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ASSETS MANAGED ON BEHALF OF THIRD PARTIES: *CITIUS, ALTIUS, FORTIUS*?

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"Further, higher, stronger" It is appropriate to use (with respect, of course) the Olympic Games motto in the opening paper of the edition of the *Revue d'économie financière* due to be published at the precise time the city hosting the 2012 games is to be announced? In reality, as far as asset prices are concerned, we are fully aware that all good things must come to an end. If we needed reminding of this fact, most recently it was the bursting of the TMT bubble did it. We also know full well that competition in the savings market is - and will continue to be - fierce. However, whilst remaining cautious and stripping out transitory slumps, in our view underlying trends augur well for continued growth in the asset management industry. Clearly though, if all asset management centres "participate" in this trend, not all will have a place on the podium[3] in 2012.

A CRUCIAL ROLE IN THE FINANCING OF ECONOMIES AND IN HOUSEHOLDS' PORTFOLIOS

Globally, assets under management for third parties (net assets of investment funds and discretionary mandates combined) total around €35,000bn - including over €12,000bn in Europe and €2,000bn in France - equal to, or in excess of, GDP in the countries and regions concerned. In 2005, regulated UCITS-type investment funds alone manage assets totalling €13,000bn (see Chart 1).

More specifically, Chart 2 shows that in less than a decade, investment funds as a proportion of GDP have almost doubled in some countries and more than tripled in others (e.g. Italy). Ireland and Luxembourg (which do not appear in the chart due to their low GDPs relative to assets under management) have witnessed even more spectacular growth. The chart also reveals the importance and dynamism of the UCITS market in France.

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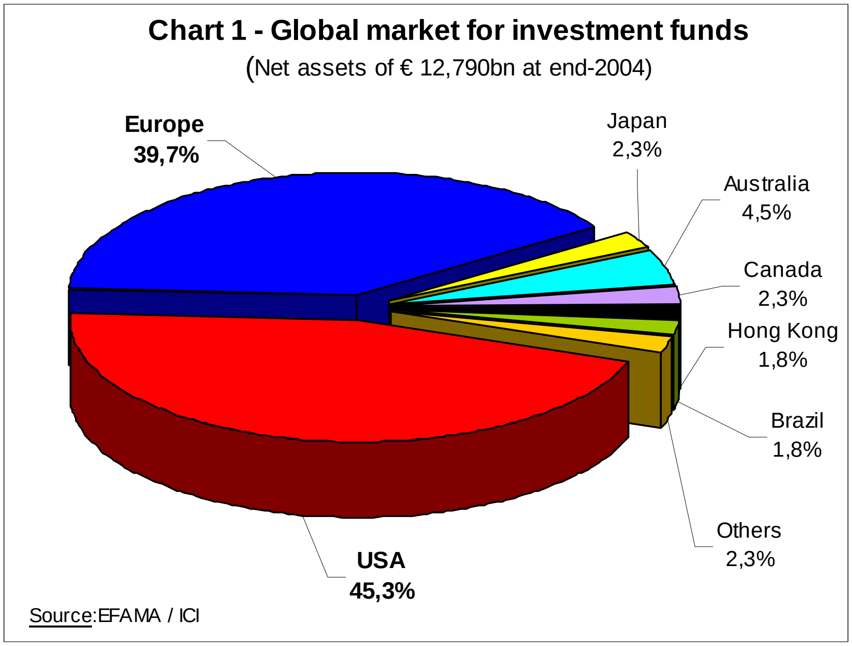
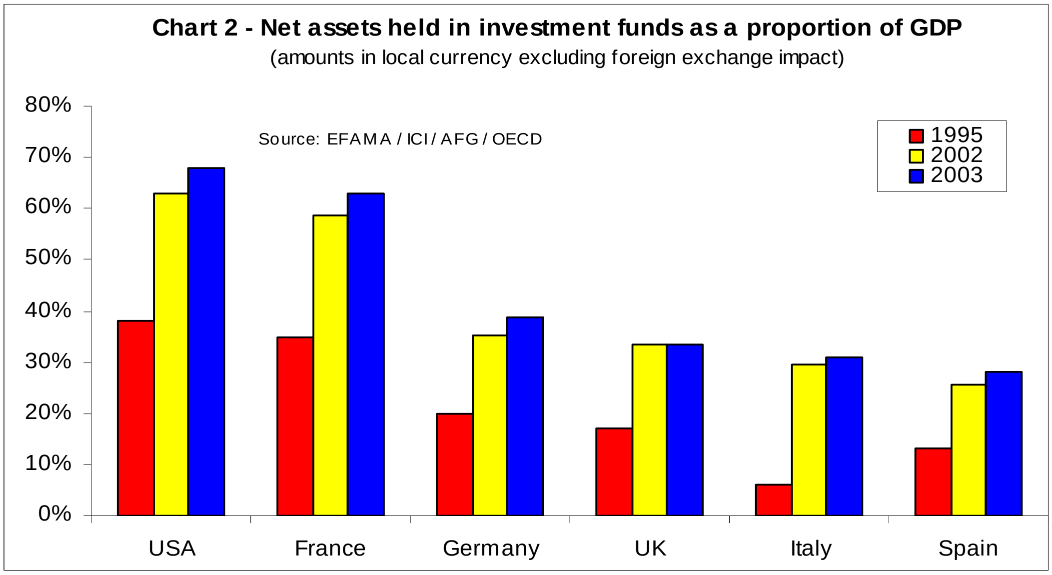
[3] The French asset management industry is in the running. See Bollon P. (2000), "Gestion: Paris peut-il être le 'Boston de l'Europe"?" *Revue d'économie financière No.* 57, pp. 137-149.



