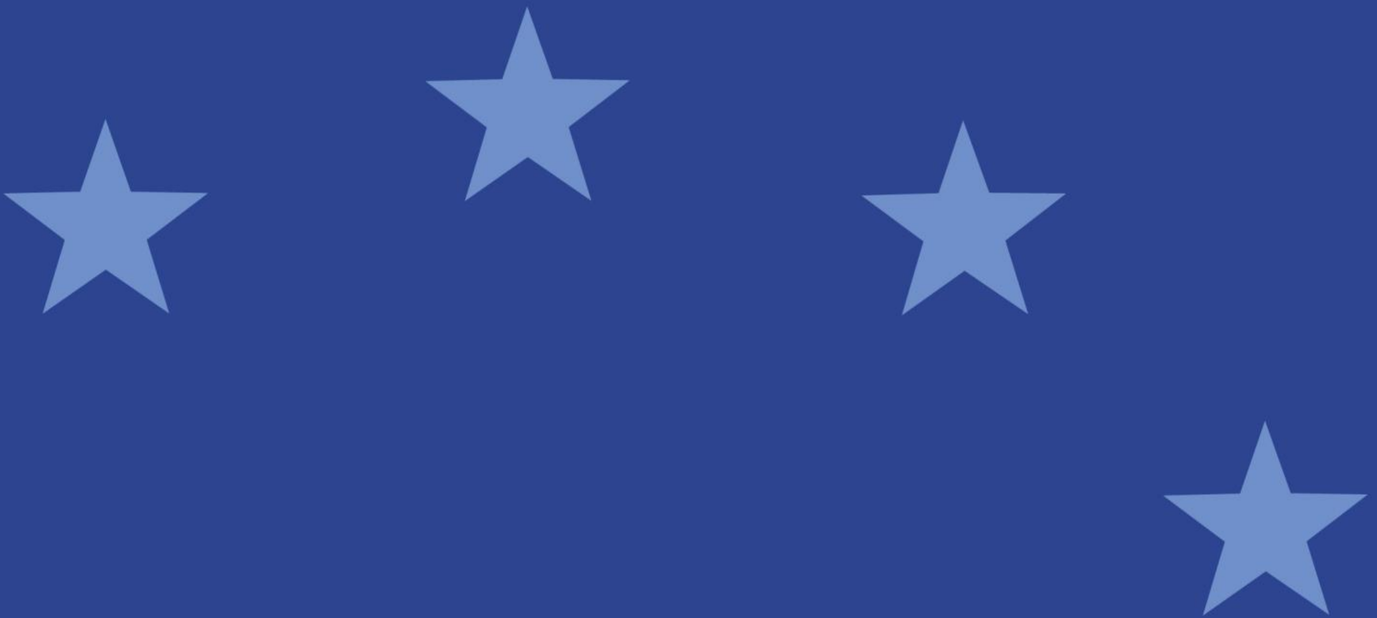
Response Form to the Consultation Paper

Guidelines on performance fees in UCITS



16 July 2019 ESMA

esma

Responding to this paper

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **31/10/2019.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA_QUESTION_PFG_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA_PFG_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_PFG_ABCD_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open consultations" → "Consultation on Position limits and position management in commodities derivatives").

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message

will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Who should read this paper

This document will be of interest to asset managers managing retail funds and their trade associations, as well as institutional and retail investors investing into such funds and their associations.

General information about respondent

Name of the company / organisation	ASSOGESTIONI
Activity	Investment Services
Are you representing an association?	☒
Country/Region	Italy

Introduction

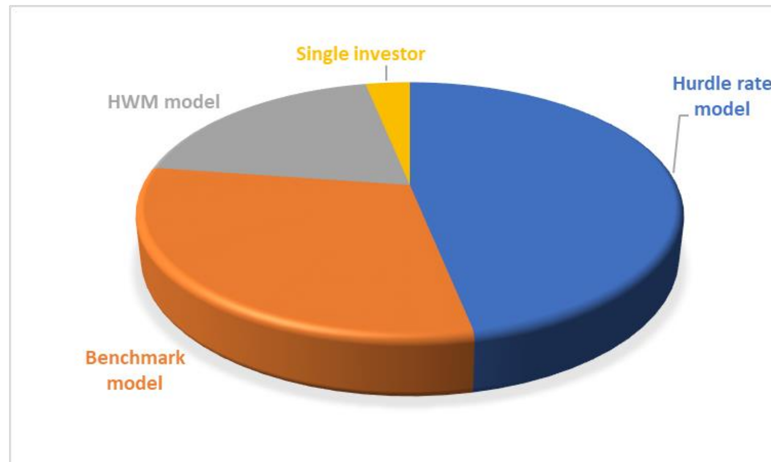
Please make your introductory comments below, if any

<ESMA_COMMENT_PFG_1>

We support and appreciate the consultation paper on performance fee that recognizes that properly structured performance fees create a very clear alignment between the final investors' goals and the investment manager's incentives. The Guidelines could improve the level playing field and the existing practices by eliminating possible distortions, considering the great importance of fund's cross border distribution. With an enhanced level of disclosure on fees and a convergency in the regulatory oversight over the modelling of the performance fee, investors would have a better understanding and choice regarding fee structures and levels.

We believe that the proposed guidelines are going to the desired direction as they recognize a variety of performance fee models considering the nature of the investment objective, strategy and policy of the fund and investors' preferences. The convergency in defining the key elements based on a principle approach is much appreciated.

As ESMA might know, around 67% of domiciliated funds in Italy have a performance fee structure. The current national regulation, based on the IOSCO Good practices for Fees and Expenses of Collective Investment Schemes (IOSCO Best practices), is broadly reflected in the current drafting Guidelines, however, we see merit in further reflections and clarifications on some fundamental issues and definitions that could lead to some side effects.



Here below our principal remarks, better explained through the response.

Where a **Benchmark or a Hurdle rate model** is used, **we totally agree in setting a minimum crystallisation period of one year**, during which positive performance is offset by under or negative performance, granting the right balance between the need to measure a performance over a relevant and long-enough time period, as well as the request to reward outperformance in a frequent manner. **The catch-up of underperformance/loss over a period longer than one-year is not an effective tool for aligning the economic interest of asset manager and investors alike.**

For a High-Water Mark (HWM) model, where the compensation between over and underperformance is embedded in the model itself for the entire life of the fund, **minimum crystallisation period is not relevant**. It would therefore be useful to clarify what HWM model is and consider this model distinct from practices that combine a Benchmark or a Hurdle rate model with other condition to be met before the performance fee could be charged (for example a previous higher NAV or High of High, named sometimes also as HWM).

We also invite ESMA to clearly acknowledge that the **calculation of performance fee could be made on the position of each single investor,** based on his/her own dates of subscription and redemption.

Furthermore, we believe that in the management of funds which aim to reflect the risk and reward profile of some pre-determined segments of the capital market represented by benchmarks (market funds) **the possibility to withdraw performance fee also with relative positive performance should be recognised.** In line with its mandate, disclosed to investors, the manager moves dynamically around the benchmark to improve the relationship between risk and return. The manager's ability to mitigate losses in negative market phases, such as in times of crisis, or in markets with negative yields, is an added value of active asset management and it should be possible to reward it.

For a well-designed performance fee structure aligning asset manager and investor's needs, a variety of performance fee models should be acknowledged in the final Guidelines. Under the principle of consistency with the investment objective and strategy of the fund, **flexibility in the combination of different elements should (continue to) be granted to asset managers**.

The setting of any further layer would then be appropriately assessed to avoid unduly "changes" of well-functioning mechanisms. Pending the final decision, the impact of the

Guidelines could be high also for management companies that already apply some standards[1] in line with IOSCO Best practices. **Reducing the modelling choice or defining one-size fits all approach would negatively impact asset management fee models with no added benefit.**
<ESMA_COMMENT_PFG_1>

[1] Please see Bank of Italy "Regolamento sulla gestione collettiva del risparmio", Title V, Chapter I, Section II, Paragraph 3.3.1.1.

Questions

Q1 : Do you agree that greater standardisation in the field of funds' performance fees is desirable? What should be the goal of standardisation?

<ESMA_QUESTION_PFG_1>
Yes, the primary objective of a common European regime is to improve the level playing field and the existing practices eliminating possible distortions, considering the great importance of fund's cross border distribution. The presence of different practices and definitions around Europe is certainly an obstacle to understanding the correct functioning of the models, not only for investors.

