EFAMA
European Fund and Asset Management Association

MARKET INSIGHTS

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BEYOND FUND CONSOLIDATION

A MORE PROMISING STRATEGY FOR BIGGER FUNDS AND FASTER COST DECLINES IN EUROPE

INTRODUCTION

The significantly higher number of investment funds in Europe compared to the United States is often cited as the primary reason for the much smaller average size of UCITS funds relative to US mutual funds. Many experts argue that this contributes to inefficiencies within the European fund industry and is a key factor behind the higher fund costs in Europe compared to the US. Discussions on this issue often conclude that removing barriers to consolidation in the UCITS market is essential for promoting the growth of European funds and lowering their costs.

This research paper finds that significant consolidation in the UCITS sector is unlikely to bring average fund sizes significantly closer to US levels and is also unrealistic. Instead, fostering conditions that support steady growth in fund assets is more likely to reduce fund costs while strengthening EU capital markets. Therefore, policymakers focused on competitiveness should prioritize measures that promote retail investing and private pension savings rather than emphasizing consolidation.

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RECENT TRENDS IN EQUITY FUNDS IN EUROPE AND THE US

The charts on the next page compare the changing number of equity funds in Europe and the US in recent years, as well as the average size of these funds. They confirm that there is a significantly higher number of equity UCITS in Europe, whereas their average size is much smaller compared to the US.

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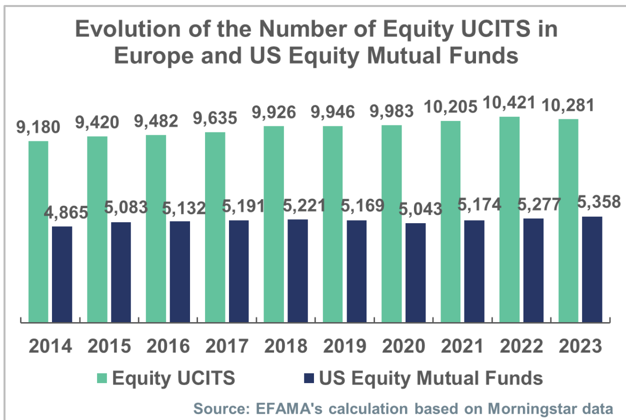
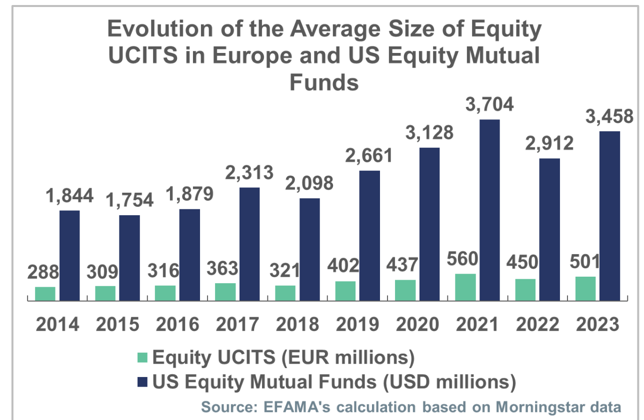
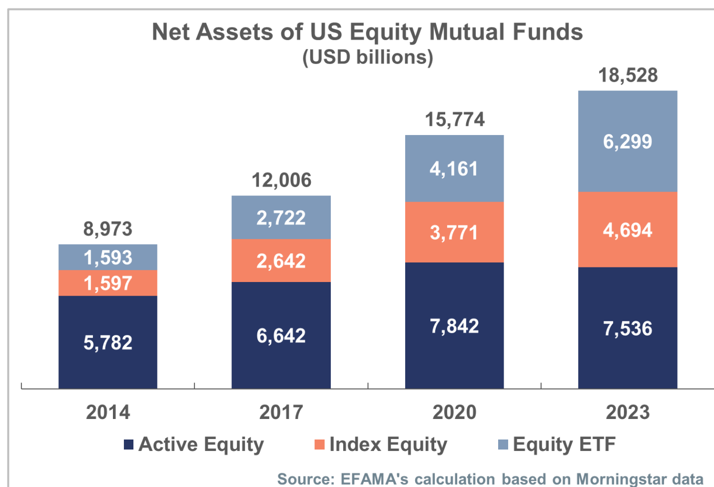


