



European Securities and
Markets Authority

Response Form to the Consultation Paper

Guidelines on performance fees in UCITS





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	BVI Bundesverband Investment und Asset Management e.V.
Activity	Other Financial service providers
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	Germany

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_PFG_1>

Generally, in a free and competitive market, pricing is an expression of the civil law principle of freedom of contract. Thus, any intervention by legislative or administrative bodies with quantitative or qualitative effects on pricing schemes need to be well justified. Against this background, standardisation for the ease of processing and (convergence in) supervision shall not be a justifiable goal itself.

However, standards in pricing schemes, such as for performance fees, could be justifiable means to serve market integration and investor protection. In terms of investor protection the EU fund regulation framework includes a comprehensive set of provisions. A major principle is the transparency of costs and fees unwinding the complexity of fee structures which includes performance fees. The UCITS Directives (L1 + L2) state the obligation of the asset management company to conduct business in a honest and fair manner and in the best interest of the fund and its investors. An asset management company shall not charge undue fees. To this extent, supervisory convergence should primarily lead to a consistent application of statutory laws, but not to the introduction of restrictions that might overstretch the intention of the legal provisions. There is no question that the concept of performance fees as such makes sense to serve the interests of investors and fund managers by allowing both sides to participate directly in the success of the investment strategy.

Also, supervisory convergence via standardisation shall not be exercised as a race to the bottom in terms of limiting the statutory freedoms the regulation provides, as it is not the purpose of standardisation to find the lowest common denominator by meeting even the strictest possible approach a single NCA exercises. On the contrary, if the aim is to really achieve a level playing field the pendulum of supervisory convergence would swing in both directions meaning that the standards to be established in the ESMA Guidelines would act as a floor and ceiling for NCAs' discretion, so that national gold plating would have to be considered as undermining a harmonised supervisory approach. In this regard, regulatory arbitrage and national gold plating may be the two sides of the same coin.



*BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's more than 100 members manage assets of some 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 22% in the EU Germany represents the largest fund market as well as the second fastest growing market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en. |

<ESMA_COMMENT_PFG_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>

We understand that ESMA observed on the issue of performance fees that the different practices across the NCAs create risks of regulatory arbitrage and inconsistent levels of investor protection. A standardisation of the principles for performance fee schemes could mitigate those risks. In the attempt to achieve supervisory convergence the task is to ensure that the interests of all market participants are appropriately balanced. |

<ESMA_QUESTION_PFG_1>

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

<ESMA_QUESTION_PFG_2>

We do not see any obstacles to standardisation from a regulatory side. In the end, the decisive factor for the degree of harmonisation will be the determination of NCAs to adjust to the future ESMA standard. |

<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>

A general statement which indicators should be considered to adequately determine a matching benchmark would hardly do justice to the variety of investment strategies. A decision should therefore be taken on a case-by-case basis. However, the technical proposal of IOSCO ("Good practice 3" referred to in this CP on page 17) provide reasonable considerations for an assessment.

In this context, one should also consider the discussion regarding the disclosure of a benchmark index in the investment objectives, strategy and policy section of the fund's KIID that was triggered by the Q&A on the Application of the UCITS Directive (see also our answer to Q19). |

<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>

The calculation of the intraperiod provisions for performance fee entitlement should be ensured in such a way that no group of investors is systematically disadvantaged. This means that an accrual-like liability should be recorded on each day on which a UCITS share price is determined in order to avoid distortions when the performance fee is paid. By creating accruals for performance fee entitlements a sudden reduction in the share price on the settlement date can be prevented as the performance fees are successively booked as accruals within the crystallisation period.

