

## The Investment Funds Industry in Ireland — A Statistical Overview

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### Abstract

This article launches a new data series on the assets and liabilities of investment funds (IFs). For the first time in Ireland, individual fund types are identified, including hedge funds. The article discusses how the new data will enhance analysis of the funds industry and their role in financial intermediation. From the establishment of the IFSC in 1987, the size of the IF sector in Ireland has increased rapidly, and Irish resident investment funds (not including money market funds) had €414.6 billion of assets under management in September 2009. Included in the article is a detailed quarterly balance sheet for four different fund types (equity, bond, hedge and other) covering four quarters, starting in the final quarter of 2008. Data on transactions are also included along the same breakdown as assets and liabilities. This article also presents data on money market funds (MMFs), to give a comprehensive overview of the size of investment funds resident in Ireland.

Detailed tables are available for download from the Statistics section of the Central Bank's website, [www.centralbank.ie](http://www.centralbank.ie).

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## 1. Introduction

This article provides an introduction to a new data series on the assets and liabilities of investment funds<sup>2</sup> (IFs) which will be released quarterly by the Central Bank. This data, for the first time, provides a breakdown of IF balance sheets by fund type, for example, it separately identifies hedge funds. The use of this new dataset will be discussed in greater detail throughout the article. The data is very important from a national perspective, and alongside this, it has important policy implications, including monetary policy and financial stability analysis, understanding portfolio shifts, and analysing the financial wealth of the non-financial sector. These data are being compiled as part of a European Central Bank (ECB) initiative to provide harmonised statistics on investment funds for the euro area.<sup>3</sup> Detailed breakdowns are provided on the assets held by different types of funds, and on the holders of units issued by the funds. New data on money market funds (MMFs) are also being published to provide a full overview of the investment funds industry in Ireland. Section 2 examines the reasons for introducing the new investment funds statistical series. Section 3 provides an overview of the funds industry in Ireland, and Section 4 outlines how the new reporting requirements were implemented. Section 5 summarises developments for each fund type since the final quarter of 2008, while Section 6 offers some tentative conclusions.

## 2. The Increased Importance of OFIs including Investment Funds

The ECB has collected detailed balance sheet data on central banks and other monetary financial institutions (MFIs), including money market funds, for some time but there were significant data gaps for non-bank financial institutions. This data gap has been recognised by the ECB and other users, particularly in the context of greater financial intermediation and

the increasingly complex interlinkages within the financial sector.

The largest non-bank financial corporation sector is the other financial intermediation (OFI)<sup>4</sup> sector which comprises a number of sub-sectors, including investment funds, financial vehicle corporations (FVCs) and other financial corporations (Chart 1). In recent years in Ireland the OFI sector has increased in importance, through the growth in the size of investment funds and the rise in securitisation. In particular internal securitisations<sup>5</sup>, of which there have been around €25 billion since December 2007<sup>6</sup>, meant that the size of credit to the OFI sector on MFIs' balance sheets became more important as loans were 'reclassified' from the residential mortgage or non-financial corporate sectors to the OFI sector as securitisations were performed. In addition, the number of FVCs resident in Ireland rose alongside increased securitisation activity.

Chart 2 shows how MFI credit to OFIs expanded in recent years in Ireland, primarily as a result of securitisations. OFIs accounted for 20 per cent of total assets of the euro area financial sector in June 2009. IFs (excluding MMFs) accounted for nearly half of this, at €4.7 trillion, with FVCs accounting for a large proportion of the remainder. The size of the OFI sector, and in particular, the IF sub-sector, highlights the need to have greater information on how they influence financial markets and on their role in financial intermediation and monetary policy transmission mechanisms.

As IFs constitute the dominant sub-sector within the OFI sector, the collection of data from these financial entities was deemed the priority by the European System of Central Banks (ESCB). Following an extensive merits and costs appraisal, the ECB passed Regulation ECB/2007/8<sup>7</sup> concerning statistics on the assets and liabilities of investment funds

<sup>4</sup> An OFI is defined as a corporation or quasi-corporation that is engaged mainly in financial intermediation by incurring liabilities in forms other than currency, deposits and/or close substitutes for deposits from institutional entities other than MFIs, or insurance technical reserves.

<sup>5</sup> An internal securitisation occurs when a bank securitises some loans, for example, mortgages, and then repurchases this securitisation, which will appear on their balance sheet as a credit to the OFI sector.

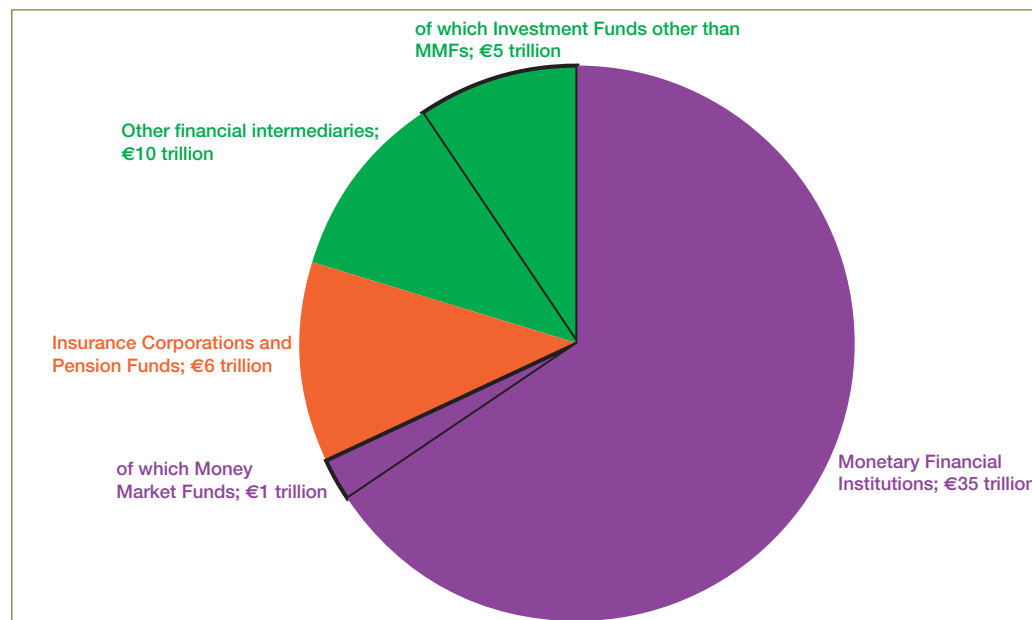
<sup>6</sup> An internal Central Bank estimate.

<sup>7</sup> Regulation (EC) No. 958/2007 of The European Central Bank of 27 July 2007 concerning statistics on the assets and liabilities of investment funds (ECB/2007/8).

<sup>2</sup> Data covered in the statistical series refers to funds authorised in Ireland only.

<sup>3</sup> The first publication of IF monthly data by the ECB, and Ireland, were released on 11 December 2009.

