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October 25, 2019

To Whom it May Concern,

We applaud ESMA's focus on performance fees in UCITS. Performance fees are critical to the future of the active management industry, and as such deserve thoughtful regulatory focus.

Without a commercial, orderly performance fee regime in UCITS, investors will have no alternative to fixed-fee funds. And we have seen the result of an industry dominated by fixed-fees: poor performance and asset-gathering, neither of which serve the interests of clients. It is therefore critical that ESMA establish a level playing field in which active managers can flourish.

Aperture is an attempt to align manager interests with those of their clients.

Our firm is a response to the proliferation of fixed fees in active management, which reward managers regardless of whether they produce outperformance for clients. That is why we use performance fees in all of our products. Moreover, we charge base fees competitive with those of passive ETFs in the same asset class when performance is at or below the stated benchmark. As outperformance is generated, a performance fee of 30% is charged on returns generated in excess of the stated benchmark.

In this construct, clients pay a market price for beta exposure, and only pay more when they get more.

Aperture's investment teams receive modest base salaries according to industry data and stand to earn most of their compensation from performance fees. Our investment team can receive up to 35% of Aperture's performance fees on realised outperformance (30%), or 10.5% of total outperformance.

In this construct, managers are primarily incentivised to perform, not to grow assets.

Furthermore, the deferral structure applied to Aperture's manager compensation is designed to incentivise long-term performance. Half of performance compensation is paid out on the past year's performance. The other half is based on the cumulative outperformance over a 3-year period, including the two years following the year in which the performance was generated. The investment team's cumulative outperformance over that 3-year period must be at least as great as the outperformance in the first year in order to earn all deferred compensation. Deferred compensation is decreased pro-rata by any underperformance. Unearned compensation is returned to the strategy over time.

In this construct, managers are dis-incentivised from taking excess risk in any single performance period.

The market has evolved, and we believe that beta needs to be separated from alpha. Fixed fee models that do not utilize performance fees cannot accomplish this effectively because they charge for beta and alpha in a single, fixed fee. In order to make performance fees a viable alternative, two considerations are critical:

1. Performance fees should be permitted in cases of negative absolute return. To disallow such fees would effectively de-commercialize performance fees in funds with market-based benchmarks by adding an additional benchmark of zero. If a manager's objective is to outperform an index, they should be rewarded whenever they beat that index. As we have stated in our responses to the consultation, clear disclosure of such scenarios is critical.

2. Performance fee periods longer than one year should not be required. A minimum of one year is advisable, however a requirement for longer periods could have the unintended consequence of increasing base fees across the industry. Managers will not want to wait more than one year to be paid, and in order to pay talented managers more each year, we believe firms would

increase base fees to make up the difference. In Aperture's case, we combined a one-year performance fee period with a three-year performance claw back in manager compensation, which we believe elongates the time horizon over which the manager is incentivised. Other firms will undoubtedly accomplish this with alternative structures. ESMA should support and enable this kind of flexibility and innovation.

We believe that one of the most important effects of an effective performance fee regime in UCITS will be to dis-incentivise asset gathering and instead to incentivise capacity constraints in funds which utilize market-based benchmarks. Managers working under performance fee models against beta-based benchmarks who gather too many assets and perform poorly as a result will see their compensation decrease. On the other hand, skilled managers who constrain their capacity to maintain performance will do well. Performance fees in both positive and negative market environments enable the manager to align with his or her client, whose interest is not in the size of the manager's fund but in its performance relative to the benchmark. This is the single most important lever missing from the industry today.

We appreciate your consideration and welcome the outcome of the consultation.

Sincerely,

Peter S. Kraus
CEO and Founder, Aperture Investors, LLC

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

In the retail marketplace, we agree that some degree of standardisation helps clients understand the available structures and the potential pros and cons of utilizing them. However, too much standardisation can also inhibit the ability of asset managers to perform (and thereby deliver returns to clients), either by restricting their ability to use certain incentives to motivate managers or by limiting the ability to charge for performance, as opposed to assets under management. For example, a point addressed in later questions is the requirement for a minimum performance period. While a minimum of one year is advisable, standardisation beyond that point to a longer time frame could create adverse and unforeseen consequences (i.e. managers who are only paid on a three-year performance lookback would have to wait three years to be paid, and firms might increase base fees to compensate as a result).

