



Commission de Surveillance
du Secteur Financier

Circular CSSF 20/764

Guidelines on performance
fees in UCITS and certain
types of AIFs



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du Secteur Financier

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Re: Guidelines on performance fees in UCITS and certain types of AIFs

Luxembourg, 18 December 2020

Ladies and Gentlemen,

To all investment fund managers of UCITS and to all AIFMs of AIFs marketed to retail investors in Luxembourg

Subject: Application of the Guidelines of the European Securities and Market Authority on performance fees in UCITS and certain types of AIFs (ESMA34-39-992).

Purpose of the Circular

The purpose of this circular is to inform you that the CSSF, in its capacity as competent authority, applies the Guidelines of ESMA on performance fees in UCITS and certain types of AIFs (Ref. ESMA34-39-992) (the “Guidelines”), published on 5 November 2020. Consequently, the CSSF will integrate the Guidelines into its administrative practices and regulatory approach with a view to promoting supervisory convergence in this field at European level as of the date of application of the Guidelines.

The Guidelines

The Guidelines are issued by ESMA in accordance with Article 16(1) of the ESMA Regulation.

The Guidelines apply primarily in relation to Article 14 of the UCITS Directive 2009/65/EC¹ as further specified by Article 22 of the UCITS Level 2 Commission Directive 2010/43/EU², as well Article 78 of the UCITS Directive 2009/65/EC as further specified by Articles 10, 12 and 14 of the UCITS Level 2 Commission Delegated Regulation (EU) 2016/438³ and in relation to Article 69 of the UCITS Directive 2009/65/EC. In respect of AIFs, the Guidelines apply in relation to Article 43 of the AIFM Directive 2011/61/EU⁴.

¹ Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

² Commission Directive 2010/43/EU implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organizational requirements, conflicts of interest, conduct of business, risk management and the content of the agreement between a depositary and a management company

³ Commission Delegated Regulation (EU) 2016/438 supplementing Directive 2009/65/EC of the European Parliament and of the Council with regards to obligations of depositaries

⁴ Directive 2011/61/EU on Alternative Investment Fund managers and amending Directives 2003/43/EC and 2009/65/EC and Regulations (EC) N° 1060/2009 and (EU) N° 1095/2010

The Guidelines apply as from 6 January 2021. Managers of any new funds created after the date of application of the Guidelines with a performance fee, or any funds existing before the date of application that introduce a performance fee for the first time after that date, should comply with these Guidelines immediately in respect of those funds. Managers of funds with a performance fee existing before 6 January 2021 should apply these Guidelines in respect of those funds by the beginning of the financial year following 6 months from 6 January 2021. The Guidelines will also be applicable as of 6 January 2021 for any newly created compartments of an existing umbrella, i.e. in relation to any new compartment setting up a performance fee at compartment or classes of units/shares level.

The Guidelines aim to promote greater convergence and standardisation in the field of performance fees. In particular, they aim to ensure that performance fee models used by IFMs and AIFMs comply with the principles of acting honestly and fairly in conducting their business activities and acting with due skill, care and diligence, in the best interest of the fund that they manage, in such way as to prevent undue costs being charged to the fund and its investors. They also aim at establishing a common standard in relation to the disclosure of performance fees to investors.

The Guidelines are attached to this circular and are available on ESMA's website [esma34-39-992_guidelines_on_performance_fees_en.pdf](https://www.esma.europa.eu/press-material/press-conferences-and-materials/esma34-39-992_guidelines_on_performance_fees_en.pdf) (europa.eu).

Scope of application

This circular shall apply to performance fees in UCITS. The circular shall also apply to AIFs managed by an AIFM, when the AIFM markets the AIF to retail investors, except for closed-ended AIFs and open-ended AIFs that are EuVECAs (or other types of venture capital AIFs), EuSEFs, private equity AIFs or real estate AIFs. In respect of AIFs, the Guidelines clarify that they apply in relation to Article 43 of the AIFM Directive 2011/61/EU. In relation to foreign AIFs marketed to retail investors in Luxembourg, the Guidelines also apply to all funds marketed in Luxembourg to retail investors in accordance with Article 46 the Law of 12 July 2013⁵ and CSSF Regulation N° 15-03⁶, as well as to funds marketed to retail investors in Luxembourg under Article 100(1) of the Law of 17 December 2010⁷, subject to the exceptions above.