The application of level 3 Guidelines is an important tool in the "ensuring supervisory convergence". We therefore share and welcome appropriate Guidelines that acknowledge the use of performance fee in UCITS funds and clarify the key elements to be used in their modelling. Indeed, standardization could reduce misunderstanding on the terms used and homogenize the relevant disclosure.

The principle-based approach used in the Guidelines is also positive and asset managers could design their fee structure in order to create an incentive for the fund operator to optimise the performance of the fund and better align the objectives and incentives of asset managers and the investor alike. To this aim, it is essential to recognize a variety of models and we invite ESMA to improve the Guidelines to better enhance its coherence with the principle embedded in the IOSCO Good Practice. We specially refer to the possibility of using the HWM model without a minimum period of crystallization or calculating the performance fee on the position of the individual participant (please see also our response to Q5).
<ESMA_QUESTION_PFG_1>

Q2 : Are there any obstacles to standardisation that could be removed by regulatory action? Please elaborate.

<ESMA_QUESTION_PFG_2>
The Guidelines will foresee a common minimum level of protection across EU as well as promoting supervisory approaches and practices. However, once the Guidelines will be finalised, it is -certainly possible that in some Member States, at national level, there are set rules which may not be compatible or, even if compatible, may require additional information. In this context it should be clarified that such circumstances do not hinder cross-border distribution.
<ESMA_QUESTION_PFG_2>

Q3 : What should be taken into consideration when assessing consistency between the index used to calculate the performance fees and the investment objectives, strategy and policy of the fund? Are there any specific indicators which should be considered (eg: historical volatility, asset allocation composition, etc.) to ensure this consistency? Please provide examples and give reasons for your answer.

<ESMA_QUESTION_PFG_3>
We strongly agree with the need for consistency between the fund's investment objectives, strategy and policy and the performance fee model. This fundamental principle in modelling the performance fee structures is also used in Italian national rules.

In terms of whether **specific indicator** should be considered in assessing the benchmark or the performance fee model, we believe that the Guidelines should provide some **flexibility** leaving the ultimate choice to asset managers. The statements in the Guideline 2 are well reflecting the fundamental element for the assessment and a one-fits all approach could not be representative of the different strategies that could be pursued. As mere examples, the overall characteristics of the fund, the type of fund (market fund, absolute fund, total return fund, life cycle fund, structured fund), the nature of the targeted financial instruments, the geographical areas, the portfolio composition, the management style could be taken into account.

While appreciating the overall Guideline 2 we have some reserve on the following statement "*in addition, a HWM model for an absolute return objective might need to include a hurdle to align the model to the fund's risk reward profile*" (paragraph 16, point a). The HWM model requires an absolute improvement in investment performance before the performance fee can be paid. Such model incentivises the asset manager not to take excessive risks that might result in losses, since any such losses will then need to be offset before any performance fee can be levied again. Since the comparison is made every day with the higher pick registered of the NAV per quote from the beginning of the fund, i.e. the HWM (and it is not linked to a specific point in time, for example the yearly date of crystallisation) the "need to include a hurdle" may distort the mechanisms and could affect the value proposition of the funds (and the levels of the rates applied).

In Italy, the HWM model rule does not require to include a hurdle and the performance fee are calibrated considering the current constraints. Should the management company be able to demonstrate that in a HWM model the hurdle does not align the model to the fund's risk-reward profile, the asset manager - in order to neutralize the impact - could increase the rate applied to the performance fee or to the management fee.

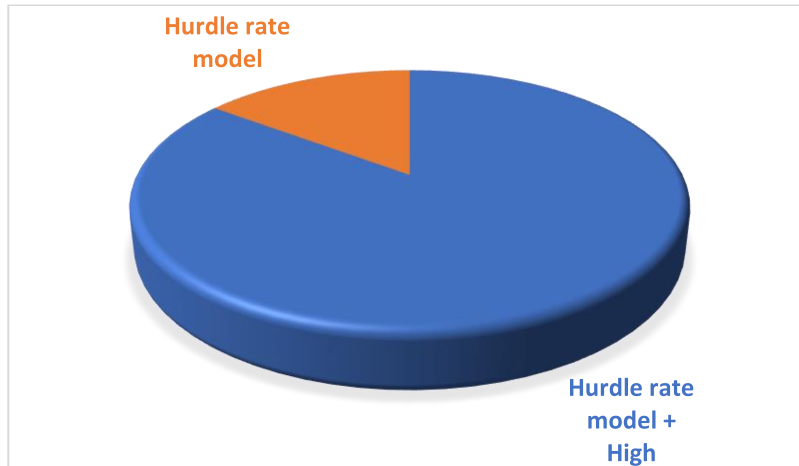
We wonder if the proposition could be read in the other way i.e. in case of Hurdle-rate model a previous higher NAV or High-of-High[2] might be used. Indeed, additional conditions to be met could be set before performance fees can be applied, among them, a "HWM", a term used to define different concepts in the offering documents (please see also our response to Q5).

Indicative example of a Hurdle-rate model plus a High-of-High (named also "HWM")

Year	NAV per quote	Hurdle rate (index + spread)	"HoH": Highest NAV per quote at year end (named also "HWM")	HoH + Hurdle rate	Excess performance	Performance fee	Cap on performance fee freely set by management company	Performance fee crystallized
	(a)	(b)	(c)	(d)= c X (1+b)	(e)= (a-d)/d	(f) = 20% x e		
T	6,500							
T+1	7,280	3,00%	6,500	6,695	8,74%	1,75%	1,50%	1,50%
T+2	7,862	3,50%	7,280	7,535	4,35%	0,87%	1,50%	0,87%
T+3	7,312	3,30%	7,862	8,122	-9,97%	-	1,50%	0%
T+4	7,678	3,20%	7,862	8,114	-5,38%	-	1,50%	0%
T+5	8,445	4,10%	7,862	8,185	3,18%	0,64%	1,50%	0,64%

It is quite common in Italy to use some previous High in a Hurdle rate model, to prevent double dipping on fees.

[2] IOSCO Best practices 2014. Definitions: "when a high-on-high ('HoH') method is used to calculate a performance fee, the performance fee may only be charged if the net asset value of the fund exceeds the net asset value at which the performance fee was last calculated and paid."



We also agree with paragraph 16, point a) of Guideline 2 where it is recognized that funds that pursue an absolute return objective are not managed in respect to a benchmark (please see also our response to Q19). In this regard we would suggest integrating the definition of "Hurdle rate" and "Reference indicator" to make clear that a hurdle rate composed using a money market index such as EONIA + spread does not qualify as benchmark.

Therefore, we would suggest the following amendments.

ESMA proposal		***Assogestioni proposal***	***Comment***
Source	***Definition***		
GL. Definitions	Hurdle rate A predefined minimum rate of return.	Hurdle rate A predefined **(fixed or variable)** minimum rate of return.	It should be clarified that a hurdle rate can be a fixed hurdle (ex 2%) or a variable hurdle using a money market index (ex Eonia + spread).
GL. 1 – par. 11	a) the reference indicator to measure the relative performance of the fund. This reference indicator can be an index (*e.g.* Eonia, Eurostoxx 50, etc.), a HWM or a hurdle rate (2%);75	a) the reference indicator to measure the relative performance of the fund. This reference indicator can be an index (*e.g.* Eonia, Eurostoxx 50, etc.), a **NAV per quote or share (e.g. HWM, HoH, etc.),** a hurdle rate (2% **or Eonia + 1%, etc.**) **or a combination.**	In line with the existing practices to combine different reference indicators, the list of the reference indicators should be updated and expanded. For example, a performance fee could be calculated as an XX% of the excess performance over a one-year period, defined as the lesser between: - the percentage increase between the value of the NAV per quote and its highest value registered by the same on the crystallisation day of previous years; and - the differential between the percentage increase of the NAV per quote and that of the reference parameter (risk-free index + XX %) over the one-year period.

We also support the net-of-costs approach for the calculation of performance fees. However, we would suggest a further effort in clarification of paragraph 18 and of the definition of "*Excess performance*". We believe that the Guidelines should mention that "Excess performance" is to calculated net of costs, but gross of those costs related to performance fees. In other words, the excess performance should be assessed before the application of a possible performance fee, thus, avoiding iterative effects in the calculation of the performance fee in the NAV per

quote at T where the performance reference period end in T (and not in T-1). According to the Italian rules, in calculating the NAV per quote of T, the return of the fund (and the other reference indicators) for the calculation of the performance fee must refer to T (and not to T-1). Thus, a gross performance fee value per quote is calculated as the use of the NAV per quote at T-1 (net of all costs, including performance fee) is not compliant with national rules and the use of the NAV per quote at T would imply a reiterative calculation. Failure to recognize also this approach, which better aligns the attribution of the performance fee to the client who subscribes or redeems funds, would have a non-marginal operating impact.

