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UCITS Costs and Fees CSA Findings:

impact UCITS managers and AIFMs

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On 24 March 2023, the Central Bank published its findings from the 2021 UCITS CSA on costs and fees, noting that **'the oversight and calibration of costs and fees should be made a priority for UCITS'** and that certain such matters would **'be an area of focus for the Central Bank in future supervisory engagements'** given the level of deficiencies identified.

During the CSA, the Central Bank assessed a sample of 59 UCITS managers' compliance with their obligations not to charge undue costs, to act in investors' best interests and to comply with UCITS rules for use of efficient portfolio management (**EPM**) techniques and connected party transactions.

While the CSA was specific to UCITS managers, the Central Bank expects AIFMs to also consider the CSA findings and its expectations when setting AIF cost and fee structures.

All fund managers are required to do a gap analysis against the CSA findings and put in place an action plan for any identified gaps by end Q3 2023.

Central Bank's CSA findings align with ESMA's but also include jurisdictional-specific findings

The Central Bank's findings follow on from, and are broadly aligned with, those issued by ESMA in May 2022. Like ESMA, the Central Bank did not find that material undue costs are being charged to investors but did identify deficiencies in UCITS managers governance of fee structures.

The findings are summarised in the table below. Notably however, both regulators have now issued expectations for UCITS managers to:

- ensure undue costs are not charged by having in place formalised, structured pricing process
- carry out periodic (at least annual) reviews of costs and fees to ensure viability and competitiveness over time
- avoid over reliance on the assessment of delegate investment managers and perform independent review of costs and fee structure
- ensure fee structures offer investors return commensurate with risk profile
- establish/improve existing EPM policies and procedures and ensure specific offering document disclosures on the use of such techniques

Going beyond the findings of ESMA, the Central Bank also published CSA findings on the use of fixed operating expense (**FOE**) models and non-discretionary investment advisory fees by Irish UCITS managers:

Fixed Operating Expense (FOE) models result in relatively higher revenue for fund managers and are supervisory focus: the Central Bank expects FOE models to be reviewed annually, calibrated to minimise the difference between fund expenses and the fixed fee, and operate such that investors are 'fully aware' of all expenses. The Central Bank found that the calibration of FOE levels by relevant sampled managers led to managers almost always receiving additional income (in some cases up to 0.15% of NAV) as a result of using the FOE model. As a result, the Central Bank's future supervisory work programme will focus on FOE models.

Non-discretionary investment advisory fee greater than that of the investment manager indicative of de-facto management role: the Central Bank's CSA findings reiterate its previously published concern arising from fee structures with an investment advisory fee greater than that of the investment manager – this is considered indicative of an inappropriate level of influence/control on the part of the advisor and of a fee structure that is not in the interests of investors. The Central Bank again confirms its expectation that investment advisors are limited to a non-discretionary role, supplementary to that of the investment manager (see Central Bank AIFMD Q&A ID1151 and 2022 Securities Markets Outlook Report for further details of this regulatory concern).

Costs and Fees CSA Findings

The following table includes (i) the CSA findings/expectations common to both the Central Bank and ESMA and (ii) any additional CSA findings/expectations from ESMA (as set out in its May 2022 Final Report).

As the Central Bank's findings require them to be read in conjunction with ESMA's findings, both columns should be taken into account for the gap analysis/action plan required by end Q3 2023.

Both ESMA and the Central Bank expect fund managers to take into account the terms of the June 2020 ESMA Supervisory Briefing on the Supervision of Costs when complying with the following expectations:

	Central Bank / ESMA CSA Findings / Expectations	Additional ESMA CSA Findings / Expectations
Pricing process	All UCITS managers are expected to have structured, formalised pricing processes supported by policies and procedures (**P&Ps**) which: • provide for the design, oversight and regular review of costs and fee structures • are overseen and approved by senior management • allow for transparent identification and quantification of all costs charged to the fund • provide for fair and equitable calculation of costs and fees, in the best interests of investors • provide for fee structures that ensure investors continue to be offered a return commensurate with the risk profile of the fund • avoid over-reliance on delegate investment managers for setting the fee structure	• Key to setting the pricing structure is the analysis of the sustainability of costs over time and/or the relative weight of fees on the investor’s return based on the different market scenarios • Regular stringent controls by internal control functions should be ensured as part of the process • Comparison with peer funds should not solely be used by fund managers in order to set the pricing of the fund, but each cost category should be separately assessed and determined in the investor’s best interest • 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

	• provide for adequate Board reporting that allows for regular review of costs and fees	• Intragroup/related-party transactions can result in higher costs and/or costs higher than average
Periodic (at least annual) review of costs and fee structures	All costs and fees charged (both new and existing) should be subject to a documented review, at least annually, including the methodology used to calculate fees. The costs and fees review should: • consider appropriateness in light of types of funds under management, actual versus target level of fund performance and role and responsibilities of relevant service provider • consider viability and competitiveness of funds in terms of being capable of providing a positive return to investors • ensure investors continue to be offered a return commensurate with the risk profile of the fund • ensure costs and fees calculation in a fair and equitable manner, in the best interest of investors • include fixed operating expense (FOE) models and compliance with UCITS undue costs principle • include fee arrangements for all EPM activities	The purpose of the periodic review should include, where possible, reducing the level of fees and ensuring the viability and competitiveness of the fund over time against peer funds
Independent (of the delegate investment manager) review	Fund managers without a documented pricing process tend to over-rely on delegate investment managers for setting fees, indicating a lack of engagement and oversight. Independent reviews of costs and fee structures should be performed and over-reliance on the assessment made by the delegate investment manager should be avoided	
EPM	• Managers using EPM must have formalised P&Ps covering EPM activities which clearly disclose fee arrangements for securities lending programmes. A significant majority of managers using EPM did not have formalised P&Ps and those that did had insufficiently detailed P&Ps • Fund offering documents must clearly disclose the EPM strategy,	• The absence of EPM policies and procedures constitutes a breach of regulatory obligations • Offering document disclosures of 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

	risks of that strategy, and fee arrangements for specific EPM techniques being used • Fees for securities lending arrangements must comply with ESMA's expectations, be clearly disclosed in fund offering documents, captured in EPM P&Ps and reviewed on a planned and systematic basis. Several sampled managers retain significantly more revenue than their peers (between 30-40%) from their programmes.	ensure compliance with these Guidelines • 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

All fund managers (UCITS managers and AIFMs) are required to do a gap analysis against the CSA findings and put in place an action plan to address identified gaps by end Q3 2023.

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