Chart 1: Total Assets of the Euro Area Financial Sector, June 2009

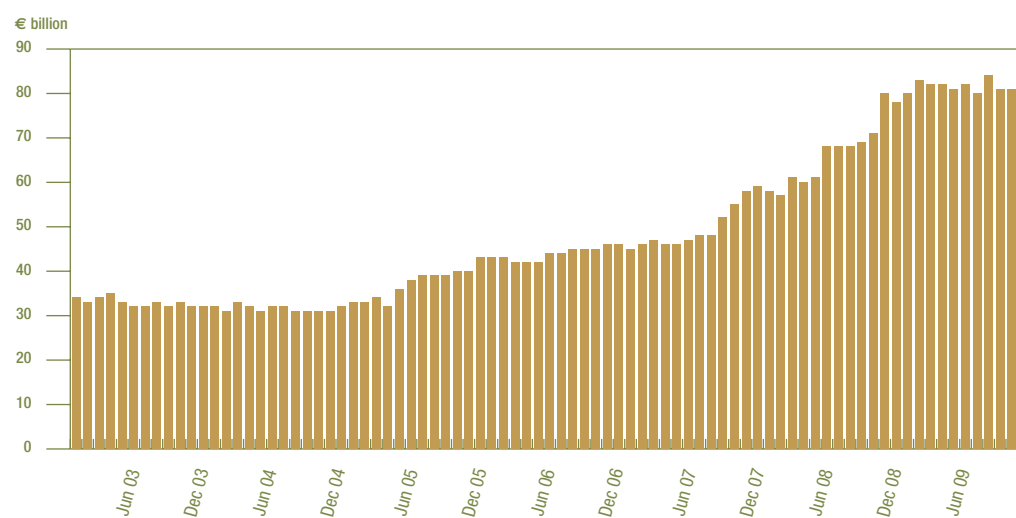


Source: European Central Bank.

in July 2007. The Regulation defines an investment fund as 'a collective investment undertaking that invests in financial and non-financial assets, to the extent that its objective is investing capital raised from the public'. By contrast, a money market fund invests in short-term, highly liquid money-market instruments

such as commercial paper, and their shares/units are close substitutes for deposits. All IFs were required to report detailed information on their assets and liabilities under the new Regulation for the first time in February 2009 with reference to December 2008 closing balances.

Chart 2: MFI Credit to the Other Financial Intermediation Sector in Ireland



Source: Central Bank of Ireland.

The advantage of the new legislation is that it harmonises the definitions of investment funds in the euro area. Previous investment fund data published by the ECB was compiled on a fragmented basis, but the new Regulation brings a standardised approach in terms of definitions, completeness, and timeliness. The old data series is presented in Chart 3. The new Regulation also provides for the collection of separate data on hedge funds and other fund types, and a more detailed breakdown of the assets and liabilities of IFs. In addition, information on transactions is now available for the first time.

While the planning for the collection of balance sheet and transactions data on IFs was in motion long before the start of the financial turmoil, the crisis highlighted the importance for the ECB to have more information on other financial sectors of the economy that could impact on the liquidity of the euro area banking system. These data would also allow the ECB to monitor the increasing tendency to transfer risks among institutions, sectors and across countries.

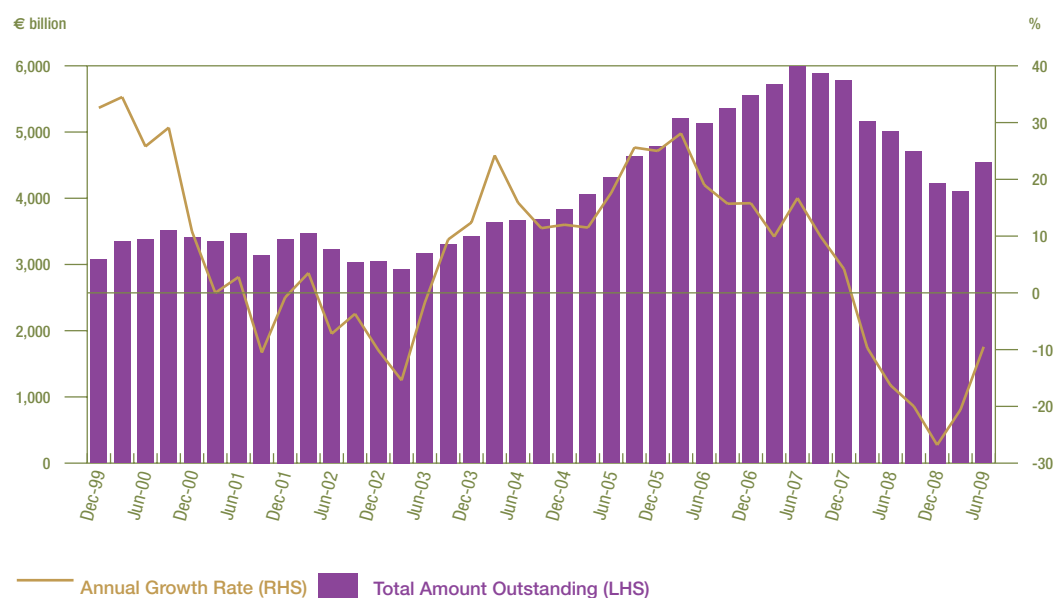
Detailed information on investment funds had been identified as crucial to policymakers for a number of reasons. In particular, the data provide essential information for monetary and financial analysis, on portfolio shifts between

monetary and non-monetary assets, and on the channelling of savings by the non-financial sectors. These insights allow a better understanding of developments in monetary aggregates. It also enables users to monitor portfolio shifts within investment funds' balance sheets and provides information on expectations for inflation and general economic activity.

Moreover, movements in the value of investment fund shares/units held by households and firms may influence aggregate demand, particularly in relation to wealth effects. Changes in the composition and quality of investment fund assets can also impact on financial markets and on liquidity provision. The data are also helpful in understanding developments in financial structures, and the increasing levels of financial intermediation.

Furthermore, the separate identification of specific fund types, and in particular hedge funds, is beneficial from a financial stability perspective, due to their high leverage and the absolute levels of return that they are committed to. The collection of transactions data also helps to monitor the investment behaviour of major institutional investors, and how this impacts on market prices and spreads.

Chart 3: Total Assets of Euro Area Investment Funds (Old Data Series)



### 3. The Funds Industry in Ireland

The growth of the investment funds industry in Ireland was the result of a number of factors. Ireland was successful in attracting financial corporations, such as fund management, corporate treasury management, banking, etc., to set up in Ireland as a result of a concerted effort to do so, for example, through the establishment of the International Financial Services Centre (IFSC) in 1987. The passing in 1989 of the 'European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations' into Irish law was one of the major factors contributing to the growth of the investment funds industry in Ireland. These Regulations meant that a fund no longer had to be domiciled in an EC country in order to operate in that country, so a fund registered in Ireland could be offered for sale in another Community country. Before these Regulations were in place, a fund had to be resident in a particular country in order to operate in that country and this favoured those countries with access to larger investment markets. Another major factor contributing to the rise of the funds industry in Ireland was the establishment in 1987 of the IFSC. The IFSC established an accommodating fiscal environment to attract funds and other related companies into Ireland, and was very successful in doing so — the number of funds registered in Ireland increased approximately

sixteen-fold between 1992 and 2009. In addition, Ireland could boast a low tax regime, and a highly educated workforce, among other attractive features. The funds industry in Ireland has now extended beyond the IFSC, and indeed Dublin, with companies now established in Galway, Cork, Wexford, etc.

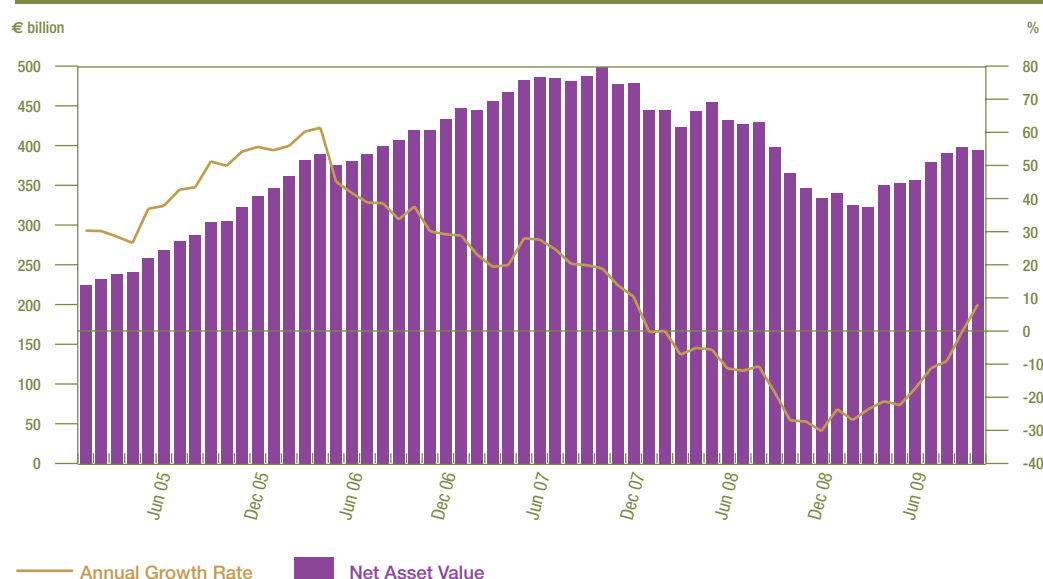
Other European countries that are large in terms of the funds industry include Luxembourg, Germany and France. The difference between Germany and France, and Ireland and Luxembourg, however, is that in Germany and France around 90 per cent of IF shares are held by domestic residents, but in Ireland and Luxembourg, this figure is less than 10 per cent in each country. Chart 4 shows the rapid expansion of the funds industry in Ireland according to the net asset value of funds authorised in the jurisdiction.

