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Central Bank publishes findings from thematic review of UCITS performance fees

Following on from its recent thematic review of payment of performance fees by UCITS, the Central Bank has sent a [letter](#) (the “**Letter**”) this week to all UCITS management companies requiring them to conduct a review of their existing performance fee methodology calculations to ensure that any performance fees charged comply with its [UCITS Performance Fee Guidance](#) (the “**Guidance**”).

It also requires them to provide written confirmation to the Central Bank that such review has taken place by 30 November next. In responding to the Central Bank, UCITS management companies must identify any issues of non-compliance with the Guidance or other issues identified in the Letter and must identify steps being taken by the UCITS management company to “rectify the situation, including any material impact on UCITS and their investors”.

What follows is an overview of the steps which will need to be taken by UCITS management companies to ensure that they are in a position to comply with the Central Bank’s request by 30 November.

(i) **Review of methodologies used to calculate performance fees**

UCITS management companies will need to review the methodologies used to calculate performance fees payable by a UCITS to ensure that the relevant methodology complies with the Guidance. If, following that review, it determines that changes must be made to existing methodologies in order to ensure compliance with the Guidance, the relevant UCITS management company must explain this in the response to the Central Bank and must outline the

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actions being taken to rectify this. It must also advise the Central Bank of any adverse impact on the UCITS and their investors.

In conducting the review of the methodology, specific regard should be had to the poor practices identified by the Central Bank in its Letter.

In determining any action to be taken, UCITS management companies should also bear in mind that the Central Bank has proposed in its consultation paper CP119 that UCITS performance fees may only crystallise on an annual basis.¹

(ii) Review of prospectus disclosure

The Central Bank also noted that in certain circumstances, disclosure to investors in the UCITS' prospectus was inadequate. In this regard, it requires UCITS management companies as part of their review to determine whether any changes to prospectus disclosures are required in order to ensure that the performance fee disclosure is clear and unambiguous and, if applicable, to identify the steps which are being taken to revise this disclosure.

In cases where the performance fee is based on outperformance of the index, this will include ensuring that the prospectus discloses the correct version of the index.² In cases where a "High Water Mark" approach is used, the Central Bank has now indicated that the prospectus should disclose that performance fees may be payable as a result of market movements rather than due to the performance of the fund manager.

(iii) Identification of any improper payment of performance fees

In responding to the Central Bank on the review of its performance fee methodologies, UCITS management companies must confirm to the Central Bank as to whether they have identified any "instances of improper payment of performance fees". As noted above, it also requires that it be notified of any adverse impact on UCITS and their investors as a result of any improper payment of performance fees or resulting from inadequate or incorrect prospectus disclosure.

(iv) Review of service providers

The Central Bank identified a number of failings on the part of administrators and depositories as part of its thematic review and, noting that the UCITS management company is responsible for the effective oversight of delegates, has required that UCITS management companies review:

- (a) the calculation procedures adopted by fund administrators to ensure that the calculation of performance fees is applied in a consistent and independent manner; and
- (b) the verification procedures used by the depositary to ensure that the verification process is carried out on all performance fee calculations, is performed prior to

¹ For further information on CP119, please refer to our previous briefing available [here](#). The Central Bank is expected to publish finalised Central Bank UCITS Regulations before the end of 2018

² The Central Bank notes that UCITS may consider disclosing the ticker code of the index in order to identify it.

payment and is performed on crystallisation, regardless of whether or not a performance fee is due for payment.

UCITS management companies will therefore need to engage with their administrator and the UCITS' depositary in order to obtain adequate information on their calculation and verification processes to enable them to conduct such a review and satisfy themselves as to the adequacy of such processes.

The Letter also reminds UCITS management companies that as part of their oversight of delegates, they must oversee compliance with the Guidance on an ongoing basis. In this regard, once the review of the calculation and verification procedures has been conducted to the satisfaction of the UCITS Management Company, it may want to consider obtaining periodic confirmations from these service providers confirming that the performance fee has been calculated and verified in accordance with the prospectus, the Guidance and the relevant procedures.

(v) Performance Fee Approval Process

UCITS management companies may also want to revise their new fund approval process to ensure that the board of directors discuss and approve the appropriateness and suitability of the proposed performance fee prior to the launch of the relevant fund. Where the performance fee is based on the outperformance of a benchmark, the board of directors should also be satisfied that the benchmark is relevant in the context of the investment policy of the relevant UCITS and should document their rationale in this regard.

Conclusion

Given the scope of the review which UCITS management companies are now tasked with conducting and the deadline of responding to the Central Bank by no later than 30 November next, UCITS management companies should be implementing a project plan to conduct the necessary reviews as soon as possible.

If Dillon Eustace can assist in any way, please get in touch with your usual contact on the Asset Management Team.

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