ASISA PERFORMANCE FEE STANDARD

INTRODUCTION

The purpose of this Standard is to create an environment of transparency and disclosure in the industry where performance fees are charged by the investment manager. This will allow the client to make an informed decision as to the desirability of one investment option over the next, and understand the financial implications thereof. To this end, the Standard aims to:

- Guide the actions of all Managers, regardless of whether performance fees are charged, insofar as the standardised terminology used.
- Guide the actions of Managers where performance fees are charged, insofar as acceptable practices and disclosure is concerned.
- Highlight the appropriate behaviour of Managers that charge Performance Fees.
- Align investors' interests in terms of investment outcomes with that of the Manager's interest in terms of revenue.
- Provide additional information to complement the reference to performance fees within the ASISA Effective Annual Cost disclosure and the ASISA Total Expense Ratio.

This Standard aims to embody the following principles in the design, calculation and disclosure of performance fees:

- Fairness
- Consistency
- Transparency
- Accuracy
- Completeness
- Appropriateness

Fund management fees charged by investment managers are structured in a way that covers and provides for various costs involved with managing and administering funds by the manager. These can include, but are not limited to:

- costs to manage the investments of the fund;
- costs to comply with regulation;
- costs to comply with mandate restrictions;
- investment administration costs;
- IT and system operating and licensing costs;
- reporting to investors including income tax and withholding tax; and
- marketing and other operational costs.

Performance fees are a form of fund management fees expressed in variable terms, as opposed to a flat fee. This variable charging structure, when well-constructed, should align the interest of both clients and managers at all times. It could be argued that the opposite is true for flat fee structures: when investment performance is low clients pay away a larger proportion of performance in fees and a lower proportion when performance is higher. Ironically, flat structures seem more expensive when the client can least afford them.

Performance fee structures have become more prevalent in recent years and some of the main reasons and advantages of these structures are:

- Demand from investors and advisors to have more options in terms of fee structures used;
- Alignment of interests between Managers and investors and in so doing discouragement of churn within funds and portfolios as a result of investors paying fees based on the performance of the fund;
- Evolution of fees usage, e.g. move away from charging initial fees as part of the flat fee to performance fee structures with/without initial fees;
- Aids in alignment of capacity management within investment firms.
- A well-structured performance fee can shift the emphasis of the manager's remuneration toward the delivery of superior long term returns rather than concentrating on accumulating assets under management.

GLOSSARY

A Manager may not refer to the concepts below by any other name, nor may he attribute different meanings to the terms in any circumstances. In all internal and external communications, whether for the purposes of marketing or not, terminology will be standardised by the industry as follows:

Performance Fee Benchmark: This is the yardstick the performance of the fund is measured against. Each fund may only have one performance fee benchmark.

Fee Hurdle: This is the level of performance the fund must achieve, prior to a fee higher than the Minimum Fee being charged. Fee Hurdles refers to the absolute hurdle (e.g. ALSI + 2% per annum) and not only the threshold (e.g. 2% per annum) and should be linked to the Performance Fee Benchmark.

Performance Fee Measurement Period: The period for which the fund performance is compared to the Fee Hurdle, each time the fee is accrued.

Sharing Ratio: The percentage of performance, relative to the Fee Hurdle, that the Manager is entitled to receive as a fee.

High Water Mark: The highest level of relative outperformance of the fund over the Fee Hurdle since inception of the fund.

Reset: In performance fee structures with a high water mark, the reset of the high water mark occurs when a performance fee is triggered.

Performance Fee Accrual Frequency: This is the frequency at which provisions are made in the fund prices in order to allow for fees in excess of the Minimum Fee.

Performance Fee Payment Frequency: This is the frequency at which the amounts provided in the fund in respect of fees in excess of the Minimum Fee are transferred from the fund to the Manager.

Base Fee: This is the portion of the annual management fee charged before any performance is taken into account.

Fee at Benchmark: This is the annual management fee that will be charged when the fund's performance is equal to the Performance Fee Benchmark over the Performance Fee Measurement Period.

Minimum Fee: This is the minimum annual management fee that may be recovered from the fund by the Manager.

Maximum Fee: This is the maximum annual management fee that may in any instance be recovered from the fund by the Manager. This fee includes the Base Fee and all performance fee elements.

COLLECTIVE INVESTMENT SCHEMES

There are a number of methodologies for performance fees with numerous possible variations in the detailed operation of even seemingly similar methodologies. No single method can be deemed to be universally superior and it is for the manager to select and design the approach most appropriate for their particular circumstances and mandate of the fund. This Standard illustrates the issues that managers should consider when designing their methodology.

