

THE COSTS OF UCITS AND US MUTUAL FUNDS

We can only compare like with like

It is often argued that European citizens are not able to fully benefit from the single market for investment funds, on the basis that the cost of UCITS is higher than the cost of mutual funds in the United States (US). In this Market Insights, we analyse this question by carrying out a detailed comparison of the cost of UCITS and US mutual funds, taking into account the various ways of calculating costs as well as the differences between Europe and the US in the way investment funds are distributed.

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KEY FINDINGS & MESSAGES

If we compare like with like, US mutual funds are not necessarily cheaper than UCITS.

- The simple average product cost of actively managed long-term and index-tracking equity funds offered to retail investors, i.e., the cost of the fund excluding the costs of distribution and advice, is currently slightly lower in Europe than in the United States.
- The cost of ownership of US mutual funds can be on average at least as high or even higher than the cost of UCITS when US investors pay to benefit from holistic financial advice (where the adviser considers a consumer's overall financial circumstances and objectives and makes recommendations to meet them).
- This result is relevant in the debate around a possible EU-wide ban on 'inducements' as it indicates that there is no guarantee that unbundling of the product and distribution costs will necessarily lead to a lower all-in price for retail investors. It is clear however that most investors cannot understand whether they are paying for the financial product, investment advice, or both combined. It would therefore be advisable to reassess the sheer volume of existing cost and charge disclosures to ensure that consumers realise how much they are paying for the quality of the product offered and the advice services that were provided, if any.

The asset-weighted average product cost of US mutual funds is significantly lower than that of UCITS. There are three main reasons for this.

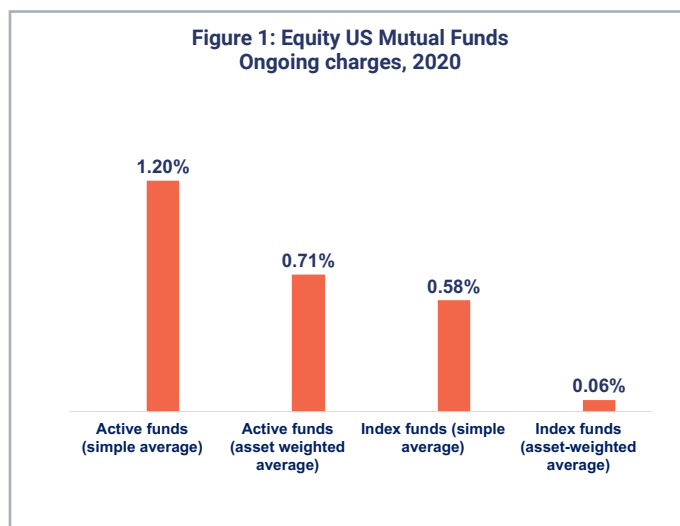
- First, the size and high degree of integration of the US mutual fund market allows fund managers to benefit from a large client base and generate important economies of scale in the US.
- Second, mutual funds play a major role in US retirement system, in particular through their 401(k) and other retirement accounts, which often invest in institutional low-cost share classes.

- Third, institutional shares offered to retail investors, in particular through their 401(k) plans, are included in the calculation of the product cost of US mutual funds, which is not the case for the UCITS covered in this study.
- These considerations highlight the importance of two policy objectives for the European Union: the need to further deepen the single market for UCITS and the importance of achieving the Capital Markets Union project, in particular in the area of pensions and investor education.

LOOKING-THROUGH ONGOING CHARGES OF US MUTUAL FUNDSⁱ

It is a fact that the ongoing charges paid by US mutual fund investors have declined substantially since 2000. However, the degree of this decline is partly driven by the way average charges are measured. This can be done using simple averages or asset-weighted averages and can encompass different investment strategies, investment styles (e.g., active and index), and client types (e.g., retail and institutional) or not.

Figure 1 demonstrates this by showing that the simple average ongoing charges figure of actively managed equity funds was 1.20% in 2020, whereas the asset-weighted average was 0.71%. The simple average ongoing charges figure of index equity funds was 0.58%, whereas the asset-weighted average was 0.06%. When the asset-weighted average is lower than the simple average, it indicates that larger funds tend to have below-average ongoing charges.



