



Self-Assessment Questionnaire, Separate Report and Management Letter for Funds

CSSF Feedback Report

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I. Context

On 22 December 2021, the CSSF published the Circulars CSSF 21/788, 21/789 and 21/790 whose aim is to improve the risk-based supervision of the CSSF, both for prudential and AML/CFT purposes, concerning investment fund managers and undertakings for collective investment.

Circular CSSF 21/790, which applies to UCITS, UCIs subject to Part II of the Law of 17 December 2010 concerning undertakings for collective investment ("**UCIs Part II**"), specialised investment funds ("**SIFs**") and investment companies in risk capital ("**SICAR**") (collectively referred to as "**UCIs**"), introduced the following requirements:

- a self-assessment questionnaire ("**SAQ**") to be completed on an annual basis by UCIs, under the responsibility of the *dirigeants* of UCIs¹, including questions on predefined topics taking due account of the characteristics of the different types of UCIs as well as the associated risks (e.g. asset valuation, investment compliance, NAV determination, costs/expenses);
- a separate report ("**SR**") to be completed by the statutory auditor ("**auditor**") of the UCIs for each year or period for which an SAQ has been submitted by the UCI, where the auditor is asked notably to verify, on the basis of a set of procedures defined by the CSSF, the accuracy of certain answers provided by the UCI in the SAQ and to provide answers to a set of predefined questions;
- a specific regulatory framework for the management letter ("**ML**") that the statutory auditor must draw up for each year or period subject to a statutory audit to the attention of the *dirigeants* of UCIs, including notably a standardised format for the ML where weaknesses or points for improvement identified have to be classified under predefined topics and assessed by means of predefined questions;
- a requirement for the *dirigeants* of UCIs to inform the CSSF proactively in case the auditor issues in the context of the statutory audit of accounting data ("**audit**") a modified audit opinion included in the annual report of a UCI.

The SAQ, SR and ML are made available to UCIs in the module « Collective Investment Sector Reporting Tool » ("**CISERO**") on the CSSF eDesk Portal in order to allow entities to prepare and to file the reports with the CSSF. Since 15 November 2023, an IT solution optimising the filling in of the SAQ for the UCIs, within the scope of Circular CSSF 21/790, is available. This solution allows notably to fill in the questionnaire through a structured file transmitted to the CSSF via the S3 ("simple storage service") protocol.

Since their introduction, the CSSF proceeded to limited updates of these reports in order to clarify certain questions and to complement, in view of the applicable regulatory requirements, certain topics of the reports.

Based on the review of the SAQs, SRs and MLs transmitted by the UCIs to the CSSF, the CSSF notes an overall satisfactory level of compliance of the UCIs with the applicable regulatory requirements.

In case the CSSF identified cases of (potential) deficiencies / non-compliances in the context of the review of the above-mentioned reports introduced by the Circular CSSF 21/790, the CSSF intervened, in accordance with a risk-based approach, towards the UCIs / IFMs with the aim of

¹ The *dirigeants* of UCIs as referred to in Article 129(5) of the UCI Law, Article 42(3) of the SIF Law and Article 12(3) of the SICAR Law (e.g. the board of directors, the board of managers).

addressing the (potential) deficiencies / non-compliances identified in these reports and to require, if any, corrective measures in order to remedy these deficiencies.

The present CSSF Feedback report sets out in Section II (“Observations”) hereafter the observations made by the CSSF in the context of the review of the SAQ, SR and ML of UCIs transmitted to the CSSF, together with the related recommendations for improvement.

The CSSF hereby invites all UCIs and their investment fund managers (where applicable) to carry out a benchmarking exercise against these observations and to proceed in a next step to the necessary corrective measures (if applicable).

II. Observations

1. Organisation of the Fund

1.1. Preliminary information on UCIs

As at 31 December 2023, there are 3.274 UCIs domiciled in Luxembourg which fall in the scope of the SAQ, SR and ML, out of which 1.596 UCITS (49%), 239 UCIs Part II (7%), 1.246 SIFs (38%) and 193 SICARs (6%).