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

The draft Guidelines specify five "key elements" around which there should be greater convergence. Although managers will require some flexibility in defining certain elements, we believe that all five warrant full disclosure and some degree of standardisation. For example, element B, consistency between the performance fee model and the fund's investment objectives, strategy and policy, is essential for clients. Regulatory action that required, for example, asset managers to explain how their benchmarks were chosen and to defend the claim that they are accurate representations of the beta in a given portfolio would undoubtedly lead to an increased use of appropriate benchmarks. We also believe that Guidelines requiring at least a one-year crystallization period are well-advised. In practice, periods less than 1 year are too short, and periods longer than one year have proven confusing and difficult for end clients to understand. Exceptions should be permitted, but they should require justification. Regulatory action however requiring the disclosure of such crystallization periods, and the defense and explanation of their construction, can only benefit clients.

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.

We believe that the following 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.

We do not believe that managers should earn performance fees solely by utilizing specifically defined subsets of securities from within their indices. Of course, some degree of concentration and security selection is what will enable a manager to outperform their index. However, in the context of an overly broad benchmark, certain forms of concentration are not indicative of manager skill. For example, a manager who invests only in US technology stocks should not be measured against the S&P 500, they should be measured against a US technology index. Similarly, a manager who factor-loads, for example by investing primarily in growth stocks, should not be measured against a broad equity index, but rather a growth equity index. We do not believe that managers should be rewarded with performance fees solely for taking sector or factor exposures, which have largely been commoditized in widely-available passive products.

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.

We agree with the principles of Guideline 3 and adhere to them in all of our strategies currently, and we agree that a one-year measurement period at a minimum is appropriate. We further view the disclosure of explanation of how the manager selected their crystallisation period of critical importance.

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Regarding (20) specifically, we do not believe that a crystallization period minimum alleviates the risk that over-performance results from “short-term gains due to random market factors.” First, we believe that all gains within the crystallization period are created equally, regardless of the time period over which they are generated. Ceteris paribus, a manager who generates a 12% annual return in their fund by earning a 12% return in January and 0% for the remainder of the year generates the same 12% annual fund return as a manager who generates a 1% return in each month of the year. Second, we do believe that the risk of compensating managers for “random market factors” should be mitigated, but not through the crystallization period. This risk should instead be controlled by requiring managers to outperform their benchmarks in order to earn performance fees, thereby eliminating performance compensation resulting from market appreciation alone.

If ESMA does decide to institute a mandatory crystallization period minimum of one year, it should permit an exception for new funds so that they can launch mid-year.

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.

Yes - all funds should have performance measurement periods of at least 12 months, regardless of whether they utilize HWMs. The exception should be for new fund launches, which should be permitted throughout the calendar year.

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

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or methodologies currently employed where the approach set out in Guideline 4 would not be appropriate?

We are strongly opposed to the limitation of performance fees to periods in which the fund has achieved positive performance. Such a limitation would seriously inhibit remuneration in down markets, and we furthermore believe it would incentivise managers to take additional risk. Any model or methodology utilizing a benchmark comprised of individual securities would be similarly impacted.

Funds benchmarked to indices should be able to earn performance fees for outperformance of their index, regardless of whether the index's absolute performance is positive or negative. If the index is down 10% but the fund is only down 5%, the fund should be able to earn a performance fee, because it has accomplished its objective of outperformance. Requiring positive performance puts an unfair and counterintuitive burden on managers: when their index performance is positive, the manager must outperform their index to earn a performance fee, but when their index performance is negative, the manager must not only outperform their index, but also make up for any negative performance it delivered in order to earn a performance fee. This would be especially unfair to active managers (and we believe a disadvantage to clients) in a world increasingly dominated by passive products. Retail clients are increasingly exposed to market risk through passive vehicles. Making it harder for active managers to earn performance fees in down markets weakens their incentive to deliver returns which are superior to passive products in such markets.