### 4. The Introduction of the New Data Series in Ireland

Regulation ECB/2007/8 forms part of a wider European System of Central Banks (ESCB) programme to develop statistics on a security-by-security basis, i.e. where reporting agents provide data on individual securities both held and issued. The Regulation followed the implementation of Guideline ECB/2004/15<sup>8</sup> on

<sup>8</sup> Guideline of the ECB of 16 July 2004 on the statistical reporting requirements of the ECB in the field of balance of payments and international investment position statistics, and the international reserves template (ECB/2004/15).

Chart 4: Annual Growth Rate of the Net Asset Value of Irish Investment Funds



Source: Central Bank of Ireland.

balance of payments and international investment position statistics (BOP/IIP) in 2004. This Guideline requires national central banks to compile the portfolio investment component of BOP/IIP statistics submitted to the ECB on a security-by-security basis.

While the Central Bank is legally responsible for meeting ECB statistical requirements, the Central Statistics Office (CSO) is the recognised competent authority for the compilation of BOP/IIP statistics in Ireland, and, as such, provides the requisite information to the ECB, on behalf of the Central Bank. Given the close links between the statistical requirements under the IF Regulation and the BOP/IIP Guideline, the Bank and the CSO undertook a joint project to integrate both reporting requirements. Collection and compilation of the data is shared by both institutions. This joint approach helps to reduce the reporting burden on funds, avoid duplication of work within the Central Bank and the CSO, and to ensure consistency between various statistical outputs. Investment funds data also provide a key input into the compilation of national and financial accounts.

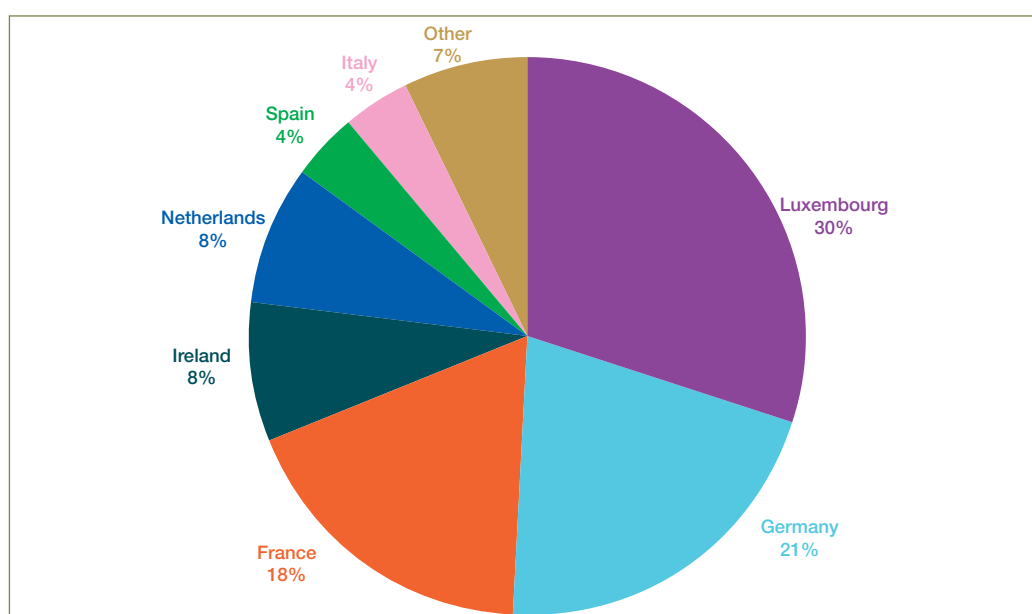
### 5. Description of the New Data Series

Investment funds are required under Regulation ECB/2007/8 to report balance sheet

data to the Central Bank on a fund-by-fund basis, in addition to the investment policy of each fund, as defined in the fund's prospectus. There are six broad fund types, which are defined by the investment strategy of the fund; equity, bond, mixed, hedge, real estate and other. In addition, these fund types are broken down into open-ended and closed-ended funds. Broadly speaking, an open-ended fund is one in which 'the units or shares are, at the request of the holders, repurchased or redeemed directly or indirectly out of the undertaking's assets', and closed-ended IFs are 'IFs with a fixed number of issued shares whose shareholders have to buy or sell existing shares to enter or leave the fund'.

The funds industry in Ireland represented around 8 per cent of total shares/units in issue in the euro area in September 2009, and Ireland is the fourth largest country in the euro area in this regard (Chart 5). Total investment funds in Ireland had assets under management of €414.6 billion in September 2009. This increased by 18 per cent since December 2008, with most of the growth being recorded in the second and third quarters of 2009 as financial markets began to recover. Around €14.5 billion of the growth since end-December 2008 was related to inflows, with the remainder being attributed to positive valuation effects.

Chart 5: Country Shares of Euro Area IF Shares/Units Issued, September 2009



Source: European Central Bank.

Table 1: Total Investment Funds (excluding MMFs)

€ million	Q4 2008		Q1 2009		Q2 2009		Q3 2009	
	Stock	Stock	Flow	Stock	Flow	Stock	Flow	
<b>Assets</b>								
Deposits and loan claims	17,063	21,113	3,842	20,160	-4,310	20,400	-277	
Securities other than shares	97,774	96,612	-1,150	111,857	14,421	126,284	12,939	
Issued by euro area residents	33,931	35,254	1,291	32,700	-3,488	38,351	4,917	
Issued by non-euro area residents	63,843	61,358	-2,441	79,157	17,909	87,934	8,021	
Shares and other equity	152,565	162,192	16,569	168,802	-19,289	193,905	3,727	
Issued by euro area residents	37,063	36,662	2,415	34,507	-6,833	41,799	1,950	
Issued by non-euro area residents	115,502	125,530	14,154	134,295	-12,456	152,107	1,777	
Investment fund shares/units (incl. MMF shares)	55,879	46,907	-6,647	47,101	-1,669	46,862	-1,228	
Issued by euro area residents	28,083	23,089	-3,940	29,240	5,190	29,385	-340	
Issued by non-euro area residents	27,796	23,818	-2,707	17,861	-6,859	17,478	-888	
Non-financial assets	7,951	9,172	1,480	15,100	4,215	15,325	282	
Other assets	18,699	12,193	-6,123	12,877	804	11,789	-3,109	
<b>Liabilities</b>								
Investment fund shares/units	329,489	331,357	10,854	357,078	-7,534	396,724	13,943	
Loans and deposits received	1,857	986	-881	661	-243	528	-190	
Other liabilities	18,586	15,847	-2,001	18,158	1,948	17,314	-1,422	
<b>Total Assets/Liabilities</b>	<b>349,931</b>	<b>348,190</b>	<b>7,972</b>	<b>375,897</b>	<b>-5,828</b>	<b>414,566</b>	<b>12,333</b>	

A key feature of the new reporting is the requirement to provide asset and liability information by individual security, with publically available identifier codes. Reporting by individual security has many advantages. Firstly, the securities can be linked to a large database<sup>9</sup> available to the ESCB, containing a wide range of attributes including price, sector and country of issuer, and issue and maturity dates, to generate a range of statistical outputs. Secondly, it allows the derivation of monthly estimates by updating the prices of the securities held. It also enables analysis of the structure of, and developments in, financial wealth arising from changes in the valuation of security portfolios held by households and non-financial corporations. The data will facilitate greater analysis of the risk exposures by these sectors, even before any financial stress is identified, which will be useful for monetary policy and financial stability analysis. Information on the individual securities issued or held by funds allows the ECB and national central banks to monitor more closely the impact of any distressed or defaulting securities, both on the funds industry itself, and

on the other economic sectors holding these securities.