ESMA proposal		***Assogestioni proposal***	***Comment***
Source	***Definition***		
GL. Definitions	Excess performance: the difference between the net performance of the portfolio and the performance of the benchmark.	Excess performance: the difference between the net performance of the portfolio **net of costs but gross of performance fee** and the performance of the **reference indicator**.	It should be clarified that the excess performance should be net of all costs but gross of the performance fee itself, to avoid iterative effects in the calculation of the performance fee in the NAV per quote at T where the performance reference period end in T (and not in T-1). In addition, the definition should be updated to reflect different "reference indicators", not only the benchmark, since the comparison could be made also with parameter different from benchmark (for example, a hurdle, an HWM and so on),
GL. Definitions	Benchmark: A market index against which to assess the performance of an investment fund.		
GL 2 – par. 18	In all cases, the excess performance should be calculated net of costs.	In all cases, the excess performance should be calculated net of costs **but gross of those costs related to the performance fee.**	

<ESMA_QUESTION_PFG_3>

Q4 : What is the anticipated impact of the introduction of Guideline 3? Do you agree with setting a minimum crystallisation period of one year? Do you think this could help better aligning the interests of fund managers and investors? Please provide examples.

<ESMA_QUESTION_PFG_4>

Performance fee should theoretically be calculated for each single investor, based on his/her own dates of subscription and redemption. Because of practical difficulties, few management companies have adopted this method and other measures/precautions have been implemented: among them, the performance fee model and the crystallization period.

The identification of the appropriate crystallization period should rely on the performance fee model which in turn depends on the fund's investment objectives, strategy and policy; it should not depend on the holding period recommended to the investor nor to the investor holding period.

For a **Benchmark or Hurdle-rate performance fee model we strongly agree with setting a minimum crystallization of one year** that would better align the interest of fund manager and investor. Such period would grant the right balance between the need to measure a performance over a relevant and long-enough time period, as well as the request to reward outperformance in a frequent manner: more frequently the fee is crystallized (i.e. monthly, quarterly) the higher the total fee earned by the asset manager. In addition, a minimum one-year period would also minimize the likelihood of excess performance depending on the volatility of the underlying rather than on the ability of the asset manager. Please note, that such minimum period is also in line with the current rules set in Italy.

For an **HWM model** or where performance fee is calculated on **each single investor**, **minimum crystallization period/frequency should not be set**.

For HWM model please see our response to Q4.

We have noted that the Guidelines do not foresee the possibility of applying the performance fee for the calculation on each single investor, however, some indirect references to the holding period of the investors are present in the Consultation paper ("*consistent with the investors' holding period*"). Since this model is theoretically correct and applied by some asset management company in Italy, this model should be clearly acknowledged also in the final Guidelines.

Although we support the minimum crystallisation period of one year, there are exceptional cases that could justify **shorter crystallisation period** such as closure or merger of funds, a new fund launch (otherwise, no funds wishing to adopt the calendar year would be technically able to apply performance fee for the first year), redemptions. In the latter, not crystallizing performance fees may cause distortions, especially in the case of particularly positive performance fee and significant redemptions: the reduction in the performance fee accrued given lower assets in the fund at the next valuation point would cause an inappropriate uplift in performance for the fund resulting solely from the change in the performance fee accrual. The remaining investors will benefit, and the management companies will not be remunerated with the fees actually accrued, missing the minimum crystallisation period.

We have **concerns with the identification of the date of the natural end of the crystallisation period** as stated in paragraph 20 of Guidelines 3 i.e. 31 December or the end of financial year of the fund. It is common practices in Italy (around 49% of the funds) to have the crystallisation of the performance fee also in a date different from the end of the year or the financial year. Spreading such reference point throughout the year will reduce the level of alea in earning performance fee because not everything depends on a single evaluation point, for example 31 December. Under a systemic point of view, possible side effects could arise if at European level only few data points in time would be linked to incentive mechanism. We would suggest therefore to delete the recommendation and let the asset manager free to identify the crystallization's date.

Finally, we have some reservation on paragraph 19 of Guidelines 3 that seems to refer, from one side, to (individual) manager remuneration and, to the other side, to the investor holding period. We would suggest deleting such paragraph given the difficulty in foreseeing ex ante and setting such periods and maintaining a clear distinction between the time horizon of staff remuneration (also recalled in the Annex II of the paper the article 14b(1) and (3) of Directive 2009/65/EC as relevant provisions in the UCITS framework) and the asset management company time horizon, organization and fee models. We would suggest therefore to delete paragraph 19.

Here below our suggestions.

ESMA proposal		***Assogestioni proposal***	***Comment***
Source	***Definition***		
GL Definitions	*Crystallisation period* – The period during which the performance fee, if any, is accrued and at the end of which it becomes payable to the management company.	*Crystallisation* ***frequency*** **– The frequency with which the accrued performance fee becomes payable to the management company**; **between two crystallisation dates, positive performance is offset by under or negative**	We would suggest including in the definition of crystallization both the frequency of crystallization (that should not be lower than one year except n the case of HWM model, single investor calculation and Fulcrum fee model) and what is going on in between two crystallization

		performance and performance fee is accrued to the fund at each calculation point of the Net Asset Value per share or unit;	dates where cumulative gains are offset by cumulative losses. During the period of crystallization, the accrual made daily could be reduced by underperformance however at the end of the period, the fee is crystallized, thereafter no mechanisms reduce the amount payable. Afterwards, the performance fee crystallized is paid to the management company.
GL 4. Par. 22	A performance fee should only be payable in circumstances where positive performance has been accrued during the performance reference period. Any underperformance or loss previously incurred during the performance reference period should be recovered before a performance fee becomes payable	A performance fee should only be payable in circumstances where positive performance has been accrued during the performance reference period. ~~**Any underperformance or loss previously incurred during the performance reference period should be recovered before a performance fee becomes payable**~~	
GL 1, par. 11	The performance fee calculation method should include, at least, the following elements: [...] b) the crystallisation period within which the performance fee, if any, is accrued and a crystallisation date, coinciding with the end of the crystallisation period, at which the performance fee is crystallised and credited to the management company;	The performance fee calculation method should include, at least, the following elements: [...] b) **the crystallisation frequency and the crystallisation date**;	In line with the updated definition of crystallisation.
GL 3 – par. 19	The frequency for the crystallisation and the subsequent payment of the performance fee to the management company should be defined in such a way as to ensure alignment of interests between the portfolio manager and the shareholders and fair treatment among investors. The manager's performance should be assessed and remunerated on a time horizon that is, as far as possible, consistent with the investors' holding period.	The frequency for the crystallisation and the subsequent payment of the performance fee to the management company should be defined in such a way as to ensure alignment of interests between the portfolio manager and the shareholders and fair treatment among investors. ~~**The manager's performance should be assessed and remunerated on a time horizon that is, as far as possible, consistent with the investors' holding period.**~~	In line with the updated definition of crystallisation period (frequency).
GL 3 – par. 20	The crystallisation period should not be shorter than one year.	The crystallisation period should not be shorter than one year. **A shorter period is admitted in case of closure or merger of funds, new fund launches or upon redemptions.**	Exceptional cases should justify shorter crystallisation period
GL 3 – par. 20	Generally, it should end either on 31 December or at the end of the financial year of the fund.	~~**Generally, it should end either on 31 December or at the end of the financial year of the fund.**~~	Spreading the crystallisation date throughout the year should be possible

GL 3 – par. 21	The minimum crystallisation period should not apply to the fulcrum fee model, as the characteristics of this model are not compatible with a minimum crystallisation period.	The minimum crystallisation period should not apply to the fulcrum fee model, **to the HWM model and when the performance fee is calculated separately for each investor** the characteristics of this model are not compatible with a minimum crystallisation period.	For a HWM model or where performance fee is calculated on each single investor, minimum crystallization period/frequency is not relevant and it should not be set

<ESMA_QUESTION_PFG_4>

Q5 : Are there any other models or methodologies currently employed that, in your view, should be exempted from this requirement? For example, do you think that the requirement of a minimum crystallisation period of 12 months should also apply to HWM models? Please provide examples on how these models achieve the objectives pursued by Guideline 3.