According to the SAQ, the majority of the non-UCITS (sub-)funds (i.e. UCIs Part II, SIFs and SICARs) are open-ended (60% of non-UCITS). For SIFs, which represent 77% of the total non-UCITS (sub-)funds, 41% of (sub-)funds are closed-ended.

For UCITS, the frequency of investor redemptions is daily for 94% of the (sub-)funds. For open-ended non-UCITS funds, daily frequency is prevalent, accounting for 37% of (sub-)funds, followed by a monthly frequency for 26% of (sub-)funds, weekly for 13% of (sub-)funds and quarterly for 8% of (sub-)funds.

1.2. Oversight of the UCI

1.2.1. Formal meetings of the *dirigeants* of UCIs

According to the SAQ, the vast majority of UCIs (UCITS and non-UCITS) hold formal meetings at least on a quarterly basis where, based on the responses received, a wide range of topics are regularly covered by the *dirigeants* of the UCIs (e.g. portfolio management, oversight of delegates, valuation, capital transactions, AML/CFT, regulatory developments, conflicts of interests, investment compliance, relationship with depositary, etc.).

The CSSF expects the *dirigeants* of UCIs to organise formal meetings according to a frequency which allows them to ensure an adequate oversight of the activities of the UCIs. The determination of the frequency shall notably take into account the specificities and risks related to the UCIs. For instance, for open-ended UCIs, the CSSF would not consider a frequency lower than quarterly to be appropriate.

The responses in the SAQ showed for a limited number of UCIs that these formal meetings did not cover the oversight of entities / service providers playing a key role in the functioning of the UCIs (e.g. appointed authorised investment fund manager, certain direct delegates of the UCI such as portfolio manager, UCI administrator).

In this context, the CSSF emphasises that all important areas / topics with regard to the functioning of UCIs shall be covered during the formal meetings of the *dirigeants* of UCIs. Accordingly, in case UCIs appoint an authorised investment fund manager (“**IFM**”) and/or directly delegate key activities to specialised service providers, the CSSF expects the *dirigeants* of UCIs to carry out an adequate oversight by having amongst others standing agenda items of their formal meetings addressing these areas / topics.

1.2.2. Conflicts of interest

According to the SAQ, an effective conflicts of interest policy and related procedures were in place for most UCIs (UCITS and non-UCITS).

The SAQ indicated for a limited number of UCIs that no effective conflicts of interest policy and related procedures were in place (i) to identify the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of the UCI and/or its investors and (ii) to manage existing (if any) material conflicts of interest. Among these limited cases, the majority of these UCIs indicated that a conflicts of interest policy and procedures were set-up at the level of the authorised investment fund manager (“IFM”) and not at the UCI level. The remaining UCIs represented some SIFs and SICARs, without an IFM, which reported not having an effective conflicts of interest policy and procedures in place.

In this context, the CSSF wishes, first of all, to point out that UCIs having appointed an IFM shall for the purpose of the questions pertaining to the identification / management of conflicts of interest at the level of the UCIs also take into account the policies and procedures in place at the level of the appointed IFM. Furthermore, the CSSF expects the UCIs to give due consideration to conflicts of interest that are specific to the UCI as a result of its organisational set-up and functioning.

While the CSSF understands, based on its supervisory work, that UCIs, which have appointed an IFM, have not always considered in their responses in the SAQ the policies, processes and procedures in place at the level of the appointed IFM, it wants to remind that, in accordance with Article 20 of CSSF Regulation 10-4 and Article 31 of the Commission Delegated Regulation (EU) 231/2013 (“CDR 231/2013”), an IFM must establish, implement and maintain an effective conflicts of interest policy.

With regards to SIFs and SICARs which are not managed by an IFM, representing a small part of the SIFs and SICARs in Luxembourg, the CSSF reminds that such UCIs shall be structured and organised in such way as to minimise the risk of investors' interests being prejudiced by conflicts of interest. More particularly, in accordance with Article 9 of CSSF Regulation 15/07 and Article 7 of CSSF Regulation 15/08, SIFs and SICARs, which have not appointed an IFM, are required to keep and regularly update a record of the types of collective portfolio management activities carried out by or on behalf of the UCI in which a conflict of interest entailing a material risk of damage to the interests of the UCI has arisen, or, in the case of an ongoing collective portfolio management activity, may arise.

