FMA

FMA Guideline 2015/2 – Code of Conduct for the Liechtenstein Fund Centre

Reference:	FMA-Guideline 2015/2
Addressees:	• Management Companies in accordance with the UCITS Act and IU Act • AIFM in accordance with the AIFM Act • Depositories in accordance with the UCITS Act, AIFM Act, and IU Act • Administrators in accordance with the AIFM Act • Distributors in accordance with the AIFM Act • Risk managers in accordance with the AIFM Act • Asset Managers and other delegated third parties in accordance with the UCITS Act, AIFM Act, and IU Act • Investment companies and other legal forms in accordance with the UCITS Act, AIFM Act, and IU Act
Concerning:	Specification of the UCITS Act, AIFM Act, and IU Act and corresponding Ordinances; Interpretation of rights and obligations
Place of publication:	FMA Website
Date of publication:	17 December 2015
Entry into force:	1 January 2016
Last amended on:	10 February 2021
Legal basis:	Article 20 UCITS Act in conjunction with Articles 25-33 UCITS Ordinance, Article 35 AIFM Act in conjunction with Article 34(2) AIFM Ordinance, and Article 29 IU Act in conjunction with Article 26 IU Ordinance

Pursuant to Article 20 of the UCITS Act in conjunction with Articles 25-33 of the UCITS Ordinance, Article 35 of the AIFM Act in conjunction with Article 34(2) of the AIFM Ordinance, and Article 29 of the IU Act in conjunction with Article 26 of the IU Ordinance, the Financial Market Authority (FMA) Liechtenstein issues this Code of Conduct, which must be complied with on a continuous basis.

Objectives

The objective of the Code of Conduct is to contribute to the protection of investors, to strengthen confidence in the Liechtenstein fund centre, and to secure and promote the integrity of the Liechtenstein financial market at home and abroad. The scope of application of this Code of Conduct extends to the following laws and ordinances:

- Law on Specific Undertakings for Collective Investment in Transferable Securities (UCITS Act) and the associated ordinance (UCITS Ordinance)
- Law on Alternative Investment Fund Managers (AIFM Act) and the associated ordinance (AIFM Ordinance)
- Investment Undertakings Act (IU Act) and the associated ordinance (Investment Undertakings Ordinance)

Purpose

The Code of Conduct serves to further specify the laws and associated ordinances enumerated above. The Code of Conduct may be drawn upon to interpret rights and duties, it ensures open and transparent information for investors, and it serves as a basis for the equal treatment of investors.

The appointed auditors apply and verify compliance with this Code of Conduct when performing their audits.

Other requirements arising from the laws or ordinances take precedence over this Code of Conduct and remain unaffected.

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1. Fiduciary duty and due diligence

1.1 Management of the fund assets

Fund assets shall be managed exclusively in the best interest of the funds, the investors, and market integrity. The investment policy set out in the constitutive documents must be complied with on a continuous basis, unless otherwise provided by law.

In regard to the managed funds and their investors, licence holders shall respect the principle of equal treatment. An exception from the principle of equal treatment may arise if permissible differentiating criteria are defined with respect to different classes of units.

Conduct must be on behalf of the integrity of the market. Licence holders shall in particular refrain from acting in a way that could interfere with transparent and market-based pricing on the securities markets. Moreover, they shall take precautions so that they cannot be misused for money laundering or terrorist financing.

1.2 Securities transactions and other trading operations/subscriptions and redemptions of fund units

Securities transactions and other trading operations (e.g., securities lending) for funds must always be conducted in accordance with the terms of the market. Practices must be refrained from that would be at the expense of a fund and its investors.

Orders shall be placed only with carefully selected counterparties who guarantee that the securities transactions and other trading operations are conducted in accordance with terms that are in conformity with the market. From an overall perspective, the orders shall represent best execution.

It must be ensured that reimbursements, trailer fees, and other payments in connection with the purchase, the portfolio, and the sale of investments of the fund directly or indirectly benefit the fund. Soft commissions (e.g., for financial analyses, market and price information systems) are permissible unless they harm the interests of investors.

It must be prevented that investors subscribe or redeem fund units at prices that are already known. As a rule, the principle of forward pricing applies.[1] The management company/AIFM must ensure compliance with forward pricing. Likewise, the necessary precautions must be taken when valuing units to prevent the exploitation of arbitrage transactions and late trading.

