

ESMA Publishes Report on Supervision of Costs and Fees in Investment Funds

Background

In January 2021, ESMA launched a Common Supervisory Action (“CSA”) with National Competent Authorities (“NCAs”) on the supervision of costs and fees in UCITS funds. The 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 to not charge investors undue costs.

In late May 2022, ESMA published its final report on the CSA. A summary of the findings is included below.

Report Findings

The main findings of this study, as presented in ESMA’s final report, are as follows:

- There is room for improvement on the application of the ESMA supervisory briefing on the supervision of costs in UCITS and AIFs, particularly for smaller ManCos;
- Certain questions arise relating to compliance with delegation rules where portfolio managers exercise significant influence over, or decide, the level of costs;
- Divergent market practices exist as to what industry reported as “due” or “undue” costs;
- Some NCAs discovered conflicts of interest at UCITS ManCos, particularly in the case of related-party transactions;
- There were instances where there were a lack of policies and procedures on efficient portfolio management and a lack of clear disclosures;
- There continues to be widespread use of fixed fee split arrangements for securities lending, with unfavourable results for retail investors.

On the matter of investor compensation, ESMA emphasizes the importance of ensuring that investors are being adequately compensated in all cases where they were charged undue costs or fees, or if calculation errors resulted in a detrimental financial impact for investors.

ESMA is keen to increase retail participation in the fund market. Verena Ross, chair of ESMA, stated the following in a press release:

“Costs remains a critical component when evaluating the ultimate benefits of an investment and, as ESMA has shown in its recent statistical reports, they remain higher for retail investors than for institutional investors. In order to promote retail participation in the fund market, continued supervisory attention is needed on the topic of costs and fees in investment funds”.

Next Steps

ESMA invites NCAs to consider enforcement actions where a significant regulatory breach has been identified. It is likely that the Central Bank of Ireland (“CBI”) will continue its ongoing engagement with UCITS ManCos in this area, which could result in Risk Mitigation Programmes being issued where appropriate and for the CBI

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to issue a letter to the industry in due course. In addition, it is likely that there will be an increased focus on costs and fees as part of the authorisation/approval process for new UCITS funds.

KB Associates' Services

KB Associates provides a range of services to investment funds including:

- The provision of UCITS ManCo/AIFM services.
- The provision of designated persons to perform UCITS business plan/AIFMD programme of activity functions.
- The provision of operational and compliance services to both UCITS and AIFMD compliant structures.

If you would like to discuss this note or KB Associates' services in general, please contact:

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