A METHODOLOGY

1. Performance Fee Benchmark appropriateness

The performance that is relevant to the calculation of a performance fee is the performance relative to a Performance Fee Benchmark. When selecting the Performance Fee Benchmark, managers should ensure it is relevant to the investment objectives and mandate of the fund and is capable of being consistently applied.

Benchmarks can generally be grouped into investable and non-investable. Examples of investable benchmarks are indices published by exchanges. Non-investable benchmark examples are inflation rates and peer groups.

Generally accepted characteristics of a benchmark are:

Investable Benchmark	Non-Investable Benchmark
Must be appropriately chosen for the type of fund and represent the relevant risk and return drivers of the product (see below).	Must be appropriately chosen for the type of fund and represent the relevant risk and return drivers of the product (see below).
Must be verifiable by an independent party i.e. prices verifiable through independent sources.	Must be verifiable by an independent party i.e. levels/values verifiable through independent sources.
Must be gross of fees.	Must be gross of fees, except in the case of peer group comparisons.
Must be calculated on a total return basis and include reinvested income or dividends.	
Must be tradable.	

Performance Fee Benchmarks should be transparently disclosed and explained to investors. Furthermore, guidelines as described below for Performance Fee Benchmarks will ensure appropriateness.

Acceptable performance fee benchmarks and behaviour include:

a. Equity and Fixed Income funds should use the appropriate Total Return Indices or an appropriate sector/asset peer group benchmark.

b. Multi-asset class portfolios can use the appropriate Total Return Composite Indices, sector peer or real return benchmarks (inflation plus type benchmarks):
   - Peer group benchmarks for performance fees allow clients to only pay performance fees should the manager do better than the average (or median) of their peers. However peer benchmarks are net of fees.
   - Where the manager is targeting an absolute or real return the use of an inflation benchmark aligns the interest of investors through a full market cycle and may be the appropriate benchmark to use. Real return benchmarks should be congruent with the risks associated with the portfolio.

c. Should an appropriate single asset class index or peer group not exist, it may be necessary to utilise an alternative benchmark until such time that an appropriate index or peer group benchmark becomes available.

d. Performance Fee Benchmark should be disclosed in the Minimum Disclosure Document.

The list below includes examples of inappropriate Performance Fee Benchmarks, hurdles and behaviour, but is not exhaustive:

a. Hurdles not relative to the stated benchmark of the fund. For example an equity fund should not have an ALSI benchmark with a cash +x% Performance Fee Benchmark and hurdle.
b. Multi-asset class funds (such as balanced funds) should not use inflation + x% where x% is not in line with the risk profile associated with the fund.
c. Money market funds should not have performance fees.
d. Equity funds should not use an inflation benchmark.
e. Index benchmarks for single asset class portfolios that do not reflect the investment universe of the fund, unless (c) in the previous paragraph applies.
f. Change of Performance Fee Benchmark or components of the performance fee structure without due notice to investors.
g. Fees earned for benchmark performance should not be at a fee hurdle lower than the Performance Fee Benchmark.

2. Convexity

The performance fee structure should in no way alter the way in which the investment manager manages the portfolio in terms of the risk being taken. There are sufficient levels of regulatory controls built into CISCA, Regulation 28 and mandate guidelines to prevent managers from acting irresponsibly and taking excessive risk. Performance fees should be earned in a linear manner. Performance fee structures should be appropriately designed to take into account the manner in which the fund is managed and performance should be seen through a full market cycle. It is also important that the fee structure should either apply a cap or a since inception high watermark.

3. Symmetry

The principle of symmetry is accepted as an important concept and is best achieved over a full market cycle. It should also be viewed in context of the total fee structure to ensure that the individual levels used are not inappropriate. There are various ways that symmetry can be achieved in terms of the entire fee, including examples below, but not limited to:

a. The effect of asymmetry can be reduced by setting a lower base fee than market or peers for performance at Performance Fee Benchmark. All other things equal, this would result in the client paying a lower fee for benchmark performance.
b. Participation for the investment manager in over and under performance if used.
    i. If there is a limit to the participation of the fund manager when the fund underperforms (i.e. the minimum total fee payable under the very worst circumstances is greater than zero), there should be a cap on the upside.
c. Rebate structure for failure to meet certain criteria on fund performance or risk parameters.
d. A high water mark is a good way to ensure a degree of symmetry, as no clients (new or old) pay the performance fee while the fund underperforms, and it is only levied once the high water mark has been surpassed.

4. Base fee

Generally the base fee of a fund with a performance fee structure should be lower than a corresponding flat fee for a similar product. However, the base fee should not be looked at in isolation, but rather as a component of the total fee package.

