



Banc Ceannais na hÉireann  
Central Bank of Ireland

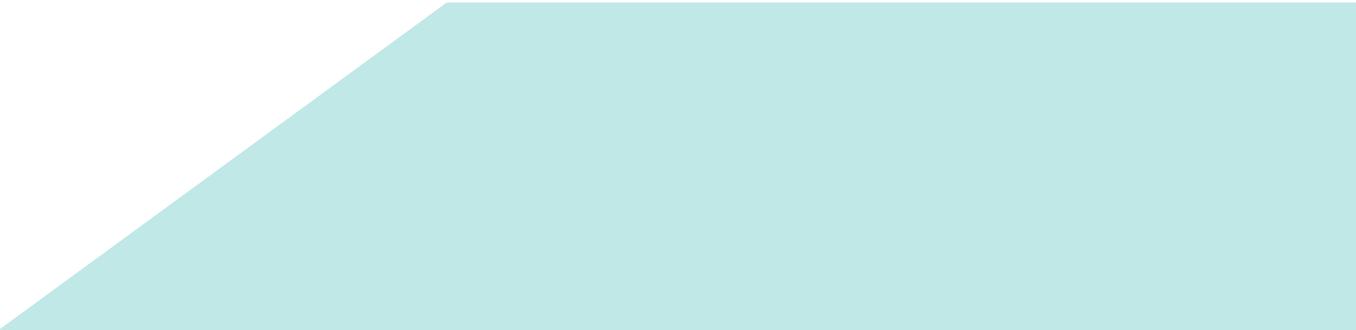
Eurosystem

# **Feedback Statement -** Consultation Paper 134: Consultation on new Central Bank performance fee guidance for UCITS and certain types of Retail Investor AIF

01 April 2021

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# Introduction

1. ESMA's Guidelines on performance fees in UCITS and certain types of AIFs<sup>1</sup> came into effect on 5 January 2021. In order to incorporate the ESMA Guidelines into the existing regulatory framework for performance fees applied by UCITS and certain types of Retail Investor AIFs (**in-scope funds**), the Central Bank issued Consultation Paper 134 (**CP 134**).
2. CP 134 proposed an approach which took into account the need to provide for a transition from the existing regulatory approach and legislation governing performance fees for pre-existing in-scope funds as well as providing for the use of performance fees in newly established in-scope funds.
3. Stakeholders were invited to provide observations and comments on the proposed amendments. The closing date for comments was 15 January 2021 and one response was received.
4. This document sets out Central Bank feedback on the response received to CP134.

Markets Policy Division  
Central Bank of Ireland  
01 April 2021

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<sup>1</sup> *Guidelines on Performance Fees in UCITS and certain types of AIFs* ESMA, reference 34-39-992 available at <https://www.esma.europa.eu/document/guidelines-performance-fees-in-ucits-and-certain-types-aifs>

# General feedback

1. Overall, the sole response received to CP 134 was supportive of the Central Bank's approach to incorporation of the ESMA Guidelines into the regulatory framework. The respondent, in noting the legislative constraints in implementing certain features of the ESMA Guidelines, encouraged the Central Bank to act quickly to ensure full alignment with those Guidelines.
2. As a matter of principle, the Central Bank is supportive of and endeavours to fully implement ESMA Guidelines. In this instance the Central Bank's long standing requirements for performance fees (which have recently been implemented into the legislative framework) pre-exist the ESMA Guidelines. This, as well as a desire to retain a consistent approach to retail investor protection, has resulted in the regulatory framework now proposed. The Central Bank will consider those aspects of the ESMA Guidelines, not currently provided for due to the legislative constraints<sup>2</sup>, in future revisions to the Central Bank UCITS Regulations<sup>3</sup> and to the AIF Rulebook.

## Specific feedback to questions posed

3. CP 134 outlined two approaches. The first related to implementation of the ESMA Guidelines to newly established in-scope funds and to those in-scope funds which either amend or introduce a performance fee. The second related to previously established in-scope funds with performance fees in place prior to the application date of the ESMA Guidelines. It requested stakeholder feedback to the approaches proposed.
4. The respondent identified a number of areas where clarification or supplementary guidance would be of benefit.

