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ESMA Findings on Costs and Fees CSA

June 2022

Following on from the common supervisory action (“**CSA**”) on costs and fees in UCITS carried out during 2021, the European Securities and Markets Authority (“**ESMA**”) has published a **report** setting out its findings. The main results of the CSA, which focused in particular on the obligation not to charge investors with undue costs, are set out below.

- There is room for improvement with respect to the application of the ESMA **supervisory briefing** of June 2020 on the supervision of costs in UCITS and alternative investment funds (“**AIFs**”), particularly for smaller management companies. ESMA reiterates the importance for all UCITS managers to have in place a structured and formalised pricing process (as emphasised in the supervisory briefing). The application of the proportionality principle should not result in smaller UCITS managers effectively dis-applying the requirements altogether.
- ESMA has some concerns regarding compliance with delegation provisions in circumstances where portfolio managers (ie, delegates) exercise significant influence or even decide the level of costs. Senior management and relevant functions / committees should play a more active role and there ought to be regular stringent controls by internal control functions.
- There are divergent market practices as to what industry reported as “due” or “undue” costs. ESMA emphasises the importance of complying with the expectations set out in the supervisory briefing in this regard and that the notion of undue costs should be primarily assessed against what should be considered the best interests of the fund and its investors.
- Conflicts of interest were discovered at some UCITS managers, in particular in the case of related-party transactions. ESMA noted the potential for intragroup / related party transactions to result in higher costs and / or costs higher than average and stressed that this is an important investor protection issue.
- There were some instances of a lack of policies and procedures on efficient portfolio management (“**EPM**”) and lack of clear disclosures as required under the **ESMA Guidelines** on ETFs and other

UCITS issues. The indication of a mere possibility of using EPM is not in line with those guidelines where such indication is not complemented and specified with the clear disclosures required by the guidelines.

- There is widespread use of fixed fee split arrangements for securities lending, with unfavourable results for retail investors.
- ESMA encourages national competent authorities to perform enhanced scrutiny on the topic of costs and fees as part of the authorisation process.

Next Steps

It is expected that the Central Bank will issue an industry letter relating to the CSA setting out its own findings and expectations with regard to costs and fees.

Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this update.

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