Source: ICI

It can also be calculated that the average ongoing charges of US equity funds were 0.50% in 2020 when calculated on an asset-weighted basis, encompassing retail and institutional share classes of actively managed and index funds. Three main factors explain this low fee level. First, the share of index equity funds in the market grew from 9.1% in 2000 to 30.4% in 2020. Second, US investors tend to invest in funds with below-average ongoing charges, in particular through their 401(k) and other retirement accounts, which often invest in institutional low-cost share classes. Third, over the past few decades, the vast majority of US investors have moved away from share classes charging both distribution fees (known as 12b-1 fees) and entry fees (known as sales loads) towards share classes sold without 12b-1 fee and sales loads. As a result of this changing distribution structure, 88% of gross sales of long-term mutual funds in 2020 went to no-loads funds without 12b-1 fees, up from 46% in 2000.

PRODUCT COST OF UCITS AND US MUTUAL FUNDS

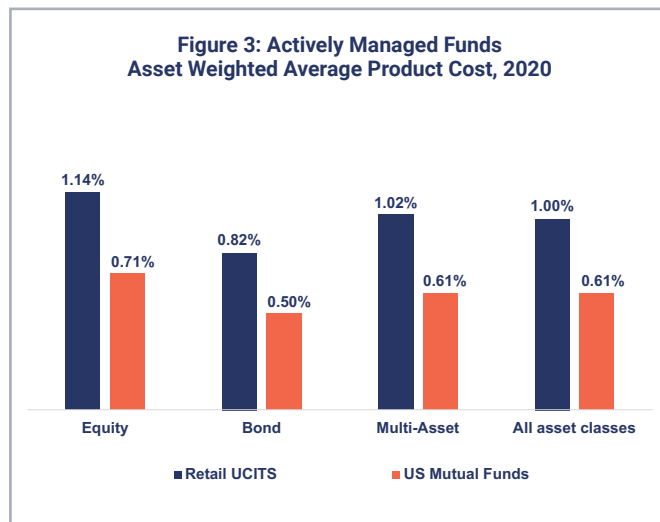
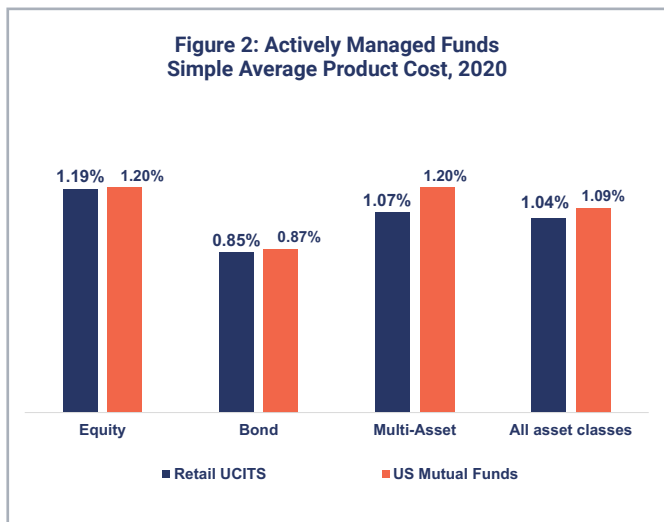
a. Actively Managed Funds

The above considerations highlight the importance of making a like-with-like comparison between the cost of UCITS and US mutual funds. In this section, we will focus on the product cost of actively managed funds, i.e., the price paid by the investor excluding distribution and advice costs.

For UCITS, we have used cost data of cross-border UCITS domiciled in Luxembourg and Ireland, which were obtained from [Fitz Partners](#), a fund research company that provides data on the product cost for which fund managers are directly responsible (net of distribution/advice costs), and the total cost of fund ownership, which includes the product cost as well as the costs of distribution and advice. We used this data in [Issue 6](#) in the EFAMA Market Insights series to analyse the cost of UCITS and we showed that the simple average product cost of actively managed cross-border UCITS offered to retail investors was 1.19% for equity funds, 0.85% for bond funds, and 1.07% for multi-asset funds, or 1.04% on average for these three categories of UCITS.

For US mutual funds, we have relied on data provided by the Investment Company Institute (ICI), with most of them being available in the [ICI 2021 Fact Book](#)ⁱⁱ. To estimate the product cost of US mutual funds, in theory, we should exclude the average distribution (12b-1) feeⁱⁱⁱ. However, the percentage of these funds held in load share classes charging a 12b-1 fee is extremely low (about 1%) and the 12b-1 fee charged in no-load share classes, which represent 72% of long-term mutual fund total net assets, is generally below 0.25% (the maximum allowed) and can be waived. For this reason, we have considered as a reasonable assumption that the product cost of US mutual funds can be estimated using the funds' ongoing charges.

