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DEVELOPMENTS IN THE COLLECTIVE INVESTMENT
INDUSTRY IN SPAIN BETWEEN 2008 AND 2019

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ABSTRACT

This article shows that collective investment undertakings (CIUs) have grown notably in recent years, both in Spain and other European countries. These developments have come in step with greater sector concentration and a rising percentage of assets managed by entities registered abroad. In line with the evidence documented internationally, the investment portfolios of CIUs domiciled in Spain reflect an increase in risk-taking over the last few years, although the weight of lower credit quality fixed-income instruments is very low. There are very close links between the Spanish banking sector and CIUs. First, a very sizeable share of the assets of Spanish CIUs is managed by subsidiaries of Spanish deposit-taking institutions. Second, a very significant proportion of CIUs' investment portfolios comprises financial assets issued by the banks themselves. Therefore, in-depth analysis of these interconnections is essential to assess the resilience of CIUs and that of the financial sector as a whole.

Keywords: collective investment undertakings, market structure, interconnection with the banking system, portfolio composition.

JEL classification: G23.

DEVELOPMENTS IN THE COLLECTIVE INVESTMENT INDUSTRY IN SPAIN BETWEEN 2008 AND 2019

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Introduction

This article describes the developments in and structure of collective investment undertakings (CIUs) marketed in Spain between 2008 and 2019. These encompass all entities created for the purposes of raising and managing funds from unit-holders and investing these in various types of assets, with a view to generating returns for investors based on the collective results. CIUs may take the legal form of investment funds or investment trust companies. In turn, these are classified into sub-categories based on whether they invest in transferable securities or real estate.²

CIUs have undergone notable growth in recent years both in Spain and worldwide, not only in absolute terms (volume of assets under management), but also in relative terms (weight within the financial sector). In particular, in 2019 Q3 the total assets of investment trust companies and investment funds marketed in Spain amounted to €483 billion, equivalent to 39% of GDP and 11% of all financial assets managed by the country's financial sector. Both ratios stand well above the levels observed in 2012 (18% and 4%, respectively).³

In a sector as vibrant and with such complex interconnections as the financial industry, the growing prominence of CIUs necessitates further study of their activity and links with other financial intermediaries. With this objective in mind, this article analyses the recent changes in the physiognomy of the CIU sector in Spain in terms of the type, size and number of entities that are marketed (second section), the links between these entities and the banking system (third section) and the composition of their investment portfolios (fourth section).

1 Laura Álvarez collaborated on this article during her secondment to the Banco de España as research assistant.

2 The main difference between investment funds and investment trust companies lies in the composition of their share capital. Investment trust companies have legal personality and their share capital is divided into shares, whereas investment funds are without legal personality and are managed by companies that do not own the fund, while the participants are unit-holders (rather than shareholders) as regards the liabilities issued by these undertakings.

3 The spread of the COVID-19 pandemic prompted a sharp correction in the prices of risk-bearing financial assets. This has most likely had a significant impact on CIUs' activity and assets. However, this article does not cover these more recent developments owing to a lack of up-to-date information.

CIUs in Spain: types and assets

The value of the shares and holdings of CIUs marketed in Spain and controlled by domestic agents has undergone considerable change in recent years, both in absolute and relative terms (see Chart 1.1). As discussed later in this article, a growing proportion of national saving is channelled through CIUs registered in other euro area countries. In view of these trends, the ratio between investment in CIUs and household and company deposits declined during the global financial crisis and the European sovereign debt crisis, reaching 20% in 2012, and subsequently climbed to stand at over 40%.

