Good Practice for Fees and Expenses of Collective Investment Schemes

Final Report

The Board
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CHAPTER 1 INTRODUCTION AND OVERVIEW

Background and purpose of this paper

1. For investors in a collective investment scheme (CIS), the fees and expenses charged are important because of their impact on investment returns. Appropriate information about these fees and expenses should be available so an investor can take them into account when making an investment decision, and not rely on past performance. However, cost transparency by itself will not always ensure good outcomes for investors. Fee arrangements, even when fully disclosed, can give rise to conflicts of interest that rules of conduct can address. High standards of transparency and conduct in this area should encourage competition among CIS operators, which should lead to a more efficient market from which investors eventually benefit.

2. Consequently, fees and expenses have long been a concern for regulators, who consider that it is both appropriate and necessary to take regulatory steps in this area. Many jurisdictions have revised their approach to CIS fees and expenses in recent years. Accordingly, this paper aims to identify common international examples of good practice that can be applied to CIS fees and expenses.

3. IOSCO's Committee on Investment Management ('C5') reviewed existing practices with respect to fees and expenses in CIS in 2004, and published a set of standards to be regarded as good or best practice.[1] It was envisaged that these practices would evolve over time, as the natural evolution of the industry resulted in new product structures, investment strategies and distribution models, leading regulators to adapt their approach. C5 therefore carried out a second review in 2015 which was able to reflect a wider range of regulatory approaches towards markets at differing stages of maturity, as the membership of C5 has grown, as well as taking account of more recent developments in its member jurisdictions.

4. The focus of regulatory approaches has been to promote competitive and informed markets to help investors understand fees and expenses and make informed investment decisions, in the context of the type and quality of services provided. The level of fees and expenses might not necessarily be a matter about which regulators would wish to issue rules or guidance. Indeed, high fees and expenses may reflect various factors such as higher operating costs that lead to better performance, so identifying what fees and expenses are charged to CIS and how they impact its performance is not straightforward.

5. The regulatory steps taken in different jurisdictions may include general principles, prohibited practices and precise rules in relation to conduct and disclosure requirements. The

[1] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf

approach varies among jurisdictions depending on their regulatory framework, the structure of their national asset management landscape and the regulator's assessment of the risks and problems facing investors. As a result, the examples of good practice set out in this report 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 approaches to issues currently acknowledged by regulators in some key areas, namely:

- permitted or prohibited costs for a CIS;
- disclosure of fees and expenses to the investor, including use of electronic media;
- remuneration of the CIS operator;
- performance-related fees;
- transaction costs;
- hard and soft commissions on transactions;
- fees associated with CIS that invest in other funds;
- fee differentiation in multi-class CIS; and
- changes to the fees and expenses of a CIS.

6. This report does not identify all possible regulatory issues concerning the fees and expenses of CIS. Given the public interest in this topic, further regulatory approaches or good practices may be identified over time.[2]

7. In the paper, the examples of good practice are identified in bold letters within boxes. The rest of the text corresponds to descriptions and discussions of issues, or possible ways of implementing good practices. In preparing this report, C5 has drawn on previous IOSCO papers on the subject of fees and expenses for CIS as well as the applicable IOSCO Principles. In addition, references are made to a survey sent to committee members in 2014 and to the feedback from the public consultation published in 2015.[3]

8. The examples of good practice in this paper include both those previously published in 2004, and new examples. The key differences and enhancements relate to:

[2] At the time of publication, jurisdictions within the European Union are preparing to implement two legislative measures that will impact in this area. The Packaged Retail Investment and Insurance Based Products (PRIIPs) Regulation will require investment product manufacturers to disclose key information, including costs and charges, in a standard template. It will apply to some retail CIS from 31 December 2016 and to those subject to the UCITS Directive from the end of 2019. The revised Markets in Financial Instruments Directive (MiFID II) will from January 2018 require improved disclosure of all costs and charges in relevant products and services, including collective investment undertakings. It does not apply directly to CIS operators but affects many of the firms that distribute CIS in the EU.

[3] Report on elements of international regulatory standards onfees and expenses of investment funds, June 2015 http://www.iosco.org/library/pubdocs/pdf/IOSCOPD491.pdf

- defining permitted and prohibited costs and how new or increased fees should be approved and/or notified to investors;
- more detail on the calculation of performance fees;
- the provision of summarised information to investors on key elements of fees and expenses;
- the use of electronic media for disclosing information to investors about fees and expenses;
- more disclosure about types of costs charged to CIS as transaction costs;
- ways to manage and disclose conflicts of interest in the use of soft commission arrangements;
- disclosure of how soft commission arrangements are used;
- disclosure of double charging structures when one CIS invests in another; and
- more detail about keeping information on fees and expenses up to date and giving investors adequate notice of material changes.

Annex 4 contains a summary table showing the examples of good practice from the 2004 report alongside the revised and expanded examples in this paper.

Definitions and scope of this paper

9. The term 'collective investment scheme' includes authorised or regulated open-ended investment funds that will redeem their units or shares, whether on a continuous or periodic basis. It also includes closed-ended funds whose shares or units are traded on regulated or organised markets.[4] The rules governing the legal form and structure of CIS vary across jurisdictions. This paper is aimed at CIS whose shares or units are permitted to be sold to retail investors. CIS that are intended for professional (wholesale) investors only, such as hedge funds using prime brokers or schemes investing in private equity and venture capital, are not intended to be in this paper's scope.

10. 'Fees and expenses', as referred to in this paper, correspond to two broad types of costs:

a. fees paid directly by the investor out of an investment to the CIS operator, an agent or associate of the CIS operator, or the CIS itself; and

b. fees and expenses borne by the CIS and deducted from its assets, which fall into four categories:

i. management fees corresponding to the remuneration of the management – including the financial management – of the CIS portfolio of assets;

[4] Authorised CIS include, for example, mutual funds and UCITS.

ii. distribution costs of the CIS, where they are allowed to be deducted from its assets or are reimbursed by the CIS operator out of its own remuneration;[5]

iii. other operating expenses of the CIS such as custody, fund accounting, or administration costs for shareholder service providers; and

iv. transaction costs associated with purchases and sales of portfolio assets, including securities lending and repo / reverse repo transactions.

11. References in this paper to (for example) disclosure to 'the CIS' should be understood to refer to a CIS which is distinct from its operator and has governance arrangements, such as a board of directors or an independent trustee, to represent the interests of its investors.

Application of the IOSCO Principles

12. Several of the IOSCO Objectives and Principles of Securities Regulation of June 2010 ("the Principles") may have a bearing on this subject, but Principles 24 and 26 are of particular relevance. [6]

13. Principle 24: "The regulatory system should set standards for the eligibility, governance, organisation and operational conduct of those who wish to market or operate a collective investment scheme."

14. The methodology for assessing the level of implementation of Principle 24 considers, among other things, whether the regulatory system in each jurisdiction addresses the regulatory issues associated with fees and expenses. This is to ensure that no unauthorised charges or expenses are levied against a CIS or its investors, and that arrangements such as commission rebates, soft commissions and inducements do not conflict with the CIS operator's duty to act in the best interest of investors. So standards concerning all the key categories identified above are relevant to this principle.

15. Principle 26: "Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme."

16. The explanation of the principle states that information on fees and charges should be disclosed to both prospective and current investors in a way that enables the investors to understand their nature, structure and impact on the CIS' performance.

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[5] The costs of distribution are identified separately in certain jurisdictions (e.g. rule 12b-1 in the USA); and in others are simply subject to management fee-sharing agreements.

[6] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf.

17. The methodology for assessing the level of implementation of Principle 26 considers, among other things, whether material matters are disclosed on a timely basis, in easy-to-understand format and language, and are kept up to date to take account of material changes affecting the CIS.

Key developments in recent years

18. Since the financial crisis of 2007/8, regulatory developments have sought to achieve greater transparency in the world of investment funds as well as clearer, more focused investor disclosure. This strengthened regulatory approach has run in parallel with significant developments in the market environment. Low interest rates have made it harder for asset managers to generate profit while, in some jurisdictions, regulatory costs have risen considerably due to reinforced reporting requirements. Asset managers have looked to innovate, focusing on specific market segments or geographical areas in the attempt to obtain greater returns.

19. In certain markets, some active fund managers decided to launch 'semi-active' CIS, which are meant to offer alpha[7] at a lower cost, while others have chosen to differentiate themselves with new products or new services to justify the level of their fees, and have invested in new alternative asset classes enabling them to deliver higher alpha. This has included demand for CIS with high-yield, multi-asset, unconstrained and alternative strategies, as well as for exchange-traded products (ETPs) with illiquid underlying assets. It has also included an increase in index tracking and low-cost products.

20. Increased investor awareness may exert downward pressure on fees, as investors learn to consider them in their investment decisions. At the same time, the rise of new technologies has created a growth of web-based portals and tools which are changing how investors receive and interact with information about CIS, including on fees and expenses.

21. Some jurisdictions now have more complex distribution models, which may result in more elaborate fee-sharing or retrocession arrangements, and regulators in those jurisdictions have put mechanisms in place to ensure risks to investors are carefully monitored. Some jurisdictions have seen direct-to-investor distribution models emerge for the first time, resulting in lower overall charges because there is no commission to be paid to distribution agents. In others, the complete separation of the costs of product manufacture and distribution has taken place in an attempt to increase transparency of costs and reduce conflicts of interest.

22. Finally, some jurisdictions have focused on increasing the alignment of interest between managers and investors, for example by creating 'skin in the game' requirements or specifying rules for remuneration policies.

[7] Alpha' refers to the excess investment return of the CIS against a selected benchmark index or a 'risk-free' rate.

CHAPTER II FEES AND EXPENSES FOR OPERATING A CIS

Defining permitted and prohibited costs

23. A large number of jurisdictions regulate the costs that can be charged to a CIS, either directly through a list of eligible costs, or indirectly by prohibiting some inappropriate costs from being charged to the CIS. Examples of what might be considered inappropriate include costs associated with:

- mergers, restructurings or transfers from one operator to another;
- expenses or losses resulting from the CIS operator's failure to meet its obligations, (e.g. financial sanctions for breaching laws or regulatory standards, interest paid on delayed settlement of payments to investors);
- advertising and promotional activities; or
- expenses which have not been disclosed in the constitutional documents of the CIS or the information provided to investors.

