May 2022

CONTRÔLES SPOT

Summary document regarding the implementation in France of the ESMA-coordinated supervisory exercise on the costs and fees of UCITS marketed to retail clients

AUTORITÉ DES MARCHÉS FINANCIERS

AMF

INTRODUCTION

As announced by the Autorité des Marchés Financiers (AMF) when it presented its supervisory priorities for 2021, the AMF took part in the **joint supervisory exercise coordinated by ESMA on the costs and fees of UCITS marketed to retail clients** (referred to in this document as retail UCITS). Specifically, based on a methodology defined by ESMA, the AMF (i) carried out a review, on a representative sample of asset management companies (AMCs) and UCITS, of practices for defining, managing and controlling the costs and fees of retail UCITS; (ii) assessed the extent to which these practices comply with the regulatory requirements set out in the UCITS IV Directive and its implementing regulations, which were the basis for ESMA's supervisory briefing published on 4 June 2020; and (iii) identified good and poor practices in this area.

The exercise involved collecting data and information, with each national authority sending out a questionnaire to a representative sample of supervised market participants.

The scope of the work targeted **49 AMCs managing €766 billion** in French and foreign UCITS (at the end of 2020, the assets in French UCITS managed by these 49 AMCs accounted for 76.83% of the total assets under management in French UCITS). The selection method used complied with the representativeness thresholds set by ESMA and covered AMCs of different sizes. The AMF decided to expand this scope to include (i) a SPOT (*Supervision des Pratiques Opérationnelle et Thématique* – operational and thematic supervision of practices) inspection campaign involving five of the 49 AMCs and (ii) in-depth interviews with six other AMCs. The work focused on:

- statistics on the fee structure of French UCITS;
- "undue" costs and risky practices;
- the price setting and review process;
- costs paid to third parties and associated conflicts of interest;
- disclosure of fees in KIIDs[1], prospectuses and marketing materials;
- efficient portfolio management techniques;
- the first-level control system for costs and fees, incident and complaint management;
- the permanent and periodic control system for costs and fees.

This documents sets out the findings of the review, undertaken during the various phases of the supervision exercise, of the practices of French AMCs authorised to manage UCITS.

This document is **neither a position nor a recommendation**. The practices identified as either "good" or "poor" highlight approaches identified during the inspections and analysis carried out that may facilitate, or hinder, compliance with the regulations on setting, charging, reporting and controlling costs and fees.

[1] Key Investor Information Documents.

AUTORITÉ DES MARCHÉS FINANCIERS

1. CONTEXT, SCOPE AND ORGANISATION OF THE AMF'S WORK

1.1. CONTEXT

The work carried out was part of ESMA's Union Strategic Supervisory Priorities (USSP) for 2021 and a common supervisory action (CSA) conducted by all national competent authorities (NCAs). The scope of this exercise covered all costs and fees related to collective investment management and **was not limited to ongoing fees**.[2] Organisation of the exercise was defined by ESMA after discussions with the NCAs.

Work started based on an ESMA publication of 21 December 2020 ("2021 Common Supervisory Action (CSA) on the supervision of costs and fees"), which included the scope of the exercise, the topics to be covered, the rules for selecting the samples of companies to be analysed and a template for the questionnaire to be sent to supervised companies.

The objectives of the exercise, as defined by ESMA, were to determine the extent to which the costs incurred by UCITS or their investors are:

i. justified considering the funds' strategy, associated risks and their benchmark;
ii. in line with the information provided to investors ex ante and ex post;
iii. calculated **honestly and fairly** and in the interest of investors;
iv. are not undue (including any costs associated with EPM techniques).

The exercise spanned a year, including a data collection phase that required AMCs to complete a detailed qualitative and quantitative questionnaire.

The AMC defined a scope of **49 AMCs** that complied with the representativeness thresholds set by ESMA and covered AMCs of different sizes. The data collection scope was broad and included all the funds and share classes of the selected AMCs (2,044 funds or compartments of French or foreign UCITS, and 6,176 share classes). The questionnaires were sent to the 49 AMCs on 9 March 2021, and the responses were received in three successive waves on 31 March, 30 April and 31 May 2021.

Of the 49 selected AMCs, **five were subject to a SPOT inspection** carried out by the AMF's Inspections Directorate, and six other AMCs were interviewed by telephone by the AMF's Asset Management Directorate.

ESMA was responsible for coordinating the exercise, which was carried out by each competent authority in its own market.

2. SAMPLE SELECTED AND WORK CARRIED OUT

<u>Phase 1: Constructing the sample and preparing and sending of the questionnaire</u>

➢ <u>Selecting the sample of AMCs and funds</u>

The objective was to select a sample of AMCs that was representative of the market in terms of size and asset class and that complied with the thresholds set by ESMA.

The resulting selection meets the following metrics:

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[2] Ongoing fees include management fees, external administrative fees (such as fees related to the depositary, account keeper, delegation of administrative and account management, registration of the UCITS in other Member States), turnover commissions and, where applicable, fees incurred by the UCITS for investing in underlying funds above a holding percentage of 20% of the UCITS' net assets (AMF Position-Recommendation DOC 2011-05). This definition excludes performance fees. Fees relating to the implementation of efficient portfolio management (EPM) techniques were also included in ongoing costs; however, the AMF's work did not show any consensus among the firms analysed regarding categorising these as "ongoing costs".

- **49 AMCs** (20.08% of the total number of UCITS managers in France; ESMA threshold: 20%).
- 2,044 funds or compartments of French or foreign UCITS[3] with assets under management of **€766 billion** (at the end of 2020, the assets of French UCITS managed by the 49 AMCs in the sample accounted for 76.83% of the total assets under management in French UCITS; ESMA threshold: 30%).
- **14 AMCs** (or 29% of the sample) using **EPM techniques** (ESMA threshold: 25%).

The types of investment management represented in this sample are shown in the table below.

Type of management	% (number of funds)	% (assets)
Equities	43%	28.15%
Diversified	25%	10.47%
Bonds	24%	14.86%
Money market	4%	45.46%
Other	4%	1.05%

➢ Composition of the questionnaire

At the end of Q1 2021, each of the selected AMCs received a three-part questionnaire:

- The first part collected qualitative information on fee structures and the process and procedures for setting up and controlling fees.
- The second part ("master data") sought a four-year breakdown of the strategy, target clients and fee structure for each of the managed funds (at share class level).
- the third part ("ongoing charges") focused on the ongoing fee components.

Phase 2: Preparing for and carrying out the SPOT inspection

➢ Selecting the AMCs to be inspected

The sample of AMCs to be inspected was a subset of the sample of 49 companies that received the above-mentioned questionnaire. The five AMCs in the SPOT inspection sample have the following characteristics.

2020 Financial Year	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Type of management	Directional and quantitative allocations	Equities, rates, money markets, loans and inflation	Equities, rates, money markets, indices and mixed	Multi-management	Stock/bond-picking
Assets (€ billion)	**74.3**	**55.7**	**23.8**	**4.1**	**<1**
Of which % retail clients	59%	46%	30%	100%	90%
Of which % UCITS collective investment management	68%	46%	86%	90%	40%

All of these AMCs are part of a larger group. For AMCs 1, 3 and 4, one of the group's entities acts as depositary for some of the funds they manage.

Lastly, only two of them use efficient portfolio management (EPM) techniques: AMC 2 (for equity funds with more than €50 million in assets only) and AMC 4 (which used securities lending as a test from March 2019 to April 2021).

3 The AMF chose to request information on all share classes of all UCITS managed by the selected AMCs. However, feeder funds and funds of funds were excluded from the scope of the work. Similarly, funds managed under delegation by the 49 AMCs were excluded from the exercise, unlike those managed under delegation.

➢ Selecting the UCITS to be tested

For the purposes of the planned tests, the inspection task force selected a sample of four to seven retail UCITS for each of the AMCs inspected,[4] based mainly on the following criteria:

- An authorisation date prior to 1 January 2018 (to have a track record of at least three years in the period under review).
- A distribution level for retail clients of more than 90%.
- The use of turnover commissions and performance fees.

3. SUMMARY OF THE MAIN FINDINGS

With regard to the cost and fee structures implemented, the AMF noted the following. Firstly, these structures are not significantly uncorrelated with the level of risk of the funds tested (as measured by the SRRI).[5] Secondly, the largest item identified is fixed management fees. Thirdly, a comparison (carried out for the same fund in the SPOT inspection campaign) between the fee structure of retail share classes and the fee structure of share classes for institutional investors shows that the maximum management fee rate of retail share classes is 0.67% higher on average than that of institutional share classes.[6]

However, the exercise highlighted two relatively uncommon but critical practices:

- First, active funds whose portfolio composition is very close to that of their benchmark index, which may suggest a rather "passive" management style, and whose fees seem very high for this type of management.
- Second, funds with a very high level of turnover commissions.

In both cases, the level of fees severely hinders the ability to achieve the management objectives and the possibility of outperforming the benchmark.

The processes for setting up and reviewing cost and fee structures are similar for all the AMCs analysed and are generally put together by a bespoke committee. However, the lack of a dedicated internal procedure was noted for the five AMCs inspected in the SPOT campaign. Three of the five AMCs inspected also had no up-to-date accounting procedure (including account numbers and accounting schemes used to record costs and fees). Furthermore, the process for setting and reviewing prices for efficient portfolio management techniques would benefit from being more structured and formalised. Lastly, the majority (four out of five) of the AMCs inspected did not make any significant changes to the cost and fee structures of retail UCITS during the period under review (the introduction of performance fees at the same time as a reduction in management fees was noted for the fifth AMC).

The system for formalising UCITS management costs and fees in the funds' regulatory and marketing documentation is supported by an operational procedure. The latest version of the funds' regulatory documentation is made available to investors on the AMCs' websites.

The tests conducted in this area during the SPOT inspections did not identify any errors in updates to the ongoing fee rate ("OFR") in the KIIDs analysed. However, several discrepancies were identified in the fee structures and levels between the KIIDs/prospectuses and the periodic reports sent to clients for all the AMCs tested. Similar discrepancies were also noted on the websites of external industry databases. Finally, **the AMF noted a total lack of information in the prospectuses of the funds tested on the existence, nature, main types of beneficiaries and general calculation formula of the rebates (retrocession)**, especially as the work carried out did reveal any checks, by the AMCs in the SPOT panel, on the information provided by the distributors of their UCITS about the fees they receive.

[4] Four retail UCITS were selected for AMCs 1 and 3, six for AMCs 4 and 5 and seven for AMC 2.

[5] "Synthetic Risk and Reward Indicator", which rates the fund on a scale of 1 to 7 and is included in the KIID.

[6] The ongoing fees also go to service providers other than the AMC. In fact, only 54% of the ongoing fees (weighted by assets under management) are kept by the AMC. This percentage drops to 48% if only the "retail" share classes are taken into consideration (see section 5.1.2 below).

Costs paid to third parties are governed by special agreements and by a conflict of interest management system consisting of a dedicated procedure, mapping and register. The quality of the procedures for managing conflicts of interest varies and the areas of risk relating to costs and fees should be more rigorously documented. However, the risks of conflicts of interest associated with the services provided by the parent group (acting as depositary – custodian - or marketer), by external distributors and by delegated managers are adequately addressed by four of the five AMCs inspected (for the fifth, the complex and changing nature of the group's capital structure meant that it was not possible to identify the names of 13.5% of the intragroup distributors in all the agreements submitted).

The internal control system implemented has three control levels.

First-level control is carried out by the AMCs' middle office, which checks the cost and fee settings in the systems and regularly checks the calculations made). It is ineffective in three of the five AMCs inspected because of a low level of formalisation (for two of the three AMCs) and an inability to systematically identify instances where the maximum fee rate, at each NAV date, has been exceeded when fees are set (for one of the three AMCs in question). In addition, the controls aimed at ensuring compliance with the maximum defined in the prospectuses (especially for entry fees) need to be improved, as do those relating to displayed fees associated with EPM techniques.

The five AMCs have set up an incident management process for this first-level control. This process is supported by a dedicated procedure and a database for recording information related to each incident. However, it is still not operational for three of the five AMCs because the procedure does not specify the impact thresholds above which the NAV must be recalculated and the method for compensating investors, and because the database lacks sufficient detail (gains/losses at stake, date and remedial measures). However, the volume of incidents relating to management costs and fees that had an impact on the NAV of managed funds remains low (less than 10% of the total volume reported) for the five AMCs inspected during the SPOT campaign. Furthermore, no significant complaints were recorded regarding the calculation and/or charging of management costs and fees.

Second-level internal control (permanent control) relies on risk mapping and a structured compliance and internal control plan (PCCI). However, the due diligence performed on costs and fees was hampered by the continued lack of work on major items (turnover commissions, performance fees, and rebates) and by insufficient explanations of the scope, methodology, results and remediation of anomalies for four of the five AMCs tested. It should be noted that the control sheets examined do not point to any significant breaches of regulations.

Lastly, third-level internal control (periodic control) relies on the group's audit services, supplemented for one AMC by an external firm. However, periodic control relating to costs and fees was limited, since no audits were carried out in this area for three of the five AMCs since January 2018. The other two AMCs were audited in this area by their respective groups. The findings of these audits, which in both cases focused on the need to strengthen the control system for fees at the first and second levels, were formalised in formal remediation plans that the inspection task force reviewed.

4. APPLICABLE REGULATIONS

At the European level, UCITS costs and fees are governed by several pieces of legislation (UCITS, MiFID II and PRIIPs, in particular) that apply to AMCs and/or distributors. The CSA exercise focuses more specifically on the requirements resulting from the UCITS Directive.

To carry out its work, the AMF drew on:

- the French Monetary and Financial Code (MFC);
- the AMF General Regulation (AMF GR).

In addition, the AMF also referred to the annual statistical report on performance and costs of retail investment products in the European Union (EU)[7] and the guidelines on performance fees in UCITS and certain types of AIFs[8] published by ESMA on 10 January 2019 and 3 April 2020, respectively.

Reminder: The table below includes all the regulations that the AMF used in its work. However, the regulatory articles listed in the shaded boxes at the end of each section below correspond to the regulatory articles specifically used to describe the findings of the inspections conducted during the SPOT campaign.

ORGANISATION, PROCEDURES AND PROCESSES FOR SETTING UP AND IMPLEMENTING MANAGEMENT COSTS AND FEES:
Establishing policies and procedures Article 321-30 of the AMF GR on establishing and maintaining adequate policies, procedures and measures to detect any risk of non-compliance with professional obligations. Articles 321-26 and 321-29 of the AMF GR on establishing, maintaining and using accounting policies and procedures. Article 321-35 of the AMF GR on the responsibility of senior management and the supervisory body. **Classification of costs and fees** Articles 321-116 to 321-124 of the AMF GR on remuneration and benefits and the composition and calculation of costs, fees and rebates. AMF Position-Recommendation DOC-2011-05 (list of financial and administrative management fees that may be paid directly by the UCITS). AMF Position-Recommendation DOC-2012-12 (guide to fees). **Performance fees** ESMA guidelines on performance fees published on 5 November 2020 (in particular points 43 to 49).[9] AMF Position 2021-01 on performance fees in UCITS and certain types of AIFs. **Efficient portfolio management (EPM) techniques** Article R. 214-18 of the MFC on the definition of EPM techniques. AMF Position 2013-06 on EPM techniques (also addressed in Articles 25, 28 and 29 of the ESMA guidelines on ETFs and other UCITS issues) and in particular point 21 of Section 6: *"All the revenues arising from efficient portfolio management techniques, net of direct and indirect operational costs, [shall] be returned to the UCITS."*

[7] https://www.esma.europa.eu/document/esma-annual-statistical-report-performance-and-costs-retail-investment-products-in-eu
[8] https://www.esma.europa.eu/sites/default/files/library/esma_34-39-968_final_report_guidelines_on_performance_fees.pdf
[9] https://www.esma.europa.eu/sites/default/files/library/esma34-39-992_guidelines_on_performance_fees_fr.pdf

REGARDING COMPLIANCE WITH THE DUTY TO ACT IN THE BEST INTERESTS OF INVESTORS WHEN SETTING, CALCULATING AND CHARGING COSTS AND FEES:

Article L. 533-10 I (3°) of the MFC and Articles 321-46 to 321-52 of the AMF GR on managing conflicts of interest.