Furthermore, these SIFs and SICARs must also, in case of possible conflicts of interest, ensure to safeguard investors' interests as required by Article 42a. (2) of the Law of 13 February 2007 relating to specialised investment funds (the “SIF Law”) and under Article 7a. (1) of the Law of 15 June 2004 relating to the investment company in risk capital (the “SICAR Law”).

Generally speaking, the CSSF expects that an effective conflicts of interest policy and effective procedures are in place for all UCIs (where the policies, processes and procedures in place at the IFM level, if applicable, shall be considered for the purpose of the responses of the SAQ).

This is of particular importance considering that, based on the SAQ review, a significant number of UCIs, which reported having such a policy in place, identified material conflicts of interest which require attention.

1.2.3. Investors in UCIs, SIFs and SICARs

In the context of the SAQ review, the CSSF observed that a limited number of SIFs and SICARs, in most cases UCIs which have not appointed an IFM, reported not having procedures in place to ensure that all investors are well-informed in accordance with Article 2 of the SIF Law or Article 2 of the SICAR Law.

Most of the concerned UCIs justified the absence of such procedures by explaining, for instance, that these UCIs were closed-ended.

In accordance with the additional explanations given under the so-called tooltip in the SAQ (“**tooltip clarifications**”), the CSSF expects that the processes/procedures in place for SIFs / SICARs ensure in any case that the well-informed status of investors in a SIF or SICAR is verified. This holds also true for the investors in closed-ended SIFs and SICARs.

An additional tooltip will be added in CISERO clarifying that, if the SIF or SICAR has appointed an IFM or other service provider for the purpose of verifying the well-informed status of the investors, a good practice is to formally approve such procedure by the *dirigeants* of UCIs.

2. Investment Compliance

The CSSF observed in the context of the SAQ and SR review that the UCIs have in general robust policies, processes and procedures in place for ensuring that the investments made are complying with applicable legal, regulatory and contractual provisions applicable to the UCIs.

2.1. Treatment of active and passive breaches

The CSSF observed that the organisational set up in place for a limited number of SIFs, in most cases SIFs which have not appointed an IFM, did not provide for a formalised policy that covers the treatment of active and passive investment breaches that may occur at the level of the (sub-)fund(s).

This observation does not comply with the expectations of the CSSF as communicated in former communications (including notably the CSSF FAQ on Circular CSSF 02/77) to the fund industry.

In this context, the CSSF reminds the industry of the introduction of the new Circular CSSF 24/856 on investor protection in the event of an NAV calculation error, an instance of non-compliance with the investment rules and other errors at UCI level, which comes into effect on 1 January 2025 and replaces Circular CSSF 02/77.

This new circular is applicable to all regulated UCIs (UCITS, UCIs Part II, SIFs, SICARs) and notably requires, in chapter 5, adequate control mechanisms to be in place at the level of the UCIs or the IFM, where applicable, to ensure ongoing compliance with the investment rules governing the functioning of UCIs and that the control arrangements, also including the frequency of the controls, must be laid down in the policies and procedures in place for the UCIs.

2.2. Investment compliance control framework

The SAQ review showed that a very limited number of UCIs stated not having an investment compliance control framework in place for the UCI which provides for materialised, standardised and/or automated post-trade (ex post) investment compliance controls (i.e. controls realised by the UCI, its IFM or a specialised service provider independent from the portfolio manager).

Many of these UCIs explained that they did have post-trade investment compliance controls in place, but that such controls were not standardised and/or automated considering in particular the nature of the investments or the size of the portfolio of the UCI.

As explained in the tooltip clarifications in CISERO, the CSSF acknowledges, in application of the principle of proportionality (e.g. UCIs with lower number of investments or lower investment activity), that the control processes do not always have to take the form of automated controls, but can be carried out through IT backed manual controls. In case of materialised / standardised controls that are manual, UCIs should positively reply to the related question in the SAQ.