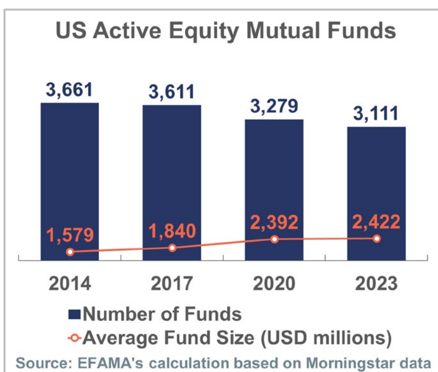


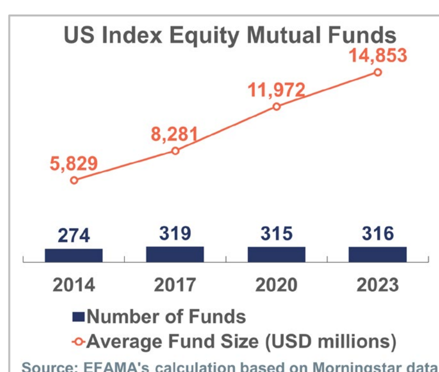
The charts below illustrate the evolution of the number of equity funds in the US, along with their net assets and average size, categorized into three types: actively managed funds, index funds, and ETFs[1].

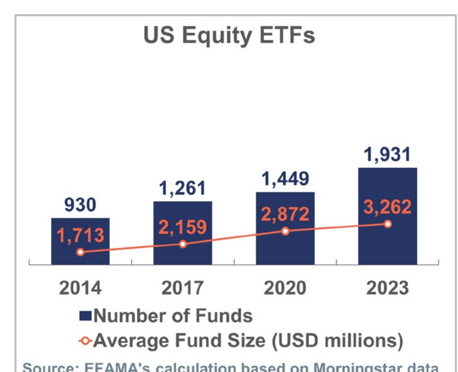
Active equity funds manage the largest share of assets, though their portion decreased from 60% in 2014 to 41% in 2023. This decline reflects the growth in the share of index funds, which rose from 18% to 25%, and ETFs, which increased from 18% to 34%.

Over the same period, the number of active funds declined from 3,661 in 2014 to 3,111 in 2023. In contrast, the number of ETFs surged from 930 to 1,931, while the number of index funds increased by 42. The average size of US index funds reached almost $15 billion, making them significantly larger than both actively managed funds and ETFs.