Article L. 214-9 of the MFC and Article 321-100 of the AMF GR on the obligation to act honestly, loyally and professionally, in the best interests of the UCITS and investors.

Article 321-101 (1°), (5°), (6°), (8°) of the AMF GR on the fair treatment of investors, on preventing undue costs being charged to UCITS and investors, on selecting and monitoring investments with great diligence and in the best interests of the UCITS and market integrity, and on implementing effective arrangements for ensuring that investment decisions on behalf of the UCITS are carried out in accordance with the objectives, investment strategy and risk limits of those UCITS.

Articles 411-129-1 and 411-130 of the AMF GR on how to deal with rebates on fees and commissions received for investments made on behalf of a UCITS.

REGARDING THE PROCEDURES FOR INFORMING INVESTORS OF THE COSTS AND FEES CHARGED:

Article L. 214-23 of the MFC on publishing the prospectus, the half-yearly report and the key investor information document.

Article L. 533-22-2-1 of the MFC on the obligation to act in an honest, fair and professional manner, in the best interests of investors and to provide investors only with information that is accurate, clear and non-misleading.

Articles 411-106 to 411-108 of the AMF GR and AMF Instruction DOC 2011-19[10] of 16 March 2021 on the preparation and content of the KIID.[11]

Article 411-114 of the AMF GR on the description in the prospectus of all the fees incurred by investors or by the UCITS.

Commission Regulation (EU) 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website (referred to as the “KIID Regulation”).

Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions (in particular sections A, on half-yearly and annual reports, and B, on the prospectus).

Content of funds’ annual reports:

[10] Relating to authorisation procedures, preparation of a KIID and a prospectus and periodic reporting for French and foreign UCITS marketed in France.

[11] Regulatory provisions taken in direct application of the European Regulation 583/2010 (KIID Regulation).

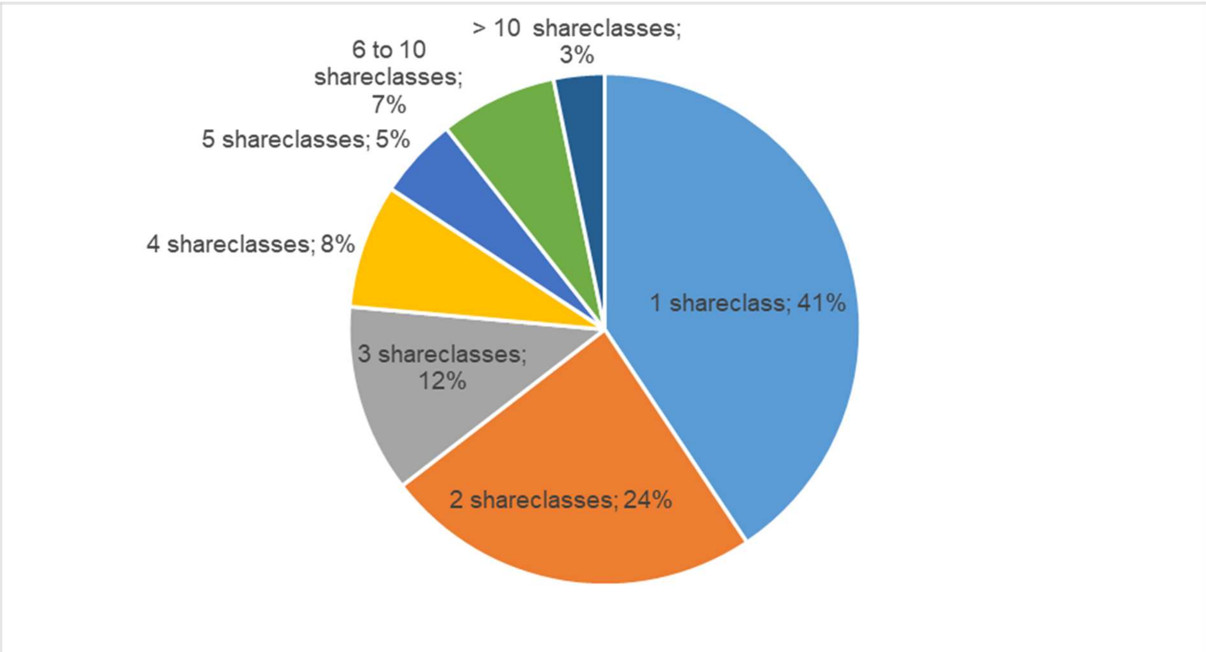
Article 411-121 of the AMF GR on the content of the annual report. **<u>Presentation of the benchmark in funds' regulatory documentation:</u>** ESMA's Q&A on the implementation of the UCITS Directive regarding the content of the KIID.
<u>REGARDING THE INTERNAL CONTROL SYSTEM</u>
Article 321-23 (IV) of the AMF GR on the requirement to maintain appropriate internal control mechanisms. Article 321-31 (I) (1°) of the AMF GR on establishing an effective and operational compliance function that operates independently and has the responsibility to monitor and regularly assess the adequacy and effectiveness of policies, procedures and measures implemented and actions taken to remedy deficiencies in the compliance of the AMC and relevant persons with their professional obligations. Article 321-27 of the AMF GR on the monitoring and regular assessment of the adequacy and effectiveness of internal control systems and mechanisms. Article 321-83 of the AMF GR on periodic control.

5. OBSERVATIONS AND ANALYSES

5.1. STATISTICS ON FEE STRUCTURE OF FRENCH UCITS

5.1.1. Fees for funds with multiple share classes

Of the 2,044 funds in the scope of the exercise, 60% have multiple share classes. The number of share classes per fund varies from 1 to 71, but 90% of the funds have between 1 and 5 share classes.



The existence of several types of share classes reflects:

- different fee levels depending on the type of client (direct or indirect distribution, minimum subscription amounts);
- different characteristics (hedged share classes, currency share classes);
- different distribution channels (e.g. one share class per distributor).

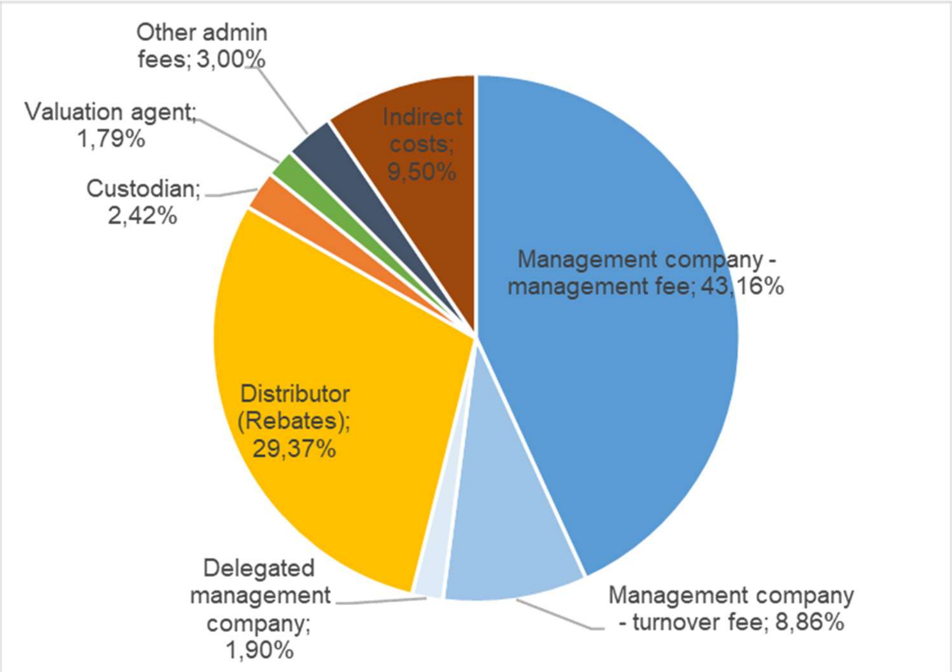
The pricing of these share classes is heavily dependent on the availability of rebates to distributors. Retail share classes (apart from clean shares[12]) generally have fees at least twice as high as equivalent institutional share classes. Moreover, the higher the minimum subscription amount for a share class, the lower the associated fixed management fee. This is particularly beneficial to large institutional investors, whose size means they obtain better pricing conditions.

The comparative analysis – during the SPOT campaign – of fee strategies between the retail and institutional share classes is in line with the above results. It revealed maximum management fee rates that were 0.67% higher on average for retail share classes, but maximum entry fees that were equivalent for most share classes in the sample.[13] Similarly, the performance fee rates are higher for retail share classes, with the notable exception of AMC 5, which initiated a rebalancing in 2020, as explained below.

5.1.2. Fee sharing

- Comparative presentation of the volumes observed

Ongoing fees also remunerate service providers other than the AMC.[14] Only 54% of ongoing fees (weighted by assets under management) are kept by the AMC. This percentage drops to 48% if only retail share classes are taken into account.



[12] "Clean shares" are UCITS share classes that do not include a commission rebate mechanism for the distributor.

[13] For three of the five AMCs (AMCs 3, 4 and 5; AMC 2 could not be included in the comparative analysis due to the large number of institutional share classes in the funds tested). However, for the only fund (tested) for AMC 1 that has both retail and institutional share classes, the maximum entry fee for the institutional share classes (5%) is much higher than for the retail share classes (2%).

[14] As mentioned above.

This analysis is broadly consistent with the findings of the SPOT campaign: the structure of the costs and fees of the five AMCs inspected is shown below[15] (on average over the three years inspected: 2018, 2019 and 2020).

Annual average over 3 years		AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Fees received (% of AMC revenue)						
Fixed management fees		93.2%	57.6%	63%	75.3%	56.8%
Turnover commissions		3.4%	6.3%	10%	17.6%	17%
Performance fees		0.8%	7.6%	1.6%	0.6%	4.2%
Securities lending fees		N/A	0.6%	N/A	Not specified	N/A
Costs paid by the AMC (% of overall costs)						
Rebates paid	to **intragroup distributors**	63.5%	44%	7%	84%	1.7%
	to **external distributors**	0.8%		27.3%	N/A	8.5%
Commission paid under **investment management delegation**		5.1%	N/A	5.4%	13.3%	N/A
Administrative fees[16]		4.2%	0.6%	4.1%	2%	12.7%

Performance fees apply to only a small portion of the assets of the retail UCITS of AMCs 1 (9%), 3 (4%) and 4 (7%). This is not the case for AMC 5, where they apply to 75.7% of assets of the UCITS.

Brokerage fees are detailed in a report that is available on the websites of the AMCs inspected. The report specifies whether or not these fees exceeded the €500,000 threshold. It also includes the basis for allocating brokerage fees between fees for investment decision support and order execution services (SADIE) (between 0% for AMC 1[17] and 63.6% for AMC 3) and equity execution fees (between 36.3% for AMC 3 and 100% for AMC 1).

➢ Less than half of the fees charged go to the AMC

Most of the funds managed by French AMCs (two-thirds of the sample) charge a flat management fee that goes to the AMC, and the AMC is responsible for paying the fees charged by the fund's various providers.[18] To make the data comparable, the AMF asked the relevant AMCs to provide details of the management fees paid by the AMC on behalf of the funds. The types of fees mentioned by the fund managers are as follows:

- To the AMC:[19]
    - management fees
- To other beneficiaries:
    - delegated management fees
    - management fee rebates to distributors
    - fixed[20] and variable[21] depositary fees
    - statutory auditor's fees
    - valuation agent fees and administrative management fees
    - indirect costs (related to the holding of fund shares).

[15] Entry fees are discussed in section 5.7.2 below. Exit fees are either zero (for AMCs 2, 4 and 5) or only apply to a marginal portion of retail UCITS for AMCs 1 and 3 (2% of assets for AMC 1 and 4% for AMC 3).

[16] These fees – included in the fixed management fee – cover remuneration for the services provided by fund administrators, depositaries, valuation agent and statutory auditors.

[17] AMC 1 fully covers SADIE fees.

[18] AMCs can implement two fee models and publish them in the UCITS prospectus: they either include a single category of management fees that includes both financial management fees and all external administrative fees, or they divide these fees into two blocks called "investment management fees" and "administrative fees external to the AMC". See AMF Position-Recommendation DOC-2011-05, section 3.9 "Management fees".

[19] In addition to fixed management and administrative fees, turnover commissions are also included in this category, according to the AMCs surveyed.

[20] Based on the fund's assets under management and subject to a minimum per fund.

[21] Related to portfolio transactions.

The above-mentioned fees account for more than 87% of total ongoing fees on average. This increases to 97% when the average is weighted by assets under management.

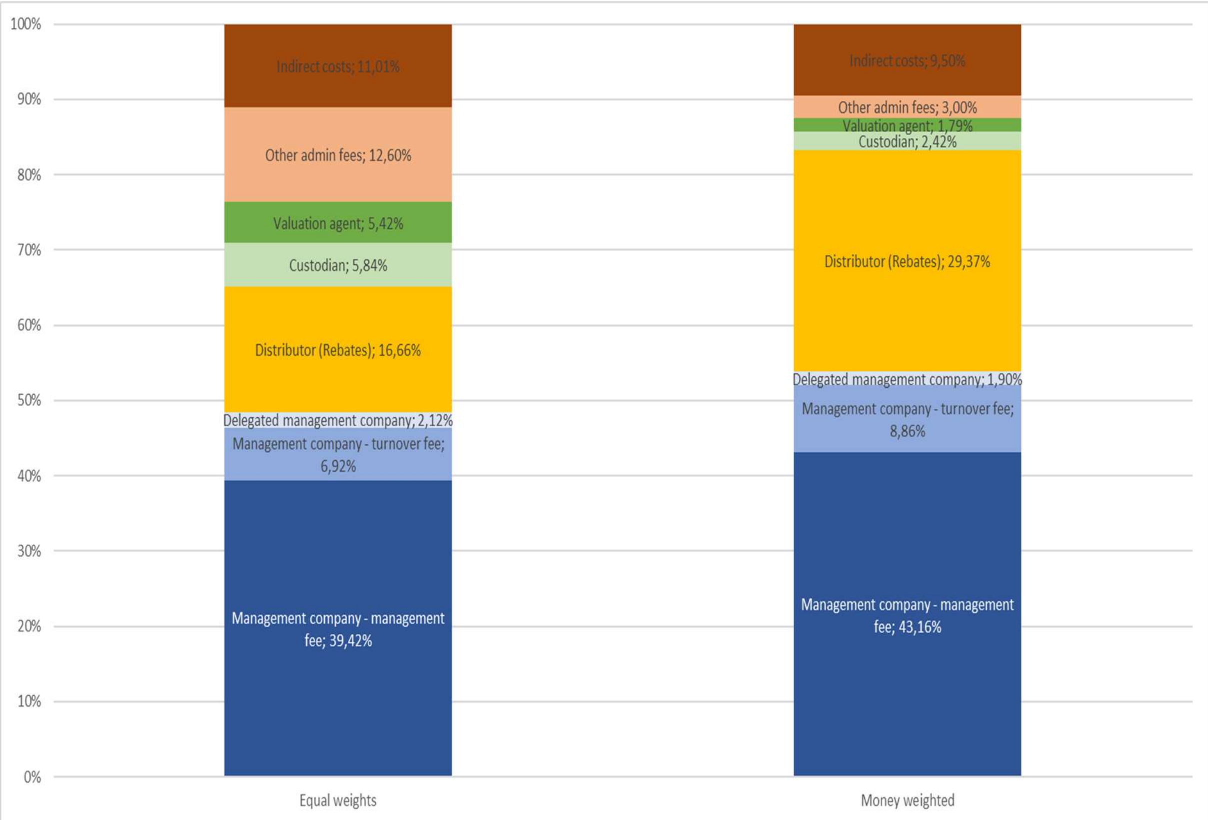
In addition to these fees, the AMCs in the sample (of 49 companies) that charge each type of fee directly to the **foreign** funds managed listed the following items (not covered by AMF Position-Recommendation 2011-05):

- fees for sector experts in relation to specific investments;
- other custodial tasks (tax claims, proxy voting);
- tax agent fees and mandatory tax advisory fees for certain countries;
- regulatory reporting costs;
- fund administrative governance costs;
- the cost of third-party service providers and in particular the databases required for the day-to-day management of the fund.[22]

It should be noted that reporting costs or costs related to access to financial databases cannot be passed on to French UCITS.

