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Closet index funds: The AMF proposes an alternative approach to those currently used in Europe

The Autorité des marchés financiers (AMF) analysed nearly 800 French funds using a method based on fund return and market data, which enables more funds to be examined than was previously possible. This approach does not relieve the regulator of carrying out an in-depth individual analysis of the funds flagged as least active in the sample.

The issue of measuring active management has been a subject of increasing interest in the academic world and among market players, consumer protection associations and regulators. The possible existence of closet index funds is an important matter for financial regulators, including the AMF, both in terms of financial information and investor protection.

Today the AMF is keen to contribute to the European debate by testing an alternative method to the so-called "active share", which is used by certain peers, including the European Securities and Markets Authority (ESMA), and which is based on a comparative analysis of a portfolio's and index's composition (but it does restrict the number of funds than can be analysed given the data available).

The method proposed by the AMF adopts a return-based approach. By using market data solely, this method can be applied to a broader sample and aims to measure the degree of relative activity within a given fund population and its persistence over time. The method is

applied to test a sample from between 2006 and 2016 of nearly 800 French funds invested in European equities.

Since the adopted identification criteria are intentionally unrestrictive in order to minimise the risk of false negatives (the risk of a fund going undetected), this has led to the flagging of a significant number of funds. On the other hand it should be noted that not all funds flagged are to be considered as potential closet index funds. The proposed method, as with all other methods, does not make it possible to dispense with an in-depth individual analysis by the regulator. The applied method allows the least active funds to be identified within a given population, but in any case it does not provide a basis to conclude in absolute terms, that those identified are indeed closet index funds.

The AMF will be particularly vigilant in its oversight of investment funds and will analyse the funds flagged in this study in finer detail. The AMF also intends to pursue its work in this field and is considering extending its work to cover a broader sample of European funds.

About the AMF

The AMF is an independent public authority responsible for ensuring that savings invested in financial products are protected, that investors are provided with adequate information and supervising the orderly operation of markets. Visit our website www.amf-france.org.

Press contact:

AMF Communication Directorate - Christèle Fradin - Tel : +33 (0)1 5345 6029 ou +33 (0)1 5345 6028


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Head of publications: The Executive Director of AMF Communication Directorate. Contact: Communication Directorate – Autorité des marchés financiers 17 place de la Bourse – 75082 Paris cedex 02