24. Such costs could be met by the CIS operator out of its revenue (management fee), although this could result in the fee (or its local equivalent) being set at a higher level.

Good practice 1

Regulators may decide to specify, or give guidance on, fees and expenses that cannot be deducted from the assets of a CIS.

The scope of fees and expenses that may and/or may not be deducted from the assets of a CIS should at least be set out in documents disclosed to investors before they invest and afterwards at the times mandated by legislation / regulation.

Remunerating the CIS operator

25. The survey of C5 members in 2014 showed that the main method of remuneration for the operator of a CIS is a periodic management fee. This is frequently based on a percentage of the value of the assets under management ('ad valorem'), or else it may be calculated on different bases – for example, a flat fee and/or a performance-related fee (see paragraphs 29 to 38).

26. The conditions for remunerating the CIS operator should have regard to the principles of:

- transparency, as explained in Chapter III;
- prevention of conflicts of interest, since the arrangements for remuneration should not incentivise the CIS operator to act in a way contrary to investors' interests;[8] and
- fairness of competition, so as not to distort behaviour among operators; disclosure requirements could address this.

27. It appears that all jurisdictions have regulatory requirements for disclosure of management fees, but there are several approaches to implementing principles for conflicts of interest.

28. Any remuneration of the CIS operator through fee-sharing agreements for fees and commissions that are paid out of the assets of the CIS in relation to investment operations should be assessed according to the principles set out above.[9] This is particularly relevant to hard commission payments (see paragraphs 71 to 72) and fee-sharing agreements where CIS invest in other funds, especially if the benefit of those agreements could go to the CIS operator or an affiliated party (see paragraphs 91 to 97).

Performance-related fees

29. As noted in the Glossary in Annex 1, performance-related management fees aim to align the economic interests of the CIS operator and the investors in the CIS. Proponents of performance-related management fees believe that these fees can be more effective than a standard, ad valorem fee in rewarding the operator of an actively-managed-CIS for the results it has achieved.

30. A few jurisdictions have entirely forbidden the use of performance fees, but the large majority allow them subject to specific regulatory requirements. Some that allow performance fees report that their use has generally increased over the past 20 years, though to differing degrees across regions and CIS types. Although originally introduced in CIS aimed at institutional investors, they have also become more popular in retail CIS in certain jurisdictions.

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8 Prevention of conflicts is a complex issue which does not only concern the remuneration of the CIS 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 CIS by the CIS operator, which is outside the scope of this paper.

Good practice 2

A regulatory regime that permits performance fees should set standards for:

- **their method of calculation;**
- **the information the CIS operator should disclose to investors about their use;**
- **the disclosure medium to be used.**

In any event, a performance fee should respect the principle of equitable treatment of investors.

31. Since the 2004 report, some jurisdictions that allow performance fees have put in place requirements to mitigate the risks they pose. These requirements include:

- imposing a limit on the amount that can be charged as a performance fee
- requiring the CIS operator to inform its regulator if the fee reaches a certain limit
- alleviating potential inequitable treatment of investors by banning charging methods such as 'last in, first out'.

32. Performance fees give CIS operators a further incentive to outperform the chosen benchmark, but they may reward luck rather than management skill, or there may be a mismatch between the CIS and the chosen benchmark. Even where such fees are properly linked to the operator's success and skill, they may incentivise an inappropriate degree of risk-taking. For example, if the CIS operator sets the management fee at a low level, sufficient to cover the actual management costs only, and then relies on a performance fee to generate its profit, there is a greater incentive for the operator to take excessive risks.

33. The CIS operator should consider what level of performance fees achieves the right balance between rewarding it for its skills in achieving the performance, while remaining in the investors' best interests.

Good practice 3

A performance fee should be consistent with the investment objectives of the CIS and should not create an incentive for the CIS operator to take excessive risks in the hope of increasing its own remuneration. To that end:

- **The calculation of a performance fee should be verifiable and not open to the possibility of manipulation; in particular, the following items should be unambiguously determined:**
  - **how investment performance will be assessed (i.e. including or excluding subscription and redemption fees, etc.);**

- **what reference benchmark will be used;**[10]
- **what the calculation formula will be (including a description, if applicable, of the method for offsetting gains against past losses).**

- **The frequency for crystallising the performance fee and transferring the amount earned in such fees to the CIS operator should not be more than once a year, except when the CIS operator uses a fulcrum fee model (see below).**
- **Any benchmark to which the performance of the CIS is to be compared should be verifiable and provided by an independent party.**

CIS operators should design calculation methods allowing for the performance fee to result in a value that is proportionate to the investment performance of the CIS. Calculation methods should not deny investors an adequate share of the return achieved from the risks taken on their behalf and previously accepted by them.

34. For a given investor, the effective performance of their investment in a CIS depends on the particular points in time when they acquire and later dispose of the shares / units. So, a performance fee should ideally be calculated separately for each investor. However, where this is not practical, the fee could be a fulcrum fee. An operator that charges a fulcrum fee is less likely to take inappropriate risks in selecting assets for the CIS, because under-performance would result in a reduction of the operator's fee.[11]

35. Alternatively, methods to ensure that cumulative gains are offset in some way by cumulative losses can be considered. Examples of relevant methods include the high-watermark and high-on-high, which require an absolute improvement in investment performance before the performance fee can be paid.[12] Such methods incentivise the CIS operator not to take excessive risks that might result in losses, since any such losses will then need to be offset before any performance fee can be levied again.

Good practice 4

Where the calculation of the performance fee is based on the fulcrum fee model:

- **the calculation of the fee is compared to an appropriate benchmark and is based on the same benchmark used to determine excess performance;**
- **the fee increases or decreases proportionately with the investment performance of the CIS over a specified period of time; and**

[10] Generally, it may not be considered good practice for the CIS operator to be allowed to create its own benchmark (even if independently verifiable) or to use one created by an affiliated party

[11] Generally, a fulcrum fee arrangement provides a fee averaged over a specified period that increases or decreases proportionately with the investment performance of the CIS in relation to the returns from an appropriate securities index.

[12] Please refer to annex 3 of the 2004 report for a presentation of some of the methods that can be used to ensure that cumulative gains are offset by cumulative losses.

- **the CIS's investment performance should be calculated on the CIS's net asset value, calculated net of costs.**

Where the performance of the CIS is not based on a fulcrum fee model but is measured with reference to a benchmark:

- **calculation of the fee is based on the same benchmark used to determine excess performance;**
- **the excess performance is calculated net of costs.**[13]

36. To respect the principle of equitable treatment of investors, a CIS operator may also resort to one or both of the following (admittedly imperfect) solutions, to alleviate the difficulty associated with calculating the performance fee separately for each investor:

- Using different notional classes of shares depending on the date of entry of the investor in the CIS (since it is unlikely to be possible to establish one class of share per date of entry, investors will need to be grouped in different share classes)
- Accruing the performance fee at each date of calculation of the NAV. This solution achieves a satisfactory, though not absolute, level of equality between investors: it does not take into account the fact that investors who enter the CIS may benefit from accrued performance fees (if the NAV of the CIS subsequently decreases, part of the decrease will be offset by the decrease in accrued performance fees which were deducted from the assets of the CIS before the investor entered it).

37. Regardless of the rules applicable to the calculation of performance fees, 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. Jurisdictions now have specific disclosure requirements in place.

Good practice 5

It remains important for investors to 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.

38. If rules have been put in place to ensure appropriate disclosure, the information should aim for simplicity rather than absolute accuracy. This could be achieved by requiring the CIS operator to give concrete examples of how the fee will be calculated, rather than a theoretical description of how it works. The information provided to investors should be sufficient to enable them to assess the effect of the performance fee on their returns. If no steps are taken to minimise inappropriate incentives, information to investors about the performance fee could also be accompanied by a prominent statement drawing attention to the risks posed by the way the performance fee operates.

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[13] The "excess performance" should be the difference between the net performance of the portfolio and the performance of the benchmark.

CHAPTER III DISCLOSING FEES AND EXPENSES

Sources of information about fees and expenses

39. Legal disclosure documents which set out key information on fees and expenses of CIS can, if they are easy to read, help current and prospective investors to focus on the information they consider essential. At the same time, knowing where and how to obtain further information about fees and expenses is crucial for enabling investors to make fully-informed decisions. Summary documents can refer to the place where more detailed information is available, so that investors can easily access it. Summary documents may supplement the more detailed disclosure documents but should not replace them.

> **Good practice 6**
>
> **Information should be disclosed to both prospective and current investors in a way that allows them to make informed decisions about whether they wish to invest in a CIS and thereby accept a particular level of costs.**
>
> **Investors should be provided with summarised information on the key elements of fees and expenses, allowing them to make informed investment decisions.**
>
> **Disclosure documents that include summarised information about fees and expenses should explain clearly where and how both current and prospective investors can obtain more detailed information about those fees and expenses.**

40. For prospective investors, a summary document (such as the key investor information document used in EU countries) can be used to present the key elements of the cost structure of a CIS. More detailed information may then be given in additional documents, such as a prospectus, periodic reports, or a statement of additional information.

41. In jurisdictions where current investors do not usually receive updates to the prospectus, periodic reports could be used instead to make the new information available. Websites, which might belong to the CIS operator or a third party (including the regulator) could also be used to disclose the new information.

Making information accessible to investors

> **Good practice 7**
>
> **To enable investors to understand what fees and expenses are charged:**
>
> - **Information should be simple, concise, set out in clear language, and should not be misleading.**
> - **Information could distinguish between fees paid directly by an investor out of his/her investment in the CIS, and other fees and expenses that are deducted from the assets of the CIS.[14]**
> - **information should avoid overloading investors with details that are irrelevant to them.**
> - **information should be delivered using a standardised fee table that discloses the total expenses ratio (TER) of the CIS or a comparable calculation based on the ongoing charges it bears;[15] and**
> - **the TER or comparable calculation should be disclosed in a standardised way, by means of a standardised fee table or financial highlights.[16]**

42. These practices could be implemented by:

- introducing a general regulatory requirement about the appropriateness and fairness of information disclosed about fees and expenses
- specifying how particular information should be presented
- defining how the information disclosed to investors should be modified in cases where it would otherwise be misleading

43. In addition, the breakdown of the single figure may be disclosed to investors to provide them with more detailed information about the sub-categories representing different elements of the CIS cost structure.