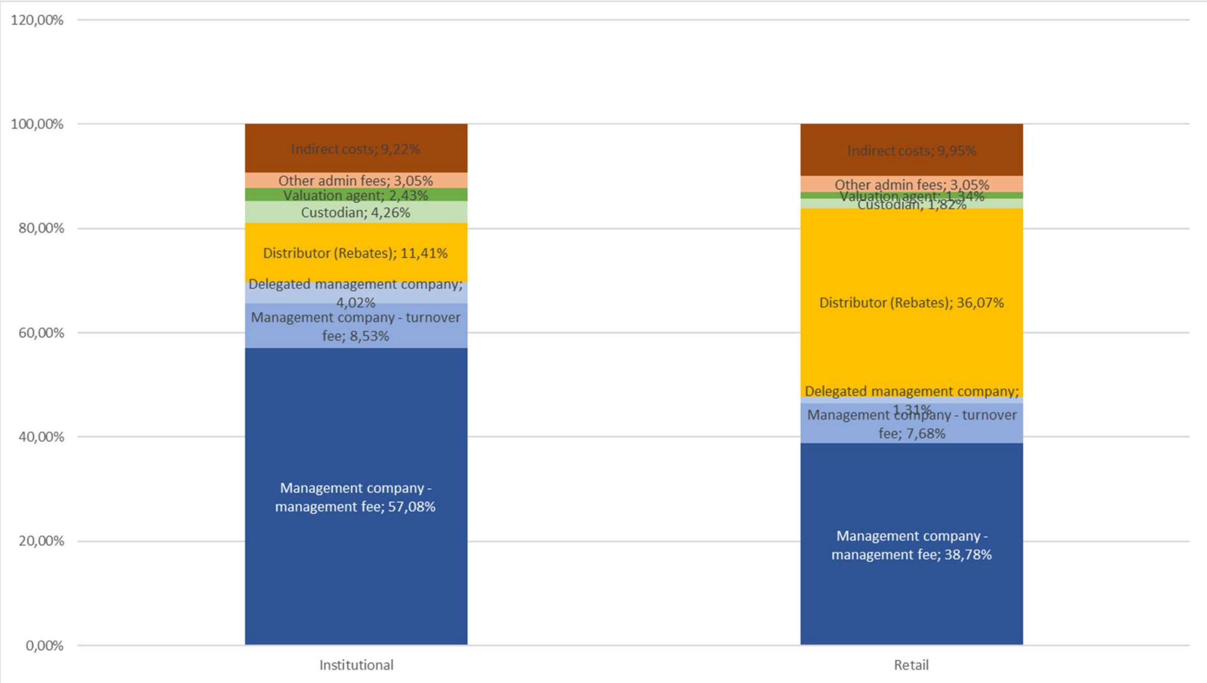
The first observation to emerge from the analyses is that, **on average, AMCs retain less than half of their total ongoing fees**.

The distribution of ongoing fees across the sample of funds, using an equally weighted average and an average weighted by assets under management, is as follows.



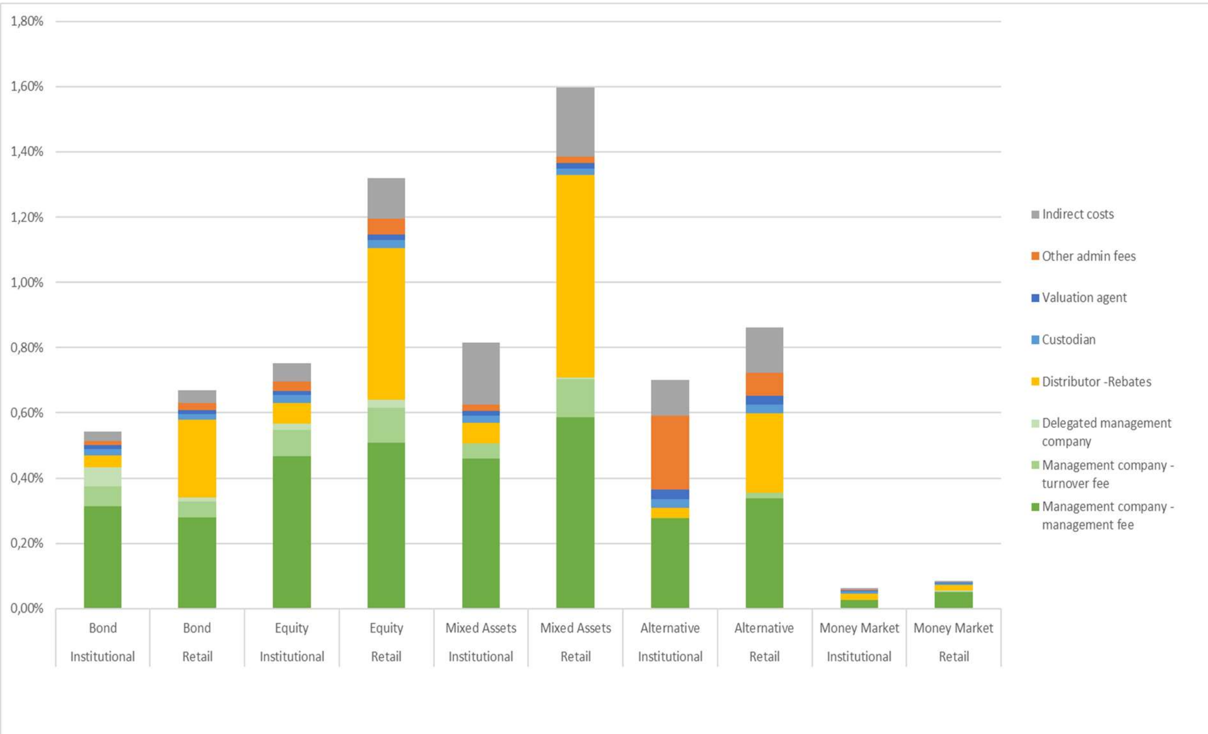
The following chart provides a breakdown by target client type (weighted by assets under management only).

[22] For example: Bloomberg, Reuters, Dow Jones News Services.



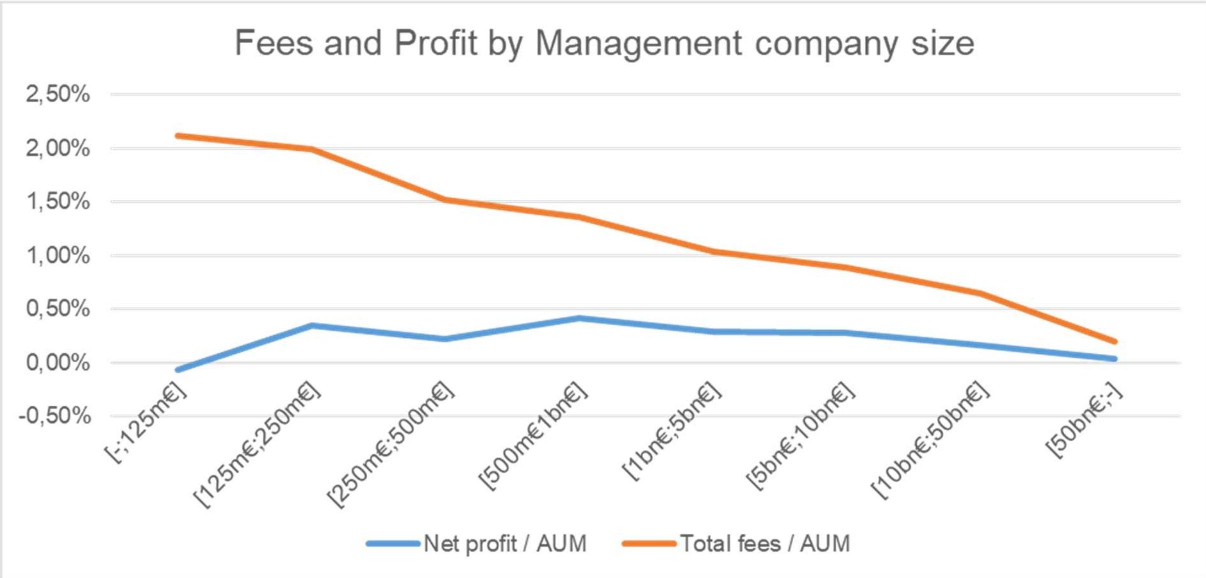
For retail share classes, distribution fees amount to more than one-third of total ongoing fees, while fees charged by the AMC (including the delegated management company) amount to barely 48% of the total.

Although the proportion of rebates varies from one asset class to another, it is still significant for retail share classes, as shown in the following graph, which shows the breakdown of ongoing fees by asset class (averages weighted by assets under management).



5.1.3. Fee level and size of AMCs

The less profitable AMCs tend to charge higher fees on average, as they have little scope for economies of scale.



5.1.4. Trends in changes to UCITS fees

AMCs have limited leeway to change the fees of the funds they manage because of competition and the costs they incur.

As a reminder, the ESMA Q&A[23] calls for disclosure of the fund's benchmark index in the KIID and for presentation of the fund's performance against its benchmark index. This requires AMCs to subscribe to the index provider's data. In addition, the SFDR[24] requires AMCs to publish ESG (environmental, social and governance) data, which means that they have to enter into agreements with non-financial data providers.

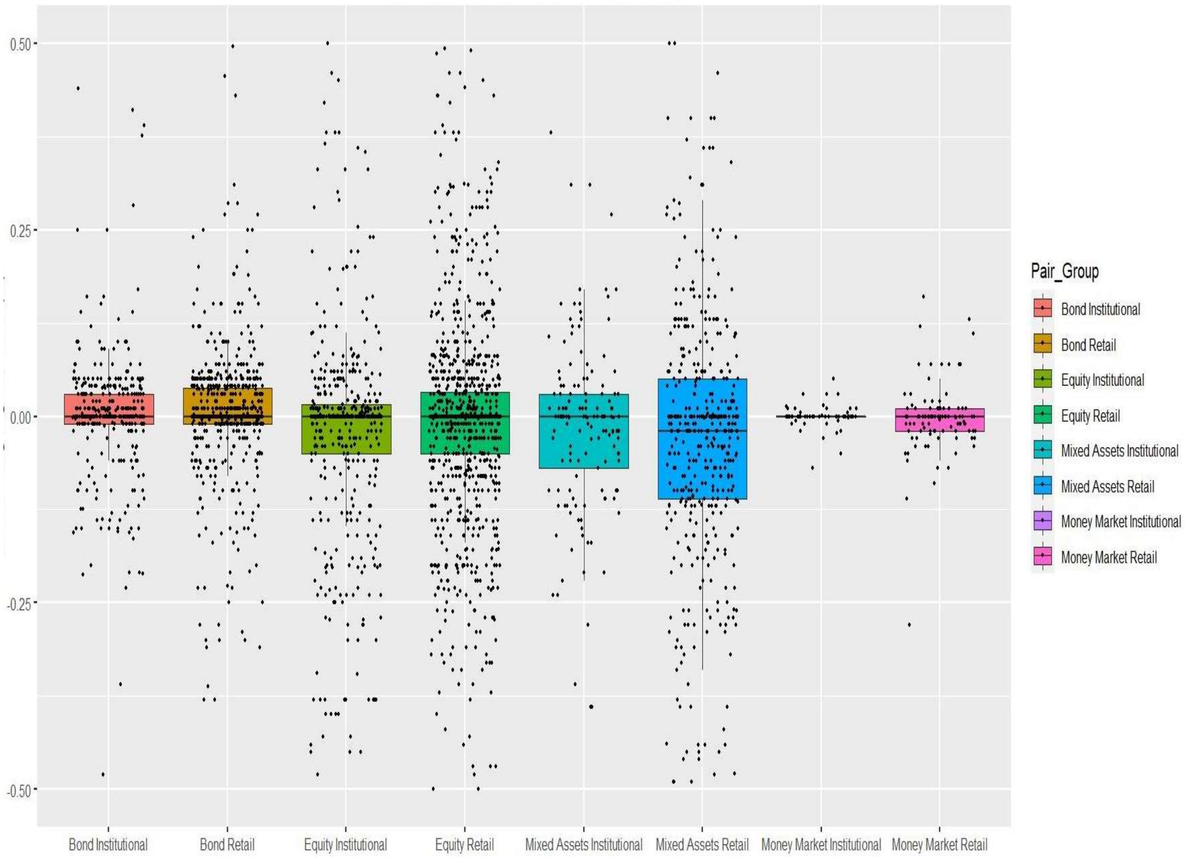
Furthermore, the growing use of distribution platforms, while allowing AMCs to expand their marketing reach, has resulted in new fees. Although these fees are presented as optional and linked to the additional services offered by the platform, smaller AMCs have indicated that they have been forced to subscribe to the additional services just to be added to the buy list.

The chart below shows that there has been no clear trend in changes to the ongoing fees over the last four years (2017 to 2020), with median values close to zero. The coloured rectangles frame half of the points of variation in ongoing fees over the four years. Their range varies from a few basis points to fewer than 20 basis points.

[23] Questions and Answers on the Application of the UCITS Directive (ESMA34-43-392).

[24] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (Sustainable Finance Disclosure Regulation – SFDR).

Ongoing charges variation on a 4 years-period (distributed by peers groups)



Lastly, the ability to audit how management costs and fees are calculated and charged is possible because the AMCs (or the valuation agent in the case of AMC 3) retain supporting documents for a period of 10 years.