1.3 Cooperation with the depositary and delegated third parties

The management company/AIFM shall work together exclusively with depositaries and delegated third parties that are continuously qualified for sound and proper fulfilment of their legal and contractual duties.

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[1] Forward pricing is the internationally applied standard for the periodic valuation of funds. As a rule, the following principles must be complied with:

- The constitutive documents must specify a precisely defined cut-off time.
- To the extent possible, the cut-off time shall be defined so that the majority of the markets where the fund is traded are still open or have not yet opened.
- Fund units are as a rule valued on the basis of closing prices/market prices that are available only after the cut-off.
- Orders to issue and redeem units that are received after the cut-off are no longer executed effective that day, but rather effective the following valuation day.

This ensures that the investor neither knows nor can estimate the value of the fund unit at the time the order is placed to subscribe or redeem units. In particular, this prevents late trading/market timing.
Example: Cut-off 12 p.m., valuation is on the basis of prices at 5 p.m., the agreed NAV is based on that valuation.

Where duties are delegated, compliance with the sections of the Code of Conduct relevant to the delegated parties must be specified in writing in the delegation contract. The parties delegating the duties shall also ensure that they are contractually accorded the requisite rights of examination, instruction, and control.

When notifying the FMA of the delegation of duties, it shall be shown that the delegated party meets the necessary requirements in its home country to perform the delegated duties.

To the extent the management company/AIFM delegates third parties to market funds managed by it (marketing agent), written marketing agreements must be concluded guaranteeing that the marketing agent complies with all provisions governing investor protection and acts in accordance with market integrity. When delegating marketing to a third party domiciled in a member state of the EU or the EEA, a marketing licence in accordance with the legal provisions of the marketing country in question (MiFID or UCITS/AIFM Directive) is required. If the distributor is domiciled in a third country, the distributor must be authorised to market funds in that country.[2]

2. Organisation

The authorised entities must have an adequate organisation that enables them to carry out their business activities properly at all times. They shall have adequate internal control procedures, resources, and competencies.

The principles of organisation relating to structure and processes as well as the internal control system and the allocation of competences must be specified in internal documents (instructions, guidelines, rules, etc.).

The management company/AIFM (including administrator) and the depositary shall take the necessary organisational measures to guarantee sound and proper business conduct as well as sound and proper valuation, posting, and safekeeping of the assets.

Taking into account their operational structure and size, a clear separation of functions between investment decisions (decision-making), trading operations (execution), and valuation of the fund assets (administration) as well as risk management must be followed. This separation of functions must also be followed in the event of delegation. The board of directors and any general management shall cumulatively have sufficient theoretical knowledge and sound practical experience in the area of funds.

The management bodies of the management company/AIFM and of the depositary must be constituted in such a way that they can fulfil the duties assigned to them independently of instructions and that legal separation is guaranteed.

3. Conflicts of interest

3.1 Organisational and personnel measures

The authorised entities shall possess appropriate organisational and personnel measures to prevent and reduce the risk of conflicts of interest.

In particular, the risk of conflict of interest arising from investment decision-making shall be reduced. It must be ensured that no incentives arise that influence the investment behaviour of the asset manager in such a way that it conflicts or could conflict with the interests of the investors.

Controls in relation to the safe-keeping and transactions of the assets shall be undertaken independently of the asset manager.

[2] If the marketing country does not provide for marketing licences or authorisations, the management company/AIFM must ensure that the third party to be delegated meets the necessary requirements for the delegated duties.

Appropriate provisions shall be issued for the management bodies and employees of the management company/AIFM to counter conflicts of interest with respect to transactions for own account.[3] At the same time, practices (such as insider trading, front running, parallel running, after running and market manipulation) shall be prevented that could be exploited to improperly obtain pecuniary advantages.

Compliance with the aforementioned provisions shall be ensured contractually in relation to delegated parties.

Should the measures not be sufficient in an individual case to guarantee that the risk of interference with client interests through conflicts of interest is prevented, then this must be indicated in an appropriate manner.

Potential conflicts of interest may for instance include the following non-exhaustive list of points:

- incentive systems for employees,
- employee transactions,
- inducements to members of the company,
- transfers within the fund,
- improvement of fund performance on cut-off date (window dressing),
- transactions between the company and the funds or individual portfolios it manages or transactions between funds and/or individual portfolios managed by the company,
- combination of several orders ("aggregated orders"),
- delegation of closely associated companies and persons,
- individual investments of substantial size,
- frequent trading,
- specification of cut-off time,
- IPO allocations.

