

Press Release

European Fund Market

London: 29 August 2003

The problem with implementing an open-door policy is that you never know who's going to stroll across the threshold. Is the European fund industry about to learn this lesson the hard way as the drive to encourage cross-border fund sales and establish a true regional market gets its second - or is it third or fourth? - wind?

European Union lawmakers have striven for close to 20 years to dismantle national regulatory frameworks that protect domestic fund providers and stifle competition. The latest legislative salvo, in the form of the Ucits 3 directive, is due to be enacted by member states this year, but like Tantalus, doomed to remain immersed up to his neck in a lake whose level recedes whenever he tries to take a drink, the goal of a single, open, pan-regional fund market continues to lie just beyond reach.

Domestic asset managers, typically divisions of banks that retain a stranglehold on distribution in many countries, control 80 percent or more of most European fund markets, according to a study led by Friedrich Heinemann for the Investment Management Association, the UK fund industry trade group, and roughly 80 percent of assets are held in funds managed by the same firm that sells them, rather than a third party. The home advantage results from daunting logistical and regulatory obstacles to a more open marketplace, including tax regimes that treat domestic funds more favourably; different rules governing advertising, consumer information and fund registration and administration, and cumbersome systems for processing cross-border sales.

Mr. Heinemann puts the cost of not having a single European fund marketplace at 5 billion euros a year, or more, in lost economic benefits. Investors suffer lackluster performance; foreign managers are denied an opportunity to offer more attractive alternatives, and corporations face higher financing costs as persistently weak investment returns limit the growth of available capital and its efficient allocation.

Although many impediments to cross-border fund sales remain, as does scepticism over the prospects for success of Ucits 3, barriers are indeed being dismantled - from the bottom up, not the top down. As European pension systems grow ever shakier and citizens are forced to provide directly for their own needs, they are demanding access to better and more varied products and services. The open-door policy is being put into place just as the door is being knocked down.

"There has been an abdication of responsibility for savings by governments and a passing of that responsibility onto individuals," James Tew, director of fund research for Europe at Standard & Poor's, observed. "That is going to make it a larger marketplace and will make it more relevant for third-party fund providers to get involved."

The most obvious losers from a free, unified fund market are the bancassurance conglomerates that have dominated European fund provision. "As people take more responsibility for their savings and become more interested in the market," Mr. Tew said, "they may discover that the offering you get from your bank manager is not the best available and is possibly biased."

Determining the winners is tricky. If the market were opened to all comers, European fund managers would not be the only ones seeking to cash in. Foreign managers, especially from the United States, have always coveted the region for its immense growth potential. Ownership of funds is low by American standards, as is investment in equities. What is high in Europe is the money that fund managers can extract from their customers. Sales charges and management fees easily surpass those available in the hyper-competitive American market.

But as a single fund market has creaked into being, American firms have displayed profound ambivalence. The expertise and economies of scale that American managers enjoy should allow them to compete effectively against Europe's home-grown talent. But their enthusiasm for doing business here is tempered by the obstacles to conducting cross-border business. Apart from the regulatory and administrative hassle, foreigners must contend with different languages and different currencies, although there are far fewer of those now, of course. Perhaps most perplexing is the variation in investment tradition and culture. American fund managers considering expanding in Europe must feel like tourists who would love to go sightseeing but can't maneuver their massive sport-utility vehicles through the narrow, cobbled streets.

Years ago, when one of the largest American fund managers was considering entering the European retail market, a senior executive lamented the assortment of investment customs, noting that "the Germans buy bond funds, the French

buy money-market funds and the British buy equity funds. Actually the British are more likely to put their money into a building society and earn less than the rate of inflation." The company, a low-cost fund provider that sells its American funds directly to investors, was also concerned about reaching a European public used to buying from banks or financial advisers who doggedly guard their turf against incursions from 'carpetbaggers'. In the end the company decided against the move.

Some American fund managers indeed find the cosy distribution arrangements a higher hurdle to clear than regulatory red tape. "Having the ability to market one product across different countries is useful, but it's only useful if you've got distribution in all those countries," said Simon Ewan, managing director for wealth in Europe of SEI, an American provider of multi-manager funds.

But as his title suggests, SEI is operating in Europe despite the fragmented market and its Byzantine complexities. So is Frank Russell Co., the other large American multi-manager firm. Other hefty American managers, such as Fidelity Investments and Franklin Templeton Group, have had significant presences in Europe since before the effort to unify the market began.

Some firms, like Merrill Lynch and Chase Manhattan (now JP Morgan Chase) have built market share in one gulp by buying European asset managers. Smaller firms, including Janus and T. Rowe Price, have also gained footholds. If a single European fund market exists one day, it may not produce an American invasion, but only because so many American managers are already here, having decided not to hang about waiting for ideal conditions.

Americans may not be the big winners in a single European market, but the American way probably will be. The traditional European bancassurance model, in which management and distribution of funds rests in the same hands, is beginning to be eclipsed, albeit slowly, by the American system, in which funds are sold by brokerages, banks or independent financial advisers offering a range of products managed by others.

Breaking down barriers to cross-border sales "is going to make it a larger marketplace and will make it more relevant for third parties to get involved," Mr. Tew said. "The changes that are occurring now already require huge changes in strategy for asset-management groups. The larger and older groups and CEOs are showing remarkable complacency about the state of their industry, but the younger CEOs seem more willing to embrace these changes. There is a sea change to the way Europe will have to look at the business, and it will take some time to get there."

The information investors use to select funds will increasingly comprise objective advice rather than sales pitches, and more of it will be the result of their own legwork, Mr. Tew said. Thanks to technology and the Internet, including sites like www.funds-sp.com, which contains S&P fund ratings, S&P Fund Stars, comparative performance tables and Fund Factsheets from 14 European markets, more objective information is available to small investors than ever before, and they ultimately will be the biggest winners from an open, competitive marketplace.

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	Total fund sizes in mn Euros	% total fund sizes of all groups
DWS	93,206.04	3.99
Nextra Investment Management Sgr Spa	86,338.93	3.69
UBS	77,221.34	3.30
Deka	66,992.08	2.87
BNP Paribas	57,272.33	2.45
Santander Central Hispano Gestión	52,544.84	2.25
Fidelity	52,185.74	2.23
Credit Suisse	50,999.92	2.18
Societe Generale	46,566.69	1.99
Credit Agricole	45,489.19	1.95
Sanpaolo IMI Asset Mngmt SGR SpA	41,848.98	1.79
Credit Lyonnais	41,498.10	1.78
JP Morgan Fleming	35,674.00	1.53
BBVA Gestión	35,479.59	1.52
Pioneer Investment Mgmt Ltd	33,554.20	1.44
Banque Populaire	32,955.61	1.41
Union Invest GmbH	31,308.81	1.34
DIT	28,419.72	1.22
Arca	26,553.28	1.14
Unicredit Fondi SGR SPA	26,434.92	1.13
TOTAL fund sizes by the 20 largest groups	962,544.31	41.19
TOTAL fund size of all groups in Europe*	2,336,643.25	

*Europe is defined as the combination of the following countries: UK, Luxembourg, Germany, France, Spain, Italy, Netherlands

Notes: The above figures represent a collective of the latest fund sizes in the above stated databases of Standard & Poor's. Groups may have been linked at the discretion of Standard & Poor's.

Source: Standard & Poor's