Among this limited number of UCIs, the CSSF also observed that a small number of UCIs did not have a fully comprehensive ex post investment compliance control framework in place for investment rules pertaining to the Sustainable Finance Disclosure Regulation ("SFDR") as some limited SFDR investment rules were not covered by this control framework. In this context, the CSSF reminds the industry of the CSSF FAQ on the Sustainable Finance Disclosure Regulation (SFDR) setting out under Question 4 that "*minimum thresholds of investments shall be considered as binding commitments of the investment strategy of the fund. The IFMs must ensure ongoing compliance with all the rules laid down in the prospectus/issuing document of the funds they manage (...).*"

The CSSF highlights that UCIs must have an (ex post) investment compliance control framework in place (i.e. controls realised by the UCI, its IFM or a specialised service provider independent from the portfolio manager) which covers all legal, regulatory and contractual investment restrictions applicable to the UCI.

2.3. Eligibility requirements for investments by UCITS

The CSSF observed in the context of the SAQ review that a limited number of UCITS did not have the following pre-trade controls in place:

- (i) the identification of any investments to be qualified in accordance with Article 41(2) (a) (i.e. "trash ratio") of the Law of 17 December 2010 concerning undertakings for collective investment;
- (ii) the carrying out (in accordance with the CSSF Feedback report dated 22 June 2021 on the ESMA Common Supervisory Action on UCITS Liquidity Risk Management) of adequate and documented liquidity analyses and forecasts at pre-investment level for trash ratio investments; and
- (iii) the verification of compliance with all applicable regulatory requirements for trash ratio investments.

The main reasons set out by UCIs in relation to the absence of such controls pointed to the following:

- no trash ratio is currently foreseen by the UCITS;
- there are no pre-trade controls, but only post-trade controls;
- the pre-trade controls lack a (documented) pre-trade liquidity assessment.

The review procedure of the auditor, through the SR, confirmed this observation.

In this context, the CSSF reminds that, in view of the due diligence obligation provided for in Article 26 of CSSF Regulation 10-4, an IFM must ensure for the UCITS managed that *“when implementing their risk management policy, and where it is appropriate after taking into account the nature of a foreseen investment, shall formulate forecasts and perform analyses concerning the investment’s contribution to the UCITS’ portfolio composition, liquidity and risk and reward profile before carrying out the investment. These analyses must only be carried out on the basis of reliable and up-to-date information, both in quantitative and qualitative terms.”* (emphasis added)

Furthermore, IFMs must, for the UCITS managed, ensure that the risks of the transferable securities acquired are adequately captured by the risk management process in place for the UCITS.

In order to comply with these obligations, the CSSF expects IFMs that manage UCITS, which invest in accordance with the prospectus in transferable securities falling under the trash ratio, to implement the necessary pre-trade controls on such investments. These pre-trade controls shall be in place before investing in such securities.

3. Valuation

The CSSF observed in the context of the SAQ and SR review that the UCIs have in general robust valuation policies, processes and procedures in place in order to ensure that the valuation of the investments is made in compliance with the provisions of the applicable legal and regulatory provisions as well as the prospectus / offering document.

3.1. Oversight & valuation policies, processes and procedures

3.1.1. Formal approval of the valuation policy/procedures in place for UCIs

The CSSF observed in the context of the SAQ review that, for some UCIs, the *dirigeants* of UCIs did not approve formally (e.g. minutes of a meeting, resolution) the valuation policies and procedures applicable for the respective UCI.

Many of these UCIs explained that the valuation policies and procedures are adopted at the level of the IFM which covers the valuation of all the funds under management and that the specificities of the valuation of the UCIs are covered in the prospectus / offering document which is approved by the *dirigeants* of UCIs.

The CSSF wishes, first of all, to remind, in accordance with the tooltip clarifications provided in CISERO, that a formal approval goes beyond the mere approval of the prospectus provisions laying down the overarching principles governing the valuation of the investments of the UCIs.

Given the ultimate responsibility of the *dirigeants* of UCIs for the functioning of the UCIs, the CSSF expects the *dirigeants* of UCIs to carry out an adequate oversight of the valuation of the investments of the UCIs. For that purpose, the CSSF expects the *dirigeants* to formally approve the valuation policies and procedures in place for the UCIs, thereby giving due consideration to the valuation risks to which the UCIs are exposed to. This shall ensure that the *dirigeants* of UCIs have an adequate understanding of the valuation policies and procedures in place for the UCIs so as to enable them to meet their oversight duties.