Regulatory reminders

- **Point 1.1.2.5 of AMF Position-Recommendation 2011-05:** *"Ongoing fees […] include in particular: management fees, fees related to the depositary, fees related to the account keeper [where appropriate]; fees related to the investment adviser [where appropriate]; statutory auditor's fees; costs related to the delegated managers (financial, administrative and accounting) [where appropriate]; turnover commissions; fees related to the registration of the fund in other member states [where appropriate]; audit costs [where appropriate]; legal fees [where appropriate]; distribution fees; entrance and exit fees when the UCITS subscribes or redeems units or shares in another UCITS or investment fund."*

5.2. "UNDUE" COSTS AND RISKY PRACTICES

5.2.1. Definition of "undue costs"

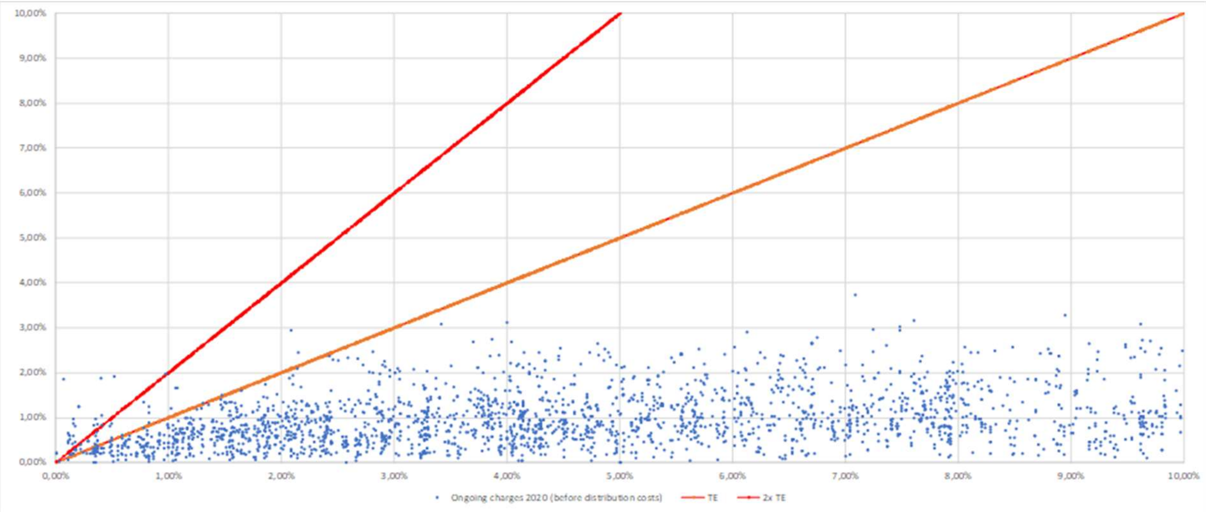
The AMCs surveyed consider that fees are "due" if they are mentioned in the fund documentation, cover the services needed to manage the fund or add value to the fund. Many of the AMCs surveyed consider marketing fees in particular to be "undue" because they are not directly related to managing the fund and benefit the AMC and not the unit holders. Some fund managers consider that fees at levels that are unsustainable for the fund may be a factor in determining undue costs.

5.2.2. Active funds close to their benchmark indices

It is debatable whether a fund's fee level would prevent it from outperforming its benchmark index regardless of the performance of the fund and the index. To assess this possibility, the share class "tracking error"[25] was compared to the level of ongoing fees in order to assess the extent to which the performance of some funds could deviate significantly from that of their benchmark index while incurring high fees.

The analysis was carried out over an annual period and across the entire sample of funds, but excluding money market funds and passively managed funds. In addition, the level of ongoing fees was considered net of distribution fees so as to focus on the fees related to financial and administrative management.

From the data analysed by the AMF, it appears that funds with ongoing fees exceeding twice the value of the tracking error have a very low chance of outperforming their benchmark index. The probability of this happening would be less than 2.3% per year (assuming a normal distribution). The low tracking error of these funds suggests a rather passive management style, even though the high ongoing fee level seems incompatible with this type of management. There are 25 share classes (14 funds) in this category.



The x-axis of the above graph is the tracking error calculated over 1 year, and the y-axis is the ongoing fee level. Each blue dot represents a share class, the orange line indicates where ongoing fees are equal to the tracking error and the red line indicates where ongoing fees are twice the tracking error. Therefore, the blue dots in the dotted orange triangle represent UCITS for which achieving the management objective is structurally impossible due to a high level of fees.

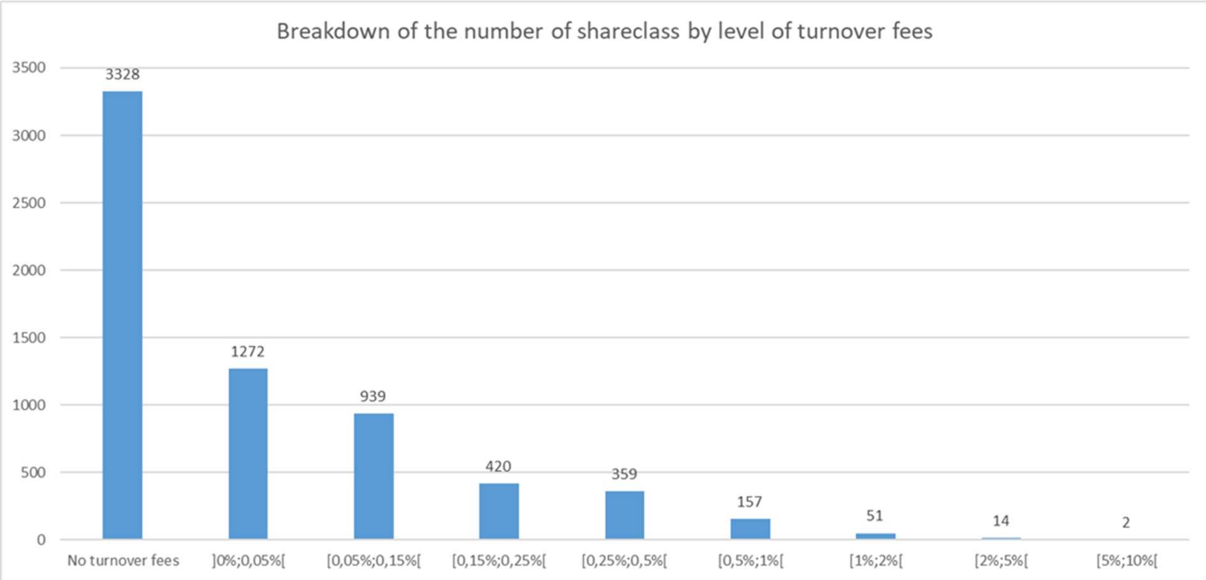
5.2.3. Turnover commissions associated with high turnover rates and related conflicts of interest

Turnover commissions are a risky practice that can give rise to conflicts of interest. The existence of this type of fees may cause a risk of increasing the number of fund purchase/sale transactions with no associated management strategy, but with the aim of generating turnover commissions that benefit the AMC.[26]

[25] The tracking error is the standard deviation of the difference between the performance of the UCITS and that of the benchmark index over a reference period (see AMF Position-Recommendation 2011-24 – "Guide to drafting collective investment marketing materials and distributing collective investments", paragraph 7).

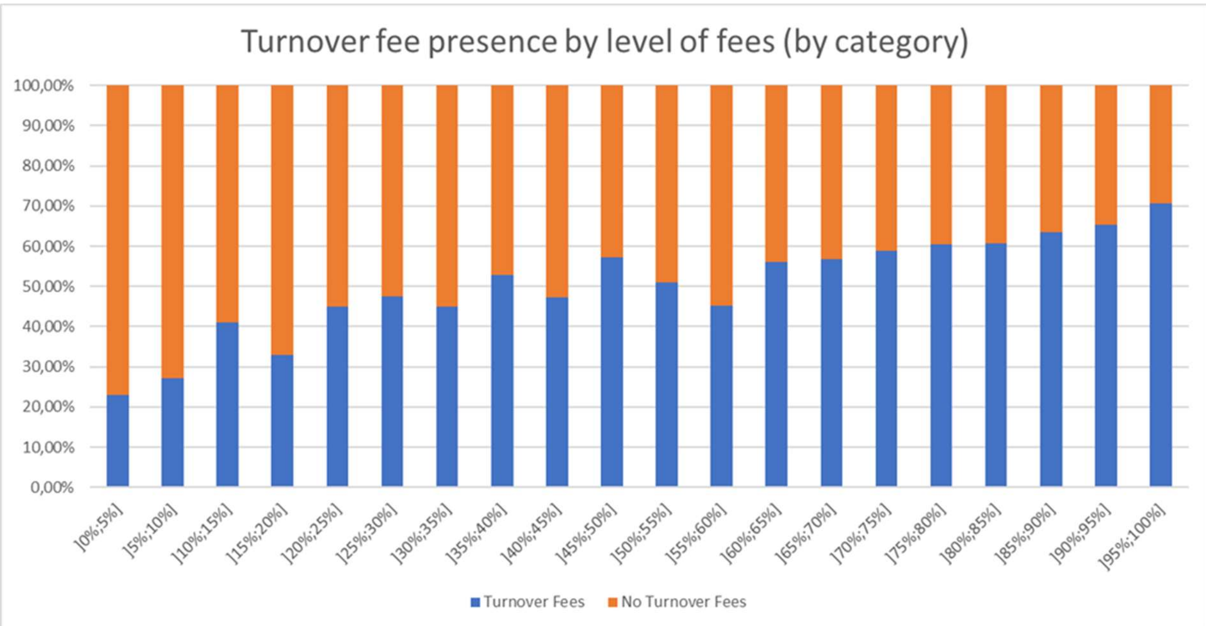
[26] As a reminder, turnover commissions are charged on each transaction. They are calculated based on the value of the securities and not the fund's net assets.

Half of the units taken into account in the financial year charge turnover commissions (paid to the depositary and/or the AMC). In more than 40% of these cases, the level of turnover commissions is very limited (less than 5 basis points).

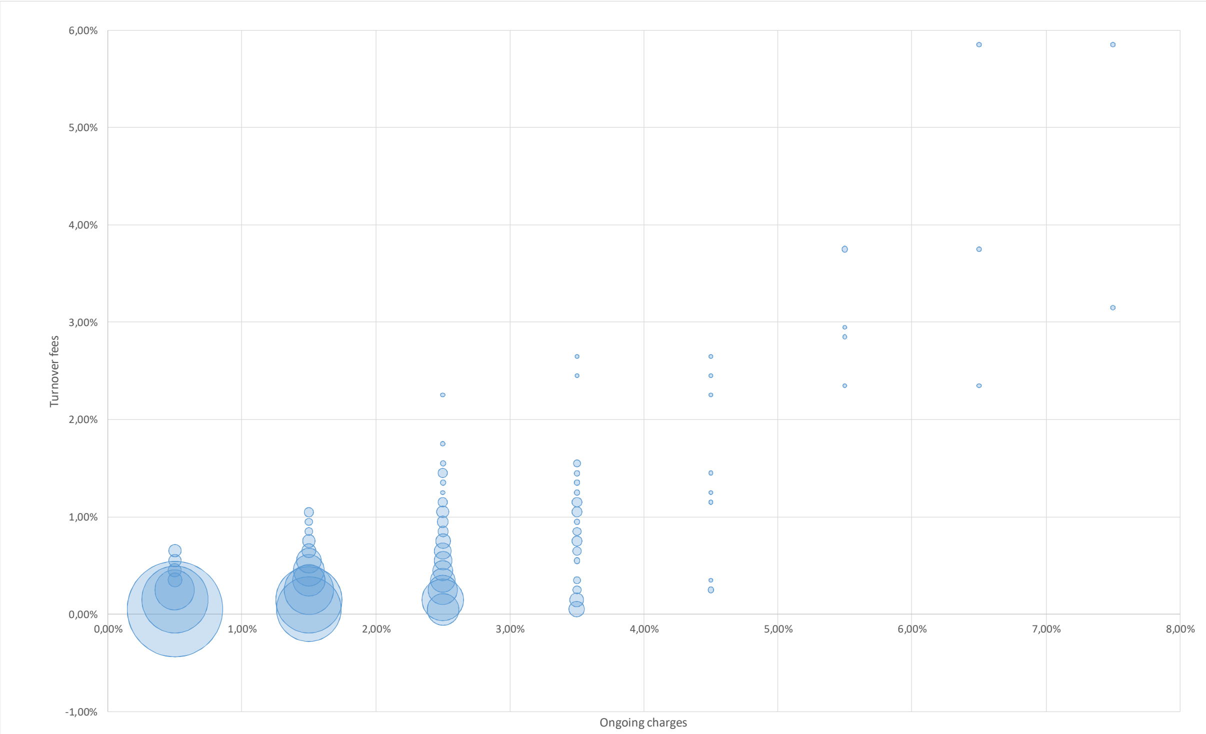


An analysis of the distribution of ongoing fee levels based on whether turnover commissions are charged or not shows that charging them does not automatically indicate a higher level of fees. However, in the case of funds with the highest fees, the proportion of those with turnover commissions increases significantly.

The following graph shows the proportion of funds charging (in blue) or not charging (in orange) turnover commissions by ongoing fee category (e.g. the category]0% ;5%] represents the 5% of share classes with the lowest ongoing fees).



The following graph shows the relationship between the level of turnover commissions and the level of ongoing fees.[27]



When we focus on the 2% of share classes with the highest fees, the vast majority (82% compared with 49% in the overall sample) charge turnover commissions payable to the fund managers. The turnover commission is on average 36% of the total fees for these share classes (compared with 14% for the total sample of share classes charging turnover commissions) and in several cases it is 75%. On average, 1.27% of the net assets of these share classes were charged through turnover commissions. Ten share classes (seven funds) charge annual turnover commissions of more than 2.5% of net assets.

Of these 2% most expensive share classes, 76% underperformed their benchmark index over the last four years. The difference between the cumulative average performance over the period (January 2017 to December 2020) and that of the benchmark index was -9.5% (-2.5% annualised average performance). It was -15% (-4% annualised average performance) when looking at only those share classes that underperformed their indices.

No problems were found with the definition of the turnover commission in the regulatory documentation. However, in most cases, the fees were defined per transaction, which makes it impossible to estimate the overall cost for the fund ex ante.[28] Furthermore, interviews with fund managers showed that, in some cases, AMCs have not defined an internal annual maximum above which the transaction fee would be deactivated.

During the investigations conducted as part of the SPOT inspections, the AMF found that turnover commissions accounted for only a minor portion of the revenue of the AMCs inspected, and the average annual turnover rates observed for the UCITS analysed were relatively low.

27 The data is grouped by windows of 1% for ongoing fees and 0.1% for turnover commissions. The width of the bubbles represents the number of share classes involved. The bubbles shown centred on the 0.5% value on the x-axis are therefore funds with ongoing fees between 0 and 1%.

28 While this is not a regulatory breach as such, it may affect the clarity of information and the ability to compare turnover commissions with fixed management fees in advance.

Annual average over 3 years	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Turnover commissions (% of AMC revenue)	€9 million (3.4%)	€13.6 million (6.3%)	€15.4 million (10%)	€11.1 million (17.6%)	€0.9 million (17%)
Percentage of turnover commissions in ongoing fees for all UCITS managed as at 31 December 2020	6%	14%	5.8%	2.3%	30.5%
Average annual turnover rate of UCITS in the sample over 3 years (2018-2020)	0.55 (4 UCITS)	1.11 (7 UCITS)	0.61 (4 UCITS)	0.03 (6 UCITS)	1.9 (6 UCITS)

Lastly, the ability to audit how management costs and fees are calculated and charged is possible because the AMCs (or the valuation agent in the case of AMC 3) retain supporting documents for a period of 10 years.

