ELEMENTS OF INTERNATIONAL REGULATORY STANDARDS ON FEES AND EXPENSES OF INVESTMENT FUNDS

TECHNICAL COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

FEBRUARY 2004
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Background

1. The Technical Committee through its Standing Committee on Investment Management (‘SC5’) has completed a review of existing practices with respect to fees and expenses in investment funds. Fees and expenses have long been a concern for regulators, and many jurisdictions are in the process of revising their approaches to these issues.

2. The review acknowledges the importance of fees and expenses in investment funds:

   - the investor should not rely solely on past performance to make an investment decision and that he or she should take fees and expenses into account when making such a decision. The bear markets experienced in recent years have increased the focus of both investors and regulators in this area;

   - ensuring transparency in this area encourages competition among fund operators. Competition leads to a more efficient market from which investors eventually benefit.

3. Yet identifying what fees and expenses are charged to funds and how these impact performance is not straightforward: high fees and expenses may simply reflect higher operating costs that lead to better performance.

4. Fees arrangements can also give rise to conflicts of interest and to breaches of the fiduciary duty of the investment fund operator. Some of these issues have to be dealt with by rules of conduct rather than with disclosure requirements.

5. Given the above remarks, all regulators consider that it is both appropriate and necessary to take regulatory steps in the area of fees and expenses. As a general rule, regulators do not dictate the level of fees and expenses; the focus of regulatory approaches has been to promote a competitive and informed market, which will then ensure that fees and expenses are understood in the context of the type and quality of services provided. Regulatory steps rely on a combination of general principles, disclosure requirements, prohibited practices and precise rules. This combination varies among regulators depending on their regulatory framework and on their assessment of the issues raised by fees and expenses.

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1 In September 2003, IOSCO’s Technical Committee published a paper entitled ‘Fees and Commissions within the Collective Investment Schemes and Asset Management :Sector: Summary of Answers to Questionnaire,’ available on the IOSCO website. That review represents a summary of regulatory approaches at a particular point of time (July 2002).

2 In May 2002, IOSCO’s Technical Committee also published a report entitled “Performance Presentation Standards for Collective Investment Schemes,” available on the IOSCO website. In February 2003, it published a consultation paper entitled “Performance Presentation Standards in Collective Investment Schemes: Best Practice Standards.” The first paper also acknowledges that fees and expenses may have a significant impact on the actual returns that are experienced by investment fund’s investors and notes that fund’s Performance Presentation Standards, which address whether fund’s performance calculations must reflect the impact of fees and expenses, promote comparability between funds. The best practice standards presented by the second paper deal, along with other issues, with the issue of fees and expenses in performance presentations.
Purposes of the paper

6. This paper aims at identifying common international best practices standards in the area of fees and expenses in investment funds through the identification of what regulators should seek to achieve when dealing with some of the issues raised by fees and expenses. These best practices will evolve over time as regulators may take into account those stated in this document by adapting their approach.

7. These best practice standards deal with issues that were identified at this stage as key issues and where regulatory best practices were agreed upon, namely those raised by:

- disclosure of fees and expenses to the investor
- conditions of remuneration of the fund operator
- performance fees
- transaction costs
- hard and soft commissions on transactions
- fees associated with funds that invest in other funds (including funds of funds)
- fee differentiation in multiclass funds
- fees and changes in fund’s operating conditions

8. These standards are not intended to serve as comprehensive requirements for the regulation of fees and expenses or to impose any obligation on any member. Generally, they reflect a level of common approach currently acknowledged by regulators in some areas. Ideally, a regular review of professional practices and regulatory requirements in this area should be done periodically.

9. This paper does not identify all possible regulatory issues concerning investment funds fees and expenses. Further, given the public interest in this topic, it is likely that additional extensive regulatory approaches or best practices are likely to emerge.

10. In the paper, the best practice standards are identified in bold letters. The rest of the text corresponds either to discussions, descriptions of issues or suggested ways of dealing with these issues and implementing the standards.

Definitions

11. The term investment fund, or collective investment scheme, includes authorized open end funds like mutual funds or UCITS. It also includes closed-end funds whose shares or units are traded in the securities market, unit investment trusts and contractual models. This paper concerns open end funds whose shares or units are sold to the public even if some of the principles expressed in it may be relevant for other kinds of investment funds (for instance closed-end funds or funds dedicated to qualified and professional investors).

12. Fees and expenses correspond to two different types of costs:

- fees paid directly by the investor out of an investment in the investment fund,
- fees and expenses borne by the fund and deducted from its assets. These fees and expenses fall into four broad categories:
• management fees corresponding to the remuneration of the management, including the financial management, of the portfolio of the fund,
• distribution costs of the fund in those jurisdictions where they are deducted from its assets,\(^3\)
• other operating expenses of the fund, including for example custody, accounting administration costs, and audit fees and other payments for shareholder service providers, and
• transaction costs associated with purchases and sales of portfolio assets.

Disclosure of fees and expenses to the investor

13. **Information on fees and expenses should be disclosed in a way that allows investors to make informed decisions about whether they wish to invest in a fund and thereby accept a particular level of costs.**

14. **Information on fees and expenses should be disclosed to both prospective and current investors**

   - For prospective investors, the prospectus (or the simplified prospectus where such a document exists) can be used to deliver key elements on the cost structure of a fund. More detailed information may then be given in additional documents (e.g. statement of additional information, full prospectus where the simplified prospectus exists, periodic reports).

   - In jurisdictions in which current investors do not usually receive the updates of the prospectus, periodic reports should then be used to make available the information. Websites, whether those of the management company or of a third party (which can be the regulator), can also be considered.

15. **The information should enable investors to understand what fees and expenses are charged.**

   - **Information delivered must be simple, concise and set out in clear language. It should avoid overloading investors with details which are not relevant for them.**

   - **Information should be delivered using a standardized fee table.**

     This fee table should distinguish between fees paid directly by the investor out of his or her investment in the fund, and expenses that are deducted from the fund’s assets.\(^4\) The fee table should also disclose the Total Expense Ratio (‘TER’) of the fund.\(^5\)

   - **Information delivered must not be misleading.**

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\(^3\) The costs of distribution are identified separately in certain jurisdictions (namely rule 12b-1 in the USA); and in others are simply subject to management fee-sharing agreements.

\(^4\) An example of a fee table can be found in Annex 1.