> **Good practice 8**
>
> **Information disclosed about fees should aim to enable investors to understand the impact of fees and expenses on the performance of the CIS.[17]**

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14 ‘Assets’ refers to both capital and accrued income of a CIS. Examples of fee disclosure tables can be found in Annex 2.

15 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.

16 Please refer to the Glossary in annex 1 for a definition of the TER.

The information should describe the cost structure of the CIS: e.g. the management fee, and operational costs such as custody fees.

Historical and forward-looking information

Good practice 9

Information should describe the fees and expenses actually paid on an historical basis and may also describe the fees and expenses likely to be paid on an anticipated basis.

Information on fees and expenses should be kept up to date and the updating frequency should be specified in legislation or regulation.

Historical information about fees and expenses charged during a certain period should be disclosed at least annually, in one or more places to be specified by regulators (e.g. in annual reports).

44. The information disclosed to the investor on an anticipated basis could use indicators such as:

- the maximum rate of fees and expenses that will, in aggregate, be charged to the CIS such that the effective level will not exceed the maximum figure disclosed; or
- the rate of fees and expenses that the CIS or its operator reasonably forecasts for the coming period.

45. In view of the different approaches taken to using historical and forward-looking information, it is not considered appropriate to propose specific good practice preferring the use of one to the other. In either case, the information should be kept up to date and disclosed adequately.

Good practice 10

Information on fees and expenses should enable investors to compare the costs of different CIS.

46. Information on forecast or anticipated costs does not always enable precise comparisons between CIS. Additionally, requirements about this information generally vary

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[17] See the IOSCO report of May 2004 on "Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards." http://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf

between jurisdictions, thus further hindering comparability. Information on an historical basis should therefore be a primary criterion for making cost comparisons between CIS registered in different jurisdictions. This implies that a common standard – the Total Expenses Ratio – could be defined between jurisdictions regarding the disclosure of ex-post (historical fee) information.

47. Additionally, in some jurisdictions, comparability between fees and expenses can be achieved by calculating their impact on the investment made by a typical investor.

Use of electronic media

48. Over the last ten years, the use of electronic media in financial services has increased rapidly, not least in the area of information disclosure; for example, websites for the CIS or its operator, electronic disclosure systems, comparison websites, etc. There are significant advantages to the use of electronic disclosure documents:

- widespread use of electronic media by investors may enable management companies to reach more investors than was possible through traditional channels;
- investors may have quicker access to CIS disclosure documents and the possibility of having access to all the information they need via one source;
- electronic devices make it easier for investors to search for documents and select the essential information within them; it might be possible, for example, for information about fees and expenses to be tailored to an individual's intended investment amount;
- investors can simultaneously compare information about the costs of different CIS through their operators' websites or one main electronic disclosure platform;
- production and printing costs of disclosure documents are expected to decrease, which might enable certain CIS expenses to be reduced;
- it becomes easier and faster to disclose any changes made to the documents;
- investors may be able to obtain past data more easily (e.g. there might be better archiving facilities); and
- reaching investors via electronic media may be more efficient than postal systems etc.

49. Taking all these advantages into consideration, the use of electronic media for disclosure of CIS fees and expenses may be recommended, although printed copies of disclosure documents should still be provided to investors upon their request, and proper consideration should be given to those existing and potential investors who do not have ready access to electronic media or have difficulty in using them. In situations where automatic use of electronic media is not considered an appropriate way to communicate with investors, approval from the investor to use electronic media may be necessary.

Good practice 11

Use of electronic media for disclosure of information on CIS fees and expenses should be encouraged, provided that:

- **appropriate circumstances exist, such as:**
  - **- the availability of suitable technical infrastructure;**
  - **- investors' consent to receive information via electronic media;**
  - **- a regulatory framework that allows the use of electronic media for disclosure by default, etc.**
- **updated disclosure documents can easily be obtained electronically;**
- **existing channels and printed copies of disclosure documents should continue to be available to investors upon request and free of charge.**

It should be ensured that sufficient and accurate information is provided to those investors who use electronic distribution channels, before they invest in CIS.

50. Regulators may provide explanations about what could be considered as consent by investors (e.g. providing an email address) in the form of guidelines.

CHAPTER IV TRANSACTION-BASED FEES AND EXPENSES

Transaction costs

51. Transaction costs arise when a CIS operator acquires and disposes of assets in the portfolio of the CIS. Typically, these will be transactions in financial instruments (securities and derivatives) but may include other asset classes such as land and buildings (real estate). They are an integral feature of investment management, since any investor – not just a professional manager – has to buy and sell assets to achieve a chosen investment strategy.

52. Transaction costs may include:

- brokerage fees charged by the intermediary executing the transaction;
- transaction-based taxes and linked charges;
- exchange fees;
- settlement and clearing costs; and
- bid / offer spread costs.

53. Transaction costs may be affected by:

- market impact costs, i.e. the fact that depending on other market events and movements during the execution of an order, the order may itself have an impact on the transaction price (for example, for transactions in assets with a low liquidity); and
- opportunity costs, i.e. situations where the longer it takes to begin or complete the execution of a trade, the greater the likelihood that other market participants will buy (or sell) the security in the meantime and drive the price up (or down) by doing so.

54. Greater convergence on a common definition could help to make it easier to compare levels of fees and expenses in CIS established in different jurisdictions. Better comparability might help investors make better-informed choices, and would enable operators to benchmark themselves more accurately against the market as a whole. However, it may be difficult to devise a single comprehensive definition, especially as most jurisdictions do not set out a standardised methodology for calculating the value of transaction costs.

Good practice 12

Regulators could define what is meant by transaction costs, taking account of other relevant definitions; alternatively, the regulator or the CIS operator could specify the types of payment that should not be charged to the assets of the CIS as a transaction cost, or indicate how the value and/or impact of transaction costs could be determined.

55. Respondents to the consultation paper broadly supported having a standard definition, but there were differing views on how it should be expressed, and a few respondents thought any definition would be too broad to be useful in practice. Many think that some types of cost, such as market impact and opportunity costs, should be excluded from any calculation.

56. An existing definition of transaction costs that might be helpful in some jurisdictions is found in IFRS9:[18] "incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have occurred if the entity had not acquired, issued or disposed of the financial instrument."

57. Like all fees and expenses, transaction costs paid by a CIS have a direct impact on its performance. They will be reflected in the performance of the CIS because they decrease the amount of assets otherwise available for investment. Transaction costs should therefore be taken into account when quantifying the per-unit cost of the performance being delivered, but they can be hard to quantify or forecast for the following reasons.

58. Although some transaction costs (for example, transaction-related taxes and broker commission on purchases and sales of equities in most markets) are explicit and can be precisely measured and reported to the CIS operator, this is not always the case. Transactions in some financial instruments (bonds, commercial paper, derivatives) are negotiated without any explicit intermediary fees, so the mark-up or mark-down is usually an intrinsic part of the price and is not disclosed separately by the counterparty to the CIS operator.[19] Other transactions include an explicit identification of brokerage costs, but accounting standards (IFRS) may allow those costs to be deducted from the cost of the transaction when it is recorded. Accordingly, information about transaction costs may not always be readily available from the accounting records of the CIS.

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[18] International Financial Reporting Standard 9: Financial Instruments, www.ifrs.org

[19] Much useful information about transaction costs can be found in the US SEC concept release of 2004: http://www.sec.gov/rules/concept/33-8349.htm and the joint UK Government and FCA call for evidence of 2015: http://www.fca.org.uk/your-fca/documents/discussion-papers/dp15-02

59. The market impact of a transaction can be difficult to quantify because it depends on a variety of factors: type of instrument, size of order, timing of the transaction, execution quality, liquidity of the underlying market, etc. Transaction costs cannot be precisely forecast since they depend on parameters not known in advance (e.g. the rate of portfolio turnover, commissions charged by the broker). Also, the overall quantum of transaction costs over a period of time can be volatile, depending on the investment strategy of the CIS operator.[20]

60. Several ideas were suggested as to effective ways of measuring the value and impact of transaction costs, including:

- the use of historical figures;
- a model that multiplies standardised rates for each asset class by portfolio turnover; or
- a method of comparing the TER (or equivalent figure) with the movement in the NAV to get an indicative figure.

61. There seems to be a consensus that explicit transaction costs can be determined accurately after the event; there is less agreement on whether implicit costs can be measured retrospectively, but impact models to estimate the total costs incurred are widely used to provide post-execution analysis and are considered by their users to provide reliable estimates. Estimating transaction costs in advance is even more prone to variation, although some people believe historical data can be used to analyse trends as a basis for estimating the costs of a new CIS portfolio. There is however a risk that predictions of costs could turn out so inaccurate as to be misleading and thus illegal in some jurisdictions.

Issues with transaction cost transparency

62. Most regulatory regimes, with a couple of exceptions, have requirements to disclose transaction costs to investors. However, there is a lack of convergence over how and where to make these disclosures. This may result in investors being either unaware of the existence of such charges, or unable to form any reasoned view of their potential or actual impact on the investment performance of the CIS.

63. Excluding transaction costs from the aggregated figure for ongoing costs disclosed to investors (e.g. the TER) is generally accepted, taking into consideration the difficulties noted above about forecasting and quantifying these costs. This implies that the disclosed costs figure will not encompass all costs charged to the CIS and that additional information might need to be disclosed, which might include one or more of the following:

- transaction costs that can be identified and quantified;

[20] It is frequently the case that in an actively-managed CIS, the total amount of transaction costs cannot be predicted with any accuracy because of variable and unknown factors, principally the size and number of transactions that might be undertaken in a future period. This is less of an issue for passively-managed portfolios but there are factors, such as the need to carry out purchases and sales following the rebalancing of the index being tracked, which can make the number and size of transactions unpredictable.

- the percentage of transactions processed by affiliated parties;
- the turnover rate of the portfolio; and
- an explanation of the turnover rate both in absolute and relative terms.[21]

However, some jurisdictions do require transaction costs to be included in the figure disclosed for aggregated ongoing costs.

