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THE COST OF UCITS AVAILABLE TO RETAIL INVESTORS

KEY DETERMINANTS BASED ON CLEAN SHARE CLASSES

INTRODUCTION

The cost of investment funds has become an important topic of discussion in the context of the Capital Markets Union (CMU) project and its goal of improving access to capital markets for retail clients.

Recent studies show that fund costs have been declining steadily and that the decrease in costs is influenced by the launch of new and cheaper funds into the market. It has also been demonstrated that larger funds have lower costs than smaller funds.¹

The objective of this report is to complement these studies by making a detailed analysis of the key determinants of the cost of UCITS measured by the ongoing charges incurred by the investor.² We focused on different categories of active and passive equity and bond funds³ and tested our hypotheses using an econometric model.

Another original aspect of this research is that it analyses the cost of clean share classes available to retail investors, i.e., share classes that are devoid of commissions paid by fund managers to intermediaries distributing their funds. Thus, this report focuses on the product cost of UCITS, i.e., the price paid by retail investors excluding distribution and advice costs. For reasons of brevity and style, we will sometimes refer to the cost of UCITS or funds in the rest of the paper, on the understanding that we are referring to the cost of retail clean share classes.

RELATION BETWEEN THE SIZE AND THE COST OF UCITS

In this section, we compare the evolution of the ongoing costs of the top 25% retail clean share classes in terms of net assets (the 'big' share classes) with the costs of the other retail clean share classes (the 'small' share classes).⁴

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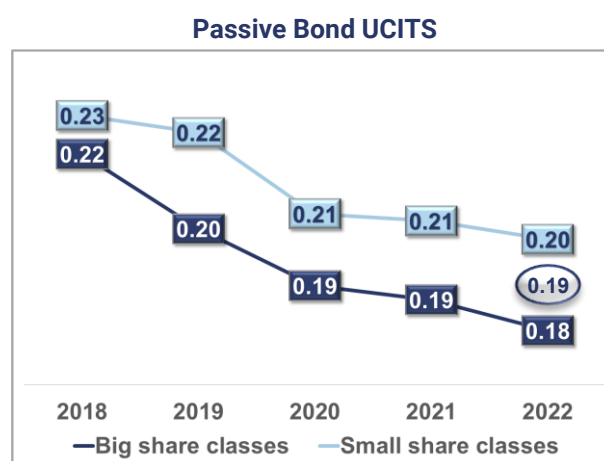
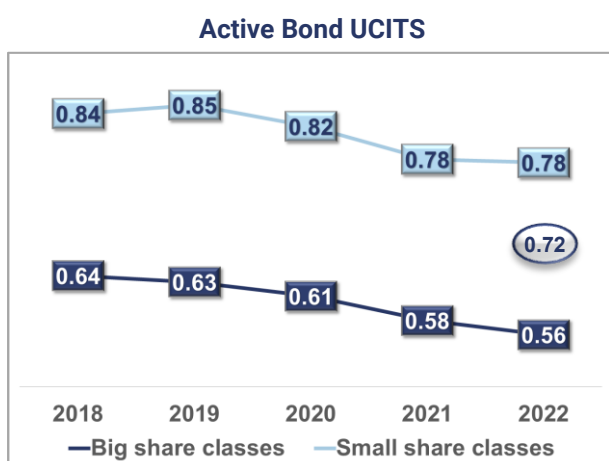
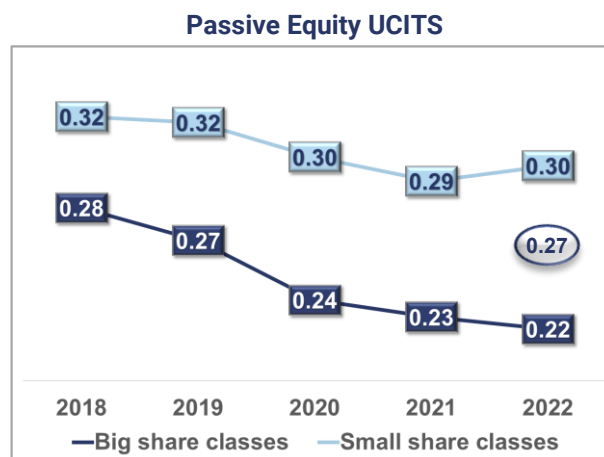
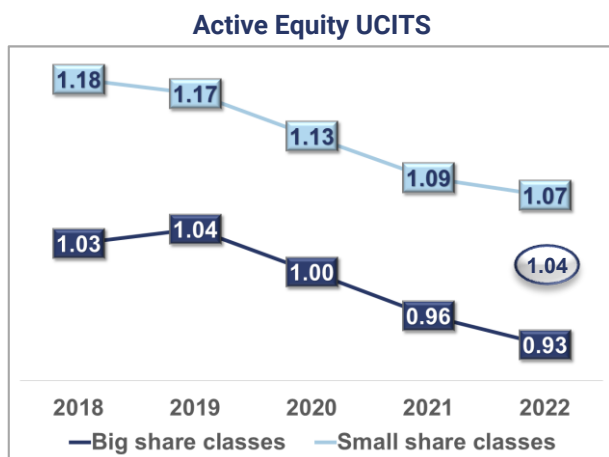
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The table below reports the average size of the big and small share classes covered in this report as well as the net asset levels (“thresholds”) beyond which share classes are classified as being big.

Category	Average retail clean share class size (EUR million)		Thresholds* (EUR million)
	Small share classes	Big share classes	
Active equity (12,055 share classes)	5	192	27
Passive equity (2,058 share classes)	48	1,421	246
Active bond (8,277 share classes)	4	150	22
Passive bond (813 share classes)	61	1,080	263

The charts below compare the evolution of the (simple) average ongoing charges of big and small share classes in 2018-2022.