3.2 Exercise of membership and creditor rights

Membership and creditor rights shall be exercised exclusively in the interest of investors. The most important principles shall be available for review at the management company/AIFM.

4. Information and transparency

4.1 Investment objectives and restrictions

Investment objectives and investment restrictions, and the associated risks of the funds shall be explained to the investors in a manner and language appropriate to the client.

The investment objectives of the fund and the risks specific to the investments shall be indicated in the constitutive documents, so that the investor can gain an objective understanding of the possible changes in value of the units. The sample prospectus of the LAFV contains suggested formulations.[4]

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[3] Securities transactions of the management company/AIFM or its employees are considered transactions for their own account or proprietary trading if they undertake them for their own account. In the case of proprietary trading, the management company/AIFM or its employees themselves act as investors.

[4] Liechtenstein Investment Fund Association (LAFV), www.lafv.li

4.2 Disclosure of information

All information to investors concerning the funds must be presented in a form that provides relevant, reliable, comparable, and clear information. Misleading information must be avoided.

The investments of the fund must be named in the statement of investments or portfolio of the semi-annual or annual report in such a way that they can be clearly identified. Abbreviations may be used as long as they do not impair identifiability.

Material events – in terms of the representation letter towards the auditor – which arise during the financial period of the fund and after the balance sheet date up to the time of approval for publication of the semi-annual or annual report must be disclosed to investors in the report. Material events are those events that could have a material effect on the investment or divestment decisions of investors.

4.3 Disclosure of performance

A consistent, true and fair information policy must be ensured to enable the investor to gain an objective understanding of the performance of the fund units.

Reports on the activities of the financial year shall include additional information such as a market overview or explanations on significant investments and disinvestments in order to allow investors to understand the performance of the fund.

Promises and guarantees concerning the future performance or wording that may imply promises and guarantees are not allowed.

4.4 Cost transparency

All costs arising from the subscription and redemption of units and from the management of the funds shall be disclosed in the constitutive documents. When publishing net asset values, the management company/AIFM shall indicate any commissions. In the semi-annual and annual reports, the total expense ratio (TER), the performance fee, and the transaction costs[5] must be published.[6] For all funds domiciled in Liechtenstein, the TER must be calculated in accordance with the method explained in the Technical Advice CESR/09-949 and its Annex 2 (CESR/09-1028) (ongoing charges).

The costs shall be determined in a way that they correspond to market practices, that they can be calculated in an objective manner, and that they do not favour any investment or transaction behaviour that contradicts the interests of the investors.

Performance fee

Performance fee models must be designed in a clear and understandable manner. The performance fee must ensure a sufficient degree of continuity. The management company/AIFM is responsible for the design and implementation of the performance fee models. The design of the performance fee model must be explained precisely and in understandable language in the constitutive documents or presented with a schematic case example.

The performance fee structure has to comply the with ESMA Guidelines On performance fees in UCITS and certain types of AIFs (see appendix)

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[5] Analogous to the specifications in the Technical Advice CESR/09-949 and its Annex 2 (CESR/09-1028).

[6] The AIFM must publish the costs incurred only if the AIF under management is marketed to private investors.

5. Valuation errors and breaches of investment restrictions

5.1 Valuation and valuation errors

The net asset value (NAV) per unit of a fund is calculated by dividing the net assets of the fund, i.e., the assets minus liabilities, by the number of units issued.

If the rules for valuation of the net asset value per unit set out in the constitutive documents of a fund are continuously on the basis of the most current and reliable information available at the time of valuation, the valuation of the net asset value per unit is deemed correct.

An error in the valuation of the net asset value per unit occurs if one or more factors or circumstances arise that entail an incorrect result.

Valuation errors of the net asset value may result from the use of an incorrect price of assets (mispricing). However, the volatility of an asset does not lead to valuation errors if the price used is derived from an objective and reliable source. Mispricing of an asset occurs when the price used for the asset does not reflect its fair value. This may arise, for example, if outdated prices or prices from a trading exchanges with too little trading volume or unreliable sources are used.

On the other hand, valuation errors of the net asset value may be caused by errors in processes. Such errors may arise, for example, from the failure to take splits, coupons, and dividends into account, the incorrect input of prices or other data, or the incorrect accrual of income and expenses (especially fees).