Date of application

This circular shall apply as from 6 January 2021.

Claude WAMPACH
Director

Marco ZWICK
Director

Jean-Pierre FABER
Director

Françoise KAUTHEN
Director

Claude MARX
Director General

⁵ Law of 12 July 2013 on alternative investment fund managers

⁶ CSSF Regulation N° 15-03 laying down detailed rules for the application of Article 46 of the Law of 12 July 2013 on alternative investment fund managers on the marketing of foreign alternative investment funds to retail investors in Luxembourg

⁷ Law of 17 December 2010 relating to undertakings for collective investment



European Securities and
Markets Authority

Guidelines

On performance fees in UCITS and certain types of AIFs

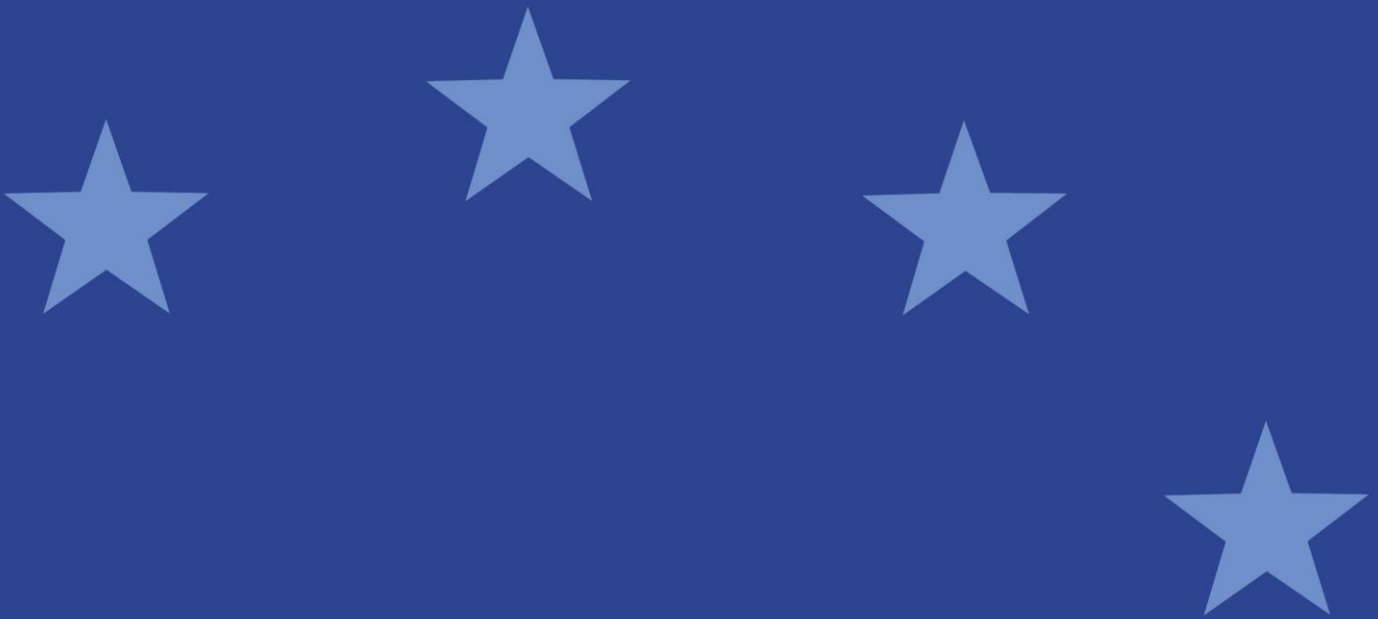


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I. Scope

Who?

