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# Key priorities for EU retail fund investors

## Irish Funds Annual Global Funds Conference 2022

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Ladies and Gentlemen,

I am very pleased to have been invited to address the Irish Funds Annual Global Funds Conference and it is a particular pleasure to be able to do this in person here in the Convention Centre in Dublin. While I appreciate the flexibility that virtual interaction brings – moving from an international meeting of the FSB to a speech at a conference in a matter of seconds - it is not the same as personal interactions during these kinds of events where we can really exchange and learn from each other's perspectives.

Today I want to give ESMA's perspectives on key priorities for European retail fund investors. With rising inflation and economic headwinds, now is the right time to look at how key policies can support the European Commission's objective of "an economy that works for people". ESMA has always given prominence to its objective to protect investors and we will certainly continue to look out for retail investors.

ESMA recently issued a report (on 29 April 2022) covering disclosures, and digital tools and channels[1], which outlines one of our contributions to the wider EU retail investment review. But – given this is the Annual Global Funds Conference - the specific focus I want to take today relates to investment funds.

[1] https://www.esma.europa.eu/sites/default/files/library/esma35-42-1227_final_report_on_technical_advice_on_ec_retail_investments_strategy.pdf

I will speak about our most important retail investor priorities by covering three topics: the PRIIPs review, costs and fees of investment funds and sustainability.

The PRIIPs regulation has now been in application for a sufficiently long period of time for some lessons to be drawn. ESMA and the other ESAs believe that a significant number of changes should be made to the regulation to improve it, and with that improve the outcomes it delivers for retail investors.

I am also in a position to be able to present the outcomes of ESMA's common supervisory action on costs and fees in UCITS. There are several important lessons to be drawn from the exercise to improve the fund industry's practices towards retail investors.

Finally, it is time to stress the growing importance of the sustainability agenda for retail investors. While we have been working hard to improve the rulebook for disclosures by investment fund and fund managers, we have to recognise the complexities involved and the challenges for retail investors, as well as the risk of greenwashing.

**The PRIIPs regulation: evolution required**

Let me start with the PRIIPs regulation, a key plank in the retail investor disclosure framework. In early May ESMA and the other ESAs published their technical advice to the European Commission on the review of the PRIIPs regulation. We consider this a key input for the retail investment strategy and hope that the Commission will take our advice on board.

Our main message is that a significant number of changes to the PRIIPs regulation are needed and we would therefore encourage the Commission and the co-legislators to consider a broad review of the PRIIPs framework. Some outstanding issues cannot be fixed without amendments to the Level 1. We also think that it is important that when proposals are made to change the PRIIPs regulation, meaningful consumer testing is conducted to calibrate any changes appropriately.

It will not come as a surprise to anyone that there is one key topic that we believe is of central importance: performance and past performance information in the PRIIPs KID.

On performance, in the ESAs' advice we recommend replacing the current requirement in the PRIIPs regulation for 'appropriate performance scenarios' to be shown for all products, with the wording 'appropriate information on performance'. This would allow more flexibility on the nature of the information provided in the performance section of the KID, and avoid the systematic need to build forward-looking performance scenarios based on modelling, which are not really appropriate for investment funds.

ESMA believes that past performance is important for the KID disclosure of investment funds. This is why we believe that reopening the PRIIPs regulation should allow also past performance to be included in the PRIIPs KID (and not in a separate document), as it is currently the case in the UCITS KII.

Apart from performance, I would also like to stress the need for some differentiation among products. The PRIIPs regulation should acknowledge that there should be the right balance in the PRIIPs KID between comprehensibility and comparability among substitutable products. We suggest that the PRIIPs regulation should be changed so that, where appropriate, in order to provide fair, clear and not misleading information to retail investors, different approaches can be taken between different types of products - provided of course that there remain key comparable elements, as it is already the case for the cost disclosure section of the PRIIPs KID.

Finally, I want to stress that in the context of any upcoming review of the PRIIPs regulation, the European Commission and the co-legislators should harness the opportunities provided by digital disclosure, for example by allowing information to be presented in a “layered” format. It is high time that the PRIIPs framework recognises the benefits of more modern forms of retail investor disclosures and moves into the digital age.

