Legal Update

Fund costs and ESG

One of the primary regulatory issues impacting the asset management industry in Europe over the past 18 months has been compliance with environmental, social and governance (“ESG”) related legislation including the Sustainable Finance Disclosures Regulation (“SFDR”) and Taxonomy Regulation. However this has occurred at a time when regulators have also been focusing on fund costs. This raises the challenge for boards of ensuring compliance with these separate and potentially conflicting obligations.

Undue Costs

ESMA cited costs and fees charged by fund managers as one of the two supervisory priorities to be addressed for 2021 under their discretion to identify key market risks. ESMA launched a “common supervisory action” (“CSA”) with the National Competent Authorities (“NCAs”) in 2021 to assess the compliance with the cost-related provisions under applicable law and to ensure funds were not paying undue charges. Work in this regard is ongoing with NCAs. EMSA’s actions in this regard also stem from the fact that the existing product level legislation, being the UCITS Directive and AIFMD already require ensuring “undue costs” are not applied. The focus of this work is to continue to exert downward pressure on fund charges for the benefit of investors.

ESG

The Taxonomy Regulation and SFDR have required additional disclosures pertaining to ESG. January 2023 is the next key date for such updates. Apart from legal costs inherent in updating documentation, the requirements under Level II of the SFDR in particular will in many cases require significant additional work to be undertaken, including potentially costs of contracting with data providers to provide information pertaining to underlying investments. All of this would appear to place additional cost pressure on funds.

Are ESG funds actually lower cost?

Perhaps surprisingly given the foregoing, a report from ESMA published earlier in 2022 found that ESG focussed funds had lower costs compared to non-ESG peers. A number of potential drivers behind this relative cheapness were identified but even after controlling for these differences, ESG funds remained statistically cheaper (and better performing) than non-ESG peers. It remains to be seen if these results will continue to be evident once the additional costs of the Level II SFDR measures begin to be incurred but this would appear unlikely. In addition, given the popularity and apparent market demand for ESG fund, such products would appear to be likely to be marketed as meriting premium management fees.

Ensuring Full Compliance

Ensuring compliance with the potentially conflicting obligations applicable to funds under both the ESG related regulatory provisions and those regarding costs will require the drafting, adoption and ongoing implementation of appropriate policies and procedures. If undertaken appropriately this will ensure that these potentially conflicting obligations are both consistently and compatibly addressed.

How Clerkin Lynch can help

The asset management team of Clerkin Lynch assists clients to ensure compliance with both the ESG related requirements as well as the cost related provisions cited above. This is achieved both through advising on the updating of documentation to reflect related requirements, including the drafting of appropriate relevant policies and procedures, as well as by operating a transparent and reasonable pricing policy for clients.

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