Put another way, there are two broad categories of funds to be considered - 1) those with beta or index-based benchmarks, and 2) those with absolute return objectives, where the effective benchmark is zero. In the latter case, by definition, a performance fee can only be charged when total return is positive. But in the former, the objective of the fund is achieved when the benchmark is outperformed, even if total return is negative.

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.

We provide prominent disclosure that the objective of the fund is to outperform its benchmark, and accompanying prominent disclosure and explanation of how the performance fee mechanism works (for example, see the language and interactive module we use to illustrate the fee structure here: https://apertureinvestors.com/intl/fund/aperture-new-world-opportunities-fund-apnwixu/), including examples and scenarios. Such a requirement would unfairly disadvantage active managers relative to passive ETFs, which are permitted to state that they "seek to track [insert specific index]" but are not required to disclose prominently that they almost always underperform those indices, in certain asset classes materially (for example, in high yield ETFs), due to transaction costs.

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.

We do not believe in the use of high water marks as we believe they engender excess risk taking on the part of portfolio managers. When a manager has a high water mark, they are incentivised to "get back to even" so that they can start earning a performance fee once again. Such an incentive can lead a portfolio manager to take excess risk. We believe far more strongly in a model that utilizes a set performance reference period, with a performance clock that resets once performance for the prior period has crystallized. When used in conjunction with a manager compensation model which relies in part on performance over a multi-year time period, such a model forces the portfolio manager to consider the risk they take in any given performance reference period in the context of the risk they took in previous periods as well as the risk they might take in future periods.

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.

We believe best practice requires the use of both the fund's fee structure and the portfolio manager's compensation (see answer to Q8). In any case, if the portfolio manager's compensation model is not aligned with the fee model of the fund, then the fee model of the fund alone may not be enough to align the fund's objectives with those of its investors.

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.

As stated in our answer to Q4, we believe that increased disclosure requirements around the setting of the performance reference period are preferable to regulation of the performance period itself. However, if a minimum must be set, it should not be less than one year (except in cases where a fund launched mid-year). Although it would be possible to envisage longer performance reference periods, ultimately, we determined that a year-long performance reference period appropriately balances the need to measure performance over a significant period of time with the need to reward portfolio managers more frequently. But the appropriateness of a specific period length will depend on multiple factors including the strategy / asset class as well as the portfolio manager's compensation model. For example, under Aperture's model, we believe that a one year performance reference period is appropriate because only half of our portfolio managers' compensation is based on a single performance reference period alone; the other half is deferred and based on the aggregation of three individual performance reference periods. In this way, we partially incentivize managers to produce both 1-year and 3-year performance. However, another firm with different managers and strategies could theoretically decide to use a longer performance reference period, say, 3-years, but use no deferred performance compensation whatsoever, paying the manager performance compensation every year based on a 3-year look back period only. Limiting asset managers' ability to customize these arrangements could stifle innovation and experimentation.

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.

As stated in Q10, we believe that different firms will develop different structures, many of which will be appropriate.

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?

This depends on the complexity of the changes to existing requirements. If for example the changes are mostly around disclosure, and do not require substantive changes to fund accounting processes and portfolio manager employment agreements, then a 12-month adoption period should be adequate. However, it might be advisable to make the Guidelines effective as of the first day of the first full fiscal year following the date of adoption, in the case where the minimum crystallization period is mandated to be a year. If on the other hand the Guidelines end up forcing changes to certain firm's core business models, then they could require years to adapt, or in extreme cases close their funds altogether.

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.

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.

We generally agree with the above-mentioned reasoning. In particular, we believe that the draft principles related to the appropriateness of the benchmark are good practice, and should not add additional expense. Realistically, any such change will undoubtedly incur additional costs, as additional Guidelines will require additional compliance and legal work.

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.