Ongoing Charges of Retail Clean Share Classes (percent)



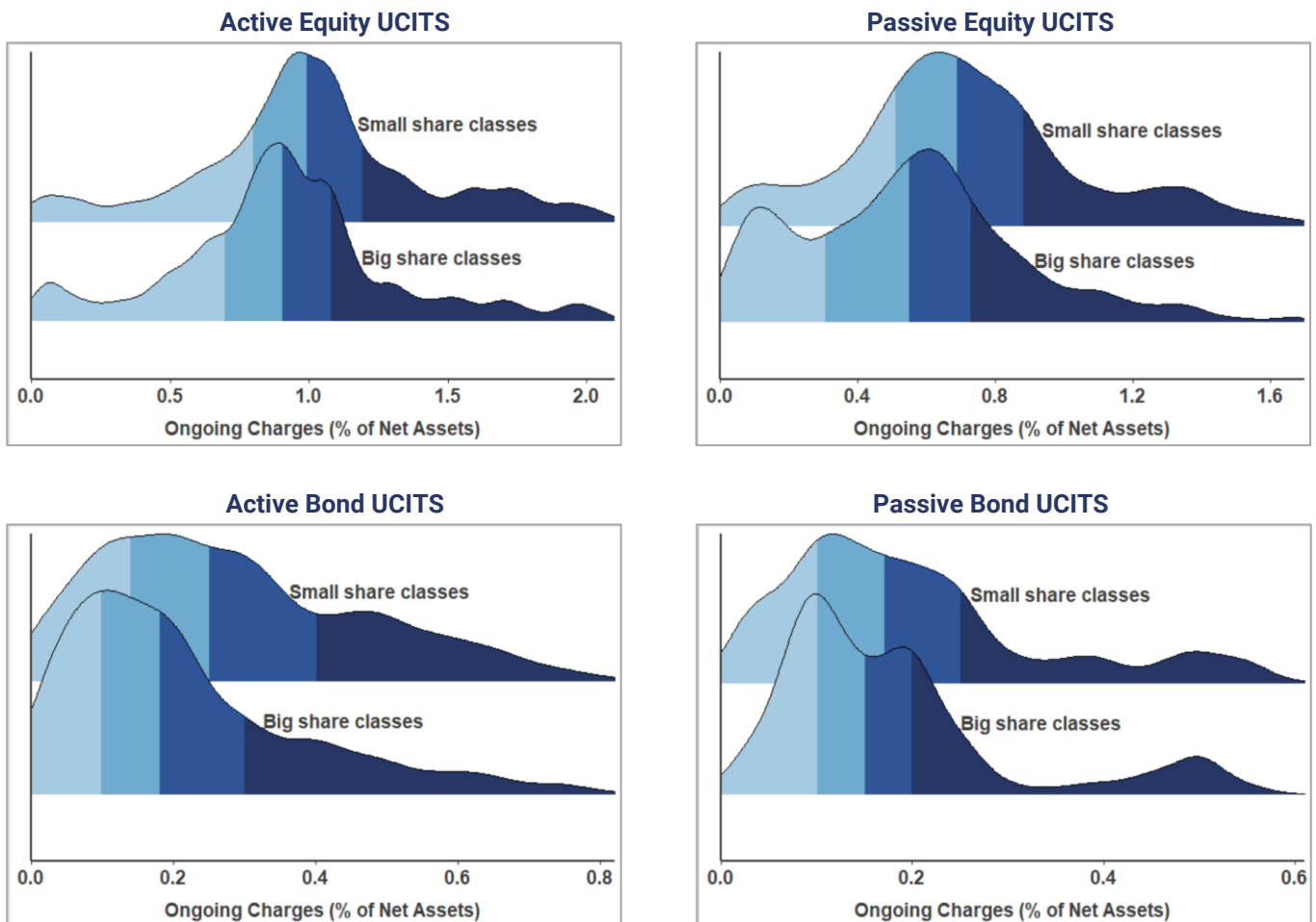
Note: The grey bubbles show the simple average ongoing charges of the retail clean share classes of the respective UCITS categories in 2022.
Source: EFAMA’s calculations based on Morningstar’s data.

The following observations can be made:

- The cost of retail clean share classes offered to retail investors has been falling steadily in recent years.
- The simple average cost of these share classes is slightly lower than the simple average cost of US mutual funds, for the four categories of funds analyzed in this section.⁵ This confirms the findings highlighted in a [previous issue](#) of our Market Insights series.
- Big share classes exhibit smaller average costs than small share classes across all sub-categories. We confirm this in a different way in Annex 1 by showing that the average cost of share classes with net assets bigger than EUR 1 billion is always smaller than the average cost of the big share classes.

The density distributions of ongoing charges displayed in the charts below show that averages provide an imperfect indication of the actual costs charged when investing in a small or a big fund. Also worth noting is that many small funds are cheaper than big funds.

Ongoing Charges of Retail Clean Share Classes (distribution)