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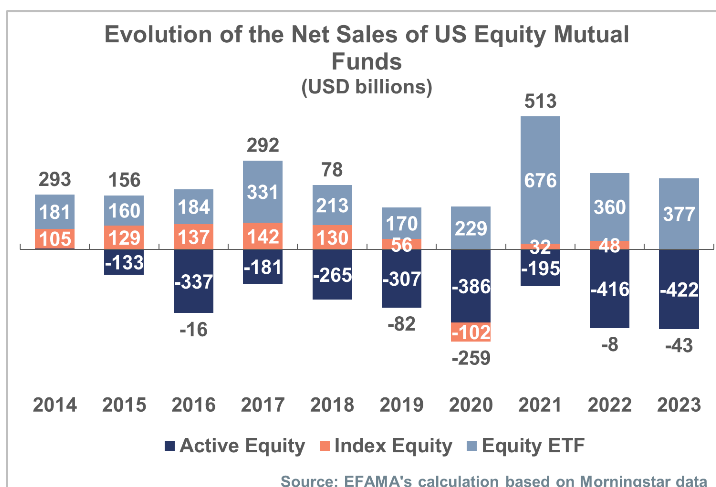
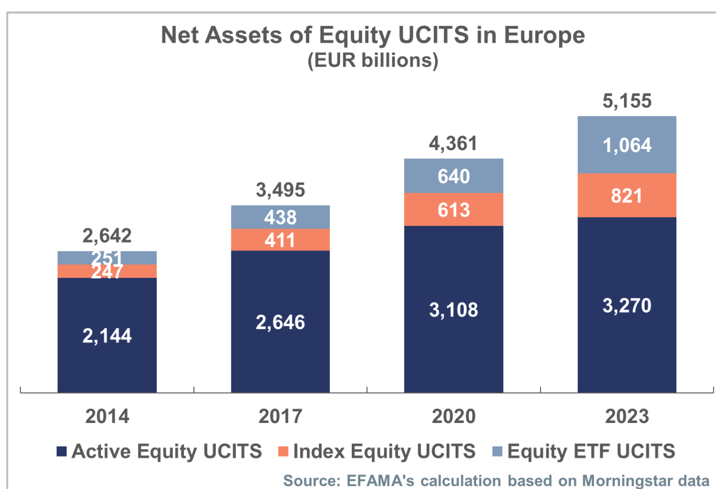
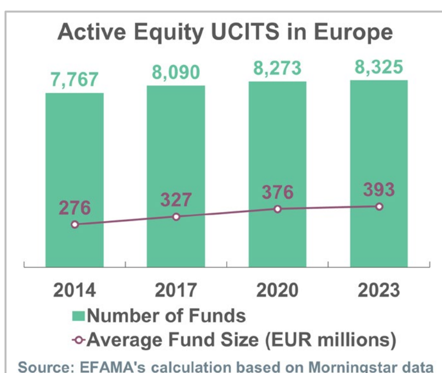
The sharp increase in the share of ETFs was mainly driven by strong investor demand. From 2014 to 2023, almost $3 trillion of new money was invested in ETFs, while active funds suffered net withdrawals of $2.6 trillion.

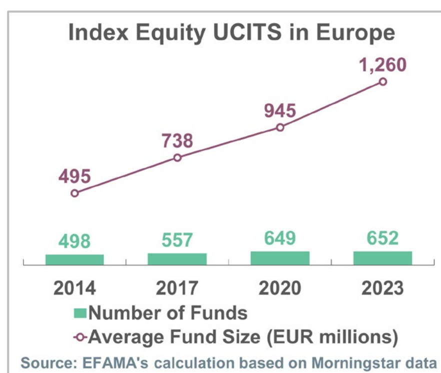


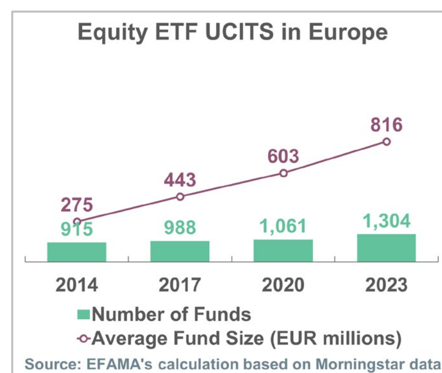
The charts below illustrate the evolution of the European equity UCITS market over the same period. Active equity funds manage the largest share of assets, though their portion decreased from 81% in 2014 to 63% in 2023. At the same time, the share of index funds rose from 9% to 16% and ETFs grew from 10% to 21%.

During this period, the number of active funds continued to grow, albeit at a slower pace in recent years, while ETFs saw the largest growth in number since 2014. The average size of active equity funds increased modestly to EUR 393 million, whereas both index funds and ETFs experienced significantly steeper growth in average size, reaching EUR 1.3 billion and EUR 816 million, respectively.