5. Key performance fee components

The ideal performance fee structure is one which is specific to each investor and their time spent invested in the fund. Unfortunately this is not possible at an individual client level within the retail space. As such the standardisation of the various performance fee components is critical to ensure fair and equitable application to all clients. Not every performance fee structure will necessarily comprise all of these components. All the components that are used in a performance fee structure should be looked at in terms of the total fee package and the nature of the particular fund or mandate.

a. Period of performance measurement

If the performance measurement period is too short then the fee could reward the manager for luck rather than skill. A longer measurement period better allows for the skill of the manager to be rewarded, and should achieve closer alignment of interest between the investors and the manager. It should also result in a lower level of volatility in performance fees and the prevention of churn within the fund. However, there is a trade-off as increasing the measurement period means the longer the time frame before the investors pay for their own performance experienced. We believe that if a rolling measurement period is used the measurement period should be at least 1 year and furthermore should be suitable for the particular type of product or mandate.

b. Method of calculation of outperformance

Performance fee accrual should occur with each valuation point i.e. calculation of CIS NAV. The daily return of the fund is calculated as a NAV/NAV return and as such is a net performance number. This number is then compared with the appropriate gross Performance Fee Benchmark (refer section 1 and section 5(d)), unless a peer group Performance Fee Benchmark is used. The outperformance can be calculated using one of the following methodologies:

i. Arithmetic outperformance = $Return_F$ – $Return_{BM}$
ii. Geometric outperformance = $(1+ Return_F)/(1+ Return_{BM})-1$
iii. Outperformance of a high water mark

c. High Watermarks (when used)

The use of a high watermark significantly increases the complexity of the performance fee structure.

A high watermark should not reset until previous underperformance has been recouped. If a performance fee has no cap, it should be required to have a since inception high watermark.

d. Net performance

As described above the fund performance is calculated on a NAV/NAV basis and as such other fees and charges have already been accrued for and thus present a net performance measure. This NAV includes previous performance fee accruals. This net performance measure will however be compared to the Performance Fee Benchmark without any adjustment for fees and charges.

e. Caps (when used)

Performance fee structures should have a cap, resulting in a maximum overall fee that an investor can expect to pay per annum. The cap should be disclosed as the

maximum fee payable by the client including the performance fee component. If a performance fee has no cap, it should be required to have a since inception high watermark.
The role of the cap is to counter excessive risk taking and to reduce the impact of extreme market movements. The cap should be considered within context of the entire fee structure.

f. Sharing Ratio
Sharing Ratios above 25% of the annualised relative performance could generally be considered excessive, however, the sharing Ratio needs to be considered in conjunction with the Base Fee and the Performance Fee Benchmark and the entire performance fee design. In general, the more demanding the Performance Fee Benchmark and the lower the Base Fee, the higher the Sharing Ratio could be and visa-versa.

B DISCLOSURE

There should be full disclosure of fees and managers should refer to the requirements contained within the ASISA Effective Annual Cost Disclosure and also the ASISA Total Expense Ratio Disclosure. The upfront disclosure should be publicly available in order to facilitate comparison between various funds. Disclosure should be clear and effective in plain language and should not confuse investors when covering the technical details of the fee calculation.

Additional information and education on performance fee components and how it differs from a flat fee, will give investors and advisors a clearer understanding of the benefits of performance fees. Managers may wish to give clients the option of a flat fee structure or a performance fee structure.

In all material where the Manager is required to disclose the annual management fee, the basis and method of calculating the performance fee must be disclosed in the following manner:

1. Basis

The basis refers to the elements making up the performance fee, as defined above. These must be disclosed by stating the quantum of each after naming the variable. Bold wording is to be used followed by only the quantum. It is considered industry best practice to present this compulsory disclosure to prospective clients in the order shown:

1.1 **Performance Fee Benchmark**: The official Performance Fee benchmark of the fund in question. This is the standard against which the performance of the fund is measured.

1.2 **Base fee**: [disclose base fee as defined above]

1.3 **Fee at Benchmark**: [disclose fee at benchmark as defined above]

1.4 **Fee hurdle**: [disclose fee hurdle as defined above]

1.5 **Sharing ratio**: [disclose sharing ratio as defined above]

1.6 **Minimum fee**: [disclose minimum fee as defined above]

1.7 **Maximum fee**: [disclose maximum fee as defined above, or if no maximum exists, disclose as "Uncapped, with a since inception high water mark – the fund's highest total TER since inception of TER was x% per annum".]

1.8 **Total Expense Ratio (TER):** [disclose TER as defined within the ASISA TER Disclosure]

1.9 **Fee example**: x% pa if the fund performs in line with its Performance Fee benchmark being [Performance Fee Benchmark]

2. Methodology

The method describes the manner in which the elements named in 1 interact with the fee provisions to produce a performance fee.

Two methods exist (rolling or cumulative). Where the fund uses a High Water Mark, four further scenarios exist (three with suspended accrual and one with negative accrual). It is considered industry best practice to present this compulsory "method" disclosure to prospective clients in the order shown, omitting points that are not applicable to the performance fee discussed.

