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ESMA Report on the Performance and Costs of EU Retail Investment Products

[31641]

March 5, 2019 TO: ICI Global Atlantic Chapter
ICI Global EU Capital Markets Union Task Force
ICI Global Regulated Funds Committee
International Operations Advisory Committee RE: ESMA Report on the Performance and Costs of EU Retail Investment Products

On 10 January 2019, the European Securities and Markets Authority (ESMA) published its first statistical report on the cost and past performance of retail investment products in the European Union (“the Report”).[\[1\]](#) The Report follows a request[\[2\]](#) from the European Commission (EC)[\[3\]](#) and takes account of previous ESMA analysis.[\[4\]](#)

Executive Summary

ESMA draws the following high-level conclusions from its analysis of the cost and past performance of UCITS funds between 2008 and 2017:

- UCITS fund charges, taken all together, reduce 3-year returns by 25% on average;
- Performance and the impact of fund charges varies widely across products, asset classes, fund types and domiciles;
- Management fees and other on-going costs constitute over 80% of investors’ costs, whilst entry and exit fees have a less significant impact;
- Retail investors pay twice the level of fund charges that institutional investors pay;
- The impact of inflation on returns is significant;
- Active equity funds consistently outperform passive equity funds on a gross basis;
- Passive equity funds consistently outperform active equity funds on a net basis;
- The costs of actively managed equity UCITS are 2.1-2.6 times those of passively managed equity UCITS.

ESMA’s analysis is intended to inform the EC’s work to foster the participation of retail investors in EU capital markets,[\[5\]](#) including identifying the key determinants of the benefits and risks retail investors in the EU should be considering when taking investment decisions.[\[6\]](#)

Performance and costs of retail investment products in the EU

ESMA’s analysis covers the EU market for UCITS,[\[7\]](#) retail AIFs[\[8\]](#) and structured retail products.[\[9\]](#) The Report contains a preface, executive summary, three substantive sections

describing the findings from ESMA's sectoral analysis, and several annexes, including a mapping of pre-contractual disclosures[\[10\]](#) and statistical material.[\[11\]](#)

Preface and Executive Summary

ESMA's analysis builds on prior work, including its semi-annual Trends, Risks and Vulnerabilities (TRV) reports[\[12\]](#) and its 2013 economic report on retaliation in the EU.[\[13\]](#) ESMA acknowledges the significant challenges it faces to assess and compare retail investment products, due to issues with the availability, quality, cross-EU heterogeneity and usability of cost and past performance data, including issues related to fund and investor domicile and the availability and treatment of distribution costs.

Fostering Retail Participation in EU Capital Markets

ESMA identifies the following two benefits from increased participation of retail investors in capital markets: (i) capital market-based products tend to provide higher returns than deposits and thus can help meet the challenges posed by population ageing and low interest rates; and (ii) the last financial and sovereign crises highlighted the need for more diversified funding channels in the EU which can, in turn, lead to more balanced allocation of capital.

ESMA's analysis of EU household financial assets (€27.2tn in 2017) shows that on average there is significant potential for increased participation of retail investors in EU capital markets. Specifically, ESMA notes that currency and deposit levels have remained broadly stable over the years at 31% of total household assets and that investment funds, and shares and equity, represent only 8% and 17% of total assets respectively.

Performance and Costs in the EU UCITS Market

ESMA's analysis shows the evolution of past performance and costs of UCITS for the major asset classes at an EU and country-by-country level for the period from 2008 to 2017. ESMA highlights the following key findings related to the impact of costs:

- Costs fluctuate less than gross performance;
- The largest cost impact comes from ongoing costs, while subscription and redemption fees have a significantly lower impact;
- Across asset classes, costs are highest for equity and alternative UCITS, followed by mixed, bond and money market UCITS;
- Costs are higher for retail compared to institutional investors;
- Costs are higher for actively managed equity funds compared to passively managed equity funds, which leads to lower performance net of costs for actively managed equity funds; and
- There is high heterogeneity in costs across Member States.

Furthermore, ESMA notes that: (i) gross annual past performance of UCITS largely follows the performance of the underlying asset classes and can vary significantly across Member States; and (ii) actively managed equity funds provide a slightly better gross performance than passively managed funds, even though the margin is small.

In its commentary on distribution,[\[14\]](#) ESMA references a recent EC study on distribution systems of retail investment products across the EU[\[15\]](#) highlighting the importance of examining distribution channels and related costs in the EU, the heterogeneity of costs across Member States, and the lack of available and usable information for investors on the

type and the level of costs.

