STANDARDS BOARD FOR ALTERNATIVE INVESTMENTS

Standardised Total Expense Ratio

STER

SBai Toolbox

1. Introduction

The management fees and additional expenses charged to investment funds have become an area of increasing investor and regulatory focus in recent years. Investors need to understand fees and charges to assess their impact on performance, compare different investment opportunities and to make well-informed investment decisions. Obviously, charges vary between different investment products (e.g. passive exchange traded funds vs. actively managed funds), and the after-fee performance is one of the most important aspects to consider.

Due to divergences in both market practice and disclosure, it can be difficult for investors to compare and contrast the categories and amount of expenses across alternative investment funds. In particular, challenges for investors can arise when costs are difficult to find or understand in offering documents, disclosure is limited in DDQs, and when the grouping / labelling of expenses in financial statements is inconsistent with offering documents.

The Alternative Investment Standards[1] require, in a fund's offering document, the disclosure of the commercial terms of a fund including the methodology used for calculating fees, the nature of any other expenses which may be payable or reimbursed by the fund to the manager, and the periodic fees payable to the fund's service providers. The actual fees and expenses should be disclosed in the fund's audited financial statement, allowing investors to readily compare fees and expenses charged with the description of such fees and expenses in the fund's offering document.

The Standards suggest considering disclosure of a total expense ratio, however the Standards do not provide guidance on that ratio's calculation. This SBAI Toolbox memo sets out the definition of a standardised methodology for calculating the expense ratio, which we have termed the Standardised Total Expense Ratio ("STER").

The STER methodology, developed by a working group of SBAI stakeholders[2], is focused on calculating a single, standardised expense ratio (per master and/or feeder fund) to enable better understanding, comparison and monitoring of structural fees and expenses of investment funds including enabling investors to undertake "apples for apples" comparisons across different funds. While this definition has been developed with alternative investment funds in mind, it equally can be applied to most types of investment funds.

Section 2 of this memo provides the definition of the STER, and section 3 provides an overview of existing standards, guidance and regulation in the area of fees and expenses.

The SBAI Toolbox is an additional aid to complement the SBAI's standard-setting activities. While alternative investment fund managers sign up to the Alternative Investment Standards on a comply-or-explain basis, the SBAI Toolbox materials serve as a guide only and are not formally part of the Standards or a prescriptive template.

---

[1] Standard 2.1 and 2.5 (see Appendix 1)

[2] See Appendix D for list of working group members

Managers, investors and securities regulators are encouraged to use the STER methodology.

2. Definition of Standardised Total Expense Ratio

This section introduces the calculation methodology of a total expense ratio for alternative investment funds. The STER is intended to be a means of providing a simple, consistent and transparent comparison of expenses among funds and their peer group.

The calculation methodology also includes a definition of the types of cost that are considered "pass-through" expenses[3] and accounts for payments for research bundled with dealing commissions (hereafter referred to as *soft dollared*[4] *research costs*).

The sum of these items should produce a STER that is comparable across all alternative investment funds – whether the manager deploys a pass-through expense model or not; whether the manager uses "hard" or "soft" dollars for research costs; and whether or not support services (i.e., middle/back office, technology, compliance, reporting, consulting) are internal or outsourced.

However, the STER does <u>not</u> account for performance fees, trading-related cost[5] and potential entry/exit/anti-dilution charges. Inclusion of these components would distort the STER calculation and make it more difficult to use it for cost monitoring and comparison purposes:

- Performance fees will vary significantly over time and differ by investor (as a function of the high watermark). Inclusion in the STER calculation would distort results and will prevent meaningful comparison across different funds
- Trading-related cost (excluding "soft" dollars) and financing costs are inherent components of a fund's investment strategy to enable the generation of returns and, therefore, are excluded. The impact of both will materialise in a fund's gross and net return
- One-off entry/exit charges are atypical for institutional mandates and cannot be accounted for in a rolling STER calculation. They should be reported separately to investors

Calculation Methodology

The STER is calculated by adding a fund's Management fee, Operating expenses, Pass-through expenses (PTE) and Research costs ("hard" and "soft" dollars) and then expressing this value as a percentage of the fund's average net assets.

$$\boldsymbol{STER = \frac{Total\ expenses}{Average\ net\ assets}}$$

$$with$$

$$Total\ Expenses = Management\ fee + Operating\ expenses + Compensation\ PTE + Other\ PTE + Direct\ research\ cost + Soft\ dollared\ research\ cost$$

[3] Pass-through expenses: costs that would normally be expected to be paid by the manager (and accordingly covered by the management fee)

[4] Soft dollars are benefits provided by a broker-dealer and paid for by brokerage commissions from financial transactions, in contrast to hard dollars (i.e., cash payments for research), which would be separately reported.