2.1 Rolling method

"The performance fee is accrued [Performance Fee Accrual Frequency], based on performance over a rolling [Performance Fee Measurement Period] period with payments to the Manager being made [Performance Fee Payment Frequency]."

2.2 Cumulative method

The performance fee is accrued [Performance Fee Accrual Frequency], based on daily performance, and paid to the manager [Performance Fee Payment Frequency]."

2.3 Optional High Water Mark

"If the fund underperforms the Fee Hurdle, then [choose one of the following options]"

- "only the minimum fee is accrued until the high water mark is again reached."
- "only the base fee is accrued until the high water mark is again reached."
- "no fee is accrued until the high water mark is again reached."

- "accrued performance fees are refunded to the fund at the sharing ratio."

Where the options above do not accurately describe the calculation method at performance levels below the High Water Mark, an appropriate disclosure must be made by completing the following statement: "If the fund underperforms the Fee Hurdle, then [ ]"

3. Frequently Asked Questions

A Manager charging performance fees, in respect of any class of any fund, must on all marketing material where the fee structure of the fund is mentioned, state the physical or internet address where the Performance Fee Frequently Asked Questions ("FAQ") document is kept as a public document (freely available to all members of the public free of charge).

Managers may group funds and classes into one or more FAQs, as long as a FAQ exists for each class of each fund under the control of the Manager that makes use of performance fees.

Although a Manager may make additions to the document, the following issues must be addressed in the manner (exact bold wording has to be used) and order as dictated here under. This may be done per class per fund (singular), or for a group of funds or classes with the same performance fee structure (plural)

Performance fee FAQ for the [Fund names and classes]:

- **What are the minimum fees for the relevant funds and classes?**
- **What are the base fees for the relevant funds and classes?**
- **What are the fees at benchmark for the relevant funds and classes?**
- **What are the maximum fees for the relevant funds and classes?**
- **At which performance levels (also called the fee hurdles) will the Manager charge more than the fees at benchmark?**
- **Are the fee hurdles the same as the relevant fund benchmarks?** If not, explain any differences and the reason for this.
- **What is the performance fee measurement period?**
- **Will more than the base fee be charged regardless of whether the fund is experiencing positive or negative performance over the performance fee measurement period?**
- **What portion of the funds' outperformances will the Manager be entitled to share, should the funds perform above their fee hurdles (also called the sharing ratio)?**
- **What fee rate will be charged if the fund delivers the following relative performance over its performance measurement period:**
    - **the funds perform 10% p.a. less than Performance Fee Benchmark**
    - **the funds perform 5% p.a. less than Performance Fee Benchmark**

- **the funds perform in line with Performance Fee Benchmark**
- **the funds perform 5% p.a. more than Performance Fee Benchmark**
- **the funds perform 10% p.a. more than Performance Fee Benchmark**

- **Do any other classes of the funds charge fixed fees instead of performance fees?**
- **Are the performance fees accrued daily (also called the Performance Fee Accrual Frequency)?** If not, disclose the accrual frequency, together with the following: "**Where fees are not accrued daily, certain unit holders may pay a higher or lower portion of the performance fee relative to the performance experienced.**"
- **Do performance fee accruals pertain to performance periods more than a month prior to accrual?** If so, disclose the accrual lag, together with the following: "**Because of the lagged XXX performance fee measurement period, unit holders entering (or leaving) the fund in that period may pay for performance which is higher or lower than that which they have experienced.**"
- **Is a rolling measurement period used**? If so, disclose the rolling period, together with the following: **"Because of the XXX rolling performance fee measurement period, unit holders entering (or leaving) the fund in that period may pay for performance which is higher or lower than that which they have experienced."**
- **How often is the performance fee paid to the Manager (also called the "Performance Fee Payment Frequency")?**
- **Should the fund experience underperformance relative to the fee hurdle, how long is that under-performance held against the Manager? In particular, at what point would that under-performance be written off from a fee calculation point of view?** This "write off" may be the consequence of a reset provision in the High Water Mark, the length of the rolling period, or another implication of the mechanics of the performance fee basis and method.
- **Does performance in excess of the hurdle need to overcome prior under-performance (also called a High Water Mark system**)? If so, explain whether fee accruals are simply suspended or whether past fee accruals are refunded. Also, disclose the circumstances under which the High Water Mark expires, if at all.
- **Do any underlying funds charge implicit performance fees?** If so, include the following: **"Where underlying funds charge implicit performance fees (i.e. implicit in their unit prices), unit holders may carry these performance fees regardless of whether the top tier fund or mandate has outperformed its own Performance Fee Benchmark."**

C EFFECTIVE DATE

The effective date for the Standard is **1 January 2017**.