\(^5\) In some circumstances, the fee table may contain prospective fee information. In that case, the TER could be disclosed through other means, such as the financial highlights. Please refer also to point 18 and annex 2 regarding the use and the definition of the TER.
The implementation of this principle can rely on one or more of the following:

- introducing a general requirement in the regulation regarding the appropriateness and fairness of the disclosure of information on fees and expenses.

- specifying how particular information should be presented.

- defining how the information disclosed to the investor must be modified in those cases in which it would otherwise be misleading.

- requiring that any situation leading to the disclosure of potentially misleading information be disclosed to investors.

16. **Fee information disclosed should be aimed at enabling investors to understand the impact of fees and expenses on the performance of the fund.**

17. **The information should describe the cost structure (e.g. the management fee, operational costs such as custody fees) of the fund.**

18. **The information should describe the fees and expenses actually paid on a historical basis, and may also describe the fees and expenses likely to be paid on an anticipated basis.**

The information disclosed to the investor on an anticipated basis may use one or more of the following indications:

- the maximum level of fees and expenses that will, in the aggregate, be charged to the fund (such that the effective level will not exceed that maximum level disclosed), or

- the level of fees and expenses that the management company reasonably forecasts for the coming period.

19. **Information on fees and expenses should enable investors to compare costs between funds.**

Information on forecast or anticipated costs does not always enable precise comparisons between funds. Additionally, requirements regarding this information vary between jurisdictions, thus further hindering any comparisons.

Information on a historical basis should therefore be a primary criterion for comparing fees and expenses between funds registered in different jurisdictions. This implies that a common standard – the Total Expense Ratio - be defined between jurisdictions regarding the disclosure of ex-post (historical fee) information.

- **Information on fees and expenses should disclose the Total Expense Ratio of the fund. This TER should be disclosed in a standardized way, standardized fee table or financial highlights.**

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6 For best practices standards, see the’ consultation paper “Performance Presentation Standards in Collective Investment Schemes: Best practice Standards.”
- Additionally, in some jurisdictions, comparability between fees and expenses can be achieved by calculating the impact of fees and expenses on the investment made by a typical investor.

**Conditions of remuneration of the fund operator**

20. The management of a fund is usually remunerated through a management fee, which is frequently asset-based, but which may be calculated on different bases (for example a flat fee or a performance fee – see paragraphs 23 to 28).

21. The conditions of remuneration of the fund operator should comply with three main principles:

- transparency, enunciated in paragraph 13,
- prevention of conflicts of interest, as conditions of remuneration of fund operators should not create an incentive to behave contrary to the interest of the investor,\(^8\)
- fairness of competition; disclosure requirements (should prevent any distortion among operators.

22. Any remuneration of the fund operator through fee-sharing agreements on fees and commissions which are paid by the fund in relation to investment operations\(^9\) should be assessed on the basis of the three principles enunciated in paragraph 21. In particular it concerns hard commissions on transactions\(^10\) (see paragraphs 32 to 37) and fee sharing agreements in funds which invest in other funds (see paragraphs 39 and 40).

As discussed below, fee-sharing agreements which do not benefit directly the fund should be banned, and in particular that the benefit of these agreements must not go to the fund operator or an affiliated party.

**Performance fees**

23. **Definition.** A performance fee is a variable fee linked to the “performance”\(^11\) of a fund. A performance fee can for example be based on a share of the capital gains or the capital appreciation of the fund’s net asset value or any portion of the fund’s net asset value as compared to an appropriate index of securities or other measure of investment performance. It is charged to the fund by the management company. It aims at creating an incentive for the management company to optimize the performance of the fund.

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7 Please refer to annex 1 for an example of a standardized fee table, and to annex 2 for a definition of the TER.
8 Prevention of conflicts is a complex issue which is not only concerns the remuneration of fund operator but may also concern other service providers like custodians.
9 This paragraph does not apply to fee-sharing agreements concerning the remuneration of the distributor of a fund. The condition of remuneration of the distributors is indeed outside the scope of this paper.
10 Soft commissions raise similar problems to some extent.
11 The “performance” of a fund should be understood in a very wide scope here to encompass any kind of variable fee. It includes capital appreciation as well as any income linked to the fund’s assets (e.g. dividends). It should be assessed with reference to a target “performance.”
24. A performance fee should not create an incentive for the management company to take excessive risks in the hope of increasing its performance fee.

For example, there is a greater likelihood that the performance fee will create an incentive if the management fee is set at a very low level, below the actual management costs, and the operator relies on a high performance fee to recover its management costs.

- If such an incentive cannot be avoided, it should be identified and minimized.
  
  • regulators can for example require that the fee be a fulcrum fee since an operator that charges a fulcrum fee is less likely to take inappropriate risks with the fund’s assets because the under-performance of the fund would result in a reduction of the operator’s fee.¹²
  
  • alternatively, methods that ensure that cumulative gains are offset in some way by cumulative losses¹³ can be considered. Such methods create an incentive for the management company not to take inconsiderate risks, since such risks might result in losses which will then need to be offset before any performance fee can be levied again.

- If no steps are taken to minimize these incentives, information on the performance fee should be accompanied by a prominent statement drawing the attention of the investor to the risks posed by the way this performance fee operates.

25. A performance fee should be consistent with the fund’s investment objectives and should not create an incentive for the operator to take undue risks and should not deny investors an adequate remuneration of the return from the risks taken on their behalf and previously accepted

- The implementation of this principle relies on the following rules regarding the calculation method:
  
  • the payment frequency¹⁴ should be reasonable. At least one year is considered a reasonable period,
  
  • the excess performance¹⁵ of the fund for purpose of calculating a performance fee should be assessed after deduction of all costs borne by the fund,
  
  • if the fund uses a benchmark to describe its investment objectives, the reference against which it calculates the excess performance should be this benchmark.

¹² Generally, a fulcrum fee arrangement provides a fee averaged over a specified period that increases or decreases proportionately with the investment performance of the fund in the relation to the investment performance of an appropriate securities index. See Annex 3. Some SC5 members raised the question of the compliance of fulcrum fees with the Capital Adequacy Directive.

¹³ Please refer to annex 3 for a presentation of some of the methods that can be used to ensure that cumulative gains are offset by cumulative losses.

¹⁴ The payment frequency of the performance fee is distinct of its calculation period which should be accrued at each net asset value.