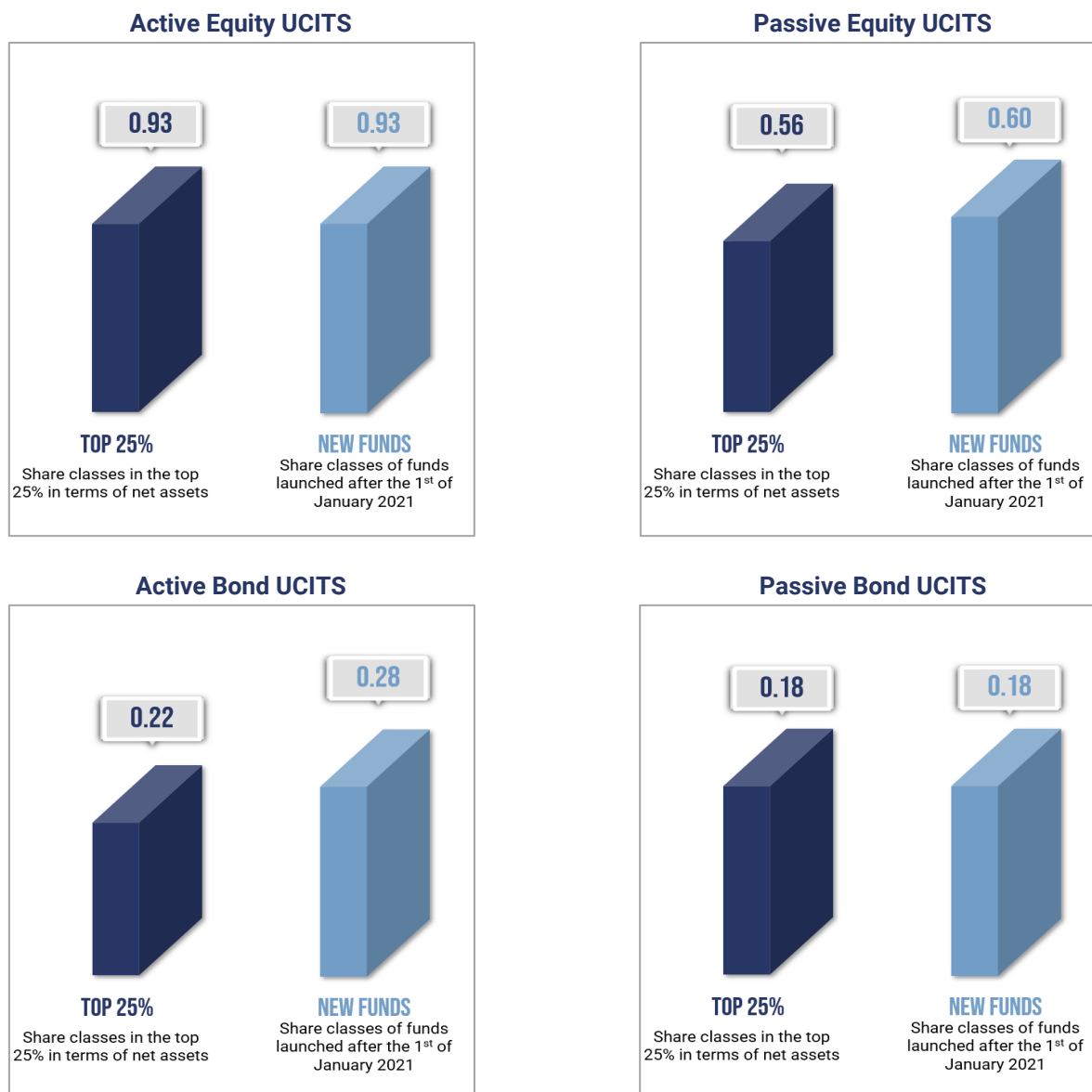


Source: EFAMA's calculations based on Morningstar's data.

RELATION BETWEEN THE AGE AND THE COST OF UCITS

We test the hypothesis that newer funds have lower costs by examining the costs of retail clean share classes launched after the 1st of January 2021. The charts below show that the average costs of these share classes are in line with the costs of the top-25% biggest share classes. This finding can be explained by the fact that investors are increasingly drawn to lower fees, particularly as the trend towards cost-consciousness gains traction in the market.

Ongoing Charges of Retail Clean Share Classes (percent, end of 2022)



Source: EFAMA's calculations based on Morningstar's data.

OTHER FACTORS AFFECTING THE COST OF UCITS

Next to fund size and fund age, the costs of UCITS are affected by other factors, including fund investment strategy, investment area, and regions of sale. We have analyzed the influence of these factors by comparing the average ongoing charges of the retail clean share classes of the different categories of UCITS shown in the table below.

The average sizes shown in the table are small because they measure the size of retail clean share classes and not of funds. This point is highlighted in Annex 2, which shows for eight categories of equity UCITS that the average fund size tends to be much larger.

Average Retail Clean Share Class Size (EUR million)		
Fund characteristics	Active equity	Passive equity
Investment strategy		
Large-cap	71	509
Small-cap	34	282
Investment area		
Global	55	345
One country	54	576
Region of sales		
Cross-border	44	532
Domestic	74	256
Fund characteristics	Active bond	Passive bond
Investment strategy		
Government	71	329
Corporate	44	377
Investment area		
Global	46	299
One country	77	375
Region of sales		
Cross-border	40	440
Domestic	78	159