Regulatory reminders

- **Article L. 214-9 of the MFC:** *"The UCITS, the depositary and the AMC shall act honestly, loyally, professionally, independently and only in the best interest of the UCITS and of the unit holders or shareholders of the UCITS. They must present sufficient guarantees as regards their organisation, their technical and financial resources and the good repute and experience of their executives."*
- **Article L. 533-10 (I) (3°) of the MFC:** AMCs "(3°) *Take all reasonable steps to prevent conflicts of interest from adversely affecting the interests of their clients. Such conflicts of interest are those that arise between the asset management companies themselves, persons under their authority or acting on their behalf, or any other person directly or indirectly linked to them by a control relationship, and their clients, or between two clients, when providing any investment or related service or combination of such services. When these measures are not sufficient to guarantee, with reasonable certainty, that the risk of harming clients' interests will be avoided, asset management companies shall clearly inform clients of the general nature or source of these conflicts of interests, before acting on their behalf."*
- **Article 321-100 of the AMF GR:** *"AMCs shall act honestly, fairly and professionally, with due skill, care and diligence, in the best interests of UCITS and unit holders or shareholders and the integrity of the market. More specifically, they shall comply with all the rules pertaining to the organisation and operation of the regulated markets and multilateral trading facilities that they use."*
- **Article 321-101 (1°) (5°) (6°) (8°) of the AMF GR:** AMCs shall *"(1°) ensure that the unit holders and shareholders of the same UCITS are treated fairly; […] (5°) act in such a way as to prevent undue costs being charged to the UCITS and its unit holders or shareholders; (6°) ensure a high level of diligence in the selection and ongoing monitoring of investments, in the best interests of UCITS and the integrity of the market; […] (8°) establish written policies and procedures on due diligence and implement effective arrangements for ensuring that investment decisions on behalf of the UCITS are carried out in compliance with the objectives, investment strategy and risk limits of these UCITS."*
- **Article 321-46 of the AMF GR:** *"AMCs shall take all reasonable measures to detect conflicts of interest that arise in the course of providing management of UCITS: (1°) Either between itself, relevant persons, or any person directly or indirectly linked to the asset management company by control, on the one hand, and its clients, on the other hand; (2°) or between two UCITS. This Section is applicable to all collective investment schemes managed by the AMC."*
- **Article 321-48 of the AMF GR:** *"AMCs shall establish and maintain an effective conflicts of interest policy, set out in writing and appropriate to their size and organisation and to the nature, scale and complexity of their business. Where an AMC is a member of a group, its conflicts of interest policy must also take into account any circumstances, of which it is or should be aware, that may give rise to a conflict of interest as a result of the structure and business activities of the other members of the group."*
- **Point 1.1.2.2 ("management objective") of AMF Position-Recommendation 2011-05:** *"The investment objective shall be consistent with the investment strategy implemented and compatible with the cost levels indicated."*

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Planned changes

- The AMF is working with the financial industry on regulatory changes targeting the two risky practices identified in sections 5.2.2 and 5.2.3 above.

5.3. PRICE SETTING AND REVIEW PROCESS

5.3.1. Organisation

The SPOT inspections revealed that the inspected AMCs organised their price setting and review process in similar ways. This is shown schematically in the table below.

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Team/individuals proposing to create or modify a pricing structure	AMC (Product Marketing Department)	AMC (Client and Strategic Marketing Departments)	AMC (Product Management Department)	Group (Financial Services Department)	AMC (MD)
Teams/individuals consulted on the proposal	AMC (Management, Legal, Middle Office, Risk, Compliance, Marketing & Communication)	AMC (MD, Management, Commercial, Research, Middle Office, Legal, Management Control, Risk Control, Compliance)	AMC (Management, Legal, Compliance)	AMC (MD)	AMC (CIU Distribution Department and Middle Office)
Teams/individuals approving the pricing structure	AMC (MD)			Group Financial Services Department	AMC (MD)
Teams setting up the approved pricing structure in the systems	AMC (CIU Accounting Department)	Group (Finance Department)	Group (Finance Department)	Director/ depositary/ valuation agent (accounting)	Depositaries/ Valuation agent
Teams responsible for **invoicing** of fees	AMC (Middle Office)	Group (Finance Department)	AMC (Middle Office)		Group (accounting)

The new pricing structures proposed for the funds managed are approved by a dedicated committee, usually called the "New Products Committee". This committee consistently produces dated and signed minutes, **except for AMC 5**. No proposed pricing structure was rejected at the initial review stage by this committee.

The AMC's parent group is involved in the process of determining fund management cost and fee structures, **except for AMC 1**.

Since there is only limited scope for changing the fees associated with a given strategy, the main reasons for changing fees are significant changes in the fund's strategy or its underlying market. This observation is supported by the findings of the SPOT campaign, which found that no significant changes in the cost and fee structures of retail UCITS had been made by the AMCs inspected during the period under review, except for AMCs 2 and 5.
AMC 2 introduced a standard cap on turnover commissions for its entire range. In an effort to align the pricing conditions of retail share classes with those of share classes dedicated to institutional investors, AMC 5 lowered the management fee and turnover commission rates of the four most actively distributed UCITS while introducing performance fees at the same time.[29]

[29] Holders were informed of these changes in a separate letter, details of which are provided in the annual report and available on the AMC's website.

5.3.2. Procedures

The SPOT inspections revealed an **incomplete procedural corpus** for setting up, configuring, invoicing and accounting for management costs and fees. These shortcomings are likely to lead to errors in charging costs and fees and in the information provided to investors in relation to costs and fees.

Firstly, the five AMCs have **no complete and operational internal procedure for calculating costs and fees for the UCITS they manage**. For AMC 1, this finding is compounded by the fact that the existing procedural corpus on the scope of management costs and fees is **updated infrequently or not at all**.[30]

Secondly, AMCs 2 and 4 **do not have an operational procedure describing the steps involved in calculating, setting up, managing and controlling** management costs and fees.

Lastly, only AMCs 2 and 4 have an **operational accounting procedure** that defines the account numbers and accounting schemes used to record costs and fees.[31] AMCs 3 and 5 do not have such a procedure in place. AMC 1's procedure has not been updated for seven years.

5.3.3. Criteria taken into account in price setting

Asset managers use a wide range of quantitative and qualitative criteria to decide how to price their UCITS. However, the main criterion is comparison with competition. This criterion is mentioned by more than two-thirds of asset managers, but it can be assumed that all take it into account.

The following criteria were also used for UCITS pricing:

- **The fund's ability to support the fee level**: 70% of AMCs use the fund's expected return and/or risk level to decide on a fee level that does not keep the fund from achieving its performance objectives.
- **The fund's profitability for the AMC**: 40% of fund managers mention this criterion, although the type of analysis varies from one AMC to another. For example, the personnel and IT costs associated with each fund are difficult to estimate.
- **The type of investor**: fees are generally higher for retail share classes, in particular in connection with lower subscription amounts per client (38% of responses).
- **Distribution fees**: the share class price should take into account any rebates (34% of responses).
- **The holding period** is taken into account in setting the fee level (21% of AMCs).

Many AMCs associate the pricing of a fund with the complexity of its management strategy, regardless of the risk level. For the same SRRI, a more complex fund will be more expensive to cover the additional costs incurred by the AMC.

Furthermore, a fund with a higher SRRI will often be more expensive. This is because, firstly, AMCs will tend to align fund prices with the competition by risk category and, secondly, the fund's expected return, which is logically higher, allows the AMC to charge higher fees on the assumption that it is not changing the fund's ability to achieve its objective.

For SRRI levels 1, 2 and 3, this trend is very clear: the higher the SRRI, the higher the average ongoing fees. However, for higher SRRI levels, the following graph[32] shows that for some SRRI levels, the link is less pronounced or even

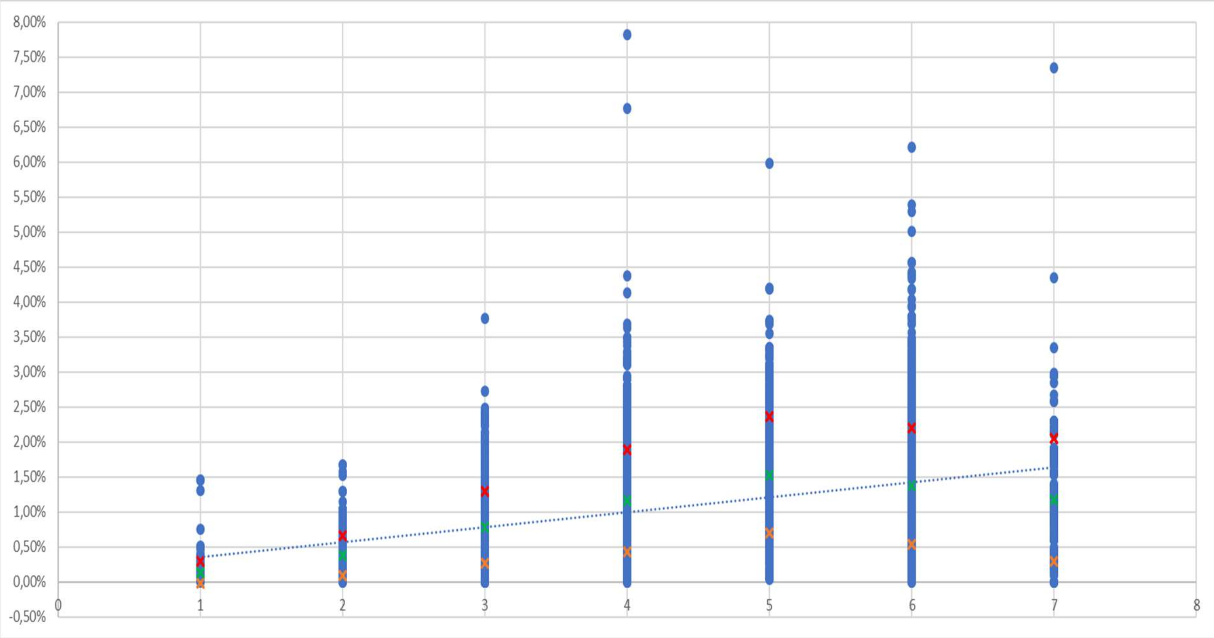
[30] Specifically, the procedure for setting performance fees has not been updated since March 2011, the procedure for changing fee structures not since April 2006 and the procedure targeting management fee rebates relating to external UCITS held in managed portfolios not since 2007.

[31] This information is required to fully understand the audit trail relating to how management costs and fees are calculated (cross-checking accounting data with data from internal and external applications for calculating costs and fees).

[32] The green crosses indicate the average ongoing fees for each SRRI level. The orange and red crosses represent the limits of the ongoing fee levels within one standard deviation of the average value.

reversed. This is due to the fact that the level of risk/return is only one of the criteria taken into account when pricing funds.

Ongoing fee level relative to share class SRRI



Investigations carried out during the SPOT campaign showed that the criteria used for the initial definition of costs and fees for retail UCITS are the same for AMCs 1, 2, 3 and 5. These criteria are both quantitative (costs associated with management, expected returns, performance outlook, commercial positioning in relation to the rest of the range and to competitors) and qualitative (underlying asset type and volatility, target market characteristics, risks associated with the new product – including compliance risks).

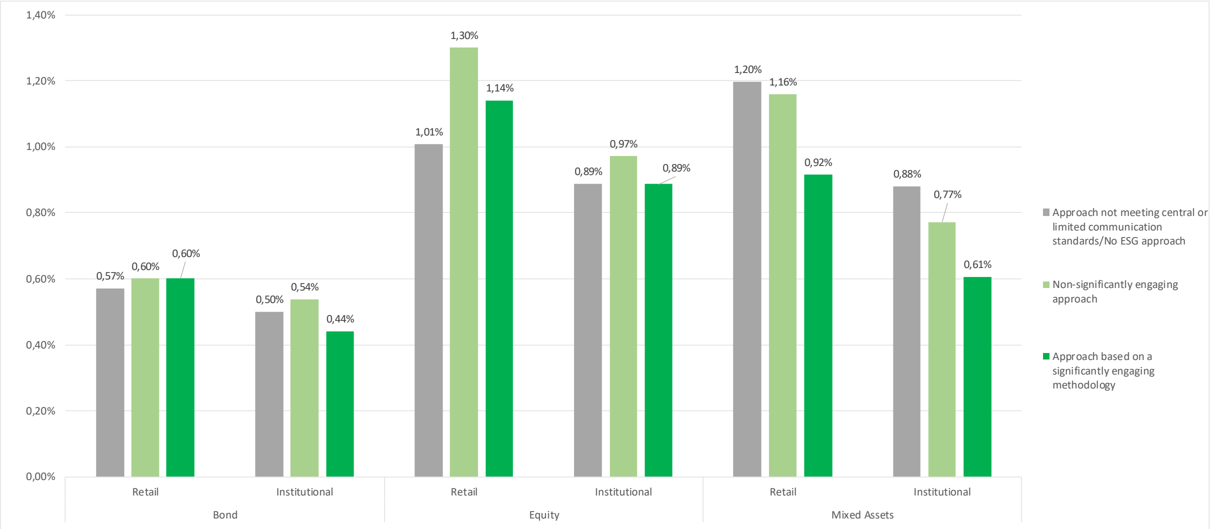
The process is different for AMC 4. When a fund is created, it sets its breakeven point (at 12 basis points). Beyond that point, according to the AMC's explanations, its parent group applies a non-formalised fee schedule (based in particular on the fund's SRRI) to determine the fee level to be charged.

Furthermore, the inspection task force did not detect any glaring discrepancy between the fee structures (described above) and the risk level of the range of retail UCITS offered by the five AMCs analysed (as measured by the funds' SRRI).

Specific case of ESG funds

It appears that, on average, out of the sample of 49 AMCs analysed, funds that take ESG criteria into account as part of a significant commitment[33] tend to have lower fees.

33 Significant commitment in asset management is consistent with one of the approaches defined in Recommendation DOC-2020-03.



Rebates (retrocessions) to clients

In a limited number of cases (about 5% of the share classes covered by the exercise), AMCs pay management fee rebates to certain clients. This has the effect of reducing the fees they pay.

This practice allows AMCs to offer a lower fee rate to large institutional clients on a case-by-case basis, especially when a "super institutional" share class does not exist or when the client has not reached the minimum subscription amount to access it.

In some jurisdictions, such as Luxembourg, the AMC may, under certain conditions, allow clients to subscribe to a share class without reaching the minimum subscription amount, provided that the minimum is reached within a certain period. **This is not allowed in France[34] and partly explains the practice of providing rebates to clients.**

Discounts are also sometimes paid to clients under "seeding" agreements where AMCs agree to reduce their management fees for a defined period of time after the launch of the fund to encourage investment.

5.3.4. Regular price reviews

Most AMCs periodically review the fee structure of their UCITS. More specifically, half the sample has defined a frequency – in most cases annually – for reviewing the fee structure of the funds they manage. For the rest of the sample, the review is carried out either on an ad hoc basis or following significant changes in fund strategy or market conditions.

Only half of AMCs have changed the fee levels of a fund during its lifetime. The main reasons given for these changes are decreasing returns of the underlying asset class (17%), a desire to increase the competitiveness of the fund (17%) or improved consistency in the range of funds offered (13%).

Some fund managers state that the review process is carried out by a committee (26% of the AMCs) or according to the same process used at fund launch (15% of the AMCs).

The examples of fee level changes provided by the AMCs over the period studied (2017 to 2020) show a broad balance of fee increases and decreases. For example, fee decreases were observed in the following cases:

[34] Article 411-22 of the AMF GR specifies that: *"Subscriptions of a given unit or share class may be reserved for a category of investors defined in the prospectus using objective criteria, such as a subscription amount, a minimum holding period or any other commitment given by the holder."*

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- Funds with a tracking error that has fallen consistently below its initial level.
- Change of strategy from an active fund to a fund managed with reference to a benchmark index.
- Reduced volatility of the underlying market.
- Low underlying market returns (for some bond funds).
- Lower fund turnover, resulting in lower turnover costs.
- Improved competitiveness by removing layers of fees such as entry fees or turnover commissions.

Cases of increased fees charged are often justified by the opposite situations to those listed above. Increased costs may also be passed on in fees, although it is often the AMC that covers the extra cost (for example, in the case of index- and ESG-related costs).