¹⁵ The “excess performance” is the difference between the fund’s gross performance and the performance of the benchmark.
Performance fees should provide some reward to the operator for the skill exercised in achieving the performance, but should not be so excessive as to bear no reasonable relationship to the services rendered by the operator:

- if a performance fee can be levied even if the absolute return of the fund is negative (this can occur if the fund outperforms its reference), this should be clearly stated in the description of the performance fee.
- an adequate portion of the excess performance of the fund should go to the investors,
- the excess performance should be calculated against a reference (‘benchmark’) that is consistent with the investment objective and the risk profile of the fund.

If no rules are set to ensure compliance with the last two requirements, disclosure requirements should be defined to ensure that investors will get the necessary information to assess whether they get a fair remuneration of the risks taken on their behalf.

26. **The calculation of a performance fee should be verifiable. It should not be possible to manipulate.**

- The following items should be unambiguously determined:
  
  - how the performance of the fund will be assessed (over what timeframe, including or excluding subscription/redemption fees, etc.),
  - what benchmark reference that the performance will be compared to. This reference must be verifiable and provided by an independent party,\(^{16}\)
  - what the calculation formula will be (including the description of the methods used to offset gains with past losses, if applicable).

27. **A performance fee should not result in a breach of the principle of equality of investors.**

- Such a breach derives from the fact that, for a given investor, the effective performance of his investment in a fund depends on his own dates of subscription and redemption. Thus, a performance fee should theoretically be calculated for each single investor, based on his date of entry into the fund. However, because of practical difficulties, no regulator has adopted this method so far.\(^{17}\)

- One may then resort to one or both of the following imperfect solutions. Disclosure requirements should be defined to ensure that investors are aware of the imperfections of these solutions.

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\(^{16}\) Generally, the manager is not allowed to create its own index (even if verifiable) or to use an index created or affiliated party.

\(^{17}\) The Swiss regulator is considering requiring that this method be implemented.
• using different notional classes of shares depending on the date of entry of the investor in the fund (since it is not possible to establish one class of share per date of entry, investors will need to be grouped in different classes of shares)

• accruing the performance fee at each date of calculation of the NAV. This solution guarantees a satisfactory though not absolute level of equality between investors: it doesn’t take into account the fact that investors who enter the fund may “benefit” from accrued performance fees (if the NAV of the fund subsequently decreases, part of the decrease will be offset by the decrease in accrued performance fees which were deducted from the assets of the fund before the investor entered the fund).

28. **Investors should be adequately informed of the existence of the performance fee and of its potential impact on the return that they will get on their investment.**

   - If rules have been set to ensure compliance with the above principles, this information should aim at simplicity rather than absolute accuracy.

   This can be achieved by requiring that the fund operator give concrete examples of how the performance fee will be calculated rather than making a theoretical description of the performance fee.

   - The information delivered to the investor should be sufficient to enable him or her to assess whether the performance fee complies with the above principles.

**Transaction costs**

29. **Definition of transaction costs.** Transaction costs are costs incurred by a fund in connection with transactions of financial instruments (securities and derivatives) in its portfolio.\(^{18}\) Transaction costs include:

   - brokerage fees
   - taxes and linked charges
   - the market impact of the transaction and the opportunity costs. The market impact corresponds to the fact that the transaction will be processed at a price that may be impacted by the transaction itself (especially for assets with a low liquidity). The opportunity costs are the costs of missed trades as the longer it takes to complete a trade, the greater is the likelihood that someone else decides to buy (or sell) the security, and by doing so, drive up (or down) the price.

30. **Issues.** Like all fees and expenses, transaction costs have a direct impact on the performance of a fund. When quantifying the per unit cost of the performance being delivered, transaction costs should therefore be taken into account. Yet transaction costs are hard to quantify and to forecast:

   - Some financial instruments (bonds, commercial paper, derivatives) are negotiated without any explicit intermediary fees. Others are negotiated with an explicit

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\(^{18}\) As discussed in Annex 2, transaction-based fees used to meet costs included in the TER (for example, custodian fees) are outside the scope of transaction costs.
identification of brokerage costs but accounting standards (IFRS) allow brokerage costs to be deducted from the cost of the transaction when recording the transaction. Accordingly, information on transaction costs may not be readily available from the accounting data of the fund.

- The market impact of a transaction is difficult to quantify precisely because it depends on a variety of factors: type of instrument, size of investment, timing of the transaction, quality of execution, liquidity of the underlying market etc.

- Transaction costs cannot be precisely forecasted since they depend on parameters that are not known in advance (e.g. turnover of the portfolio, commissions charged by the broker).

- Transaction costs can be very volatile depending on the investment strategy of the management company.

31. **Some information on transaction costs should be disclosed to investors. This information will usually be incomplete. It should however never be misleading.**

Excluding transaction costs from the TER is generally accepted, taking into consideration the difficulties underlined in paragraph 30 about forecasting and quantifying these costs.

This implies that the TER does not encompass all the costs charged to the fund and that additional information has to be disclosed.

- The latter can include one or more of the following:
  
  • disclosure of those transaction costs that can be identified and quantified
  • disclosure of the percentage of transactions processed by affiliated parties
  • disclosure of the turnover rate of the portfolio, along with an explanatory note commenting this turnover rate both in absolute\(^{19}\) and relative terms.\(^{20}\)

- Some jurisdictions require that transaction costs be included in the TER, despite the practical difficulties raised by such a requirement.

- Transaction costs will be reflected in the performance of the investment fund because the costs affect the cost of the fund’s investment.

**Hard and soft commissions on transactions**

32. **Definition of hard commissions.** A hard commission is a fee-sharing agreement between a fund’s operator and a broker in which the broker agrees to split with the operator company the transaction fees paid by the fund to the broker for processing transactions for the fund.

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\(^{19}\) I.e., the turnover – expressed in a percentage – recorded during a specific period.

\(^{20}\) I.e., the comparison – expressed in a percentage – between the turnover registered during a specific period and the turnover recorded during the previous period.
33. **Definition of soft commissions.** Soft commissions (or soft dollar benefits) correspond to any economic benefit, other than clearing and execution services, that a fund operator receives in connection with the fund’s payment of commissions on transactions that involve the fund’s portfolio securities. Soft commissions are typically obtained from, or through, the executing broker.

34. The fiduciary duty of a management company towards investors is a general principle which requires that management companies cannot benefit from their position in connection with the placement and execution of fund portfolio transactions at the expense of investors.