64. In recent years, there has been an increased level of analysis of the effects that transaction costs can have on investment returns, especially over the long term. A number of academic studies and independent investigations have tried to quantify these effects, and some suggest that over several years, such costs can significantly erode the returns investors might have expected.[22] The difficulties that such studies face are the absence of data, and the relative lack of awareness and understanding among investors (including institutional investors) about the significance of this issue.

65. The environment of internationally low interest rates in recent years has, in some jurisdictions and for certain strategies, also drawn more attention to the levels of transaction costs in CIS.[23]

66. The 2014 survey indicated that most jurisdictions do not require disclosure of some types of transaction cost. For example, it may be difficult for CIS operators to obtain specific information from counterparties about implicit costs. Nonetheless, CIS documents could disclose the existence of transaction costs and explain to investors how such costs may impact performance. CIS operators could report or account for explicit costs, as recommended in the 2004 report.

67. Respondents to the 2015 consultation paper had several useful suggestions that could provide effective disclosure. These included giving historical figures in percentage terms, with additional information in narrative form to explain the unpredictability of future costs; a breakdown between cost types, each shown as a percentage of the total fees and expenses charged to the CIS; showing which entities (especially those connected with the CIS) received a significant share of the total costs incurred; or a breakdown of costs by sub-category, shown as both a percentage and a cash value in relation to the average amount of capital invested.

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21 "Absolute" refers to the turnover recorded during a specified period, expressed as a percentage; "relative" refers to the comparison, expressed as a percentage, between the latest absolute figure and the equivalent figure for the preceding period.

22 See for example "Shedding Light on "Invisible" costs: Trading Costs and Mutual Fund Performance", Edelen Roger, Evans Richard, and Kadlec Gregory, Financial Analysts Journal, Volume 69. Number 1.

23 See for example "The Arithmetic of "all-in" investment expenses", John C. Bogle, Financial Analysts Journal, Volume 70, Number 1.

Good practice 13

Where transaction costs are deducted from CIS assets, the fact that the CIS may incur certain transaction costs should be disclosed to investors before they invest. For example, documents should be provided or made available that:

- **contain, to the extent known, a detailed description of the CIS's fees and expenses;**
- **describe the types of cost that will be or may be charged as transaction costs.**

Where the actual amount of transaction costs is known to the CIS operator after the event, that amount (or the total of all such amounts charged in a specified period) could be disclosed to the CIS and its investors.

Information about transaction costs should be provided in enough detail not to mislead investors by omission.

68. It may be difficult to estimate a CIS's future transaction costs due to a number of practical reasons.

69. It is sometimes suggested that the most useful form of fees and expenses disclosure for an investor would be a single figure encompassing all charges and costs, including transaction costs. A few CIS operators have voluntarily adopted this model, enabling investors to know in advance the maximum charge they can incur by investing in that CIS. However, the CIS operator must then manage the number and volume of portfolio transactions it undertakes in line with the fee, in which case the value may be inaccurate because some costs cannot be accurately measured.

70. It also has to be considered that the absolute level of such costs over a given period might not, by itself, be a good indicator of whether or not the CIS operator had entered into transactions in the interests of investors – i.e. by investing in a timely way to secure a profit or conversely by exiting a position to avoid a loss.

Hard and soft commissions on transactions

71. As part of a CIS operator's fiduciary duty towards the investors in the CIS, the operator should not benefit from its position in connection with the placement and execution of portfolio transactions at the expense of investors. Both hard and soft commission arrangements can result in the CIS operator receiving a benefit, the only real difference being that "hard" arrangements refer to a cash amount whereas "soft" arrangements refer to benefits in kind (goods and services).

72. Hard and soft commission arrangements may compromise the CIS operator's duty to act in the best interest of investors because:

- there is less incentive for the operator to seek the best value for money for the CIS and its investors when directing transactions to brokers, over and above the requirements of its best execution policy, since it has a commercial interest in such a choice and is able to pass costs on to the CIS that it would otherwise have to pay out of its own revenue;[24]
- such arrangements may create incentives for the operator to increase the turnover of the CIS portfolio, to generate more commission that results in more hard or soft benefits;
- hard and soft commissions might not be included in the aggregated costs figure (e.g. TER) and are usually not as transparent to investors, so there may be weak accountability for the expenditure.

Good practice 14

Because soft commission arrangements may create conflicts of interest for CIS operators, such conflicts should either be eliminated, or managed (e.g. through disclosure) in the best interests of investors.

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

- a prohibition on the use of soft commission arrangements;
- restrictions on the types of goods and services that may be obtained through such arrangements – for example, they may limit soft commissions to research-related services, or set a 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 CIS);
- making the use of such arrangements conditional on informed client consent;
- requiring CIS operators to disclose the amounts of soft commission charged to the CIS portfolio and the value of goods and services received in return;
- requiring CIS operators to rebate the value of softed goods and services to the CIS portfolio;
- requiring soft commissions to be formalised in some way, e.g. by written agreements communicated to the compliance officer of the CIS operator; or

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24 For example, the CIS operator, by using cheaper execution options such as electronic communications networks that do not provide softed goods and services, would then have to pay for those services itself.

- reliance on some form of self-regulation, provided this is recognised (and can thus be enforced) by the regulator.

74. A CIS operator should not derive any cash benefit for itself from soft commission or other commission-sharing arrangements. Where hard or soft commissions are permitted, the obligation of a CIS operator to obtain best execution for the CIS should not be compromised.

Good practice 15

Transactions should be entered into for the benefit of the CIS and its investors and not to generate an order flow and/or dealing commission.

Transactions should always be executed in accordance with the principles of best execution, and the use of hard or soft commissions should not compromise the CIS operator's obligation in this regard. This implies transactions should be executed on market terms, where applicable.

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

If hard commissions are permitted, they should be for the exclusive benefit of the CIS, meaning that any hard commission should be paid either directly to the CIS or indirectly (e.g. through a reimbursement).

Hard commissions should not be a criterion when a CIS operator chooses an intermediary to perform or arrange execution.

75. If hard commissions are used to meet costs that should normally be met out of fees and expenses captured by the calculation of the TER (or equivalent figure), that calculation should also incorporate such commission payments.

Good practice 16

If soft commission arrangements are permitted, they should not be the sole or a primary criterion when a CIS operator chooses an intermediary to perform or arrange execution.

76. Where two or more intermediaries are equally able to satisfy best execution requirements, the CIS operator may take account of the availability of soft commission arrangements when choosing between them. Soft commission arrangements should solely benefit the holders of the CIS from which the commission payment originates. Alternatively, if that is not possible the arrangements should be disclosed in such a way that investors are

able to assess the scope of the arrangements and how the soft commissions will benefit others. In addition, regulation could require the CIS operator to reimburse the CIS for the value of any softed goods and services paid for out of the assets of the CIS via dealing commission, but which did not benefit the CIS.

Managing and disclosing the conflicts of interest effectively

77. IOSCO looked further into soft commission arrangements in its 2007 report.[25] That report, like the 2004 report, recognised concerns over their use and examined in some detail the conflicts typically present between the interests of the CIS operator and those of the CIS and its investors. The 2007 report also recognised that the financing of investment research by CIS was an accepted and widely-used mechanism; and that soft commission arrangements – notably the provision of investment research – could provide benefits to CIS investors if conflicts of interests are properly managed.

78. Some market participants suggested, in their response to the 2015 public consultation, that a combination of regulatory and market-driven developments have helped to allay concerns about these conflicts of interest in recent years. Some said that regulation has improved cost transparency and stimulated competition among research providers. They strongly advocated the use of commission-sharing agreements, arguing that these separate out the decision-making about where to execute dealing orders and where to obtain research, while providing an efficient payment mechanism. They suggested that markets which allow or encourage commission-sharing have seen lower commission rates and growth in the provision of independent research as a result, and that investment managers are incentivised to use tools that help them to cut costs and deliver better returns for investors.

79. Although there are differing views about whether soft commissions actually benefit investors, it seems that – in the absence of alternative market mechanisms for certain goods and services to be priced and distributed – softing may currently be the only practical way to recompense the providers of those goods and services in those markets. CIS operators and other asset managers (the "buy side") have responsibility for deciding how their clients' money is spent, but the way that some market counterparties of CIS operators (the "sell side") structure their business models can make it difficult for the buy side to manage effectively some of the conflicts of interest it faces around the use of dealing commission to pay for research and other services.

80. Jurisdictions that permit soft commission arrangements can limit the potential conflicts of interest by setting standards for the buy side, the sell side or both. There are a number of ways that regulators may choose to address a CIS operator's use of soft commission arrangements. One possible approach is to specify types of goods and services that should not be paid for through dealing commission. These could include items such as

[25] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD255.pdf

certain IT services and equipment, or expenses for travel, accommodation and entertainment provided to key staff of the CIS operator or its associates.

81. Another possible approach could be to specify what goods or services can properly be paid for by soft commissions. For example, an indicative list of the types of investment research and research-related services that a regulator considers acceptable, or the criteria that a CIS operator should apply to determine whether investment research is an eligible service, could help to avoid uncertainty.

82. Even if restrictions apply to the types of goods and services that may be softed, the CIS operator may face conflicts of interest over the specific arrangements in place with the provider. Operators should be able to identify the situations that typically arise and to develop policies and procedures for managing them in the interests of the CIS and its investors. For example, the operator should consider its fiduciary obligations when it:

- arranges for a transaction to be executed by an associated company;
- receives softed goods and services for which it can negotiate an explicit price;
- receives softed goods and services for which there is no explicit market price; or
- receives a bundle of softed goods and services, only some of which can be shown to benefit the CIS and its investors.

83. Another way of addressing conflicts of interest is through record-keeping arrangements. A CIS operator, by keeping a record of all soft commission arrangements it enters into and of all goods and services it receives through such arrangements, can also demonstrate that it has identified conflicts of interest and has taken steps to manage them effectively.

84. Where commission-sharing agreements are permitted that facilitate payments to other brokers or independent providers of investment research that benefits the CIS, they may help to manage conflicts of interest by reducing incentives for CIS operators to accept bundled goods and services that add no value for the CIS.

Good practice 17

Rules, guidance or a regulatory code could enable CIS operators to determine which types of goods and services may legitimately be paid for with dealing commission, or which types should not be paid for in this way.

