

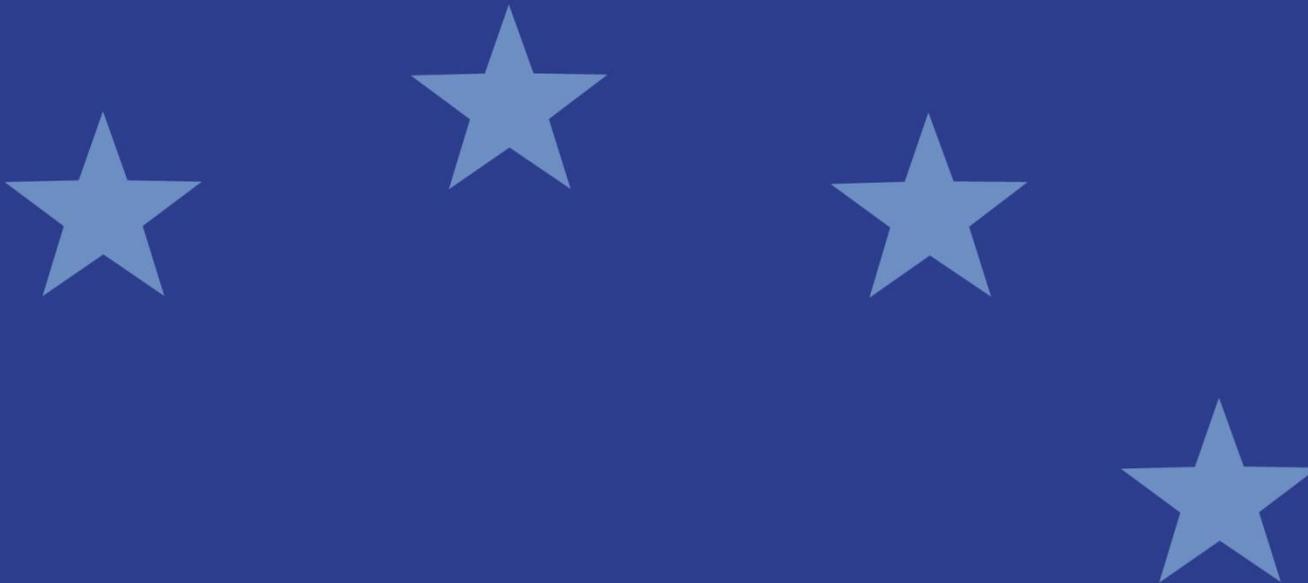


European Securities and
Markets Authority

Retail investors – Funds, performance and costs in the EU

CEPS-ECMI Task Force on Asset Allocation in Europe, Brussels, 20 March 2018

Steffen Kern, Chief Economist and Head of Risk Analysis, ESMA



Overview

1. Market and regulatory background
2. ESMA monitoring and analysis
3. Commission mandate on investment returns
4. Outlook

1. Market and regulatory background

Retail investors benefit from vast and diverse EU single market...



Markets

Shares

Market cap: EUR 12 tn

Listed: >9,000

Sovereign bonds

Outstanding: EUR 9 tn

Instruments: >1,200

Corporate bonds

Outstanding: EUR 6.5 tn

Instruments: >25,000

Securitised instruments

Outstanding: EUR 1,2 tn

Transactions: >1,100



Infrastructure

CCP

Transactions: EUR 29 tn

CCPs: 17

CSD

Managed: EUR 52 tn

CSDs: 38

Trading platforms

Registered markets: 55

MTFs: 51

OTFs: 10

SIs: 46

Trade repositories

TRs: 8

Trade reports: >11 bn p.a.

CRAs

CRAs: 44

Credit ratings: >600.000



Investors

UCITS

AuM: EUR 9.4 tn

Managers: >1,300

Funds: >31,000

AIFs

AuM: EUR 5.8 tn

Managers: >2,500

Funds: >28,000



... and comprehensive oversight by NCAs and ESMA

Funds: UCITS/AIFMD for single market, wider choice, lower costs

- Cross-border availability through EU passport
- UCITS standardised summary product information; strong disclosure to investors
- Governance, management requirements; risk management, prudential oversight

PRIIPs: Enhanced transparency to retail investors

- Key Information Documents (KIDs)

MiFID2-MiFIR: Improved retail investor protection

- More transparency on costs, charges, prices, transparency around inducements
- Stricter controls on product governance; independent investment advice
- Product interventions on products not in the interest of investors