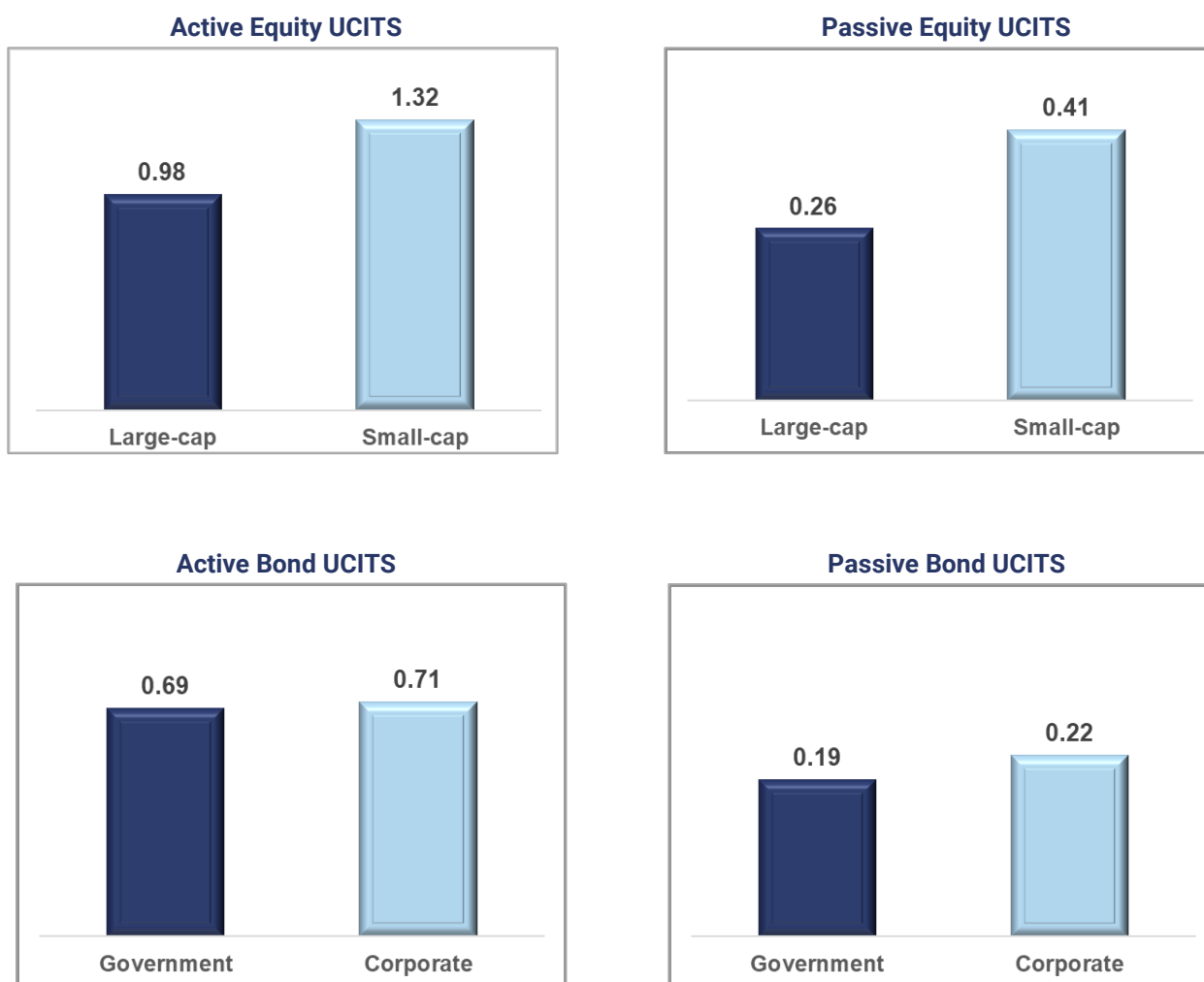
Source: EFAMA's calculations based on Morningstar's data.

Relation between the cost of UCITS and their investment strategy

We find that the average costs of retail clean share classes of active and passive equity UCITS investing in large capitalization companies have lower costs than those investing in small capitalization companies. This result is consistent with the fact that the retail clean share classes of large-cap funds tend to be bigger than those of small-cap funds.

In the bond funds universe, the retail clean share classes of active and passive corporate bond funds are only slightly more expensive on average than those of government bond funds. This finding is somewhat surprising because the average size of government bond retail clean share classes is significantly higher, and the management of corporate bond funds requires more research.

Ongoing Charges of Retail Clean Share Classes (percent)



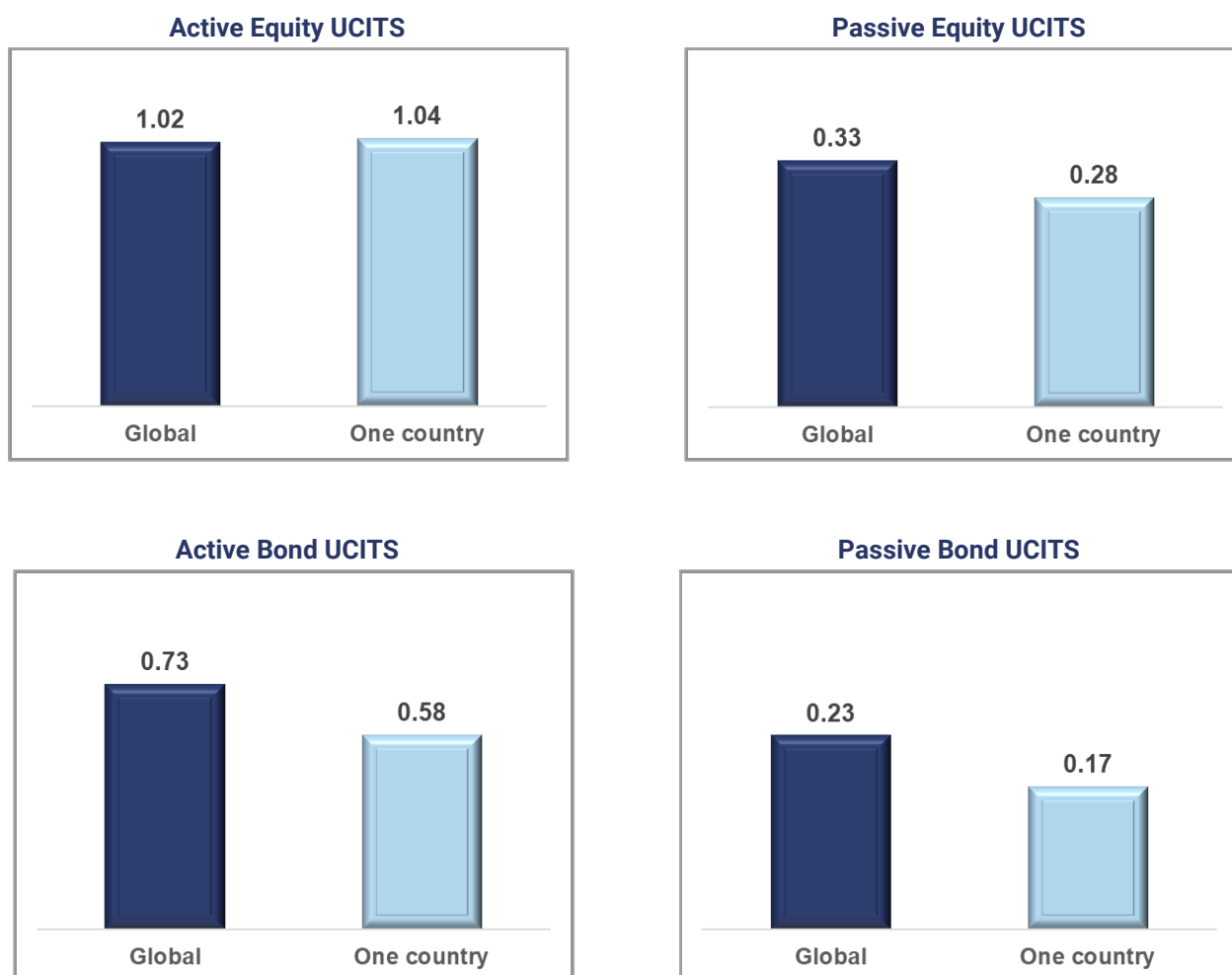
Source: EFAMA's calculations based on Morningstar's data.

