[Investors see lower net returns from potential closet index funds]

Closet indexing refers to the situation in which asset managers claim to manage their funds in an active manner while in fact tracking or staying close to a benchmark index. The authors of the study looked at annual fund-level data for the period 2010 to 2018, finding that investors saw both lower expected returns and higher fees when they invest in closet indexers compared with active funds. Overall, the net performance of potential closet indexers was worse than the net performance of genuinely active funds, as the marginally lower fees of potential closet indexers are outweighed by reduced performance.

Closet indexing is a practice that has been criticised by supervisors and investor advocacy groups on numerous occasions in recent years, over concern that investors are being misled about a fund’s investment strategy and objective and are not receiving the service that they have paid for.

ESMA and NCAs have worked to identify potential closet indexers by examining metrics on fund composition and performance and by conducting follow-up detailed supervisory work on a fund-by-fund basis. ESMA recognises that such metrics, while imperfect screening tools, are a useful source of evidence to help direct supervisory focus.

This study published today does not aim to identify particular closet indexers, but analyses how closet indexing relates to the costs and performance of EU-domiciled equity funds. In so doing, it aims to contribute to the understanding of closet indexing in the EU.