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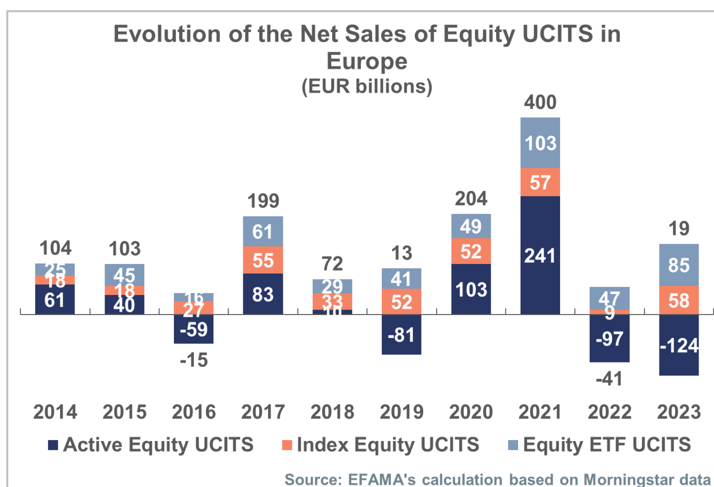
These trends reflect the evolution of investor demand, with ETFs gathering the largest amount of new money from 2014-2023 (EUR 501 billion), compared to EUR 380 billion and EUR 176 billion for index and active funds, respectively.

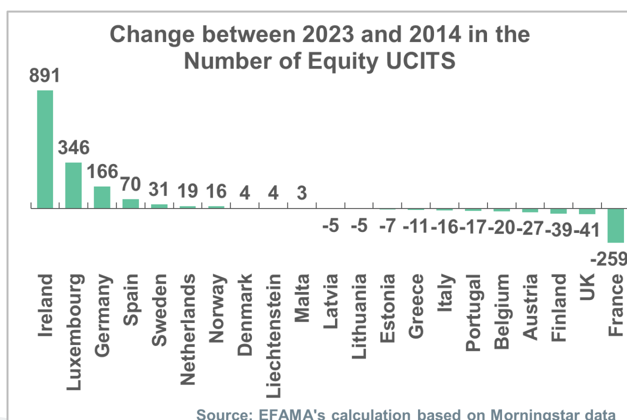


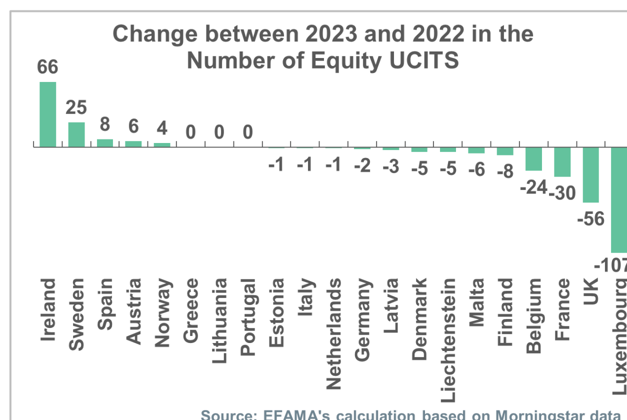
FUND CONSOLIDATION AND AVERAGE FUND SIZE

The large number of UCITS and their much smaller average size compared to US mutual funds raise significant concerns among policymakers, consumer organizations, and other stakeholders. Indeed, larger funds benefit from economies of scale to cover certain fixed costs such as costs related to regulatory filings, payments to custodians, fund administrators, and depositaries, expenses for financial reporting, and fees for legal counsel and independent auditors. This helps to explain why larger funds typically offer lower fees to investors. Our analysis in a separate report confirmed that the average cost of share classes with net assets exceeding EUR 1 billion is consistently lower than that of smaller share classes.[2]

These considerations have led to frequent recommendations to consolidate the UCITS market. For example, in its recent market report on the costs and performance of EU retail investment products, ESMA noted that UCITS are, on average, much smaller than US funds. It contended that this size difference can, at least partially, explain the substantial cost disparities between EU and US funds. In its accompanying press release, ESMA emphasized that "*the market inefficiencies revealed by this higher cost level show the need to focus on the competitiveness of EU markets, within a future Savings and Investments Union*."[3]

Fund consolidation can be achieved through various methods, including closing underperforming funds, merging them into better-performing ones, or purchasing a competing fund management company to streamline operations and reduce the total number of funds. Collaboration through a joint venture is another possible approach. Three key factors drive fund management companies to pursue these strategies: the increasing costs associated with regulation and data management, ongoing pressure to reduce fees, and value-for-money assessments that evaluate relative costs and performance.