Relation between the cost of UCITS and their investment area

We find that the retail clean share classes of active equity UCITS investing globally have almost the same cost as those of funds focusing on one country. This finding is consistent with the fact that the average size of these share classes is broadly similar. On the other hand, the retail clean share classes of passive equity UCITS investing globally are slightly more expensive than those of funds focusing on one country. This is in line with the fact that the average size of the retail clean share classes of global passive equity funds is smaller than that of equity funds investing in only one country.

In the bond funds universe, active and passive global bond UCITS are more expensive than funds investing in only one country. This finding is consistent with the fact that the average size of retail clean share classes of global funds is smaller than that of one-country funds.

Ongoing Charges of Retail Clean Share Classes (percent)



Source: EFAMA's calculations based on Morningstar's data.

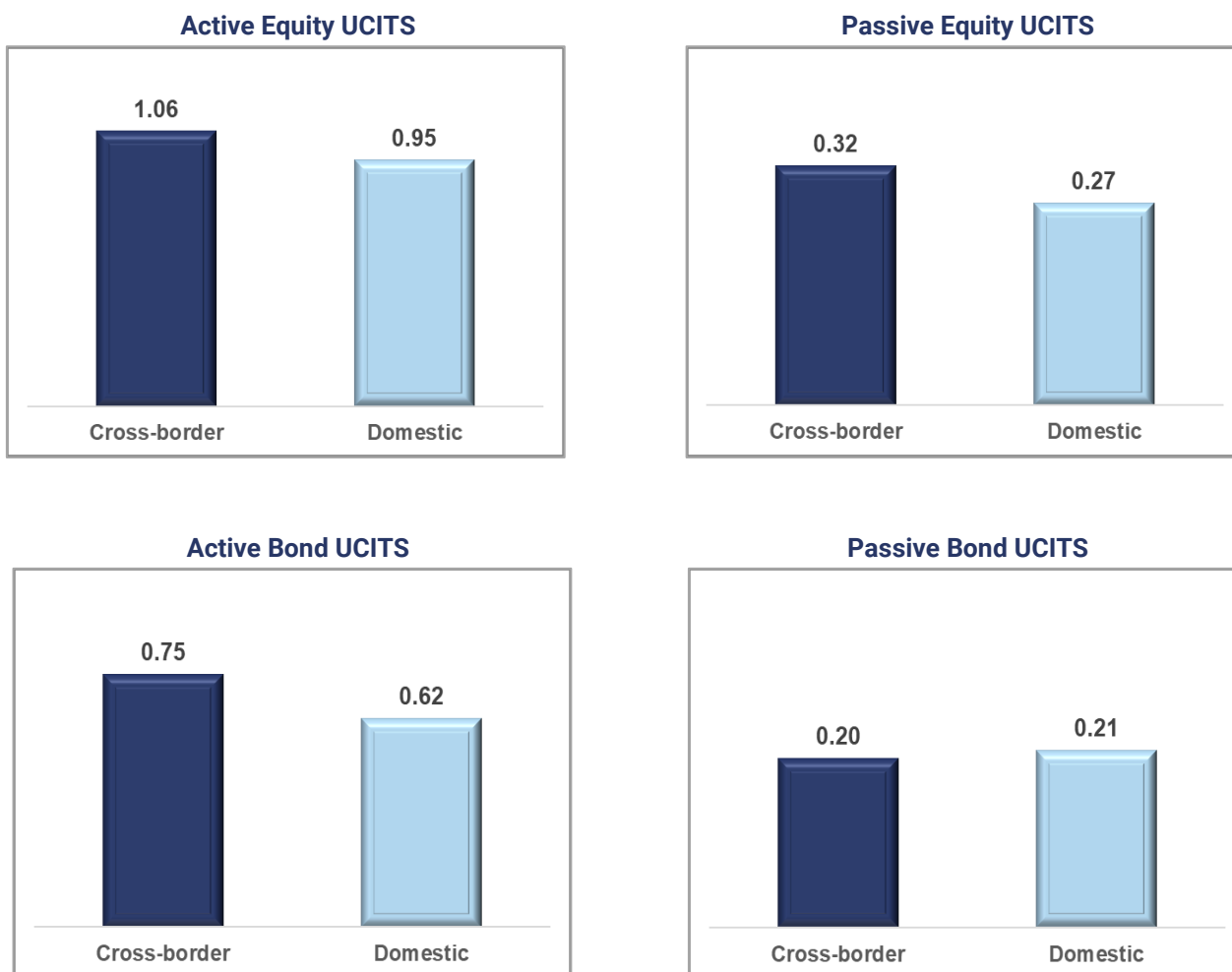
Relation between the cost of UCITS and their regions of sale

We use Morningstar's classification to distinguish between cross-border funds, i.e., funds that are registered for sale in at least 2 countries, and domestic funds that are sold in only one country.

We find that the average costs of the retail clean share classes of cross-border active equity and bond funds are higher than those of domestic funds. This finding is in line with the fact that the retail clean share classes of domestic funds are, on average, significantly bigger than those of cross-border funds.