Following this approach, Figures 2 and 3 compare the simple and asset-weighted product cost of actively managed UCITS and US mutual funds.



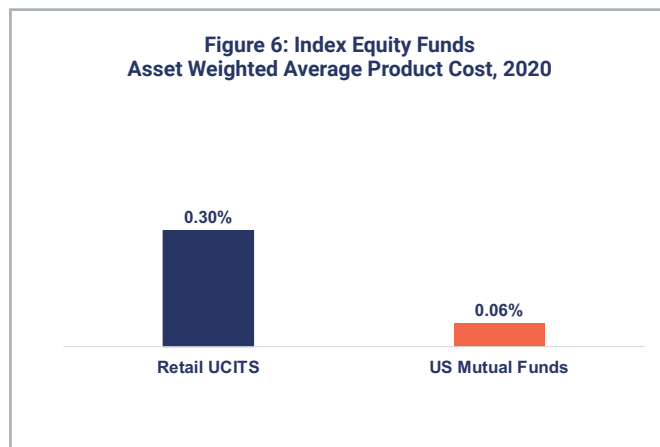
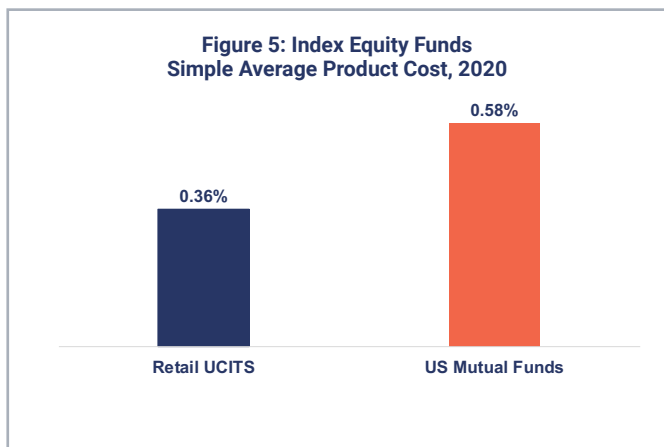
Sources: EFAMA calculations based on Fitz Partners' data, and ICI

It can be seen that:

- The simple average product cost of actively managed UCITS offered to retail investors is currently slightly lower than that of actively managed US mutual funds.
- When the comparison is based on the average asset-weighted ongoing charges, UCITS have a significantly higher product cost than US mutual funds.

b. Index Funds

Turning our attention to index-tracking funds, we find that the simple average product cost of retail index equity UCITS is lower in Europe than in the US, i.e., 0.36% against 0.58%. In contrast, when the average cost is calculated on an asset-weighted basis, the product cost of an index equity fund is significantly lower in the US than in Europe, i.e., 0.06% against 0.30%.