The CSSF further expects the *dirigeants* of UCIs to formally approve the use of valuation models in the context of the valuation of investments which are material in the UCIs’ portfolio. The CSSF does however not expect the *dirigeants* of UCIs to validate the models in place. The CSSF expects

the *dirigeants* rather to have an overall understanding of the valuation models that are used, together with their main features and key drivers.

Considering that the *dirigeants* of UCIs have the ultimate responsibility for the valuation of the investments of UCIs, they shall be comfortable with the valuation methods applied.

3.1.2. Escalation process of material valuation issues

The SAQ review showed that a very limited number of UCITS, respectively a limited number of non-UCITS, stated that their organisation did not provide for an escalation process to the *dirigeants* of UCIs (e.g. escalation by the IFM if any) in case of significant valuation issues which may impact investors' interest.

The CSSF emphasises the importance of such escalation process in the context of the oversight work performed by the *dirigeants* of UCIs concerning the valuation of the investments and expects significant valuation issues (i.e. UCI-specific or market-driven) to be escalated on a timely basis, whether or not these issues are managed by the IFM of the UCI or by a dedicated valuation committee.

As a result, the CSSF expects the *dirigeants* of UCIs, in the context of their oversight duties, to be aware of the significant valuation issues affecting UCIs and to perform the necessary follow-ups in view of remediation (if necessary).

3.1.3. Valuation frequency of investments of the UCIs

The CSSF observed in the context of the SAQ review that a limited number of UCIs invested a material portion of their NAV in assets or financial derivative instruments ("**FDIs**") which were valued at a frequency lower than the frequency of the net asset value determination.

In this context, the CSSF wishes to point to the importance for open-ended UCIs to have in place appropriate procedures that ensure the proper and accurate valuation of the assets and liabilities of the UCIs for the calculation of each net asset value so as to ensure that the net asset value is accurate and that subscription and redemption orders can be properly executed at that net asset value, in the best interest of all the investors of the UCIs.

In this context, the CSSF expects open-ended UCIs to have an alignment between the frequency of the net asset value determination and the frequency of the valuation of investments.

The CSSF wishes to remind in this context the provisions of Article 74 of the CDR 231/2013 supplementing the AIFM Directive 2011/61/EU laying down "1. *The valuation of financial instruments held by open-ended AIFs shall take place every time the net asset value per unit or share is calculated pursuant to Article 72(1)*. 2. *The valuation of other assets held by open-ended AIFs shall take place at least once a year, and every time there is evidence that the last determined value is no longer fair or proper.*" (emphasis added)

In the event an open-ended UCI invests a material portion of its NAV in "other assets", as referred to above, which are valued at a lower frequency than the net asset value determination, the CSSF expects the UCI to be able to demonstrate that the last determined value of such other assets remains fair and proper for the net asset value determination.

3.1.4. Arm's length character of transactions

According to the SAQ, the organisational set up in place for some UCIs (including at the level of the IFM if applicable) does not provide for a documented procedure whose objective is to ensure

that transactions on quoted and unquoted investments (incl. FDIs), concluded with related parties to the UCI, are done on an arm's length basis. In the comments provided in the concerned SAQs, many UCIs confirmed that such a documented procedure would promptly be put in place.

In this context, the CSSF wishes to highlight that the different sectorial regulations of UCIs require the identification and proper management of conflicts of interest in relation to the activities of collective portfolio management carried out by or on behalf of the UCIs. In addition, the processes in place for UCIs shall ensure the best execution of portfolio transactions.

The CSSF thus expects, for all UCIs, that a documented procedure, whose objective is to ensure that transactions on quoted and unquoted investments (incl. FDIs) concluded with related parties to the UCI are done on an arm's length basis, is in place.

3.1.5. Independent valuation source

The CSSF observed in the context of the SR review that for a very limited number of UCITS, the auditor pointed to individual investments valued on the basis of prices/valuations obtained from a source which was not independent and for which a documented analysis with relevant and observable facts, to ensure that the prices/valuations represent the fair value of the investments, was not available.

