ireland).

The primary administrative formality, the passport, does not seem to be a hindrance to entry in terms of cost or time

The European passport is working efficiently. Lead times are reduced, because as soon as a European fund has given its national authority the necessary documents, the fund can then launch its cross-border marketing. The obligation to translate the information conveyed about the product on offer in another European country, while it does add to the cost, seems legitimate in terms of investor protection and legal consistency between countries.

Concerning the costs of the passport, each country is free to set them, and they can be collected in the form of a tax set by its Parliament (as is the case in France), or fees set by the receiving country's market authority. The diversity of these fees demonstrates that the fee amount has no impact on the choice of export territories. For example, Germany and Italy, whose entry fees for marketing passports are among the highest (Germany) and the lowest (Italy) in Europe, both receive a virtually identical number of European funds.

Most importantly, these fees, which should be put into perspective in light of the legal costs of creating new prospectuses or new products suited to a new client base, are very low. Within a range of €0 to €4,000, they represent between 0% and 0.0016% of the average amount of assets under management in European funds[(3)] . Therefore, it seems unlikely that these fees could be a real barrier to getting established in a new European market.

Ultimately, in view of the success in numbers and the low associated costs, the European passport is working efficiently. However, for the time being, it does not seem to have resulted in a total commercial success, because a number of "passported" funds do not seem to be actively marketed across borders. Indeed, the number of funds that have completed the procedures and obtained a passport is much higher than the number of European funds actually being marketed. This means that certain barriers to marketing may persist, and that these seem to be more closely related to demand level and distribution networks than to administrative constraints.

There are limits on the distribution of "passported" products

The weight of distribution networks, primarily bank networks, in the product and service offering

Bank networks are the preferred distribution channels in Europe. In many countries, the very great majority of European funds' collection from institutional or individual parties is done by retail links to holding or private banks. Since the vast majority of these networks are domestic, this makes it harder to market funds that do not have relays within the bank networks. In France, this mode of distribution is important, as are the links between asset management companies and lending institutions. These latter may encourage the business in question to choose "house" products from their management companies. Given the range of the offering within the existing networks, this factor is not damaging for the consumer in terms of depth of offering, but it may be, in terms of cost.

Investments are needed to adapt to local consumers

Specific national features, in terms of investor profiles, create structural constraints, which must be factored in by any funds entering a national market. Within Europe, we are seeing major differences in terms of savings rates, assets, and risky asset holding (equities, mutual funds, and bonds)[(4)] . This latter makes up 11% of the value of household assets in Belgium, 5% in Germany, about 3.5% in Italy and France, and less than 2% in Spain. This shows that the products being marketed and the relevant guidance must adapt to local savings practices.

To this end, and as in all industries, any new entrant to the market must invest in business development, marketing, and advertising to stand out from the national products, send a signal as to the quality of its product, or offer competitive prices in order to attract new clients. This also presupposes a significant investment capacity, which favours large funds or niche strategies.

Heterogeneous tax laws are influencing supply and demand of financial products

European consumers are strongly urged toward national savings products offering tax advantages. For management companies that want to offer their products in another country, then, it is a question of grasping the differences between national laws, so as to offer products that comply with incentives in force locally. This means a legal compliance cost that may be substantial. In addition, there are, in certain European countries, fees or an additional administrative charge to comply with certain national tax statutes or procedures (appointing a tax representative, or sending specific financial reports, to obtain a preferential tax status for investors, as in Germany, Austria, or the United Kingdom).

National preference in financial products is still important for consumers

Varied consumer appetite for European products may also be explained by cultural biases emphasized by economic literature. The existence of a home bias and a family bias causes individual investors to prefer financial products that are issued by national actors, or whose brand or features are already familiar to them. These biases are also reinforced by a lack of financial education, which is quite uneven in Europe. The end result is that, with equivalent features, foreign funds will have more trouble being marketed in a given country than funds issued by national management companies.

