

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Securities Circular: 1/05

Securities Unit

17th June 2005

Unit Tel: (+356) 21441155

Unit Fax: (+356) 21449308

CIRCULAR TO CATEGORY 1 TO 4 INVESTMENT SERVICES LICENCE HOLDERS

Dear Licence Holder

Re: Performance Fees payable to Retail Fund Managers or Advisors

The purpose of this letter is to inform interested parties of MFSA's plans to introduce new standard licence conditions in Part C.II and Part C.III of the Investment Services Guidelines issued in terms of Section 6(2) of the Investment Services Act, 1994, relating to performance fees.

In this regard, it is proposed that all locally based licensed retail schemes subject to the standard licence conditions set out in Part C.II or Part C.III of the Investment Services Guidelines, and which charge performance fees over and above the management and any advisory fees, will be required to comply with the conditions set out in Annex 1 attached hereto.

The main purpose of the proposed new requirements is to ensure that the basis of calculation of performance fees is such as to align the economic interest of the fund manager or advisor, with that of the investor and above all, for this to be fair to investors. In drawing up the proposed new requirements, the MFSA has taken note of international regulatory developments and accepted practice concerning performance fees charged on retail schemes.

The MFSA would like to publish the proposed new requirements as soon as possible and would therefore appreciate if any comments in their regard, be submitted in writing as soon as possible and by not later than the 20th July 2005. Following, consideration of the feedback received, the MFSA will proceed to publish the new requirements. Once published, any existing schemes having a performance fee structure which is currently not in line with the new requirements, will be requested to submit to MFSA for its review and approval within two weeks from publication, proposed revisions to their prospectus to bring themselves in line.

Any queries in relation to the above should be addressed to Mr Robert Higgans or the undersigned. Please be guided accordingly.

Yours sincerely



Cristina Parlato Trigona
Director

Annex 1 – Proposed New Regulatory Requirements for Performance Fees in respect of retail schemes

1.0 In the case of a retail collective investment scheme, a performance fee may only be adopted on the following basis:

- a) the performance fee should be fair and reasonable. In determining the fairness of such fee, consideration should be made to the other applicable fees to a Scheme;
- b) the performance fee should be easy to understand and calculate;
- c) the performance fee should be clearly disclosed and explained to investors;
- d) the performance fee may only be payable in the form specified in condition 2.0.

2.0 Performance fees may be payable on:

- a) new high NAV per share over the life of the Scheme, where the starting price is the initial offer price or any other benchmark if this is higher *or*
- b) the out-performance of a relevant index

In case of (a) above, no performance fee shall be paid/accrued until the NAV per share exceeds the previous highest net asset value per share on which the performance fee was paid/accrued (if any), or the initial offer price or any other benchmark if this is higher (the “water mark”). The performance fee is only payable on the increase over the watermark.

In case of (b) above, the index must be relevant to the Scheme. The performance fee would only be payable on the amount by which the Scheme out performs the index and any underperformance of the index in preceding periods since launch, is recouped before a fee becomes due in subsequent periods.

3.0 The Prospectus should contain clear disclosure on the performance fee including:

- a) details on the calculation of the performance fee including the accrual basis and when the fee is actually paid, the calculation period for determining the fee and the first such period;
- b) a risk warning that the increase in NAV which is used as a basis for the calculation of performance fees, may be comprised both of realised gains as well as unrealised gains as at the end of the calculation period, and as a result, performance fees may be paid on unrealised gains which may subsequently never be realised by the scheme;
- c) details regarding any maximum amount or percentage of NAV that a performance fee might represent in any one accounting period and appropriate warnings in case where there is no maximum;
- d) worked examples showing the operation and impact of performance fees.

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- 4.0 The Scheme or its Manager or Administrator as applicable, should adopt appropriate controls and structures for the on-going supervision of the procedures and processes in the calculation and payment of performance fees.
- 5.0 The calculation of the performance fee should be verified by the custodian of the Scheme.