We do think that non-index hurdle rates should be allowed (e.g. interest rates, absolute return benchmarks). We currently use one with respect to our recently launched Aperture Credit Opportunities Fund (SOFR+2%). However, we think that just as with index-based benchmarks, such a hurdle rate needs to be substantively connected to the investment objective of the fund. For example, in our Credit Opportunities Fund, we use SOFR +2% because we believe that over time it approximates the return one could earn through passive exposure to global credit markets, and we want our managers to outperform that beta before they can earn a performance fee. The example used in Q15 of an equity fund linked to EONIA therefore does make sense to us. However, as we have stated previously, we

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believe the solution to such a structure is increased disclosure so that the client can make up their own mind, not a regulatory mandate that such a model is disallowed. There is opportunity for ESMA to innovate beyond for example what the SEC permits in the US, where performance fee hurdles must be linked to an index of securities (no absolute return or interest-rate benchmarks are permitted).

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.

No additional comment.

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.

The policy objective should be clarified. "Performance" is distinguishable from "out" or "under"-performance, and so these terms should not be used interchangeably. Since the Guidelines rightly contemplate performance fees for both beta-based and absolute-return-based funds, the language must be precise. If the reference period is one year, we agree that negative under-performance within the period should be offset by out-performance in order to earn a performance fee. In the case of an absolute return fund, this would also mean that negative performance needs to be offset by positive performance. However, in the case of an index-based benchmark that would not be true - total return could be negative even though outperformance could be positive, therefore triggering a performance fee.

This proposal creates a serious issue which would make UCITS funds with performance fees non-commercial and would likely stifle their use. We have partially addressed this issue in our response to Q6. A requirement to have positive absolute performance before a performance fee can be earned negates the efficacy of any benchmark-based performance fee. In the case of an index-based hurdle, if the performance of the index were -10%, but the fund's performance was -5%, then no performance fee could be earned. In the case of an interest rate benchmark the same principle would apply in a negative interest rate environment. Such a situation seems neither fair to asset managers nor beneficial to clients, since the client's alternative to the actively-managed product with performance fees is either a) passive products, which would be delivering a negative return in this hypothetical scenario, or b) actively-managed products with fixed fees, which historical data has shown have a difficult time beating the market (we believe in part because fixed fees incentivise asset-gathering, not performance).

As stated in response to Q6, requiring positive performance puts an unfair and counterintuitive burden on managers: when their index performance is positive, the manager must outperform their index to earn a performance fee, but when their index performance is negative, the manager must not only outperform their index, but also make up for any negative performance it delivered in order to earn a performance fee. This would be especially unfair to active managers (and we believe a disadvantage to clients) in a world increasingly dominated by passive products. Retail clients are increasingly exposed to market risk through passive vehicles. Making it harder for active managers to earn performance fees in down markets weakens their incentive to deliver returns which are superior to passive products in such markets. The implementation of such a requirement would serve only to reduce the availability of active alternatives that can compete with passive products on both price and performance.

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.

The proposed Guideline would make Aperture's business inoperable in Member States. The inability to earn a performance fee when absolute performance is negative would mean that our model would not be economical, and we would be forced to close our UCITS funds. We charge passive-like fees when performance is at or below our stated benchmarks. Such fees serve only to cover most, but not all, of our costs. Our model is designed so that we only profit when our managers exceed their benchmarks. Limiting our ability to do so when benchmark performance is negative makes our model unprofitable.

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.

We believe that ESMA is right to insist on increased disclosure around the use of performance fees. Although we believe that when properly structured, they can better align client interests with those of asset managers than can fixed fees, they can also be more complicated to explain. We think that an increased ability (or even requirement) to show hypothetical scenarios under fixed fee and performance fee-based models would help clients understand the costs and benefits of such models. Hypothetical scenarios are important because we believe that what ultimately matters are the net returns to the client, and a focus only on the level of potential fees is counterproductive. For example, ceteris paribus, a fund which charges a fixed fee of 0.5% but delivers a net return of 5% is clearly inferior to a fund which ends up charging a hybrid fixed + performance fee of 2% but which delivers a net return of 6%. Disclosure based only on cost could be misleading, as the fund with the performance fee is 4x more expensive, even though in this hypothetical it delivers a superior net return. Because of the potential complexity of performance fee models, Aperture also believes that certain forms of graphical illustration can be beneficial, for example, that which we’ve designed here: https://apertureinvestors.com/intl/fund/aperture-new-world-opportunities-fund-apniyhe/