Regulatory approaches could take the form of principles and/or a non-exhaustive list of examples, that allow some flexibility to reflect innovations likely to function in the interests of investors provided that the CIS operator:

- **takes steps to satisfy itself that the receipt of such goods and services does not impair its duty to act in the best interests of the CIS and its investors; and**

- **has policies and procedures in place for overseeing the use of soft commission arrangements and addressing potential conflicts of interest.**

Disclosure of hard and soft commission arrangements

85. A number of different regulatory approaches to disclosing commission arrangements have emerged, including prior disclosure to prospective investors in a CIS and ongoing periodic disclosure to the CIS and/or existing investors.

86. Prior disclosure can inform investors in a general way of the practices of the CIS operator and of what measures are in place to ensure these practices are adequately controlled. Ongoing ex-post disclosure may describe what commission has been paid and which goods and services supplied. The nature of the disclosure will depend on the governance of the CIS, which is outside the scope of this paper; if the CIS has a board of directors, for example, it may be more appropriate for details of softed goods and services to be presented to them than to the individual investors.

87. If hard commissions do not accrue for the exclusive benefit of the CIS, the CIS operator should disclose to investors the scope of the hard commissions generated by transactions in the portfolio of the CIS. This should help investors to understand their contribution to the revenues of the CIS operator.

88. In the case of soft commission arrangements, details to be disclosed might include, for example:

- the types of goods and services paid for with soft commission;
- the names of brokers or other counterparties receiving commission, including if applicable any parties paid under commission-sharing agreements;
- the total value of soft commissions paid out over a specified period;
- an itemised breakdown of the total payments to each broker or counterparty;
- a calculation or reasonable estimate of the value of goods and services paid for with soft commission; and/or
- an analysis of the conflicts of interest related to soft commissions, and how these might affect the duty of the firm to act in the best interests of its clients.

89. Some respondents to the 2015 consultation paper pointed to existing national or regional standards which they thought were sufficiently robust, but there was no clear consensus about a particular model or about whether detailed information should be provided. It was suggested that regulators should permit, or possibly even mandate, the use of commission-sharing agreements to provide greater transparency.

Good practice 18

A CIS operator that uses hard or soft commission arrangements should disclose relevant information about them, in documents to be provided or made available to investors before they invest and that contain, to the extent known, a detailed description of fees and expenses payable.

The information to be disclosed should include at least:

- **the existence of such arrangements;**
- **the types of goods and services that may be acquired through soft commission arrangements; and**
- **the measures that may, if required, be taken to manage the conflicts of interest related to these commission payments.**

A CIS operator that uses hard or soft commission arrangements should periodically disclose adequate information to the CIS and/or its investors about the transactions executed and related commissions that have been paid in the preceding period, resulting in the CIS receiving research services.

90. CIS operators using commission-sharing agreements would receive details of the split of execution and non-execution costs, which they could then pass on to the CIS itself (e.g. where it has its own board) or to investors.

CHAPTER V OTHER ISSUES

CIS that invest in other vehicles (including funds of funds)

91. A CIS may invest through one or more other pooled vehicles to gain exposure to the assets required to help it achieve its investment objective. A fund of funds is a CIS which invests a significant part of its assets in this way (50% of assets is a common threshold to identify a fund of funds, but it varies among regulators). Investing through vehicles such as other funds, trusts or partnerships may impose additional costs, which may affect an investor's investment return.

92. Funds of funds are presented as a means of:

- achieving cost-effective diversification of the portfolio, for example for flexible asset allocation for balanced CIS portfolios; and
- gaining access to different managers specialising in different asset classes or management styles (multi-management).

93. CIS investing in other funds often involve a double fee structure. In this type of structure, two different types of service are being remunerated; fees at the top tier (the investing CIS) remunerate the CIS operator for performing the asset allocation and selecting the funds at the bottom tier (the underlying funds), while the fees paid from the underlying funds remunerate the operators of those funds for their activities. However, this may give rise to conflicts of interest where both the investing and underlying funds are managed by the same CIS operator (or by affiliated parties), or where fee-sharing arrangements between the investing and underlying funds benefit the operator of the investing CIS.[26] Some jurisdictions may prohibit such arrangements from benefitting the CIS operator.

94. It is important for the costs of a CIS investing in other vehicles to be disclosed so that investors are aware of the total cost of investing through the CIS. The operator of the investing CIS might not always have full knowledge of the indirect costs, especially when investing through a multi-layered arrangement. In that case, if the indirect costs can be reasonably estimated, the CIS operator may wish to include this information when calculating the overall costs of the investing CIS.

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[26] This could occur when part of the fees (subscription / redemption fee, management fee, etc.) that are charged directly or indirectly by an underlying fund could benefit the operator of the investing CIS either directly or through a third party (who then receives the proceeds from the fee-sharing agreement). If an agreement benefits the investing CIS itself, the underlying fund may waive part of the relevant fee paid by the CIS and the conflict of interest is avoided.

Good practice 19

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 CIS. When a CIS invests substantially in other vehicles, the management costs of the investing CIS and the underlying CIS (including any management fees paid to affiliates) should be disclosed to investors.

95. It is good practice to disclose a double fee structure by publishing a 'synthetic TER'[27] where possible and where the exposure to underlying funds is material enough to affect the total cost to the investor. Calculation of a synthetic TER may raise practical problems. It will usually rely on the last available data for the TER of the underlying fund, but in some cases the underlying funds might not disclose a TER. The data used may differ from the true current TER of each underlying fund, so the figure disclosed will be an approximation of the true synthetic TER.

96. Also, to calculate the synthetic TER, the operator of the investing CIS must keep track of the TER of each underlying fund that it has invested in over a given period. It may be argued that this is impractical and excessively costly, but it will be necessary if the CIS operator wants to be able to analyse and understand the performance and costs of the underlying funds.

Good practice 20

Conflicts of interest that arise because of investment in other funds should be avoided or mitigated.

Fee-sharing agreements, if permitted, should exclusively benefit the investing CIS and should not benefit the CIS operator, either directly or through a third party.

If the investing CIS invests in underlying funds managed by affiliated parties, this fact should be disclosed to investors and any subscription / redemption fees charged by the underlying fund should be waived (except for any part of those fees that are paid to the underlying fund to cover the costs of the subscription or redemption).[28]

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[27] As defined in the Glossary in Annex 1; use of the term "TER" refers in this section to whatever figure is disclosed for ongoing charges, as discussed in Part II of this paper.

[28] In some jurisdictions, subscription fees are split so the underlying fund receives an amount to cover costs linked to the subscription (e.g. brokerage costs where the amount of the subscription is invested in new assets). These costs exist regardless of the fact that the underlying fund is managed by an affiliated party, so the requirement to waive

If the underlying fund is a multi-class CIS (see paragraph 98 below), the investing CIS should identify the classes in which it might wish to invest and, if they are similar in all other respects, invests in the class with the lowest-charging fee structure.

97. This does not mean that the investing CIS should systematically select the cheapest class; it may take other criteria into account, such as the types of service provided for each class (e.g. reporting) or other objective criteria such as the minimum subscription amount. However, where two classes offer comparable services, the class with the lower-charging fee structure should be selected.

Multi-class CIS

98. Multi-class CIS offer investors different types of shares, known as "classes". Each class is typically invested in the same portfolio of financial instruments and has the same investment objective and policy. However, each class may offer different investor services and/or distribution arrangements, with different fees and expenses. This means that different classes may have different aggregated cost figures (TER or equivalent) and different performance results. The existence of different share classes should be disclosed in the CIS prospectus.[29]

Good practice 21

The existence of different share classes should not breach the principle of equal treatment of investors who invest, or have invested, in the same share class.

Investors in the same class should bear the same fees and expenses that are reflected in the disclosed costs figure (TER or equivalent) for that class. Those fees and expenses should not be waived for only certain shareholders within a class.

Differences in fees and expenses should be based on objective criteria disclosed in the prospectus (e.g. the amount of subscription).

No share class should benefit from an advantage that would result in prejudice to the interests of another share class or to the CIS as a whole.

the subscription fee should apply only to the part of the fee that goes to the CIS operator. The same approach applies for redemption fees. In some jurisdictions, aggregate distribution expenses may be limited.

[29] See the ESMA discussion papers of December 2014 and April 2016 for a broader analysis of issues relating to CIS (UCITS) with multiple share classes:
https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1577_dp_on_share_classes_for_publication.pdf
https://www.esma.europa.eu/sites/default/files/library/2016-570_discussion_paper_on_ucits_share_classes_2016_0.pdf

Changes to the fees and expenses of a CIS

99. All the examples of good practice described in this paper are based on the assumption that the main characteristics of a CIS, such as its investment objective and policy or its fee structure, have not undergone any significant change that would render the recommended disclosures irrelevant or misleading. (The examples do not address the situation where a CIS operator chooses to waive part of its fee over a given period.)

> **Good practice 22**
>
> **The CIS operator should not begin to deduct a new type of fee from the assets of a CIS, or increase its management fees, unless at a minimum the fee change is approved by the regulatory authority (in jurisdictions where the laws or regulations require it to do so) or else by an appropriate person or entity (e.g. board of directors, specified independent governance process, etc.).**
>
> **Regulators should require information disclosed to investors to be updated if an event occurs that changes the fees and expenses of a CIS. The way that this is done, and the urgency of the update, may depend on how material the change is.**

100. If there are significant changes to the main characteristics of a CIS, disclosure information should be modified if necessary to ensure that it is not misleading to current or prospective investors. Where prospective investors are concerned, any necessary adaptation can:

- require a prominent statement to be inserted to the effect that, following significant changes to the main characteristics of the CIS, information based on historical data may no longer be relevant to investors who are considering investing in the CIS; or
- define precise additional requirements to deal with such cases (e.g. if the cost structure of the CIS undergoes significant change that results in an increased TER or equivalent figure, a revised figure should be calculated, based on both historical and new data relating to the costs that have changed significantly).

