

New ESMA Opinion on Undue Costs for Funds

The European Securities and Markets Authority ("ESMA"), the lead regulatory authority for financial services in the European Union (the "EU"), released a new opinion on 17th May 2023 on undue costs for UCITS and AIFs, (ESMA34-45-1747) (the "Opinion"). This sets out suggestions for possible clarifications to the notion of "undue costs" to be included in the underlying UCITS legislation and under the AIFMD.

Background

ESMA launched a common supervisory action ("CSA") in 2021 to focus on the supervision of costs and fees of UCITS across the EU. This followed the identification of the significant impact of costs on the ultimate performance of retail products, in particular, and the inherent inhibition this posed to investment by such investors. The aim of the CSA was to assess compliance with the key cost-related provisions already included in the UCITS legislation as well as to investigate the extent to which these provisions were overseen and enforced by the national competent authorities ("NCAs") in the individual member states in practice. While primarily aimed at UCITS, similar concerns pertaining to AIFs were also highlighted.

The Opinion has been prepared in light of the responses by the NCAs to ESMA's related survey on the supervision of costs (the "Survey") and a summary of the responses to that survey are included as an annex to the Opinion.

Updates Proposed

Some of the key findings of the Survey were that the lack of specificity on what constituted "undue" costs and charges in the relevant EU legislation and the fact that related supervisory briefings were only issued by way of guidance meant that there were significant challenges to pursuing related enforcement actions or ensuring investor compensation.

In order to address these particular concerns, the Opinion recommends the

updating of the UCITS directive (specifically Articles 2(1) and 14) and the AIFMD (specifically Articles 4(1) and 12). The related updates would provide greater clarity on the notion of undue costs and charges, including by requiring level 2 technical standards be drawn up specifying "due" and "undue" charges in different scenarios. This would also provide a solid basis for related enforcement actions. The proposals build on other relevant considerations, such as the list of costs included under PRIIPS. This would not only bring clarity but also address disclosure.

Next Steps

The Opinion has been addressed to the European Commission in order to encourage it to consider whether legislative updates are warranted. Accordingly, prior to the adoption of any such revised legislative provisions the terms of the Opinion are not legally binding on regulated firms. However, boards of directors of regulated EU funds, fund promoters and investment managers, as well as management companies and AIFMs (who constitute the "Responsible Persons" for the purposes of the existing related legislative provisions) would be well advised to note the potential for the provisions outlined to become mandatory and to consider pre-emptively interpreting the rules pertaining to costs in light of the clarifications proposed in the Opinion, both as a defensive safeguard and to show compliance with best practice. It can be noted that the Central Bank of Ireland has already recently written to UCITS in Ireland in relation to undue costs, with action required by quarter 3 of 2023. It would be advisable for the Opinion to be taken on board when complying.



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