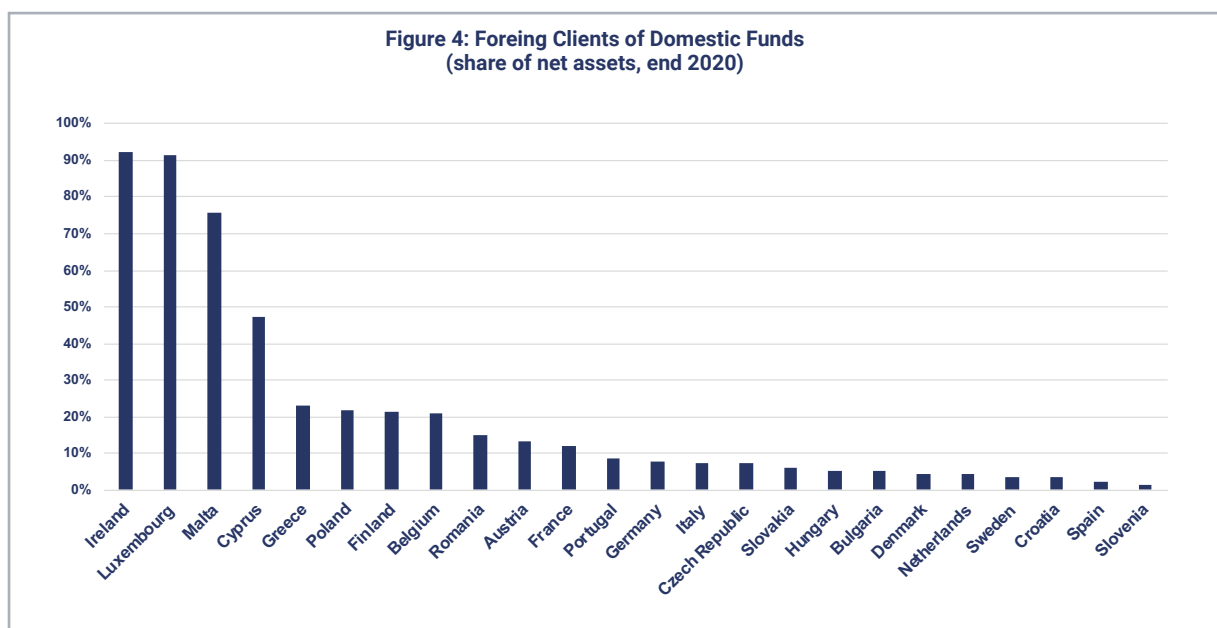


Sources: EFAMA calculations based on Fitz Partners' data, and ICI

c. Policy analysis and recommendations

The above results highlight that the product cost of US mutual funds is significantly lower than that of retail UCITS when costs are calculated on an asset-weighted basis. This finding can be explained by three main factors:

- **The size and a high degree of integration of the US mutual fund market.** This allows fund managers to benefit from a large client base and generate important economies of scale. The trend is particularly strong in the market for index equity funds whose average size is now more than four times as large as the average actively managed equity mutual fund (EUR 7.7 billion against EUR 1.8 billion). The situation is different in Europe where UCITS operate against a backdrop of 27 varying local regulatory regimes and different languages. This largely explains why the vast majority of home-domiciled funds are held domestically in most European countries, except in the cross-border fund centres, as shown in Figure 4 below. For this reason, there are considerably more UCITS in Europe than in the US (34,351, compared to 7,636 US mutual funds at the end of 2020). This situation prevents the emergence of UCITS that are as large as their US equivalents and explains why the asset-weighted average cost of UCITS is only slightly lower than the simple average cost.
- **The size of the US retirement system and the role of mutual funds in retirement savings.** At the end of 2020, US retirement market assets totalled \$35 trillion, and 32% of this market (\$11.1 trillion) is invested in mutual funds. Because of the huge amount of money invested in DC plans (such as 401(k) plans) and other retirement accounts (such as IRAs), savers benefit from the low cost of institutional share classes. On the other hand, the funded pension market is small in most European countries, except in the Netherlands, the UK and Sweden, and remains largely organised around national rules and restrictions.
- **The inclusion of institutional shares in the calculation of the product cost of US mutual funds.** The institutional market is characterised by a high level of competition among existing and new mutual fund sponsors, which puts downward pressure on costs. As regards UCITS, only share classes offered to retail investors are included in this analysis.



Source: EFAMA calculations based on ECB data

The above considerations highlight the importance of two policy objectives for the European Union:

- **The need to further deepen the single market for UCITS.** Many factors explain why the UCITS market is fragmented and predominantly organised along national lines, in particular national tax regimes applicable to investment funds and investors, gold-plating requirements, cultural preferences for domestic investment products, and, more recently, the drive of European fund managers to innovate and respond to the strong demand for products with a particular focus on E, S or G, which is likely to increase the number of UCITS in the coming years. Furthermore, regulatory barriers, in particular national rules concerning marketing requirements and the de-notification of UCITS from host Member State jurisdictions, limit the possibility of cross-border distribution.

The adoption of the UCITS IV Directive in 2009, which introduced master-feeder structures, a framework to facilitate the mergers of cross-border and domestic funds and a passport for management companies, helped achieve economies of scale and increase the average size of long-term UCITS, from EUR 137 million on 2010 to EUR 302 million on 2020. However, progress remained limited and, hence, the European Commission proposed new regulatory rules to reduce barriers to the cross-border distribution of UCITS, which were adopted in 2019. An important result of the [new rules](#) has been the removal of the requirement for asset management companies to establish a mandatory physical presence in a host jurisdiction as a condition for marketing their funds therein. Management companies will also benefit from a centralised and updated information database held by ESMA, which will facilitate the cross-border notification procedure.

