

Updated ESMA Report on Fund Costs and Fees

The European Securities and Markets Authority (“ESMA”) has recently published a report (the “Costs Report”) on the Common Supervisory Action (“CSA”) regarding costs and fees for investment funds, that it commenced with National Competent Authorities (“NCAs”) during 2021. This article highlights some of the findings of the Costs Report as well as the implications and likely next steps.

Background

AS noted in our detailed article entitled “Scrutiny due for Undue Charges”, ESMA launched a CSA with the NCAs of European member states to focus on undue costs. This was launched in the wake of research illustrating the negative impact of high costs on fund products and the implications of this for investor protection as well as retail participation in the financial markets. Legal fees were among the items expressly highlighted. Interestingly the CSA noted the specific existing legal requirements incumbent on UCITS managers and AIFMs respectively under current legislation to monitor and address such concerns. The implications of this are that failure to do so constitutes a regulatory breach and indeed that a lack of policies and procedures to monitor related matters could constitute a dereliction of duty even in the absence of undue costs.

Report Highlights

In the Costs Report ESMA has highlighted the importance of ongoing supervision in relation to costs, considering their high impact on investors’ returns. Key findings include: increased compliance is required particularly for smaller management companies; there is divergence regarding reporting of costs as “due” or “undue”; conflicts of interest, in particular in cases of related-party transactions; a lack of policies and procedures regarding efficient portfolio management (EPMs) as well as deficiencies in related disclosures as required under the ESMA “Guidelines on ETFs and other UCITS issues”; and widespread use of fixed fee splits arrangements for securities lending with unfavourable results for retail investors.

Concerns are also raised in the Costs Report regarding compliance with the applicable delegation rules where portfolio managers i.e. delegates, exercise significant influence over, or even determine the level of, costs. This is likely to be of significant relevance in Ireland and Luxembourg, where delegation models are common.

Next steps and Enforcement

ESMA has noted that the area of costs and fees is a priority due to the high relevance for investor protection and invited the NCAs to seize the opportunity of the publication of the Costs Report to consider taking related enforcement actions, particularly in cases where significant related regulatory breaches were identified. It further noted that it will continue to work with the NCAs on this topic so further related regulatory activity is to be expected. It emphasised the importance of ensuring investor compensation for undue costs, as well as where calculation errors resulted in financial detriment. Market participants would be well advised to ensure they have procedures in place to demonstrate compliance.

How Clerkin Lynch can Help

The Financial Services team at Clerkin Lynch assists clients with the drafting and ongoing implementation of policies and procedures to ensure compliance with applicable guidance and requirements derived from both European and Irish regulatory sources, including those relating to costs and charges. In addition, as a supplier of legal services Clerkin Lynch ensures that the rates applicable assist clients in meeting their related regulatory obligations by representing solid commercial value.



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