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Economy and international financing

French non-money market investment funds: a sharp decrease in outstanding amounts in 2018

In 2018, and for the first time since 2011, French and euro area non-money market investment funds recorded a decrease in outstanding amounts (of 7.9% and 2.4%, respectively). This contraction is mainly due to valuation effects resulting in a 5.2% reduction in outstanding amounts in the case of France and a 5.3% reduction in the case of the euro area. French funds also recorded an outflow of 2.7% of outstanding amounts attributable to cross-border mergers within the euro area; a process that is contributing to the gradual integration of savings markets in Europe.

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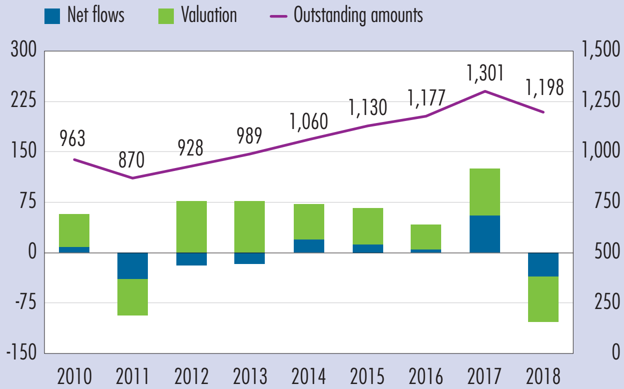
JEL codes
G11, G23

EUR **1,198** billion
outstanding amounts of French non-money market investment funds (IFs) in 2018

EUR **-68** billion
decrease in value

EUR **-36** billion
net outflows, of which outflows of EUR 41 billion are attributable to cross-border mergers

Change in French non-money market investment funds (IFs) since 2010
(EUR billion; left-hand scale: flows and valuation, right-hand scale: outstanding amounts at end-December)



Source: Banque de France.

1 A contraction of outstanding amounts due to both valuation effects and net flows

A 7.9% decrease in outstanding amounts, mainly related to downward valuations

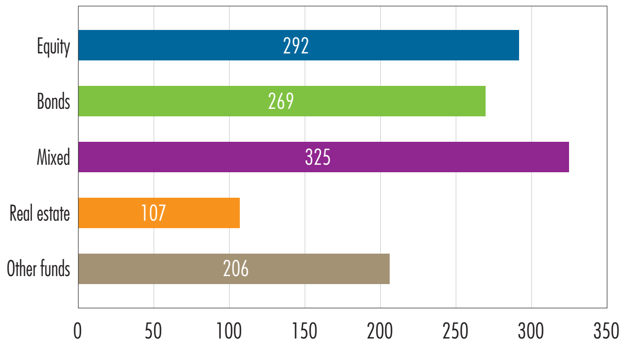
At the end of December 2018, the outstanding amounts of French non-money market investment funds (investment funds – IFs) amounted to EUR 1,198 billion, accounting for 80% of all outstandings in both money market and non-money market funds in France. After the strong growth observed in 2017 (EUR 134 billion, of which EUR 55 billion was due to net inflows), IFs declined significantly in 2018, by EUR 103 billion. This represents a 7.9% decrease on December 2017. Non-money market investment fund shares/units held by households accounted for 3.7% of their financial net worth in 2018, falling well short of life insurance policies and regulated savings products, which accounted for 38% and 15%, respectively.

A third of this decline (EUR 36 billion over the year), which is the first since 2011, is due to a scope effect related to cross-border fund mergers (see Section 2). However, the remaining two-thirds are attributable to negative valuation flows of EUR 68 billion (5.2% of outstanding amounts) resulting from the change in the main stock market indices and the average performance of euro area IFs over the period (see Section 3).

