MFSA MALTA FINANCIAL SERVICES AUTHORITY

Circular

13 February 2025

Review of the Total Expense Ratio of Collective Investment Schemes

1.0 Background

As part of its ongoing supervisory processes, during 2023 and 2024 the Malta Financial Services Authority ('**MFSA**') carried out an assessment on the Total Expense Ratio ('**TER**') of investment funds licensed in Malta. The TER is a key metric capturing the total cost of operating an investment fund and indicates the ongoing cost deducted from investor returns, expressed as a percentage of the assets held within the portfolio of a fund. Consequently, the TER is an important measure to evaluate a fund's past and potential future performance.

This assessment has been carried out as a follow-up to a Common Supervisory Action ('**CSA**') led by the European Securities and Markets Authority ('**ESMA**') during 2021 on the supervision of costs and fees of UCITS[1]. The aim of this exercise was to evaluate the compliance of Maltese UCITS Managers and Self-Managed UCITS Schemes with the cost-related provisions established within the UCITS framework, whilst also considering the supervisory briefing on cost supervision[2] issued by ESMA in June 2020. In this regard, the CSA revealed instances whereby the performance fee was erroneously being included in the ongoing charge figure. The TER review carried out by the MFSA incorporated a high-level review of 391 investment funds followed by a deep dive on sixty-five (65) investment funds authorised by the MFSA.

2.0 Methodology applied

According to the CESR Guidelines on the methodology for the calculation of the ongoing charges figure in the Key Investor Information Document ("KIID")[3], the ongoing charges is defined as "*the ratio of the total disclosable costs to the average net assets of the UCITS*". Given that the TER is designed to measure ongoing charges associated with the day-to-day operations of an investment fund, the TER is composed of *total expenses* divided by *the average Net Asset Value ('NAV')*, whilst excluding one-off charges such as performance fees and transaction costs, as denoted within the following formula:

[1] Outcome of the 2021 Common Supervisory Action ('CSA') on UCITS Costs and Fees conducted on Maltese UCITS Managers and Self-Managed UCITS Schemes
[2] esma34-39-1042_supervisory_briefing_on_the_supervision_of_costs.pdf
[3] Microsoft Word - 10-674 Guidelines KID Charges methodology for publication.doc

Total Expense Ratio =

$$\frac{Total\ Expenses - performance\ fees - transaction\ costs - other\ one-off\ costs}{Average\ NAV}$$

This exercise covered 391 investment funds, out of which it transpired that 65 investment funds had a high TER. Subsequently, the Authority engaged with the respective funds and/or fund managers to establish whether there are plausible reasons for a high TER.

The outcome of the engagement indicated that: (i) in certain cases the formula applied to calculate the TER was incorrect. For instance, the total NAV as opposed to the average NAV was being used in the denominator or certain one-off costs were not excluded from the numerator; or (ii) there were justifiable reasons for a high TER, in the remaining 22 investment funds, primarily due to:

a) significant drops in the Net Asset Value (“NAV”);
b) a high number of redemption requests;
c) restricting of the funds; and
d) funds liquidating their portfolio.

3.0 Engagements and Remediation

Reducing the Total Expense Ratio and ensuring it remains a reasonable and feasible percentage requires strategic decisions. The Authority expects the Board of Directors of the Schemes and the Investment Managers to take the necessary precautionary measures to keep the TER within reasonable limits.

The Board of Directors have a fiduciary duty towards the investors of the investment funds, which includes ensuring that investors are not subjected to abnormal or unjustified fees, thereby maintaining the integrity and fairness of the investment fund’s fee structure. The Board of Directors shall periodically review and assess the costs and fees associated with the investment fund to ensure that no undue or excessive costs are being charged and that ultimately, investors are receiving a fair return. The MFSA will be incorporating similar assessments in its annual supervisory programme.

4.0 Conclusion

The TER plays a critical role in understanding the cost-effectiveness of an investment fund. That said, this should not be considered in isolation but alongside other critical factors such as the investment fund’s investment objective, historical performance, and risk profile. A well-managed TER supports investor confidence, aligns with regulatory standards, and enhances the fund’s overall competitiveness. In the interest of transparency, the Authority expects Directors of investment funds to: (a) assess the calculation methodology of the TER; (b) establish procedures for monitoring the accuracy of the TER; and (c) ensure that it is kept within reasonable limits, potentially through comparatives with the TER of peers.

5.0 Contacts

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