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These factors help explain why the growth in the number of UCITS has slowed in recent years, with a decline in the number of funds in many domiciles, as illustrated in the charts on the previous page. Ireland and Luxembourg remain notable exceptions, largely due to the global success of the UCITS brand and the central role these two jurisdictions play in distributing UCITS across Europe and beyond.

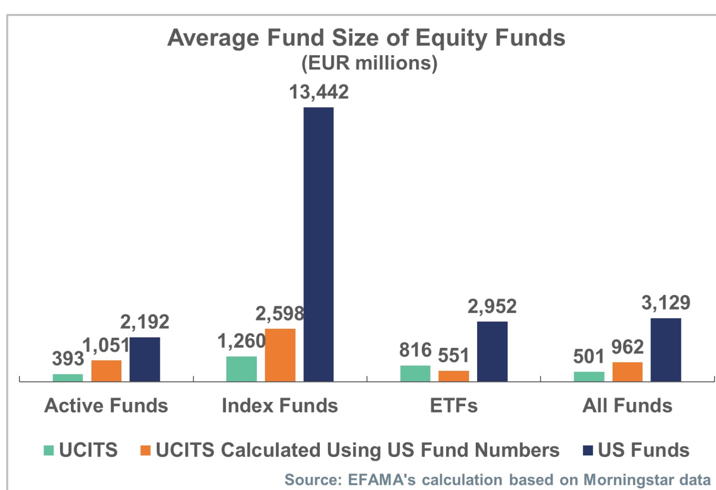
Although the number of equity UCITS domiciled in Luxembourg declined in 2023, the total number of funds decreased by only 140, or 1.4%. Various regulatory, operational, and market-specific challenges have kept this reduction minimal and are likely to continue limiting further declines in the coming years.

- **Regulatory Complexity**: While UCITS operate under a harmonized EU framework, divergent national rules create significant hurdles. These include variations in tax treatment, disclosure requirements, and registration procedures. Regulatory approvals for mergers necessitate coordination with multiple national competent authorities. Furthermore, merging funds often requires renegotiating distribution agreements, which can be a major obstacle.
- **Operational Challenges**: Aligning investment strategies, fee structures, and risk profiles across merging funds is complex. Integrating back-office systems, IT platforms, and reporting mechanisms can be both technically demanding and costly. Additionally, informing and securing consent from investors involve substantial efforts.
- **Market-Specific Issues**: Regulatory barriers, national tax regimes, language differences, local preferences, and entrenched networks of local fund distributors make it easier for fund managers to establish and maintain funds in their home countries. These factors cater to the needs of local distributors and clients while complying with local tax and investment rules. This dynamic explains the high number of UCITS domiciled at the national level. The greater the number of local requirements, the higher the likelihood of fund fragmentation and the lower the chance of successful consolidation.

Even if solutions were found to overcome these challenges and facilitate fund consolidation, the impact on the average size of UCITS would remain modest.

The chart below illustrates this by showing how the average size of equity UCITS would change if their number were reduced to match that of US funds. The results are striking: the average size of equity UCITS would rise to EUR 962 million but still fall far short of the US equity fund average of EUR 3,129 million.