The majority of the concerned investments were more complex structured products listed on a stock exchange, but for which prices were provided by the issuer of the product, entailing thus a risk of conflicts of interest.

The CSSF expects for UCIs investing in more complex structured products, valued on the basis of prices/valuations obtained from a source which is not independent, to have the necessary processes in place (e.g. valuation cross-checks, reasonableness test, etc.) to ensure that the prices/valuations provide for a reliable and independent valuation of the investment.

3.2. Modified audit opinions and Management letter observations

The CSSF noted that most UCIs have clean audit opinions and no ML observations.

For the limited number of UCIs which did have a modified audit opinion and/or ML observations, the CSSF noted that findings relating to valuation is the main category of findings raised by the auditors in the different closing documents (i.e., annual reports, MLs, SRs) of the UCIs. Moreover, the CSSF observed that the vast majority of the modified audit opinions issued by the auditors is related to non-UCITS.

The reasons underlying the modified audit opinions mostly concern the absence of or the lack of information and/or documentation supporting the fair valuation of one or several asset(s) in the UCI portfolio.

In this context, the CSSF expects that the availability of the information / documentation allowing the fair valuation of the assets of the UCIs is verified and ensured before the investment decision is taken and on an ongoing basis during the holding period of the investments.

In case the auditor includes a modified audit opinion in the audit report issued in the context of the statutory audit of the UCI, the CSSF would also like to remind UCIs that Circular CSSF 21/790 requires the *dirigeants* of UCIs to send a letter to the CSSF, without having been expressly required to do so by the latter, explaining the underlying reasons for the modified audit opinion, its impact on the UCI and its investors as well as the corrective measures, including the timeline for their implementation, taken by the *dirigeants*.

The information to be included in this letter and the delivery modalities are available under the following link: <https://www.cssf.lu/en/Document/follow-up-on-modified-audit-opinions-issued-by-the-approved-statutory-auditors-in-the-context-of-the-statutory-audit-of-ucis/>

Furthermore, the CSSF observed in the context of the review of the ML that UCIs investing in less liquid / illiquid assets generally have robust valuation processes and procedures in place. Nevertheless, for a limited number of UCIs in the alternative investment fund space and investing in less liquid / illiquid assets, the CSSF observed room for improvement, for instance, with respect to:

- the availability in due time of the audited annual reports of the underlying investments in order to corroborate the fair valuation of these investments;
- the monitoring of the appropriateness of the valuation models used for less liquid/ illiquid investments (e.g. private equity, private debt, real estate), considering the specificities of these investments.

4. NAV determination

4.1. Accounting standards

Based on the data gathered through the SAQ, Luxembourg generally accepted accounting principles ("Lux GAAP") is the accounting standard which was adopted by most UCIs (i.e. over 90% of UCIs) for the preparation of their annual report, followed by International Financial Reporting Standards ("IFRS").

4.2. Market timing

The SAQ review showed that some UCIs did not perform a documented assessment regarding the risk of market timing for all the active sub-funds. This observation was confirmed by the auditors as part of the SR.

In this context, the CSSF would like to remind UCIs that Circular CSSF 04/146 stipulates that *"The cut-off time, the time at which the securities prices which are taken into account for the calculation of the NAV are fixed and the time at which the NAV is calculated must be combined in a manner so as to minimise any arbitrage possibilities arising from time differences and/or imperfections/deficiencies in the method of determination of the NAV of the UCI. UCIs which, due to their structure, are exposed to Market Timing practices must put in place adequate measures of protection and/or control to prevent and avoid such practices. The introduction of appropriate subscription, redemption and conversion charges, an increased monitoring of dealing transactions and the valuation of the portfolio securities at "fair value" may constitute possible solutions for such UCIs. The board of directors of the UCI analyses such solutions with care and will implement them or make certain that they are implemented."* (emphasis added)

As explained in the tooltip clarifications provided in CISERO, the general coverage of the risk of market timing (as defined by Circular CSSF 04/146) in the prospectus of the Fund is not considered sufficient by the CSSF.