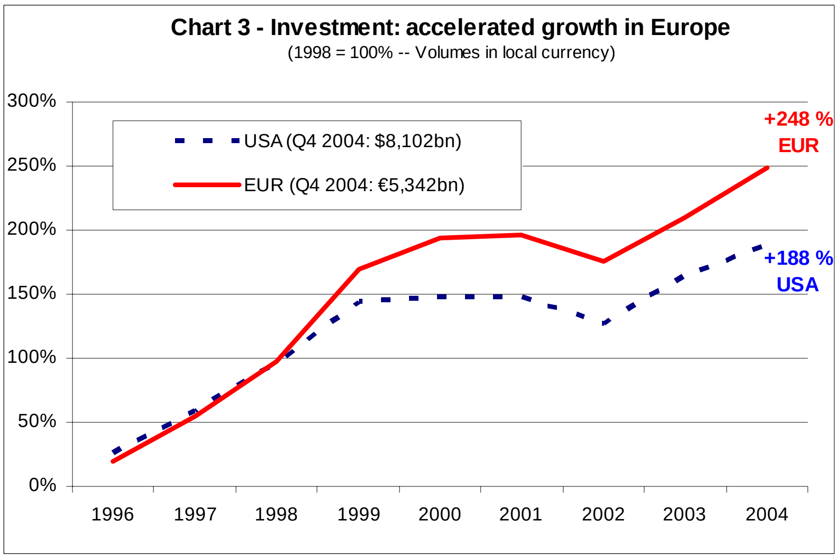


In countries with developed capital markets, investment funds - whether held directly or indirectly via, in particular, insurance companies or pension funds - now account for 10-30% of household financial assets, and their contribution to stock market capitalisations is in some cases as high as 20-30%.

Virtually everywhere in the world, asset management on behalf of third parties actively contributes to market liquidity by facilitating the mobilisation of a growing proportion of the savings and assets of economic agents. It is a key driver of the 'securitization' of the financing of the economy and of banking disintermediation, turning savers into investors.

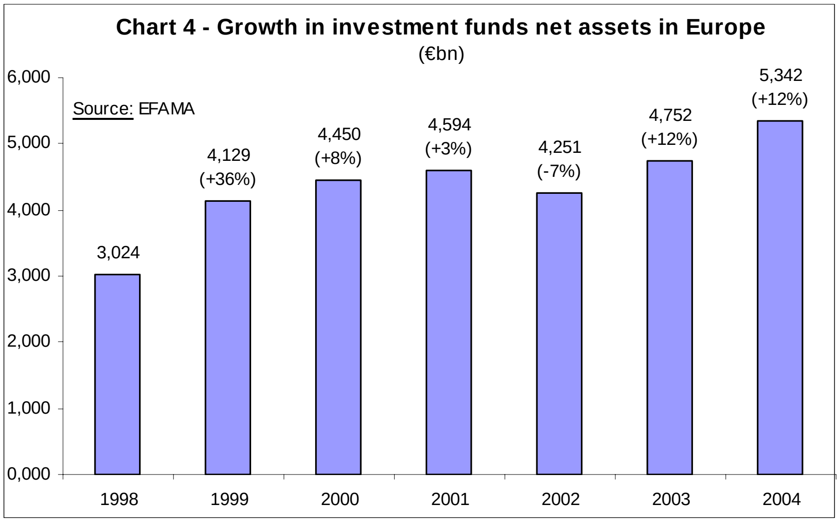
A DYNAMIC EUROPEAN MARKET FOR INVESTMENT FUNDS