A decrease that affects almost all fund categories

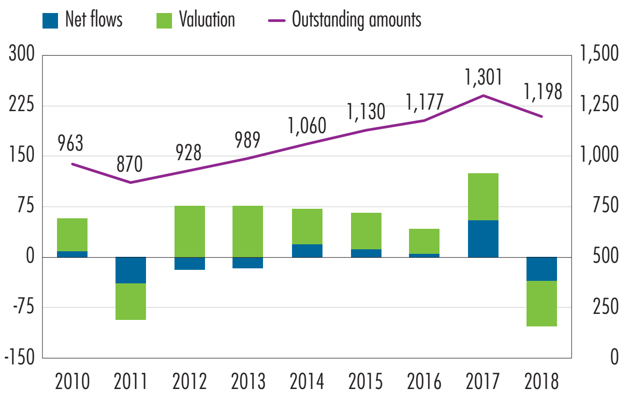
The outstanding amounts of all categories[1] of non-money market funds decreased in 2018, with the exception of real estate funds and employee savings funds. Equity funds account for more than half of the total decrease in outstanding amounts with a drop of EUR 63 billion due to strongly negative valuation effects and cross-border mergers (see Section 2). The bond and mixed fund

C2 Net IF assets in December 2018
(EUR billion)



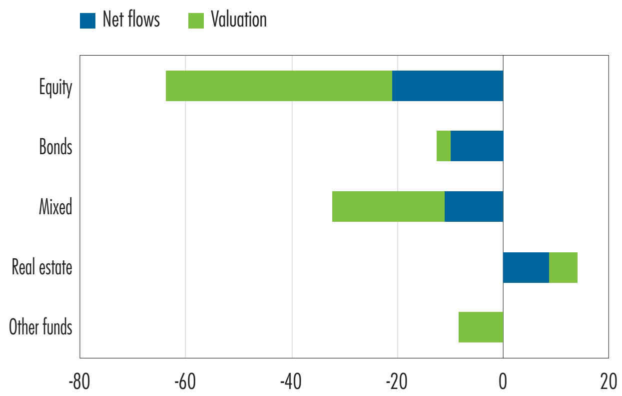
Source: Banque de France.

C1 Change in IFs since 2010
(EUR billion; left-hand scale: flows and valuation, right-hand scale: outstanding amounts at end-December)



Source: Banque de France.

C3 Breakdown of annual change by fund type in 2018
(EUR billion)



Source: Banque de France.

1 The categories considered are equity, bond, mixed and real estate funds, hedge funds and other funds. Other funds include employee savings funds, capital investment funds and structured funds.

categories, also hit by downward valuations during the year (decreases of 1% and 6% of outstanding amounts, respectively), sustained net redemptions of almost EUR 21 billion. Real estate funds, which had net assets of EUR 107 billion at the end of 2018 (see Chart 2), were the exception, recording net subscriptions and valuation gains of 8% and 5%, respectively, in annual growth terms. Within the "other funds" category, which accounted for net inflows over the year of EUR 0.1 billion, only employee savings funds received positive net subscriptions (EUR 3 billion).

Sales were concentrated on equity and debt securities issued by non-residents

The sales of securities recorded under assets by all funds mainly concerned equity, almost all of which was issued by non-residents, with outflows amounting to EUR 34 billion over the year (see Table 1). Equity holdings decreased by 18% compared with December 2017. With regard to debt securities, despite the general reduction of EUR 10 billion that was also concentrated among non-resident issuers, there was a reallocation between short-term (up EUR 5 billion) and long-term (down EUR 15 billion) holdings. These cumulative redemptions of EUR 44 billion in equity and debt securities also essentially concern securities issued by non-financial corporations (EUR 39 billion). Only those issued by general government recorded positive flows in 2018 of EUR 5 billion.

Conversely, deposits and holdings of foreign investment fund shares/units were up by EUR 8 billion (a 10% increase in outstanding amounts) at the expense of French IFs (down EUR 3 billion).

Euro area monetary and financial institutions are behind the main redemptions

Resident insurance firms, general government and non-financial corporations continued to be net buyers of investment fund shares/units in 2018, investing EUR 9 billion, EUR 6 billion and EUR 1 billion, respectively (see Chart 4). The other sectors were net sellers, particularly non-resident euro area monetary and financial institutions (MFIs), which made substantial redemptions of EUR 30 billion amounting to 30% of the outstanding amounts.

Insurance firms and resident households were responsible for almost half (47%) of investment fund share/unit subscriptions, with EUR 462 billion and EUR 241 billion, respectively (see Chart 5).