[5] Brokerage commissions (excluding "soft" dollared research cost), financing and stock loan fees, interest/dividend expenses, bank charges, transaction cost, taxes, etc.

- The STER can be calculated at the master fund level and/or for each feeder
  - When calculated at the master fund level, all feeder fund expenses need to be accounted for in the numerator
  - When calculated at the feeder fund level, the respective feeder fund expenses are directly allocated in full to each feeder fund and the master fund expenses are allocated pro rata (NAV-weighted) for each numerator category[6]
- The denominator is the average net assets of the master fund (or respective feeder fund) for the observation period
- The STER should be annualised for observation periods less than a year

Example 1: STER disclosure

Expenses are displayed on a fund-by-fund basis in basis points (bps), whereby each expense category has already been divided by the Average Net Assets.

Name of Fund/Name of Share Class	2016 Actual (in bps)
Management fee	150
Operating expenses	28
Compensation pass-through expenses	0
Other pass-through expenses	7
Direct research costs	0
Soft dollared research costs	9
STER	194 bps

Description of Inputs

Investors can source the information required for the STER calculation from the offering memorandum, the audited financial statements and directly from the manager:

- The Management fee can be sourced from the offering memorandum.
- Information included in the financial statements includes Operating expenses, Pass-through expenses and Direct research costs. In situations where only generic categories are available (such as “other expenses” and “professional fees”), a further breakdown is required from the fund administrator or manager.
- Information sourced from the manager should include Soft dollared research costs.

[6] Numerator categories: Management fee, Operating expenses, Compensation PTE, Other PTE, Direct research cost, Soft dollared research cost

1. Management Fee

If the STER is calculated at the feeder fund level/for a specific share class, the feeder fund management fee is used. If the STER is calculated at the master fund level, for simplicity reasons, the Management fee for the largest share class by AUM (i.e., not an average or blended rate) is used. This is sourced from the offering memorandum of the fund.

2. Operating expenses

Operating expenses **exclude** pass-through expenses (as defined below). Operating expenses include:

- Administration fees
- Audit fees
- Tax consulting fee for fund-specific taxation
- Legal expenses, such as for updating the fund offering memorandum (excludes deal-related legal costs)
- AIFMD depositary fees
- Custody fees7
- Organisational fees (fund formation costs)
- Independent directors' or trustee fees
- Insurance for fund directors
- Reasonable travel costs for the fund directors to attend board meetings
- Corporate secretarial costs
- Regulatory registration fees related to fund and investments
- Fund specific reporting fees (HSR, 13G, 13F)

3. Pass-Through Expenses

For purposes of the STER, Pass-Through Expenses are charges that would normally be expected to be paid by the manager (and accordingly covered by the management fee charged). Pass-Through Expenses that generally would be thought of as manager expenses can be categorized as (1) compensation pass-through expenses and (2) other pass-through expenses; however, they ought to be reviewed closely for both appropriate disclosure as well as actual amounts charged to the fund.

a) **Compensation Pass-Through Expenses**: Generally, salaries, benefits and bonuses are borne by the management company and paid out of the firm's management fee income (and deemed to be funded via the management fee and performance fee). However, a small number of managers charge these types of costs to the funds under what is known as a "trader compensation" model. These managers normally operate multi-portfolio manager models, where each trader/trading group is paid on their own performance; thus, they are ensured a pay-out, even if the fund as a whole loses money and does not generate any performance fee. The managers argue that this pass-through structure gives them an edge in recruiting the best talent, as traders know they will always get paid. Among the best known exponents of this model are some high-profile managers who charge 0% management fee and 100% expense pass-through, while other managers within this peer group have variants of this, or sometimes just high management and performance fees per se. Compensation pass-through expenses continue to be the exception in the industry.
b) Examples of **Other Pass-Through Expenses** include:
   - Systems costs, such as order management system, portfolio management system, accounting system, data warehouse, risk system, compliance monitoring system, reconciliation tool, confirmation/affirmation matching tool
   - Outsourcing costs (Middle Office, Back Office, IT consultant, Compliance consultant)

