



4 September 2018

Re: Thematic Review of UCITS Performance Fees (the “review”)

Dear Sir/Madam,

The Central Bank of Ireland (the “Central Bank”) recently carried out a thematic review of the payment of performance fees by UCITS.

The purpose of the review was to establish whether the procedures used to calculate and pay performance fees in UCITS, ensure that investors’ interests are protected at all times. The review investigated the methodologies and parameters selected and applied in the calculation of UCITS performance fees to examine if they are in line with UCITS Performance Fees Guidance (the “Guidance”) issued by the Central Bank. This review was carried out in parallel to a Consultation on amendments to the Central Bank UCITS Regulations (CP 119¹), which proposes to introduce requirements in relation to performance fees.

The review identified approximately 350 UCITS that accrued performance fees in 2017. Of these, authorised officers reviewed a sample of circa 30%. During the course of the review, the Central Bank identified a number of good practices across the majority of the sample of UCITS sub-funds reviewed. Good practices included:

- UCITS that had clear and unambiguous prospectus disclosure in respect of the performance fee methodology;
- UCITS that clearly disclosed the version of the index to which the performance fee methodology related;
- Transparent, comprehensive and frequent review of performance fee calculations by Fund Service Providers; and
- Fund Service Providers with dedicated performance fee teams.

The Central Bank, however, has also identified, in approximately 10% of the sample of UCITS sub-funds, instances of non-compliance with the Guidance. The Central Bank is concerned that

¹ CP119 proposes to incorporate existing Central Bank performance fee guidance into the Central Bank UCITS Regulations.



the Guidance is not being applied in a consistent and comprehensive manner, which, in some cases, may be detrimental to the interest of UCITS and their investors.

The purpose of this letter is to highlight key supervisory issues identified from the review and actions to be taken to mitigate these issues. The Central Bank will also commence supervisory engagement with the individual UCITS that were the subject of the review, where specific supervisory issues were identified, as well as with the Depositaries and Fund Administrators (“Fund Service Providers”) of those UCITS.

Fund Management Companies²

As outlined in the Central Bank’s Fund Management Companies Guidance, the Fund Management Company is responsible for the effective oversight of delegates and must ensure that delegated tasks are performed to an appropriate standard. This includes tasks delegated with respect to performance fee charges, including the calculation and verification of these. It is the expectation of the Central Bank that the board of the UCITS Fund Management Company discusses and approves the appropriateness and suitability of proposed UCITS performance fee methodology before implementation. Furthermore, when the UCITS is launched and established the Fund Management Company should continue to oversee compliance of same.

In view of the findings of the Central Bank’s review detailed below, Fund Management Companies which manage UCITS that charge performance fees are hereby required to carry out a review of their existing methodologies in order to be satisfied that performance fees charged comply with the Guidance including incorporating the findings of the Central Bank’s review detailed below. The Chairman of the Board of the Fund Management Company should provide written confirmation to the Central Bank by email to themedinspections@centralbank.ie by 30 November 2018 that this review has taken place and whether, in the course of the review:

- any required changes to existing methodologies have been identified;
- any required changes to prospectus disclosure have been identified;
- any instances of improper payment of performance fee have been identified; and
- actions are being taken to remedy the above.

In carrying out its review, the Fund Management Company should be cognisant of, and take appropriate action, to address the following:

²Fund Management Companies means a UCITS management company and the self-managed UCITS investment company.



1. The Central Bank has identified cases where performance fees were calculated based on Gross Asset Value (“GAV”) contrary to the Guidance to pay UCITS performance fees based on Net Asset Value (“NAV”). UCITS performance fees must only be calculated based on NAV.
2. The Central Bank also identified instances of UCITS calculating performance fees based on the outperformance of a benchmark or index, which did not appear to be relevant in the context of the UCITS policy, as set out in the Guidance. Any UCITS calculating performance fees based on outperforming an index must be able to demonstrate that the index is relevant in the context of the UCITS policy. As part of the review, the Fund Management Company should satisfy itself that the benchmark chosen complies with this requirement and record in writing the basis for being so satisfied.
3. The Central Bank identified that, where performance fees are paid on the basis of achieving a new high net asset value per share (“the High Water Mark approach”), such fees accruing may be the result of market movements rather than due to the performance of the Investment Manager. The Central Bank identified inadequate disclosure practices in this regard and considers that investors may not be fully aware of the circumstances which led to the payment of the performance fee.
4. The Central Bank’s review also identified instances where UCITS calculating performance fees on the basis of the High Water Mark approach were not using the initial offer price as the starting price for calculations as set out in the Guidance. Any UCITS calculating a performance fee on the basis of the High Water Mark approach must ensure that the initial offer price is taken as the starting price for calculations.
5. The Guidance provides that any underperformance of the index in preceding periods be clawed back before a performance fee becomes due in subsequent periods. UCITS have been identified where underperformance of the index is only clawed back for a specified period. The Fund Management Company must satisfy itself that investors were not disadvantaged where clawback was limited to a certain period and amend the UCITS performance fee methodology to comply with the Guidance.
6. Where performance fees are based on the outperformance of an index, the Central Bank found cases where it was unclear as to which version of the index was being used. The Central Bank requires that the prospectus clearly disclose the version of the index being used. For example, UCITS may consider disclosing the ticker code relating to the index in order to identify it.
7. The Central Bank observed poor practices at Fund Administrators in certain areas of the calculation of UCITS performance fees including:



- Performance fees paid on invoiced amount issued by the Investment Manager without full reconciliation to the Fund Administrator calculation; and
- Fund Administrators using pre-designed manual calculation tools created by Investment Managers of the UCITS without any independent validation of the methodology.

The Central Bank requires that the Fund Management Company reviews the calculation procedures adopted by Fund Administrators to ensure that the calculation of performance fees is applied in a consistent and independent manner.

8. The Central Bank observed poor practices at Depositaries in the verification of the calculation of UCITS performance fees (“the verification process”), including:
- The verification process only being applied to a sample of UCITS performance fee calculations;
 - The verification process carried out post payment of the performance fee; and
 - The verification process only carried out where a performance fee is due for payment.

The Central Bank requires that the Fund Management Company reviews the verification procedures adopted by their Depositaries to ensure that:

- The verification process is carried out by the Depositary on all UCITS performance fee calculations;
- The verification process is performed by the Depositary prior to payment; and
- The verification process is performed on crystallisation by the Depositary, regardless of whether or not a performance fee is due for payment.

Where the Fund Management Company identifies any issues as outlined in this letter or any other instances of non-compliance with the Guidance, the Central Bank must be notified of the steps being taken by the relevant UCITS to rectify the situation including any adverse impact on UCITS and their investors.

This letter must be brought to the attention of all members of the board of the Fund Management Company and to the relevant responsible persons within the Fund Service Providers. The Central Bank will have regard to the contents of this letter as part of future supervisory engagement.



Should you have any queries in relation to the contents of this letter, please contact:
themedinspections@centralbank.ie.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Patricia Dunne'.

Patricia Dunne
Head of Securities and Markets Supervision