These fluctuations in CIUs' assets have largely been shaped by the changing conditions of the financial markets where these vehicles invest and the returns offered by other savings alternatives, such as bank deposits.⁴ For instance, between 2008 and 2012, the global financial crisis and the European sovereign debt crisis prompted a significant deterioration of financial market conditions. This resulted in a decline - both via valuations and, primarily, redemptions - in the assets of securities funds domiciled for tax purposes in Spain⁵ (see Chart 1.2). These redemptions gathered momentum as a result of investment in bank deposits becoming more appealing owing to a marked increase in their returns, at a time when deposit-taking institutions sought to raise funds via this channel in response to the marked tensions in the wholesale financial markets. By contrast, since 2013 the assets of investment funds have grown. This trend was mainly attributable to positive net subscriptions for these products, driven by declining returns on bank deposits, along with more favourable conditions in the financial markets. Upward momentum in the prices of the financial assets in which these undertakings invest, particularly in 2019, likewise contributed to the increase in their assets owing to the valuation effect.

In cumulative terms, the increase in the assets of CIUs registered in Spain clearly outpaced nominal GDP growth between 2008 and 2019. This resulted from the expansion observed since late 2012. In any event, collective investment has grown more moderately in Spain than in the euro area (see Chart 1.3). The slower relative growth of collective investment in Spain is not so much due to domestic agents being less inclined to invest in such products as to the greater buoyancy of undertakings domiciled for tax purposes in other countries, such as Luxembourg and Ireland, which attract savings from both domestic investors and the rest of Europe, including Spain.⁶

4 Other factors, such as changes to savings taxation and greater financial knowledge among households, may also generate fluctuations in the relative weight of CIUs over time.

5 The breakdown between net subscriptions and valuation effects is only available for investment funds registered in Spain.

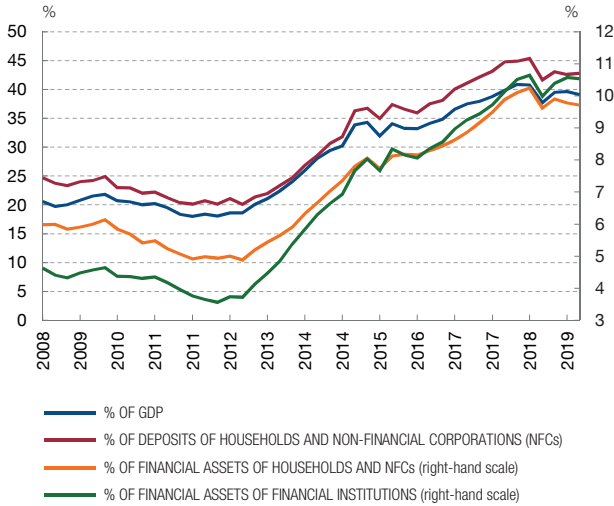
6 This trend has likewise been shaped by the slower recovery in the Spanish household saving rate as compared with that in euro area countries.

Chart 1

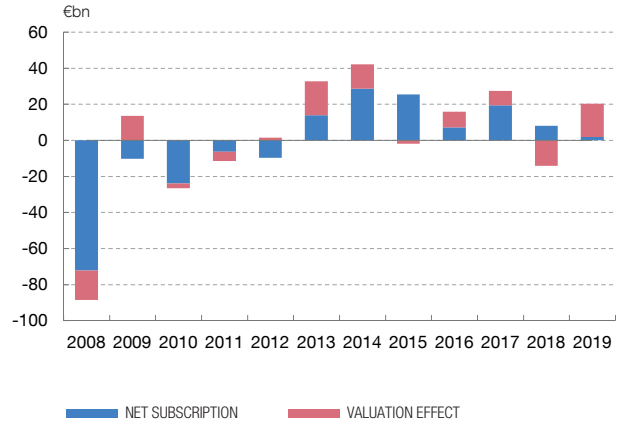
THE RELATIVE IMPORTANCE OF THE COLLECTIVE INVESTMENT INDUSTRY IN THE FINANCIAL SECTOR HAS INCREASED IN RECENT YEARS

In recent years, CIUs, which intermediate in a significant and growing percentage of household wealth, have expanded significantly in Spain owing to positive net subscriptions and a larger valuation effect in 2019. However, the growth in Spain in the last few years has been outpaced by the rest of the euro area.