[7] Custody fees do not usually arise as an expense item which is directly charged to funds in situations where assets are held with prime brokers. However, where funds hold securities in segregated custody accounts (e.g. "long-only" investment funds) and custody fees are directly charged to the fund, this expense should be included in STER calculations.

- Controls reports, such as SSAE 16 or ISAE 3402
- Litigation (excluding deal-related litigation), regulatory fines, indemnification and other extraordinary costs
- Reporting costs, including risk reporting (e.g., Form PF, AIFMD Annex IV, CPO-PQR; costs might include third party consultants, auditors, and software)
- Travel costs (excluding research-related travel, as this is included in the "Direct research costs" category below). It would be unusual to see other travel costs, such as marketing-related travel, charged to the fund
- Marketing and promotional costs
- Business insurance (E&O, PI)

4. Direct Research Costs

This refers to research paid for using hard dollars. Examples include: data services, pricing feeds, subscriptions to periodicals, research-related travel, expert networks and broker/sell-side research. This is not consistently disclosed as a separate line item in financial statements.

5. "Soft Dollared" Research Costs

This refers to research paid for using trade commissions. In addition to research reports, some jurisdictions also permit soft dollars to pay for expenses such as Bloomberg, order management systems and expert network costs.

There often is judgement involved in determining soft dollars – the SEC's strict definition is that any commissions paid above execution rates relate to soft dollars (including broker research)[8] whereas some managers only consider items paid for with soft dollar credits[9] as soft dollar costs.

"Soft dollared" research costs are not readily identifiable by investors without assistance from the manager, as they are hidden within dealing commissions, and this may in turn be hidden within the realised and unrealised gains and losses disclosures in financial statements.

6. Exclusions from the STER

Costs specifically excluded from the STER include:

- Interest expense
- Dividend expense
- Performance fees
- Commissions or brokerage fees (excluding soft dollar commissions)
- Stock loan fees
- Transaction taxes (stamp duty, income tax, withholding tax)

---

[8] Section 28(e) of the Securities Exchange Act of 1934, as amended (15 U.S.C. § 78bb(e)), establishes a safe harbor for money managers who use client funds to purchase brokerage and research services for their managed accounts. Under Section 28(e), a money manager is protected from liability for a breach of fiduciary duty solely on the basis of having paid more than the lowest commission rate for "brokerage and research services provided by a broker-dealer," the manager determines in good faith that the amount of the commission is reasonable in relation to the value of such services. Client commissions utilized to pay for brokerage and research often are referred to as "soft dollars." As fiduciaries, money managers are obligated to act in the best interest of their clients, and cannot use client commissions or other assets to benefit themselves, absent client consent. Money managers who obtain research services with soft dollars are not paying for those services with their own funds, which benefits the money manager and creates a conflict of interest in selection the broker-dealer(s) to execute the clients' trades. Section 28(e) addresses this conflict by permitting money managers to pay more than the lowest commission rate (sometimes referred to as "paying up") to obtain brokerage and research services, so long as they make a good faith determination regarding the reasonableness of commissions paid. (Source: Proskauer: Client Commission (Soft Dollar) Arrangements: The Section 28(e) Safe Harbor).

[9] The broker accrues soft dollars (paid through trading commissions) in an account from which invoiced research (by the broker and others) is paid.

- Transaction-linked legal costs
- Entry/exit commissions or fees paid directly by the investor
- Bank charges

Disclosure of the STER

It is recommended that the STER be calculated on a quarterly basis. Whether calculated by the manager or the administrator[10], the STER and its constituent parts (as per Example 1) should be disclosed to investors in the DDQ and in regular reporting, such as the newsletter.

