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UCITS - State of Play

Recent trends, plus challenges and opportunities for 2025

Following its successful UCITS 2024 series, Arendt held a UCITS – State of Play hybrid event on 29 January 2025, where guest speakers discussed the main trends that are impacting UCITS and what to expect in this space for the year ahead.

The event commenced with a brief welcome from Arendt Co-Chair and Partner in the Investment Management practice, Michèle Eisenhuth, who shared more about the firm's commitment to advising on such funds. Guest speaker Paul Donovan, UBS Global Wealth Management Chief Economist, then outlined a forward-looking, macroeconomic overview.

The panel discussion that followed brought together Gisèle Dueñas Leiva (Head of Manager Research Sales EMEA, BlackRock), Riccardo Lamanna (State Street Country Head for Luxembourg) and Laurent Van Burik (Head of Unit Investment Funds, Commission de Surveillance du Secteur Financier (CSSF). Moderating the panel was Arendt's Florence Stainier, Partner in the Investment Management practice, who provided key facts and figures on the past and current state of play.

Recent trends in assets under management (AUM)

Stainier shared more about the evolution in assets under management (AUM), citing figures from the European Fund and Asset Management Association (EFAMA) report published in December 2024. With a growth of 8.3% in AUM in the EU in 2023, these are expected to surpass €32 trillion by the end of Q3 2024, while the share of investment funds in total AUM is also anticipated to grow steadily.

She noted the "increased proportion of equities and bonds in portfolios of active managers in 2023, driven by the rising valuations in both asset classes, with correlated decline of cash and other assets in portfolios." Additionally, bonds were the top-selling category for 2023, while 2024 marked a steady growth for ESG investments.

In Luxembourg, while there's still a steady increase in AUM in UCITS, Stainier noted the "continued decrease in a number of UCITS funds and sub-funds, which is the result of consolidation, looking at rationalisation of fund ranges." There's also still good momentum when it comes to Article 8 funds.

Macroeconomic overview and forecast

Even if economics is a straightforward science, how much politicians will have an impact on it—and how it pertains to financial markets—can be problematic. In his speech providing a macroeconomic overview, Donovan emphasised that over the past decade, economic data has been harder to trust in real time for a few reasons.

> *"The underlying economics is the foundation for financial markets, but we are going to see increased volatility from political noise and the growing challenges of an insecure world. I don't think we should be too pessimistic… we just have to focus more on economists and less on politicians."*
>
> Paul Donovan, UBS Global Wealth Management Chief Economist

Stock markets are expected to reach new records at the end of Q3 2024, having continued to rise during Q1 and Q2 2024, with the share of investment funds in total AUM continuing to grow steadily.

Florence Stainier, Partner in the Investment Management practice, Arendt & Medernach

First, there has been "a dramatic drop in survey response rates" including, for instance, the UK's Labour Force Survey, which was suspended in October 2023 due to low response rates. Without robust response rates, data tends to get distorted. Furthermore, with the speed at which the global economy is changing, "we keep missing parts of the economy that have developed, or which have increased in terms of their importance," Donovan added. Finally, political bias is also influencing economic responses.

Paul Donovan, UBS Global Wealth Management Chief Economist

Although Donovan noted the generally benign economic environment in developed economies, with stable consumer spending and optimism related to job security and income, the rise of economic nationalism cannot be dismissed in a single economic cycle. "We're at a time of dramatic structural change in the global economy," he added. "When we get these periods of dramatic change, the security that individuals feel in their social and economic status starts to be undermined." This, in turn, can lead to the rise of "scapegoat economics", which can manifest through stricter measures related to trade protection and the movement of people.

"We're also starting to see capital flows subject to economic nationalism," Donovan explained. This is a problem he believes has the potential to grow, even if it's one that is currently underrated. Guarding against economic nationalism and resisting "prejudice politics" and associated disruptions will be key: "We just have to focus more on economists and less on politicians."

Trends in client appetite

Over the years, UCITS ETFs have developed a global client base. That global footprint allows European investors to leverage the benefits of scale in the industry and for global investors to benefit from the European standard.

During the panel discussion, BlackRock's Dueñas Leiva called 2024 an interesting year for a few reasons. UCITS exchange-traded products (ETP) inflows set a new record in 2024, with $266.2 billion added–surpassing the $194.5 billion added in 2021 and marking a sharp increase from 2023 ($157.1 billion).

There's been continued focus on ETFs, with a lot of interest in US exposure.

UCITS investors were aligned in their preference for US equities, rates and investment grade fixed-income exposures, according to Dueñas Leiva. "An important trend in our industry is that investors seek more precise, granular exposures in their tactical asset allocations," she said.