A few suggestions for improving Europe's competitiveness

Promote technological innovation and European convergence on distribution and marketing

The digitalisation of distribution networks, which lessens the benefits of a local presence or familiarity with habitual distribution networks, may be a beneficial factor for lesser dependence on national distribution networks. We must also make sure that the recent financial regulations, due to their implementation cost, are not a factor that promotes closed architectures or existing large distribution networks.

To give digital a fair chance, the AMF recommends rethinking European oversight of freedom to provide services, by integrating these new distribution practices (e.g. defining concepts of territoriality and advising in the digital era), as well as harmonising marketing rules for online services and better cooperation in overseeing, investigating, and sanctioning online service providers. Also needed are a Europe-wide clarification of the "upstream" phase of providing services (pre-marketing) or available payment/delivery tools that would ensure continuity of European products and services all along the marketing chain.

Ensure equal protection for European investors, whatever the nationality of the product subscribed to

Cultural specificities must be considered in how information is sent to investors, so that it can play its role in full: to inform, explain, and alert. This means that, for the public, the language of marketing information must be the investor's language.

In addition, European regulations must not result in depriving the receiving country's authority of the means to ensure that the provision of financial services on a cross-border basis is suited to the specific nature of the retail investors located within its territory. In-depth knowledge of the individual investors' financial education levels, risk profiles, and preferences is required to ensure consumer protection, and thereby maintain confidence in products coming from other Member States. It would be dangerous to stop sending information on the European funds to the receiving authority when marketing them in its country. In such a situation, cross-border products and services could threaten the proper protection of retail investors and damage the image of products coming from other Member States.

Therefore, the AMF would like to see the role of national regulatory authorities endorsed as being predominant, to guarantee that supply meets the features of demand, specifically with regard to promotional literature on European funds.

Ensure equal protection for European investors, whatever their nationality

This is chiefly about improving the financial education of European investors so that they can better understand their investment actions. Europe-wide, the AMF is calling for the creation of a European financial education plan. Next, for consumers, knowing who to turn to in case of a problem related to a financial investment is critical. Easy access to a mediation system targeting financial products, as is the case in France, also makes it possible to simplify claims processes and give the investor confidence, including when purchasing European financial products.

Faced with illegal trading sites or dangerous platforms (Forex, binary options, etc.), the AMF wants every European citizen to be protected promptly, to avoid any crisis of confidence. To this end, every European national authority should have the option of reacting quickly, in case the originating government for the companies causing damage to its investors takes no action, by e.g. temporarily withholding authorization from such actors.

Thus, the AMF proposes a form of delegation of powers between competent authorities, in case of abusive practices or marketing unsuited to the target population. In order to act quickly to protect consumers, it would give receiving authorities the option of acting on behalf of the originating authority.

This proposal seems all the more relevant because it is rare to see the originating authority carry out any inspections in another European territory. Making sure there is ongoing dialogue and mediation at the ESMA level in such difficulties will result in improved protection of European investors.

En savoir plus

- Cross-border distribution of funds in Europe: identify the real barriers and enhance investors' confidence
- Three proposals to develop cross-border investments in Europe

Keywords EUROPE & INTERNATIONAL

[1] This observation is supported by the European Commission's Consultation, which estimates that 80% of UCITS and 40% of European AIFs are marketed across borders in Europe.

[2] Estimates taken from Lipper extractions done in April 2016 on the basis of primary active funds by country, UCITS and AIF combined (shown here as a percentage of the total number of funds).

[3] Average portfolio for European funds, taken from EFAMA estimates. See EFAMA (2015), "International Statistical Report Q3 2015".

[4] Arrondel & Savignac (2016), "Immobilier et actifs financiers des ménages : quelles différences de comportement au sein de la zone euro ?" [Household real estate and financial assets: what are the differences in behaviour within the eurozone?] ", Rue de la Banque n°19, February 2016, Banque de France.

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