> **Good practice 23**
>
> **Requirements should aim to make current investors aware of changes to fees and expenses that have occurred. If those changes relate to a significant increase of management fees, appropriate actions by the CIS operator may include:**
>
> - **allowing investors a period of time (preferably one determined by a regulatory authority) between when notice is issued to investors about the changes and when those changes come into force;**

- **allowing investors to redeem their investment free of charge during the period of notice;**
- **allowing investors to vote against approving the introduction of the change, where appropriate.**

Requirements should also be defined for the initial period when a CIS or share class starts up.

Conclusions

101. The examples of good practice set out in this paper aim to indicate the many ways in which regulators can deal with CIS fees and expenses. The review carried out by C5 in 2015 confirmed certain of the recommendations of the 2004 report in key areas, and showed that many jurisdictions have made efforts since 2004 in areas such as improving the clarity and simplicity of disclosure material to enhance investors' understanding.

102. At the same time, these revised examples introduce some new elements or build on what was previously said. Many jurisdictions have identified the need to respond to the massive growth in electronic and internet-based interactions between CIS operators and investors, so examples are given of ways in which fair treatment of investors can be ensured regardless of the medium they use to manage their money.

103. Another area in which both market and regulatory practice has developed is the transparency of and accountability for transaction costs. The revised examples place greater emphasis on this topic so that investors are more aware of factors that may affect investment performance. Enhanced good practice about the use of transaction-based commissions, to pay for services such as investment research, supports these aims. The examples show how it is possible to encourage more competition and market efficiency (for example through the use of commission-sharing agreements) and advocate better reporting of how CIS operators manage the conflicts of interest in this area..

104. Markets will continue to evolve and change and further revisions or enhancements to these examples of good practice will undoubtedly be desirable in the future, but it is hoped that the ones expressed in this document will help to drive fairness and transparency in an industry which has an important role in helping to manage the long-term savings of many millions of people around the world.

ANNEX 1

GLOSSARY OF TERMS

The following definitions have been devised for the purpose of this paper only. They do not necessarily correspond to the definitions used in the laws and regulations of any jurisdiction that is a member of C5.

'Transaction costs' are costs incurred by a CIS in connection with the acquisition or disposal of assets of the portfolio. An exact inclusive list varies amongst regulators. Acquisition and disposal may be understood to include "temporary" transactions such as stocklending or repo / reverse repo.

'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 CIS 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 fund operator to the CIS.[30]

'Hard commissions' are fee-sharing agreements between a CIS operator and a broker in which the broker agrees to split with the operator the dealing commission paid by the CIS to the broker for processing transactions for the CIS.

'Soft commissions' (or 'soft dollar benefits') are certain economic benefits – goods or services – that a CIS operator may receive in connection with the payment of dealing commissions by the CIS on transactions involving its portfolio securities. They exclude the transactional costs linked to execution (i.e. the pure cost of buying and selling securities) but they are typically obtained from, or through the agency of, the broker.

'Soft commission-sharing agreements' are agreements between a CIS operator and a broker that allow the CIS operator, when paying commission to the broker, to separate payment for execution from payment for other 'softed' goods and services that benefit the CIS. The broker will facilitate instructions from the CIS operator to re-direct some or all of the non-execution-related part of the payment to third parties to recompense them for goods and services they have provided.

[30] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf

A ‘performance-related fee’ is a variable management fee linked to the performance of a CIS portfolio, and usually payable in addition to a basic fee (generally asset-based). It can, for example, be based on a share of the capital gains or the capital appreciation of the net asset value, or any portion of the net asset value, as compared to an appropriate index of securities or other measure of investment performance. The fee is paid by the CIS to the CIS operator. Its aim is to align the economic interests of the CIS operator and the investors in the CIS, thus creating an incentive for the CIS operator to optimise investment performance. The ‘performance’ of a CIS should be understood in a very wide scope here, to include capital appreciation as well as any income linked to the CIS’s assets (e.g. dividends).

‘Prospectus’ includes any offering document having a similar purpose.

‘Total expense ratio’ (‘TER’) refers to any standardised calculation that aims to reflect different types of fees and expenses in a single figure, such as a percentage rate, to illustrate the combined impact of those fees and expenses on investment returns. Such calculations will typically include all amounts that are paid from the CIS to the CIS operator or other service providers on an ongoing basis, though certain payments (such as portfolio transaction costs, or subscription or redemption fees paid directly by the investor) may be excluded from the figure depending on the methodology.

ANNEX 2

EXAMPLES OF FEE DISCLOSURE TABLES

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

The following is the fee table and expenses table as required by Item 3 of Form N-1A. Form N-1A is generally used by mutual funds to file registration statements (e.g. prospectuses) with the U.S. Securities and Exchange Commission.
See https://www.sec.gov/about/forms/formn-1a.pdf

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. You may qualify for sales charge dicounts if you and your family invest, or agree to invest in the future, at least $[_________] in [name of fund family] funds. More information about these and other discounts is available from your financial professional and in [identify section heading and page number] of the Funds' prospectus and [identify section heading and page number] of the Fund's statement of additional information.

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 you pay each year as a percentage of the value of your investment)

Management Fees	_____%
Distribution [and/or Service] (12b-1) Fees	_____%
Other Expenses	_____%
____	_____%
____	_____%
____	_____%
Total Annual Fund Operating Expenses	_____%

Example

This Example is intended to help you compare the cost of investing in the Fund with the cost of investing in other mutual funds. The Example assumes that you invest $10,000 in the Fund for the time periods indicated and then redeem all of your shares at the end of those periods. The Example also assumes that your investment has a 5% return each year and that the Fund's operating expenses remain the same.

	1 Year	3 Years	5 Years	10 Years
Although your actual costs may be higher or lower, based on these assumptions your costs would be:	$	$	$	$

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses if you did not redeem your shares:	$	$	$	$

The Example does not reflect sales charges (loads) on reinvested dividends [and other distributions]. If these sales charges (loads) were included, your costs would be higher.

***

[Form N-1A includes extensive instructions on how to complete these items. For more information, please see: https://www.sec.gov/about/forms/formn-1a.pdf, pp. 3-6.]

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

A) Fees and Expenses Charged to CIS	**%**
Total Expense Ratio (yearly)	
The Management Fee[31] (yearly) - CIS Operator %.. - Depositary %.. - Management Company %.. - Distribution and Sales Fees %..	
Depositary Fee	
Other Expenses (such as audit fee and other operative costs etc.)	
B) Fees and Commissions Charged to Investors	
a) Performance fee (%)	
b) Subscription Fee	
c) Redemption Fee	

[31] If CIS operator shares the management fee with other parties, the proportion that is transferred to other parties is disclosed.

The following example of a fee table for a UCITS authorised in an EU member State is taken from CESR's template for the Key Investor information document (CESR/10-1321)

Charges for this Fund

The charges you pay are used to pay the costs of running the fund, including the costs of marketing and distributing it. These charges reduce the potential growth of your investment.

One-off charges taken before or after you invest	
Entry charge	[]%
Exit charge	[]%
This is the maximum that might be taken out of your money [before it is invested][before the proceeds of your investment are paid out].	
Charges taken from the fund over a year	
Ongoing charges	[]%
Charges taken from the fund under certain specific conditions	
Performance fee	[]% a year of any returns the fund achieves above the benchmark for these fees, [insert name of benchmark].

The **entry** and **exit charges** shown are maximum figures. In some cases you might pay less - you can find this out from your financial adviser.

The **ongoing charges** figure is based on expenses for the year ending []. This figure may vary from year to year. It excludes:

- Performance fees
- Portfolio transaction costs, except in the case of an entry/exit charge paid by the UCITS when buying or selling units in another collective investment undertaking

For more information about charges, please [see pages x to x / section x] of the fund's prospectus, which is available at www.ucitsfund/prospectus

Annex 3 Summary table of good practices

Good practice 1 Regulators may decide to specify, or give guidance on, fees and expenses that cannot be deducted from the assets of a CIS. The scope of fees and expenses that may and/or may not be deducted from the assets of a CIS should at least be set out in documents disclosed to investors before they invest and afterwards at the times mandated by legislation / regulation.
Good practice 2 A regulatory regime that permits performance fees should set standards for: ▪ their method of calculation; ▪ the information the CIS operator should disclose to investors about their use; ▪ the disclosure medium to be used. In any event, a performance fee should respect the principle of equitable treatment of investors.
Good practice 3 A performance fee should be consistent with the investment objectives of the CIS and should not create an incentive for the CIS operator to take excessive risks in the hope of increasing its own remuneration. To that end: ▪ The calculation of a performance fee should be verifiable and not open to the possibility of manipulation; in particular, the following items should be unambiguously determined: - how investment performance will be assessed (i.e. including or excluding subscription and redemption fees, etc.); - what reference benchmark will be used;[32] - what the calculation formula will be (including a description, if applicable, of the method for offsetting gains against past losses). ▪ The frequency for crystallising the performance fee and transferring the amount earned in such fees to the CIS operator should not be more than once a year, except when the CIS operator uses a fulcrum fee model (see below). ▪ Any benchmark to which the performance of the CIS is to be compared should be verifiable and provided by an independent party. CIS operators should design calculation methods allowing for the performance fee to result in a value that is proportionate to the investment performance of the CIS. Calculation methods should not deny investors an adequate share of the return achieved from the risks taken on their behalf and previously accepted by them.

[32] Generally, it may not be considered good practice for the CIS operator to be allowed to create its own benchmark (even if independently verifiable) or to use one created by an affiliated party

Good practice 4

Where the calculation of the performance fee is based on the fulcrum fee model:

- the calculation of the fee is compared to an appropriate benchmark and is based on the same benchmark used to determine excess performance;
- the fee increases or decreases proportionately with the investment performance of the CIS over a specified period of time; and
- the CIS's investment performance should be calculated on the CIS's net asset value, calculated net of costs.

Where the performance of the CIS is not based on a fulcrum fee model but is measured with reference to a benchmark:

- calculation of the fee is based on the same benchmark used to determine excess performance;
- the excess performance is calculated net of costs.33

Good practice 5

It remains important for investors to 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.

Good practice 6

Information should be disclosed to both prospective and current investors in a way that allows them to make informed decisions about whether they wish to invest in a CIS and thereby accept a particular level of costs.

Investors should be provided with summarised information on the key elements of fees and expenses, allowing them to make informed investment decisions.

Disclosure documents that include summarised information about fees and expenses should explain clearly where and how both current and prospective investors can obtain more detailed information about those fees and expenses.