<ESMA_QUESTION_PFG_5>

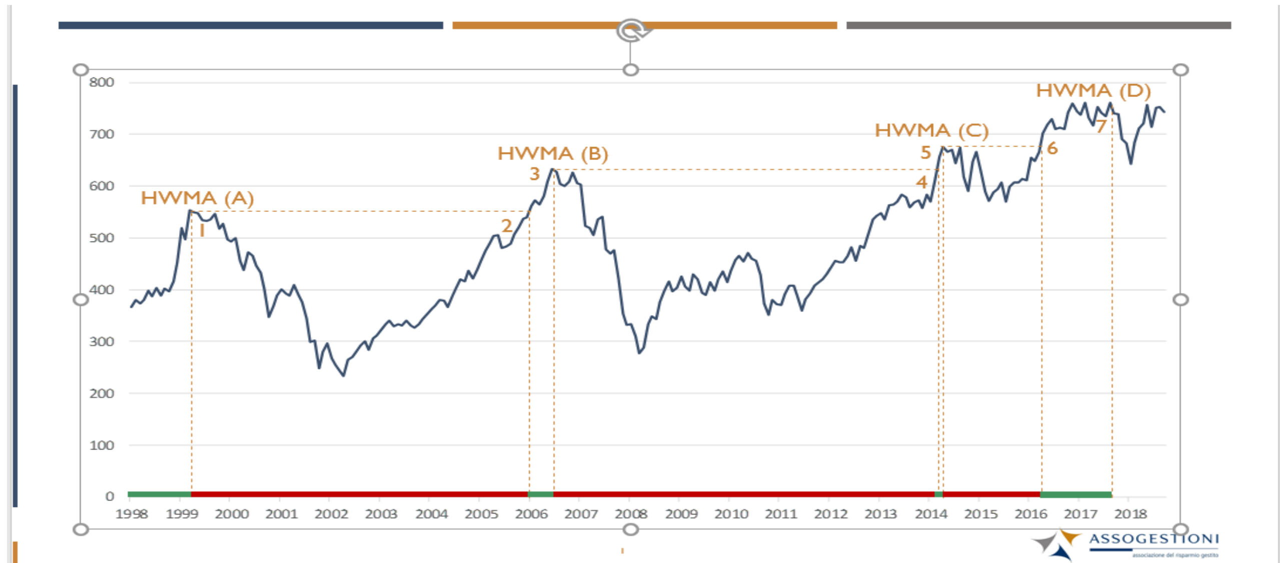
The minimum crystallisation period/frequency should be disapplied in presence of HWM model (absolute or relative HWM model) or when the performance fee is calculated separately for each investor. For the latter please see our answer to Q4.

The reasons behind the proposal to apply a minimum crystallisation period also for HWM model it is not clear to us. We believe that it could be a possible misunderstanding and confusion on the HWM model and on the meaning of “HWM”. We see merit in clarifying what is a HWM model and, based also on Italian rules, we would suggest to take this model distinct and separate from practices that combine a Hurdle rate model with a previous High NAV per quote value before the performance fee could be charged (for example a High of High).

Currently at national level, Bank of Italy requires a frequency of crystallisation of minimum one year during which the positive performances are offset with the negative ones in order to ensure that the overperformance does not reflect contingent short-term situations period. However, this provision is not required in case of an HWM model, where the compensation mechanism is implicit in the model itself, and the guarantee of a correct withdrawal from investors is determined by two circumstances: i) the choice of the model, which must be consistent with the investment policy; ii) the comparison of the excess performance from the beginning of the life of the fund. In this context, the frequency of crystallisation in the HWM model, which may be lower or higher than a year, is not relevant.

An example helps us show better how the HWM model works.

The fund crystallizes every day the performance fee if the NAV per quote increases to a higher level than the highest NAV per quote ever reached ("absolute high watermark level" or “HWM-A”), starting from the fund’s inception date (first HWM). When a new high is reached, it becomes the new maximum to beat. The performance fee, equal to X% of the excess performance, is applied on the total net value of the fund on each calculation day of the NAV per quote. The payment of the crystallised performance fee is made the first day of each month.



The blue line is the performance of the fund, the green lines (at the bottom of the graph) show the frequency of the crystallisation and, most important, on what value and on what net assets the performance fee would apply.

The graphs shows clearly that with a HWM setting a crystallisation period/frequency is irrelevant because all the underperformances are recouped before starting to earn performance fee again: the asset management earns a performance fee (crystallized every day for more than one year period) until HWMA (A); but for the following seven year (from point 1 to 2) it does not earn anything because it is not exceeding the maximum HWMA (A). Then it starts to earn again (from point 2 to 3) until the NAV per quote decreases from HWMA (B) and so on.

In our experience HWM model ensure alignment of interests between the portfolio manager and the shareholders and fair treatment among investors because:

- performance fees apply only once - over the entire life of the fund - for each level of added value created by the asset management;
- the effect of volatility in the calculation of the performance fee is eliminated;
- make the distribution of performance fees among investors more equitable, attributing the performance fee simultaneously to the creation of the added value.

Should the minimum crystallisation frequency apply, it would imply a single point in time HWM model: the performance fee could be taken if the NAV per quote exceed the highest value recorded at the end of the previous crystallisation dates. In other words, instead of looking at the maximum value of the NAV per quote each day (HWM) one should look at the year-end values (only). The HWM model would become a Hurdle rate model capped to zero plus a High of High (please see also our response to Q3).

The transformation of the HWM model other than reducing the models available to asset managers, could involve a moral hazard dilemma:

- in case of positive performance, for example at the beginning of the year, it could be an incentive to liquidate part of the portfolio by investing in low risk securities, to consolidate the accrual;
- in case of negative performance, additional risks could be taken to increase the possibility of accruing performance fees;
- in case of a reset date, it could be an incentive to maintain the value of the lowest NAV per quote, so to start the new reference period with an easily overcome objective.

Therefore, we believe that five different models should be recognised in the final Guidelines: Benchmark model, Hurdle rate model, HWM model, Fulcrum fee model and the calculation of the performance fee on the position of the single investors. The above is in line with our understanding of IOSCO Best practice, where other measurement of investment performance are permitted[3] and alternative methods ensure that cumulative gains are offset in some way by cumulative losses[4].

ESMA proposal		***Assogestioni proposal***	***Comment***
Source	***Definition***		
GL. Definitions	High-Water Mark (HWM) The highest Net Asset Value per share or unit.	High-Water Mark (HWM) The highest Net Asset Value per share or unit **starting from the date of inception or the date of a structural investment objective change.**	The absence of clarification regarding the reference period in which the peak is reached (the whole life, a specified period or a single point in time) can rise different interpretations. For example, HWM could also be understood as an high-on-high (HoH) which could be used as an additional layer in the benchmark or hurdle rate performance fee model. Where applied a HoH, the performance fee are payable on the basis of achieving a new High of the NAV per quote at the crystallisation date in addition to achieving, at the same date, an excess performance. The value of HoH could be different from the HWM.
		High-of-High (HoH) The highest Net Asset Value per share or unit at which the fund last crystallized a performance fee	
GL. Definitions	High-Water Mark (HWM) model A performance fee model whereby the performance fees are payable on the basis of achieving a new High-Water Mark. The initial offer price should be taken as the starting price for the calculations (i.e. performance fees should be payable based on the subsequent outperformance by the net asset value per share of the initial offer price)		In the light of the updated definition of the meaning of HWM we agree with the ESMA definition of the HWM model. Under this scenario, it is our understanding that the plain use of a HoH, or a High previous NAV, different from a HWM, does not imply a HWM model.

<ESMA_QUESTION_PFG_5>

[3] IOSCO Best Practice 2016 "A 'performance-related fee' is a variable management fee linked to the performance of a CIS portfolio, and usually payable in addition to a basic fee (generally asset-based). It can, for example, be based on a share of the capital gains or the capital appreciation of the net asset value, or any portion of the net asset value, as compared to an appropriate index of securities or other measure of investment performance. […]"

[4] IOSCO Best Practice 2016 "34. For a given investor, the effective performance of their investment in a CIS depends on the particular points in time when they acquire and later dispose of the shares / units. So, a performance fee should ideally be calculated separately for each investor. […]" and "35. Alternatively, methods to ensure that cumulative gains are offset in some way by cumulative losses can be considered. Examples of relevant methods include the high-watermark and high-on-high, which require an absolute improvement in investment performance before the performance fee can be paid. […]"

Q6 : In your view, should performance fees be charged only when the fund has achieved absolute positive performance? What expected financial impact (e.g. increase or decrease of the manager's remuneration or increase or decrease of the financial return for investors) would the proposed Guideline 4 have for you/the stakeholder(s) you represent? Are there models or methodologies currently employed where the approach set out in Guideline 4 would not be appropriate?