**Costs and fees for investment funds**

I am very pleased to be able to present to you the outcome of some major work that ESMA has completed recently in support of the retail investment strategy. We are publishing today the outcome of the common supervisory action (CSA) on costs and fees for UCITS funds. The CSA’s aim was to assess, foster and enforce the compliance of supervised entities with key cost-related provisions in the UCITS framework, in particular the obligation of not charging investors with undue costs. Underlining how important costs and fees are from an investor protection perspective, in 2020 ESMA included this topic as a Union Strategic Supervisory Priority (USSP). Among ESMA’s supervisory convergence tools to address key market risks impacting Member States, USSPs allow to collectively highlight a priority area on which NCAs are expected to undertake supervisory action.

I would like to highlight three important results of the CSA exercise. First of all, it showed room for improvement in the application of the ESMA supervisory briefing on the supervision of costs in UCITS and AIFs[2]. This was particularly the case for smaller entities which have in place less formalised pricing processes compared to entities managing larger amounts of assets. While the principle of proportionality may justify expecting less sophisticated processes from smaller entities compared to larger ones, this should not result in a situation where some smaller UCITS managers effectively disapply these requirements altogether.

This result reflects a finding in ESMA's annual statistical report on cost and performance of retail investment products[3], which shows that "*across time horizons and asset classes, larger funds have lower costs than smaller funds*". Therefore, it is important for national competent authorities (NCAs), to address the topic of costs of smaller funds. We see a risk that without some focus on this point, investors are being charged undue costs from smaller funds and managers, due to the lack of a structured pricing processes. This issue is further amplified by their reduced possibility to benefit from economies of scale.

Secondly, the results of the analysis also showed that, in some instances, UCITS managers over-relied on delegated portfolio managers for the pricing of the fund. In this context, questions also arise concerning compliance with delegation rules where portfolio managers (i.e. delegates) exercise significant influence or even decision making power over the level of costs. Against this background, we would like to stress the importance that UCITS managers perform an independent analysis of the fee structures once those have been established and to avoid overreliance on the assessment made by the delegated portfolio manager.

Lastly, we would like to stress the importance of ensuring that investors are adequately compensated in all cases where they were charged with undue costs or fees, and also in cases where there were calculation errors that resulted in a financial detriment for investors. This is a topic of high importance from an investor protection perspective and fund managers' timely and efficient compensation of investors in these cases should be an important supervisory focus point.

Beyond these three findings from the CSA exercise, I would also like to emphasise the importance of disclosures. I will get to the sustainability elements of disclosures in a second,

[2] https://www.esma.europa.eu/sites/default/files/library/esma34-39-1042_supervisory_briefing_on_the_supervision_of_costs.pdf
[3] https://www.esma.europa.eu/sites/default/files/library/esma_50-165-1677_asr_performance_and_costs_of_eu_retail_investment_products.pdf

but this element is also essential for costs and fees. In order to promote retail participation in funds' investment, investors should be able to easily compare the costs and performance of investments funds. In this respect, I would favour the creation of online calculator tools allowing retail investor to calculate the costs and fees of funds distributed across the EU. These tools, which would also be in line with the recommendation from ECA auditors in their recent report on investment funds[4], would also allow investors to obtain easily information about all funds that respond to certain criteria, and to compare the costs and performance of those funds.

**Sustainability and greenwashing**

Probably one of the most important topics for retail investor products today is sustainability and sustainable finance.

Demand for sustainable financial products remains strong. Investors are increasing their allocation to sustainable investment products and vehicles. According to Morningstar data, the net asset value of ESG funds increased by 17 % between March 2021 and March 2022. Net inflows into ESG equity funds have amounted to EUR 218 billion over the last 3 years, compared to EUR 55 billion in their non-ESG peers.

Meanwhile, the regulatory framework is only slowly adapting to this increasing demand for, and also supply of, sustainable investment funds. SFDR constitutes a key building block of the European sustainable finance framework. While the rules already became applicable in March 2021, the detailed technical rules are unfortunately still awaiting publication in the Official Journal.

We at ESMA, together with our 'sister' authorities (EBA and EIOPA) have been heavily involved in creating technical rules for the SFDR disclosures for financial products. At the same time, we are urgently awaiting clarity on corporate disclosures from legislation such as CSRD.

We acknowledge that the sustainability disclosure framework is incomplete and imperfect at this time. In an ideal world, the disclosures required for financial market participants and financial products would have followed a comprehensive corporate transparency regime. That corporate transparency framework is still work in progress though - through the CSRD, its accompanying reporting standards, and not forgetting the global standards being promulgated

[4] https://www.eca.europa.eu/Lists/ECADocuments/SR22_04/SR_SM-for-Invest-Funds_EN.pdf

by the ISSB. All these will help to complete the picture and significantly improve the underlying sustainability information over time.