Disclosure of the STER in the audited financial statements may be confusing due to the existence of a different expense ratio already included in the financial highlights note for funds which use US GAAP.[11] The STER differs from the financial highlights expense ratio, as the financial highlights expense ratio generally includes all expenses including trading expenses and financing cost while the STER excludes trading expenses and financing costs.

To assist investors in their verification of the STER during the due diligence process, managers should include disclosure of soft dollar costs in the audited financial statements via a soft dollars note. This should disclose the total soft dollar cost, a description of the types of expenses paid for through soft dollar credits and soft dollar costs that are inherent in higher-than-execution commission rates but not paid for using soft dollar credits.

It is important to highlight that the STER cannot be used in conjunction with gross performance (e.g., subtracting STER from gross performance to calculate net performance before performance fees) since "soft dollared" expenses are already accounted for in the gross performance (i.e., lowering gross performance by the amount of soft dollar expenses) and also included in the STER.

3. Overview of Existing Standards, Guidance and Regulation

The topic of disclosure of fees and expenses is not new and the Standards Board for Alternative Investments (SBAI) covers this area in detail (see Appendix A: Alternative Investment Standards – Commercial Terms). For example, Standard 2.5 covers the disclosure of fees and expenses in the fund's annual report, ensuring comparability to the fees and expenses set out in the fund's offering document. The Guidance to Standard 2.5 also references disclosure of a Total Expense Ratio (TER), or gross versus net return; however, no detailed definition of the calculation of the TER is provided.

In most jurisdictions, regulation of asset management activities and prospectus disclosures usually includes general requirements for the disclosure of fees and expenses. In some jurisdictions, the regulation of mutual (retail) funds includes more prescriptive requirements in relation to the eligible fees that can be charged and the format of disclosure of such fees. Appendix B provides an overview of regulatory requirements in major jurisdictions in relation to fees and expenses.

In the *United States*, for example, most fund managers are registered as investment advisers with the US Securities and Exchange Commission (SEC) pursuant to the Investment Advisers Act of 1940 (IAA or '40 Act). The SEC takes the position that registered investment advisers owe a fiduciary duty to their investors, which requires the full and accurate disclosure of all fees and expenses charged by the investment advisers. Failing to

---

[10] Fund Administrators usually will not be able to independently verify the Soft Dollared Research Cost.

[11] See FASB ASC 946-205-50: Non-Registered Investment Partnership – Financial Highlights. For the US GAAP financial highlights expense ratio, the determination of expenses should follow the presentation of expenses in the fund's statement of operations. It includes performance fees (broken out as before and after), and would include any trading expenses and financing costs that are included in the operating expenses on the Statement of Operations (P&L). Management fees are included. Realized and unrealized losses are not included in the expense ratio.

do so also may constitute securities fraud by making “any untrue statement of a material fact or omit[ting] to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading.” In addition, Form N-1A (item 3), which generally is used by mutual funds to file registration statements (e.g., prospectuses) with the SEC, includes an overview of fees and expenses of the fund. It also includes one-off shareholder fees (such as sales charges and redemption fees) and ongoing fund operating expenses payable each year (including management fees, distribution fees and other expenses). Appendix C.1 includes a detailed overview of the items included in the Form N-1A Filing.

In the *European Union*, the **Alternative Investment Fund Managers Directive (AIFMD)** requires a description of all fees, charges and expenses and the maximum amounts thereof which are directly or indirectly borne by investors. In addition, the **Undertakings for Collective Investments in Transferable Securities (UCITS)**, which provides a single European regulatory framework for (retail) investment funds, provides for fee disclosure to investors via a succinct Key Investor Information Document (KIID), allowing investors to compare investment funds via a common format.