Hard and soft commissions raise the question of the compatibility of these practices with this fiduciary duty:

- They may create an incentive for management companies to direct transactions to brokers on criteria other than best execution services and to increase the turnover of the fund to generate more soft and hard commissions. When doing this, management companies may compromise their duty to act in the best interest of the investors. This incentive is further increased by the opacity of such commissions. It is however partially balanced by the fact that high transaction costs eventually lead to a lower net asset value (NAV) and thus to lower revenues for the management company, since its management fee is usually defined as a percentage of the NAV.

- Their opacity also means that there is less incentive for management companies to seek the best value for money for their customers when directing transactions to brokers.

- Lastly, they could result in a lack of transparency since costs that should normally be paid out of fund assets and thus included in the TER may be met through hard and soft commissions.

35. **Regulators also agree that soft commissions may create conflicts of interest for fund managers.** Regulation should therefore seek to ensure that those conflicts are either eliminated or managed in the investor’s best interests;

Appropriate regulation of soft commissions may consist of one or more of the following:

- A prohibition on the use of soft commissions;
- Restrictions on the types of goods and services that can be obtained through soft commission arrangements;
- Making the use of soft commissions conditional on informed client consent;
- Requiring fund managers to disclose the amounts of soft commission charged to a fund or portfolio, and the value of goods and services received in return;
- Requiring fund managers to rebate the value ofsofted goods and services to client funds.

Where soft commissions are permitted, a fund manager’s obligation to obtain best execution must not be compromised
A fund manager must not derive any cash benefit for itself from soft commission or other commission-sharing arrangements.

36. **Transactions should always be executed in accordance with best execution principles.** This implies that they be executed on market terms.

   - If they are not prohibited, **hard commissions should not be a criteria when a management company chooses an intermediary.** If they are permitted, the soft commissions should not be the sole or primary criteria when a management company chooses an intermediary. The current trend among regulators is to consider as an acceptable practice the fact that a management company chooses an intermediary that provides soft commissions as long as the broker can provide execution services that are equal to or better than other brokers.

   - **Requirements to disclose information to the regulator may assist the regulator in evaluating whether best execution principles are complied with.**

37. **If permitted, hard commissions should be for the exclusive benefit of the fund.** This means that any hard commissions should either be paid directly to the fund or indirectly (e.g. through a reimbursement).

   - If hard commissions do not accrue for the exclusive benefit of the fund, they should at least be adequately disclosed to investors. Disclosure requirements should enable investors to assess the scope of the hard commissions generated by transactions on the fund they have invested in and to understand their contribution to the revenues of the management company.

   - If hard commissions are used to meet costs that should normally be met out by fees and expenses taken into account into the TER calculation, they should be incorporated in the calculation of the TER.

38. **Soft commissions should benefit solely to the holders of the fund which is at the origin of these soft commissions.**

   - Alternatively, soft commissions that do not benefit solely to the holders of the fund should either:
     - be limited to research products and services, or
     - be disclosed in such a way that investors are able to assess the scope of these soft commissions and how they will benefit to others.

   - To limit the risks where management companies take advantage of soft commissions, regulators can set limits on the nature of soft commissions that are allowed. For example, they can limit soft commissions to research related services. They may also issue a list of authorized and/or forbidden soft commissions. They may also set the principle that “softable” products and services should only be the ones that provide lawful and appropriate decision-making responsibilities (i.e. the ones that bring a direct benefit or advantage to the management of the fund). Regulators can also rely

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21 Regulatory works are currently undertaken by various jurisdictions that could be taken into account in the short run to update the definition of best practices in this particular field.
on self regulation provided this self regulation is given some form of recognition (and can thus be enforced) by the regulator.

- They can also require that soft commissions used to pay for services that should be met out of fund’s assets be incorporated in the calculation of the TER.

- They can also require that the management company reimburses the fund of any soft commissions that were paid out of transaction costs paid by the fund and that did not benefit to the fund.

- They can also require that soft commissions be formalized in some way (for example, they should be formalized by written arrangements and these arrangements should be communicated to the compliance officer of the asset management company).

**Funds that invest in other funds (including funds of funds)**

39. **Definition.** Funds of funds are a sub-category of funds that invest in other funds. Whereas the latter includes any fund that invests part of its assets in other funds, the former generally refers only to funds that invest a *significant* part of their assets in other funds. 50% is a common threshold to identify funds of funds, but it varies between regulators.

40. Funds of funds are presented by the industry as a means of:

- achieving cost effective diversification of the portfolio, for example for flexible asset allocation or for balanced funds;

- having access to different managers specializing in different asset classes or management styles (multi-management).

41. Funds that invest in other funds raise two concerns:

- Funds that invest in other funds often or usually involve a double fee structure. This double fee is not in itself illegitimate as two different types of services are remunerated: fees at the top tier fund level remunerate the management company for the asset allocation and the selection of the bottom tier funds, and fees of the bottom tier funds remunerate the management companies for the management of these bottom tier funds.

- A conflict of interests may arise where:
  - The bottom tier funds are managed by the fund operator or by an affiliated party, or
  - fee-sharing agreements between the top tier and bottom tier funds benefit the top tier fund management company. Some jurisdictions may prohibit such agreements that benefit the top-tier fund operator.

22 When part of the fees that are charged directly or indirectly to the fund by an underlying fund (subscription/redemption fees, management fee, etc.) could benefit to the management company of the top tier
42. **Information on fees and expenses should enable investors to understand that if there is a double fee structure, it will impact the performance of the fund.**

Whenever possible, the implementation of this principle should rely on the disclosure of the synthetic TER.\(^{23}\)

The calculation of the synthetic TER raises practical problems:

- it will usually rely on the last available data regarding the TER of the bottom tier funds. In some cases, the top-tier fund may invest in bottom-tier funds that do not disclose a TER. The data used may differ from the true, current TER of the bottom tier funds. The figure disclosed will thus usually be an approximation of the true synthetic TER.

- to calculate the synthetic TER, the management company of the top tier fund must keep track of the TERs of all the bottom tier funds in which the top tier fund invested over a given period. On the one hand, it may be argued that this is impractical, especially for the top-tier funds seeking to minimize operating costs. On the other hand, this will anyhow be necessary if the management company wants to be able to analyze and understand the performance and expenses of the underlying funds.