The EU UCITS Market

ESMA estimates that EU UCITS assets were c.€9.7trn at the end 2017, representing 34.2% of global investment fund net assets. The commercial data used by ESMA for the Report covers €6.6trn of UCITS assets (68% of the total), of which €4.3trn or 65% is identified as marketed to retail investors across the following asset classes in 2017:[\[16\]](#)

- €1.7trn in net assets of equity UCITS funds;
- €1.2trn in net assets of bond UCITS funds;
- €1.1trn in net assets of multi-asset UCITS funds;
- €0.3trn in net assets of money market UCITS funds;

ESMA highlights that the share of UCITS indicated as being targeted to institutional investors increased from 27% to 35% between 2012-2017.

Performance and Costs across the EU

ESMA highlights the following key findings from its analysis of the past performance of UCITS:

- Average annual gross returns of UCITS have fluctuated over the last decade;
- Average returns between 2008-2017 were 7.3%, 5.3% and 4.6% for equity, mixed and bond UCITS funds respectively;
- In 2017, gross returns for retail investors on average were 16%, 6% and 2% for equity, mixed and bond UCITS funds respectively;

ESMA highlights the following findings from its analysis of the impact of costs on UCITS returns:

- Average costs between 2008-2017 were 2%, 1.8% and 1.4% for equity, mixed and bond UCITS funds respectively;
- Costs are predominately driven by the Total Expense Ratio (TER) rather than subscription and redemption fees;
- Across asset classes, costs on average take out 25% of gross returns between 2015-2017;

ESMA's analysis of UCITS returns[\[17\]](#) shows the following 1- and 10-year performance for each category of UCITS:

- Equity UCITS funds: 1- and 10-year performance was 16% and c.7% respectively;
- Bond UCITS funds: 1- and 10-year performance was 2.5% and c.5.3% respectively;
- Mixed UCITS funds: 1- and 10-year performance was 6.1% and c.4.6% respectively;

Retail and Institutional Investments

ESMA's analysis UCITS distribution shows the following breakdown of distribution by asset class:

- Retail UCITS distribution: 39% equity, 27% bond, 25% mixed, 6% MMF and 3% alternative;
- Institutional UCITS distribution: 30% equity, 29% bond, 7% mixed, 30% MMF and 4% alternative.

ESMA asserts that the main difference between retail and institutional distribution of UCITS is cost, noting that retail investor costs are higher than those for institutional investors by 0.9%, 0.5%, 0.2% and 0.6% for equity, bond, MMF and alternative UCITS funds respectively. Based on this analysis, ESMA draws the following conclusions:

- Retail UCITS have slightly higher gross annual returns than institutional UCITS (as for equity at a 1-year horizon or bonds at a 7-year horizon), which may suggest that institutional investors consider liquidity needs and risk considerations to a higher degree compared to retail clients;
- Gross returns for retail and institutional UCITS follow very similar patterns, but net returns are lower for retail compared to institutional investors, in part due to lower cost institutional share classes and better-informed investment decisions and higher bargaining power by institutional investors.

Inflation and Impact on Performance

ESMA analyses the net real returns of UCITS after the impact of inflation.[\[18\]](#) Due to data limitations, ESMA's analysis is based on inflation in the fund's domicile rather than the investor's domicile. At EU level, ESMA finds the impact of inflation on UCITS as 1.9% over a 1-year horizon and 0.7% over a 3-year horizon. At Member State level, ESMA finds considerable variation in the impact of inflation, for instance ranging between 0.01% in Ireland compared to 1.5% in Belgium over a 3-year horizon.

UCITS Performance by Management Type

ESMA's analysis of the cost and past performance of actively and passively managed equity UCITS covering €2.4trn in AuM at end 2017 (c. 64% of the market), reveals the following findings:

- Over the last 5 years the AuM of passively managed UCITS has averaged around 10% of the equity EU market;
- Growth in the AuM of passively managed UCITS has been 11%, 39% and 95% over 1, 3 and 10 years compared to 10%, 26% and 78% for actively managed UCITS.

ESMA's analysis of the impact of costs on returns shows:

- Gross returns of actively managed equity UCITS have outperformed passively managed equity UCITS over 1-year and 3-year periods by 4% and 5% respectively;
- Costs have been stable and consistently higher for actively managed equity UCITS, impacting annual gross returns by 1% compared to 0.6% on average for passively managed equity UCITS;
- 1-year and 3-year net returns of actively and passively managed funds are similar at c. 14% and 9% respectively, while being higher for passively managed UCITS compared to actively managed UCITS at longer time horizons: 7-year returns of 9.7% and 8.4% and 10-year returns of 5.8% and 5.5%.

