



SMSG OPINION

SMSG opinion on the European Commission 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

I. Executive summary

On October 13, 2017 the EC requests the ESAs to issue recurrent reports on the cost and past performance of the main categories of retail investment, insurance and pension products. The aim of this opinion is to share with ESMA the views of the SMSG on the EC request, with a particular focus on issues that might affect the reporting activity that will be performed by ESMA.

The SMSG welcomes the EC request as a valuable action for retail investors as well as for the industry. Clarity, helpfulness and comparability across products should be carefully considered when drafting the reports on cost and past performance.

In this opinion the SMSG highlights issues related to the measurement of fees as well as to the availability of information, and considers that transaction costs should be reported in a way that would not bias comparison. The SMSG also notes that the EC request does not explicitly mention risks when describing the content of the reports, although performance is strictly related to the risk exposure. The SMSG observes that the segmentation by Member State requested by the EC entails the risk of mixing up an assessment of the products available to investors of a certain country with an assessment of the investment firms domiciled in a certain country. This opinion also mentions issues related to the sampling approach.

Lastly, the SMSG notes that the EC request represents a very costly task for the ESAs. The timing of the steps outlined in the EC request appears to be particularly challenging.

II. Background

1. **The EC request to ESAs.** On October 13, 2017 the European Commission (henceforth “EC”) invites, with a formal request, the European Supervisory Authorities (“ESAs”) to issue recurrent reports on the cost and past performance of the main categories of retail investment, insurance and pension products. This request (“EC request to ESAs”) contributes to the objective of the Capital Markets Union (“CMU”) Action Plan to foster the participation of retail investors in capital markets by supporting the assessment of the net return of retail investment products and the impact of diverse fees and charges.
2. **The rationale of the EC request to ESAs.** The full implementation of different legislative measures in the European Union (e.g. UCITS, MiFID/MiFIR, IDD, IORPII and PRIIPs) was intended to increase transparency at every level for products and distributors. A question remains whether investors make

proper use of the information made available thanks to the regulation. The ultimate objective of the EC request to ESAs is to ensure that these new disclosures and reporting are made easily accessible to, and effectively support, retail investors in their investment choices. Such recurrent reports are intended to enhance competition pressure and drive pricing discipline in these markets. They may also form a basis for public authorities to identify market segments and regions where investors are in a sub-optimal situation and identify those issues which call for careful analysis.

3. The scope of the reports. The reports on cost and performance should cover the following investment products: products covered by PRIIPs-KID and UCITS-KIID (UCITS investment funds, AIF investment funds sold to retail investors, structured products sold to retail investors, insurance-based investment products), personal pension products and, at a later stage, defined contribution occupational pension schemes.
4. The principles of the reporting of cost and past performance. The reporting of cost and past performance of different categories of the products, subject to the availability of data, should be based on the following principles: Member State by Member State analysis, comparability of indicators, appropriate level of granularity with categories comprising products with broadly homogenous characteristics, net return and impact of costs, all fees impacting the net performance of retail investment products should be reported, the reporting on cost and performance should present the net return for various periods of time (i.e., time horizons) and the impact of inflation should be taken into account. Qualitative and quantitative comparisons of the costs and performance indicators of different categories of products should be provided both at the levels of each Member State and the EU, and should include comparison between net returns of different categories of products as well as proportion of impact of costs on the net return.
5. Steps. The EC request outlines four steps. The first step is the mapping of the cost and performance data requirements under EU or national legislation for pre-contractual disclosures and reporting to investors. The second step concerns the development of country-specific methodologies. The third step relates to data collecting and processing. The fourth step refers to the reports on cost and past performance to be produced by the ESAs. The EC request allows that the first iterations of the reports may be based on data that are already available and requires that a description of the difficulties faced during the implementation of the first iteration should be included in the report, together with any appropriate recommendation for the consecutive reporting cycles. The first reporting on the costs and performances as well as data availability is expected by Q3/Q4 2018, according to the tentative timetable outlined in the EC request.

III. General Comments

6. The SMSG welcomes the EC request to ESAs as a valuable action for retail investors as well as for the industry. Retail investors are expected to benefit from the availability of information on costs and past performance of investment products, making easier and well-grounded their investment decisions. The industry will also benefit from the availability of information supporting fair competition among players. Issuing recurrent reports on costs and performance could also enhance competitive pressure and improve pricing discipline in these markets.
7. Clarity, helpfulness and comparability across products should be carefully considered when drafting the reports on cost and past performance as *retail* investors are identified as the main target of such

reports¹. Easy-to-understand measures and appropriate communication tools may be useful in this respect. It might be useful to complement the data included in the reports with indications (and appropriate warnings) on how to use the information on past performance.

