

Undue costs

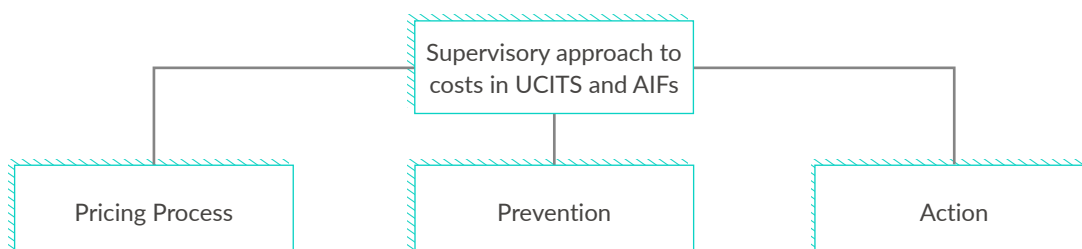
Pricing process for UCITS and AIFs

A documented pricing process with prescribed content will need to be put in place for UCITS and AIFs, if the ESMA briefing of 4 June 2020 targeted at national regulators on the supervision of costs in UCITS and AIFs is implemented.

ESMA has proposed a series of measures to harmonise the approach of national regulators to the supervision of costs in UCITS and AIFs. The proposal is aimed at preventing undue costs being charged to investors in UCITS and AIFs which is enshrined in the UCITS and AIFM legislation.

The notion of undue costs should be assessed against what should be considered the best interest of the fund or its investors. Costs should be consistent with and not prevent the achievement of the investment objective. The pricing process should enable clear identification and quantification of costs.

We expect that the Central Bank of Ireland (CBI) will implement and apply these measures to UCITS managers, UCITS, AIFMs and AIFs authorised by the CBI.



Pricing Process

A structured pricing process will need to be developed in respect of UCITS and AIFs. It should be documented and periodically reviewed.

The pricing process should:

- » consistent with the characteristics of the fund, such as the level of complexity of the fund
 - » sustainable, taking into account the expected net return of the fund, its risk profile and investment strategy
 - ensure equal treatment of investors and that costs do not materially prejudice the interest of any class of investor or potential investor. This applies except for AIFs not distributed to retail investors that disclose preferential treatment in fund document as permitted under relevant legislation
 - ensure no duplication of costs, particularly for an externally managed fund where costs are charged to the fund and to the management company
 - address whether there is a cap on fees and how it is disclosed to investors
- address whether the costs are
 - » linked to a service provided in the investor's best interest including whether they are
 - » necessary for the fund to operate in line with its investment objective
 - » strictly functional in the course of the ordinary activity of the fund or to fulfil regulatory requirements
 - » proportionate compared to market standards and the type of service provided, by comparison with costs of similar funds

- ensure any performance fees charged and disclosed comply with ESMA guidelines on performance fees
- ensure disclosure to investors of all costs in line with applicable EU and national requirements
- address whether the pricing process and all charged costs are based on reliable and documented data

The pricing process should clearly set out responsibilities of relevant persons in the UCITS manager, UCITS or AIFM in determining and reviewing the costs charged to investors. If there are conflicts of interest, the pricing process should ensure that the risk of damage to investors' interests will be prevented.

Supervisory prevention of undue costs

ESMA outlines how national regulators' can incorporate the review of pricing processes in their supervisory activity to ensure that undue costs are not charged to investors. Supervisory reviews should be on a case by case basis during one or more of the following:

- a fund's authorisation stage
- off-site supervision
- on-site inspections
- approval of material changes to the fund
- thematic reviews
- assessment of investors' complaints

While undertaking their supervisory activity, national regulators should cover business conduct, strategic risk and reputational risk and should ensure:

- clear, comprehensive, accurate and understandable disclosure to investors of the existence, nature and amount of the fund's costs and fees
- costs charged are consistent with fund documents and consistent across fund documents, including marketing material.

Supervisory action if undue costs are identified

If a national regulator, during the course of its supervisory action, concludes that undue costs have been charged to investors, ESMA sets out actions that may be taken by the national regulator. These actions may include:

- investor compensation
- reduction of fees
- review of disclosure documents
- communication of good and poor practices to markets, stakeholders or the press

Conclusion

We will monitor the response of the CBI following the issue of ESMA's supervisory briefing of 4 June 2020, and any indications of how the CBI intends to react. While ESMA's briefing is not subject to any 'comply or explain' mechanism for national competent authorities and is non-binding, we anticipate that UCITS managers, UCITS and AIFMs authorised by the CBI will be expected to comply with the guidelines set out in the briefing.

This would mean that a written pricing process will need to be put in place in respect of each UCITS and AIF managed.

The A&L Goodbody Asset Management & Investment Funds team can assist you with advice about the potential implications of ESMA's supervisory briefing for your Irish authorised firm or fund product, and in due course, putting in place a pricing process for Irish UCITS and AIFs as may be required by the CBI.

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