

ESMA ISSUES OPINION ON UNDUE COSTS OF UCITS AND AIFS

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Asset Management and Investment Funds Alert

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On 17 May 2023, the European Securities and Markets Authority (ESMA) issued its [*Opinion on undue costs of UCITS and AIFs*](#) (the Opinion).

BACKGROUND TO THE OPINION

The Opinion follows ESMA's Common Supervisory Action (CSA) with National Competent Authorities (NCAs) that was launched in January 2021. The aim of the CSA was to assess compliance with the cost-related provisions of the UCITS framework and the requirement that investors not be charged undue costs.

ESMA found that the outcome of its CSA showed divergent market practices as to what were “undue” costs and that further legislative specification on the concept would provide for better convergence and a better basis for NCAs to take supervisory and enforcement actions. The Opinion therefore makes suggestions to the European Commission (the Commission) for clarifications under the UCITS Directive and the AIFMD.

ESMA'S PROPOSALS

Clarification of the Notion of Undue Costs in the UCITS Directive and AIFMD

In its Opinion, ESMA considers that a further specification of the notion of undue costs in both the UCITS and AIFMD frameworks would provide NCAs with a clearer legal basis to take supervisory and enforcement actions where needed.

Furthermore, ESMA expresses the view that the Commission should clarify the eligibility of costs in light of the broad “List of costs” (the PRIIPs List) set out in Commission Delegated Regulation (EU) 2017/653 (the PRIIPs Regulation). This, ESMA believes, would provide clarity on the topic but also ensure that all costs charged to funds and investors are properly disclosed. ESMA also suggests that it be empowered to develop draft regulatory technical standards to specify the circumstances where the costs included in the PRIIPs List should be considered eligible, taking into account funds' investment policies and to specify the conditions NCAs may authorise on a case-by-case basis additional cost categories not included in the PRIIPs List.

The assessment of costs eligibility (Eligibility Test) should, according to ESMA, also take account of the relevant fund type as some costs borne by some kinds of AIFs and their investors are not borne by UCITS and their investors. To ensure the Eligibility Test is therefore meaningful, ESMA considers it important for fund managers to assess the appropriateness of costs on a case-by-case basis, taking account of the fund type and its investment policy.

The proposed legislative amendments to Article 14 of the UCITS Directive and Article 12 of the AIFMD are set out in full in the Opinion.

Development of a Pricing Process and a Framework for Redress and Sanctions

The Opinion states that the assessment regarding undue costs should also cover *quantum* to cover situations where the cost itself meets the Eligibility Test by its nature but the rate of the charge is too high. While acknowledging that the NCAs are not price regulators, ESMA considers it important that transactions take place at prices or at conditions equal to or better than market standards.

In this regard, ESMA considers that it would be positive for the Commission to make legislative proposals to clarify what should be taken into account for the purpose of making this assessment. The Opinion goes on to state that specific attention should be given to the compliance function of the fund manager to ensure internal controls and appropriate reporting to NCAs and investors of detected shortcomings and the actions to address them.

ESMA also believes that such legislative proposal should ensure that managers reimburse or indemnify investors without undue delay where undue costs have been charged including where such costs have been incorrectly calculated to investors' detriment.

Finally, the Opinion expresses the view that NCAs should be empowered to impose sanctions of a minimum given percentage which should be proportionate to unduly charged fees where a manager has intentionally or negligently committed an infringement.

The Opinion proposes draft updates to the UCITS Directive and AIFMD introducing obligations for managers to develop a pricing process in line with the above.

NEXT STEPS

The Commission is working on policy proposals as part of the Retail Investment Strategy (the RIS), which aims to empower retail investors, enhance confidence and trust and increase their participation in the capital markets. ESMA expects the Opinion to be taken into consideration in the Commission's upcoming RIS proposals.

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