43. **Conflicts of interest that arise because of the investment in other funds should be minimized.**

- If permitted, fee-sharing agreements should benefit exclusively the top tier fund. They should not benefit the management company, be it directly or through a third party.

- if the top tier fund invests in funds managed by affiliated parties, this should be disclosed to investors and subscription/redemption fees should be waived (except for those fees that go to the fund to cover the costs linked to the subscription/redemption\(^{24}\)).

- if the bottom tier fund is a multiclass fund (see below paragraph 44), the top tier fund should invest in the class with the lowest fee structure among the comparable classes in which it wishes to invest. This does not mean that the management company of the top tier fund is expected to opt systematically for the cheapest class. It may take into account other criteria, such as the types of services provided to each class (e.g. reporting) or other objective criteria (such as the minimum subscription amount). However, should two classes offer comparable services, it should invest in the class with the lowest fee structure.

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\(^{23}\) As defined in Annex 2.

\(^{24}\) In some jurisdictions, subscription fees are split between fees that go to the management company and fees that go to the fund to cover costs linked to the subscription (e.g. brokerage costs linked to the investment of the subscription in new assets). These last costs exist regardless of the fact that the bottom-tier fund is managed by an affiliated party. The requirement to waive subscription fees should therefore be restricted to the waiving of the fees that go to the management company. The same approach applies for redemption fees. In some jurisdictions, aggregate distribution expenses may be limited.
Multiclass funds

44. **Definition.** Multi-class funds are funds that offer investors different types of shares, known as “classes”. Each class is typically invested in the same portfolio of securities and financial instruments and has the same investment objectives and policies. But each class has different investor services and/or distribution arrangements with different fees and expenses and therefore different performance results. This means that different classes may have different TERs. The existence of different share classes should be disclosed in the prospectus of the fund.

45. **The existence of different share classes should not result in a breach of equality of investors who invest or have invested in the same share class.** The investors in the same class should bear the same fees and expenses that are reflected in the TER for the class. Those fees and expenses should not be waived for only certain shareholders within a class. Differences in fee and expenses shall be based on objective criteria disclosed in the fund prospectus (e.g. the amount of subscription).

46. **No advantage should be provided to a share class that would result in a prejudice to another share class or to the fund.**

Changes in a fund’s operating conditions

47. All best practices described in this paper are based on the implicit assumption that a fund’s main characteristics (investment objectives and policies, cost structure) have not undergone significant changes that would render disclosure set out in these best practices either irrelevant or misleading. They are also based on the assumption that a management company will not waive part of its management fees over a given period.

48. Should such a situation occur, fund disclosure should be modified to ensure that no misleading information is disclosed to current or prospective investors.

49. As far as prospective investors are concerned, adaptations can either be:

   - to require that a prominent statement be inserted stating that, following significant changes in the main characteristics of the fund, information based on historical data may not be relevant for investors considering investing in the fund.

   - to define precise additional requirements to deal with such cases (e.g. if the cost structure of the fund undergoes significant changes that result in an increase of the TER, a pro-forma TER should be calculated based on both historical figures and new data on the costs that have changed significantly).

50. **As far as current investors are concerned, requirements should aim at ensuring that the investor is aware of changes to fees and expenses that have occurred and, if these changes of costs concern management fees are significant appropriate regulation may consist of one or more of the following:**
- allowing an investor to redeem his investment free of charge, or
- allowing fund investors to vote against the authorization of changes.

51. **Requirements should also be defined for the start up period of funds.**

**CONCLUSION**

52. Fees and expenses raise important investor protection issues for Regulators. The jurisdictions of SC-5 members regulate disclosure of fees and expenses in several ways. This Report suggests some best practice standards that emerge from a consideration of practices in various jurisdictions.

53. The Technical Committee welcomes comments on the suggested best practice standards presented in this Report. Observations on whether the standards outlined above are correct and sufficient would be particularly helpful.

54. All interested parties are requested to comment by May 30, 2004. Comments in English are invited by post, fax or e-mail, addressed as follows:

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Members of the Technical Committee may also ask for comments from members of the Investment Funds trade association in their jurisdiction. Written comments received will be sent to the IOSCO General Secretariat.
Annex 1

Examples of a fee table

The fee table has to comply with the three following rules:

- The fee table must reflect all the fees and expenses of the fund. But, it may not include the transaction costs which may be subject to separate disclosure adapted to their specificity. Accordingly, the attention of the investor has to be drawn on this fact;

- The fee table must distinguish clearly the fees charged directly to the investor and the fees and expenses borne by the fund and deducted from its assets;

- The fee table must include the Total Expense Ratio (TER) as defined in annex 2.25

The following example of a fee table is provided by the US Authority

Include the following information, in plain English under rule 421(d) under the Securities Act, after Item 2:

Fees and expenses of the Fund

This table describes the fees and expenses that you may pay if you buy and hold shares of the Fund.

Shareholder Fees (fees paid directly from your investment)

Maximum Sales Charge (Load) Imposed on Purchases (as a percentage of offering price)   ___%  
Maximum Deferred Sales Charge (Load) (as a percentage of ____ )     ___%  
Maximum Sales Charge (Load) Imposed on Reinvested Dividends [and other Distributions] (as a percentage of ____ )     ___%  
Redemption Fee (as a percentage of amount redeemed, if applicable)      ___%  
Exchange Fee                                                                  ___%  
Maximum Account Fee                                                          ___%  

Annual Fund Operating Expenses (expenses that are deducted from Fund assets)

Management Fees                                                              ___%  
Distribution [and/or Service] (12b-1) Fees                                   ___%  
Other Expenses                                                               ___%  

______________________________    ___%  
______________________________    ___%  
______________________________    ___%  

Total Annual Fund Operating Expenses                                        ___%  

Instructions.

1. General.

(a) Round all dollar figures to the nearest dollar and all percentages to the nearest hundredth of one percent.
(b) Include the narrative explanations in the order indicated. A Fund may modify the narrative explanations if the explanation contains comparable information to that shown.
(c) Include the caption “Maximum Account Fees” only if the Fund charges these fees. A Fund may omit other captions if the Fund does not charge the fees or expenses covered by the captions.

(d) (i) If the Fund is a Feeder Fund, reflect the aggregate expenses of the Feeder Fund and the Master Fund in a single fee table using the captions provided. In a footnote to the fee table, state that the table and Example reflect the expenses of both the Feeder and Master Funds.