Table 1: UCITS Fee disclosure in the Key Investor Information Document (KIID)[12]

One-off charges taken before or after you invest		
Entry Charge	[]%	The entry and exit charges shown are maximum figures. In some cases you might pay less – you can find this out from your financial advisor.
Exit Charge	[]%	
Charges taken from the fund over a year		
Ongoing Charges[13]	[]%	The Ongoing Charges figure is based on expenses for the year ending []. This figure may vary from year to year. It excludes: Performance Fees and portfolio transaction cost[14]. For more information about charges, please [see pages x to x / section x] of the fund’s prospectus, which is available at [web address].
One-off charges taken before or after you invest		
Performance Fee	[]% a year of any returns the fund achieves above the benchmark for these fees [insert name of benchmark]	

In addition, in the EU, the **Packaged Retail and Insurance-based Investment Products (PRIIPs)** regulation seeks to help (retail) investors better understand and compare key features of packaged retail investment products, including product details, performance and costs. The cost disclosure includes one-off cost (e.g. entry-/exit-fees/anti-dilution levies), recurring cost (ongoing portfolio management cost, actual transaction cost (incl. market impact, charges, commissions, taxes)).[15] It is important to highlight

[12] Source: Investment Association template for a KIID: http://www.theinvestmentassociation.org//assets/files/consumers/2015SampleKIID.pdf . The table originates from CESR’s template for the Key Investor information document (CESR/10-1321). Also see FCA Handbook: COLL 4.7 Investor information and marketing communication: https://www.handbook.fca.org.uk/handbook/COLL/4/7.html

[13] Formerly known as Total Expense Ratio (TER)

[14] Except in the case of an entry/exit charge paid by the UCITS when buying or selling units in another collective investment undertaking.

[15] See PRIIPs Regulation: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1286&from=EN, the European Fund and Asset Management Association (EFAMA) has published a PRIIPs information exchange template: https://www.efama.org/Pages/European-PRIIPs-Information-Exchange-Templates.aspx

that the STER presented in this memo does not incorporate one-off cost and transactional cost (except for payments for research bundled with commissions).

In the *United Kingdom*, some non-UCITS funds (e.g., property funds) provide (retail) investors with either a KIID, a Simplified Prospectus or a Key Features Document. The Simplified Prospectus will show the annual cost of operation of the fund as a Total Expense Ratio (TER), which corresponds to the Ongoing Charges plus Performance Fees paid in the previous year in the UCITS framework. It is important to observe that the inclusion of the Performance Fee in the TER calculation can make comparison between funds more difficult – a fund which has performed well in the previous year (and thereby paid performance fees to the manager) might look more expensive than a fund which has not performed well. Therefore, the separate disclosure of Ongoing Charges and Performance Fees is preferable for comparison purposes.

The United **Kingdom's Local Government Pension Scheme Advisory Board (LGPS Advisory Board)**, which has been set up to encourage best practice, increase transparency and coordinate technical standards for LGPS, has developed a voluntary **Code of Transparency** for asset managers to further investment fee transparency and consistency. This Code enables LGPS funds to report costs to the LGPS Advisory Board. The Code includes a template for completion by asset managers to report costs and expenses for segregated portfolio management and pooled funds. In addition to consistent disclosure of management/ongoing fees, performance fees, transaction costs (incl. broker commissions), indirect fees and ancillary services charges, the template also provides historic gross and net performance for multiple observation periods and asset turnover (% p.a.).[16]

In order to help retail investors better understand the key features of certain investment products, the *Hong Kong* Securities and Futures Commission (SFC) has developed a **Product Key Facts Statement (KFS)**[17] which sets out, among other things, the dealing charges (subscription, switching and redemption fees), ongoing charges (management, custodian, performance and administration fees) and other fees payable by the fund (see details in Appendix C.3).

In *Singapore*, the Investment Management Association of Singapore (IMAS) published **Guidelines for the Disclosure of Expense Ratios** in 2005 (more details are available in Appendix C.4)[18]. The framework requires the disclosure of two separate expense ratios, one including and the other excluding the performance fee from the calculation.

This overview shows that there are many different methodologies and approaches to calculating and disclosing fund expenses, with usually more prescriptive regulatory disclosure requirements where funds are offered to retail investors (e.g., UCITS, '40 Act, Hong Kong SFC KFS). Some frameworks (PRIIPs, LGPS Code of Transparency) include trading-related expense items (such as brokerage expenses) and PRIIPs also includes market impact.

In the context of MiFID II, the separation of payments for research will result in such payments becoming an explicit expense to the fund (in such cases research cost is borne by the client/fund), thereby becoming an item to be accounted for in the Ongoing Charge[19] and the Total Expense Ratio calculations.