CMU: Important package to improve functioning of single market

- COM proposal for Regulation on facilitating cross-border distribution of funds

ESMA: Investor protection central operational objective

- ESMA continuous market monitoring: TRV reporting on capital flows and returns
- ESMA warnings, statements, analysis: ICOs, VCs, CFDs/BOs, closet indexing

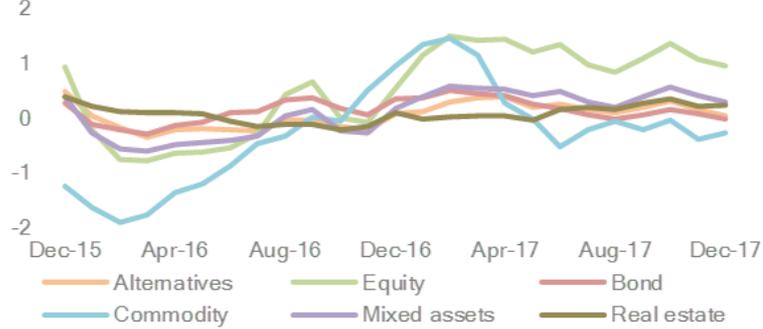
2. ESMA monitoring and analysis

ESMA semi-annual retail investor monitoring in TRV

>60 indicators, incl. funds returns...

Fund performance

Equity funds outperform



Note: EU-domiciled investment funds' annual average monthly returns, asset-weighted, in %.
Sources: Thomson Reuters Lipper, ESMA.

... retail portfolios returns...

Retail portfolio returns

Returns oscillating around 5Y average

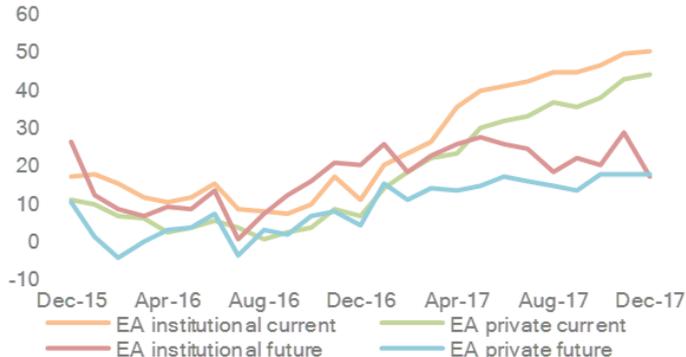


Note: Annual average monthly returns for a representative portfolio for households, in %. Asset weights, computed using ECB Financial Accounts by Institutional Sectors, are 37% for collective investment schemes (of which 12% mutual funds and 25% insurance and pension funds), 31% for deposits, 22% for equity, 7% debt securities and 3% for other assets.
Sources: Thomson Reuters Datastream, Thomson Reuters Lipper, ECB, ESMA.

... investor sentiment...

Investor sentiment

Investor sentiment continues to rise

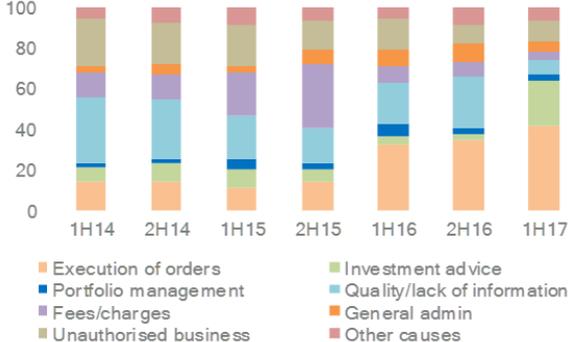


Note: Sentix Sentiment Indicators for Euro Area private and current institutional investors on a ten-year horizon. The zero benchmark is a risk-neutral position.
Sources: Thomson Reuters Datastream, ESMA.

... investor complaints, and others

Complaints filed directly with NCAs, by cause

Execution of orders the main cause for complaint



Note: Complaints reported directly to NCAs by financial instrument, % of total. Data collected by NCAs.
Sources: ESMA complaints database.