The balance sheet data collected includes a detailed breakdown of the assets of investment funds, and a less extensive breakdown of their liabilities. For each type of fund, breakdowns by financial instrument and by sector and geography of counterparty are provided. More details on these breakdowns are provided in Box 1.

### 5.1 Equity Funds

Equity funds are investment funds that invest primarily in shares and other equity. In Ireland, equity funds are the predominant fund type and accounted for over 47 per cent of the value of total shares/units in issue in the third quarter of 2009 (Table 2). This is up from 44 per cent of total shares/units in issue as of the fourth quarter of 2008, mostly at the expense of mixed funds, and is in contrast to the overall euro area statistics, where equity funds are the second largest fund type accounting for 28 per cent of total shares/units in issue in the third quarter of 2009.

<sup>9</sup> The ECB's Centralised Securities Database.

**Box 1: Description of the Balance Sheet Data Collected<sup>10</sup>**

The assets side represents the investment portfolio of investment funds, and data is collected according to six instrument categories. The largest investments by funds are in shares and other equity, excluding holdings of other IFs' shares/units, which are identified separately in the tables. After equities, IFs invest mostly in securities other than shares, or more simply, bonds.

Deposits and loan claims include all deposits that IFs have placed with banks and other institutions. This category also includes any loans that an IF may have advanced. Non-financial assets details IFs' holdings of all non-financial assets, such as real estate and commodities. Finally, remaining assets comprises financial derivatives with a positive market value, and all other assets which are not classified above. This could include accrued interest.

There is less detail on the liabilities side of the balance sheet due to the fact that the main category is IF shares/units in issue, which account for around 95 per cent of total liabilities. These are the units sold by the funds to the public in order to raise capital to make investments. This item is the equivalent of the net asset value (NAV) of the fund, which is the total value accruing to the investors/shareholders of the fund. Loans and deposits received cover all cash balances that a fund has received, such as a loan to make an investment or money received from the sale of shares/units. Finally, other liabilities are all remaining liabilities not captured in the above categories, including financial derivatives with a negative market value, and interest/dividends due but not yet paid on loans or deposits received, etc.

One of the new features of the data is the breakdown of the balance sheet by geography and by sector. Geography gives the residency of the counterparty of the IF for both assets and liabilities for each financial instrument category, according to three main regions: Ireland; other monetary union member states; and rest of the world.

The sectoral breakdown gives information on the economic sector of the counterparty. This is broadly broken down into monetary financial institutions (MFIs), general government and other non-bank, non-government sectors. Finally, a maturity breakdown for certain instruments, such as securities other than shares is provided. This category is also provided on a currency basis.

In addition to stocks, national central banks had the option to collect either revaluations or transactions data along the same balance sheet breakdown as detailed above. The Central Bank collects transactions data, and from these revaluations are calculated. This allows changes in stock to be broken down between those arising from transactions and those arising from market movements or other valuation effects.

On the basis of the detailed security-by-security quarterly data reported to the Central Bank, an estimation of monthly balance sheet data, and transactions, are derived. In Ireland, all funds (IFs and MMFs) also report their NAVs to the Central Bank each month. The NAV of a fund is the total market value of the assets of a fund after all debts have been paid; more simply, it is the total value accruing to the investors/shareholders of the fund. In addition to the NAV, funds also report their issues and redemptions of shares/units, and net proceeds over the month. These monthly data are used to estimate IFs' balance sheets by fund type in those months that are not reported to the Central Bank, i.e. off-quarter months, for example, January and February. In addition, pricing information from the ECB securities database is matched with the detailed securities breakdown to provide monthly revaluations by type of fund. These monthly breakdowns are also supplied to the ECB.

<sup>10</sup> ECB, 'Euro Area Investment Fund Statistics (Other than Money Market Funds) — Explanatory Notes, December 2009, [www.ecb.int](http://www.ecb.int).

Trends in the data largely reflect movements in financial markets (Chart 6). The earlier part of 2009 saw large declines in worldwide stock markets, with some of the main equity indices falling by between 20 and 25 per cent from the start of 2009 up to early March. This was reflected in the funds data, with a drop in the value of equity funds of around €10 billion between January and February 2009, with an overall fall of €6.3 billion between the fourth quarter of 2008 and the first quarter of 2009. Since then the value of equity funds have steadily increased with gains of about 39 per cent between the first quarter of 2009 and the third quarter of 2009. This was due to a combination of improved performance in equity markets, and new inflows into these funds.

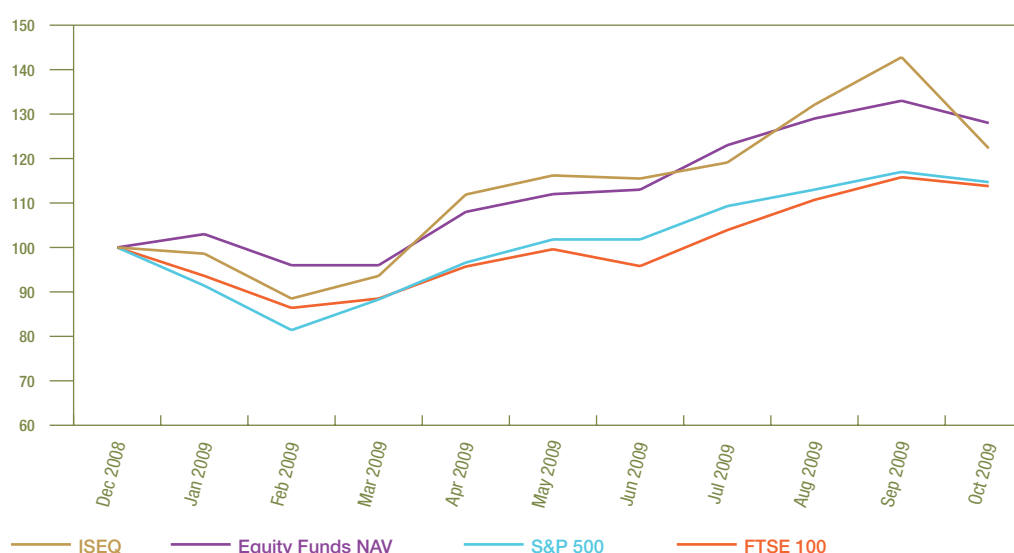
As expected, shares and other equity make up the majority of total assets of equity funds. In the fourth quarter of 2008 they accounted for about €115.2 billion of total assets of €145.2 billion. Over 77 per cent of shares and other equity held by IFs were issued by non-euro area residents, with IFs' holdings of these shares increasing during 2009, reaching 83 per cent by the third quarter. Developments in transactions in shares and other equities are noteworthy, as shown in Table 2. While overall the transactions were positive in the first three

quarters of 2009, there were negative transactions, or outflows, from shares and other equities issued by euro area residents, which were offset by the positive inflows by funds into equities issued by non-euro area residents. Most of the outflow from euro area residents was from non-financial corporates resident in other monetary union member states.

The statistics show that the value of shares and other equity increased by €42.8 billion from the fourth quarter of 2008 to the third quarter of 2009. Approximately €35 billion of the increase was due to positive valuation effects, with the balance of about €7.6 billion due to inflows. In general, positive valuation may increase consumption as a result of a wealth effect. It should be noted, however, that holders of investment fund units are primarily residents of non-euro area countries or financial institutions.