In this context, we welcome ESMA's May 2021 [Guidelines](#) on marketing communications under the newly revised regime on the cross-border distribution of funds. We would however encourage further harmonization of marketing and fund distribution practices via ESMA's convergence powers to ensure a common interpretation of existing UCITS rules, as well as to discourage Member States' attempts at "gold-plating" such rules.

• **The importance of achieving the Capital Markets Union project**, in particular in the area of pensions. As stressed in the [Final Report of the High Level Forum on the CMU](#), "an enhanced take-up of capital-funded pensions would strengthen the demand side of the CMU by bringing considerably more assets to be invested in the European economy, increase risk sharing and stimulate integration of European capital markets." This would contribute towards the growth of a European equity culture. As a result, EU citizens will bear the fruits of the compounding returns of long-term and well-diversified stakes in the real economy. It is likewise important to strengthen the efforts to address the financial literacy gap which prevents the vast majority of European citizens from understanding why they should put their savings to better use. Financial individuals are also likely to better save for retirement to benefit from a more comfortable pension income.

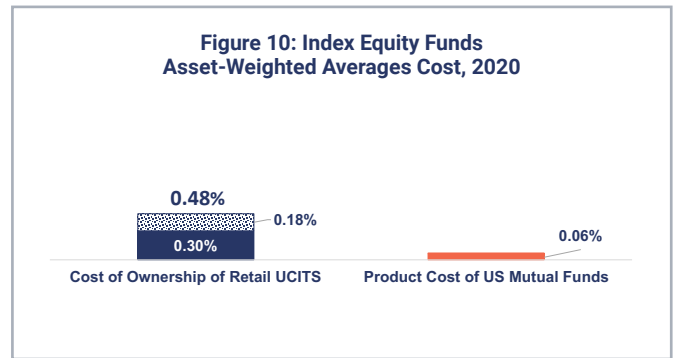
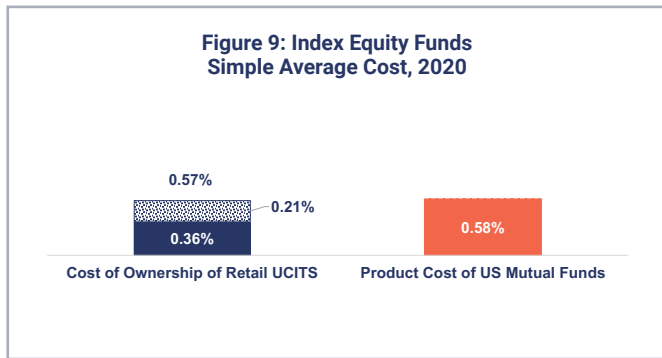
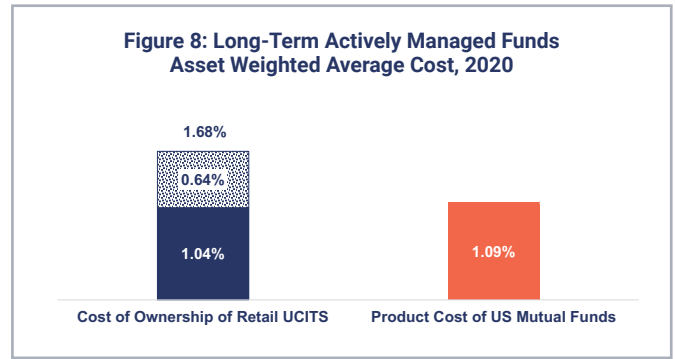
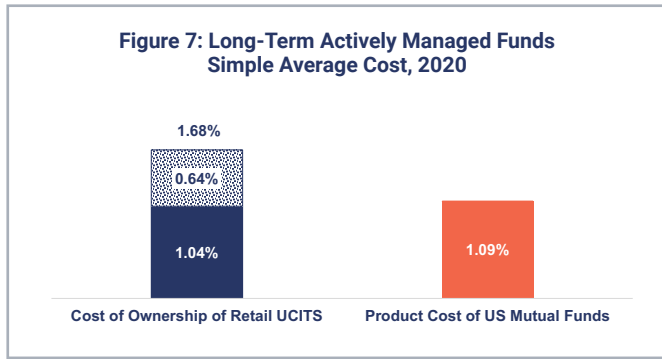
COST OF OWNERSHIP OF UCITS AND US MUTUAL FUNDS