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<sup>2</sup> As outlined in CP 134, e.g. more frequent crystallisation than annually, a performance reference period shorter than the life of the fund, fulcrum fees, verification of the calculation of the performance fee by an entity other than the depositary.

<sup>3</sup> Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2019 (S.I. 230 of 2019) (**Central Bank UCITS Regulations**)

## Queries of general application

5. **Regulatory responsibility for compliance.** The respondent noted that the draft Guidance could be interpreted in conjunction with existing legislation and rules that would result in different entities being responsible for the same activity.

**Central Bank:** Where the Guidance is being applied in the context of a UCITS, responsibility for compliance with this Guidance rests with the Responsible Person of the UCITS as such term is defined in the Central Bank UCITS Regulations. Where the Guidance is being applied in the context of a Retail Investor AIF, responsibility rests with the Retail Investor AIF. The Guidance will be clarified in this regard.

6. **Scope of Guidance application.** The respondent sought clarification in the Guidance in relation to two distinct queries, (i) the exclusion of certain types of Retail Investor AIFs and (ii) the extent to which Guidance would apply at share class or at fund level, (in particular, whether it would apply to the launch of a new share class within an existing fund).

**Central Bank:** The Guidance will be updated to reflect the exclusion from scope of Retail Investor AIFs that are closed-ended and open-ended Retail Investor AIFs that have been established as EuVECA, EuSEF or that follow venture capital, private equity or real estate strategies.

The Guidance applies at fund level. New classes within an existing fund with performance fees availing of the transition period shall continue to comply with the regulatory regime that applies to other classes within the fund.

Additionally, where an AIFM seeks to market shares of an AIF managed by it to retail investors in Ireland pursuant to Article 43 of the AIFMD (Regulation 44 of the European Union (Alternative Investment Fund Managers) Regulations 2013) the Central Bank will require that this Guidance applies to performance fees of those AIFs (other than those AIFs which are out of scope of this Guidance). Relevant guidance in this regard will be updated.

7. **Application of Guidance to funds managed by multiple managers.** The respondent queried the manner in which the Guidance would be applied to funds managed by multiple managers and its consistency with existing provisions of the Central Bank UCITS Regulations and associated UCITS Guidance.
8. The respondent also queried the extent to which a performance fee could crystallise and subsequently be paid upon resignation of a manager notwithstanding the resignation occurred within a calculation period.

**Central Bank:** The provisions of the Central Bank UCITS Regulations and existing UCITS Performance Fees guidance relating to funds managed by multiple managers are unaffected by the issuance of this Guidance. In this regard, a Responsible Person should continue to ensure that obligations arising under the Central Bank UCITS Regulations and UCITS Performance Fees guidance continue to be met. The Central Bank does not consider it warranted that further clarification in this regard is made.

The Central Bank agrees it is appropriate to clarify, in the context of the resignation of a manager (whether occurring within a fund managed by multiple managers or a single manager) within a calculation period, the ability to crystallise performance fees during that calculation period. The Central Bank also considers, in order to avoid operational risk, the payment of performance fees, if any, can also be paid at such time.

The position in relation to UCITS in this regard will also apply to Retail Investor AIFs.

## Technical queries

9. **Performance fee calculation methodology.** The respondent sought clarification in relation to the high on high (HoH) performance fee model, noting the manner in which it is typically implemented (i.e. on the basis of a less than annual crystallisation). The respondent observed that in the absence of an ability to crystallise more frequently than annually there appeared to be little difference between the HoH performance fee model and the high watermark (HWM) model.

10. Additionally, the respondent noted the interaction between Regulation 40(4) of the Central Bank UCITS Regulations (which prevents crystallisation or payment of a performance fee more than once a year) with the need to align the crystallisation date for all share classes in a UCITS (and seek to align the crystallisation date with 31 December or the end of the financial year of the fund). It observed there was a need to permit a once-off non-annual crystallisation during a 12-month period to achieve such alignment.
11. The respondent sought general confirmation that performance fee methodologies in existing authorised funds remain valid.