[33] The "excess performance" should be the difference between the net performance of the portfolio and the performance of the benchmark.

Good practice 7

To enable investors to understand what fees and expenses are charged:

- Information should be simple, concise, set out in clear language, and should not be misleading.
- Information could distinguish between fees paid directly by an investor out of his/her investment in the CIS, and other fees and expenses that are deducted from the assets of the CIS.[34]
- information should avoid overloading investors with details that are irrelevant to them.
- information should be delivered using a standardised fee table that discloses the total expenses ratio (TER) of the CIS or a comparable calculation based on the ongoing charges it bears;[35] and

the TER or comparable calculation should be disclosed in a standardised way, by means of a standardised fee table or financial highlights.[36]

Good practice 8

Information disclosed about fees should aim to enable investors to understand the impact of fees and expenses on the performance of the CIS.[37]

The information should describe the cost structure of the CIS: e.g. the management fee, and operational costs such as custody fees.

Good practice 9

Information should describe the fees and expenses actually paid on an historical basis and may also describe the fees and expenses likely to be paid on an anticipated basis.

Information on fees and expenses should be kept up to date and the updating frequency should be specified in legislation or regulation.

Historical information about fees and expenses charged during a certain period should be disclosed at least annually, in one or more places to be specified by regulators (e.g. in annual reports).

[34] 'Assets' refers to both capital and accrued income of a CIS. Examples of fee disclosure tables can be found in Annex 2.

[35] 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.

[36] Please refer to the Glossary in annex 1 for a definition of the TER.

[37] See the IOSCO report of May 2004 on "Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards." http://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf

Good practice 10

Information on fees and expenses should enable investors to compare the costs of different CIS.

Good practice 11

Use of electronic media for disclosure of information on CIS fees and expenses should be encouraged, provided that:

- appropriate circumstances exist, such as:

  - the availability of suitable technical infrastructure;
  - investors' consent to receive information via electronic media;
  - a regulatory framework that allows the use of electronic media for disclosure by default, etc.

- updated disclosure documents can easily be obtained electronically;
- existing channels and printed copies of disclosure documents should continue to be available to investors upon request and free of charge.

It should be ensured that sufficient and accurate information is provided to those investors who use electronic distribution channels, before they invest in CIS.

Good practice 12

Regulators could define what is meant by transaction costs, taking account of other relevant definitions; alternatively, the regulator or the CIS operator could specify the types of payment that should not be charged to the assets of the CIS as a transaction cost, or indicate how the value and/or impact of transaction costs could be determined.

Good practice 13

Where transaction costs are deducted from CIS assets, the fact that the CIS may incur certain transaction costs should be disclosed to investors before they invest. For example, documents should be provided or made available that:

- contain, to the extent known, a detailed description of the CIS's fees and expenses;
- describe the types of cost that will be or may be charged as transaction costs.

Where the actual amount of transaction costs is known to the CIS operator after the event, that amount (or the total of all such amounts charged in a specified period) could be disclosed to the CIS and its investors.

Information about transaction costs should be provided in enough detail not to mislead investors by omission.

Good practice 14

Because soft commission arrangements may create conflicts of interest for CIS operators, such conflicts should either be eliminated, or managed (e.g. through disclosure) in the best interests of investors.

Good practice 15

Transactions should be entered into for the benefit of the CIS and its investors and not to generate an order flow and/or dealing commission.

Transactions should always be executed in accordance with the principles of best execution, and the use of hard or soft commissions should not compromise the CIS operator's obligation in this regard. This implies transactions should be executed on market terms, where applicable.

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

If hard commissions are permitted, they should be for the exclusive benefit of the CIS, meaning that any hard commission should be paid either directly to the CIS or indirectly (e.g. through a reimbursement).

Hard commissions should not be a criterion when a CIS operator chooses an intermediary to perform or arrange execution.

Good practice 16

If soft commission arrangements are permitted, they should not be the sole or a primary criterion when a CIS operator chooses an intermediary to perform or arrange execution.

Good practice 17

Rules, guidance or a regulatory code could enable CIS operators to determine which types of goods and services may legitimately be paid for with dealing commission, or which types should not be paid for in this way.

Regulatory approaches could take the form of principles and/or a non-exhaustive list of examples, that allow some flexibility to reflect innovations likely to function in the interests of investors provided that the CIS operator:

- takes steps to satisfy itself that the receipt of such goods and services does not impair its duty to act in the best interests of the CIS and its investors; and
- has policies and procedures in place for overseeing the use of soft commission arrangements and addressing potential conflicts of interest.

Good practice 18

A CIS operator that uses hard or soft commission arrangements should disclose relevant information about them, in documents to be provided or made available to investors before they invest and that contain, to the extent known, a detailed description of fees and expenses payable.

The information to be disclosed should include at least:

- the existence of such arrangements;
- the types of goods and services that may be acquired through soft commission arrangements; and
- the measures that may, if required, be taken to manage the conflicts of interest related to these commission payments.

A CIS operator that uses hard or soft commission arrangements should periodically disclose adequate information to the CIS and/or its investors about the transactions executed and related commissions that have been paid in the preceding period, resulting in the CIS receiving research services.

Good practice 19

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 CIS. When a CIS invests substantially in other vehicles, the management costs of the investing CIS and the underlying CIS (including any management fees paid to affiliates) should be disclosed to investors.

Good practice 20

Conflicts of interest that arise because of investment in other funds should be avoided or mitigated.

Fee-sharing agreements, if permitted, should exclusively benefit the investing CIS and should not benefit the CIS operator, either directly or through a third party.

If the investing CIS invests in underlying funds managed by affiliated parties, this fact should be disclosed to investors and any subscription / redemption fees charged by the underlying fund should be waived (except for any part of those fees that are paid to the underlying fund to cover the costs of the subscription or redemption).[38]

If the underlying fund is a multi-class CIS (see paragraph 98 below), the investing CIS should identify the classes in which it might wish to invest and, if they are similar in all other respects, invests in the class with the lowest-charging fee structure.

[38] In some jurisdictions, subscription fees are split so the underlying fund receives an amount to cover costs linked to the subscription (e.g. brokerage costs where the amount of the subscription is invested in new assets). These costs exist regardless of the fact that the underlying fund is managed by an affiliated party, so the requirement to waive the subscription fee should apply only to the part of the fee that goes to the CIS operator. The same approach applies for redemption fees. In some jurisdictions, aggregate distribution expenses may be limited.

Good practice 21 The existence of different share classes should not breach the principle of equal treatment of investors who invest, or have invested, in the same share class. Investors in the same class should bear the same fees and expenses that are reflected in the disclosed costs figure (TER or equivalent) for that class. Those fees and expenses should not be waived for only certain shareholders within a class. Differences in fees and expenses should be based on objective criteria disclosed in the prospectus (e.g. the amount of subscription). No share class should benefit from an advantage that would result in prejudice to the interests of another share class or to the CIS as a whole.
Good practice 22 The CIS operator should not begin to deduct a new type of fee from the assets of a CIS, or increase its management fees, unless at a minimum the fee change is approved by the regulatory authority (in jurisdictions where the laws or regulations require it to do so) or else by an appropriate person or entity (e.g. board of directors, specified independent governance process, etc.). Regulators should require information disclosed to investors to be updated if an event occurs that changes the fees and expenses of a CIS. The way that this is done, and the urgency of the update, may depend on how material the change is.
Good practice 23 Requirements should aim to make current investors aware of changes to fees and expenses that have occurred. If those changes relate to a significant increase of management fees, appropriate actions by the CIS operator may include: ▪ allowing investors a period of time (preferably one determined by a regulatory authority) between when notice is issued to investors about the changes and when those changes come into force; ▪ allowing investors to redeem their investment free of charge during the period of notice; ▪ allowing investors to vote against approving the introduction of the change, where appropriate. Requirements should also be defined for the initial period when a CIS or share class starts up.

ANNEX 4

SUMMARY TABLE OF EXAMPLES OF GOOD PRACTICE, 2004 - 2016

Good practices identified in the 2004 report	Good practices identified in the 2016 report
	GP1 Defining Permitted and Prohibited Costs **Regulators may decide to specify, or give guidance on, fees and expenses that cannot be deducted from the assets of a CIS.** **The scope of fees and expenses that may and/or may not be deducted from the assets of a CIS should at least be set out in documents disclosed to investors before they invest and afterwards at the times mandated by legislation / regulation.**
	GP11 Use of electronic media **Use of electronic media for disclosure of information on CIS fees and expenses should be encouraged, provided that:** **• appropriate circumstances exist, such as** **- the availability of suitable technical infrastructure,** **- investors' consent to receive information via electronic media,** **- a regulatory framework that allows the use of electronic media for disclosure by default, etc.** **• updated disclosure documents can easily be obtained electronically** **• existing channels and printed copies of disclosure documents should continue to be available to investors upon request and free of charge.**

Good practices identified in the 2004 report	Good practices identified in the 2016 report
	It should be ensured that sufficient and accurate information is provided to those investors who use electronic distribution channels, before they invest in CIS.
	<u>GP17 Managing conflicts of interest effectively</u> **Rules, guidance or a regulatory code could enable CIS operators to determine which types of goods and services may legitimately be paid for with dealing commission, or which types should not be paid for in this way** **Regulatory approaches could take the form of principles and/or a non-exhaustive list of examples, that allow some flexibility to reflect innovations likely to function in the interests of investors, provided that the CIS operator:** **- takes steps to satisfy itself that the receipt of such goods and services does not impair its duty to act in the best interests of the CIS and its investors; and** **- has policies and procedures in place for overseeing the use of soft commission arrangements and addressing potential conflicts of interest.**
	<u>GP18 Disclosure of hard and soft commission arrangements</u> **A CIS operator that uses hard or soft commission arrangements should disclose relevant information about them in documents to be provided or made available to investors before they invest and that contain, to the extent known, a detailed description of fees and expenses payable.**

Good practices identified in the 2004 report	Good practices identified in the 2016 report
	The information to be disclosed should include at least: - the existence of such arrangements - the types of goods and services that may be acquired through soft commission arrangements; and - the measures that may, if required, be taken to manage the conflicts of interest related to these commission payments **A CIS operator that uses hard or soft commission arrangements should periodically disclose adequate information to the CIS and/or its investors about the transactions executed and related commissions that have been paid in the preceding period, resulting in the CIS receiving research services.**
1. 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.	GP6 Information should be disclosed to both prospective and current investors in a way that allows them to make informed decisions about whether they wish to invest in a CIS and thereby accept a particular level of costs.
2. Information on fees and expenses should be disclosed to both prospective and current investors.	
	GP6 Investors should be provided with summarised information on the key elements of fees and expenses, allowing them to make informed investment decisions.
	GP6 Disclosure documents that include summarised information about fees and expenses should explain clearly where and how both current and prospective investors can obtain more detailed information about those fees and expenses.