1. These guidelines apply to managers and competent authorities.
2. In case Member States allow AIFMs to market to retail investors in their territory units or shares of AIFs they manage in accordance with Article 43 of the AIFMD, the guidelines also apply to AIFMs of those AIFs, except for:
 - (a) closed-ended AIFs; and
 - (b) open-ended AIFs that are EuVEGAs (or other types of venture capital AIFs), EuSEFs, private equity AIFs or real estate AIFs.

What?

3. These guidelines relate to performance fees in UCITS and in the AIFs referred to in paragraph 2.
4. In respect of UCITS, they apply primarily in relation to Article 14 of the UCITS Directive as further specified by Article 22 of the UCITS Level 2 Directive. They also apply in relation to Article 78 of the UCITS Directive as further specified by Articles 10, 12 and 14 of the UCITS Level 2 Regulation and in relation to Article 69 of the UCITS Directive.
5. In respect of the AIFs referred to in paragraph 2, they apply in relation to Article 43 of the AIFMD.

When?

6. These guidelines apply from two months after the date of publication of the guidelines on ESMA's website in all EU official languages.
7. Managers of any new funds created after the date of application of the guidelines with a performance fee, or any funds existing before the date of application that introduce a performance fee for the first time after that date, should comply with these guidelines immediately in respect of those funds.
8. Managers of funds with a performance fee existing before the date of application of these guidelines should apply these guidelines in respect of those funds by the beginning of the financial year following 6 months from the application date of the Guidelines.

II Legislative references, abbreviations and definitions

Legislative references

<i>AIFMD</i>	Directive 2011/61/EU on Alternative Investment Fund managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 ¹
<i>AIFMD Level 2 Regulation</i>	Commission Delegated Regulation (EU) No 231/2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision ²
<i>ESMA Regulation</i>	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC ³
<i>KIID Regulation</i>	Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website ⁴
<i>UCITS Directive</i>	Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) ⁵
<i>UCITS Level 2 Directive</i>	Commission Directive 2010/43/EU implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the

¹ OJ L 174, 1.7.2011, p.1

² OJ L 83, 22.3.2013, p.1.

³ OJ L 331, 15.12.2010, p. 84.

⁴ OJ L 176, 10.7.2010, p. 1.

⁵ OJ L 302, 17.11.2009, p. 32.

	agreement between a depositary and a management company ⁶
<i>UCITS Level 2 Regulation</i>	Commission Delegated Regulation (EU) 2016/438 supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries ⁷

Abbreviations

<i>AIF</i>	Alternative Investment Fund
<i>AIFM</i>	Alternative Investment Fund Manager
<i>ESFS</i>	European System of Financial Supervision
<i>ESMA</i>	European Securities and Markets Authority
<i>EuSEF</i>	European Social Entrepreneurship Fund
<i>EuVECA</i>	European Venture Capital Fund
<i>IOSCO</i>	International Organisation of Securities Commission
<i>NAV</i>	Net Asset Value
<i>UCITS</i>	Undertaking for Collective Investments in Transferable Securities

Definitions

<i>benchmark</i>	a market index against which to assess the performance of a fund.
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⁶ OJ L 176, 10.7.2010, p. 42–61