We also accept that the disclosures to investors in the SFDR are complex by nature and difficult for especially retail investors to understand. This was consistent feedback we received, as the ESAs, during consumer testing of the product templates. We expect the product templates to significantly enhance comparability of disclosures when they become mandatory from next year, but the underlying complexity of the information is, and will continue to be, a persisting challenge.

Despite these challenges, we need to move ahead urgently with what we have.

We at ESMA are doing what we can to enhance clarity for you in the funds industry. The ESAs will shortly publish a statement clarifying several areas of our RTS that we know have been unclear to market participants. We also plan to issue a comprehensive set of formal Q&As after the delegated regulation is published in the Official Journal on the practical application of the rules, covering the SFDR disclosures and the additional taxonomy-related product disclosures.

Additionally, I am pleased to announce that ESMA will publish today a supervisory briefing on sustainability risks and disclosures in the area of investment management. Supervisory briefings are an important tool in ESMA's supervisory convergence toolbox. This briefing will promote convergence with regard to how the national competent authorities supervise investment funds with sustainability features.

We continue to discuss these disclosure requirements with the national authorities across Europe to support a consistent interpretation of the regulatory requirements and ensure investors, wherever they are, can truly benefit from the enhanced transparency.

In summary, we recognise that the comprehensive nature of the disclosures are complex for investors to understand and the technically challenging rules are difficult for the market to digest. The ESAs will continue to consider how to simplify the disclosures for investors and streamline the rules for the financial market participants. We need to acknowledge however that not all tools are in our hands, given the constraints dictated by the applicable legislative provisions. We will nonetheless do what we can. Finally, we will also need to address the new mandates given to us by the Commission on nuclear and gas disclosures and the review of the principal adverse impact indicators.

Going beyond the design of the rules, I would like to add a few words on their actual application and the dangers of greenwashing. While SFDR was designed to enhance transparency around sustainability, we have noted that in practice the disclosures are often being used as product classification. Status as “Article 8” or “Article 9” funds are being used in marketing material by fund managers as quality labels for sustainability. We are particularly concerned for investors investing in products disclosing under Article 8 SFDR.

It is important to remember that the purpose of Article 8 disclosures is to highlight any kind of environmental or social characteristics promoted by such products – however small it might be. It is therefore very important that investors do not take the mere presence of an Article 8 disclosure as an indication of sustainability per se. It is essential that investors review the disclosures to determine the actual sustainability characteristics and to what extent the product applies those characteristics in reality in the product’s investment strategy.

The ESAs will work with NCAs to reduce what one might call “over-disclosure” by investment funds under Article 8, to avoid misleading disclosures to investors about the greenness of a product. We also support future legislative efforts to create clear criteria for financial products making sustainability disclosures. For instance, a comprehensive solution could be to introduce sustainability labels for financial products, in order to help generate much needed clarity for retail investors.

**Conclusion**

With investor protection being one of ESMA’s most important founding objectives, the EC’s retail investment strategy provides us with an opportunity to consider carefully how the legislative and regulatory framework currently operates for retail investors in Europe and how we can further improve it.

We think that the time has come to launch a comprehensive review of the PRIIPs regulation. Such a review can make a real difference in bringing greater comprehensibility to key information disclosures for retail investment products and provide the possibility to include past performance information, which is particularly important for investment funds. There is also an opportunity to make greater use of digital formats for disclosures by upgrading the KID and make it ready for the digital age.

ESMA's supervisory action on costs and fees has also taught us that there could still be improvements to how smaller managers apply pricing and how investors are compensated for errors.

Finally, with retail investors increasingly turning to sustainable products in their savings and investment decisions, it is important that we work hard to clarify and simplify the complex legislative framework for sustainability disclosures. At the same time, investors should be vigilant to ensure that they do not misinterpret transparency measures as sustainability labels.

We look forward to continuing to engage with investors and industry to make sure that the ultimate beneficiary, the retail investor, is and remains at the heart of all our efforts. The retail investment strategy needs to be a success!

Thank you again for giving me the opportunity to make these remarks to you today. I certainly welcome the continued input from the Irish funds industry to ESMA's work on these important topics.

Thank you very much.