The CSSF expects, upon launch of a sub-fund or in case of material changes to a sub-fund that modifies its exposure profile to the risk of market timing, that this risk is subject to a specific and documented assessment in order to ensure that the rules on market timing are complied with.

4.3. Liquidity Management Tools (“LMTs”)

According to the SAQ, the vast majority of open-ended UCIs have a wide range of Liquidity Management Tools (“LMTs”, i.e. anti-dilution levy, swing pricing, lock-up, redemption gating, redemption deferral, redemption in kind, side pocket, dual pricing and temporary suspension of redemption) at their disposal for ensuring an effective liquidity management of the UCIs.

However, a limited number of open-ended UCIs reported to have only one LMT at their disposal, being the possibility to temporarily suspend redemptions.

The CSSF considers that these UCIs shall review their LMT toolkit and, in view of their (liquidity) risk profile, avail themselves of a wider range of LMTs allowing them to manage liquidity and dilution risks under normal and stressed market conditions.

In this context, the CSSF wishes to refer to the CSSF working paper “An Assessment of Investment Funds’ Liquidity Management Tools”, showing that LMTs, such as swing pricing, can mitigate dilution of the fund value. In addition, the study showed that swing pricing dampens fund outflows during episodes of elevated market volatility, except during episodes of systemic stress, such as the March 2020 turmoil.

The CSSF further observed in the context of the SR review that very few exceptions were raised by auditors in relation to LMTs. In limited cases, auditors raised exceptions with regard to the existence of a documented internal policy / procedure in place for the UCI concerning the application of (i) the anti-dilution levy process or (ii) the swing pricing process.

In this context, the CSSF expects a documented internal policy/procedure to be in place for the UCIs concerning the application of the LMTs available for the UCIs.

5. Expenses

5.1. Other recurring costs (“ORC”) / total expense ratio (“TER”) and formalised assessment of costs/fees

The SAQ review showed that UCIs globally have a level of other recurring costs (“ORC”) or a total expense ratio (“TER”) that is consistent with the levels generally observed for their respective asset class category (e.g. bonds, equities, etc.).

More specifically for UCITS, the CSSF identified a very limited number of funds with a level of costs/fees that is too high compared to those observed for similar funds and requested the respective outlier UCITS / their IFMs to take and implement the necessary corrective measures/actions in order to remediate the situation in a short delay and in the best interest of these UCITS’ investors.

The main reason for the high level of costs/fees for these UCITS was the low amount of assets under management. The CSSF has also noted in this respect that the fixed costs represent a large portion of these high level of costs/fees for the UCITS with a low amount of assets under management.

The CSSF further performed a detailed and close follow-up of the UCITS / IFMs concerned in order to ensure that the necessary corrective measures (e.g. significant decrease in fees following the renegotiation of contracts, liquidation, merger) are implemented to remedy the situation within a short timeframe.

In this respect, the CSSF will continue its reviews and analyses of the levels of costs/fees charged to UCIs by means of dedicated thematic analyses, based in particular also on the information collected through the SAQ for UCIs.

In the context of the SAQ review, the CSSF also observed that some UCIs responded that no formalised assessment was in place for the UCIs (including at the level of the IFM if applicable) to notably verify that the costs/fees are proportionate compared to market standards and to the type of services provided.

It is the responsibility of the *dirigeants* of UCIs to ensure, on an ongoing basis, an efficient management of the UCIs in the best interest of investors and to react immediately when the financial situation of a UCI does no longer allow for such an efficient management. In order to ensure such efficient management, the CSSF expects a formalised assessment of the costs/fees together with the level of ORC / TER of the different share classes of the UCIs to be in place for UCIs.

The CSSF expects furthermore that the costs/fees for a given UCI are, at least on an annual basis, discussed in a formal meeting of the *dirigeants* of UCIs. For that purpose, the discussion shall be supported by quantitative and qualitative information allowing a thorough exchange and related decisions (if necessary).