A minimum crystallisation period of 1 year, which does not have to correspond to the calendar or fiscal year of the fund, appears reasonable and is also the current BaFin practice. However, an exception to this provision may be appropriate in exceptional circumstances. For instance, if the launch of a fund is delayed due to a longer approval process than expected, the original crystallisation period, as stipulated in the documents submitted for approval, may not be adhered to in the first year. In such exceptional cases, a deviation from the minimum 12 months should be possible. Example: A fund should be launched on 1 January, with the fiscal year and crystallisation period corresponding to the calendar year. However, the fund does not receive its approval until 5 January. Without a subsequent change of the crystallisation period, the manager of this fund, which has set 31 December as the crystallisation date in its documents, would only be entitled to realise a performance fee for the first time after almost 24 months. This de facto prolongation of the crystallisation period is unreasonable. |

<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>

|A minimum crystallisation period of 1 year appears reasonable also when using HWM models. |

<ESMA_QUESTION_PFG_5>

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>

|When assessing a suitable performance fee scheme the range of existing fund strategies should be taken into account. A performance fee is meant to recognise the fund manager's managing skills against a certain benchmark/hurdle. Exceptional management quality

justifying a performance fee can also materialise if the overall performance of the fund is negative, but not at the same degree as the relevant comparator.

For example, in an overall declining market a manager of a long-only equity fund may only achieve relative outperformance, thereby still showing superior skill as compared to the market as a whole. A limitation of performance fees to absolute positive performance does also not accommodate for the fact that a significant number of investors are more concerned about stability and value retention even under difficult market conditions, and those investment strategies should be evaluated by a relative outperformance.

We therefore recommend leaving structures that would entitle for performance fees even in the event of absolute negative performance as an acceptable option. |

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>

The term "prominent warning" is judgemental. A Performance fee based on relative outperformance is, however, legitimate (see our answer to Q6). We suggest to provide a description of the performance model in the UCITS prospectus (e.g. concept of absolute vs. relative performance) which could be referred to in other fund documents.

From a German perspective, according to BaFin standards an explicit note must be included that the performance-related remuneration can also be charged if the share price development in the reference period was negative. |

<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>

We strongly advise against using the term "reset" in the context of a HWM. Semantically, a "reset" would mean that after expiry of the relevant "reset" period, all previous performance will be discarded for purposes of performance fee calculation, and a new period will start "from scratch" as in a newly launched fund. This would not be a very reasonable approach for performance fee regimentation and is probably also not what ESMA has in mind. Instead, a "revolving" interval might be pursued. A revolving interval of (x) years means that on completion of a fiscal year of the fund, the oldest year of the interval will be discarded from consideration, and the most recent year takes its place. As a result, always the (x) most recent years of performance values are being considered.

The adequate revolving period must be determined in the trade-off between incentive effect and risk. Too short periods reduce the incentive for the manager to compensate for losses. Too long periods can lead to increased risk exposure, especially if the fund's share price is well below the HWM. Especially an infinite period (life cycle of a fund) would be critical in case of a fundamental market drop. In any case, the recovery of a major loss might take a very long time until a performance fee could again be generated. From an economic point of view, the liquidation of such a fund and a new launch of a similar product might be the sensible measure, which however is not necessarily in the interest of the investors.

We would like to point out that levying fees on individual investor level is a largely theoretical concept which, in particular for retail funds with thousands of investors to which the management company does not have direct access, is operationally complex and impractical. Further, in order to keep operational costs under control, performance fee models cannot be tailored to the specifics of each and every individual fund. Therefore, in terms of standardisation of supervisory practices a predefined time horizon seems to be the most suitable approach.

One should be aware that under certain circumstances the HWM calculation model may lead to investors being affected differently. This depends on the development of the NAV and the investor's point of entry. For example, a new investor who invests below a previously achieved HWM may benefit from the fact that performance fee accruals have been made in the past, so that this investor – unlike former investors – won't contribute until the HWM is reached again.

<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>

We oppose the idea that an infinite period (life cycle of a fund) or the recommended holding period would appropriately take into account the interests of the asset management company (see our answer to Q8).