5.1.1 Materiality thresholds

A valuation error shall be considered material if its difference to the correct valuation of the NAV reaches or exceeds the following thresholds:

Funds by asset category:	
Money market	0.25%
Fixed income	0.50%
Convertible bonds	0.75%
Equities and equity-like investments	1.00%
Asset allocation fund < 50% in equities	0.75%
Asset allocation fund ≥ 50% in equities	1.00%
Listed alternative investments	2.00%
Non-listed alternative investments	4.00%

These materiality thresholds constitute maximum values. In its internal documents, the management company/AIFM may define lower values. If valuation errors are classified as insignificant, the originally published net asset value per unit can be maintained. The settled subscriptions and redemptions of fund units do not have to be corrected.

5.1.2 Consequences of material valuation errors

Material valuation errors must be corrected immediately, and the lawful state of affairs must be restored. If the material valuation error is discovered by the depositary, the depositary must inform the management company/AIFM without delay; the management company/AIFM must institute the measures described below to restore the lawful state of affairs.

If a material valuation error is discovered:

- the net asset value per unit determined during the error period must be recalculated,
- the loss to the fund and/or the fund's investor must be estimated on the basis of the corrected net asset value per share, and
- the FMA and the auditor must be informed immediately.

To ensure a uniform approach, the management company/AIFM is required in the event of a loss due to a material valuation error to prepare a compensation plan as further specified in the points set out below in Section 5.1.3 as part of a compensation procedure (subject to the simplified procedure set out in Section 5.4). This compensation plan does not affect any civil claims for damages by the investor, however. It is expressly pointed out that the fund must be indemnified if a loss occurs.

5.1.3 Compensation procedure in the event of material valuation errors

The compensation procedure encompasses the preparation of a compensation plan and compensation payment for the benefit of the fund or for the benefit of investors who already redeemed their units, but were still invested in the fund at the time the loss occurred.

a) Compensation plan

The compensation plan must be prepared to correct the material valuation error and must contain the following points:

- recalculation of the net asset value per share for the error period;
- determination of the compensation that must be paid to the investors or for the benefit of the fund assets;

As part of the regulatory audit, the auditor must include a statement on any compensation plans. Furthermore, the compensation plan must be presented to the FMA upon request. The scope of the compensation plan and the verification thereof may be adjusted according to the amount of the loss incurred.

b) Determination of the amount and the time of the compensation payment in the event of material valuation errors

A material valuation error has an impact on the assets of investors and the fund only if units were subscribed or redeemed between the time the loss was incurred and the error was corrected by the management company/AIFM. Moreover, a loss is considered remedied if the respective transactions of units were cancelled and corrected. If this is not possible, however, a distinction must be made between an overvaluation and an undervaluation of the unit value.

Compensation payments must be made close in time to the correction of the valuation error and the preparation of a compensation plan.

5.2 Breaches of investment restrictions

In the event of breaches of investment restrictions, a distinction is made in principle between active and passive breaches.

Active breaches are caused by the person entrusted to manage the portfolio when misinvestments are undertaken, where they are either unlawful or do not comply with the restrictions set out in the constitutive documents.

Passive breach may be due to the following, non-exhaustive circumstances, without any purchases or sales of investment having been made: market fluctuations, subscriptions and redemptions of units, or rating changes. As a consequence of these circumstances, investments exceed or fall below the investment limits set out either in the constitutive documents or by law.

A passive breach becomes an active breach if it is not corrected within a reasonable period of time. If the correction is not made within a reasonable period of time, the management company/AIFM must document the decisions made and any measures taken in a comprehensible manner. The FMA may demand inspection of this documentation.

What is understood to be a reasonable period of time is determined on a case-by-case basis and must be documented by the management company/AIFM in each individual case and audited by the auditor.

5.2.1 Consequences of active breaches

The active breach must be corrected immediately, and the lawful state of affairs must be restored. If the active breach is discovered by the depositary, the depositary must inform the management company/AIFM without delay; the management company/AIFM must institute the measures described below to restore the lawful state of affairs.

If the fund incurs a loss due to the correction of an active breach, the fund must be indemnified by the management company/AIFM. The management company/AIFM must assess the damages (loss) and credit it to the fund or any affected investors who have already redeemed their fund units. Even if no tansactions of fund units occurred during the error period, the damages must be credited to the fund. If the correction of the active breach results in a gain, the gain shall remain in the fund assets. Irrespective of whether the correction of the active breach resulted in a loss or a gain, the FMA must be informed of the active breach immediately once the lawful state of affairs has been restored.