(ii) If the prospectus offers more than one Class of a Multiple Class Fund or more than one Feeder Fund that invests in the same Master Fund, provide a separate response for each Class or Feeder Fund.

2. Shareholder Fees.

(a) (i) “Maximum Deferred Sales Charge (Load)” includes the maximum total deferred sales charge (load) payable upon redemption, in installments, or both, expressed as a percentage of the amount or amounts stated in response to Item 8(a), except that, for a sales charge (load) based on net asset value at the time of purchase, show the sales charge (load) as a percentage of the offering price at the time of purchase. A Fund may include in a footnote to the table, if applicable, a tabular presentation showing the amount of deferred sales charges (loads) over time or a narrative explanation of the sales charges (loads) (e.g., __% in the first year after purchase, declining to __% in the __ year and eliminated thereafter).

(ii) If more than one type of sales charge (load) is imposed (e.g., a deferred sales charge (load) and a front-end sales charge (load)), the first caption in the table should read “Maximum Sales Charge (Load)” and show the maximum cumulative percentage. Show the percentage amounts and the terms of each sales charge (load) comprising that figure on separate lines below.

(iii) If a sales charge (load) is imposed on shares purchased with reinvested capital gains distributions or returns of capital, include the bracketed words in the third caption.

(b) “Redemption Fee” includes a fee charged for any redemption of the Fund’s shares, but does not include a deferred sales charge (load) imposed upon redemption.

(c) “Exchange Fee” includes the maximum fee charged for any exchange or transfer of interest from the Fund to another fund. The Fund may include in a footnote to the table, if applicable, a tabular presentation of the range of exchange fees or a narrative explanation of the fees.

(d) “Maximum Account Fees.” Disclose account fees that may be charged to a typical investor in the Fund; fees that apply to only a limited number of shareholders based on their particular circumstances need not be disclosed. Include a caption describing the maximum account fee (e.g., “Maximum Account Maintenance Fee” or “Maximum Cash Management Fee”). State the maximum annual account fee as either a fixed dollar amount or a percentage of assets. Include in a parenthetical to the caption the basis on which any percentage is calculated. If an account fee is charged only to accounts that do not meet a certain threshold (e.g., accounts under $5,000), the Fund may include the threshold in a parenthetical to the caption or footnote to the table. The Fund may include an explanation of any non-recurring account fee in a parenthetical to the caption or in a footnote to the table.

25 In some circumstances, the fee table may contain prospective fee information. In that case, the TER could be disclosed through other means, such as the financial highlights.
3. Annual Fund Operating Expenses.

(a) “Management Fees” include investment advisory fees (including any fees based on the Fund’s performance), any other management fees payable to the investment adviser or its affiliates, and administrative fees payable to the investment adviser or its affiliates that are not included as “Other Expenses.”

(b) “Distribution [and/or Service] (12b-1) Fees” include all distribution or other expenses incurred during the most recent fiscal year under a plan adopted pursuant to rule 12b-1 [17 CFR 270.12b-1]. Under an appropriate caption or a subcaption of “Other Expenses,” disclose the amount of any distribution or similar expenses deducted from the Fund’s assets other than pursuant to a rule 12b-1 plan.

(c) (i) “Other Expenses” include all expenses not otherwise disclosed in the table that are deducted from the Fund’s assets or charged to all shareholder accounts. The amount of expenses deducted from the Fund’s assets are the amounts shown as expenses in the Fund’s statement of operations (including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X [17 CFR 210.6-07]).

(ii) “Other Expenses” do not include extraordinary expenses as determined under generally accepted accounting principles (see Accounting Principles Board Opinion No. 30). If extraordinary expenses were incurred that materially affected the Fund’s “Other Expenses,” disclose in a footnote to the table what “Other Expenses” would have been had the extraordinary expenses been included.

(iii) The Fund may subdivide this caption into no more than three subcaptions that identify the largest expense or expenses comprising “Other Expenses,” but must include a total of all “Other Expenses.” Alternatively, the Fund may include the components of “Other Expenses” in a parenthetical to the caption.

(d) (i) Base the percentages of “Annual Fund Operating Expenses” on amounts incurred during the Fund’s most recent fiscal year, but include in expenses amounts that would have been incurred absent expense reimbursement or fee waiver arrangements. If the Fund has changed its fiscal year and, as a result, the most recent fiscal year is less than three months, use the fiscal year prior to the most recent fiscal year as the basis for determining “Annual Fund Operating Expenses.”

(ii) If there have been any changes in “Annual Fund Operating Expenses” that would materially affect the information disclosed in the table:

(A) Restate the expense information using the current fees as if they had been in effect during the previous fiscal year; and

(B) In a footnote to the table, disclose that the expense information in the table has been restated to reflect current fees.

(iii) A change in “Annual Fund Operating Expenses” means either an increase or a decrease in expenses that occurred during the most recent fiscal year or that is expected to occur during the current fiscal year. A change in “Annual Fund Operating Expenses” does not include a decrease in operating expenses as a percentage of assets due to economies of scale or breakpoints in a fee arrangement resulting from an increase in the Fund’s assets.

(e) The Fund may reflect actual operating expenses that include expense reimbursement or fee waiver arrangements in a footnote to the table. If the Fund provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, or whether it can be terminated at any time at the option of the Fund.
5. **New Funds.**

For purposes of this Item, a “New Fund” is a Fund that does not include in Form N-1A financial statements reporting operating results or that includes financial statements for the Fund’s initial fiscal year reporting operating results for a period of 6 months or less. The following Instructions apply to New Funds.

(a) Base the percentages expressed in “Annual Fund Operating Expenses” on payments that will be made, but include in expenses, amounts that will be incurred without reduction for expense reimbursement or fee waiver arrangements, estimating amounts of “Other Expenses.” Disclose in a footnote to the table that “Other Expenses” are based on estimated amounts for the current fiscal year.

(b) The New Fund may reflect expense reimbursement or fee waiver arrangements that are expected to reduce any Fund operating expense or the estimate of “Other Expenses” (regardless of whether the arrangement has been guaranteed) in a footnote to the table. If the New Fund provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, or whether it can be terminated at any time at the option of the Fund.

(c) Complete only the 1- and 3-year period portions of the Example and estimate any shareholder account fees collected.