Since 1995, the US and European investment fund industries have experienced substantial, albeit irregular, growth in net assets, most markedly in Europe since 1999. Whether it is a case of the US market reaching maturity or the European market catching up, in the space of 10 years, assets under management in Europe have increased by a factor of around 2.5, compared to 1.9 in the USA (see Chart 3).



Over the last decade (1995 to 2004), average annual growth has been 10.6% in Europe and 7.3% in the US. In almost all the European markets, the rapid growth in assets under management is attributable to a combination of dynamic financial markets (with the exception of the equities markets in 2000-02) and net subscriptions which have generally (particularly in France) remained positive even through stock market crises. In the last two years, net subscriptions have once again become the main driver of growth in assets under management, accounting for 60% of the increase (the market effect accounting for the remaining 40%).

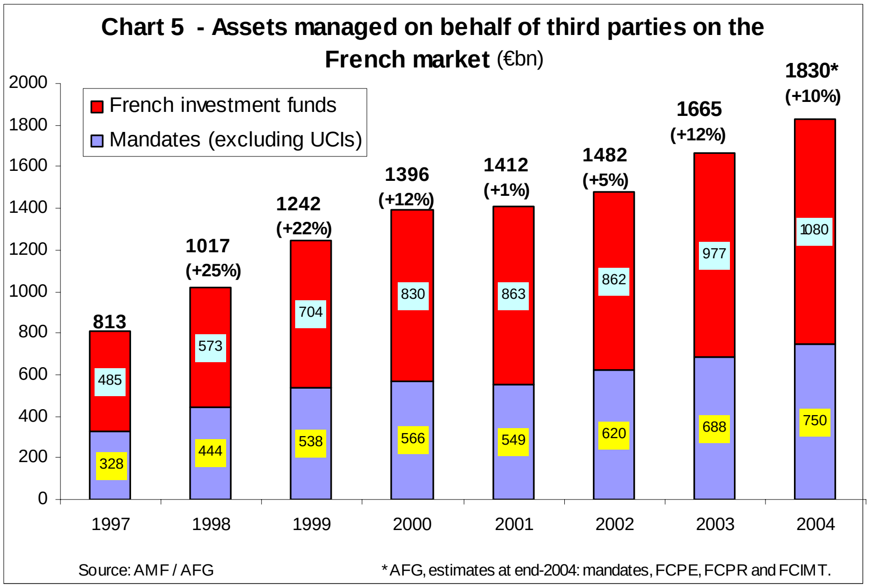
The 'securitization' of assets, most notably in Continental Europe due to its belated adoption of this concept, and savers' increased preference for investment funds seem to be fuelling this unprecedented boom in the asset management markets (see Chart 4). But there is still a long way to go in Continental Europe, where, mainly because of the weakness and even absence of long-term investment structures (particularly funded pension schemes), over 40% of financial assets are still invested in short-term instruments, predominantly bank deposits, which compares to a maximum of around 15% in the USA. It has nonetheless been estimated that the European investment fund management market will continue on its upward trajectory, with assets under management reaching €8,000bn by 2010, giving a reasonable estimate of annual growth of around 7%.