<ESMA_QUESTION_PFG_6>

No, we believe that an absolute positive performance criteria is not appropriate for a Benchmark model.

The use of a Benchmark model implies an investment objective and a strategy pursuing the risk and reward profile of some market segments which are represented by indices that should be consistent with the investment policy as set in Guideline 2. In this case, an active manager moves dynamically around the benchmark in order to improve the relationship between risk and return. The benchmark identifies the risk profile and the opportunities of the market in which the fund typically invests and its clear disclosure strengthens the fiduciary relationship with the investor.

The rationale requiring not only to outperform the fund's benchmark, but also make up for any negative performance could be that the performance fee can be charged only when the performance of the fund is "satisfying" and that a negative performance can never be deemed satisfying, regardless the level of the active return.

But benchmarks are following the economic cycles and asset managers should not be incentivized to increase the level of active risk by deviating from the benchmark in case of negative performance. This would go against the fundamental principle of designing the performance fee model with no incentives to take excessive risks, also recalled in paragraph 23 of Guidelines 3.

A moral hazard dilemma could arise if there were an incentive in focusing on achieving better performance only during a positive market cycle.

We believe that the manager's ability to mitigate losses in negative market phases, such as in times of crisis, or in markets with negative yields is a value added of the active asset management and it should be possible to reward. In any case, the asset management company retains the freedom of choice. Therefore, in line with our current national regulation, we suggest the following amendments.

ESMA proposal		***Assogestioni proposal***	***Comment***
Source	***Text***		
GL 4. Par. 22	A performance fee should only be payable in circumstances where positive performance has been accrued during the performance reference period.	A performance fee should only be payable in circumstances where **relative or absolute** positive performance has been accrued during the performance reference period.	We would suggest clarifying the meaning of "positive performance" recognizing expressly that in both relative or absolute positive performance a performance fee could be applied (upon asset manager single decision).

<ESMA_QUESTION_PFG_6>

Q7 : If the performance fee model that you currently use provides for performance fees to be payable in times of negative returns, is a prominent warning on this provided to investors in the legal and marketing documents of the fund? If not, should this be provided? Please give examples for your answer and details on how the best interests of investors are safeguarded.

<ESMA_QUESTION_PFG_7>
If the concept of applying performance fees in presence of relative positive performance will be acknowledged, we believe that this information should be part of the proper information and fair and transparent communication on performance fees that should be given to enhance investor understanding (please see also our response to Q19). However, we do not believe that a warning sign or specific highlighting should be included as to the point of performance fees payable in times of negative returns.
<ESMA_QUESTION_PFG_7>

Q8 : What are your views on setting a performance reference period for the purpose of resetting the HWM? What should be taken into account when setting the performance reference period? Should this period be defined, for example, based on the whole life of the fund (starting from the fund's inception date), the recommended holding period of the investor or the investment horizon as stated in the prospectus? Please provide examples and reasons for your answer.

<ESMA_QUESTION_PFG_8>
Pending the uncertainty around the meaning of "HWM" (please see also our answers to Q3 and Q5), we would assume that the question is intended to refer to the "HWM model" and not where a "High NAV", sometimes also named as "HWM", is used in combination with a Hurdle rate model. This because only with a HWM model i) the mechanism of compensation of the underperformance/loss before a performance fee could be levied is embedded for the whole life of the fund and ii) the identification of a reset period from the start of the fund (inception date) is compatible.

First of all, we believe that there is a minimum of contradiction on the HWM model where in Guideline 3 is requested a crystallization period/frequency minimum of one year and in the Guideline 4 the possibility is given to reset the HWM after a time period to be identified.

We believe the consistency between investment policy and the performance fee model as essential, so we are perplexed on foreseeing a reset in the HWM model. Should a reset be applied, it should be set in a way that would take into account the whole life of the fund (inception date or structural investment objectives changes). This would guarantee such mechanism to be fair and correct.

To be much clearer on this point, we believe that while an annual reset is compatible with a Benchmark model or a Hurdle rate model it would not be appropriate in a HWM model as it would contradict the logic of the model itself.

We would also highlight - that in the consultation paper the reference to the "*performance reference period*" is made under two nuance: from one side, as just commented, it defines the time limit for compensating for negative or underperformance after which such mechanism can be reset (Guidelines 1), from the other side, it is the time period in which the return of the fund is compared with the reference indicator (Definitions).

In line with national rules, we would suggest to clearly distinguish and name differently these two concepts, since they could lead to unintended consequences where a non-HWM model apply. Should the performance reference period be longer than 12 months, an overperformance on an extended period of time (i.e. the performance reference period) would be requested also for a market fund with a Benchmark model's performance fee.

We believe that, while a performance reference period for the calculation of performance fees should be provided and clearly communicated, the final Guidelines shall (continue to) grant flexibility on its definition. One-size fits all reference period setting negatively impacts asset management fee models with no added benefit.

Please see also our response to Q10.

Lastly, when a fund utilises a HWM – in our understanding a HWM model - we have some remarks on the following statement: "*Where a fund utilises a HWM, it should only be reset where during the performance reference period (i) the new HWM exceeds the last HWM or (ii) the fund has undergone significant structural changes*" (Guidelines 4, par. 24). As regards (i) we wonder if the term "reset" is appropriate when a new high HWM is reached since a "reset" usually implies a lowering of the threshold. While for (ii) we believe that clear rules should be applied in case of structural change to avoid that a reset could apply without adequate information and protection being provided to investors. Therefore, to avoid misunderstanding and in view of the existing rules on charges to the investment policy in the UCITS framework, we would suggest deleting such statements.

ESMA proposal		***Assogestioni proposal***	***Comment***
Source	***Text***		
GL Definitions	*performance reference period: t*he time horizon over which the performance is measured and compared with that of the reference indicator.		We would suggest to clearly distinguish and name differently the "performance reference period" and coordinate it with the definition of crystallization, since the relevance of all these aspects are strictly correlated with the performance fee model used.
GL 1. Par. 11	The performance fee calculation method should include, at least, the following elements: […] c) the *performance reference period* at the end of which the mechanism for compensating for past underperformance or negative performance can be reset;	The performance fee calculation method should include, at least, the following elements: […] c) **the time horizon for the purpose of resetting the HWM in a HWM model**;	
GL 4. Par. 24	Where a fund utilises a HWM, it should only be reset where during the performance reference period (i) the new HWM exceeds the last HWM or (ii) the fund has undergone significant structural changes. For the purpose of resetting the HWM, a performance reference period should be defined.	~~Where a fund utilises a HWM, it should only be reset where during the performance reference period (i) the new HWM exceeds the last HWM or (ii) the fund has undergone significant structural changes~~. **Where a HWM model is used, a time horizon for the purpose of resetting the HWM could be defined, based on the whole life of the fund (inception date or structural investment objective changes)**	Should a reset be applied, the whole life of the fund (inception date or structural investment objective changes) should be considered. This guarantee such mechanism to be fair and correct.

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<ESMA_QUESTION_PFG_8>

Q9 : Alternatively, would it be possible to envisage predefined time horizons for the purpose of resetting the HWM, such as 3 or 5 years? Please provide examples and details on what you think would be the best practice in order to better align the interests of fund managers and investors.

<ESMA_QUESTION_PFG_9>
In line with our response to Q8, we are perplexed to envisage the possibility for resetting in case of HWM model. However, if a criterion should be identified, it should consider the whole life of the fund (inception date or structural investment objectives changes). This would guarantee that such mechanism could be fair and correct.
<ESMA_QUESTION_PFG_9>

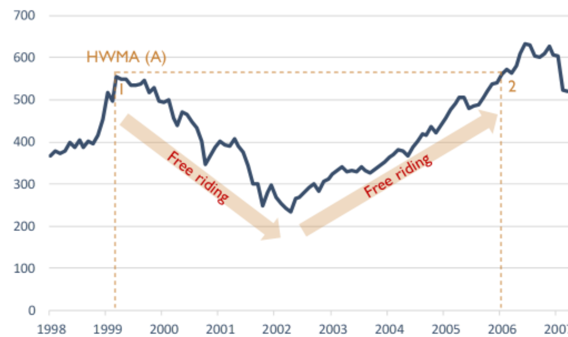
Q10 : How long do you think the performance reference period should be for performance fee models based on a benchmark index? What should be taken into account when setting the performance reference period for a performance fee benchmark model? Would it be possible to envisage predefined time horizons for the purpose of resetting the performance fee based on a benchmark, such as 3 or 5 years? Please provide examples and details on what you think would be the best practice in order to better align the interests of fund managers and investors.