Investigations carried out as part of the SPOT campaign showed that the process for reviewing the cost and fee structures of funds during their lifetime is identical for AMCs 2 and 3 and similar to the creation process described in the table in section 5.3.1 above. AMC 4 has the ability to submit a proposal for changes to this structure to the group, which may or may not approve it at the New Products Committee. Lastly, AMC 1 does not conduct a regular review of the pricing conditions for these funds (except in the case of transfers), unlike AMC 5, which reviews these conditions every week at a sales meeting at the same time as it reviews the inflow and performance results.

Regulatory reminders

- **Article 321-23 (II) of the AMF GR:** *“AMCs […] II. […] shall establish and maintain effective decision-making procedures and an organisational structure that clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities.”*
- **Article 321-26 of the AMF GR:** *“AMCs shall establish and maintain effective accounting policies and procedures that enable them, at the request of the AMF, to deliver in a timely manner financial reports which reflect a true and fair view of their financial position and which comply with all applicable accounting standards and rules.”*
- **Article 321-29 (1), (2) of the AMF GR:** *“AMCs shall: (1) Ensure that the accounting procedures referred to in Article 321-26 are applied so that unit holders and shareholders in the UCITS are protected; (2) Establish appropriate procedures to ensure the proper and accurate valuation of the assets and liabilities of the UCITS, as consistent with the applicable rules referred to in Article L. 214-17-1 of the Monetary and Financial Code.”*
- **Article 321-30 of the AMF GR:** *“AMCs shall establish and maintain appropriate operational policies, procedures and measures to detect any risk of non-compliance with the professional obligations referred to in II of Article L. 621-15 of the Monetary and Financial Code and the subsequent risks and to attenuate those risks. For the purposes of the preceding paragraph, AMCs shall take into account the nature, scale, complexity and range of the businesses that they engage in.”*

Good practices

- Formalising (and keeping) in a dated and signed record the conclusions of the approval committee regarding the new pricing structures decided for the funds.
- Involving all departments in the price setting process (operational, legal, marketing, management, executive).
- Establishing and updating peer groups to benchmark fund prices against the market.
- Formally simulating all the costs generated by the fund before it is priced, and keeping the results of the simulations carried out until the next pricing change.
- Implementing a review, at least annually, of the fund’s pricing model[35] (structure and level of charges).

[35] This good practice should be distinguished from the annual update of the ongoing fee rate (“OFR”) in the funds’ KIIDs. This annual update stems from the obligation to base the OFR on the previous year’s figures (Articles 10 and 11 of EU Regulation 583/2010) (KIID Regulation)).

Poor practice

- Failure to put in place a process to regularly assess the cost and fee structure of the funds managed based on various criteria, including performance net of fees, index performance, comparability of existing structures with those of similar funds, and the difference in costs per share class.

5.4. COSTS PAID TO THIRD PARTIES AND CONFLICTS OF INTEREST

5.4.1. Procedures and mechanisms implemented to manage conflicts of interest

A total of 17 procedures for managing conflicts of interest were received from the 49 AMCs in the sample (21 AMCs reported no conflicts of interest relating to costs and fees). The formats and content of these procedures vary.

For example, for the five AMCs inspected in the SPOT campaign, the conflict of interest management system consists of a dedicated procedure, a mapping (reviewed annually), a register and regular monitoring. Conflicts of interest that may exist with the group (acting as depositary or marketer), external distributors and delegated managers are adequately dealt with,[36] **except in the case of AMC 1**. For AMC 1, potential conflicts of interest with respect to third parties receiving remuneration from the AMC are not spelled out either in the procedure or in the conflict of interest management mapping provided.

5.4.2. Types of conflict of interest situations

The types of conflicts of interest identified by the AMCs in the sample are shown in the table below.

Conflict of interest type	Number of AMCs reporting such a conflict (out of 49 AMCs)
No conflict	21
Distributors	13
Depositary/Administrative agent/Valuation agent	8
Execution desk/Brokerage	7
Transaction counterparties	5
Delegated managers	5
Carbon offset contract	1
Investment advice	1
Investment in in-house funds	1

5.4.3. Distribution and rebates (retrocessions)

The most frequently mentioned type of conflict of interest relates to distributors. Of the 49 AMCs, 47 reported paying rebates on certain funds. The fees paid to distributors are compensation for marketing-related services (for example, investment advice, marketing, reporting, and collecting documents that make up know-your-client information).

The work carried out shows that clean shares are currently in the minority. They account for 17% of all share classes in the sample and 3% of assets under management. Some AMCs also choose to separate management and administrative fees in their prospectuses and marketing communications (two-part presentation). In addition to providing transparent information, this practice limits the basis for calculating rebates[37] and therefore limits the rebate amount.

36 The risks of potential conflicts of interest related to remuneration paid by the AMC to third parties are detailed in the procedure, the probability of their occurring and the associated level of impact are estimated in the mapping, and these risks are subject to regular formal controls. Any anomaly identified as part of these controls is also recorded in the register mentioned.

37 Rebates are deducted from the financial management fees (excluding administrative fees).

Rebate agreements generally provide for approximately 50% of management fees to be paid back to the distributors. The median level of intragroup rebates is 55%. AMCs that rely on an intragroup distribution network have higher than average rebates. They justify this by pointing to the cost of maintaining a distribution network and the levels of inflows that it brings. For example, an AMC backed by a banking network pays between 50% and 70% of management fees to the group (which employs more than 7,500 wealth and banking advisers).

To manage any conflicts of interest that might exist in the context of these relationships, AMCs rely mainly on formalised distribution contracts and on regular monitoring of the rebates paid.

Investigations carried out as part of the SPOT campaign showed that AMCs 2, 3 and 5 market UCITS both directly through an internal team and through their group. This is not the case for AMC 4, which markets the funds it manages solely through its parent group,[38] or for AMC 1, which transferred the entire marketing function to a dedicated group entity from early 2020.[39]
The five AMCs inspected also use external distributors. However, none of them works with business finders.

The rules for calculating rebates are formalised in signed and dated agreements for the five AMCs. However, in the case of AMC 1, the complex and changing nature of the group's capital structure meant that it was not possible to identify the names of a minority (13.5%) of the intragroup distributors in all of the agreements provided. The AMC plans to clarify this situation in relation to the migration – in progress at the time of the investigations – of all existing agreements to the single group entity mentioned above.

The volumes of business involved between January 2018 and December 2020 relating to distribution and rebates are presented in the table below.

		AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
% of UCITS assets distributed	by external distributors	29.6%	28%	56%	None	20%
	by the group	70.4%	72%	44%	100%	80%
Rebate rate (as % of management fees)	to external distributors	50%	between 5 and 78%	between 40 and 60%	N/A	between 35 and 50%
	to the group	65%	between 25 and 87%	between 55 and 66%	between 89 and 92%	between 21.2 and 45.5%
Total **rebate amounts** over the period under review (€ million)	to external distributors	7.9	72.6	95 (94.6)	N/A	1.5
	to the group	476.6	82.9	26.8 (23.5)	110	0.2 (0.4)

The inspection task force **found discrepancies between the rebate amounts reported in the annual disclosure sheets/annual control reports and those derived from the internal audit trails** of AMCs 3 and 5 (the audit trail values are marked in red in the table above). These discrepancies (of around €1 million for AMC 3 and €100,000 for AMC 5) are due to an insufficient level of cross-checking – before submitting the annual disclosure sheets/annual control reports – between the rebate amounts recorded in the general ledger on the one hand and derived from the internal calculation applications on the other.

5.4.4. Depositaries (custodians)

Eight AMCs reported potential conflicts of interest with their depositary, especially when the depositary and the AMC are part of the same group or the depositary is a shareholder. Several conflicts of interest are described in this case, relating to the selection of the service provider and its remuneration.

The measures identified to deal with these conflicts of interest are the following:
- The best selection procedure.

[38] Investors subscribing either in securities accounts/equity savings plans or in unit-linked life insurance policies offered by the group.
[39] Since 27 February 2020, all marketing agreements that the AMC manages directly are being transferred to the entrusted group entity.

- Monitoring of portfolio turnover in the case of turnover commissions charged directly by the depositary (or that are paid to it by the AMC as rebates).
- Compliance with the rules resulting from the transposition of the UCITS V Directive into French law on this subject[40] (and in particular the independence of the AMC's decision-making bodies and the depositary).

Investigations carried out as part of the SPOT campaign revealed that the parent group of three of the five AMCs inspected is also the depositary for some of the UCITS that they manage. This is the case for AMC 1 (99% of assets under management), AMC 3 (52%) and AMC 5 (33%). The group is remunerated for this service:

- either through costs included in the fixed fund management fees (for AMC 1);
- or through turnover commissions charged on the funds. In this case, 50% of these commissions are paid to the group by AMC 3 and 100% by AMC 5.

These remuneration arrangements are set out in a dedicated agreement and in the prospectuses of the UCITS in question. For AMC 5, the risks associated with the group's role as depositary for some of the UCITS it manages are not covered by an agreement but by the AMC's conflict of interest management system (procedure, mapping, monitoring and register).
The five AMCs have implemented a process for regularly assessing the services provided by the group in its role as depositary (as is the case for all external service providers). It includes a comparison (at least annually) of the quality/price ratio with other external depositaries.

5.4.5. Delegated financial managers

In terms of delegated managers, the work carried out during the SPOT campaign revealed that three of the five AMCs inspected had delegated the management of some of their UCITS to an external manager. These are AMCs 1, 3 and 4.

The delegated managers' remuneration rates are presented below.

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Funds with delegated management	8 UCITS (3.1% of total UCITS assets under management)	None	8 UCITS (6% of total UCITS assets under management)	6 UCITS (32% of total UCITS assets under management)	None
Delegated managers' remuneration rates	Between 0.4 and 1.3%	N/A	Between 0.2 and 0.7%	Fixed management fee of 0.6% or sliding scale (between 0.07% and 0.5%) depending on the amount of fund assets under management	N/A

For AMCs 1 and 4, this delegation is governed by a dedicated agreement that defines the calculation method and the rate of the delegation commission paid. The funds pay the delegated managers directly. A robust audit trail provides a means of reconstructing how this commission is calculated.

For AMC 3, the delegated managers are not paid by the funds but by the AMC. A delegated management committee is in place to review the monitoring of the UCITS concerned on a quarterly basis. This committee reviews (i) due diligence questionnaires, (ii) risk reports produced by delegated managers, (iii) any operational incidents and (iv) recent events affecting the delegated funds (e.g. changes to the prospectus).

40 Directive 2014/91/EU was published in the Official Journal of the European Union on 23 December 2015. It was transposed into French law by Ordinance 2016-312 of 17 March 2016. Article 6 of this Ordinance refers to depositaries.

Regulatory reminders

- **Articles L. 533-10 (I) (3°) of the MFC**: *"AMCs […] (3°) Take all reasonable steps to prevent conflicts of interest from adversely affecting the interests of their clients. Such conflicts of interest are those that arise between the AMCs themselves, persons under their authority or acting on their behalf, or any other person directly or indirectly linked to them by a control relationship, and their clients, or between two clients, when providing any investment or related service or combination of such services. When these measures are not sufficient to guarantee, with reasonable certainty, that the risk of harming clients' interests will be avoided, AMCs shall clearly inform clients of the general nature or source of these conflicts of interests, before acting on their behalf."*
- **Article 321-46 of the AMF GR:** *"The AMC shall take all reasonable measures to detect conflicts of interest that arise in the course of providing management of UCITS: (1°) Either between itself, relevant persons, or any person directly or indirectly linked to the asset management company by control, on the one hand, and its clients, on the other hand; (2°) or between two UCITS. This Section is applicable to all collective investment schemes managed by the AMC."*
- **Article 321-48 of the AMF GR:** *"AMCs shall establish and maintain an effective conflicts of interest policy, set out in writing and appropriate to their size and organisation and to the nature, scale and complexity of their business. Where an AMC is a member of a group, its conflicts of interest policy must also take into account any circumstances, of which it is or should be aware, that may give rise to a conflict of interest as a result of the structure and business activities of the other members of the group."*
- **Articles 321-100 and 321-101 (5°) of the AMF GR**: already cited above.

Poor practices

- Not formalising and keeping dated and signed agreements defining the rebate rules in place with each of the distributors (intra- and extra-group) identified individually by name.
- Not implementing a cross-check – before submitting the annual disclosure sheets/annual control reports – between the rebate amounts (paid to group/external distributors) recorded in the general ledger and derived from the internal calculation applications.

5.5. DISCLOSURE OF COSTS AND FEES

5.5.1. Procedures

Investigations carried out as part of the SPOT campaign revealed that the five AMCs inspected had each implemented an operational procedure for preparing, approving, checking and disseminating regulatory and marketing documents for their funds. The procedure also explains how to present management costs and fees in these documents. These procedures refer to AMF Instruction 2011-19.[41]

However, this procedure **needs to be expanded for AMC 3 and AMC 4**. AMC 3's procedure does not cover the process of producing annual and semi-annual reports for clients. AMC 4's procedure does not include sufficient details on the stages and parties involved in the process for creating/modifying regulatory documents.

[41] This instruction details the rules that apply to UCITS for preparing a key investor information document (KIID), a prospectus and periodic disclosures.

5.5.2. KIID

The size of the sample of fund share classes (over 6,000) meant that it was not possible to analyse all KIIDs. A review of a selection of KIIDs from each of the AMCs in the sample showed that the documents largely comply with the provisions applicable to presenting and explaining fees, particularly those provisions in the KIID Regulation.[42]

With regard to calculating ongoing fees, the relative simplicity of the fee structure of French funds reduces the complexity of the calculation (ongoing fees are often limited to management fees,[43] turnover commissions and indirect costs related to investing in funds, with the AMC paying other administrative costs).

Furthermore, in almost half of the cases, at least one third party performs an independent calculation or check. In most cases, the calculation is performed by the valuation agent, but it might also be performed by the depositary or an external auditor.

For newly launched funds or funds for which the historical value of ongoing fees is no longer considered representative, ongoing fees cannot be estimated based on historical data.[44] In these cases, the way in which AMCs calculate the ongoing fee ratio depends on the complexity of the fund's fee structure. The estimate may be based on the maximum management fees in the prospectus or on the combination of this and the estimated indirect[45] and external[46] costs at their contractual level. For more complex fee structures – including for example turnover commissions – a more detailed analysis is required. The most common approaches are to base the calculation on a similar fund or other share classes of the same fund or to perform a simulation taking into account, for example, the estimated turnover of the fund.

As part of the SPOT campaign, a test was carried out on the process of checking the ongoing fee rate ("OFR") before publishing it in the KIID. For the five AMCs, the OFR mentioned in the KIID when a new fund is created is an estimate:[47]

- For AMCs 2, 3 and 4, this estimate is based on the sum of maximum management fees and transaction fees. The level of transaction fees is estimated taking into account the asset class and turnover. The level of portfolio turnover for each fund is estimated based on the portfolio manager's strategy and investment style.
- For AMC 5, the estimate is based on the OFR of similar products already in the range.
- For AMC 1, however, the OFR at the time of fund creation is equal to the maximum management fee rate stipulated in the regulations.

The reasons why the calculated ongoing fee level might no longer be representative vary from one AMC to another. The most common reasons are changes in the fee structure or a change in strategy. Only 15% of AMCs calculate rolling estimates of ongoing fees during the year and have specific thresholds to trigger a new estimate of ongoing fees. The threshold at which an AMC publishes a new version of the KIID before the end of the current year varies significantly, from a 5% to a 20% change in ongoing fees.