T1 Main non-money market investment fund asset items

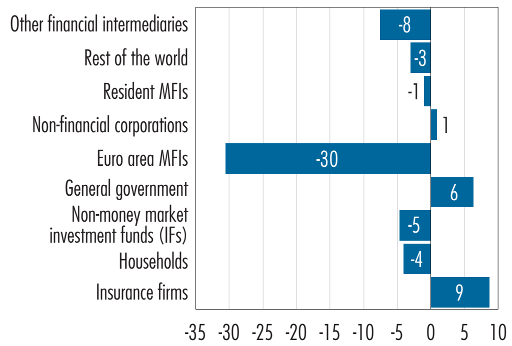
(EUR billion)

	Balance December 2018	Net flows 2018	2017/2018 change
Deposits	51	2	2
Debt securities	383	-10	-15
Resident	116	0	-1
Euro area	173	-2	-4
Rest of the world	94	-8	-9
Equity	411	-34	-86
Resident	213	-2	-26
Euro area	109	-21	-40
Rest of the world	88	-11	-20
Investment fund shares/units	299	4	-14
Resident	206	-3	-13
Euro area	87	8	1
Rest of the world	6	0	-1

Source: Banque de France.

C4 2018 investment fund flows by holding sector

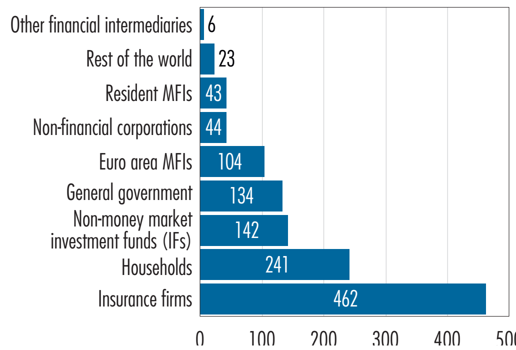
(EUR billion)



Source: Banque de France.
Note: MFI – monetary and financial institution.

C5 IF outstanding amounts by holding sector in December 2018

(EUR billion)



Source: Banque de France.
Note: MFI – monetary and financial institution.

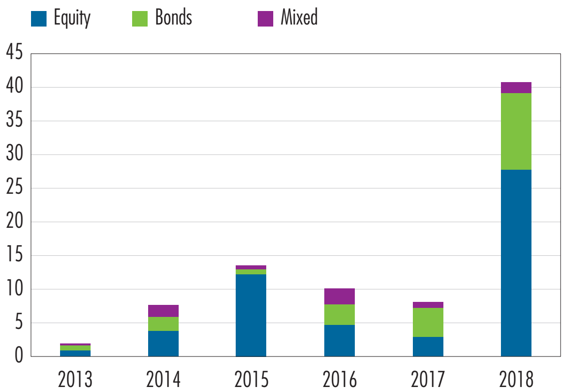
2 Cross-border mergers weighed heavily on the change in French fund outstanding amounts

Mergers account for the entire outflow

Cross-border fund mergers within the euro area are a mechanism for European financial market integration. This is reflected in the increase in the size of funds, which aims to enhance liquidity and reduce the relative share of fixed costs in the management of savings, particularly household savings (see Box 1 below for the statistical implications of these cross-border mergers). Since 2014, these transactions have accounted for approximately EUR 10 billion per year but 2018 was exceptional, with flows of EUR 41 billion (see Chart 6). Since 2013, total mergers, which in practice result in a fund simply changing its country of residence, have accounted for EUR 82 billion and have thus reduced net subscriptions of resident IFs by the same amount. Adjusting for the effects of these mergers, the cumulative net inflows of EUR 41 billion over the 2013-18 period would in fact amount to EUR 123 billion (see Chart 7).