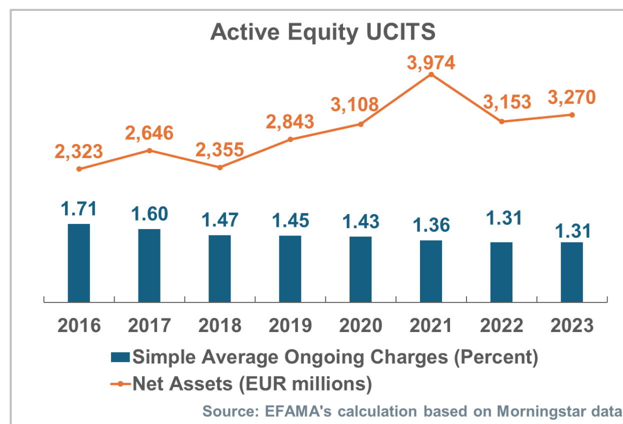
This highlights the inherent limitations of consolidation as a strategy for achieving scale comparable to the US market. This is especially true given that reducing the number of equity UCITS from 10,281 to 5,358 to match the count of US mutual funds is entirely unrealistic.

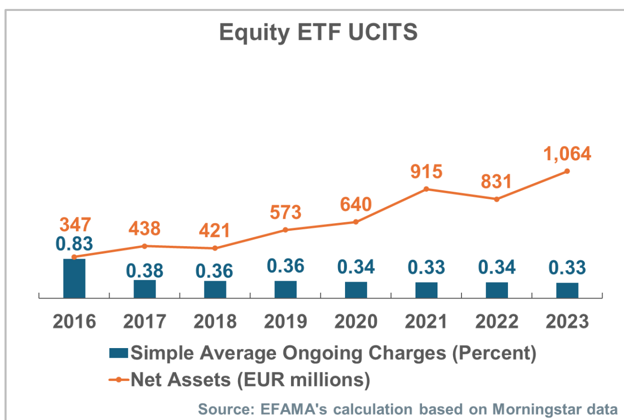


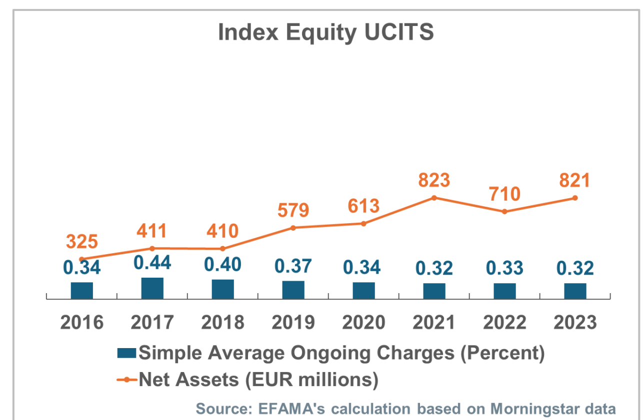
FUND ASSET GROWTH VERSUS FUND CONSOLIDATION

Rather than focusing on reducing the number of UCITS to increase their average size and lower costs, a more effective strategy would be to foster conditions that support the continued growth of UCITS assets. A Granger causality test confirms that the net assets of equity UCITS significantly influence their average ongoing charges across the three categories analyzed in this paper. The results are presented in the Annex and illustrated in the charts below.

Building on this finding, we strongly believe that encouraging better saving habits and strengthening the role of private and occupational pensions – within the framework of the future European Savings and Investments Union – would be crucial for increasing the average size of UCITS. A key reason for the disparity in fund sizes between the US and Europe is the much larger pension savings market in the US, where mutual funds play a central role in retirement planning. At the end of 2023, mutual fund assets held in defined-contribution pension plans and individual retirement accounts (IRAs) totaled $11.9 trillion, representing 47% of all mutual fund assets. This underscores the critical role of strong pension savings systems in driving fund asset growth and reducing costs.[4]







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CONCLUDING REMARKS

There is a stark contrast between Europe and the US in the number of available investment funds, with Europe maintaining a significantly larger pool. This discrepancy can be attributed to several factors, including the strong local presence of European fund managers and the success of global managers in leveraging the UCITS passport to sell funds across borders. Additionally, the rise of ESG funds and the growing popularity of ETFs – typically cross-border products – have further expanded fund offerings in these segments.