In the passive market, the average cost of the retail clean share classes of cross-border equity funds is higher despite the fact that their average size is significantly bigger than that of domestic equity funds. It can also be seen that the ongoing charges of cross-border bond funds are only slightly less expensive, even though the average size of these funds is significantly bigger.

Ongoing Charges of Retail Clean Share Classes (percent)



Source: EFAMA's calculations based on Morningstar's data.

ECONOMETRIC ANALYSIS OF THE POTENTIAL DETERMINANTS OF THE COST OF UCITS

To statistically measure the relation between the cost of equity and bond UCITS and the factors analysed in the previous sections, we estimated the following equations using ordinary least squares (OLS), for active and passive retail clean share classes:

Regression equation for retail clean share classes of equity UCITS

$$Cost_i = \beta_1 + \beta_2 \log(Share_size_i) + \beta_3 New_i + \beta_4 Large_cap_i + \beta_5 Small_cap_i + \beta_6 Global_i + \beta_7 Cross_border_i + \sum_{j=1}^c \beta_{j,i} Domicile_{j,i} + \partial_i$$

where:

$Cost_i$ is the ongoing charge of the i^{th} retail clean share class at the end of 2022,

$Share_size_i$ represents the net assets in euros of the i^{th} retail clean share class,

New_i is the dummy variable identifying the retail clean share classes that were created after the 1st of January 2021,

$Domicile_{j,i}$ is the categorical variable identifying the i^{th} retail clean share classes registered in domicile j ,

$Large_cap_i$ and $Small_cap_i$ are the dummies for large-cap and small-cap funds,

$Global_i$ is the dummy for global funds,

$Cross_border_i$ is the dummy for cross-border funds, and

∂_i is the error term.

Regression equation for retail clean share classes of bond UCITS

$$C_i = \beta_1 + \beta_2 \log(Share_size_i) + \beta_3 New_i + \beta_4 Government_i + \beta_5 Corporate_i + \beta_6 Global_i + \beta_7 Cross_border_i + \sum_{j=1}^c \beta_{j,i} Domicile_{j,i} + \partial_i$$

where:

C_i is the ongoing charge of the i^{th} retail clean share class at the end of 2022,

$Share_size_i$ represents the net assets in euros of the i^{th} retail clean share class,

New_i is the dummy variable identifying the retail clean share classes that were created after the 1st of January 2021,

$Domicile_{j,i}$ is the categorical variable identifying the i^{th} clean retail share classes registered in domicile j ,

$Government_i$ and $Corporate_i$ are the dummies for government and corporate funds,

$Global_i$ is the dummy for global funds,

$Cross_border_i$ is the dummy for cross-border funds, and

∂_i is the error term.

We have the following comments regarding these equations:

- The variable corresponding to share class size is introduced in the regression equation in its log form to address the skewness of the distribution of the size of share classes and handle the possibility that the relationship between cost and size is not linear.
- We added a dummy variable to separate the newer share classes from the older ones. In simple words, the dummy variable takes a value of 1 if a share class was created after the 1st of January 2021 and 0 otherwise. If the coefficient of the dummy variable turns out to be significant and negative, this would confirm that new share classes tend to be cheaper.
- We also introduced dummy variables to group the funds by country of domicile to check whether the fund's domicile has an impact on the fund cost.⁸

The results of the estimation of the equations are presented below⁹ and summarized in the table on the next page.

ACTIVE EQUITY UCITS		PASSIVE EQUITY UCITS	
Depend. variable: Ongoing charges (12,055 observations)		Depend. variable: Ongoing charges (2,058 observations)	
Share class size (log)	-8.21e-3***	Share class size (log)	-1.52e-2***
New fund (dummy)	-1.58e-1***	New fund (dummy)	-1.78e-2
Large-cap (dummy)	-7.65e-2***	Large-cap (dummy)	-1.03e-1***
Small-cap (dummy)	2.69e-1***	Small-cap (dummy)	7.13e-2
Global (dummy)	-1.32e-2	Global (dummy)	2.29e-2**
Cross-border (dummy)	3.59e-3	Cross-border (dummy)	-7.01e-3
Adj. R squared	82.0%	Adj. R squared	69.3%

ACTIVE BOND UCITS		PASSIVE BOND UCITS	
Depend. variable: Ongoing charges (8,277 observations)		Depend. variable: Ongoing charges (813 observations)	
Share class size (log)	-2.04e-2***	Share class size (log)	-8.00e-3***
New fund (dummy)	-1.64e-1***	New fund (dummy)	-6.79e-2***
Government (dummy)	2.96e-3	Government (dummy)	6.81e-3
Corporate (dummy)	-7.24e-3	Corporate (dummy)	4.10e-2***
Global (dummy)	7.11e-2***	Global (dummy)	3.93e-2***
Cross-border (dummy)	3.81e-2***	Cross-border (dummy)	-5.84e-2***
Adj. R squared	75.2%	Adj. R squared	70.24%

The following observations can be made.

- **Size:** The coefficients of the share class size are negative and statistically significant in all fund categories. This means that on average the bigger the share class, the lower its cost. To run a robustness check, we have run the regression with fund size as the size regressor, instead of the share class size¹⁰. We found that our results remain robust in this model specification as well.
- **Newly launched funds:** The coefficient corresponding to a new fund is negative and highly significant in the case of active equity funds and active and passive bond funds. This means that new active funds tend to be cheaper than existing ones. This can be explained by the fact that new funds do not have a track record in terms of performance history and reputation; for this reason, they often charge a lower fee to attract investors. In the case of passive equity funds, the coefficient is not significant. Thus, new passive funds are not necessarily cheaper than existing funds, as their cost is already quite low.