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The following example of a fee table is provided by the Portuguese Authority

<table>
<thead>
<tr>
<th>Costs</th>
<th>Fee (%)</th>
<th>Fee (amount €)</th>
<th>%NAV (a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management fee</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Flat fee</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Costs</td>
<td>Fee (%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------------</td>
<td>---------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subscription fee</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer fee</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Redemption fee</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(1) Average of the reference period.
(2) Excluding transaction costs.

Unit holders table fee
Annex 2

Definition of the Total Expense Ratio

1. **Definition.** The Total Expense Ratio (TER) of a fund is equal to the ratio of the fund’s total operating costs to its average net assets. It is calculated at least once a year, generally with reference to the fiscal year of the fund. It may be calculated for other periods, for example for the purpose of periodic shareholder reports.

2. **Included costs.** The total operating costs are all the expenses which are deducted from fund’s assets. These costs are usually shown in a fund’s statement of operations for the relevant fiscal period.

   They are assessed on an “all taxes included” basis: charges such as VAT on management fees or registration tax should be taken into account.

   - They include any expenses of the fund that are necessary for the course of operations such as:
     - management fees (including performance fees)
     - distribution costs taken out from the fund’s assets if they are distinguished from the management fee
     - administration costs
     - custody fees
     - audit fees
     - payments to shareholder service providers
     - payments to attorneys
     - the impact of fee-sharing agreements if they result in artificially lowering the TER

   - They also include start-up costs.

3. **Excluded costs.** The total operating costs do not include:

   - transaction costs, including settlement and clearing costs (except for fee-sharing agreements)

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26 Artificial reduction of the TER, for example through direct charge to the unit holders of the management fees (which is possible in certain jurisdictions), have to be corrected and taken into account in the TER calculation.
27 Distribution costs are frequently met through management fee-sharing agreements but some jurisdictions may impose a separate disclosure (typically the 12b-1 fee in United States).
28 includes legal review of registration statement or any amendment, legal advice for the fund’s board of directors
29 Fee-sharing agreements on fees not included in the TER which benefit the fund’s service providers, typically hard commissions on transaction costs benefiting the fund manager, allow that the explicit fees are artificially lowered and accordingly have to be taken into account to avoid any distortion in the TER calculation.
30 Different accounting standards may lead to differences in the way those costs are taken into account in the TER (amortization)
31 some jurisdictions explicitly exclude costs considered as extraordinary (e.g. litigation costs)
32 fee-sharing agreements are dealt with below.
The question of including transaction costs in the TER remains open. It can be argued that transaction costs are more appropriately linked to the value of the fund’s assets than to its costs of operations.\textsuperscript{33} It can further be argued that including transaction costs in the TER raises practical issues (detailed in point 19). This has led a majority of regulators to exclude transaction costs from the TER:

- interest on borrowing\textsuperscript{34}
- sales loads or any other fees paid directly by the investor.

4. Authorized vs. forbidden costs. Some jurisdictions regulate the costs that can be charged to a fund either directly - through a list of eligible costs - or indirectly - by forbidding that some costs be charged to fund (e.g. start up costs) -. These rules could result in a higher level of the management fee (or its local equivalent) since any forbidden costs will then be met by the management company out of its revenue (management fee).

5. TER and financial statements. Though the TER is computed using financial statements, in some jurisdictions, it can also include some costs that are not recorded as expenses in the statement of operations of the fund (e.g. fee-sharing agreements).

6. Calculation method. Costs charged to the fund must be accrued at each calculation of the net asset value. The average net assets must be calculated using figures that are based on the fund’s net assets at each calculation of the net asset value. Alternatively, net asset values determined no less frequently than the end of each month may be used.

7. Performance fees. Performance fees should be included in the TER. However, to enable the investor to distinguish between costs that will be charged to the fund regardless of its performance and a performance fee that may vary significantly from one year to another, the performance fee should also be disclosed separately, as a percentage of the average net asset value.

8. Fee-sharing agreements on fees borne by the fund but not included in the TER (for example hard commissions on transaction costs benefiting to the custodian or to the fund manager). If this kind of agreement is authorized, they should be taken into account when calculating the TER to prevent any distortion.

9. Method of calculation of fees. Fees may be levied using different methods of calculation (e.g. flat fee, asset based fee, transaction based fee). However, the scope of the TER is defined with reference to the nature of the fees and not to their method of calculation. This method of calculation should therefore not be a criterion when assessing whether a fee is included in the TER or not.

For example:

- the custodian and depositary may in some cases receive fees paid not only as a percentage of the NAV of the fund but in proportion to the transactions of the fund. In spite of the fact that these payments are transaction-based, they cover costs which are by nature included in the functioning costs of the fund. When such a situation occurs, the

\textsuperscript{33} It may be argued that transaction costs are undertaken by the fund operator to improve the performance.

\textsuperscript{34} interest on borrowing is a cost linked to the value of the fund’s asset and not to its operation. It should therefore be excluded from the TER, although in some jurisdictions it is included in the TER.
remuneration of the custodian/depositary out of transaction costs must be included in the TER.
- although generally not reflected in the TER, transaction costs paid to brokers may be structured as flat fees or fees based on volume; however, such fees, regardless of their method of calculation, should be regarded as transaction costs.

10. Funds that invest in other funds. There are two different layers of costs in funds of funds: the costs of the top-tier fund, which are given by the “direct” TER, and the costs of the bottom-tier funds. These latter costs generally are not disclosed in the “direct” TER yet they can contribute significantly to the cost structure of the fund of fund.

Additionally, funds that invest a significant part of their assets in other funds are very close to funds of sub-advisors (funds that rely on sub-investment advisors to make their investment decisions). Yet, whereas the TER of funds of sub-advisors takes into account the cost of these sub-advisors, the “direct” TER of funds of funds generally will not take into account the costs of the underlying funds (subscription/redemption fees, management fees). Accordingly, the comparison of the “direct” TER of a fund of fund with the TER of a fund with sub-advisors could be confusing.

To improve the relevance of the TER of funds of funds and its comparability with the TER of funds of sub-advisors, it is therefore helpful to add an additional requirement for funds of funds, namely that they compute and disclose a synthetic TER (direct + indirect TER)

The synthetic TER is equal to the ratio between:

- the fund’s total operating costs and all the costs charged to the fund by underlying funds (subscription/redemption fees, TER of the underlying funds)
- the average net assets of the fund.

Accordingly, the calculation of this synthetic TER requires that a fund of funds keep track of all the subscription/redemption fees and of the TERs of all the underlying funds in which the fund of funds is invested.