a. Current State of the Market

Another way to compare the cost of UCITS and US mutual funds is to look at the cost of ownership. In Europe, except in the Netherlands and the UK, the distribution and advice costs are embedded in the total ongoing charges paid by retail investors to fund managers before being retroceded to distributors. In [Issue 6](#) in the EFAMA Market Insights, we showed that the simple average cost of ownership of actively managed cross-border UCITS was 1.68% for retail clients using advice-based distribution channels, with, on average, 38% of this fee (0.64%), being paid to distributors through retrocessions^{iv}.

In the US, investors have the choice of investing in so-called no-load mutual funds in which shares are sold without a commission or sales charge. However, a very large number of investors are paying intermediaries for advice and assistance out of their pockets. Indeed, according to ICI, 75% of households owning US mutual fund shares outside employer-sponsored retirement plans own funds purchased with the help of an investment professional providing investment advice and recommendations. The cost of this advice is paid by the investor directly to the financial professional, instead of being embedded within the fund's ongoing charges. Consequently, the asset-based fee paid to these professionals should be added to the product cost of mutual funds to get an estimation of the cost of ownership of these funds.

Figures 7-10 below compare the simple average and the asset-weighted average cost of ownership of UCITS and US mutual funds, assuming that US investors are investing in no-load share classes. Under this assumption, the cost of ownership of US mutual funds can be considered as being equal to their product cost. Under these circumstances, the average cost of ownership of US funds is lower than that of retail UCITS, except for index equity funds.



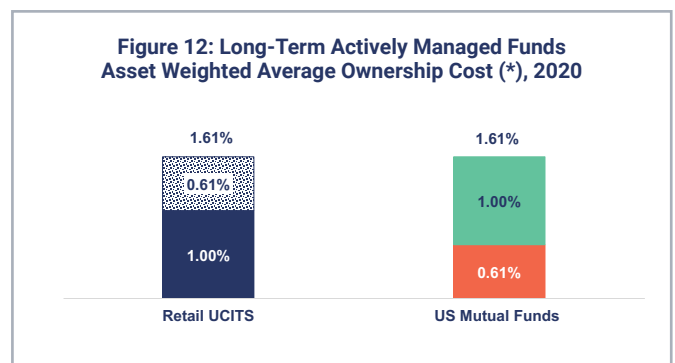
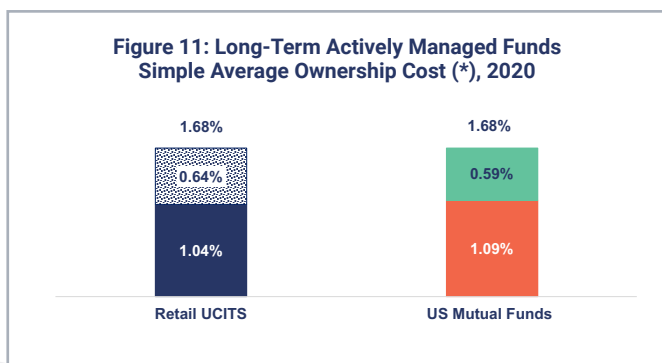
Note: the cost of ownership of retail UCITS is equal to the sum of the product cost and the costs of distribution and advice of retail UCITS.

Sources: EFAMA calculations based on Fitz Partners' data, and ICI

Figures 11-14 below show the maximum advice fee level that would equalise the cost of ownership of US mutual funds and UCITS when US investors pay intermediaries for advice. **The meaning of this concept can be illustrated by noting that Figure 7 shows that the cost of ownership of a long-term actively managed US fund whose product cost is equal to 1.09% will be lower than that of a retail UCITS if the advice fee is lower than 0.59%.**

The maximum advice fees shown in Figures 11-14 are rather low compared to the average fee charged by a professional providing holistic financial advice (where the adviser considers a consumer's overall financial circumstances and objectives and makes recommendations to meet them). By way of illustration, the usual fee in the UK is an average of 2.4% of the amount invested for the initial advice and 0.8% per annum for ongoing advice^v. In the US, according to ISS Market Intelligence, the advice fees range from up to 1.5% of managed assets for small investment accounts (those below US\$100,000) down to approximately 1.0% for larger investments (those over US\$1 million)^{vi}.