C6 French IFs: cross-border mergers by fund category

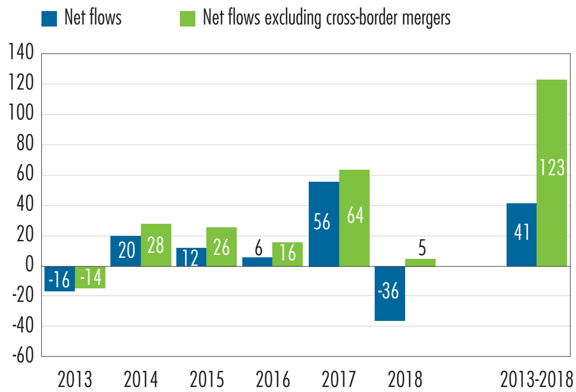
(EUR billion)



Sources: Banque de France and the *Autorité des marchés financiers* (AMF, the French Financial Markets Authority) for cross-border mergers.

C7 Net non-money market investment fund flows, adjusted for cross-border mergers

(EUR billion)



Sources: Banque de France and the *Autorité des marchés financiers* (AMF, the French Financial Markets Authority) for cross-border mergers.

BOX 1

Recording cross-border mergers in the national accounts and the impact on the measurement of financial savings

Mergers with foreign funds are recorded as negative flows in the national accounts of the country of the absorbed fund and as positive flows in the accounts of the country of the acquiring fund. However, the negative flow recorded does not necessarily correspond to redemptions by investors, who may remain the same despite the fund changing its country of domiciliation. In the case of individual investors, if they continue to hold shares or units in a foreign fund, the impact on their overall savings amount measured in the national accounts will be neutral: only its structure will change, with holdings of foreign investment fund securities increasing and French investment fund holdings declining. Fund transfers are transparent[1] to investors, as the management company may continue to be based in Paris[2] while the tax on income from investments remains that of the investor's country of residence.

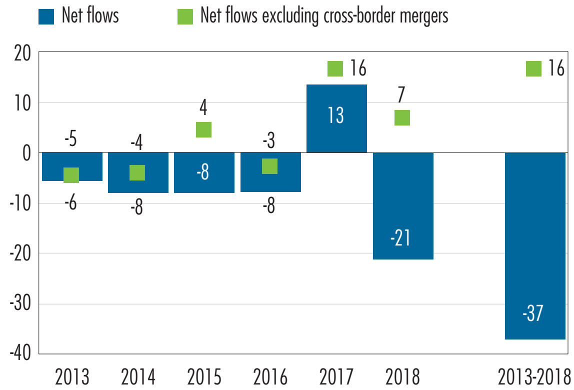
1 They must, however, be disclosed to investors.
2 Only the custodian needs to be domiciled in the same country as the fund.

Equity funds (particularly ETFs) are the most affected by these mergers

Since 2013, mergers have mainly affected equity funds (a total of EUR 53 billion) and bond funds (a total of EUR 18 billion), with EUR 28 billion and EUR 11 billion, respectively, in 2018 alone. Therefore, after adjustment for these mergers, net subscriptions to equity funds amounted to EUR 7 billion in 2018, compared with an unadjusted negative EUR 21 billion in total (see Chart 8).

The funds concerned are mainly exchange-traded funds (ETFs) with EUR 27 billion related to relocations in 2018 (out of EUR 30 billion in total since 2013). Consequently, French ETF outstanding amounts fell by half during the year (taking into account valuation effects).

C8 Annual net equity fund flows
(EUR billion)



Sources: Banque de France and the *Autorité des marchés financiers* (AMF, the French Financial Markets Authority) for cross-border mergers.

Mergers are mainly due to the rationalisation of fund categories

The increase in cross-border mergers, which very often involve Luxembourg funds, has been due to a number of factors.

- Over the years, Luxembourg has developed a fiscal and regulatory environment (administrative management rules, tax agreements with non-EU countries, etc.) that makes it a major point of entry into Europe for non-European investors.

- Asset managers are engaged in a process of rationalisation and concentration of their fund categories in response to competitive pressure from non-European asset managers that are often larger in size. Size alone can allow for economies of scale as fixed costs can be spread across a larger number of customers (and the management fees charged to customers may potentially be reduced). For example, new, stricter regulations, particularly with regard to sales literature provided to investors and transparency on fees (the Markets in Financial Instruments Directive – MiFID II – that regulates packaged retail and insurance-based investment products – PRIIPs – in Europe) push up management companies' fixed costs and may encourage them to increase their critical mass in order to reduce their management fees. This rationalisation has benefited Luxembourg funds as they cover both a French and international clientele.