In the third quarter of 2009, the second largest asset category for equity funds resident in Ireland was investment fund shares/units, including MMF shares/units. These represent investments in shares/units issued by other investment funds. This stood at €13.6 billion in the fourth quarter of 2008 and remained fairly static in value terms up to the third quarter of 2009. There was, however, a small outflow during 2009, amounting to €1.7 billion.

Chart 6: Stock Market Indices and Equity Funds' Net Asset Value (31/12/2008 = 100)



Source: Central Bank of Ireland and Thomson Reuters Datastream.

Table 2: Equity Funds — Amounts Outstanding and Transactions

€ million	Q4 2008		Q1 2009		Q2 2009		Q3 2009	
	Stock	Stock	Flow	Stock	Flow	Stock	Flow	
<b>Assets</b>								
Deposits and loan claims	4,185	3,943	-587	4,464	1,102	4,796	-419	
Securities other than shares	6,945	4,921	-1,986	5,356	389	12,209	7,294	
Issued by euro area residents	2,212	1,850	-275	2,001	209	4,777	2,787	
Issued by non-euro area residents	4,733	3,071	-1,711	3,355	180	7,432	4,507	
Shares and other equity	115,228	113,351	5,017	136,729	494	158,060	2,116	
Issued by euro area residents	26,212	20,917	-2,741	23,144	-1,444	27,657	-384	
Issued by non-euro area residents	89,016	92,434	7,758	113,585	1,939	130,403	2,501	
Investment fund shares/units (incl. MMF shares)	13,583	12,038	-582	13,044	-915	13,461	-180	
Issued by euro area residents	8,423	7,216	-832	8,437	-107	9,326	351	
Issued by non-euro area residents	5,160	4,822	250	4,608	-808	4,134	-531	
Non-financial assets	2,862	3,480	677	2,439	-791	2,922	210	
Other assets	2,360	1,926	-548	1,765	-304	1,766	19	
<b>Liabilities</b>								
Investment fund shares/units	143,851	137,557	1,158	161,844	378	190,756	8,444	
Loans and deposits received	1	0	-6	3	2	23	21	
Other liabilities	1,311	2,101	838	1,951	-406	2,433	576	
<b>Total Assets/Liabilities</b>	<b>145,163</b>	<b>139,659</b>	<b>1,990</b>	<b>163,798</b>	<b>-25</b>	<b>193,213</b>	<b>9,041</b>	

Securities other than shares accounted for just under 5 per cent of total assets of equity funds in the fourth quarter of 2008, increasing slightly to 6 per cent in the third quarter of 2009.

Overall transactions in securities other than shares over the period amounted to inflows of €5.7 billion, with the majority of transactions occurring in the third quarter of 2009. The remainder of assets held by equity funds are made up of deposits and loan claims, non-financial assets and other assets.

As is the case with all fund types, the vast majority of liabilities of equity funds are investment fund shares/units in issue by the funds. In the fourth quarter of 2008, this figure was €143.9 billion and rose to €190.8 billion in the third quarter of 2009, and accounted for 98.7 per cent of total liabilities. Transactions over this period amounted to about €10 billion with the majority of these inflows coming in the third quarter of 2009 at €8.4 billion. The rest of the increase between the quarters was due to €37 billion of positive revaluation effects.

Over half of equity funds' shares in issue are held by rest of the world residents, for which no sectoral breakdown is gathered. For Ireland and other euro area countries, the main counterparty to these shares in the third quarter

of 2009 was OFIs, followed by insurance corporations and pension funds.

## 5.2 Bond Funds

Bond funds invest primarily in securities other than shares. These include IFs' holdings of all negotiable debt securities, such as government and corporate bonds, treasury and local authority bills, commercial paper and certificates of deposit. Bond funds accounted for around 25 per cent of total shares/units in issue in Ireland in the third quarter of 2009; these are the second largest fund type in Ireland. Conversely euro area statistics show that bond funds are the largest fund type in the euro area, accounting for 32 per cent in the third quarter of 2009.

The value of bond funds increased by over €14 billion between the fourth quarter of 2008 and the third quarter of 2009, with around €7 billion due to inflows and the remainder due to valuation changes, reflecting a movement by investors into higher grade bonds, such as government bonds or AAA bonds. This follows closely the movements seen in sovereign debt markets, as yields across maturities fell and prices increased due to investors looking for less risky assets. Interestingly, large inflows occurred in the second quarter of 2009, even as stock markets had begun to recover.

Table 3: Bond Funds — Amounts Outstanding and Transactions

€ million	Q4 2008		Q1 2009		Q2 2009		Q3 2009	
	Stock	Stock	Flow	Stock	Flow	Stock	Flow	
<b>Assets</b>								
Deposits and loan claims	2,223	1,357	-631	1,633	-928	1,550	-123	
Securities other than shares	76,276	77,533	767	83,882	6,299	89,954	4,386	
Issued by euro area residents	27,973	26,556	-1,814	25,748	-1,636	28,119	1,598	
Issued by non-euro area residents	48,303	50,977	2,581	58,134	7,934	61,835	2,788	
Shares and other equity	1,024	2,099	1,184	2,238	-493	1,058	-1,455	
Issued by euro area residents	264	180	-140	277	-60	312	-28	
Issued by non-euro area residents	760	1,919	1,323	1,961	-433	746	-1,427	
Investment fund shares/units (incl. MMF shares)	3,885	3,530	-87	2,914	-802	2,903	128	
Issued by euro area residents	2,316	2,015	-274	1,791	-407	1,767	87	
Issued by non-euro area residents	1,569	1,516	187	1,123	-394	1,136	40	
Non-financial assets	877	2,095	1,246	6,055	2,194	7,158	1,210	
Other assets	6,511	4,728	-1,892	4,268	-120	4,235	-1,441	
<b>Liabilities</b>								
Investment fund shares/units	83,481	83,713	112	90,636	2,960	97,690	3,769	
Loans and deposits received	107	129	21	74	-62	78	-34	
Other liabilities	7,208	7,502	454	10,281	3,252	9,091	-1,032	
<b>Total Assets/Liabilities</b>	<b>90,796</b>	<b>91,344</b>	<b>587</b>	<b>100,991</b>	<b>6,150</b>	<b>106,859</b>	<b>2,703</b>	

The largest proportion of assets on the balance sheet of Irish resident bond funds were securities other than shares, which amounted to around 84 per cent of total assets in the third quarter of 2009. Over two-thirds of securities other than shares held were issued by non-euro area residents. These investments were primarily in less liquid, longer maturity securities, of over two years. Inflows of €11.4 billion occurred between the start of the first quarter of 2009, and the third quarter of 2009, with €6.3 billion of these inflows occurring in the second quarter of 2009.

Shares and other equity made up a small amount of the total assets of bond funds; in the third quarter of 2009 they amounted to just under 1 per cent of total assets. Combined with shares issued by investment funds, including MMFs, just over half of the shares held by bond funds were issued by euro area residents. Non-financial assets, which include property and commodities, increased steadily from €877 million in the fourth quarter of 2008 to €7.2 billion in the third quarter of 2009. Around €4.7 billion of this was due to net inflows with the remainder attributable to positive valuation effects.

The largest category on the liabilities side of the balance sheet is investment fund shares/units, which accounted for around 90 per cent of total liabilities over all the quarters. Their value increased from €83.5 billion in the fourth quarter of 2008 to €97.7 billion in the third quarter of 2009 and in 2009 there was €7 billion of positive valuation changes and the remainder attributable to net inflows.

The next largest category is other liabilities, which increased from just over €7 billion in the fourth quarter of 2008, to €9.1 billion in the third quarter of 2009; however there was a net outflow of just over €1 billion in the third quarter of 2009, in contrast to net inflows of over €3 billion in the previous quarter. The remainder of liabilities were loans and deposits received which comprised only 0.07 per cent of total liabilities in the third quarter of 2009.