8. The SMSG notes that the EC Request represents a very costly task for the ESAs. The timing of the steps outlined in the EC Request appears to be particularly challenging, taking into account data availability and the complexity of the technicalities associated to the reporting of cost and past performance of investment products.
9. Given the scope, the complexity and the implications of the EC Request to ESAs, the reporting on cost and past performance of retail investment products appears to be a long-term project. The actual shape of the reports is expected to change over time, depending on data availability. This evolving feature could possibly also allow for the inclusion of additional dimensions that are currently not considered in the EC request to ESAs (e.g., Environmental, Social and Governance aspects).

IV. Specific Comments

10. Methodology (and level playing field). The Commission request refers to cost and past performance of *retail* (investment, insurance and pension) products. From the point of view of a retail investor, cost and performance indicators should ideally be comparable across different products (mutual funds, structured products, insurance products, pension products). It is advisable that the methodology to calculate returns and assess costs is homogenous across products in order to make any comparison meaningful² and to insure a level-playing field among firms belonging to different industries. Coordination among ESAs on the methodologies that will be used in their respective reports might be useful to address this point.
11. Fees and transaction costs. On page 4, the Commission request asks for reporting “all fees impacting the net performance of retail investment products”. The EC request also clarifies that the reporting should include “notably the investment costs (asset management fees, custodian fees) and possibly transaction costs”. The SMSG considers that transaction costs should be reported in a way that would not bias comparisons, and highlights the following two issues to be carefully considered and disclosed in the reports. First, the choice of an ex post versus an ex ante approach in the measurement of fees and costs. Second, the availability of information on transaction costs in all EU countries.
12. Transparency on distribution costs. The EC request calls for highlighting the differences in fees across distribution channels. However, distribution costs are in some cases bundled into management fees (e.g., when the asset managers transfer part of their fees to distributors). This might bias comparisons: management fees might be in some cases large because of the inclusion of distribution fees. The SMSG believes that this feature deserves careful consideration. The SMSG also notes that ESMA is already active on this issue (see, e.g., “The impact of charges on mutual fund returns”, in the ESMA Report on Trends, Risks and Vulnerabilities, No. 2, 2017).
13. Risk dimension. A solid assessment of the quality of the asset management services should take into account not only the returns generated by the investment product but also its risks. However, the EC request does not explicitly mention risks when describing the content of the reports. The possible lack

¹ “The ultimate objective of this action is to ensure that these new disclosures and reporting are made easily accessible to, and effectively support, *retail investors* in their investment choices.” (EC Request to ESAs, page 2, emphasis added).

² This is also acknowledged on page 3 of the EC request (“Comparability of indicators”).

of the risk dimension in the reports that will be produced deserves some comments. Negative historical performance shown in the reports might be viewed as evidence of high risk, by contrast highly positive historical performance might not be considered – especially by retail investors – as evidence of risky investments, even when high returns are actually explained by the level of risk exposure. Nevertheless, partitioning by (i.) product categories and (ii.) level of active management (as called for by the EC request) might also be considered as a way to incorporate the risk dimension. Simple measures like the ratio between return and risk might be considered by ESMA in order to include in the reports indicators useful to assess the level of returns per unit of risk.

14. Member State segmentation. The EC request calls for a “Member State by Member State analysis”. The identification of investment products (e.g., mutual funds) belonging to a country may be based on different criteria, like (a.) a market perspective (i.e., financial products sold or distributed in a certain country) or (b.) be based on the headquarters of the investment company (i.e., financial products manufactured in a certain country or management companies incorporated in a certain country). This country identification step is important as there is the risk of mixing up an assessment of the products available to investors of a certain country (sub a.) with an assessment of the investment firms domiciled in a certain country (sub b.). The SMSG also notes that the identification of financial products sold in a country deserves a careful consideration.
15. Sampling approach. The EC request allows “working on the basis of representative samples of products” (page 4) and suggests a sampling approach based on volumes³. Some SMSG members raised concerns about the possibility of misleading samples based on historical market shares (e.g., a weighting scheme based on current volumes assumes that investors in the future will invest exactly as the current market shares imply). An additional criteria that might be considered in the selection of a sample might be how ‘problematic’ or complex is a product (i.e., where there might be greater need for investor protection). Some members of the SMSG also highlighted that, as long as larger funds exhibit lower costs, the evidence reported on costs would be affected by a sampling strategy that assigns larger weights to larger funds. The SMSG considers that in any case the criteria used for sample construction should be clearly disclosed and appropriately motivated in the report.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA’s website.

Adopted on 20 September 2018

[Signed]

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³ “The weightings of different product categories within the sample analysed should be adjusted so to reflect the volumes of different categories of products sold locally.” (EC Request to ESAs, page 4).