⁷ OJ L 78, 24.3.2016, p. 11–30

<i>benchmark model</i>	a performance fee model whereby the performance fees may only be charged on the basis of outperforming the reference benchmark.
<i>crystallisation frequency</i>	the frequency at which the accrued performance fee, if any, becomes payable to the management company.
<i>excess performance</i>	the difference between the net performance of the portfolio and the performance of the benchmark.
<i>fulcrum fee</i>	a type of performance fee which provides for the level of the fee to increase or decrease proportionately with the investment performance of the fund over a specified period of time in relation to the investment record of an appropriate reference indicator (including a negative fee deducted from the basic fee charged to the fund).
<i>fund</i>	a collective investment undertaking subject to the requirements of the UCITS Directive and an AIF referred to in paragraph 2
<i>fund managed in reference to a benchmark</i>	a fund where the benchmark index plays a role in the management of the fund, for example, in the explicit or implicit definition of the portfolio's composition and/or the fund performance objectives and measures
<i>High-Water Mark (HWM)</i>	the highest NAV per share or unit.
<i>High-Water Mark (HWM) model</i>	a performance fee model whereby the performance fee may only be charged on the basis of achieving a new High-Water Mark during the performance reference period.
<i>High-on-High (HoH) model</i>	a performance fee model whereby the performance fee may only be charged if the NAV exceeds the NAV at which the performance fee was last crystallised.
<i>hurdle rate</i>	a predefined minimum fixed rate of return.
<i>manager</i>	<ul style="list-style-type: none"> a) a management company (as defined in Article 2(1)(b) of the UCITS Directive); b) an investment company that has not designated a management company authorised pursuant to the UCITS Directive; and

	c) an AIFM (as defined in Article 4(1)(b) of the AIFMD) of the AIFs referred to in paragraph 2 of these guidelines.
<i>performance reference period</i>	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.
<i>reference indicator</i>	the reference indicator against which the relative performance of the fund will be measured.

III Purpose

9. These guidelines are issued under Article 16(1) of the ESMA Regulation. The purpose of these guidelines is to establish consistent, efficient and effective supervisory practices within the ESFS and to ensure the common, uniform and consistent application of Union law. Their objective is to promote greater convergence and standardisation in the field of performance fees and promote convergent supervision by competent authorities. In particular, they aim to ensure that performance fee models used by the management companies comply with the principles of acting honestly and fairly in conducting their business activities and acting with due skill, care and diligence, in the best interest of the fund that they manage, in such a way as to prevent undue costs being charged to the fund and its investors. Also, they aim at establishing a common standard in relation to the disclosure of performance fees to investors.

IV Compliance and reporting obligations

Status of the guidelines

10. In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants must make every effort to comply with these guidelines.
11. Competent authorities to which these guidelines apply should comply by incorporating them into their national legal and/or supervisory frameworks as appropriate, including where particular guidelines are directed primarily at financial market participants. In this case, competent authorities should ensure through their supervision that financial market participants comply with the guidelines.

Reporting requirements

12. Within two months of the date of publication of the guidelines on ESMA's website in all EU official languages, competent authorities to which these guidelines apply must notify ESMA whether they (i) comply, (ii) do not comply, but intend to comply, or (iii) do not comply and do not intend to comply with the guidelines.
13. In case of non-compliance, competent authorities must also notify ESMA within two months of the date of publication of the guidelines on ESMA's website in all EU official languages of their reasons for not complying with the guidelines.
14. A template for notifications is available on ESMA's website. Once the template has been filled in, it shall be transmitted to ESMA.

V Guidelines on performance fees

Guideline 1 - Performance fee calculation method

15. The calculation of a performance fee should be verifiable and not open to the possibility of manipulation.
16. The performance fee calculation method should include, at least, the following elements:
 - 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, a hurdle rate (2%) or a combination (e.g.: HWM + hurdle rate);
 - b. the crystallisation frequency at which the accrued performance fee, if any, becomes payable to the manager and a crystallisation date at which the performance fee is credited to the manager;
 - c. the performance reference period;
 - d. the performance fee rate which may also be referred to as the “flat rate” i.e. the rate of performance fee which may be applied in all models;
 - e. the performance fee methodology defining the method for the calculation of the performance fees based on the abovementioned inputs and any other relevant inputs; and
 - f. the computation frequency which should coincide with the calculation frequency of the NAV (e.g.: if the fund calculates its NAV daily, the performance fee should be calculated and accrued in the NAV on a daily basis).
17. The performance fee calculation method should be designed to ensure that performance fees are always proportionate to the actual investment performance of the fund. Artificial increases resulting from new subscriptions should not be taken into account when calculating fund performance.
18. A manager should always be able to demonstrate how the performance fee model of a fund it manages constitutes a reasonable incentive for the manager and is aligned with investors’ interests.
19. The performance fee provisions and their final payments should be allocated and reversed in a symmetrical way. For example, it should not be possible to apply simultaneously an allocation rate (e.g. 20% of the performance of the fund when the performance increases) and a different reversal rate (e.g. 15% of the – negative – performance of the fund when the performance decreases).
20. Performance fees could be calculated on a single investor basis.