While fund mergers are often proposed as a strategy to consolidate the UCITS market, several factors suggest this approach is unlikely to substantially reduce the number of UCITS funds. Many local fund managers protect their market share within their home countries, relying on established local distribution networks to maintain their competitive advantage. Furthermore, US funds are predominantly sold domestically, while UCITS are marketed in numerous jurisdictions worldwide. These diverse markets, each with unique investor preferences and distribution structures, often require multiple funds tailored to specific local needs.

More fundamentally, our research indicates that even if Europe reduced the number of funds to US levels, the impact on average fund size would be limited. Therefore, if the primary policy goal is to lower fund costs for investors, the focus should shift from fund consolidation to fostering asset growth within existing funds. Both US and European experiences show that as fund assets grow, investor fees tend to decline.

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THE VOICE OF THE EUROPEAN INVESTMENT MANAGEMENT INDUSTRY

EFAMA is the voice of the European investment management industry, which manages around EUR 30 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities.

EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

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ANNEX - RELATIONSHIP BETWEEN TOTAL NET ASSETS AND AVERAGE ONGOING CHARGES[5]

We used the Granger causality test[6] to test whether the total level of net assets of equity UCITS can help predict the average ongoing charges of these funds. We estimate the following relationship between the two variables using yearly data during the period 2016-2023:

$$lnOngoing_Charges_t = \sum_{i=1}^{m} \alpha_i lnOngoing_Charges_{t-i} + \sum_{j=1}^{m} \beta_j \, lnNet_Assets_{t-j} + \varepsilon_t$$

$$lnOngoing_Charges_t = \sum_{i=1}^{m} \alpha_i lnOngoing_Charges_{t-i} + \sum_{j=1}^{m} \beta_j \, lnNet_Assets_{t-j} + \varepsilon_t$$

where Ongoing_Charges is the variable corresponding to the average ongoing charges of equity UCITS, and Net_Assets is the variable corresponding to the net assets of equity UCITS.

We applied logarithmic transformations to all the series to achieve stationarity, as the pre-analysis revealed that they were initially non-stationary.

The table below presents the results of the Granger causality test with 1 lag. It reveals that the null hypothesis that total net assets of equity UCITS do not Granger-cause their average ongoing charges is rejected. This rejection implies that the **total net assets of equity UCITS are significantly useful in predicting their average ongoing charges**.

Table I. Granger causality test statistics for the net assets and average ongoing charges of equity UCITS during the period 2016-2023

Null hypothesis (H_0)	No. of observations	F-statistics	P-value
ACTIVE EQUITY UCITS			
Net_Assets does not Granger cause **Ongoing_Charges**	8	6.36	0.07
Ongoing_Charges does not Granger cause **Net_Assets**	8	1.06	0.36
INDEX EQUITY UCITS			
Net_Assets does not Granger cause **Ongoing_Charges**	8	18.51	0.01
Ongoing_Charges does not Granger cause **Net_Assets**	8	0.33	0.60
ETF EQUITY UCITS			
Net_Assets does not Granger cause **Ongoing_Charges**	8	11.30	0.03
Ongoing_Charges does not Granger cause **Net_Assets**	8	0.00	0.95

Conversely, the reverse proposition does not hold true.

[1] Our analysis primarily relies on Morningstar Direct data, as EFAMA does not collect data on index equity funds. Although ICI has this data, we use Morningstar for consistency throughout the analysis.
[2] See Market Insights, Issue #15 , "The cost of UCITS to retail Investors" (March 2024).
[3] The ESMA report is available on ESMA here.
[4] See 2024 ICI Fact Book.
[5] This econometric analysis has been performed by Vera Jotanovic, Senior Economist, EFAMA.
[6] The Granger causality test is a statistical hypothesis test for determining whether one time series is useful in forecasting another. A time series *X* is said to Granger-cause *Y* if it can be shown that *X* values provide statistically significant information about future values of *Y*.