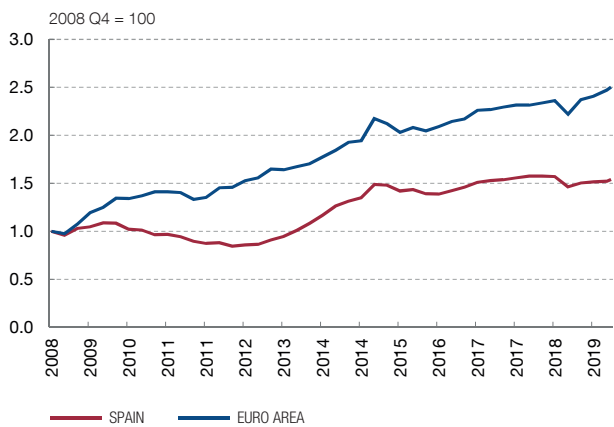
1 DEVELOPMENTS IN THE ASSETS OF CIUs MARKETED IN SPAIN (a)



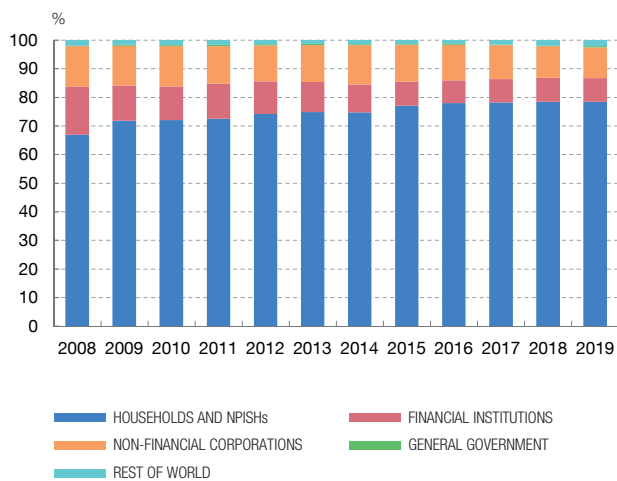
2 BREAKDOWN OF CHANGE IN THE ASSETS OF INVESTMENT FUNDS (b)



3 CIU ASSETS IN EACH AREA, AS A % OF GDP (c)



4 UNITS IN INVESTMENT FUNDS AND SHARES IN INVESTMENT TRUST COMPANIES, BY HOLDING SECTOR (d)



SOURCES: Banco de España, ECB and CNMV. Latest observation for Charts 1 and 4: 2019 Q3.

- a Includes financial, real estate and foreign CIUs marketed in Spain.
- b Includes securities funds registered in Spain.
- c Includes CIUs registered in each area that are classified under sub-sector S.124 of ESA-2010.
- d Includes CIUs registered in Spain that are classified under sub-sector S.124 of ESA-2010.