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42 Articles 10 and 11 in particular.

43 Where the AMC has decided not to split these fees into two separate components (financial management fees and external administrative fees).

44 Refer to Articles 10 (2) (b), 11 (1) (b) and 13 (1) of Regulation (EU) 583/2010 (KIID Regulation).

45 Position-Recommendation 2011-05 states: *"When a UCITS invests more than 20% in other collective investments, the running cost rate shall take into account all the costs incurred by the UCITS itself in its capacity of investor in the underlying collective investments."*

46 When administrative fees are paid directly by the fund.

47 Refer to the Article 13 of Regulation (EU) 583/2010 (KIID Regulation): *"1. Where a new UCITS cannot comply with the requirements contained in Article 10(2)(b) and Article 11(1)(b), the ongoing charges shall be estimated, based on the expected total of charges. 2. Paragraph 1 shall not apply in the following cases: (a) for funds which charge a fixed all-inclusive fee, where instead that figure shall be displayed; (b) for funds which set a cap or maximum on the amount that can be charged, where instead that figure shall be disclosed so long as the management company gives a commitment to respect the published figure and to absorb any costs that would otherwise cause it to be exceeded."*

For the five AMCs inspected as part of the SPOT campaign, the OFR shown in the funds' KIID for year N is updated with the ongoing fees charged in year N-1.[48] The tests carried out on the KIIDs produced between January 2018 and December 2020 on the sample of funds selected did not identify any incorrect OFRs. The five AMCs have implemented a monitoring process at this level that has a robust audit trail (including the valuation agent's calculation files, middle office control documents and accounting supporting documents), **with the exception of AMC 5, which does not formalise its due diligence at this level**.

5.5.3. Presentation of performance fees in regulatory documentation

The analysis of how performance fees are presented in the regulatory documentation of the fund sample defined above for the five AMCs inspected in the SPOT campaign did not reveal any significant deviation from ESMA's 2020 guidelines.[49]
Firstly, the KIIDs/prospectuses of the funds in the sample that charge performance fees specify the method and basis for calculating these fees together with the index and reference period. **However, the inspection task force found that the prospectuses did not include concrete examples of the calculation.**
Secondly, the related annual reports indicate the performance fee rate applied and the fee amount charged over the past financial year.[50]
Lastly, the calculation files collected are evidence of a robust audit trail.

5.5.4. Marketing materials

The latest version of fund marketing materials is generally available to prospective investors on the AMCs' websites, with the exception of AMCs 1, 3 and 4 (inspected as part of the SPOT campaign), which do not provide this type of documentation.

Lastly, all the AMCs inspected as part of the SPOT campaign feed industry comparison databases with information on the cost and fee structure of the funds they manage. These databases include Morningstar, Quantalys, Kneip, Fundsquare, Bloomberg, Core Alpha, Europerformance, Financialexpress, Refinitiv, Standard & Poors and OPCVM 360.

5.5.5. Testing on regulatory and marketing information

The accuracy of the information presented in regulatory and marketing documentation was examined as part of the SPOT campaign across the sample of UCITS defined above. This examination covered all the documentation produced during the inspection period (prospectuses, KIIDs, annual reports, monthly factsheets and other marketing materials).

The results of this testing are presented below by cost and fee type. The most contentious practices are highlighted **in orange**. The percentage of funds affected by the observation (of the total number of funds tested) is shown in brackets.

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
No. of retail UCITS tested	4	7	4	6	6
Subscription fees	No discrepancies identified	Missing from annual reporting (57%)	No discrepancies identified		Missing from annual reporting (100%)
Redemption fees	No discrepancies identified	Missing from monthly reporting (14%)			Discrepancies between

[48] In accordance with Article 10 (2) (b) of Regulation 583/2010 (the KIID Regulation): *"1. The 'Charges' section of the key investor information document shall contain a presentation of charges in the form of a table as laid down in Annex II. 2. The table referred to in paragraph 1 shall be completed in accordance with the following requirements: […] (b) a single figure shall be shown for charges taken from the UCITS over a year, to be known as the 'ongoing charges,' representing all annual charges and other payments taken from the assets of the UCITS over the defined period, and based on the figures for the preceding year."*

[49] ESMA Guidelines on performance fees in UCITS and certain types of AIFs (Annex IV).

[50] In line with point 49 of the ESMA 2020 Guidelines on performance fees.

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
No. of retail UCITS tested	4	7	4	6	6
					KIIDs/prospectuses, marketing material and monthly reporting (17%)
Fixed management fees	No discrepancies identified	Discrepancies between monthly reporting of 31/12/2020 and prospectus of 30/11/2020 (14%)	No discrepancies identified	Discrepancies between prospectuses and monthly and annual reporting (33%)	No discrepancies identified
Administrative fees	No discrepancies identified	Missing from reporting and marketing material (57%)	No discrepancies identified		
Turnover commissions	No discrepancies identified	Missing from reporting (86%)			
Performance fees	No discrepancies identified	Differences between KIID and 2020 annual report (14%) Calculation rules missing from monthly reporting (86%)			
Indirect management fees	Missing from annual reports (100%) Calculation methods and associated costs are not included in the reporting (100%[51])	N/A	No discrepancies identified		N/A
Rebates (retrocessions) paid	**No information on the existence, nature, types of beneficiaries is specified in the prospectuses and KIIDs of the funds tested[52] (100%)**				
EPM-related fees	N/A	Partially mentioned in the prospectuses[53] (100%)	N/A	No discrepancies identified	N/A
Brokerage fees[54]	**Exact amount not specified in the regulatory documentation available on the AMC's website.**				

In addition to the discrepancies found between regulatory documents (which are due to a lack of internal control), a major observation from this analysis is **the lack of information in the regulatory documents examined about the rebates paid by AMCs to the various parties involved** (distributors, delegated managers, depositaries, statutory auditors, valuation agents, etc.). This information does not appear in any other material that the AMCs make available to investors. With regard to the remuneration received by distributors, it should be noted that the five AMCs do not check that distributors pass on the information to clients before providing advice.

51 This percentage applies only to the UCITS in the sample whose management is delegated to a third party.

52 Article 321-116 of the AMF GR states that unit holders must be informed of the fees and commissions paid to third parties by AMCs *"in a manner that is comprehensive, accurate and understandable, prior to the management of a UCITS"*. The GR does not specify how this information shall be provided.

53 The prospectuses of the funds in question merely specify (as a percentage of the revenues generated) the maximum level of operating costs incurred by the AMC in connection with the securities lending transactions carried out.

54 As a reminder, Article 321-119 of the AMF GR specifies that: *"All fees and commissions paid by the UCITS for transactions in portfolios under management, with the exception of subscription and redemption transactions relating to collective investment schemes or investment funds of third countries, shall be trading costs. They include: (1) Intermediation costs, taxes and duties included, charged directly or indirectly by third parties that provide: (a) Order reception and transmission services and order execution services on behalf of third parties referred to in Article L. 321-1 of the Monetary and Financial Code; (b) Investment decision aid services and order execution services; (2) If applicable, a turnover commission shared exclusively between the asset management company and the custodian of the UCITS […]"*

In addition to the above observations, the inspection task force noted that **previous versions** of the KIIDs/prospectuses, monthly/annual reports and reports on brokerage fees **are not made available on the AMCs' websites** (only the latest updated version is available).

Furthermore, **the websites of two of the industry databases mentioned above contain information that is missing, contradictory or has no stated source** when compared with the data provided in the regulatory documentation produced by the AMCs. Specifically:

- For AMC 2, no information on indirect management fees, turnover commissions, performance fees, brokerage fees, administrative fees and rebates paid to distributors was identified on the two comparison database websites. Furthermore, for one of the seven funds tested, one of the comparison database websites claims that subscription fees are zero, whereas the regulatory documentation states that these fees are 5%.
- For AMCs 1, 3 and 4, the website of one of the two comparison databases lists a non-zero "transaction fees" rate for the funds tested. However, the source of this rate cannot be determined from the regulatory or marketing documentation for the funds.

The five AMCs in the sample said that they did not have control over the process of updating the data on their funds' costs and fees in the industry databases. However, noting the inspection task force's observations, AMC 3 said it would contact the industry database company reporting the above-mentioned "transaction fees" to try to understand the source of this information.

Regulatory reminders

- **Article L. 214-23 (III) of the MFC**: *"III. – Open-ended investment companies and AMCs shall prepare a KIID for each of the UCITS they manage, containing appropriate information on the essential characteristics of the UCITS in question. This document is provided to investors prior to subscription."*
- **Article L. 533-22-2-1 of the MFC**: *"AMCs shall act in an honest, fair, and professional manner best serving the interests of investors. All information, including marketing literature, provided to investors by an AMC must be accurate, clear and not misleading. Promotional communications must be clearly identifiable as such. The AMF General Regulation shall specify the conditions for applying the first two paragraphs above, taking into account the nature of the activity carried out, the nature of the financial instrument in question, and whether the investor is a professional."*
- **Article 321-30 of the AMF GR**: already cited above.
- **Article 321-116 of the AMF GR:** *"AMCs shall be deemed to be acting honestly, fairly and professionally in accordance with the best interests of a unit holder or shareholder of a UCITS if, in relation to management of a UCITS, they pay, provide or receive the following fees, commissions or non-monetary benefits: (1) a fee, commission or non-monetary benefit paid or provided to or by a unit holder or shareholder of a UCITS or to or by a person on behalf of the unit holder or shareholder of a UCITS; (2) a fee, commission or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of that third party, where the following conditions are satisfied* ***: (a) the unit holder or shareholder of a UCITS is clearly informed of the existence, nature and amount of the fee, commission or benefit or, where the amount cannot be ascertained, the method of calculating that amount; (b) this disclosure is made in a manner that is comprehensive, accurate and understandable, prior to the management of a UCITS;*** *(c) asset management companies may disclose the essential terms of the arrangements relating to the fees, commissions or non-monetary benefits in summary form, provided that they undertake to disclose further details at the request of the unit holder or shareholder of a UCITS and provided they honour that undertaking; the payment of the fee or commission, or the provision of the non-monetary benefit, must be designed to enhance the quality of the relevant service to the unit holder or shareholder of a UCITS and not impair compliance with the asset management company's duty to act in the best interests of the unit holder or shareholder of a UCITS; (3) Proper fees which enable or are necessary for the management of a UCITS, such as custody costs, settlement and exchange fees,*

regulatory levies or legal fees, and which, by their nature, cannot give rise to conflicts with the asset management company's duty to act honestly, fairly and professionally in accordance with the best interests of unit holders or shareholders of a UCITS."

- **Article 411-107 (2), (4) of the AMF GR**: *"The KIID, whose content is pre-contractual, shall fulfil the following conditions: (2) It shall contain accurate, clear, non-misleading information that is consistent with the […] UCITS prospectus. […] (4) It shall contain information about the following essential characteristics of the UCITS […] (d) Costs and associated charges;"*
- **Article 19 of the standard template for the prospectus in Annex XIV of AMF Instruction DOC 2011-19**:[55] *"The purpose of the prospectus is to provide an exhaustive description of charges, fees and compensation paid to the different parties and intermediaries, along with further information (indirect management fees, for example) providing a breakdown of the total ongoing charges given in the key investor information document (KIID), **and more particularly**: […]"* Thus, **the presentation of fees as stipulated in the instruction does not exclude information on costs paid to third parties**.
- **Section 46 of the ESMA guidelines on performance fees in UCITS and certain types of AIFs (Annex IV)**: *"The prospectus and, if relevant, any ex-ante information documents as well as marketing material, should clearly set out all information necessary to enable investors to understand properly the performance fee model and the computation methodology. Such documents should include a description of the performance fee calculation method, with specific reference to parameters and the date when the performance fee is paid, without prejudice to other more specific requirements set out in specific legislation or regulation. The prospectus should include **concrete examples** of how the performance fee will be calculated to provide investors with a better understanding of the performance fee model especially where the performance fee model allows for performance fees to be charged even in case of negative performance."*
- **Section A of the Annex to Regulation (EU) 2015/2365 of 25 November 2015**: *"Information to be provided in the UCITS half-yearly and annual reports and the AIF's annual report – Global data: […] The amount of securities […] on loan as a proportion of total lendable assets defined as excluding cash and cash equivalents; […] Concentration data: […] Top 10 counterparties of each type of SFTs […] (Name of counterparty and gross volume of outstanding transactions) […] Data on return and cost for each type of SFT […] broken down between the collective investment undertaking, the manager of the collective investment undertaking and third parties (e.g. agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFT […]"*

Good practices

- Implementing an operational and traceable control of the OFR update process in the KIID.
- Setting a threshold above which a new estimate of ongoing fees must be performed and published during the year.

Poor practices

- Failure to mention in the prospectuses of the relevant funds the existence and nature of the rebates (retrocessions) in place, the main types of beneficiaries of these rebates (e.g. parent group, external distributors, delegated managers) and the formula used to calculate them in general terms (for example, *"rebates are calculated as a percentage of the management fee"*).
- Not regularly checking the consistency of data relating to costs and management fees between the individual components that make up the regulatory documentation.

[55] On the authorisation procedures, preparation of a KIID and a prospectus and periodic reporting for French and foreign UCITS marketed in France.

- Not contacting industry comparison database organisations when discrepancies are found between the management fees presented in these databases and the funds' regulatory documentation.
- Not providing on-request access to previous versions of the regulatory documentation on the AMC's website.

5.6. EFFICIENT PORTFOLIO MANAGEMENT (EPM) TECHNIQUES

The objective of the work carried out on EPM techniques was to ensure that:

- the fee structures associated with these EPM techniques do not allow AMCs to charge "undue" costs or benefit from hidden revenues;
- investors are properly informed about EPM.

Of the 49 management companies in the sample, 13 reported using EPM techniques. Cases involving EPM were identified for the following assets.

Transaction type	Number of AMCs
Securities lending/borrowing	11
Repurchase and reverse repurchase	9
Buy/sale with a right of redemption	1
Total return swaps (when similar to securities lending/borrowing)	1

Two interviews were conducted with those fund managers making the most use of EPM. **The interviews highlighted that these techniques are less attractive for funds due to lower remuneration rates** than before the 2008 crisis (even though implementation costs remain high and fixed for most). In the sample of funds analysed, fund revenues from securities lending ranged from 0 to 12 basis points of net assets per year. In addition, due to the rise of algorithmic trading, demand for "rare" securities has diminished, also reducing expected revenues.

As part of the SPOT campaign, only AMCs 2 and 4 used EPM techniques during the period under review. For AMC 4, this use was ad hoc. It involved securities lending only and was used on six funds from March 2019 to April 2021. The small proportion of securities available for lending,[56] the low financial gains for the funds (less than 1 basis point, i.e. less than €10,000) and the difficulties in setting up effective automatic controls on the associated costs meant that the AMC decided not to extend the experiment. As a result, AMC 4 did not set up a specific procedure for the use of EPM techniques.
For AMC 2, the use of EPM is standard practice for equity funds with more than €50 million in assets under management. When the UCITS uses securities lending, the revenues generated by these transactions is paid to the UCITS in full. Fees covering these transactions are then charged to the UCITS. These costs are charged to the UCITS by the AMC, which then pays a share to the group's brokerage desk for its role as securities lending agent.

5.6.1. Procedures

Only four of the 13 AMCs that used EPM techniques provided procedures covering their use. AMCs that did not have procedures explained that this was because they paid all revenues to the funds. Others provided extracts from the funds' prospectuses and annual reports concerned as documentation.

The SPOT campaign revealed that for AMC 2, the costs and fees associated with the EPM transactions carried out are covered by an operational procedure.