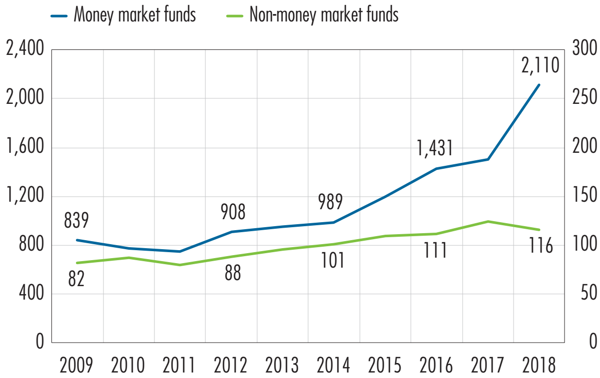
BOX 2

Increase in average outstanding amounts under management of investment funds

The process of concentration of fund categories has resulted in an increase in average outstanding amounts under management of French funds: for non-money market funds, their number has followed a slightly downward trend over the last ten years (down 7%), in contrast to the total outstanding amounts, which grew over the same period. Thus, on average, a non-money market fund managed almost EUR 120 million (see chart) in 2018, up 40% on 2009. The increase in average outstanding amounts under management of money market funds is even more striking with the significant reduction in the number of funds over the last ten years (the number is one-third of what it was at the beginning of the period). In 2018, a money market fund managed an average of more than EUR 2 billion, up 150% compared with 2009.

Money market and non-money market investment funds: average outstanding amounts under management since 2009

(EUR million; left-hand scale: money market funds, right-hand scale: non-money market funds)



Source: Banque de France.

The French financial sector has made substantial efforts in recent years to improve its competitiveness in order to address the challenge presented by foreign funds.[2] In 2016, the *Autorité des marchés financiers* (AMF – the French Financial Markets Authority) and the *Association française de la gestion financière* (AFG – the French Asset Management Association), for example, launched the FROG (French Routes and Opportunities Garden) working group to make the Paris financial centre more attractive in terms of asset management. Since 2017, a set of concrete measures addressing legal structure, marketing and fee transparency in particular have been implemented to improve the visibility and distribution of French IFs abroad. In addition, the French "Pacte" law contains a package of provisions intended to modernise the rules applicable to asset management in order to further enhance the competitiveness of the Paris financial centre.

3 A lacklustre year in the euro area as well

Outstanding amounts of IFs decreased for the first time since 2011

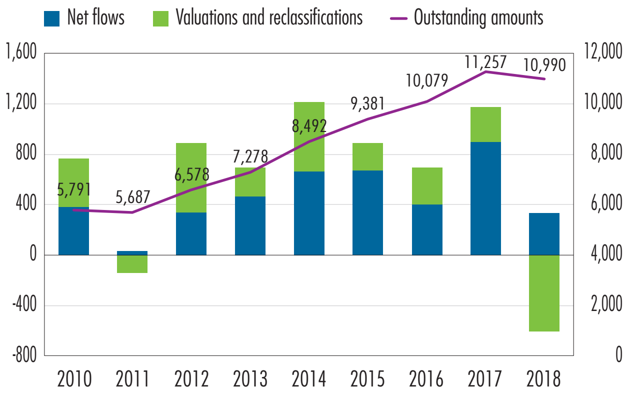
Outstanding amounts of IFs in the euro area amounted to EUR 10,990 billion at the end of 2018, down from EUR 11,257 billion the year before. Net subscriptions in the euro area fell away sharply compared with 2017 at EUR 364 billion compared with EUR 900 billion the previous year (see Chart 9 below). These net flows, combined with a negative 5.3% valuation effect[3] over the year, resulted in an overall decline in outstanding amounts of EUR 266 billion (down 2.4%) – a first since 2011. The last time a decline of this magnitude was reported was in 2008.

2 According to the *Association française de la gestion financière* (AFG, the French Asset Management Association), the outstanding amounts of foreign IFs managed in France has tripled over the last ten years to EUR 450 billion at the end of 2018.

