

ESMA updates on supervisory work on closet indexing

FUND MANAGEMENT

PRESS RELEASES

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The European Securities and Markets Authority (ESMA) has published a Statement providing details of its work on closet index tracking funds.

Closet indexing, also known as *index hugging*, refers to the practice of fund managers claiming to manage portfolios actively when in reality the fund stays close to a benchmark. ESMA is concerned the practice may harm investors as they are not receiving the service or risk/return profile they expect based on the fund's disclosure documents while potentially paying higher fees compared to those typically charged for passive management.

ESMA conducted research on a sample of 2,600 funds for the period 2012-2014 to determine whether it could find any indication of closet indexing at an EU-wide level. Quantitative metrics, such as the percentage of a UCITS' portfolio that does not coincide with the underlying equity benchmark, indicated between 5 and 15% of UCITS equity funds could potentially be closet indexers. ESMA then reviewed the investor disclosure documents of the funds concerned, to see how they described their management strategy, and found they tended to confirm the quantitative analysis results.

Steven Maijoor, ESMA Chair, said:

"Closet indexing is an issue which has attracted the attention of investor protection groups and investors alike throughout the European Union and ESMA has played a key role in an EU-wide inquiry to get to the heart of the matter.

"Investor protection is core to our mission and the preliminary findings raise questions that merit closer analysis. Fund managers must provide investors with information that is fair, clear and not misleading. In partnership with national regulators we are taking a closer look into this issue."

Next steps

ESMA will continue to work with national regulators to determine further actions as the analysis gives only a first indication of whether particular funds are closet index trackers. This work will include an active role for ESMA in the coordination of further analysis carried out at the national level, while fuller investigations on a fund-by-fund basis will necessarily fall in the remit of national competent authorities, as part of their regular

supervisory work. Together with national competent authorities, ESMA will also assess the need for further steps to ensure that all market participants comply with disclosure obligations to the full extent.

Notes for editors

1. ESMA created a sample of funds, focusing on UCITS equity funds, domiciled in EU Member States, that were not categorised as index-tracking UCITS and that had:
 - assets under management of more than € 50mn;
 - an inception date before 1 January 2005; and
 - management fees of more than 0.65% of the net asset value (NAV) of the fund.

1. There are around 29,000 UCITS funds in total in the EU.

1. ESMA is an independent EU Authority that was established on 1 January 2011 and works closely with the other European Supervisory Authorities responsible for banking (EBA), and insurance and occupational pensions (EIOPA), and the European Systemic Risk Board (ESRB).

1. ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union (EU). As an independent institution, ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.