5.2. Efficient Portfolio Management (“EPM”) / Securities Financing Transactions (“SFT”) operational costs/fees

The CSSF observed in the context of the SAQ review that for a limited number of UCITS, which concluded EPM/SFT transactions, the organisational set up does not provide for a comprehensive assessment of the adequacy of the operational costs/fees that are deducted from the gross revenues arising from EPM/SFT transactions in order to justify the ratio of gross revenues to direct and indirect operational costs/fees arising per EPM/SFT.

In this context, the CSSF would like to remind UCITS of the “CSSF FAQ – Use of Securities Financing Transactions by UCITS” which clarified that “*The CSSF expects UCITS IFMs to perform a comprehensive assessment of the adequacy of the operational costs / fees that are deducted from the gross revenues arising from SFTs.*”

In order to comply with the present requirement and notably ensure that the costs / fees do not include any hidden revenue, UCITS IFMs must be able to justify, by means also of quantitative information, the relevance of the underlying cost drivers which make up the total costs / fees borne by the UCITS. In a general manner, UCITS have to be able to justify the ratio of gross revenues to direct and indirect operational costs / fees arising per SFT and to provide corresponding documentary evidence of the underlying rationale.” (emphasis added)

As a reminder of the feedback provided already in the “CSSF feedback report on ESMA Common Supervisory Action on the Supervision of Costs and Fees of UCITS”, IFMs / UCITS have to adhere in that context strictly to the guidance given by the CSSF in the above mentioned CSSF FAQ.

6. Relationship with depositary

In general, based on the SAQ and SR review concerning the relationship of the UCIs with their depositary, the CSSF observed that robust processes are in place concerning reconciliation and safekeeping of assets as well as cash flows monitoring and other oversight duties.

The CSSF observed further that escalation processes from the depositaries to the UCIs are in place and that some UCIs did receive escalations from their depositary in respect of "Oversight on valuation of shares/units" and "Oversight on investment restriction monitoring". Other irregularities escalated by depositaries are mostly related to failed trades, pending security settlements and cash flow monitoring.

In this context, the CSSF would like to highlight the responsibility of the depositary of UCITS and non-UCITS with an authorised Alternative Investment Fund Manager ("AIFM") with regards to its oversight duties including (i) oversight of the valuation of shares/units of UCIs, (ii) oversight of the investment restrictions of UCIs, oversight of the sale, issue, re-purchase, redemption and cancellation of units or shares of UCIs and (iii) oversight of the income calculation and distribution of UCIs, as required under the Law of 17 December 2010, the Law of 12 July 2013 on alternative investment fund managers (the "AIFM Law"), Commission Delegated Regulation (EU) 2016/438 ("CDR 2016/438") and CDR 231/2013.

In the context of the oversight duties of depositaries, the CSSF expects depositaries to actively follow-up on all the irregularities falling under their oversight duties, whether these were identified by the depositary or not, and ensure that any irregularity is duly remediated.

7. Disclosures

The CSSF observed in the context of the review of the SR that a very limited number of exceptions have been raised by auditors in relation to the disclosure requirements covered by the SR (i.e. performance fees disclosure, securities financing transactions disclosure and ESG disclosures).

The CSSF observed, for instance, that:

- For a small number of UCIs disclosing under Article 8 SFDR, which must include the information referred to in Article 11(1) of SFDR in an annex to the annual report by using Annex IV of the RTS, the following question was not covered in the disclosure: *"Did the financial product invest in fossil gas and/or nuclear energy related activities complying with the EU Taxonomy?"*.

The concerned UCIs missed the RTS update which occurred in February 2023 and which included this additional question in Annex IV of the RTS.

- A small number of UCIs, which provide for the possibility of the payment of a performance fee, did not have all the disclosure elements as required under point 49 of the ESMA Guidelines on performance fees in UCITS and certain types of AIFs (i.e. *"The annual and half-yearly reports and any other ex-post information should indicate, for each relevant share class, the impact of the performance fees by clearly displaying: (i) the actual amount of performance fees charged and (ii) the percentage of the fees based on the share class NAV"*).

The disclosure provided in the annual report of the concerned UCIs did not provide for the amount of performance fees at share class level, but only at fund level and did not provide the percentage of performance fees based on the net asset value (NAV) of the concerned share classes.