### 5.3 Hedge Funds

Data from the ECB show that hedge funds accounted for 2 per cent of total IF shares/units in issue in the euro area in September 2009. Ireland accounted for half of the euro area total; the next closest country was Luxembourg, at 19 per cent. Hedge funds in Ireland accounted for 9 per cent of shares in issue by funds resident in Ireland, or €38 billion in value terms.

Table 4: Characteristics of Hedge Funds

<b>Return objective</b>	Positive absolute returns under all market conditions, without regard to a particular benchmark. Usually managers also commit their own money; therefore, the preservation of capital is very important.
<b>Investment strategies</b>	Position-taking in a wide range of markets. Free to choose various investment techniques, including short-selling, leverage and derivatives.
<b>Incentive structure</b>	Typically 1-2 per cent management fee and 15-25 per cent performance fee. Quite often high watermarks apply (i.e. performance fees are paid only if cumulative performance recovers any past shortfalls) and/or a certain hurdle rate must be exceeded before managers may receive any incentive allocation.
<b>Investor base</b>	High net worth individuals and institutional investors. High minimum investment levels. Not widely available to the public. Securities issued take the form of private placements.

Source: Garbaravicius and Dierick, 2005.<sup>11</sup>

There is no legal or even generally accepted definition of a hedge fund. For investment fund statistics, the ECB's Guideline on Monetary Financial Institutions and Markets Statistics<sup>12</sup> defines a hedge fund as:

'any collective investment undertaking, regardless of its legal structure under national laws, which applies relatively unconstrained investment strategies to achieve positive absolute returns, and whose managers, in addition to management fees, are remunerated in relation to the fund's performance. For that purpose, hedge funds have few restrictions on the types of financial instrument in which they may invest and may therefore flexibly employ a wide variety of financial techniques, involving leverage, short-selling, or any other techniques. This definition also covers funds that invest, in full or in part, in other

hedge funds provided that they otherwise meet the definition.'

Some hedge fund characteristics are outlined in Table 4.

The role of hedge funds and their implications for financial stability has been debated extensively in light of the financial crisis. On the one hand, hedge funds are recognised as contributors to the provision of liquidity and the integration of financial markets, while on the other hand, concerns have been raised that they are a possible source of counterparty risk.

The balance sheets of Irish resident hedge funds have a markedly different make-up compared to other fund types. Hedge funds hold just under one quarter of their assets in the form of deposits and loan claims; this compares with 5 per cent for total funds in September 2009. These higher levels of deposits may in fact be margin accounts that funds hold. Hedge funds are known to engage in short-selling, along with many other varied

<sup>11</sup> Garbaravicius, T and F. Dierick (2005), 'Hedge Funds and Their Implications for Financial Stability', ECB, August.

<sup>12</sup> Guideline of the European Central Bank of 19 December 2008 Amending Guideline ECB/2007/9 on Monetary, Financial Institutions and Markets Statistics (Recast) (ECB/2008/31).

Table 5: Hedge Funds — Amounts Outstanding and Transactions

€ million	Q4 2008		Q1 2009		Q2 2009		Q3 2009	
	Stock	Stock	Flow	Stock	Flow	Stock	Flow	
<b>Assets</b>								
Deposits and loan claims	7,525	10,143	2,807	9,207	-3,187	8,573	-579	
Securities other than shares	5,497	2,540	-2,999	4,230	1,802	4,393	-224	
Issued by euro area residents	997	2,849	1,991	1,351	-1,451	759	-815	
Issued by non-euro area residents	4,500	-309	-4,991	2,878	3,253	3,634	590	
Shares and other equity	8,396	12,230	3,393	8,515	-3,547	9,711	1,168	
Issued by euro area residents	3,154	6,332	2,967	4,636	-1,783	4,993	398	
Issued by non-euro area residents	5,242	5,898	426	3,879	-1,764	4,718	769	
Investment fund shares/units (incl. MMF shares)	8,094	8,555	617	15,505	7,877	14,385	-1,449	
Issued by euro area residents	1,574	942	-650	9,899	10,254	8,760	-1,013	
Issued by non-euro area residents	6,520	7,612	1,267	5,606	-2,377	5,624	-436	
Non-financial assets	939	973	68	572	-761	65	-504	
Other assets	1,664	787	-701	1,510	1,550	1,245	-475	
<b>Liabilities</b>								
Investment fund shares/units	27,162	32,841	5,531	37,527	3,869	37,135	-986	
Loans and deposits received	487	452	-33	284	-76	54	-204	
Other liabilities	4,466	1,935	-2,312	1,727	-58	1,182	-873	
<b>Total Assets/Liabilities</b>	<b>32,115</b>	<b>35,228</b>	<b>3,186</b>	<b>39,538</b>	<b>3,734</b>	<b>38,372</b>	<b>-2,063</b>	

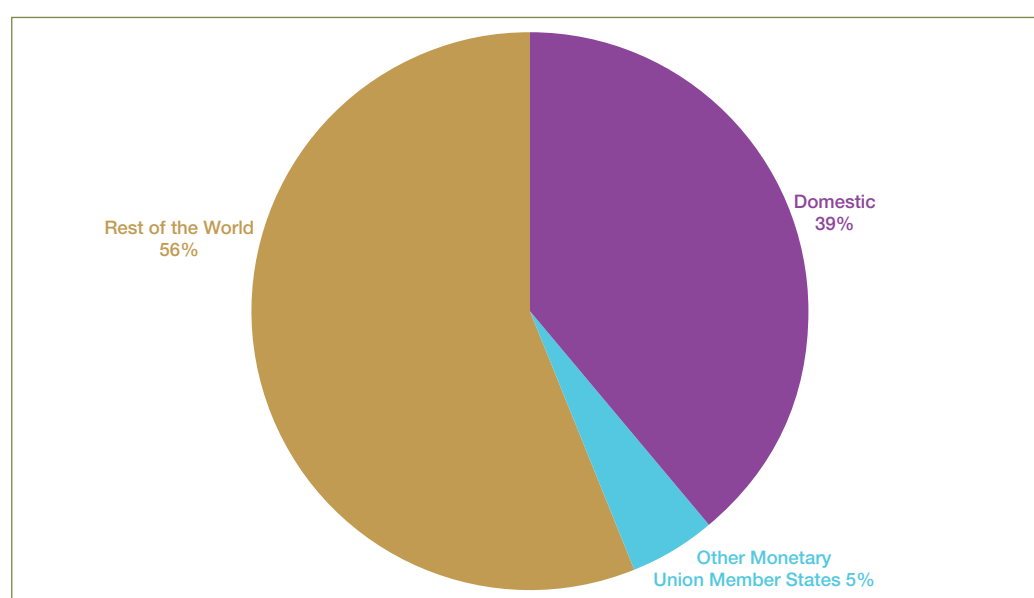
investment strategies, and margin accounts are one of the components of short-selling. Another key characteristic of some hedge funds is the use of leveraging, which is the use of debt for investment purposes. Due to the minimal amount of borrowing on the liabilities side of the balance sheet, the data show that Irish resident hedge funds are not using the more conventional method of leveraging, i.e. borrowing. This does not mean that Irish hedge funds are not leveraging as they may be using the margin accounts on the assets side of the balance sheet as a form of leveraging.

The largest asset type held in September 2009 was shares/units issued by other investment funds, including MMFs. Many hedge funds are funds-of-funds; these are funds that invest only in the shares of other funds. This high proportion of shares of other funds may also reflect the investment policy of hedge funds, which is primarily to maximise their return on investments. In the second quarter of 2009,

hedge funds made net investments of almost €8 billion in other funds, which counteracted a reduction of €6.7 billion in equities and deposits over the same period. As with most other fund types, the majority of the assets that are held by Irish resident hedge funds are from outside the euro area. However, as Chart 7 demonstrates, the proportion of assets held by hedge funds that have Irish resident counterparties is two-fifths, which is much higher than for total funds. This reflects the fact that fund-of-funds hedge funds are investing in other funds resident in Ireland.