We also refer to our answer to Q8 regarding the use of the term “resetting”. Regarding the adequate revolving interval, we think that different asset classes and investment strategies may call for different time horizons. Against this background the asset management company should be able to exercise discretion when determining a period appropriate for the specific fund. Under the impression of the supervisory practice of BaFin that uniformly requires a performance reference period of 5 years, we feel that this rigid precondition is too inflexible to accommodate to different investment strategies. On the other hand we concede that a very short time horizon (e.g. only 1 year) would undermine the objective of balancing the interests of investors and fund managers and is therefore untenable. ESMA's Guidance could suggest a typical/average horizon of, for example, 3 years. Nevertheless, as opposed to the suggested reference horizon in Q8, 5 years should be an absolute (regulatory) maximum.

<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 do not see a substantial difference for the assessment of a suitable performance reference period when using a benchmark index in connection with a HWM (see answers to Q8 and Q9).

<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>

We see no positive effect for investors by aligning the crystallisation period with the performance reference period. The crystallisation period is simply a tool for defining the frequency of performance fee withdrawals from the fund. It is a mere technical feature, as the performance fee due is accrued on fund level on each valuation day anyway. Materially, aligning the performance fee model with the investors' holding period is hence best achieved by means of the performance reference period, i.e. the period at the end of which past underperformance can be reset.

<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>

It would generally be sensible to allow an implementation phase of at least 18 to 24 months after the Guidelines come into effect. UCITS which need to adapt existing fee models should be allowed to do so at a reasonable point in time, as, for example, an interference with a running performance fee reference period should be avoided.

<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>

With regard to the argument of mitigating regulatory arbitrage the application of the Guidelines to AIFs appears a bit peculiar, as the marketing of (non-)EU AIFs to retail

investors is subject to NCA approval. Thus, on each domestic market the competent NCA may ensure a level playing field between domestic and (non-)EU AIFs. This is the difference to the UCITS EU-passporting regime where NCAs do not have the authority to exercise national gold plating rules to inbound EU UCITS. |

<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>

|We generally agree with the reasoning on benefits and costs. |

<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>

|The interests of all stakeholders should be balanced and the performance fee scheme should reflect the fund's risk-reward profile. The striking example of an equity fund that is measured against EONIA implies a mismatch. However, in more diverse investment strategies a performance fee without a hurdle rate might still be reasonable. Again, this should be decided on a case-by-case basis. In this regard, whether a performance fee model is suitable should also be evaluated in terms of anticipated overall fees (base management fee plus performance fee). |

<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>

|We do not expect significant additional costs for compliance with the proposed Guidelines in relation to those funds that already obey the sample cost clauses stipulated by BaFin. However, for funds which are launched outside of Germany but are designated to be marketed in Germany compliance costs may arise. Especially in cross-border cases where funds are marketed in more than one member state a harmonised application of the Guidedance by the NCAs involved is necessary. |

<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>

We understand that the term 'positive performance' in Guideline 4 refers to absolute as well as relative performance (see also Q6). Against this background, German UCITS that already obey the BaFin standards should not be significantly impacted. |

<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>

We do not expect significant additional costs for compliance with the proposed Guidelines in relation to those funds that already obey the sample cost clauses stipulated by BaFin. However, for funds which are launched outside of Germany but are designated to be marketed in Germany compliance costs may arise. Especially in cross-border cases where funds are marketed in more than one member state a harmonised application of the Guidedance by the NCA's involved is necessary. |

<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>

In this context, one should also consider the discussion that was triggered by the Q&A on the Application of the UCITS Directive with regard to the disclosure of a benchmark index which the CP on page 54, Guidance 5, para. 29 refers to. Not in all cases can it be assumed that a benchmark used in a performance fee model has to be disclosed in the objectives and investment or the past performance section of the KIID. With regard to costs, it should be noted that the display of a benchmark may be subject to significant license fees. |

<ESMA_QUESTION_PFG_19>