Investment returns under increasing scrutiny

ESMA analysis on investment fund gross and net returns

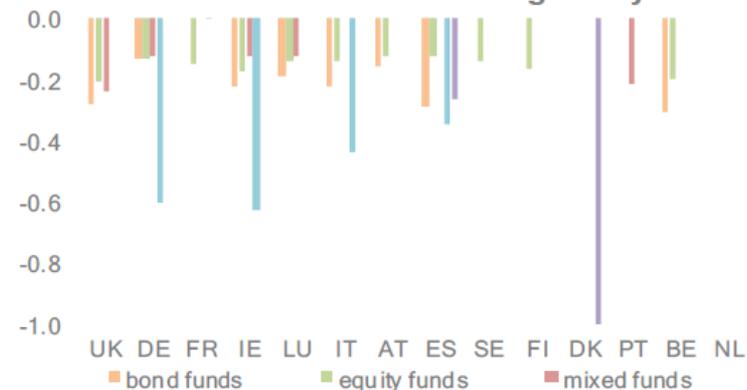
- ESMA analysis of structural market issues: Systematic analysis of gross and net EU fund returns
- Wide, representative coverage: 20,000 funds sold to retail and institutional clients
- Sensible time horizon: 3Y period 2013-2015
- Focus on returns and costs: Gross returns vs. Total Expense Ratio, covering administrative and management fees in the form of front and end loads, and annual charges
- First results published, TRV 2-17

Relative return reductions through TER, loads and inflation
Return reductions more severe for retail clients



Note: Relative reductions in RoI generated by TER, front and back-load charges and inflation. Time averages across sample horizon, in ppt.
Sources: Thomson Reuters Lipper, ESMA.

Estimates for sensitivity of flows to TER
Flows in some countries react negatively to TER



Note: Impact of TER on flows, significant at 90%. Derived from benchmark model.
Sources: Thomson Reuters Lipper, ESMA.

Key preliminary insights: 1 light, 5 shadows

- 1. Reasonable gross returns**
 - EU UCITS +9% p.a. (vs STOXX +21%, S&P EA sovereign bond index +6%)
- 2. Fees greatly reduce investor benefit**
 - Gross returns reduced by 20%
 - Incl. Inflation, investors lose 1/3 of their returns
- 3. Payout factor 1: Where?**
 - Gross returns 6% (AT, ES, FR, IT) to 14% (UK) p.a.
 - Cost-related reductions <10% (NL, SE), >25% (AT, ES, IT, LU), 31% in BE
- 4. Payout factor 2: What?**
 - Cost-related return reductions up to 15% for equity, 32% for bond funds
- 5. Payout factor 3: How?**
 - Active and passive equity funds score ~15% gross returns p.a.
 - Cost-related reductions 15% for active vs 4% for passive equity funds
- 6. Payout factor 4: Who?**
 - Cost-related reductions highest for retail investor (21%) vs institutionals (13%)
 - Esp. MMFs for retail investors (35% return reduction), bond funds (32%)

Landscape of returns raises key structural questions

- Distribution costs, regional cost differentials, investor preferences and home bias, comparative costs (bank products, insurance, SRPs), risk adjusted returns

Comparative perspective: Commission mandate (1\2)

Commission mandate to report on investment returns

- Key project

- EU-level, comparative insight into returns of retail investments, insurance and pensions products

- Scope

- Products covered by PRIIPs-KID and UCITS-KIID, incl. UCITS investment funds
- AIF investment funds sold to retail investors for which KIID rules are applicable at national level
- Structured products (e.g. structured deposits and structured notes) sold to retail investors
- Insurance-based investment products; personal pension products

- ESMA focus

- Enhanced UCITS analysis
- AIFs and SRPs

Comparative perspective: Commission mandate (2\2)

Principles for ESA reporting

- Member State by Member State analysis
- Comparability of indicators
- Appropriate level of aggregation, active and passive reported separately
- Net Return and impact of optimally all costs
 - Investment costs (asset management fees, custodian fees)
 - Transaction costs
 - Performance fees
 - Administration costs
 - Fees and commissions charged by financial intermediaries
 - Initial charges (subscription fees)
 - Exit charges (redemption fees)
 - Focus on costs associated with distribution channels; subject to data availability
- Varied time horizon, incl. last 1, 3, 7, 10Y subject to data availability
- Inflation to be taken into account

On-going work and next steps

Follow-up work on investor warnings

- Closet indexing
- Virtual currencies, Initial Coin Offerings
- Contracts for Difference, Binary Options

Reporting on fees and charges in investment services

- Commission timetable
 - Step 1: Mapping disclosures, Q4 2017
 - Step 2: Development of methodology for the first iteration, Q1/Q2 2018
 - Step 3: Data collecting and processing, Q2/Q3 2018
 - Step 4: First reporting on the costs and performances and data availability, Q3/Q4 2018
- ESMA schedule
 - Enhanced UCITS analysis by end-18
 - AIF and SRP analysis by end-19



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