On the liabilities side, the same is true for Irish resident hedge funds' shares in issue — residents outside the euro area held 70 per cent in the third quarter of 2009. A sectoral breakdown of counterparties is not available outside the euro area, but Irish residents' holdings of hedge funds' shares are dominated by OFIs, insurance corporations and pension funds.

Chart 7: Irish Resident Hedge Funds — Assets by Location, September 2009



Source: Central Bank of Ireland.

Overall, the balance sheets of Irish resident hedge funds are quite diverse when compared with the other fund types. It is difficult to analyse how diverse hedge funds are due to their investment strategies, the use of complex investment products and short-selling. While hedge funds hold primarily longer-term securities, their holdings of short-term securities are affected by the convention of reporting short positions as negative assets.

#### 5.4 Other Funds

'Other funds' consist of three remaining fund types; mixed funds, real estate and other funds. These funds accounted for 18 per cent of total IF shares in issue in Ireland in September 2009, with mixed funds accounting for the largest proportion. Assets under management of other funds were largely shares and other equity, including IF and MMF shares/units, amounting to €41.1 billion in September 2009. Other funds have a higher proportion of non-financial assets on their balance sheets as real estate funds primarily invest in properties and land. On the liabilities side, the value of shares in issue fell since the start of 2009, from €77.2 billion in the first

quarter, to €71.1 billion in the third quarter. Some of this reflects an outflow by investors into different fund types, particularly during the second quarter of 2009.

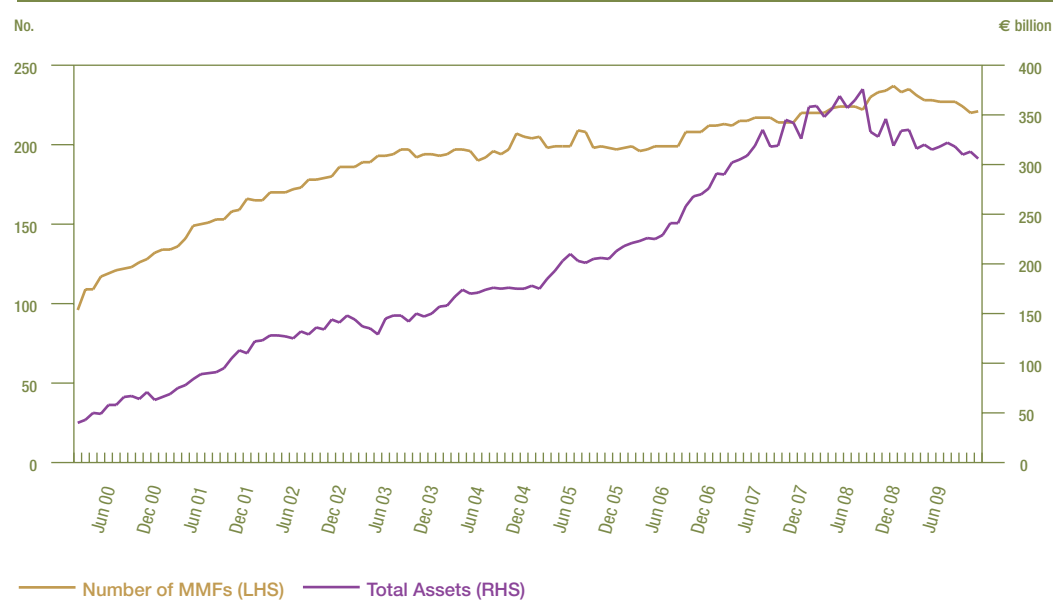
#### 5.5 Money Market Funds

The primary focus of this article is the new data series on investment funds, which do not include MMFs. However, MMFs are another important component of the MFI statistics and the financial sector, and the presentation of these data in this article provides a comprehensive overview of the investment funds industry in Ireland. The availability of separate data on MMFs, therefore, enhances monetary analysis and provides a better overview of the funds industry as a whole. The ECB defines a MMF as an entity whose business it is to receive deposits and/or close substitutes to deposits from entities other than MFIs and for their own account to grant credit and/or invest in securities. MMFs primarily invest in money market instruments, MMF shares/units, other transferable debt instruments with short maturities, and bank deposits, or pursue a rate of return that approaches the interest rates of money market instruments.

Table 6: Other Funds — Amounts Outstanding and Transactions

€ million	Q4 2008		Q1 2009		Q2 2009		Q3 2009	
	Stock	Stock	Flow	Stock	Flow	Stock	Flow	
<b>Assets</b>								
Deposits and loan claims	3,130	5,670	2,254	4,856	-1,297	5,480	844	
Securities other than shares	9,056	11,617	3,069	18,389	5,932	19,728	1,484	
Issued by euro area residents	2,749	3,999	1,389	3,599	-610	4,695	1,347	
Issued by non-euro area residents	6,307	7,618	1,680	14,789	6,543	15,033	136	
Shares and other equity	27,917	34,512	6,975	21,320	-15,743	25,076	1,898	
Issued by euro area residents	7,434	9,233	2,328	6,450	-3,546	8,837	1,965	
Issued by non-euro area residents	20,483	25,279	4,647	14,870	-12,198	16,239	-67	
Investment fund shares/units (incl. MMF shares)	30,317	22,784	-6,595	15,638	-7,830	16,113	273	
Issued by euro area residents	15,771	12,916	-2,183	9,113	-4,550	9,531	234	
Issued by non-euro area residents	14,546	9,868	-4,412	6,525	-3,279	6,582	39	
Non-financial assets	3,273	2,624	-511	6,033	3,574	5,180	-635	
Other assets	8,163	4,752	-2,982	5,334	-323	4,543	-1,212	
<b>Liabilities</b>								
Investment fund shares/units	74,994	77,246	4,053	67,070	-14,741	71,142	2,717	
Loans and deposits received	1,262	405	-863	300	-107	372	27	
Other liabilities	5,601	4,308	-980	4,199	-839	4,608	-92	
<b>Total Assets/Liabilities</b>	<b>81,857</b>	<b>81,960</b>	<b>2,210</b>	<b>71,570</b>	<b>-15,687</b>	<b>76,122</b>	<b>2,651</b>	

Chart 8: Number and Total Assets of MMFs Resident in Ireland



Source: Central Bank of Ireland.