<ESMA_QUESTION_PFG_10>
We have a strong reserve if the question implies the catching-up of underperformance/loss over a period longer than one year for models other than HWM in consideration of the request on how to define this period as well as its reset.

We believe that minimum crystallisation frequency/reset period of one year, during which positive performance is offset by under or negative performance, would be the most appropriate for Benchmark model and Hurdle rate model, as granting the right balance between the need to measure a performance over a relevant and long-enough time period, as well as the request to reward outperformance in a frequent manner. Otherwise, it would not be an effective tool for aligning the economic interest of asset manager and investors.

As possible further side effects we see: (1) accentuate the free-riding phenomena; (2) preference in setting higher management fee.

Free riding is a condition that occurs when an investor could benefit from the overperformance without performance fee. It usually associated with a HWM model but the logic beyond is valuable across all models. In the graph below, it would be clear that the investor will not pay any performance fee from period 1 to 2 even if the fund is outperforming, because all the previous underperformance/losses are not yet compensated.



The impact of the Guidelines on the fee structure of the product is directly correlated to the setting currently used. Based on Italian rules, where for a Benchmark model and a Hurdle-rate model is not requested a catch-up period beyond the year, any "change" of this well-functioning mechanisms could impact the value proposition of the products. The introduction of additional constraints on performance fee could make the financial statements of asset management even more uncertain and thus could determine an increase in the rates of the performance fees applied or the change of the fund fee structure, possibly leading to a higher management fee.
<ESMA_QUESTION_PFG_10>

Q11 : Alternatively, do you think the performance reference period should coincide with the minimum crystallisation period or should it be longer/shorter? Please provide examples and reasons for your answer.

<ESMA_QUESTION_PFG_11>
In line with national rules, we believe that the performance reference period i.e. the time horizon over which the performance is measured and compared with that of the reference indicator should (continue) not be defined in the final Guidelines.

Furthermore, we believe that twelve months crystallisation/reset period is an appropriate minimum and should be the standard for the crystallisation of performance fees for Benchmark or Hurdle rate performance fee models.
<ESMA_QUESTION_PFG_11>

Q12 : What are your views on when the Guidelines should become applicable? How much time would managers require to adapt existing fee mechanisms to comply with the requirements of these Guidelines?

<ESMA_QUESTION_PFG_12>
Regarding the transitional period, two different timelines are proposed in the Guidelines depending on whether a performance fee structure is currently in place in the fund or not. A transitional period of 12 months starting from the date of application of the Guidelines is proposed where a performance fee is currently used, otherwise the Guidelines apply immediately from the application date.

The practical effect of the Guidelines will depend of the final decision and an appropriate timing should be given to management companies to recalibrate the fee structure or adapt existing disclosure and fee mechanism. The methods and time of application of the new performance fee calculation model may involve changes in the rules set with consequence on all actors involved, among them the fund, the investors, the management company and the depositary.

Considering legal and operational issues, we believe that 18 months minimum are needed to be able to comply with the Guidelines. A one-size fits all approach of 12 months starting from the application date would be questionable since the performance fee mechanisms are based on the individual fund and the deadline may fall within the performance reference period. A higher period should be allowed if a catch-up period longer than one year would be requested for Benchmark and Hurdle rate models to avoid overlaps of calculation/time period.

The same transitional period should be granted also for new funds. A possible change in the fee mechanisms involves the setting of new processes and controls which request some time for the management companies and fund accounting functions. Until the updating of such procedures, news funds/share classes with a performance fee structure could not be offered anymore. In addition, dealing with two parallel mechanism of calculation of performance fee could not be in the best interest of an asset manager considering costs and operational risks.

<ESMA_QUESTION_PFG_12>

Q13 : Do you consider that the principles set out in the Guidelines should be applied also to AIFs marketed to retail investors in order to ensure equivalent standards in retail investor protection? Please provide reasons.

<ESMA_QUESTION_PFG_13>

<ESMA_QUESTION_PFG_13>

Q14 : Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits as regards the consistency between the performance fees model and the fund's investment objective? What other types of costs or benefits would you consider in this context? Please provide quantitative figures, where available.

<ESMA_QUESTION_PFG_14>
As indicated in our response to question 3, we believe consistency between performance fee model and fund's investments objective of the utmost importance. Current rules in Italy are based on this principle. However, we insist on the fact that setting of all other aspects such as the crystallisation frequency and the performance reference period are complementary to the models. The setting of any further layer would then be appropriately assessed to avoid unduly "changes" of well-functioning mechanisms. Pending the final decision, the impact of the Guidelines could be high also for management companies that already apply some standards.
<ESMA_QUESTION_PFG_14>

Q15 : In relation to Guideline 2, do you think that models of performance fee without a hurdle rate, or with a hurdle rate not linked to the investment objective (but clearly stated in the offering documents), should be permissible? For example, do you think that equity funds with a performance fee linked to EONIA, or a performance fee which is accrued as long as there are positive returns, should be allowed? Please give examples and reasons for your answer.

<ESMA_QUESTION_PFG_15>
As regards the examples proposed, in our view, funds which performance fee accrued as long as there is positive return may imply a HWM model, therefore if such model is acknowledged, the accrual effect should be permissible; while funds with a performance fee implying an index does not necessarily mean an active management with respect to a "benchmark" and funds that use a risk free rate (index) could be used in combination with other indicator in absolute return strategies, relying also on equity markets (please see also our response to Q19).

Therefore, an appropriate assessment of the whole fund characteristic should be made in order to decide whether the performance fee structure is permissible or not, bearing in mind that it is the investment objective that determines how a performance fee is suitable, not the other way round.

Again, we deem fundamental the principle 2 of the Guidelines where it states that performance fee should be coherent with the investment objective, strategy and policy of the fund and with principle 5 which imply a better understanding and choice for investors regarding fee structures and levels in the relevant fund's documentations.
<ESMA_QUESTION_PFG_15>

Q16 : What additional costs and benefits would compliance with the proposed Guideline bring to you/the stakeholder(s) you represent? Please provide quantitative figures, where available.

<ESMA_QUESTION_PFG_16>
In line with our response to Q4, we believe that a minimum crystallization frequency is not relevant for a HWM model.

Please note, the 80% of Italian based fund that apply a Benchmark model or a Hurdle rate model (77% on AUM) are already compliant with a minimum crystallisation frequency of one year. While 20% of funds using a HWM model and single investor base model (23% on AUM) would not be compliant.
<ESMA_QUESTION_PFG_16>

Q17 : What is the anticipated impact from the introduction of this proposed Guideline? Are there models or methodologies currently employed where this Guideline would not be appropriate? If so, please provide examples of these and details of how the best interests of investors are safeguarded.

<ESMA_QUESTION_PFG_17>
In line with our response to Q6 we believe that the possibility to withdraw performance fee also with relative positive performance should be recognised. In Italy, it is applied on a fund by fund basis at the own decision of asset management company.

As regards the recovery of negative/underperformance we understand that Italian based funds that use Benchmark or Hurdle rate models are compliant with the proposed Guidelines as long as the compensation period of positive performance with underperformance is one year. If the principle is to be understood differently, it may impose unjustified requirements and even possible changes to the fee structure.

In case of HWM or investor-based model, Italian based funds are already compliant because all the underperformance are recouped before earning a performance fee.
<ESMA_QUESTION_PFG_17>

Q18 : What additional costs and benefits would compliance with the proposed Guideline bring to the stakeholder(s) you represent? Please provide quantitative figures, where available.

<ESMA_QUESTION_PFG_18>
Please see our response to Q17.
<ESMA_QUESTION_PFG_18>

Q19 : Which other types of costs or benefits would you consider in the disclosure of the performance fees model? Please provide quantitative figures, where available.

<ESMA_QUESTION_PFG_19>
We fully embrace and support the requirement of fair, comprehensive and transparent disclosure of performance fees in the relevant funds' documentations. Investors would be better equipped to understand and select the funds they prefer and deem more suitable to their investment objectives.

However, disclosure should be appropriate depending of the fund documentation types. For example, information on performance fee could possibly collide with the length constrain, while a broad disclosure with concrete example could be easily given in the prospectus or in the fund rules.