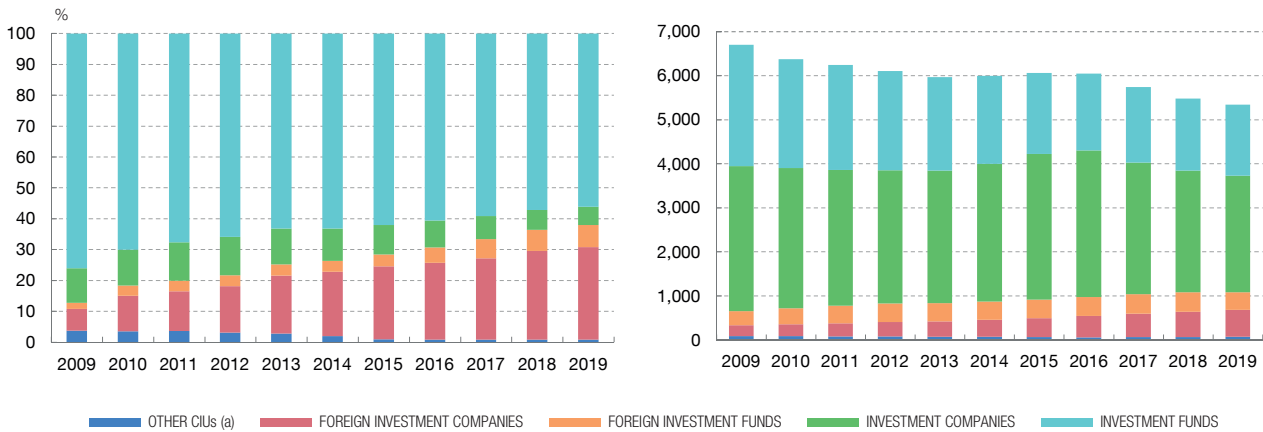
Chart 2

THE GROWING INTERNATIONALISATION AND CONCENTRATION OF CIUs MARKETED IN SPAIN

The percentage of assets intermediated by CIUs marketed in Spain and registered abroad, mainly investment trust companies, has grown significantly in recent years. Despite the declining share of assets held by investment funds registered in Spain, the growth in their assets in recent years, together with the fall in the number of such CIUs, has resulted in greater concentration in this type of fund.

1 ASSETS OF CIUs MARKETED IN SPAIN, BY CATEGORY

2 NUMBER OF CIUs MARKETED IN SPAIN, BY CATEGORY



SOURCE: CNMV. Latest observation: 2019 Q3.

a Includes real estate investment funds and trust companies and hedge funds.

Chart 1.4 shows that households make up the bulk of the shareholders and unit-holders of Spanish CIUs: their weight in the assets of these investment undertakings grew from 67% in 2008 to 78% in 2019, while that of non-financial corporations and financial institutions declined, standing at 11% and 8%, respectively, in 2019. Further, practically all Spanish CIUs are marketed domestically, with foreign investors holding just 2% of their assets in 2019.

Aside from the above overall dynamics, the industry has undergone considerable structural transformation in recent years. Two changes are particularly noteworthy: first, the weight of foreign CIUs in the Spanish market has grown significantly, up from 9% of total sector assets in 2009 to 37% in September 2019 (see Chart 2.1). At end-2019, the euro area countries with the largest percentage of assets of CIUs registered in the euro area were Luxembourg (34% of the euro area total) and Ireland (21%), followed by Germany (18%) and France (11%), while Spain stood in seventh place (2%). The growing market share of foreign CIUs has undermined the standing of Spanish-registered securities funds, whose share has declined by 20 percentage points (pp) since 2009, although they continue to attract more than half of the assets invested in CIUs. The share of Spanish investment trust companies has likewise fallen in the same period, down from 11% to 6%.

Second, the number of CIUs marketed in Spain has dropped notably in recent years (see Chart 2.2). This decline, together with the growth in assets controlled by the

sector, has driven up the average volume of assets held by these entities. This trend has been particularly striking in the case of securities funds domiciled for tax purposes in Spain. Between 2009 and 2019, the annual average number of these funds declined from 2,751 to 1,614, while their assets grew by €101 billion.⁷ As a result, the average size of Spanish securities funds expanded 172% to €168 million. As detailed in the following section, this trend was in part shaped by the consolidation of the Spanish banking sector in recent years, leading to the greater concentration of this type of investment fund.

Interconnection between CIUs and the banking sector

The collective investment industry and the banking sector are closely linked through various channels. A very significant share of the assets of CIUs is managed by subsidiaries of Spanish deposit-taking institutions (hereinafter, banks). Specifically, in recent years, over 80% of the assets of securities funds registered in Spain have been administered by management companies that are subsidiaries of Spanish banks (see Chart 3.1).⁸ The existence of this link can influence the activity and results of the banking sector. Although banks offer close substitutes to CIUs, such as deposits, they also benefit from the growth of this industry through the sales commissions that they receive and, indirectly, through other fees (such as those for management and custody).