These considerations indicate that US investors are likely to pay a total cost of ownership higher than European investors if they want to benefit from holistic financial advice. **On the other hand, in general, they pay less than in Europe when they rely on low-cost automated advice services that do not involve face-to-face meetings and interaction with human financial advisers.**



**Figure 13: Index Equity Funds
Simple Average Cost of Ownership (*), 2020**



**Figure 14: Index Equity Funds
Asset-Weighted Average Ownership Cost (*), 2020**



(* These figures show the **maximum advice fees** that would equalise the cost of ownership of US mutual funds and UCITS when US investors pay intermediaries for advice. These fees are highlighted in green.

Sources: EFAMA calculations based on Fitz Partners' data, and ICI

b. Policy Analysis and Recommendations

Our analysis shows that US mutual funds can be on average at least as costly or even more expensive than UCITS when US investors pay an asset-based fee to a financial professional to identify their financial goals, analyse their existing financial situation and receive investment advice. This result is relevant in the debate around a possible EU-wide ban on 'inducements' as it indicates that there is no guarantee that unbundling of the product and distribution costs will necessarily lead to a lower all-in price for retail investors.

Of course, as explained earlier, US investors may decide to invest without receiving advice and in this case, they would invest on average at a lower cost than European investors. Still, it is also true that the majority of European households, especially among the less wealthy part of the population, lack the proper skills and competence level to invest without assistance. **This highlights the value of having access to investment advice to understand the benefits of investing in capital markets as well as the drawbacks of keeping an excessive amount of savings in cash.**

Within this context, there are two points to be mindful of. First, it is well documented that many retail clients do not seek the sort of advice that would equip them to make better investment decisions. The [evaluation](#) of the impact of the Retail Distribution Review and the Financial Advice Market Review published by the Financial Conduct Authority (FCA) in the UK in December 2020 confirmed this by showing that (i) only 8% of UK adults received regulated financial advice in 2020 and (ii) access to advice is, in practice, limited for consumers with smaller pots. Second, the FCA research also found that many consumers do not feel comfortable using automated advice services relying on algorithms. Most people want to speak to a person, especially during the initial onboarding process, to make sure they are not making mistakes. This can explain why robo-advisors remain a small fraction of the advice market. **Any debate on a ban on inducement should consider these points and particularly the potential risk of an advice gap for the group of retail clients who is most in need of guidance.**

Finally, our analysis confirms that distribution costs are a crucial component impacting the total cost of ownership borne by investors. The assessment of distribution costs is, however, significantly impaired due to scarce data availability. ESMA highlighted this point in its latest report on the performance and costs of EU Retail Investment Product, noting that distribution costs "are not included as a specific cost as we are not able to identify such fees"^{vii}. In those circumstances, **despite the sheer volume of the existing cost and charges disclosures, it is clear that most investors cannot understand whether they are paying a fee for the financial product, investment advice, or both combined. It would therefore be useful to reassess those disclosures to ensure that investors are presented with the most relevant information front and centre to enable them to make informed and appropriate investment decisions.**

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FOOTNOTES

ⁱ This section is based on information presented in Chapter 6 of 2021 [Investment Company Fact Book](#).

ⁱⁱ To be precise, ICI provides data on US fund expense ratios, which are nearly identical to the ongoing charges.

ⁱⁱⁱ Entry fees, or sales loads as they are called in the US, are not included in the ongoing charges, in either Europe or the US. This means that only the 12b-1 fees should be deducted from the ongoing charges of mutual funds to have an estimation of their product cost.

^{iv} This estimation of the cost of ownership does not include entry and exit fees that may be paid by investors. These fees vary between types of funds, share classes, markets and individual distribution arrangements. As these fees are often subject to negotiation and may vary for individual fund transactions, they are not taken into account in this analysis. Their impact on the overall cost paid by the investors over the overall investment period.

^v See the [evaluation](#) of the impact of the Retail Distribution Review and the Financial Advice Market Review published by the Financial Conduct Authority (FCA) in the UK in December 2020.

^{vi} Institutional Shareholder Services group of companies (ISS) provide, among other things, high-quality data, analytics, insight and fund services for institutional investors and companies, globally. As part of its development, ISS acquired Strategic Insight in 2019. More on ISS can be found on its [website](#).

^{vii} See page 64 in [ESMA report](#).



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