- **Large-cap/Small-cap equity funds:** The coefficients for active and passive large-cap equity UCITS are negative and significant, confirming that funds investing predominantly in large capitalization have on average a lower cost. The reason for this could be found in the higher research costs of investing in small-cap companies.
- **Government – Corporate bond funds:** The coefficients for active and passive government bond funds and for active corporate bond funds are not statistically significant. However, the coefficient is positive and significant for passive corporate funds. This result indicates that funds investing in government bonds or corporate debt should not have an impact on the cost of their retail clean share classes, except for passive corporate funds that tend to be more expensive.
- **Global funds:** The coefficients for passive equity funds and active and passive bond UCITS investing globally are positive and statistically significant, implying that these funds tend to be more expensive than funds focusing on securities issued in one country. On the other hand, the coefficient for active equity UCITS investing globally is not statistically significant.
- **Cross-border funds:** The coefficient is positive and significant for active cross-border bond funds, suggesting that this category of funds tends to be more expensive than domestic funds. However, the coefficient is negative and significant for passive cross-border funds.

Impact of Different Fund Characteristics on the Cost of Retail Clean Share Classes				
(+ statistically significant positive impact, (-) statistically significant negative impact, (--) no significant impact				
Share class characteristics	Equity funds		Bond funds	
	Active	Passive	Active	Passive
Size ⁽¹⁾	—	—	—	—
New launched share class ⁽²⁾	—	--	—	—
Large cap equity funds ⁽³⁾	—	—		
Small cap equity funds ⁽⁴⁾	+	--		
Government bond funds			--	--
Corporate bond fund ⁽⁵⁾			--	+
Global funds ⁽⁶⁾	--	+	+	+
Cross-border funds ⁽⁷⁾	--	--	+	—

(1) The negative signs mean that an increase in a fund size tends to decrease its cost to investors.
(2) The negative signs mean that new launched funds tend to be less expensive than existing funds.
(3) The negative signs mean that large cap equity funds tend to be less expensive than small/mid cap funds.
(4) the positive sign means that small cap equity funds tend to be more expensive than mid/big cap funds.
(5) The positive sign means that passive corporate bond funds tend to be more expensive than other types of bond funds.
(6) The positive signs mean that global active equity funds and passive and active bond funds tend to more expensive than domestic funds.
(7) The positive (negative) sign means that the bond fund category concerned tends to be more (less) expensive than other bond fund categories.

CONCLUDING REMARKS

From a policy perspective, several conclusions are particularly important.

First, **the simple average cost of clean share classes of equity and bond UCITS offered to retail investors has declined in recent years**. The following factors contributed to this trend:

- **The rise of passive investing:** As a percentage of UCITS net assets, the market share of ETFs and index funds has grown from 9% in 2012 to 20% in 2022.¹¹ As investors have shown a preference for lower-cost investment options, many fund managers have no choice but to adjust their fees to remain competitive.
- **Investor awareness:** With increased access to information and greater (mandated) cost transparency, investors are better equipped to compare different investment options. As a result, they are more likely to choose funds with lower fees, putting pressure on fund managers to further reduce the costs of their funds.
- **Technology:** Advances in technology have made it possible for fund managers to operate more efficiently. Automation and improved systems have helped reduce operational costs, allowing fund managers to lower fees without compromising the quality of their services.

Second, **the simple average cost of retail clean share classes of equity and bond UCITS is lower than the simple average cost of US mutual funds**, which are already largely considered as low-cost products.

Third, **larger funds tend to have lower costs than smaller funds**. This is the case because economies of scale allow funds to absorb their fixed costs over a larger asset base. This helps explain why the asset-weighted average product cost of US mutual funds is significantly lower than that of UCITS as the size and high degree of integration of the US mutual fund market allow fund managers to benefit from a large client base and generate important economies of scale.

To see UCITS grow in size, it would be necessary to further deepen the single market for UCITS. In this regard, the recent conclusion of the AIFMD/UCITS review represents an important premise, to be complemented by the review of the UCITS eligible assets regime expected to start in the spring of 2024. We expect that the clarifications around the eligibility of several types of financial instruments – old and new – will be beneficial to further increase the attractiveness and the average size of UCITS funds for a broader retail and institutional audience.

Fourth, **other factors than size have an impact on the cost of funds, particularly their investment strategy and geographical focus**. This is the case in particular because funds investing in certain asset classes or geographic regions may require more extensive research.

Fifth, **the cost differences between the various categories of funds analyzed in this paper are small**. The largest cost differences among large-cap, small-cap, global and one country equity funds were 0.34% for active funds and 0.15% for passive funds. These differences are much lower than the differences in net returns that can be observed when comparing funds following different investment strategies. By way of illustration, the average net returns of the retail clean share classes of small/mid-cap passive equity funds, large-cap active equity funds and global passive equity funds were 11%, 15%, and 19% respectively in 2023.

Sixth, it follows from the previous point that **while cost is an important factor, other factors ought to be also considered**. To help them navigate the complex array of investment options and make informed decisions based on their investment horizon, risk appetite and preferences, most retail investors benefit from seeking financial advice. It is therefore essential to ensure that retail investors keep access to affordable and quality advice under the Commission's proposed Retail Investment Strategy.

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ENDNOTES

1. See for instance, [EFAMA 2023 Fact Book](#), [ESMA 2023 Report on Costs and Performance of EU Retail Investment Products](#), [ICI 2023 Report on Ongoing Charges of UCITS](#).
2. Ongoing charges include adviser, administration, custodian, legal and any other fees that will typically not vary from year to year. They do not include performance fees and transaction costs.
3. Passive funds include ETFs.
4. We split the distribution of each share class category at the third quartile, which serves as the respective threshold, distinguishing between big and small share classes.
5. Data on the cost of US mutual funds are provided by the Investment Company Institute (ICI) in its [2023 Fact Book](#). ICI provides data on US fund expense ratios, which are nearly identical to the ongoing charges. In theory, we should exclude the average distribution (12b-1) fee. However, gross sales to no-load mutual funds without 12b-1 fees represented 91% of total gross sales to long-term US mutual funds in 2022, and the 12b-1 fee is generally below 0.25% (the maximum allowed) and can be waived. For this reason, it is a reasonable assumption that the product cost of US mutual funds can be estimated using the funds' ongoing charges.
6. Funds sold in more than one country.
7. Funds sold in a single country.
8. To avoid the 'dummy variable trap' we exclude one country value from the regression, in accordance with econometric theory. The number of domicile countries differs in each regression, depending on where the funds are domiciled in a particular category. On average, there are around 20 domicile dummies per regression.
9. ***, ** and * correspond to 1%, 5% and 10% significance levels respectively. The model shows no problem of multicollinearity. The number of observations for each variable level are reported in Annex 3.
10. This robustness check allowed us to avoid small share classes belonging to big funds possibly biasing the results.
11. See page 43 of [EFAMA 2023 Fact Book](#).