This requirement would provide clarity for investors to all funds that invest in other funds, regardless whether these funds are regulated or unregulated and whether they calculate a TER or not.

11. Audited figures. The TER should be calculated in accordance with a methodology validated by the auditors of the fund. It should be based on audited figures at least once a year.

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35 Except for some jurisdictions where it is impossible to apply this “requirement” to unregulated funds.
Annex 3

Performance fees

Definitions

1. **Performance fee.** A performance fee is a variable management fee linked to the “performance”\(^{36}\) of a fund payable in addition to the basic fee (generally asset-based). A performance fee can for example be based on a share of the capital gains or the capital appreciation of the fund’s net asset value or any portion of the fund’s net asset value as compared to an appropriate index of securities or other measure of investment performance. It is paid by the fund to the management company. Its objective is to create an incentive for the management company to optimize the performance of the fund.

2. **Fulcrum fee.** A fulcrum fee is a type of performance fee. When a fulcrum fee is used the level of the fee increases or decreases proportionately with the investment performance of the fund over a specified period of time in relation to the investment record of an appropriate securities index. This means that a fulcrum fee can be negative, and thus deducted from the basic fee charged by the management company to the investment fund.

3. **High-watermark and high-on-high.** The rationale of these methods is that the fund should not be entitled to a performance fee unless it can be demonstrated that there has been an absolute improvement in performance and not simply because the investment fund outperforms a particular benchmark.

4. When a high-watermark (‘HWM’) method is used to calculate a performance fee, the performance fee may only be charged if the net asset value of the fund exceeds the highest net asset value previously attained in the past.

5. When a high-on-high (‘HoH’) method is used to calculate a performance fee, the performance fee may only be charged if the net asset value of the fund exceeds the net asset value at which the performance fee was last calculated and paid.

6. We shall use the term of ‘performance fee’ as defined in 1 which with no other specific rules (as ‘fulcrum fee,’ ‘high watermark performance fee’ and ‘high on high performance fee’).

Examples

7. Let us consider a CIS with the following characteristics:

   - management fee: 3%
   - performance fee: 20% of the excess performance over S&P 500. This performance fee is accrued at each calculation of the net asset value but is paid to the fund manager at the end of each year.

---

\(^{36}\) The “performance” of a fund should be understood in a very wide scope here. It includes any income linked to the fund’s assets (e.g. dividends) as well as capital appreciation.
With the following assumptions:\(^{37}\)

- there are no subscriptions or redemptions during the periods considered
- both the NAV and the S&P 500 follow simple trends: they either increase or decrease linearly

8. Calculation of a performance fee

<table>
<thead>
<tr>
<th></th>
<th>Beginning of year 1</th>
<th>End of year 1</th>
<th>End of year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Benchmark performance (S&amp;P 500)</strong></td>
<td>100</td>
<td>140</td>
<td>126</td>
</tr>
<tr>
<td><strong>Gross performance of the fund(^{(1)})</strong></td>
<td>100</td>
<td>120</td>
<td>114</td>
</tr>
<tr>
<td>Performance fee</td>
<td>4</td>
<td>1,2</td>
<td></td>
</tr>
<tr>
<td><strong>Effective NAV</strong></td>
<td>116</td>
<td>106,8</td>
<td></td>
</tr>
</tbody>
</table>

\(^{(1)}\) I.e. the NAV at the end of the year prior to the impact of the performance or fulcrum fee for the current year, but already taking into account the impact of the basic management fee.

In this example, the fund continuously over-performs the benchmark, so both the performance and fulcrum fee mechanism induces a positive fee for the fund manager.

Therefore, as the NAV at the end of year two is not higher than the NAV at the end of year one, both high on high and high watermark methods should exclude the payment of a performance fee for the year two.

9. Performance fee vs. fulcrum fee

<table>
<thead>
<tr>
<th></th>
<th>Beginning of year 1</th>
<th>End of year 1</th>
<th>End of year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Benchmark performance (S&amp;P 500)</strong></td>
<td>100</td>
<td>140</td>
<td>126</td>
</tr>
<tr>
<td>NAV without performance fee</td>
<td>100</td>
<td>120</td>
<td>96</td>
</tr>
<tr>
<td>1/ Performance fee</td>
<td>4</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Effective NAV</td>
<td>116</td>
<td>96</td>
<td></td>
</tr>
<tr>
<td>1/ Fulcrum fee</td>
<td>4</td>
<td>-2,4</td>
<td></td>
</tr>
<tr>
<td>Effective NAV</td>
<td>116</td>
<td>98,4</td>
<td></td>
</tr>
</tbody>
</table>

At the end of year 2, the fund has underperformed its benchmark, so there is no performance fee but there is a negative fulcrum fee which has to be deducted from the basic management fee.

\(^{37}\) These assumptions are for the sake of simplifying the examples and the calculations.
10. High watermark performance fee vs. high on high performance fee

<table>
<thead>
<tr>
<th></th>
<th>Beginning of year 1</th>
<th>End of year 1</th>
<th>End of year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Benchmark performance (S&amp;P 500)</strong></td>
<td>100</td>
<td>95</td>
<td>112</td>
</tr>
<tr>
<td><strong>NAV without performance fee</strong></td>
<td>100</td>
<td>98</td>
<td>118</td>
</tr>
<tr>
<td><strong>Highest NAV attained in the past</strong></td>
<td>120</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Latest NAV with a performance fee</strong></td>
<td>110</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/ HoH performance fee</td>
<td>0</td>
<td>0,24 (1)</td>
<td></td>
</tr>
<tr>
<td>Effective NAV</td>
<td>98</td>
<td>117,76</td>
<td></td>
</tr>
<tr>
<td>1/ HWM performance fee</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Effective NAV</td>
<td>98</td>
<td>118</td>
<td></td>
</tr>
</tbody>
</table>

(1) Assuming that both the benchmark and the performance of the funds are rising during the year 2 in a linear way.

At the end of year one, even if the funds over-perform its benchmark, the NAV of the funds stays below both the high-watermark and the high-on-high thresholds.

At the end of year two, as the NAV exceeds the corresponding threshold and the fund over-performs its benchmark, a high on high performance fee can be charged to the fund. This fee is accrued from the moment the NAV exceeds the threshold of 110 (i.e. the NAV of the fund on the basis of which a performance fee was last paid).