PRESS RELEASE

BETTER FINANCE welcomes the new European Guidelines on Funds' "Performance" Fees

Brussels, 27 April 2020 - On 3 April the European Securities and Markets Authority (ESMA) published its final guidelines on performance fees in investment funds, applicable to Undertakings for Collective Investment in Transferable Securities (UCITS) and certain types of Alternative Investment Funds (AIFs).

These guidelines aim to provide rules for fund managers when charging performance fees to retail investors as well as for National Competent Authorities (NCAs) when supervising performance fees models and disclosure across the European Union (EU).

BETTER FINANCE, as the dedicated representative of European individual investors, was the only user-side organisation to provide extensive feedback to EMSA on the matter and is pleased to see that many of its proposals have been taken on board as part of the Guidelines:

- UCITS/AIF managers can only charge a performance fee in case of outperformance versus their own stated benchmark.
- Performance fees must be calculated on the basis of excess return, net of all costs, including the performance fee.
- If a performance fee is levied even in the case of negative returns - for instance when the fund's benchmark is at -7% and the fund itself does slightly better at -5% - then the fund's KIID must include a prominent warning indicating that the performance fee does not imply positive returns.
- A fund whose asset class is not the same as that of its stated benchmark (e.g. an equity fund benchmarked against a money market index) is not allowed to charge a performance fee.
- These guidelines will be extended to AIFs marketed to individual investors.

A key aspect taken under consideration by the guidelines is that of the "High-Water Mark" (HWM) model used to ensure that no performance fee is paid in case of a decrease in a fund's net asset value and that a performance fee is not paid twice for the same amount of performance. Basically, if a fund's net asset value declines during a year, no performance fee should be payable to the investment manager, nor should any performance fee be charged for the subsequent increase up to the HWM (but no higher), since the investor would not have made any return on his investment yet. For this reason, a fund should only charge a performance fee for an increase in net asset value over the HWM.

In this regard, BETTER FINANCE is pleased with ESMA's decision to "*recommend that the performance reference period for the HWM model, where this is shorter than the whole life of the fund, should be set equal to at least 5 years*". ESMA added that "*the HWM model should be set equal to the whole life of the fund or to a minimum of 5 years, in order to ensure an adequate protection of retail investors. This would avoid the possibility to pay performance fees twice or more for the same level of performance, in line with the feedback received from consumers' representatives*".

However, ESMA did not follow BETTER FINANCE proposals on all counts and decided not to ban performance fees where investment objectives (such as for index-tracking fund) are incompatible with the concept of a performance fee.

Nor did ESMA follow BETTER FINANCE on the principle of obliging UCITS managers who charge performance fees when they overperform, to reduce their management fee when they underperform. So, performance fees remain unfortunately a one-way street; "heads I win, tails you lose".

"Overall, BETTER FINANCE is very thankful the European supervisor for this thorough improvement on the use of "performance" fees by investment fund companies, that will better protect fund investors", said Guillaume Prache, Managing Director.

***

Contact: Chief Communications Officer | Arnaud Houdmont | +32 (0)2 514 37 77 | houdmont@betterfinance.eu