Gisèle Dueñas Leiva, Head of Manager Research Sales EMEA, BlackRock

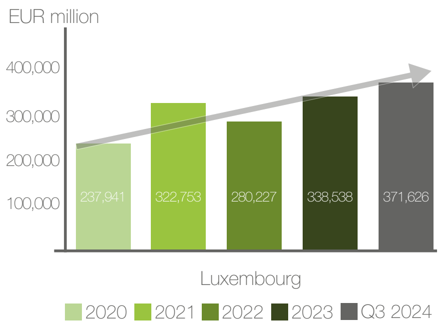
+ 8.3%

2023 growth in AUM in the EU, per a December 2024 report by EFAMA, which anticipates Q3 2024 AUM to reach over €32 trillion

+ 7.16%

Luxembourg's UCI evolution over the last 12 months

Net assets of Luxembourg UCITS ETFs



"Investors are looking to really be able to position themselves for their views and tactical asset allocation way more, with increasing demand for specific exposures."

Gisèle Dueñas Leiva, BlackRock Head of Manager Research Sales EMEA

Luxembourg regulator's perspective

The CSSF's Van Burik confirmed similar macroeconomic trends, saying there were net inflows into mainly money market funds, bond funds, and some segments of (mainly US) equity funds, as well as the movement toward the restructuring of funds, either via liquidation or mergers of smaller sub-funds, to increase asset size and enhance cost efficiency.

Laurent Van Burik, Head of Unit Investment Funds, Commission de Surveillance du Secteur Financier, or CSSF

On the ESG front, the CSSF has noted a slower growth of Article 8 and 9 funds under the Sustainable Finance Disclosure Regulation (SFDR), with more funds being created under Article 6. "It's difficult to explain the reasons for that," Van Burik said, adding that some actors may have decided to be more careful with their ESG commitments. "I think a lot of clarity on [the regulatory framework] has been put forward by the European Commission, the European Securities and Markets Authority (ESMA) and the CSSF, but there are still a few open questions, so perhaps some hesitation in the market." He reminded the audience that a revamp of the SFDR is currently in the EU Commission's pipeline.

Another trend in the market is tokenisation of fund units. In addition to one player being recently authorised by the CSSF to fully tokenise native fund units on the blockchain, other market players have shown interest in this topic in their discussions with the CSSF. Luxembourg's Blockchain Law IV, adopted in December 2024, adds additional flexibility.

Tokenisation will be fundamental in tempting other types of investors.

"In 2023, 35% of new investors in stocks were below the age of 35," Stainier noted. Van Burik commented, "We know those are probably the people interested in getting access to these funds in alternative ways."

Adapting service offering

Similarly, State Street has seen a rise in interest in both the tokenisation of fund units, particularly amongst the younger generation, and cryptocurrencies. Other trends noted by Lamanna were the relative higher growth of passive funds compared to active funds, as well as the continued interest in ETFs.

"State Street aims to partner with clients and invest with them as they are looking to service providers to provide more steps in the value chain," Lamanna said. Part of the State Street strategy has therefore been to take on more of the investment value chain with more sophisticated activities, whether related to regulatory pressures or new asset classes or reporting, so that clients can focus on their core activities.

Riccardo Lamanna, State Street Country Head for Luxembourg

Clients and the market, Lamanna explained, also need more clarity on ESG expectations. Furthermore, "we still see a very fragmented approach, particularly when we look at our role as a depositary bank. A more consistent approach from regulators would help to develop services that bring more value to clients."

SFDR Article 8 and 9 products: evolution between February 2022 and September 2024

Blockchain Law IV

On 19 December 2024, Luxembourg adopted Blockchain Law IV, which has opened up significant new opportunities to use the Luxembourg DLT framework, such as expanding this framework to include unlisted equity securities and facilitating the provision of services to issuers with additional flexibility in terms of custody arrangements. These innovations aim to encourage the financial industry to make use of blockchain and DLT in Luxembourg.

"Tokenisation is key. It's another way to enhance distribution of funds, UCITS particularly, and to tackle other types of investors."

Laurent Van Burik, CSSF Head of Unit Investment Funds

He suggested the possibility of passporting the depositary bank. "While we understand that the depositary bank is there to effectively protect the final investor, allowing for the passporting of it thus creating a more unified environment, will help reduce costs, eliminate unnecessary administrative burdens for clients and generate a higher standard in the service."

Ongoing industry discussions

Several discussions are ongoing amongst stakeholders, including the EU Commission, ESMA and the CSSF, including the reassessment in terms of eligible assets for UCITS. According to Van Burik, the CSSF "favour[s] less that the outcome of the changes is that the investment universe for UCITS funds is more restrictive than what we have today."

In November, the CSSF also launched a data collection exercise on behalf of ESMA so as to provide ESMA with information on all costs, fees and expenses linked to UCITS and AIFs for a one-off report. The subject of costs has been discussed, for example, in relation to the retail investment strategy and basis product labels. "Those discussions are very important for the industry," Van Burik added, "and I can only invite the industry to follow those discussions."

With ESG and prospectus updates and disclosure requirements, the CSSF is also reviewing its approval process and how it can allow for an even more efficient exchange with financial sector players and a better time to market.

Conclusion

There are challenges but also promising expectations on the horizon for UCITS, with additional opportunities to tackle the retail market.

Simplifying the journey of investments, easing distribution capacities, be it through tokenisation or other technological developments, and avoiding damage to the UCITS brand, especially with the narrowing of eligible assets and way of managing UCITS, will be key.

Arendt has over 180 dedicated UCITS and regulatory specialists, covering the entire value chain.

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