

Submission Date

01/05/2022

ESMA_QA_963

Status: Answer Published

Additional Information

Level 1 Regulation

Undertakings for Collective Investment in Transferable Securities Directive (UCITS) Directive 2009/65/EC

Topic

Costs and fees

Subject Matter

Performance reference period for the benchmark model

Question

Based on paragraph 40 of the Guidelines on performance fees, how should the performance reference period for the benchmark model be set?

ESMA Answer

Original language

[ESMA 34-43-392 UCITS Q&A, Section 11, 3a] & [ESMA 34-32-352 AIFMD Q&A, Section 15, 5]

The benchmark model is defined as a performance fee model whereby the performance fees may only be charged on the basis of outperforming the reference market index. See the definitions Section of the Guidelines on performance fees.

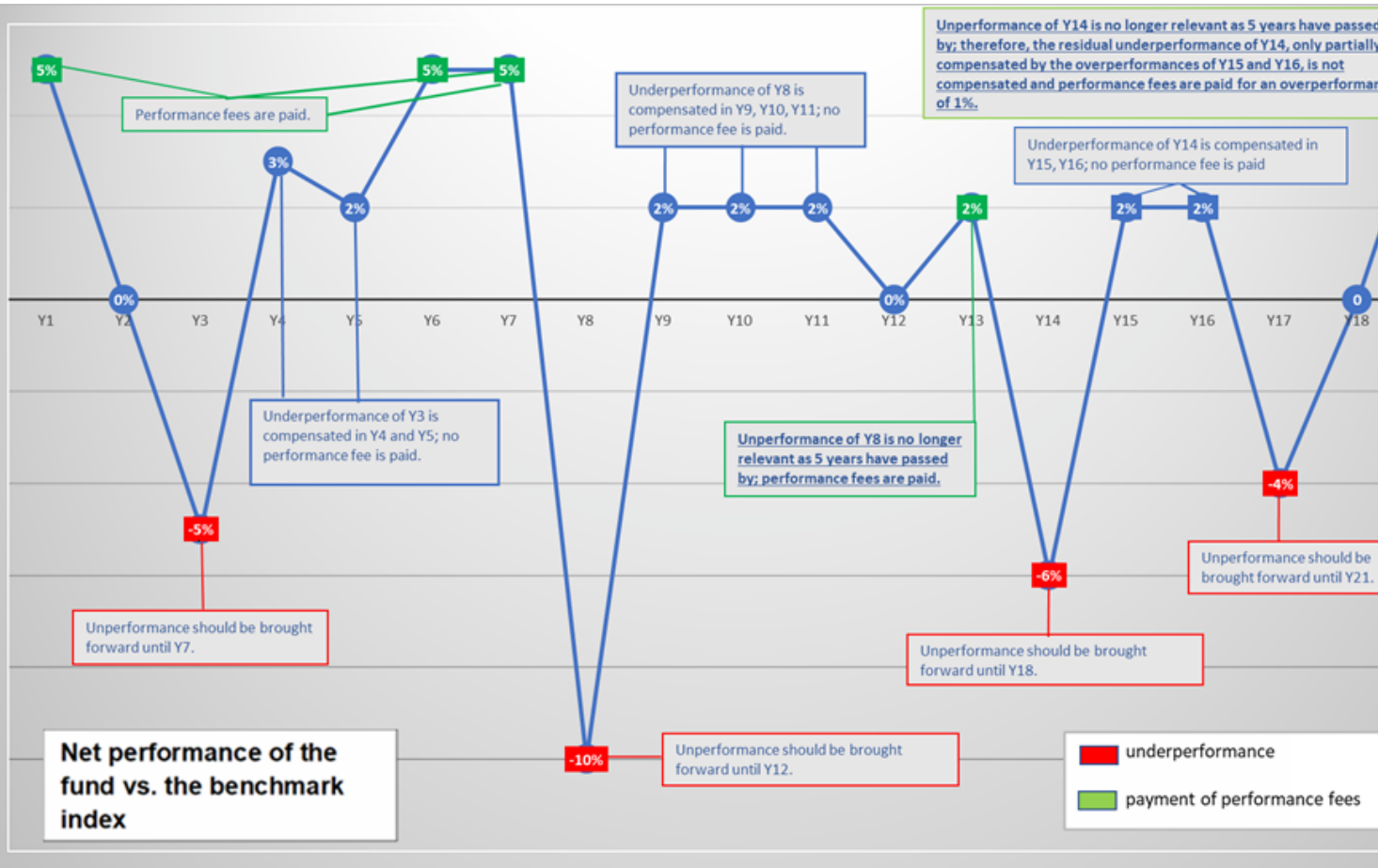
Paragraph 40)^[1] of the guidelines recommends that:

