

Regulatory Focus on Undue Costs in UCITS and AIFs

What You Need To Know

Fund management companies ("FMCs") must ensure that undue costs are not being charged to investors in funds that they manage – this is expressly prescribed in (i) the UCITS Regulations; and (ii) AIFMD Level 2.

Ensuring that investors are not being charged undue costs has been an area of regulatory focus for some time for both the Central Bank of Ireland ("Central Bank") and the European Securities Markets Authority ("ESMA").

Key Regulatory Developments

In July 2019, the Central Bank issued a letter to industry on its thematic review of closet indexing by UCITS highlighting the need for FMCs to review the fee structure and charges on all share classes of their funds on an annual basis. See our previous client update *Central Bank Closet-Tracker Review: Focus on Transparency and Governance*¹.

In June 2020 ESMA issued a supervisory briefing requiring FMCs to produce a detailed 10-point "Pricing Process Report" for each AIF or UCITS they managed:

- a) to identify, quantify and assess all costs charged to the relevant fund; and
- b) to consider options (such as investor compensation) if undue costs were identified.

See our previous client update *Introducing the Pricing Process: New ESMA Guidance on Fund Costs Reporting*².

In March 2023, the Central Bank issued a Dear CEO letter following an EU wide review of costs and fees in UCITS. This set out findings and required actions for FMCs, including conducting a gap analysis of their existing policies and procedures for the design, oversight and regular review of the costs and fees structures. See our previous client update, *Central Bank of Ireland Findings Following EU Review of Costs and Fees in UCITS*³.

Proposed Changes

Current proposals to update the UCITS and AIFMD frameworks aim to clarify and enhance FMCs' obligations on ensuring that investors are not being charged undue costs.

On 17 May 2023, ESMA published an Opinion on undue costs of UCITS and AIFs ("Opinion"). It suggests amendments to AIFMD and the UCITS Directive:

- a) to require FMCs to act to prevent undue costs being charged to a fund and its investors;
- b) to develop a pricing process; and
- c) to reimburse or indemnify investors without undue delay, where undue costs have been charged.

On 24 May 2023, the European Commission published its Retail Investment Strategy which

¹ <https://maples.com/en/knowledge-centre/2019/7/central-bank-closet-tracker-review-focus-on-transparency-and-governance>

² <https://maples.com/en/knowledge-centre/2020/6/introducing-the-pricing-process-new-esma-guidance-on-fund-costs-reporting>

³ <https://maples.com/en/knowledge-centre/2023/3/central-bank-findings-following-eu-review-of-costs-and-fees-in-ucits>

proposes an Omnibus Directive to amend a number of existing legislative frameworks, including AIFMD and the UCITS Directive. The Omnibus Directive builds on the Opinion's proposals with similar amendments being put forward including obligations on FMCs:

- a) to maintain and operate an effective pricing process;
- b) to conduct an annual review to determine if undue costs have been charged; and
- c) to reimburse the fund or investors for undue costs where they are identified.

Next Steps

As detailed in our previous client update, Central Bank of Ireland Findings Following EU Review of Costs and Fees in UCITS³, one of the Central Bank's expectations was for FMCs to have structured, formalised pricing policies and procedures in place which would include procedures for the design of cost and fees structures (as well as ongoing review).

FMCs were required to conduct a gap analysis of the findings / expectations from the Central Bank's Dear CEO letter and, where appropriate, put a plan in place by 30 September 2023 to address any gaps identified.

We have extensive experience in advising FMCs on undue costs matters, including the application of the relevant regulations and principles and the design and review of policies and procedures.

We can also assist FMCs in preparing for and responding to Central Bank supervisory engagement and inspections.

Further Information

For further information, please liaise with your usual Maples Group contact or any of the persons listed below.

Financial Services Regulatory

Dublin

Stephen Carty

+353 1 619 2023

stephen.carty@maples.com

Lorna Smith

+353 1 6192125

lorna.smith@maples.com

Philip Keegan

+353 1 619 2122

philip.keegan@maples.com

Alison Gibney

+353 1 619 2158

alison.gibney@maples.com

Funds & Investment Management

Dublin

Adam Donoghue

+353 1 619 2041

adam.donoghue@maples.com

Eimear O'Dwyer

+353 1 619 2065

eimear.odwyer@maples.com

Caitriona Carty

+353 1 619 2157

caitriona.carty@maples.com

Ian Conlon

+353 1 619 2714

ian.conlon@maples.com

Ronan Cremin

+353 1 619 2756

ronan.cremin@maples.com

John Gallagher

+353 1 619 2073

john.gallagher@maples.com

Frances Hamilton

+353 1 619 2069

frances.hamilton@maples.com

Deirdre McIlvenna

+353 1 619 2064

deirdre.mcilvenna@maples.com

Aaron Mulcahy

+353 1 619 2104

aaron.mulcahy@maples.com

Niamh O'Shea

+353 1 619 2722

niamh.oshea@maples.com

Peter Stapleton

+353 1 619 2024

peter.stapleton@maples.com

Emma Conaty

+353 1 619 2708

emma.conaty@maples.com

London

Fearghal De Feu

+44 207 466 1714

fearghal.defeu@maples.com

Cayman Islands

Pádraig Brosnan

+1 345 814 5441

padraig.brosnan@maples.com

James Meehan

+1 345 814 5311

james.meehan@maples.com

The Maples Group's Irish legal services team is independently ranked first among legal service providers in Ireland in terms of total number of funds advised (based on the most recent Monterey Insight Ireland Fund Report, as at 30 June 2022).

February 2024

© MAPLES GROUP

This update is intended to provide only general information for the clients and professional contacts of the Maples Group. It does not purport to be comprehensive or to render legal advice. Published by Maples and Calder (Ireland) LLP.