This link also means that the dynamics of the banking sector have a most noticeable influence on developments in this segment of CIUs. Thus, for example, the consolidation of the Spanish banking sector in recent years has played a key role in the increase in the degree of concentration of the Spanish securities fund industry.⁹ In particular, as shown in Chart 3.2, the concentration of this sector, measured using the Herfindahl index,¹⁰ increased very significantly between 2012 and 2015, precisely at a time when the number of Spanish and foreign financial groups with which the

7 Significant declines were also observed in the number of investment trust companies (from 3,293 to 2,646) and real estate CIUs and hedge funds (from 17 to 6 and 67 to 61, respectively). Hedge funds are a separate type of CIU and not subject to the same investment restrictions as securities and real estate CIUs. Therefore, they can freely choose the assets in which to invest, adopting more sophisticated investment strategies than traditional funds.

8 In Europe, the percentage of total assets held by investment funds whose management companies are subsidiaries of banks is also high, and it is estimated that over 50% of large management companies in the euro area are subsidiaries of banks. For more details, see N. Doyle, L. Hermans, P. Molitor, and C. Weistroffer (2016). *Shadow banking in the euro area: risks and vulnerabilities in the investment fund sector*, Occasional Paper Series No 174.

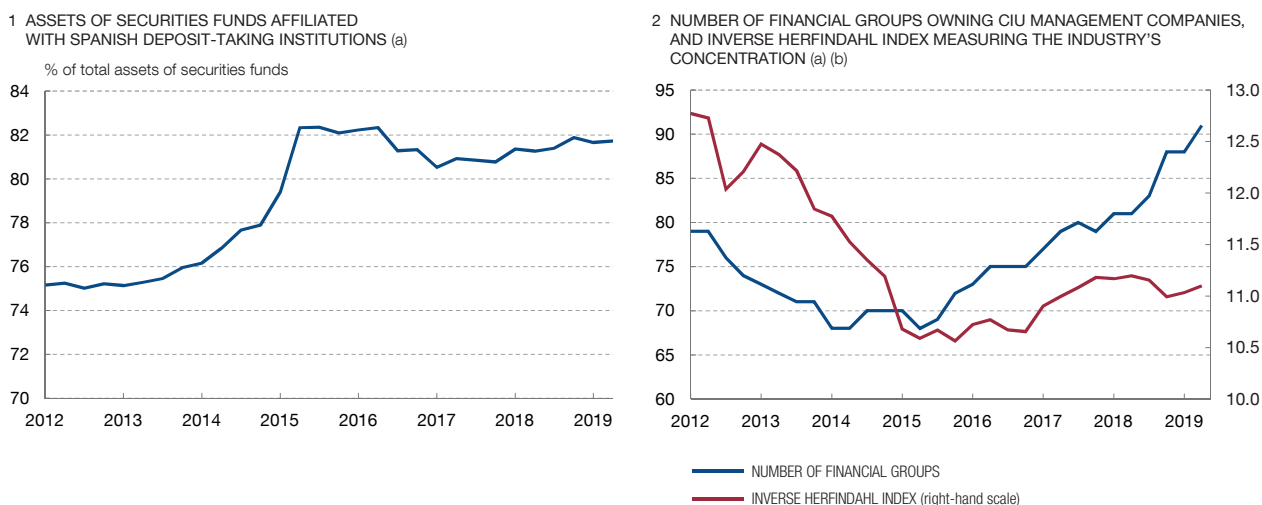
9 The analysis presented in this section focuses on the segment of securities funds domiciled in Spain, for which better quality and more detailed information is available. As shown in Chart 2.1, this segment includes most of the assets of CIUs marketed in Spain.