5.6.2. Payout and sharing of revenues

The work carried out did not identify any revenues, excluding direct and indirect costs, that would not be paid back into the fund.

[56] Due to the need to respect the tax ratios of these funds, all of which are eligible for equity savings plans.

The SPOT campaign revealed that for AMC 2, since 1 April 2021, the costs billed to the UCITS in connection with securities lending transactions represent 35% of the revenues generated[57] (the remaining 65% being retained by the funds).

5.6.3. Information on EPM in regulatory documentation

All the AMCs analysed specified in the relevant fund prospectuses the proportion of revenue from EPM transactions used to pay for the costs generated by these transactions (and which, therefore, is not paid back to the funds). However, none of these AMCs provides a cost breakdown in the annual report of the funds concerned, distinguishing between direct and indirect costs, which would have made it easier to assess the relevance of revenue sharing. Only one AMC (out of 49) does not disclose EPM-related costs in its prospectus or annual report; it only discloses the revenue associated with the funds.[58]

The SPOT campaign revealed that for AMC 2, investors are informed in the prospectuses of the existence of this mechanism and the maximum costs associated with each securities lending/borrowing transaction (expressed as a percentage of the revenue generated). The annual reports of the funds mention the revenue from securities lending and the associated costs, the details of the securities lent and the ten main counterparties. However, neither of these two documents mentions the beneficiaries of these costs, nor their breakdown between the various beneficiaries.

Regulatory reminders

- **Article L. 533-10 (I) (3°) of the MFC**: already cited above;
- **Articles L. 321-46 and 321-48 of the AMF GR** on managing conflicts of interest: already cited above;
- **Article 321-100 and 321-101 of the AMF GR**: already cited above;

  Point VI of AMF Position DOC 2013-06 on efficient portfolio management techniques: *"21. "All the revenues arising from efficient portfolio management techniques, net of direct and indirect operational costs, should be returned to the UCITS. […] 27. The UCITS' annual report should also contain details of the following: a) the exposure obtained through efficient portfolio management techniques; b) the identity of the counterparty(ies) to these efficient portfolio management techniques; c) the type and amount of collateral received by the UCITS to reduce counterparty exposure; and d) the revenues arising from efficient portfolio management techniques for the entire reporting period together with the direct and indirect operational costs and fees incurred."*

Good practice

- Including the details of the top 10 securities lent in the annual reports of the funds using EPM techniques.

Poor practices

- Failure to formalise in an approved, dated and signed procedure for processing EPM techniques, including aspects relating to costs and fees.
- Failure to distinguish between direct and indirect costs related to EPM in regulatory documentation.

[57] Over the period under review, this revenue amounted to €5.1 million, of which €3.4 million (66%) was paid as rebates to the group.
[58] In this context, the statutory auditors received the revenue already offset against costs and presented it in the annual report.

5.7. FIRST-LEVEL CONTROL SYSTEM FOR COSTS AND FEES, INCIDENT AND COMPLAINT MANAGEMENT

5.7.1. Monitoring of compliance with the maximums defined in the prospectus

All AMCs in the sample have a monitoring process in place to ensure that the maximum fee levels defined in the prospectus are not exceeded. This process depends on the types of fees that are charged to the fund.

Checking that the maximum is not exceeded consists of a simple reconciliation process performed by the middle office for:

- Management fees: a provision is calculated at each valuation and the middle office checks as part of its reconciliation process that the provision is correct and below the maximum;
- Turnover commissions: the maximum in the prospectus is generally expressed as an amount/percentage per transaction. The middle office can then check the correct commission level as part of its transaction reconciliation process. Rarely, an overall maximum (expressed as a percentage of net assets) is included in the prospectus, which would require an additional and more complex control.

For more sophisticated fee structures with both variable and fixed components, the reconciliation between the fees charged and the maximum in the prospectus can be more complex. A periodic check is carried out at different intervals:

- Weekly or monthly (36% of AMC responses).
- Quarterly or half-yearly (18% of AMC responses).
- Annually (32% of AMC responses).

Investigations carried out as part of the SPOT campaign revealed that depositaries supplemented this control mechanism by issuing (automated) alerts if the maximum fee rate was exceeded. No such alerts were received by the five AMCs inspected during the inspection, except for AMC 1. The alert in question involved a UCITS with low assets under management (€10,000) that exceeded the maximum fee rate (1.5%) on the net asset value (NAV) on 2 October 2019. The AMC remedied this anomaly by replacing the rule for calculating this rate, as set in the depositary's tool (in which it was rounded up), with a truncation.[59]

The maximums defined in the prospectus must be complied with at all times. A low control frequency implies a high risk of non-compliance. The fair treatment of unit holders is not ensured if the maximums are only adhered to occasionally.

A test was carried out as part of the SPOT campaign to verify the quality of the process implemented within AMCs to detect when the maximum management and operating fee rate, at each NAV date, is exceeded at the time fees are set. This test targeted the funds in the sample defined above for the five AMCs. This process was found to be effective for AMCs 1 and 2, **partially effective for AMC 3 and not effective for AMCs 4 and 5**.
For AMC 3 and AMC 5, this control is not sufficiently formalised.[60] For AMC 4, the inspection task force found that two different funds exceeded the maximum fee rate without the AMC detecting this previously. The fee rates set for these two funds are 1.465% and 1.2924% respectively, compared with the maximum rates of 1% and 1.2% set out in the prospectuses.

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59 A rule that results in only a limited and fixed number of decimal places after the decimal point.

60 AMC 3 started to formalise this control only in July 2019. However, no exceeding of the maximum fee rate was reported in the operational incident database or in the permanent control reports between January 2018 and June 2019. AMC 5 has not formalised this control at all. Here again, however, the sampling check carried out by the second-level permanent control did not detect that any maximum fee rates had been exceeded.

5.7.2. Control of entry fees paid to the distributor

The SPOT campaign found that the majority of AMC 5's UCITS (between 89% and 99%) charge entry fees. However, they made up only a small proportion of average revenue over the three years inspected (between 0.1% and 2%).

For the 49 AMCs in the study, entry fees, unlike other fees, are not paid to the fund but rather are paid directly by investors to the distributor without passing through the AMC's accounts. This is the case for AMC 4 in the SPOT campaign.

The prospectuses of the funds concerned stipulate maximum entry fees. It is therefore up to the AMC to check that the fees actually paid are below the maximum.
In practice, less than 40% of the AMCs surveyed do so.

Some AMCs indicate that they control the entry fees on each subscription in the following cases (not exhaustive):
- Entry fees are paid to the distributor as a rebate.
- The AMC centralises all subscriptions/redemptions for the funds it manages.
- The depositary provides information for each subscription where entry fees would be paid (in one case, the AMC approves each transaction).

The AMCs report that this approach is supplemented by a second-level control of the controls carried out by the centralising agent or depositary.

However, some AMCs do not perform any controls in this area. They rely on controls that may be performed by the depositary or on the fact that a maximum is stipulated in the distribution agreement. This is the case for the five AMCs tested in the SPOT campaign.

5.7.3. Controls on marketing materials

The process most frequently described by the AMCs surveyed in terms of controls on marketing materials is for compliance teams to ensure consistency with the KIID. In about a quarter of the cases, the pricing information used in KIIDs and marketing materials is stored in the same database. This allows the AMC to ensure that there are no inconsistencies between the two types of document. In other cases, where marketing materials refer to the level of ongoing fees, ex post controls are carried out to verify the consistency of the documents.

5.7.4. Incident and complaint management procedure and organisation

All 49 AMCs in the sample have an incident management procedure. Only a minority of them do not have a predefined level for the seriousness of incidents.
The incident management process is triggered based on first-level controls performed by the middle office.[61] The investigations carried out as part of the SPOT campaign revealed the following main findings:
- An ex ante control carried out on configuring the approved costs and fees in the relevant systems.
- An ex post control carried out by type of fee once the cost and fee amounts had been calculated by the systems and/or the ad hoc teams. The inspection task force noted that direct/indirect management fees, turnover commissions and performance fees are particularly targeted.

Following these controls, any error found results in an incident report. The five AMCs inspected have a dedicated procedure for incident reporting and a database for recording such incidents. However, the incident management process is not operational for AMCs 1, 3 and 4. For the first two, the procedure in place does not specify the impact

61 In addition to this internal due diligence, the funds' statutory auditors verify the costs and fees charged as part of their periodic due diligence. Any errors detected are documented in the annual reports on the funds' accounts. No errors of this type were identified by the inspection task force in the course of their investigations.

thresholds above which the NAV must be recalculated nor the method of compensating investors. For the third, its database does not include the gains/losses (in euros) at stake, the date the incident was resolved or the remedial measures taken.[62]

5.7.5. Volume and handling of incidents and complaints

Of the 49 AMCs in the sample, 21 reported incidents relating to calculating or disclosing costs and fees since January 2019. The errors identified are of low impact. The main types of errors were incorrectly setting the level or rules for calculating fees (particularly with regard to performance fees) and failing to apply the rebate rate to the fees charged.

The work carried out as part of the SPOT campaign supports this analysis. The volume of incidents relating to management costs and fees that had an impact on the NAV of managed funds is low (less than 10%) for the five AMCs inspected during the inspection period. AMC 2 did not experience any incidents of this type. For AMCs 1 and 5, these incidents were related to errors in setting the rules for calculating performance fees. None of these incidents had an impact on investors (AMC 5 asked the funds' statutory auditors to confirm its analysis).

Furthermore, no complaints were received about calculating and/or charging management costs and fees for the retail UCITS managed by the five AMCs inspected, except in the case of AMC 5. Of the complaints AMC 5 received between January 2018 and December 2020, 46% (6 of 13) related to ongoing fees that were considered too high in relation to the performance of two of the UCITS managed. However, it is worth putting this significant percentage into perspective: all six complaints were made by a single client.

Regulatory reminders

- **Article 321-23 (IV) of the AMF GR**: AMCs *"shall establish and maintain effective and adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the asset management company"*.
- **Article 321-30 of the AMF GR**: already cited above.

Poor practices

- Not implementing a formalised control for detecting, when setting fees, whether the maximum management and operating fees rate, at each NAV date, has been exceeded.
- Failure to implement an operational system for managing incidents relating to management costs and fees, consisting of:
  - a procedure specifying the impact thresholds above which the NAV must be recalculated and the method for compensating investors;
  - an incident database that includes the gains/losses (in euros) at stake, the incident resolution date and the remedial measures taken.

5.8. PERMANENT AND PERIODIC CONTROL SYSTEMS FOR COSTS AND FEES

In addition to the first-level controls described above, the work carried out as part of the SPOT campaign provided an understanding of the permanent and periodic control systems used by the five AMCs inspected. These systems can be broken down as follows.

[62] Investor information, whether or not investors are compensated and the amount and date of compensation, if any.

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Compliance Officer	In-house (100% of his/her working time)	In-house (100% of his/her working time)	In-house (function performed by the AMC's legal director at 50% of her working time)	In-house (100% of his/her working time)	In-house (100% of his/her working time)
Team responsible for **permanent controls** (in addition to Compliance Officer)	7 in-house employees	1 in-house employee	2 group internal control employees, seconded to the AMC for 100% of their working time	None	Internal control delegate (22 work days per year)
Team responsible for **periodic controls**	Group general inspectorate		Group internal audit		Group internal audit and external firm

The main risks relating to costs and management fees are identified in each of the five AMCs' risk maps:

- Incorrect calculation of management costs and fees (which could lead to significant NAV errors);
- Charging of undue costs;
- Errors in the regulatory documentation produced;
- Excessive fund turnover (in relation to turnover commissions);
- Insufficient/ineffective management of conflicts of interest (in relation to internal/external partners receiving remuneration for fund management).

Compliance and internal control plans ("PCCIs") cover each of these risks with ad hoc controls.

However, with the exception of AMC 1, there are **significant shortcomings in the implementation of the planned controls**. For example, during the period under review:

- for AMC 5: no controls were carried out on brokerage and research fees and on rebates to distributors. Furthermore, the turnover rate control sheets and regulatory documentation produced in 2018 and 2019 do not shed any light on the due diligence performed. Lastly, no controls were carried out on marketing materials in 2018 and 2019;
- for AMC 4: no controls were carried out on the remuneration received by the AMC in 2019 and 2020, nor on the periodic reports produced between 2018 and 2020, nor on the quality of the delegated middle-office service, nor on turnover commissions, performance fees or rebates paid;
- for AMC 3: despite their inclusion in the PCCI, no permanent control report was produced on the completeness and accuracy of KIIDs/prospectuses and reporting, marketing materials (in 2018), conflict of interest management (in 2020) and brokerage fees (in 2019 and 2020);
- for AMC 2: the control sheets relating to marketing materials do not explain the rules for selecting the sample tested.

Nevertheless, the inspection task force notes that the control sheets produced **do not reveal any significant anomalies** in the process for setting, calculating, charging and managing retail UCITS' costs and management fees.

However, the follow-up of (minor) anomalies found in the control sheets examined is inadequate for AMCs 2, 4 and 5. The remediation plans associated with these anomalies are not mentioned either in the control sheets following those that identified the anomalies or in the reports produced by internal committees (dedicated to compliance, internal control and/or risk).

Lastly, the lack of a periodic control in each of the three consecutive years of the inspection period was noted in relation to management costs and fees for AMCs 1, 2 and 4. AMCs 3 and 5 were audited in this area by their respective groups. The findings from these audits, which in both cases focused on the need to strengthen the control system for fees at first and second levels, were covered by formal remediation plans that the inspection task force examined.

AUTORITÉ DES MARCHÉS FINANCIERS AMF

Regulatory reminders

- **Article 321-23 (IV) of the AMF GR**: AMCs *"IV […] shall establish and maintain effective and adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the asset management company".*
- **Article 321-27 of the AMF GR**: *"AMCs shall monitor and, on a regular basis, to evaluate the adequacy and effectiveness of their systems, internal control mechanisms and other arrangements established in accordance with Articles 321-23 to 321-26, and to take appropriate measures to address any deficiencies."*
- **Article 321-30 of the AMF GR**: *"AMCs shall establish and maintain appropriate operational policies, procedures and measures to detect any risk of non-compliance with the professional obligations referred to in II of Article L. 621-15 of the French Monetary and Financial Code and the subsequent risks and to attenuate those risks. For the purposes of the preceding paragraph, asset management companies shall take into account the nature, scale, complexity and range of the businesses that they engage in."*
- **Article 321-31 (I)(1) of the AMF GR**: *"I. – The AMC shall establish and maintain an effective compliance function that operates independently. Its role is to: Monitor and, on a regular basis, assess the adequacy and effectiveness of policies, procedures and measures implemented for the purposes of Article 321-30, and actions taken to remedy any deficiency in compliance of the asset management company and the relevant persons with their professional obligations referred to in II of Article L. 621-15 of the Monetary and Financial Code."*
- **Article 321-83 of the AMF GR**: *"AMCs, where appropriate and proportionate in view of the nature, scale, complexity and range of their business, shall establish and maintain an effective internal audit function which is separate and independent from their other functions and activities and which has the following responsibilities: (1) To establish and maintain an effective audit plan to examine and evaluate the adequacy and effectiveness of the asset management company's systems, internal control mechanisms and arrangements; (2) To issue recommendations based on the result of work carried out in accordance with point 1; (3) To verify compliance with those recommendations; (4) To provide reports on internal audit issues in accordance with Article 321-36."*

Poor practices

- Failure to ensure regular and formalised follow-up of anomalies identified by internal control in the process of setting, calculating, charging and managing UCITS costs and fees.
- Failure to carry out periodic control audits of the main items relating to UCITS management costs and fees.