As properly structured performance fees create a very clear alignment between the final investors' goals and the investment manager's incentives, we broadly believe that the existing rules on disclosure in the UCITS framework are enough and we do not see the need to make a specific disclosure in all ex-ante information documents. In addition, the possible delimitation of the ex-ante disclosure to the concept of "if relevant" could leave to different interpretations by NCAs. We also see merit in clarifying the meaning of "the potential impact on the investment return" in the ex-ante documentation as an illustration of how the performance fee mechanism would work in different scenarios.

As regard the ex-post information, we would suggest much clarity on the information that should be provided on the performance fee with specific reference to the broad statement that would require that in any ex-post information, additional to annual and half-yearly report, should be indicate the amount of the performance fee of the class/funds in monetary and in percentage terms. Again, if a performance fee is been acknowledged, investors should be informed via the existing disclosure vehicles set in the UCITS framework.

In addition, in our view, the information given on ex-post performance fee should be coherent with the accounting rule and the time period of the report (annual or lower than annual). Please also note, that the statement of cost and revenues may not be included in the half-yearly report in line with article 69, paragraph 4 of the UCITS Directive.

In line with above we would suggest the following remarks.

ESMA proposal		***Assogestioni proposal***	***Comment***
Source	***Text***		
GL 5 – par. 26	Investors should be adequately informed about the existence of performance fees and about their potential impact on the investment return	Investors should be adequately informed about the existence of performance fees and ~~about their potential impact on the investment return~~ **how the performance fee mechanism**	We see merit in clarifying the meaning of "the potential impact on the investment return".

		would work in different scenarios.	
GL 5 – par.27	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.	The prospectus **or fund rules and the KIID** ~~**and, if relevant, any ex-ante information documents as well as marketing material,**~~ should clearly set out all **relevant** 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 **or fund rules** should include concrete examples of how the performance fee will be calculated to provide investors with a better understanding of the performance fee model.	Where properly structured performance fees create a very clear alignment between the final investors' goals and the investment manager's incentives, so we do not see the need to make a specific disclosure in all ex-ante information documents. In addition, the possible delimitation of the ex-ante disclosure to the concept of "if relevant" could leave to different interpretations by NCAs. The information to be disclosed should be appropriate depending on the type of documentation of the fund.
GL 5 – par.30	The annual and half-yearly reports and any other ex-post information should indicate, for each relevant share class, the impact of the fees over the crystallisation period, 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 annual report and, **where applicable, in the** half-yearly reports ~~**any other ex-post information**~~ should indicate, for each relevant share class, the impact of the fees ~~**over the crystallisation period**~~, by clearly displaying: (i) the actual amount of performance fees charged and (ii) the percentage of the fees based on the share class NAV	Ex-post information of performance fee should be provided in the existing disclosure vehicles set in the UCITS framework. Please take into consideration that the crystallisation period could be different from the time period of the report.

Regards the information to be included in the KIID, we agree with the transparency requested in article 10(2)(c) of the KIID regulation, but we would suggest further effort in terms of clarity to the updated UCITS Q&A documents (ESMA34-43-392), with particular reference to Q&A

8b[5] and 4b[6] that deals on disclosure regarding the use of a benchmark, including for a performance fee.

Where a UCITS references an index for the sole purpose of measuring its performance fees against it, that UCITS should not be necessarily understood as being managed according to that same index. Thus, it would depend on the investment objective and the strategies pursued and these features could not simply derive from the provision of a performance fee. In this sense, also the Guidelines 2 where states that "*For instance, for funds that pursue an absolute return objective, a HWM model or a hurdle is more appropriate than a performance fee calculated with reference to an index because the fund is not managed with a reference to a benchmark*".

Therefore, if a fund follows an absolute return (i.e. unconstrained) investment strategy and any wording or graphic representation in the UCITS KIID or prospectus implying the fund is active managed with reference to an index (as per answer 8b or 4b in the UCITS Q&As) would inevitably mislead investors.

In addition, different performance fee models could be applied and the requirements in terms of disclosure should not create unfair disadvantages. For example, the decision of an asset manager to have for an absolute strategy a Hurdle rate or a Hurdle rate plus a High or a HWM model or a HWM model plus a hurdle would not let to different disclosure.

Please some herewith some practical examples based on existing KIID.

Example A.

An Active Fund– Share Class XX
ISIN: XX; Base Currency: XX

Objectives and investment policy

Objectives. *The management aims to optimize the Fund's return, over a time horizon of slightly over 5 years, in compliance with an identified risk target with a 99% monthly VaR (Value at Risk) of -X%. This risk measure makes it possible to quantify the maximum potential loss that the Fund's portfolio may incur over a one-month time horizon with a 99% probability level. (…)*

Investment policy. *The Fund invests in fixed income, money market and equity instruments; the latter may not however exceed XX% of the assets. (…)*
The management style is flexible. The choice of weightings between asset classes, the selection of different geographical investment areas, of different currencies and of individual financial instruments (e.g. shares, bonds, derivatives and UCIs) will be performed on the basis of macroeconomic, financial and market analysis, while also accounting for the residual duration of the Fund's investment horizon and the performance already achieved. The management is characterized by the use of statistical methods to control portfolio risk. (…)

Charges
(…)

Charges related to performance	*Between 1 March XXXX and 28 February XXXX, the performance fee was 0.*

NOTE: The KIID communicates a fully flexible (i.e. unconstrained) investment objective as a one seeking to capture growth opportunities across several markets and strategies by investing different type of instruments.
The fund is managed in line with pre-determined risk limit expressed in terms of a VaR measure. Such risk measure is purely internal and shall not be construed as forming the fund's investment objective.

A benchmark representative of the investment objective/policy has been thus clearly excluded => i.e. the fund is therefore clearly not managed with "reference to a benchmark" as per Answer 8b of the UCITS Q&As. In similar way, no indication of the degree of manager discretion from any benchmark is relevant.

[5] ESMA Q&A on Application of the UCITS Directive (ESMA34-43-392). Question 8b: What is the meaning of 'whether this approach includes or implies a reference to a benchmark' in Article 7(1)(d) of Commission Regulation (EU) No 583/2010? Answer 8b: A UCITS managed in reference to a benchmark index is one where the benchmark index plays a role in the management of the UCITS, for example, in the explicit or implicit definition of the portfolio's composition and/or the UCITS' performance objectives and measures. […] However, the following are (non-exhaustive and noncumulative) examples of where an approach may include or imply reference to a benchmark index and where a UCITS should disclose that it is managed in reference to that benchmark index: […] • Performance fees are calculated based on performance against a reference benchmark index. • The UCITS has an internal or external target to outperform a benchmark index.[…]

[6] ESMA Q&A on Application of the UCITS Directive (ESMA34-43-392). Question 4b: Where a UCITS refers to an index in its investment objectives and policy as a benchmark and will measure the performance against this that index, but does not intend to track that it, is it necessary to show the performance of the benchmark index in the past performance section of the KIID? […] For additional clarity, the requirements of Article 18(1) apply to all UCITS, including total return/absolute return UCITS. For example, the requirement also applies to cases where: - The comparator is not named a 'benchmark', but the objectives and investment policy make it clear that it is a comparator the UCITS aims to outperform. […] The UCITS targets outperformance of the benchmark index over a period of time, for example 'X% per annum over four years'. […]

	(The performance fee) *is calculated as 20% of excess performance over the period between 1 March of every year and the last day of February of the following year (herewith "one conventional year"), defined as the lesser between:* *- the percentage increase between the value of the share class and its highest value registered by the same on the last valuation day of previous conventional years; and* *- the differential between the percentage increase of the share class (…) and that of the following reference parameter in the conventional year: (Risk free index + XX %). (…)*

Past performance

2012	2013	2014	2015	2016	2017	2018
		3.4%	-0.8%	-0.4%	0.6%	-5.4%

NOTE: The fund KIID clearly discloses the application of a performance fee, with references to a variable hurdle rate (risk free index + %) and a previous High (HoH).

In line with the logic to Answer 8b of the UCITS Q&As, the risk free index could act as a benchmark concurring to determine a potential performance fee levy. Hence, considering ESMA's broad notion of a UCITS "being managed in reference to a benchmark index" as one including any reference or indicator which is merely "playing a role" in the management of the UCITS, the risk free index should – strictly speaking – also be disclosed in the "objectives and investment policy" section of the UCITS KIID, as well as in the "past performance" one. The % increase or decrease of the risk free index (+X%) between 2014-2018 should therefore be added to the chart.

Investors would consequently be led into (erroneously) believing that the risk free index is in effect a representative benchmark to measure the fund's real performance, whereas in reality a) it is used as an alternative to a HoH (which may apply if the difference between the value of the fund's share and the previous HoH is less than the difference between the former and the risk free rate +x%); and b) is merely used to gauge absolute performance in relation to a risk free-market rate.