10 The Herfindahl index is calculated as the sum of squared market shares of each of the banking and non-banking financial groups to which the management companies making up the industry belong. A high index indicates high market concentration. Chart 3.2 shows the inverse of this index, representing the hypothetical number of identically-sized management companies sharing the market.

Chart 3

STRONG INTERCONNECTION BETWEEN SECURITIES FUNDS AND THE BANKING SECTOR

There are very close links between the Spanish banking sector and CIUs, as evidenced by the fact that a very significant proportion of the assets of securities funds marketed in Spain are managed by affiliates of domestic deposit-taking institutions. Further, the industry has become considerably more concentrated in the last few years, primarily due to the recent consolidation of the Spanish banking sector.



SOURCES: Banco de España and CNMV. Latest observation: 2019 Q2.

a Includes securities funds registered in Spain.

b The inverse Herfindahl index represents the hypothetical number of financial groups with CIU management companies if all were of identical size.

management companies of these funds are affiliated fell from 79 to 68. This decline was chiefly attributable to the decrease in the number of management companies that are subsidiaries of Spanish banks (from 28 to 19). Between 2016 and 2019, the number of financial groups owning investment fund management companies rose, reaching a total of 91 in 2019 Q2. This increase was primarily the result of the emergence of new non-banking financial groups that are smaller than the management companies affiliated with Spanish banks, whose number hardly varied. Hence, the Herfindahl index held relatively flat between 2016 and 2019.

Another channel connecting banks and CIUs is the latter's holdings of assets issued by the former. This interconnection is particularly significant in the case of management companies that are subsidiaries of banks. For instance, in June 2019, shares of Spanish banks held by equity investment funds managed by banking groups represented 9% of these funds' assets, compared with 4.7% in the case of other equity investment funds registered in Spain. In the same month, outstanding bonds issued by Spanish banks accounted for 4% of the assets of fixed-income investment funds managed by entities belonging to Spanish banking groups, compared with 3.8% in the case of other fixed-income investment funds. The magnitude of these exposures not only means that the market valuations of these assets have a significant influence on the profitability and assets of CIUs, but also

that abrupt changes in the holdings of such assets can have a bearing on the funding conditions of the banking sector. Moreover, CIUs invest in liquid assets, such as bank deposits and repos, generally with Spanish banks as a counterparty, thereby creating another direct channel of connection. In June 2019, these assets had a weight of around 6.9% on the balance sheet of securities funds.

A more indirect interconnection between CIUs and banks derives from both groups of entities holding the same financial assets. For example, in June 2019, Spanish sovereign bonds accounted for 11% of the assets of securities funds domiciled for tax purposes in Spain, and 7.1% of the total assets of Spanish banks. Again, fire sales of these assets by either group of entities could affect the valuation of the investment portfolios of the other group.

Composition of CIUs' portfolios

The composition of Spanish CIUs' portfolios has undergone major changes in recent years. For instance, the share of fixed-income securities and deposits has declined substantially, from 54% and 23% in 2009 to 40% and 11%, respectively, in 2019 (see Chart 4.1). Part of this decline has been offset by the greater prominence of equity investment, which rose by 9 pp to 17% during the same period. This development, which can also be observed in the euro area as a whole,¹¹ albeit to a lesser extent, could have been driven by investors' search for greater expected returns against a backdrop of historically low interest rates associated with highly expansionary monetary policies. This change in portfolio composition means that final investors in CIUs have a more pronounced risk profile, as equity securities tend to show greater price volatility. In any event, despite this development, in mid-2019 equity and equity fund shares accounted for less than a quarter of the total volume of assets under management (see Charts 4.1 and 4.2).

Chart 4.3 summarises the changes in the portfolios of shares and bonds held by securities funds registered in Spain, according to the currency of denomination. Between December 2014 and June 2019 (latest data available), an increase of 4 pp can be seen in these funds' exposure to equity securities denominated in currencies other than the euro, primarily in the US dollar. As regards fixed income, a slight increase (2 pp) can be seen in the holdings of bonds denominated in US dollars; this was probably attributable to the search for assets with higher interest rates than euro-denominated bonds, whose share decreased by 2.2 pp. The reduction in the holdings of euro-denominated financial assets therefore points to a greater exposure to exchange rate risk.