Table 7: Balance Sheet of Money Market Funds

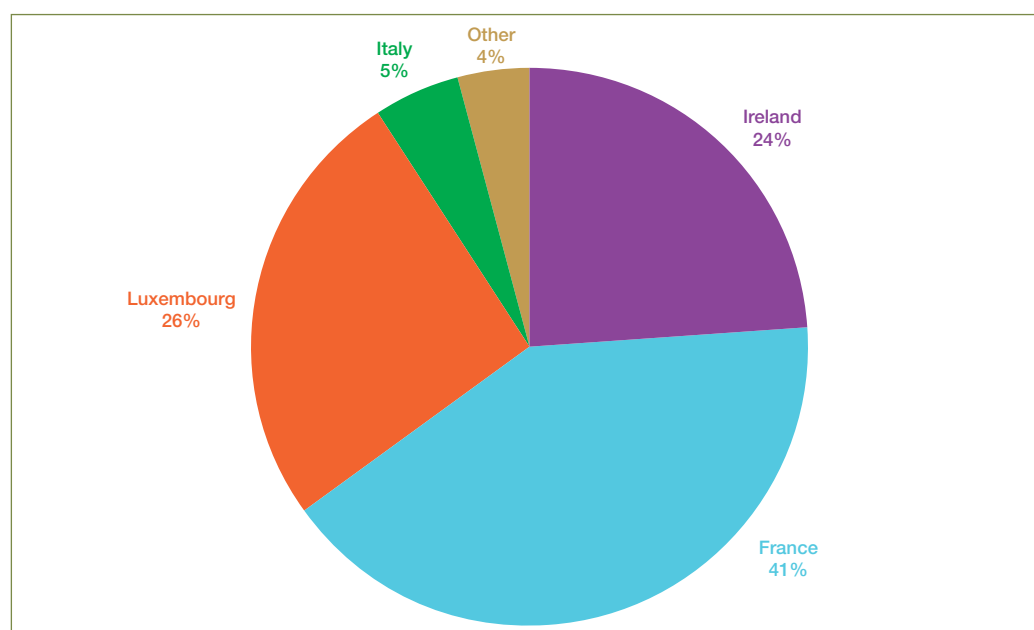
€ million	Dec. 2003	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Sep. 2009
<b>Assets</b>							
Deposits and loan claims	7,016	8,486	13,843	21,342	51,663	51,182	28,363
Securities other than shares	141,242	165,592	197,441	252,714	272,124	265,017	280,166
Issued by euro area residents	30,804	30,936	39,259	40,192	52,470	59,962	78,874
Issued by non-euro area residents	110,438	134,656	158,182	212,521	219,653	205,055	201,292
Shares and other equity	173	25	20	18	15	11	7
MMF shares/units	449	979	874	830	950	839	816
Other assets	1,248	400	711	1,169	1,419	2,290	499
<b>Liabilities</b>							
MMF shares/units	148,304	174,105	210,969	274,157	323,207	316,917	305,993
Other liabilities	1,824	1,377	1,920	1,915	2,963	2,423	3,858
<b>Total Assets/Liabilities</b>	<b>150,128</b>	<b>175,482</b>	<b>212,889</b>	<b>276,072</b>	<b>326,170</b>	<b>319,340</b>	<b>309,851</b>

Money market fund shares/units are included in the measure of M3 (the broad money supply measure) as their units are close substitutes for deposits. Ireland had over 220 MMFs in September 2009; this had increased from just under 100 at the start of 2000 (Chart 8). The total assets of MMFs increased substantially since the start of this century, and expanded very rapidly, to €310 billion in September 2009. Total MMF shares/units in issue in the euro area in September 2009 was €1.3 trillion; Ireland accounted for 24 per cent of this. France and Luxembourg accounted for a further 67 per cent of shares in issue (Chart 9).

Chart 10 shows that the structure of Irish MMFs' balance sheets has remained relatively stable over the last few years. The liabilities side of the balance sheet comprise mainly MMF shares/units in issue. Table 7 shows a substantial rise in MMF shares/units between 2006 and 2007. There were sizeable redemptions during the worst of the financial turmoil, particularly in September 2008. This reflected investors' concerns regarding the safety of some funds in the context of intensifying financial tensions during September 2008 (ECB, 2008)<sup>13</sup>.

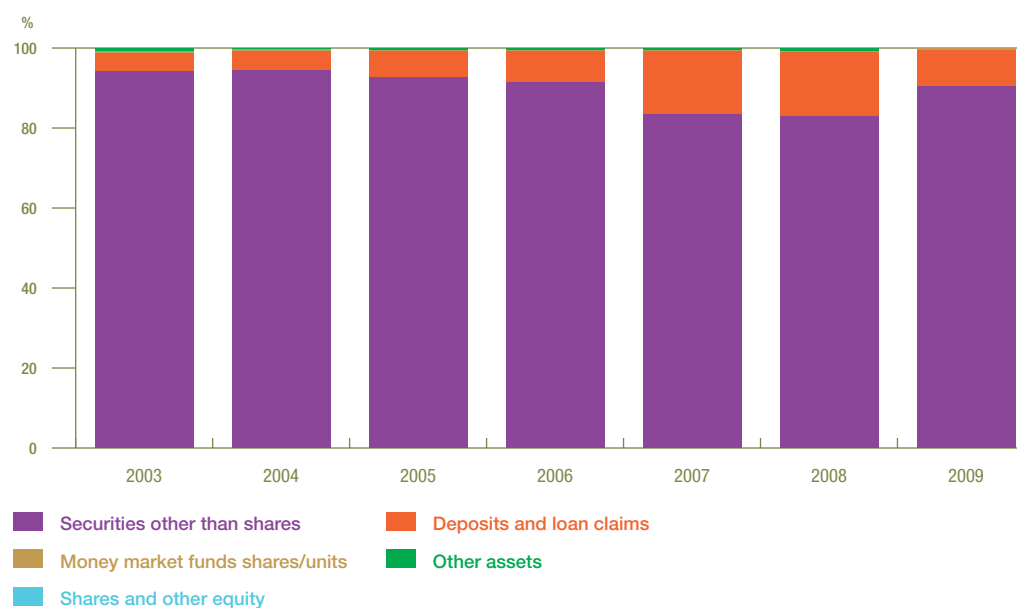
<sup>13</sup> ECB, (2008), 'Monthly Bulletin November', ECB, November.

Chart 9: Country Shares of Euro Area MMFs Shares/Units Issued, September 2009



Source: European Central Bank.

Chart 10: Proportionate Breakdown of MMF Balance Sheet by Asset Type



Source: Central Bank of Ireland.

On the assets side, over the time period under analysis, the largest assets held by MMFs were short-term securities other than shares, in particular those issued by non-euro area residents. Deposits and loan claims increased as a proportion of MMFs' balance sheets during 2007 and 2008, and as a consequence, securities other than shares fell to below 90 per cent. This most likely reflected a desire by the funds to remove some of their assets from riskier categories like corporate bonds, short-term paper, and complex short-term structured securities, etc. This trend may also reflect the fact that during the worst of the financial crisis, there were severe liquidity restrictions, and very few new investment opportunities in securities. Towards the end of the third quarter of 2009, however, the proportion of MMF assets held in deposits reduced again, to just over 9 per cent.

Money market funds are generally seen as safe havens for investors, however, during the financial turmoil there was uncertainty over their exposure to riskier sub-prime bonds, and the value of their shares fell. A prime example of this was MMFs in the US during September 2008. After the fall of Lehman Brothers, one of the oldest and largest MMFs in the US 'broke the buck', where the value of its shares went

below US\$1, due to some of their assets being notes issued by Lehman Brothers. This was unprecedented. Following this, there was a run on some US MMFs, as investors sold off their shares. As a result, the US Federal Government and the US Department of the Treasury had to take action to restore the confidence in these funds and MMFs were given a 12-month guarantee in September 2008 (Baba, McCauley and Ramaswamy, 2009)<sup>14</sup>. MMFs, or mutual funds, are popular in the US, as an alternative investment to deposits. It should be noted that the definition of MMFs provided by the ECB covers a wider range of entities than the constant NAV funds guaranteed by the US authorities.

## 6. Conclusion

The availability of comprehensive statistics on investment funds makes a significant contribution to filling the data gaps for the OFI sector. This will be further enhanced with the advent of statistics on FVCs later in 2010. The new dataset on investment funds will become more useful for analytical purposes over time, as a longer time series is developed.

<sup>14</sup> Baba, N, R. McCauley and S. Ramaswamy, (2009), 'US Dollar Money Market Funds and Non-US Banks', BIS Quarterly Review, March.

Nevertheless, the data provide crucial information on the role of funds within financial intermediation, and on portfolio shifts, especially between monetary and non-monetary assets. The separate availability of money market fund data enhances the possibilities for monetary analysis, given their inclusion in the MFI sector, and the inclusion of their shares within M3.

The data will also make a significant contribution to tracking the development of the funds industry in Ireland. In Budget 2010, the

Minister of Finance announced that he will 'bring forward measures to strengthen Ireland's competitive edge in this important sector'. The Irish Funds Industry Association (IFIA) welcomed this announcement, and said that it will help Ireland remain competitive as a funds centre in the future.<sup>15</sup> The data series will be extremely beneficial in assessing the developments of each fund type, in particular hedge funds, and in monitoring investment strategies adopted.

<sup>15</sup> 'Finance Bill Tax Changes Set to Help Ireland Become EU Funds Centre', Irish Times, 2 January 2010.