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EFAMA is the voice of the European investment management industry, which manages over EUR 28.5 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.

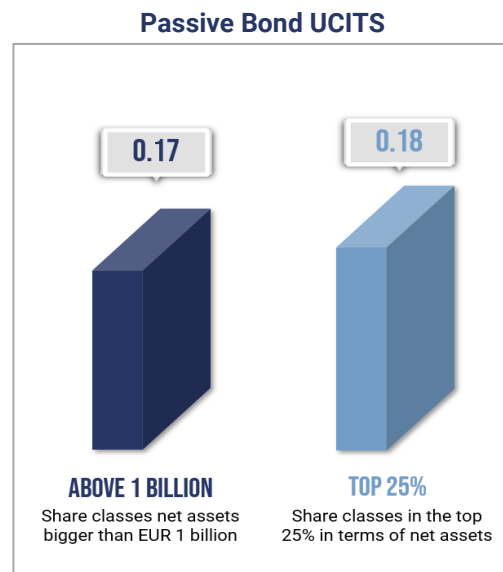
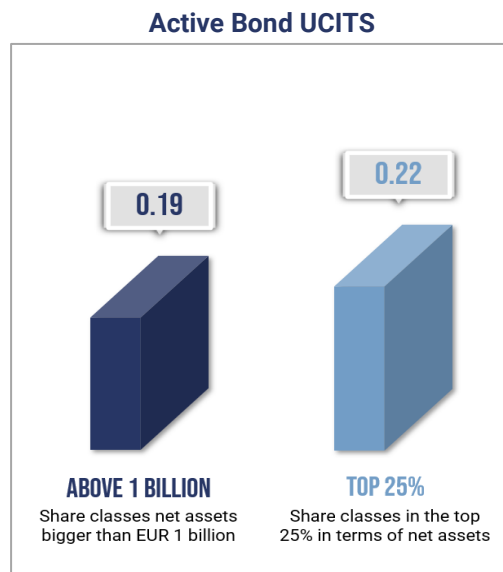
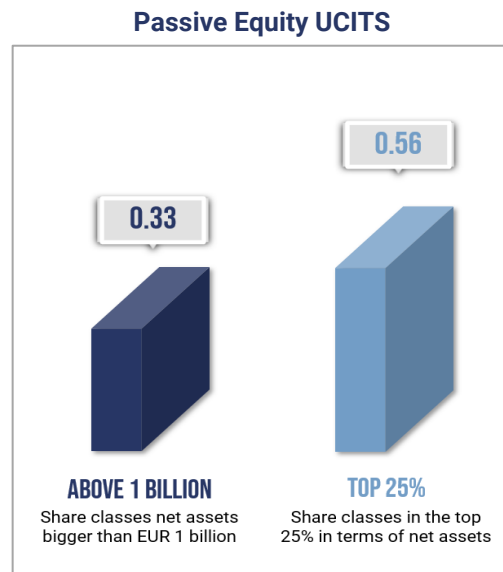
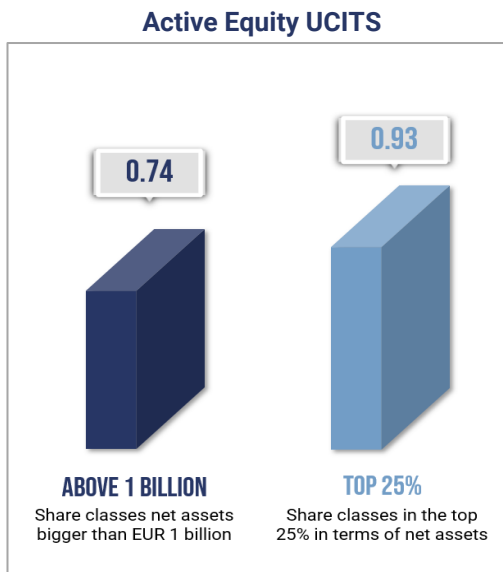
Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities.

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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EU transparency register: 3373670692-24

Ongoing Charges of Retail Clean Share Classes
(Percent, end of 2022)



Source: EFAMA's calculations based on Morningstar's data.

ANNEX 2

Average Size of Equity Funds (EUR million)		
Fund characteristics	Active equity	Passive equity
Investment area		
Global	306	789
One country	316	1,164
Region of sales		
Cross-border	347	914
Domestic	272	973

ANNEX 3

Number of Observations in the Econometric Analysis								
Regressors	Equity funds				Bond funds			
Continuous variable	Active		Passive		Active		Passive	
Size	12,055		2,058		8,277		813	
Dummy variables	Value 1	Value 0	Value 1	Value 0	Value 1	Value 0	Value 1	Value 0
Age	2,659	9,396	437	1,621	1,687	6,590	157	656
Large-cap equity funds	5,520	6,535	1,472	586				
Small-cap equity funds	322	11,733	13	2,045				
Corporate bond funds					2,312	5,965	243	570
Government bond funds					602	7,675	388	425
Global funds	8,673	3,382	1,379	679	6,917	1,360	519	294
Cross-border funds	8,238	3,817	1,298	760	5,809	2,468	508	305
Categorical variable (Domicile)	17 countries		11 countries		16 countries		7 countries	