**Central Bank:** The Central Bank does not consider that use of the HWM or HoH performance fee models as outlined in the ESMA Guidelines is dependent on the frequency of crystallisation. The distinction between the models is the level at which the performance is calculated. Under the HWM performance fee model, performance fees are payable on the basis of achieving a new highest net asset value per share or unit during the performance reference period. By way of contrast, for the HoH performance fee model, performance fees are payable if the net asset value of the fund exceeds the net asset value at which the performance fee was last crystallised. This distinction is set out in footnotes 12 and 13 of the Final Report<sup>4</sup> accompanying the ESMA Guidelines.

In relation to UCITS, the Central Bank notes the possible complexity of implementing an aligned crystallisation date for all share classes with the requirements of Regulation 40(4) of the Central Bank UCITS Regulations. It would appear appropriate that an affected UCITS should in the first instance seek alignment of the crystallisation date by extending the date of crystallisation for the impacted share classes to achieve such alignment.

The Central Bank expects a Responsible Person or a Retail Investor AIF to review relevant performance fee practices to ensure they are in compliance with applicable law and the Guidance now published. The onus to ensure such compliance rests firmly with those entities.

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<sup>4</sup> [https://www.esma.europa.eu/sites/default/files/library/esma\\_34-39-968\\_final\\_report\\_guidelines\\_on\\_performance\\_fees.pdf](https://www.esma.europa.eu/sites/default/files/library/esma_34-39-968_final_report_guidelines_on_performance_fees.pdf)

12. **Consistency between performance fee model and a fund's investment objectives, strategy and policy.** In addition to an observation that the requirement to calculate performance fees net of all costs would result in a significant change to performance fee calculation methodologies, the response observed an inconsistency as between Regulation 40(3) of the Central Bank UCITS Regulations and paragraph 22 of the ESMA Guidelines. The respondent outlined the view that consistency between a benchmark and investment policy is only required in the event a performance fee is based on out-performance of the index it tracks.

**Central Bank:** The calculation of performance net of all costs (for example management and administration fees) is the general approach that should be taken. An exception to this is the ability to calculate fees without first deducting the performance fee itself and is only available where in so doing the best interests of investors are served.

The Central Bank agrees that Regulation 40(3) specifically addresses the requirements of benchmark disclosure in the context of structuring a performance fee. The Central Bank would expect that a benchmark as referred to in a fund's investment policy is appropriate in the context of the fund's investment policy and strategy. In this regard, the Central Bank considers paragraph 22 of the ESMA Guidelines as being reflective of its own expectations in terms of disclosure of a fund's investment objectives, strategy and investment policy.

13. **Disclosure.** The response contained a number of queries relating to the location of disclosure on the performance fee model.

**Central Bank:** The Central Bank expects the Responsible Person or Retail Investor AIF to ensure the disclosure of performance fee models utilised in respect of a fund to be transparent and easily comprehensible. This could include, for example, inclusion in the prospectus of a sample calculation to illustrate the manner in which the performance fee model operates. The provision of this information in ex ante information documents such as the UCITS KIID, the PRIIPs KID, prospectus and marketing information will be of benefit to investors in understanding the manner in which the performance fee operates. The impact of performance fees on the investor should also be clearly disclosed by way of

regular financial reports and other relevant documentation provided to investors in the fund.

14. **Status of existing Central Bank guidance on performance fees.** The respondent queried the impact Guidance implementing the ESMA Guidelines would have on the existing UCITS Performance Fees guidance.

**Central Bank:** The Central Bank does not see any inconsistency between existing UCITS Performance Fees guidance and the Guidance which implements the ESMA Guidelines. Both sets of guidance will be amalgamated.

15. **Transition arrangements.** Clarity was sought on the application date of the Guidance for funds availing of the transition period.

**Central Bank:** The Guidance applies from the accounting period beginning on or after 5 July 2021. For example in the context of a fund with an accounting period that ends on

- 5 July 2021, the Guidance is effective for the period starting on 6 July 2021,
- 30 September 2021, the Guidance is effective for the period starting on 1 October 2021,
- 31 December 2021, the Guidance is effective for the period starting on 1 January 2022.

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