Good practices identified in the 2004 report	Good practices identified in the 2016 report
3. 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. The fee table should also disclose the Total Expense Ratio ('TER') of the fund. - Information delivered must not be misleading.	GP7 To enable investors to understand what fees and expenses are charged: - information should be simple, concise, set out in clear language, and should not be misleading. - **Information could distinguish between fees paid directly by an investor out of his/her investment in the CIS, and other fees and expenses that are deducted from the assets of the CIS** - information should avoid overloading investors with details that are irrelevant to them - **information should be delivered using a standardised fee table that discloses the total expenses ratio (TER) of the CIS or a comparable calculation based on the ongoing charges it bears** - the TER or comparable calculation should be disclosed in a standardised way, by means of a standardised fee table or financial highlights
4. Fee information disclosed should be aimed at enabling investors to understand the impact of fees and expenses on the performance of the fund.	GP8 Information disclosed about fees should aim to enable investors to understand the impact of fees and expenses on the performance of the CIS.
5. The information should describe the cost structure (e.g. the management fee, operational costs such as custody fees) of the fund.	GP8 The information should describe the cost structure of the CIS: e.g. the management fee, and operational costs such as custody fees.
6. 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.	GP9 Information should describe the fees and expenses actually paid on an historical basis and may also describe the fees and expenses likely to be paid on an anticipated basis.

Good practices identified in the 2004 report	Good practices identified in the 2016 report
	GP9 Information on fees and expenses should be kept up to date and the updating frequency should be specified in legislation or regulation. **Historical information about fees and expenses charged during a certain period should be disclosed at least annually, in one or more places to be specified by regulators (e.g. in annual reports).**
7. Information on fees and expenses should enable investors to compare costs between funds. - 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.	GP10 Information on fees and expenses should enable investors to compare the costs of different CIS.
	GP2 A regulatory regime that permits performance fees should set standards for: - **their method of calculation** - **the information the CIS operator should disclose to investors about their use; and** - **the disclosure medium to be used.**
8. A performance fee should not create an incentive for the fund operator to take excessive risks in the hope of increasing its performance fee.	GP3 A performance fee should be consistent with the investment objectives of the CIS and should not create an incentive for the CIS operator to take excessive risks in the hope of increasing its own remuneration. To that end:
9. A performance fee should be consistent with the fund's investment objectives and should not create an incentive for the operator to take excessive risks and should not deny investors an adequate remuneration of the return from the risks taken on their behalf and previously accepted.	

Good practices identified in the 2004 report	Good practices identified in the 2016 report
10. 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, • what the calculation formula will be (including the description of the methods used to offset gains with past losses, if applicable).	GP3 The calculation of a performance fee should be verifiable and not open to the possibility of manipulation; in particular, the following items should be unambiguously determined: - how investment performance will be assessed (i.e. including or excluding subscription and redemption fees, etc.) - what reference benchmark will be used - what the calculation formula will be (including a description, if applicable, of the method for offsetting gains against past losses)
	GP3 The frequency for crystallising the performance fee and transferring the amount earned in such fees to the CIS operator should not be more than once a year, except when the CIS operator uses a fulcrum fee model. **Any benchmark to which the performance of the CIS is to be compared should be verifiable and provided by an independent party** **CIS operators should design calculation methods allowing for the performance fee to result in a value that is proportionate to the investment performance of the CIS.Calculation methods should not deny investors an adequate share of the return achieved from the risks taken on their behalf and previously accepted by them.**

Good practices identified in the 2004 report	Good practices identified in the 2016 report
	GP4 Where the calculation of the performance fee is based on the fulcrum fee model: ▪ **the calculation of the fee is compared to an appropriate benchmark and is based on the same benchmark used to determine excess performance;** ▪ **the fee increases or decreases proportionately with the investment performance of the CIS over a specified period of time; and** ▪ **the CIS's investment performance should be calculated on the CIS's net asset value, calculated net of costs.** **Where the performance of the CIS is not based on a fulcrum fee model but is measured with reference to a benchmark:** ▪ **calculation of the fee is based on the same benchmark used to determine excess performance;** ▪ **the excess performance is calculated net of costs.**
11. A performance fee should not result in a breach of the principle of equality of investors.	GP2 In any event, a performance fee should respect the principle of equitable treatment of investors.
12. 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.	GP5 It remains important for investors to 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.

Good practices identified in the 2004 report	Good practices identified in the 2016 report
	GP12 Regulators could define what is meant by transaction costs, taking account of other relevant definitions; alternatively, the regulator or the CIS operator could specify the types of payment that should not be charged to the assets of the CIS as a transaction cost, or indicate how the value and/or impact of transaction costs could be determined.
13. Some information on transaction costs should be disclosed to investors. This information will usually be incomplete. It should however never be misleading.	**GP13 Where transaction costs are deducted from CIS assets, the fact that the CIS may incur certain transaction costs should be disclosed to investors before they invest. For example, documents should be provided or made available that:** **(i) contain, to the extent known, a detailed description of the CIS's fees and expenses** **(ii) describe the types of cost that will be or may be charged as transaction costs.** **Where the actual amount of transaction costs is known to the CIS operator after the event, that amount (or the total of all such amounts charged in a specified period) could be disclosed to the CIS and its investors.** **Information about transaction costs should be provided in enough detail not to mislead investors by omission.**
14. Regulators also agree that soft commissions may create conflicts of interest for fund operators. Regulation should therefore seek to ensure that those conflicts are either eliminated or managed in the investors' best interests;	GP14 Because soft commission arrangements may create conflicts of interest for CIS operators, such conflicts should either be eliminated, or managed (e.g. through disclosure) in the best interests of investors.

Good practices identified in the 2004 report	Good practices identified in the 2016 report
	GP15 Transactions should be entered into for the benefit of the CIS and its investors and not to generate an order flow and/or dealing commission.
15. Transactions should always be executed in accordance with best execution principles. This implies that they be executed on market terms. - If hard commissions are not prohibited, hard commissions should not be a criterion when a Fund operator chooses an intermediary. If soft commissions are permitted, the soft commissions should not be the sole or primary criteria when a Fund operator chooses an intermediary. - Requirements to disclose information to the regulator may assist the regulator in evaluating whether best execution principles are complied with. 16. 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).	GP15 Transactions should always be executed in accordance with the principles of best execution, and the use of hard or soft commissions should not compromise the CIS operator's obligation in this regard. This implies transactions should be executed on market terms, where applicable. Requirements to disclose information to the regulator may assist the regulator in evaluating whether relevant best execution principles are complied with. If hard commissions are permitted, they should be for the exclusive benefit of the CIS, meaning that any hard commission should be paid either directly to the CIS or indirectly (e.g. through a reimbursement). Hard commissions should not be a criterion when a CIS operator chooses an intermediary to perform or arrange execution).
	GP16 If soft commission arrangements are permitted, they should not be the sole or a primary criterion when a CIS operator chooses an intermediary to perform or arrange execution..
17. 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.	GP19 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 CIS. **When a CIS invests substantially in other vehicles, the management costs of the investing CIS and the underlying CIS (including any management fees paid to affiliates) should be disclosed to investors.**

Good practices identified in the 2004 report	Good practices identified in the 2016 report
18. 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 Fund operator, 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). - 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	GP20 Conflicts of interest that arise because of investment in other funds should be avoided or mitigated. - Fee-sharing agreements, if permitted, should exclusively benefit the investing CIS and should not benefit the CIS operator, either directly or through a third party. - If the investing CIS invests in underlying funds managed by affiliated parties, this fact should be disclosed to investors and any subscription / redemption fees charged by the underlying fund should be waived (except for any part of those fees that are paid to the underlying fund to cover the costs of the subscription or redemption) - If the underlying fund is a multi-class CIS, the investing CIS should identify the classes in which it might wish to invest and, if they are similar in all other respects, invests in the class with the lowest-charging fee structure.
19. 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).	GP21 The existence of different share classes should not breach the principle of equal treatment of investors who invest, or have invested, in the same share class. Investors in the same class should bear the same fees and expenses that are reflected in the disclosed costs figure (TER or equivalent) for that class. Those fees and expenses should not be waived for only certain shareholders within a class. Differences in fees and expenses should be based on objective criteria disclosed in the prospectus (e.g. the amount of subscription)
20. No advantage should be provided to a share class that would result in a prejudice to another share class or to the fund.	GP21 No share class should benefit from an advantage that would result in prejudice to the interests of another share class or to the CIS as a whole.

Good practices identified in the 2004 report	Good practices identified in the 2016 report
	GP22 The CIS operator should not begin to deduct a new type of fee from the assets of a CIS, or increase its management fees, unless at a minimum the fee change is approved by the regulatory authority (in jurisdictions where the laws or regulations require it to do so) or by an appropriate person or entity (e.g. board of directors, specified independent governance process, etc.). **Regulators should require information disclosed to investors to be updated if an event occurs that changes the fees and expenses of a CIS. The way that this is done, and the urgency of the update, may depend on how material the change is.**
21. 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.	GP23 Requirements should aim to make current investors aware of changes to fees and expenses that have occurred. If those changes relate to a significant increase of management fees, appropriate actions by the CIS operator may include: ▪ **allowing investors a period of time (preferably one determined by a regulatory authority) between when notice is issued to investors about the changes and when those changes come into force** ▪ allowing investors to redeem their investment free of charge during the period of notice ▪ allowing investors to vote against approving the introduction of the change, where appropriate.
22. Requirements should also be defined for the start-up period of funds.	GP23 Requirements should also be defined for the initial period when a fund or share class starts up.