To ensure a uniform approach, the management company/AIFM is required in the event of a loss to prepare a compensation plan as further specified in the points set out below in Section 5.2.2 as part of a compensation procedure (subject to the simplified procedure set out in Section 5.4). This compensation plan does not affect any civil claims for damages by the investor, however.

5.2.2 Compensation procedure in the event of active breaches

The compensation procedure encompasses the preparation of a compensation plan and compensation payment for the benefit of the fund or for the benefit of investors who already redeemed their units, but were still invested in the fund at the time the loss occurred.

a) Compensation plan

The compensation plan must be prepared to correct the active breach and must determine the compensation to be paid to the investors or for the benefit of the fund assets.

As part of the regulatory audit, the auditor must include a statement on any compensation plans. Furthermore, the compensation plan must be presented to the FMA upon request. The scope of the compensation plan and the verification thereof may be adjusted according to the amount of the loss incurred.

b) Determination of the amount and the time of the compensation payment in the event of active breaches

In the event of an active breach, the compensation payment encompasses the loss arising from the non-compliant transaction as well as the resulting costs (e.g., transaction costs for purchase and sale) in connection with the correction of the active breach (absolute approach) or the negative difference between the loss/gain arising from the non-compliant transaction as well as the resulting costs (e.g., transaction costs for purchase and sale) in connection with the correction of the active breach and the loss/gain of the overall portfolio during the time between occurrence and correction of the active breach (relative approach).

For each fund, the management company/AIFM must decide on one of the two methods in advance and apply it in any event of an active breach. The selection of the calculation method must be set out in an internal instruction. Any change to the method must be in the interest of the investor and may only be made with the approval of the auditor.

Compensation payments must be made close in time to the correction of the active breach and the preparation of a compensation plan.

5.3 Responsibilities of the auditor

When auditing the compensation plan as part of the regulatory audit of the fund, the auditor must assess whether the cases enumerated in the compensation plan have been dealt with correctly. The auditor must also assess whether the procedures for determining the financial compensation payments to be made for the benefit of the fund or the investors meet the requirements of the UCITS Act, AIFM Act or IU Act and the Code of Conduct. The auditor documents in the report on the regulatory audit of the fund the cases of material valuation errors and/or active breaches occurred in the business year.

5.4 Simplified procedure

If the total amount of the compensation payment is lower than 0.01% of the net asset value or CHF 20,000 (or the equivalent in a different currency), whichever is larger, the preparation and submission of the compensation plan and the participation of the auditor described above are not necessary. However, it is expressly pointed out that the fund/the investors must be indemnified in any event of a loss.

6. List of changes

With the amendment date of 21 February 2017, the references of this Guideline to the AIFM Ordinance have been changed following the amendment of the AIFM Ordinance due to EEA adoption of the AIFM Directive. In addition, the transitional regime was abolished due to the lack of need for such regulation.

With the amendment of 27 August 2018, this Guideline was supplemented by data protection provisions (in accordance with the General Data Protection Regulation).

With the amendment date of 19 December 2019, the provisions on disclosure of performance, valuation, and valuation errors (including materiality thresholds) have been revised. In addition, provisions regarding disclosure of information have been added. The Investment Undertakings Act (IU Act) was included in the scope of application of the Guideline.

With the amendment date of 10 February 2021 the ESMA Guidelines on performance fees in UCITS and certain types of AIFs were added as appendix and the section on performance fee was amended.

7. Data protection

The FMA processes personal data exclusively in accordance with the general data processing principles of the General Data Protection Regulation (Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC) and in line with applicable data protection law. Information regarding the processing of personal data, including details about the purpose of processing, the data controller and the rights of data subjects can be found in the FMA Privacy Policy: https://www.fma-li.li/de/fma/datenschutz/fma-information-zum-datenschutz.html

8. Entry into force

This Guideline was approved by the Board of Directors of the FMA on 17 December 2015 and enters into force on 1 January 2016.

The changes on 21 February 2017 enter into force on the same date.

The changes on 19 December 2019 enter into force on 1 February 2020.

The changes on 10 February 2021 enter into force on the same date.

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Appendix - ESMA Guidelines on performance fees in UCITS and certain types of AIFs

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.[7]

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.

[7] 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.