Example B

An Active Fund of Funds – Share Class XX
ISIN: XX; Base Currency: XX

Objectives and investment policy

The fund pursues an investment policy aimed at capturing growth opportunities offered in fixed income, money markets and equity markets through a blend of non-directional strategies. In the absence of a reference parameter (for its investment policy and objectives), *the portfolio is managed in respect to a predetermined level of risk identified with an* (absolute) *VaR (Value at Risk) with a 99% confidence interval over a 1-month period (…)*

In line the principle of diversification, the portfolio is primarily invested in open-end UCIs. Special attention is given to UCIs with flexible investment strategies and to those combining heterogeneous investment strategies (so-called, multi-strategy, global macro, long/short). In this regard, the fund has ample flexibility in terms of investing across geographical areas/markets, issuers, activities, sectors and management styles. The portfolio of the fund is invested significantly in equity UCIs, including ones with long/short exposures. (…)

NOTE: The KIID communicates a fully flexible (i.e. unconstrained) investment objective as a one seeking to capture growth opportunities across several markets and strategies by investing in open-end funds. The prospectus expressly mentions that "for the fund, in relation to its adopted management style, it is not possible to identify a benchmark that is representative of the investment policy. Replacing the benchmark is an alternative risk measure represented by a monthly VaR with a 99% confidence interval and quantifying the maximum loss to the portfolio in any given month with a 99% probability".

A benchmark representative of the investment objective/policy has been thus clearly excluded => i.e. the fund is therefore clearly not managed with "reference to a benchmark" as per Answer 8b of the UCITS Q&As. In similar way, no indication of the degree of manager discretion from any benchmark is relevant

Charges

(…)

Charges related to performance	*10% of excess performance, defined as the lesser between:* *1) the positive differential between the value of the share class (…) and on the reference parameter (LIBOR + 250 bps) for each calendar year; and* *2) the percentage change between the value of the share class and the absolute HWM* (High-on-High). *In the course of the last calendar year, the charge related to performance has been equal to 0.00%.*

Past performance

2014	2015	2016	2017	2018
	-0.8%	-4.1%	2.6%	-4.5%

NOTE: As in the previous example, the fund KIID clearly discloses the application of a performance fee, with references to a variable hurdle rate (LIBOR + 250 bps) and an HoH, named absolute HWM.

In line with the logic to Answer 8b of the UCITS Q&As, the risk free index could act as a benchmark concurring to determine a potential performance fee levy. Hence, considering ESMA's broad notion of a UCITS "being managed in reference to a benchmark index" as one including any reference or indicator which is merely "playing a role" in the management of the UCITS, the risk free index should – strictly speaking – also be disclosed in the "objectives and investment policy" section of the UCITS KIID, as well as in the "past performance" one. The % increase or decrease of the LIBOR (+250 bps) between 2015-2018 should therefore be added to the chart.

Investors would consequently be led into (erroneously) believing that the risk free index is in effect a representative benchmark to measure the fund's real performance, whereas in reality it is merely used to gauge absolute performance in relation to a risk free-market rate. Secondly, the performance fee measurement against the LIBOR + hurdle rate is only conditional to it being the lesser of the difference between the fund's share class value and that of a competing HWM. If the latter were to apply, references to the hurdle rate in the past performance chart would have no meaning.

Therefore, we would suggest clarifying this point and we would contribute with some suggestions.

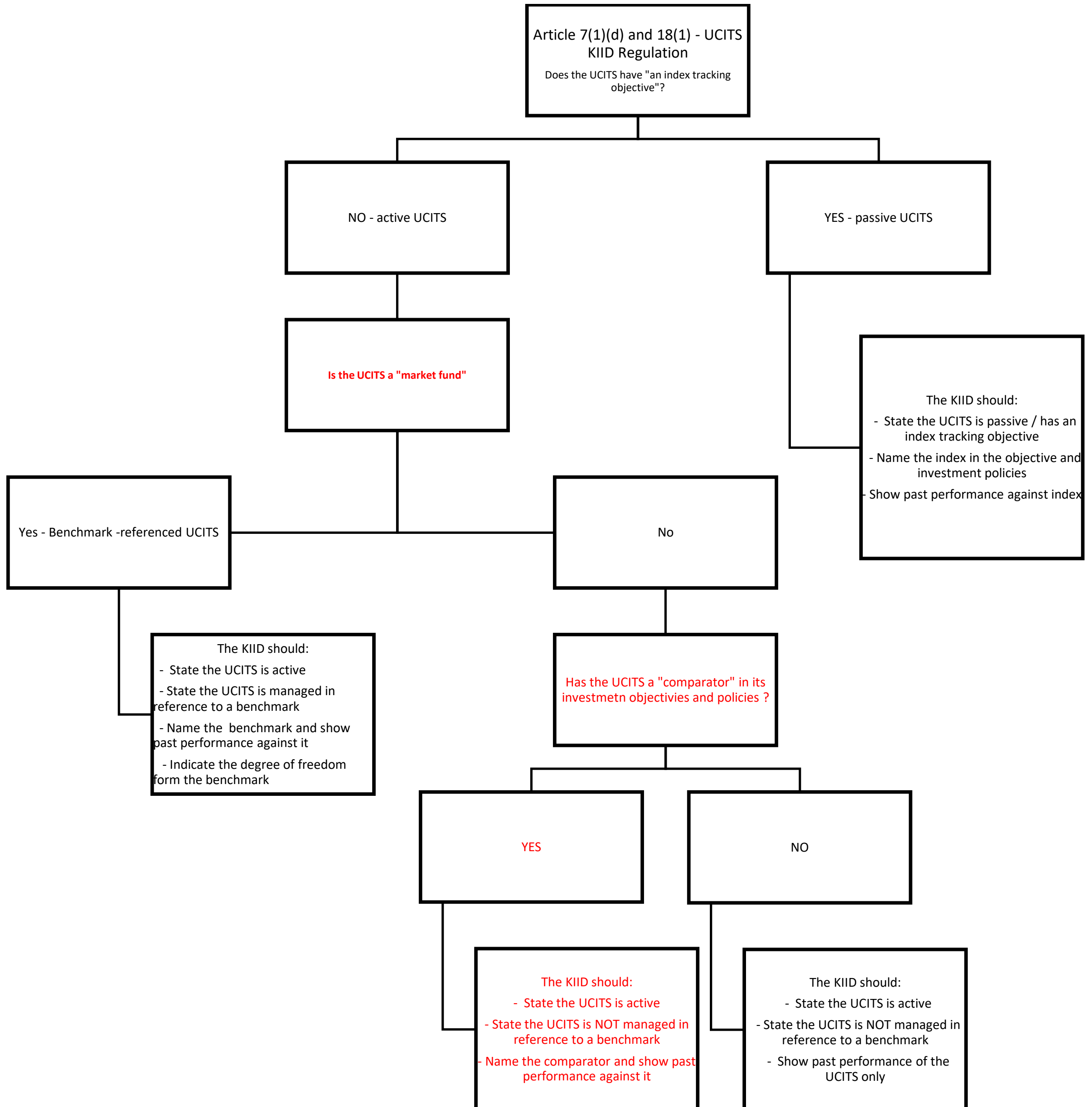
It could be clarified with a Q&A that the disclosure of a performance fee in the "Expenses" section of the KIID does not trigger as such the qualification of the fund in the "Objectives and investment policy" as (active) fund managed respect a benchmark. Therefore, no indication on the degree of freedom from benchmark should be given as well as the past performance of the benchmark.

Otherwise, a table could improve clarification for some types of funds identified by the CESR for the calculation of the synthetic risk and return indicator (SRRI) (CESR/10-673).

	Market fund	***Absolute return fund***	***Total return fund***
KIID			
Section 1 "Objectives and investment policy"			
Statement: "State the UCITS is active/non active in reference to a *benchmark*"	Yes, *Benchmark*	Not applicable	Not applicable, but reward objectives states in the objectives and investment policy
Degree of freedom from the *benchmark*	Yes	Not applicable	Not applicable
Section 3 "Charges"			
Performance fee	Yes	Yes	Yes
Section 4 "Past performance"			
Benchmark/Comparator* past performance	Yes	Not applicable	Not applicable, but reward objectives states in Section 1

(*) For Q&A 4b the objective and investment policy make it clear that it is a comparator the UCITS aims to outperform.

Another possible proposal is to update the graph of the Q&A 8a.



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