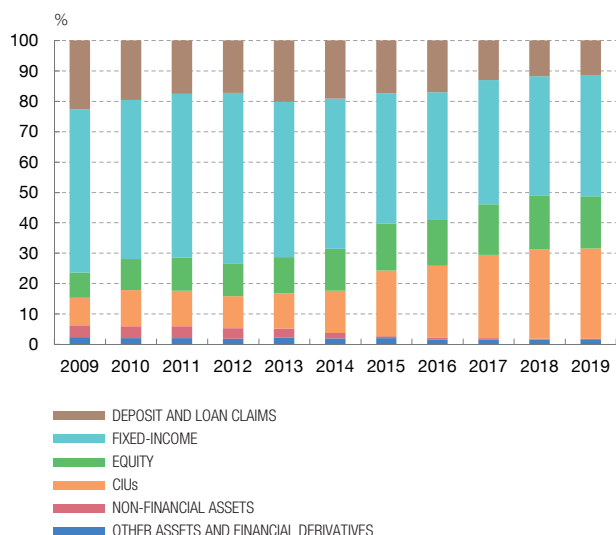
¹¹ On European Central Bank statistics, fixed-income assets and deposits held by CIUs in the euro area fell by 2 pp and 1 pp, respectively, between 2009 and 2019, whereas equity securities held rose by 3 pp during the same period.

Chart 4

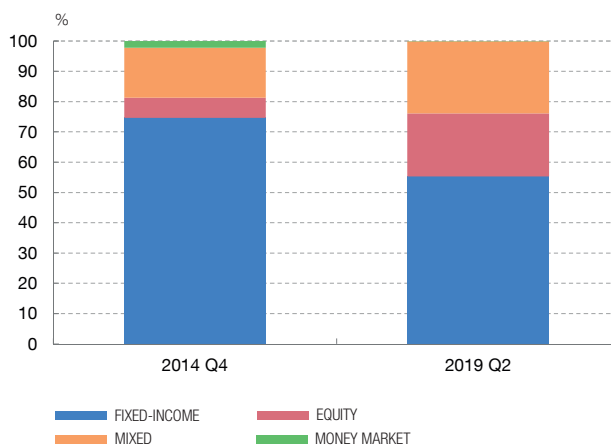
SHIFT IN THE INVESTMENT OF CIUs REGISTERED IN SPAIN TOWARDS EQUITY SECURITIES

The weight of deposits and fixed-income securities in the portfolios of CIUs registered in Spain has declined, while the proportion invested in equity assets and in other CIUs has increased. Likewise, the portfolios of securities funds registered in Spain have seen an increase in the weight of holdings of shares and bonds in foreign currency and high quality credit bonds.

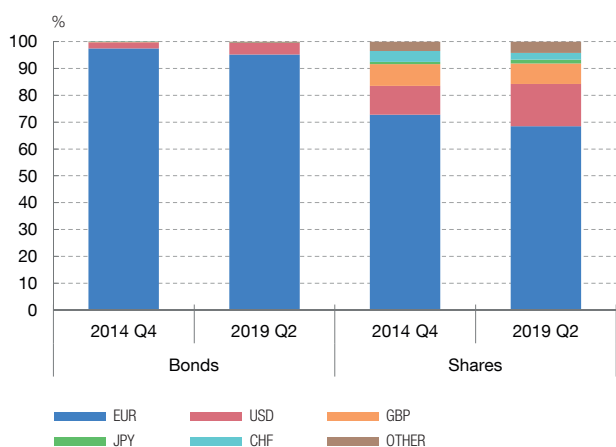
1 ASSET STRUCTURE OF CIUs REGISTERED IN SPAIN (a)