Guideline 2 - Consistency between the performance fee model and the fund’s investment objectives, strategy and policy

21. The manager should implement and maintain a process in order to demonstrate and periodically review that the performance fee model is consistent with the fund's investment objectives, strategy and policy.
22. When assessing the consistency between the performance fee model and the fund's investment objectives, strategy and policy, the manager should check:
 - a. whether the chosen performance fee model is suitable for the fund given its investment policy, strategy and objective. 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; 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;
 - b. whether, for funds that calculate the performance fee with reference to a benchmark, the benchmark is appropriate in the context of the fund's investment policy and strategy and adequately represents the fund's risk-reward profile. This assessment should also take into account any material difference of risk (e.g. volatility) between the fund's investment objective and the chosen benchmark, as well as the consistency indicators included below under paragraph 26. For example, it should not be deemed appropriate for a fund with a predominantly long equity-focused strategy to calculate the performance fee with reference to a money market index.
23. As a general principle, if a fund is managed in reference to a benchmark index and it employs a performance fee model based on a benchmark index, the two indices should be the same.
24. This includes, *inter alia*, the case of:
 - performance measures: the fund has a performance objective linked to the performance of a benchmark (e.g.: Index A + positive absolute return objective; Index A + HWM; Index A + X% hurdle rate etc)
 - portfolio composition: the fund portfolio holdings are based upon the holdings of the benchmark index (e.g.: the individual holdings of the fund's portfolio do not deviate materially from those of the benchmark index).
25. In such cases, the benchmark used for the portfolio composition should be the same as the benchmark used for the calculation of the performance fee.
26. However, in case the fund is managed in reference to a benchmark but the fund's portfolio holdings are not based upon the holdings of the benchmark index (e.g.: the index is used as a universe from which to select securities), the benchmark used for the portfolio composition should be consistent with the benchmark used for the calculation of the performance fee. Consistency should be primarily assessed against the similar risk-return profile of different benchmarks (e.g.: they fall into the same category in terms of Synthetic Risk Reward Indicator and/or volatility and expected return). The following is a non-exhaustive cumulative list of "consistency indicators" which should be taken into account by the manager, based on the type of investment of the fund (for example, equities, bonds or derivatives):

Consistency Indicators

- expected return;
- investment universe;
- beta exposure to an underlying asset class;
- geographical exposure;
- sector exposure;
- income distribution of the fund;
- liquidity measures (e.g.: daily trading volumes, bid-ask spreads etc);
- duration;
- credit rating category;
- volatility and/or historical volatility.

27. Where performance fees are payable on the basis of out-performance of a benchmark (e.g. “Eurostoxx 50 + 3%”, “Eonia”, etc.), it would not be appropriate to take a reference indicator that would set a systematically lower threshold for fee calculation than the actual benchmark (e.g. computing performance fees based on “Eurostoxx -1%” where the objective of the fund is “Eurostoxx”).
28. Where the calculation of the performance fee is based on a fulcrum fee model, the performance fee should be based on the same benchmark used to determine excess performance.
29. In all cases, the excess performance should be calculated net of all costs (for example, management fees or administrative fees) but could be calculated without deducting the performance fee itself as long as this would be in the investor’s best interest (i.e. it would result in the investor paying less fees).
30. If the reference indicator changes during the reference period, the performance of the reference indicator for this period should be calculated by linking the benchmark index that was previously in force until the date of the change and the new reference indicator used afterwards.