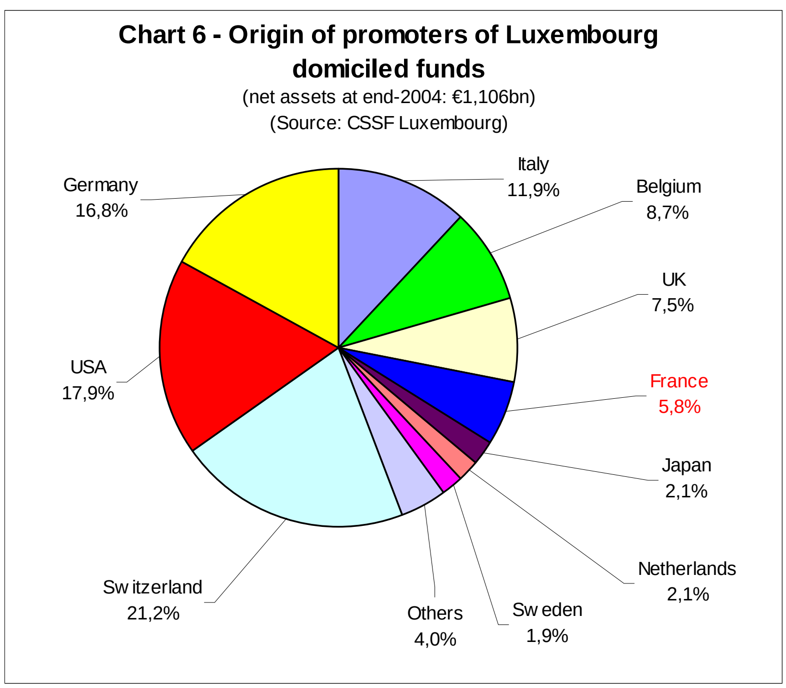
In all likelihood, some centres (e.g. Ireland, Luxembourg, France and Spain) will expand faster than average, whilst the pace of growth will slow in others (Germany and Italy, though France is not safe from such a trend either), due to competition from products that are less regulated than UCITS and/or the attraction of funds governed by foreign law. It should be stressed that overall this latter phenomenon in no way reflects a lack of appetite for investment funds, but rather a specialization and probably concentration of activities around certain European financial centres, particularly those that offer players comparative advantages.

FRANCE AND LUXEMBOURG LEAD THE EUROPEAN FUND MARKET

France – which returned to double-digit growth in assets under management in 2003 – is Europe's largest investment fund market and well out in front for the management of investment funds. Most notably, unlike other major European markets, French assets under management continued to rise - albeit modestly – even during the stock market crises from 2000 to 2002, with sustained positive net subscriptions underpinned by the innovative, diversified product offering and investor confidence (see Chart 5).



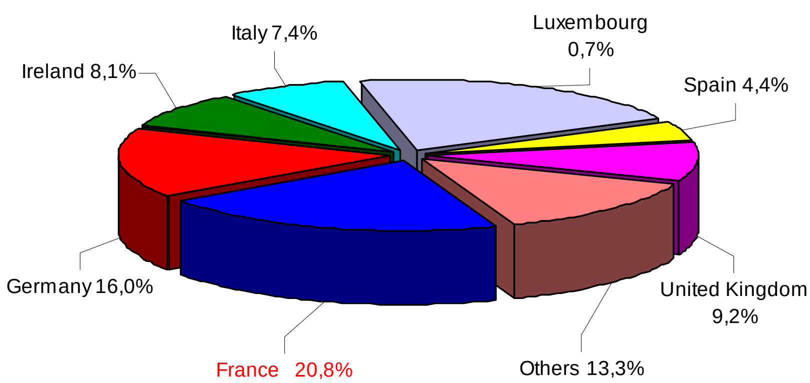
In terms of fund domiciliation, in the first quarter of 2005, the Luxembourg market took the lead by a narrow margin. Luxembourg is a very particular case: it is Europe's leading off-shore market, specialising in administrative and accounting management while generally leaving financial management to the country of origin of the promoter (*round-trip funds* - see Chart 6).



Also note the remarkable performance of Ireland, which has risen to fifth place ahead of Italy and Spain, with a market share in excess of 8%, compared to less than 2% at end-1998. Its success is due to the increasing importance of its offshore centre Dublin, largely thanks to its flexible and efficient regulation, which gives it a distinct advantage in terms of innovation and product offerings, especially in alternative management. As a market, it is therefore more comparable with Luxembourg than with other countries. Finally, note that the UK's relatively modest UCITS assets (€490bn) do not reflect the country's global importance in asset management for third parties - a market estimated to be worth nearly €2,800bn. Overall, the European investment fund market is concentrated, with six countries - France, Luxembourg, Germany, the UK, Ireland and Italy – accounting for four fifths of the total market (see Chart 7).

