WILLIAM FRY

// ASSET MANAGEMENT & INVESTMENT FUNDS

Asset Management & Investment Funds Update

June 2022

UCITS Costs and Fees CSA Findings

On 31 May 2022, ESMA published findings from the 2021 UCITS CSA on costs and fees (the **Findings**). The costs and fees CSA, which formed part of, and will feed into, the broader EU retail investment strategy, was conducted over the course of last year and involved co-ordinated supervisory action on UCITS managers' compliance with applicable cost-related UCITS rules, adherence to the terms of the ESMA briefing on the supervision of costs (see here for details) and the EPM guidance set out in the ESMA Guidelines on ETFs and other UCITS issues.

CSA Findings

The Findings highlight satisfactory levels of compliance by UCITS managers with the above-mentioned costs-related rules and guidance. Particular issues are, however, identified with respect to smaller managers either having less formalised pricing processes or no pricing process at all per the expectations set out in the 2020 ESMA briefing on the supervision of costs. The Findings also highlight a problematic over-reliance on portfolio managers in the context of pricing resulting from the exercise of significant influence/ceding of decision-making on the levels of costs and fees to delegate portfolio managers.

ESMA views/recommendations based on the Findings are summarised below:

- ***pricing process for all managers:*** all UCITS managers, regardless of the characteristics of the management company (including the size of AuM), must establish and periodically review a structured and formalised pricing process, in line with the characteristics of the fund(s) and the recommendations enshrined in the ESMA briefing on the supervision of costs
- ***no disapplication on proportionality grounds:*** the principle of proportionality may justify less sophisticated processes but should not result in a full disapplication of the requirement to have in place a structured and formalised pricing process in line with the ESMA briefing on the supervision of costs. ESMA considers the risk of undue costs may be higher in the case of smaller funds/UCITS managers
- ***independent analysis*** of fee structures should be carried out and over-reliance on the assessment made by the delegate portfolio manager should be avoided
- ***authorisation stage monitoring:*** regulatory control of UCITS cost/fee structure at authorisation stage should continue with enhanced scrutiny of costs and fees encouraged by ESMA

- ***annual review of costs:*** the level of costs should be periodically, and at least annually, reviewed and monitored in order to compare the estimated ongoing charges with the actual expenses incurred by the fund and, where possible, reduce the level of fees and ensure the viability and competitiveness of the fund over time against peer funds and in line with the best interests of investors

- ***value review:*** analysis regarding the sustainability of costs over time and/or the relative weight of fees on the investor's return based on the different market scenario is of paramount importance when setting the pricing structure of the fund

- ***intragroup/related-party transactions:*** intragroup/related-party transactions can result in higher costs and/or costs higher than average

- ***EPM in focus:***

    - the absence of EPM policies and procedures constitutes a breach of regulatory obligations and NCAs should take stricter measures to rectify any such identified breaches

    - disclosing a theoretical possibility of using EPM is not in line with the ESMA Guidelines on ETFs and other UCITS issues – boilerplate disclosures that do not clearly inform investors of specific arrangements and risks cannot ensure compliance with these Guidelines and NCAs should focus on stricter measures to ensure compliance

    - fee-split arrangements, involving the deduction of securities lending agents' fees from EPM revenue generated, merit further investigations and analysis as it appears there is limited consideration of fair market rates when entering into such arrangements, in particular intra-group arrangements.

Next steps

- ***enforcement action:*** NCAs should consider not only enhanced supervision but also enforcement actions in the limited cases where a significant regulatory breach was identified during the CSA

- ***investor compensation:*** investors must be adequately compensated in all CSA cases where they were charged with undue costs/fees or there were calculation errors that resulted in a financial detriment for investors

WILLIAM FRY

DUBLIN | CORK | LONDON | NEW YORK | SAN FRANCISCO | SILICON VALLEY

William Fry LLP | T: +353 1 639 5000 | E: info@williamfry.com

williamfry.com