ESMA highlights the following findings from its analysis of the returns of UCITS ETFs:

- In 2017, the annual gross returns of UCITS equity ETFs averaged 10% compared to -1.2% for UCITS bond ETFs;
- Between 2007-2018, annual gross returns were 16% and 10% over 1 year and 3-year periods respectively for UCITS equity ETFs compared to 0.5% and 4% for UCITS bond ETFs;

ESMA identifies that ETF costs have remained relatively stable over time at 0.7-0.8% and 0.5% on average for UCITS equity ETFs and UCITS bond ETFs respectively. ESMA finds that ongoing costs account for the largest part of overall costs for UCITS ETFs aside from inflation, which ESMA suggest reduces gross annual returns on average by 1% across various time horizons.

Next Steps

The EC will consider ESMA's analysis alongside the reports produced by the other ESAs^[19] in determining whether future legislative or non-legislative action is required, including under the auspices of the CMU. The EC is also taking forward related actions to complement prior work it has completed concerning retail investment,^[20] including a study on options for the development of online tools and services.^[21]

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[Attachment](#)

endnotes

[1] ESMA Annual Statistical Report, Performance and costs of retail investment products in the EU 2019, available from

https://www.esma.europa.eu/sites/default/files/library/esma50-165-731-asr-performance_and_costs_of_retail_investments_products_in_the_eu.pdf

[2] ESMA News Release: ESMA receives mandate on fund performance from the European Commission, dated 19 October 2017, available from

<https://www.esma.europa.eu/press-news/esma-news/esma-receives-mandate-fund-performance-european-commission>

[3] A joint request was made by the European Commission to the three European Supervisory Authorities - Request to the European Supervisory Authorities to report on the cost and past performance of the main categories of retail investment, insurance and pension products, available from

https://www.esma.europa.eu/sites/default/files/library/ares20175008790_request_to_esas_to_issue_recurrent_reports_-_cmu_action.pdf

[4] The impact of charges on mutual funds returns, ESMA Report on Trends, Risks and Vulnerabilities No. 2, 2017, available from

https://www.esma.europa.eu/sites/default/files/library/esma50-165-422_trv_-_vulnerabilities_-_investor_protection_corrected.pdf

[5] https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/capital-markets-union-action-plan/fostering-retail-investment_en

[6] p4, Report

[7] p8-32, Report

[8] p32-39, Report

[9] p39-45, Report

[10] p48-50, Report

[11] p50-118, Report

[12] <https://www.esma.europa.eu/databases-library/esma-library/trends>

[13] Economic Report: Retailisation in the EU, 3 July 2013, ESMA, available from https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-326_economic_report_-_retailisation_in_the_eu_0.pdf

[14] p9, Report

[15] Distribution systems of retail investment products across the European Union, Final Report, European Commission, available from https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems_en.pdf

[16] ESMA noted that the commercial dataset it used from Thomson Reuters Lipper contained elements of data covering €7.4trn of UCITS assets (76% of the market), but only a subset of this data contained all the parameters needed for the full analysis.

[17] 1-year performance in 2017 and 10-year performance between 2008-2017

[18] ESMA analysis is based on the annual rate of change of the Harmonised Index of Consumer Prices (HICP) reported at a monthly frequency

[19] The European Banking Authority published a report on the costs and performance of structured deposits, available here <https://eba.europa.eu/-/eba-publishes-report-on-cost-and-performance-of-structured-deposits>, and the European Insurance and Occupational Pensions Authority published a report on insurance and pension products, available here <https://eiopa.europa.eu/Pages/News/EIOPA-analyses-costs-and-past-performance-of-insurance-and-pension-products.aspx>

[20] See Memo 29774, RE: ICI Global Response to European Commission Green Paper on Retail Financial Services, dated 18 March 2016, available from <https://www.iciglobal.org/iciglobal/pubs/memos/memo29774>

[21] Tender for Study on options for development of online tools and services supporting retail investors in investment decisions, available from <https://etendering.ted.europa.eu/cft/cft-display.html;eTenderingPublic=aKcMGmkeRPFg0V2XKZYgFFiicQAUOXXrQr5ij0jDKURajPE8iraB!33118069?cftId=3823>