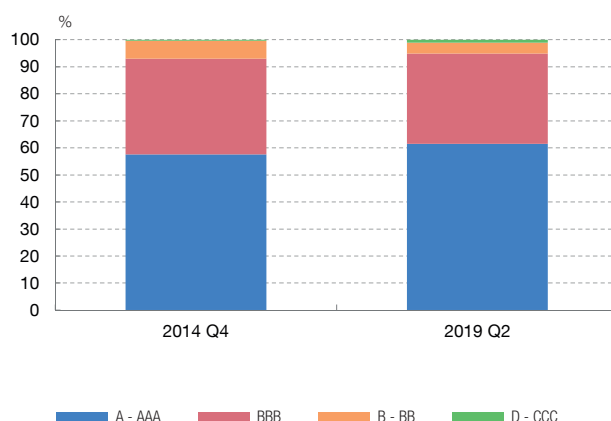
2 FUND UNITS HELD BY SECURITIES FUNDS REGISTERED IN SPAIN, BY FUND TYPE (b)



3 SHARES AND BONDS HELD BY SECURITIES FUNDS REGISTERED IN SPAIN, BY CURRENCY OF ISSUANCE



4 BONDS HELD BY SECURITIES FUNDS REGISTERED IN SPAIN, BY RATING (c)



SOURCES: Banco de España, ECB, CNMV and Reuters.

a Sub-sector S.124 of ESA-2010.

b The mixed fund group includes all funds that cannot be exclusively categorised as fixed-income or equity funds. Accordingly, this category includes mixed equity funds, mixed fixed-income funds, passive funds, global funds, absolute return funds and guaranteed funds.

c Each credit category includes the corresponding sub-categories. For example, the BBB credit category includes the sub-categories BBB+, BBB and BBB-. The most recent rating is assigned to each bond. Included are the ratings assigned by DBRS, Fitch, JCR, Moody's and S&P.

The bulk of fixed-income investments are concentrated in investment-grade bonds. Within this group, an improvement can be observed in average credit quality, as the share of bonds rated between A and AAA rose from 58% in December 2014 to 61% in June 2019 (see Chart 4.4). However, when assessing the risks of this portfolio, the large proportion of investment-grade bonds with a lower credit quality (i.e. BBB rating), accounting for 33% of the total in mid-2019, should be borne in mind. The price of these bonds is especially sensitive to changes in the macroeconomic setting. For example, in situations such as the current sharp deterioration in the macroeconomic outlook, rating agencies could downgrade some of these bonds to below investment grade. This could trigger bouts of abrupt price drops associated with fire sales by institutional investors whose portfolios include such bonds, owing to the restrictions on their investments in high-yield (lower quality) bonds. Finally, holdings of this type of bond decreased by 2 pp between 2014 and 2019, and barely accounted for 5% of fixed-income securities in mid-2019.

Chart 4.1 shows another trend characterising the developments in Spanish CIUs' portfolios in recent years: the increase in the percentage of asset investments held in other CIUs, from 9% in 2009 to 30% in 2019, which could be a result of the search for more efficient investment management. However, this practice could lead to a rise in the expenses borne by unit-holders, owing to the greater costs passed on through fees (for subscription, redemption and management) associated with investments in other CIUs.¹² It should also be borne in mind that such indirect fees are not included for the purposes of maximum legal limits.

In short, the increase in the assets of the collective investment industry in Spain, the high degree of concentration, its interconnection with the banking sector and the greater risk-taking in recent years suggest the need for a profound, ongoing analysis of this industry to assess its own resilience and that of the financial sector as a whole.

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12 S. J. Brown, W.N. Goetzmann & B. Liang (2005), "Fees on fees in funds of funds", *The World Of Hedge Funds: Characteristics and Analysis* (pp. 141-160), show that investments of investment funds in other CIUs entail an increase in the fees passed on to unit-holders, adversely affecting their returns.