Guideline 3 - Frequency for the crystallisation of the performance fee

31. The frequency for the crystallisation and the subsequent payment of the performance fee to the manager 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.
32. The crystallisation frequency should not be more than once a year.
33. Paragraph 32 could not be applied where the fund employs a high water-mark model or a high-on-high model where the performance reference period is equal to the whole life of the fund and it cannot be reset, as in this model performance fees cannot be accrued or paid more than once for the same level of performance over the whole life of the fund.
34. Paragraph 32 should not apply to the fulcrum fee model and other models which provide for a symmetrical fee structure (whereby performance fees would decrease or increase based on the performance of the fund), as the characteristics of these models are not compatible with the recommendation enshrined in paragraph 32.
35. The crystallisation date should be the same for all share classes of a fund that levies a performance fee.
36. In case of closure/merger of funds and/or upon investors' redemptions, performance fees, if any, should crystallise in due proportions on the date of the closure/merger and/or investors' redemption. In case of merger of funds, the crystallisation of the performance fees of the merging fund should be authorised subject to the best interest of investors of both the merging and the receiving fund. For instance, in case where all involved funds are managed by the same manager (e.g. in the context of a cross-border merger), crystallization of performance fees should be presumed contrary to investors' best interest unless justified otherwise by the manager. Generally, the crystallisation date should coincide with 31 December or with the end of the financial year of the fund.

Guideline 4 – Negative performance (loss) recovery

37. 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. In order to avoid misalignment of interests between the fund manager and the investors, a performance fee could also be payable in case the fund has overperformed the reference benchmark but had a negative performance, as long as a prominent warning to the investor is provided.
38. The performance fee model should be designed to ensure that the manager is not incentivised to take excessive risks and that cumulative gains are duly offset by cumulative losses.
39. The manager's performance should be assessed and remunerated on a time horizon that is, as far as possible, consistent with the recommended investors' holding period.
40. 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.
41. 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.
42. The performance reference period should not apply to the fulcrum fee model and other models which provide for a symmetrical fee structure, as in these models the level of the performance fee increases or decreases proportionately with the investment performance of the fund.

Guideline 5 - Disclosure of the performance fee model

43. Investors should be adequately informed about the existence of performance fees and about their potential impact on the investment return.
44. In case a fund allows for a performance fee to be paid also in times of negative performance (for example, the fund has overperformed its reference benchmark index but, overall, has a negative performance), a prominent warning to investors should be included in the KIID.

45. In case a fund managed in reference to a benchmark computes performance fees with a benchmark model based on a different but consistent benchmark (as per the case under paragraph 26 of the guidelines), the manager should be able to explain the choice of benchmark in the prospectus.
46. 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 especially where the performance fee model allows for performance fees to be charged even in case of negative performance.
47. In line with the principles set out in Guideline 1, the main elements of the performance fee calculation method should be indicated.
48. The KIID should clearly set out all information necessary to explain the existence of the performance fee, the basis on which the fee is charged and when the fee applies, consistently with Article 10(2)(c) of the KIID Regulation. Where performance fees are calculated based on performance against a reference benchmark index, the KIID and the prospectus should display the name of the benchmark and show past performance against it.⁸
49. The annual and half-yearly reports and any other ex-post information should indicate, for each relevant share class, the impact of the performance fees by clearly displaying: (i) the actual amount of performance fees charged and (ii) the percentage of the fees based on the share class NAV.

⁸ See Section II Key Investor Information Document (KIID) for UCITS, Question 8 (Disclosure of the benchmark index in the objectives and investment policies) of the UCITS Q&A document (ESMA34-43-392), available at <https://www.esma.europa.eu/press-news/esma-news/esma-qas-clarify-benchmark-disclosure-obligations-ucits>.



Commission de Surveillance du Secteur Financier

283, route d'Arlon

L-2991 Luxembourg (+352) 26 25 1-1

direction@cssf.lu

www.cssf.lu