

Fitz Partners Q2 Newsletter

Insights on Fund Governance



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Introduction

Fund governance and fund regulations in Europe and in the UK have become a focus in all our clients' meetings this year, and I thought I could share with you some developments, news and insights based on Fitz Partners' proprietary data which may be relevant to you too.

We have picked the main current areas of discussion across the European fund industry linked to fund governance:

- **ESMA Common Supervisory Action and review of fund costs**
- **Impacts of UK Assessment of Value, 3 years on**
- **European fund board structures and independent directors fees**

ESMA - Common Supervisory Action and review of fund costs

As we are working with a growing number of fund managers across Europe to formalise their current fee review processes to comply with ESMA's recent guidelines, it is obviously with great interest that we read ESMA's latest conclusion of their 2021 Common Supervisory Action (CSA) Survey on fund costs and fees, published a few weeks ago. The survey was carried out by the National Competent Authorities (NCAs, local regulators) and in its [Final CSA Report](#), ESMA re-established their focus on **improving governance practices and enforcing cost compliance**.

The report overall focused on reviewing areas such as:

- **Setting and Reviewing Fees** – ESMA highlighted the need for independent analysis of fee structures to avoid “[over-relying] on the assessment made by the delegate portfolio manager.” (Final CSA Report, 31st May 2022, ESMA, p.8).
- **Undue Costs** – ESMA acknowledged the subjectivity around defining ‘undue costs’ and that managers may evaluate potential undue costs annually by considering peer group comparisons to define what an ‘undue cost’ means for any specific fund. “[Fund] performance should be assessed on an at least annual basis and the review of costs and fees should be therefore performed at least in the same frequency, in order to minimise the risk of undue costs being charged.” (Final CSA Report, 31st May 2022, ESMA, p.8).
- **Related-Party Transactions** – While ESMA has noted that conflicts of interest may arise from related-party transactions, the majority of NCAs reported zero cases of related-party transactions resulting in higher costs for funds. “only three NCAs observed a proportion between 0-10% of the funds in the CSA [...] where intragroup/related-party transactions resulted in higher costs/costs higher than average. In one jurisdiction this percentage was higher than 20%.” (Final CSA Report, 31st May 2022, ESMA, p.10-11).
- **Quantitative Findings** – NCAs reported that fund managers profiting from economies of scale are more likely to set lower prices for investors. ESMA notes that their findings support the ESMA 2022 ASR, which observed that “the top-25% funds, in terms of size, were around

20% cheaper than the bottom-25% funds across the asset classes considered". (ESMA Annual Statistical Report, 5th April 2022, ESMA, p.10).

ESMA concluded their CSA Survey positively, with several NCAs reporting a decrease in costs to investors as a result of the initiative. We welcome their conclusions, as Fitz Partners participate directly or indirectly to a large number of these reviews through the delivery of our Fund Charges data or the Benchmarking and Reporting works carried out for our cross-border clients.

Impacts of the UK Assessment of Value, 3 years on.

The UK Assessment of Value (AoV) is already three years old, and we thought it would be a good time to highlight some of its impacts on the UK funds since 2019, especially as many are discussing the possibility of **extending such a process to European cross-border funds**. In order to measure its impact, Fitz Partners analysed the changes in UK share classes fee structures, level of fees or liquidations among UK funds which were present in 2019.

Fund fees reductions:

- **23.07%** of existing legacy retail classes have reduced their management fee since 2019.
- **19.38%** of existing clean classes have reduced their management fee since 2019.

Fund fees increases / fixed fee structures:

- **9.78%** of retail classes and **9.38%** of clean classes have increased their management fee since 2019. Most of them apply a fixed fee model.

Fund liquidations:

- **12.59%** of (UK domiciled) fund products existing in 2019 have been liquidated in the last three years.
- **17.89%** of the UK 'legacy retail' classes existing in 2019 have been liquidated in the last three years.

European fund board structures and independent directors fees

Last but not least, Fitz Partners delved into the increasingly important governance topic of fund board structures and independent directors fees. The presence of independent non-executive directors on fund boards has become a powerful way to promote fiduciary responsibility and stronger fund governance.

In our latest Report we analysed 370 fund ranges across Luxembourg and Dublin managing over €3.4 trillion and found that the number of independent directors per board would differ depending on the fund domicile. In Ireland for example, **66%** of fund boards have between 2 to 3 independent directors on average, whereas in Luxembourg, a comparable proportion of **60%** have only 1 to 2 independent directors.

Although in Luxembourg fund boards are not required to have independent directors, at least one sits on two-thirds of all fund boards. Whilst a **minimum of 3 independent directors**, to "establish more accountability", is recommended by the IFIA's Corporate Governance Code, just **over 50%** of fund boards in Ireland have 3 or more independent directors. A smaller proportion, around **40%** of the Luxembourg boards have also at least 3 independent directors.

Asset managers may consider other variables than domicile when considering board structures and directors remunerations, such as the number of fund products and level of assets covered by each board. **Independent directors covering umbrellas with over 100 products are paid roughly twice the average fee when compared to umbrellas with under 20 products.** Our research shows that there is a natural correlation between independent directors fees and the number of funds or size of assets to be covered by each director – a reflection of independent directors workload and responsibilities.

In Summary

We expect to see an increased focus on fund governance by regulators in Europe as discussions around investor protections and fiduciary responsibility grows even further in our industry. Fitz Partners is dedicated to supporting asset managers in meeting their regulatory requirements and further developing their fiduciary duties. We are supporting our clients through the delivery of best-in-class fund fees and expenses data as well as the provision of benchmarking solutions and board reporting in line with current FCA or ESMA guidelines.

I hope you found our brief review of fund governance topics helpful, please do not hesitate to contact us if you have any questions regarding the topics above or if you wish to discuss any developments in the European fund industry in general.