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Additional Information

Level 1 Regulation
Alternative Investment Fund Managers Directive (AIFMD) Directive 2011/61/EU

Level 3 Regulation
Performance Fees - Guidelines on performance fees in UCITS and certain types of AIFs - ESMA34-39-968

Topic
Costs and fees

Additional Legal Reference
Guidelines on performance fees in UCITS and certain types of AIFs

Subject Matter
Performance fees

Question

Section XV: ESMA’s guidelines on performance fees in UCITS and certain types of AIFs
Question 1 [last update 30 March 2021]: Based on paragraphs 40 and 41 of the guidelines on performance fees in UCITS and certain types of AIFs (“Guidelines on performance fees”), should performance fees be paid only at the end of the performance reference period of 5 years?

ESMA Answer

30-03-2021

Original language

No. The Guidelines on performance fees do not prevent to pay performance fees during the performance reference period of 5 years and/or in the first years of a fund's existence, in case the fund has not existed for 5 years. By way of example, if on the crystallisation date of the fund (e.g. at the end of the second year of existence of the fund), the fund has overperformed the reference indicator and there is a positive accrual of performance fees those can be paid. In this case, the accrual will be crystallised in the payment of the performance fees to the management company. On the contrary, if on the crystallisation date of the fund (e.g. at the end of the third year of existence of the fund) the fund has underperformed the reference indicator and as a consequence there are no accrued performance fees, this underperformance is brought forward for the purpose of the calculation of performance fees the following year. In this way, compensation of negative performances is ensured over the years during a reference period of 5 years.

Example:

• **Crystallisation date: end of the second year of existence of the fund**

Performance of the fund: 10%

Performance of the reference indicator: 5%

Overperformance: 5%

Performance fees can be paid to the management company

• **Crystallisation date: end of the second year of existence of the fund**

Performance of the fund: 10%

Performance of the reference indicator: 10%

Overperformance: 0%

No crystallisation of performance fees

• **Crystallisation date: end of the third year of existence of the fund**

Performance of the fund: 5%

Performance of the reference indicator: 10%

Underperformance: -5% (this underperformance should be taken into account in the subsequent calculation of performance fees)

Not only performance fees cannot be paid but the underperformance of -5% should be brought forward to the following year and clawed back before any performance fee can be paid (see below)

• **Crystallisation date: end of the fourth year of existence of the fund**

Performance of the fund: 8%

Performance of the reference indicator: 5%

Overperformance: 3%

Underperformance from year 3 -5%

Global net performance: -2%

Not only performance fees cannot be paid but the underperformance of -2% should be brought forward to the following year and clawed back before any performance fee can be

paid

This should not prevent NCAs to require funds to apply stricter rules (e.g. to crystallise fees only after 5 years or to apply reference periods longer than 5 years), bearing in mind that any specific provision applying at national level in addition to the provisions set out in the guidelines should not jeopardise the rules regarding funds' cross border distribution (See Chapter XI of the UCITS Directive) and the split of competences between the home and host competent authority (See Chapter XI of the UCITS Directive) to this regard.

Paragraph 40) of the Guidelines on performance fees states that "In case the fund employs a performance fee model based on
a benchmark index, it should be ensured that any underperformance of the fund compared to the benchmark is clawed back
before any performance fee becomes payable. To this purpose, the length of the performance reference period, if this is shorter
than the whole life of the fund, should be set equal to at least 5 years."

Paragraph 41) of the Guidelines on performance fees states that "Where a fund utilises a HWM model, a performance fee should be payable only where, during the performance reference period, the new HWM exceeds the last HWM. The starting point to be considered in the calculations should be the initial offering price per share. For the HWM model, in case the performance reference period is shorter than the whole life of the fund, the performance reference period should be set equal to at least five years on a rolling basis. In this case, performance fee may only be claimed if the outperformance exceeds any underperformances during the previous five years and performance fees should not crystallise more than once a year.