Chart 7 - European market for investment funds

(AUM at end-2004: €5,342bn - Source: EFAMA)



THE DEMAND FOR EQUITY OR EQUITY-ORIENTED FUNDS IS LIKELY TO STRENGTHEN GIVEN CONSUMER NEEDS FOR LONG-TERM INVESTMENTS

Despite the sharp corrections suffered by the stock markets between 2000 and 2002, the overriding characteristic of the last ten years in the European market has been the dynamic growth of equity-oriented and/or structured funds in countries such as France, Belgium and Spain, together with the boom in multi-management. Whether it is a peculiarity of the product offering, most notably "profiled" funds, targeted at the specific needs of investors and their desired risk/performance profile -, but also at institutional investors such as insurance companies -, or a reflection of a demand which is characterised by a low appetite for the risk of investing in pure equities funds, some Continental European countries have - unlike the US market [4]to date - developed a huge market of diversified funds and a wide range of capital protected or guaranteed return funds.

At the end of 2004, diversified funds thus accounted for 13% of the total assets in Europe, compared

[4] Note however that in the USA, protected or life-cycle funds are now making the news as baby boomers are gradually reaching retirement age.

to 6.5% in the US. However, although US funds are mainly (up to 55%) invested in equities, there is some convergence between the two markets in terms of the proportion of variable income funds (equities, diversified and guaranteed funds combined) as a proportion of total assets (around 50% in Europe, compared to 60% in the USA).

The importance of equity or equity-oriented funds as a percentage of total assets is rising thanks to renewed investor interest in virtually all European countries, including six in which the relative importance is now higher than in the USA. Within Europe, however, there are still marked discrepancies, with the UK at one extreme (70% of total assets invested in equity UCITS) and Portugal at the other (7%).

With confidence in the stock markets restored, in the future variable income funds are likely to comprise 60-70% of net assets in the European fund industry.

HIGH GROWTH POTENTIAL

The European asset management market as a whole has considerable growth potential. Various studies suggest that, all else being equal, by 2010 assets under management should rise by 30-50%. Aside from the positive impact of the development of a larger, harmonised, more liquid financial market likely to generate economies of scale, three favourable factors should combine to make this growth target achievable and promote continued expansion:

• ***external factors***:

- persistance of a relatively high savings rate;
- continued securitization of household financial assets and lower appetite for fixed-income investment, particularly for bank deposits, of which the interest is in most cases capped by French authorities;
- the success of unit-linked life insurance;
- the development and extension of third pillar pensions in the form of defined-contribution, and at the same time, the reform of contributory pensions schemes, with the establishment and/or development of funded reserves;
- the spread of employee savings schemes throughout Europe...

• ***asset management drivers***:

- adaptation to changes in investor preferences as regards the performance and security of investments by the strengthening and the diversification of managerial styles;
- revival of active management and breakthrough of multi-management and so-called alternative management (hedge funds, private equity, property etc);
- rationalisation of the product range in order to control costs and consolidate margins (the true basis of financial independence for asset management companies and of quality of service provided to

savers);

- structuring and regulation of distribution of savings products in Europe with a view to creating a strong financial advice business, which is currently insufficiently developed;
- better financial education for our fellow European citizens, an essential condition for governance in line with the new risks assumed by private investors;

• ***saver/investor driven factors****:*

- linked to this better education, a change of attitude towards risk, with savers gradually becoming investors for whom the worst risk is not to take any risk, as this entails a significant underperformance;
- given the development of 'instividual' markets, impact of this change in attitude on the investment strategy of some institutional investors whose assets are now mainly invested in interest-bearing products;
- increased recourse to asset management and management mandates to maximise the return on assets, to take greater advantage of professional knowledge and risk diversification, this has been a very pronounced trend in the USA over the last few years where direct ownership of stocks is declining to the benefit of mutual funds and other managed accounts.

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Do these factors not constitute a better plan for the asset management industry today and in the future than growth projections and forecasts which could be disproved by reality?

With the return of double-digit growth, the global investment fund market has recovered its dynamism, particularly funds investing in equities, diversified funds, capital-protected products and so-called alternative funds. Investment funds are a favoured investment tool. Asset management companies must continue to strive towards greater professionalism, transparency and accessibility to enable them to make an important contribution to financing savers' replacement income and more generally, their future projects. To conclude, let's hope the regulators will be able to combine their obvious objective of policing the market with a greater willingness not to hamper its development through "preventative" intervention which reduce the innovative dynamism of the global asset management industry, preventing it from fully meeting the needs of its customers which need it to go *citius, altius,* and *fortius* over the long term.