3 Valuations and reclassifications (a change in methodology or new inflows), etc. We assume that the "reclassification" effect is weak, but we are unable to calculate it.

C9 Euro area IFs

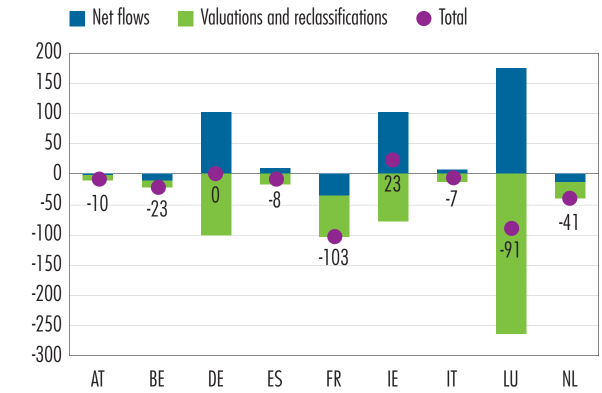
(EUR billion; left-hand scale: flows, valuation and reclassification, right-hand scale: outstanding amounts at end-December)



Source: Banque de France.

C10 Change in IFs over 12 months by country in 2018

(EUR billion)



Source: European Central Bank.
Note: AT: Austria, BE: Belgium, DE: Germany, ES: Spain, FR: France, IE: Ireland, IT: Italy, LU: Luxembourg, NL: Netherlands.

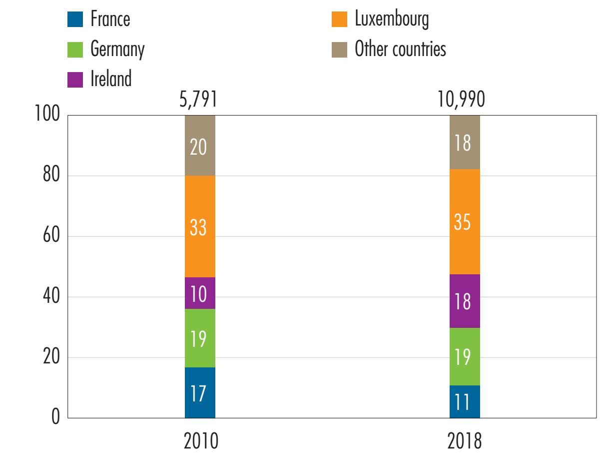
Trends differ from country to country

Following downward valuations, all countries recorded a decrease in their outstanding fund amounts in 2018 with the exception of Ireland, which reported an increase of EUR 23 billion (see Chart 10). France, Belgium and the Netherlands together sustained combined outflows of EUR 72 billion, 50% of which was borne by France (see above). Nevertheless, positive subscription flows were recorded in five countries, mainly Luxembourg, Ireland and Germany, which recorded inflows of EUR 174 billion, EUR 102 billion and EUR 101 billion, respectively. In Luxembourg, subscriptions were mainly made in equity funds (50%), which contributed to the extremely negative valuation of the outstanding amounts in the country (down EUR 265 billion). In Ireland and Germany, subscriptions were more diversified, with 70% of flows in Ireland channelled into mixed funds, hedge funds and other funds and 95% of net flows in Germany directed towards mixed funds, real estate funds and other funds.

Changes in market shares between 2010 and 2018 (see Chart 11) indicate a transfer between France, which lost 6 percentage points from 17% at the end of 2010 to 11% in 2018, and Ireland, which gained 8 percentage points up to 18% at the end of 2018. The market shares of Germany and Luxembourg remained largely unchanged, and Luxembourg continues to be the European market leader with a 35% share. These four countries account for 72% of total outstanding amounts in the euro area. Other countries with significant asset management include the Netherlands (8% at the end of 2018), Italy (3%), Spain (3%), Austria (2%) and Belgium (1%).

C11 Breakdown of IF outstanding amounts within the euro area in 2010 and 2018

(breakdown in %, amounts in EUR billion in December)



Source: European Central Bank.
Note: The four countries shown have the largest holdings of investment fund outstanding amounts in the euro area.

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