1. any underperformance of the fund compared to the benchmark index should be clawed back before any performance fee becomes payable; and
2. the length of the performance reference period^[2], if this is shorter than the whole life of the fund, should be set equal to at least 5 years.

In order to comply with the above recommendations, it should be ensured that any underperformance is brought forward for a minimum period of 5 years before a performance fee becomes payable, i.e. fund managers should look back at the past 5 years for the purpose of compensating underperformances.

In case the fund has overperformed the benchmark index, the fund manager should be able to crystallise performance fees.

The following example illustrates the principles above (please note that the two tables below relate to the same example, the first one illustrated through a graphical representation, while the second one displayed in numerical terms):



	Net performance	Underperformance to be compensated in the following year	Payment of performance fees
Y1	5%	0%	YES
Y2	0%	0%	NO
Y3	-5%	-5%	NO
Y4	3%	-2%	NO

Y5	2%	0%	NO
Y6	5%	0%	YES
Y7	5%	0%	YES
Y8	-10%	-10%	NO
Y9	2%	-8%	NO
Y10	2%	-6%	NO
Y11	2%	-4%	NO
Y12	0%	0% [3]	NO
Y13	2%	0%	YES
Y14	-6%	-6%	NO
Y15	2%	-4%	NO
Y16	2%	-2%	NO
Y17	-4%	-6%	NO
Y18	0%	-4% [4]	NO

Y19

5%

0%

YES

The following are additional examples aimed at further clarifying the mechanism of compensation of underperformances:

1. in the case the net performance of the fund in Y18 was equal to 2% (instead of 0%), the underperformance to be carried forward to the following year (Y19) would be equal to -4%. This is in light of the fact that during Y18, the underperformance of -2% coming from Y14 should still be compensated and, in addition to that, the performance of -4% coming from Y17 should be brought forward to the following year.
2. in the case the net performance of the fund in Y18 was equal to 5% (instead of 0%), the underperformance to be carried forward to the following year (Y19) would be equal to -1%. This is in light of the fact that the residual underperformance coming from Y17 that was not yet compensated (-1%) should be brought forward to the following year (Y19).
3. in the case the net performance of the fund in Y18 was equal to 7% (instead of 0%), the net performance of the fund would compensate the underperformance of -6% coming from Y17. The positive accrual of performance fees for the 1% difference would therefore be crystallised in the payment of the performance fees to the management company. There would be no underperformance to be carried forward to Y19.

This is in line with the principle in the guidelines that underperformance in a given year (e.g. Y14) should still be compensated during a period which includes the fifth year following that underperformance (Y18), while not be brought forward to the sixth year (Y19).

[1] This is defined as “the time horizon over which the performance is measured and compared with that of the reference indicator, at the end of which the mechanism for the compensation for past underperformance (or negative performance) can be reset”.

[2] 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.”

[3] The underperformance of Y12 to be taken forward to the following year (Y13) is 0% (and not -4%) in light of the fact that the residual underperformance coming from Y8 that was not yet compensated (-4%) is no longer relevant as the 5-year period has elapsed (the underperformance of Y8 is compensated until Y12).

[4] The underperformance of Y18 to be taken forward to the following year (Y19) is 4% (and not -6%) in light of the fact that the residual underperformance coming from Y14 that was not yet compensated (-2%) is no longer relevant as the 5-year period has elapsed (the underperformance of Y14 is compensated until Y18).