[16] Local Government Pension Scheme Code of Transparency: http://www.lgpsboard.org/index.php/the-template

[17] Hong Kong SFC Product Key Facts:
http://www.sfc.hk/web/EN/files/PCIP/KFS/20141216%20KFS%20template%20of%20General%20Fund%20(Eng)(Clean).pdf

[18] IMAS Guidelines:
http://www.imas.org.sg/uploads/media/2012/10/25/19_200505_-_IMAS_Revised_Guidelines_on_Expense_Ratio.pdf

[19] In the UCITS KIID

Appendix A

Alternative Investment Standards – Commercial Terms

The disclosure of commercial terms is covered by the Alternative Investment Standards (Standard 2.1), covering the disclosure of methodologies for calculation of base management fees, performance fees, expenses payable by the fund to the manager, periodic fees to service providers, and other material fees payable by the fund. In addition, Standard 2.2 covers dealing with material changes to fees and expenses payable by the fund to the manager (investor consent or ability to redeem prior to changes taking effect). Standard 2.5 covers the disclosure of fees and expenses in the fund's annual report, ensuring comparability with the fees and expenses set out in the fund's offering document. The Guidance to Standard 2.5 also references disclosure of a Total Expense Ratio (TER) or gross versus net return.

Alternative Investment Standards – Commercial Terms

Standard 2.1

The commercial terms applicable to the relevant interest being offered in a particular fund should be disclosed in the fund's offering documents in sufficient detail and with sufficient prominence (taking into account the identity and sophistication of potential investors).

The SBAI envisages that in most circumstances such disclosure would, amongst other things, include:

Fees and expenses

- fair disclosure of the methodology used to calculate performance fees;
- details of any other remuneration received by the manager in connection with its management of the fund (this will be relevant, for example, where a fund is a "feeder" fund into another fund managed by the same manager);
- the basis of calculation for any base management fee and details of the nature of any expenses which may be payable or reimbursed by the fund to the manager;
- to the extent possible, the amount of, and/or method of calculating, the periodic fees payable to the fund's other service providers;
- to the extent known, a description of other material fees, costs, and charges which will be payable by the fund;
- if applicable, the fact that the fees and expenses payable to service providers may change.

(…)

Standard 2.2

Changes to the fees and expenses payable by the fund to the manager or parties related to the manager, or the redemption rights available to investors which the fund governing body considers to be materially adverse to investors should not be effected without either (a) obtaining investor consent in accordance with the provisions relating to shareholder voting/consent/approvals contained in the fund's constitution or offering documents, or (b) providing advance notice sufficient for investors to redeem prior to the effective date of the changes without penalty.

Standard 2.5

The fees and expenses (including but not limited to management and performance fees) charged to the fund should be disclosed in the fund's audited financial statements. This includes explanations in *the annual report which allow investors to compare, readily, the fees and expenses charged with the description of such fees and expenses set out in the fund's offering documents where this is not obvious from the disclosure in the financial statements.*

For example, the categories and captions in the fund's financial statements might correspond to those used in the fund's offering documents so that they can be easily compared.

Managers might also consider disclosure of a total expense ratio (TER) or gross vs. net return for the period under review.

Standard 2.6

On the establishment of a fund, a fund manager should liaise with the fund's administrator to ensure that the methodology for calculating fees payable to the manager (and in particular performance fees) is agreed in advance. Such methodology should be accurately described in the fund's offering documents.

Appendix B

Regulatory requirements in relation to fees and expenses

Asset management regulation around the globe deals with the disclosure of fees and expenses charged to the fund in different ways.

The spectrum of approaches ranges from pure disclosure-based approaches (e.g., description of all fees, charges and expenses) to more detailed requirements (for example, regarding the calculation method/crystallisation of performance fees[20]).

Examples of regulatory requirements[21]

Jurisdiction	Summary of legislation/principles
Australia	Regulatory Guide RG 97: Disclosing fees and cost in Product Disclosure Statements (PDSs) and periodic statements
Bermuda	Bermuda's AIFM regime currently pending (11-2016). The requirements will be identical to those imposed by Article 23(1)(i) of the AIFMD. • Section 38(p) of the Investment Business (Alternative Investment Fund Managers) Rules 2016 (the "AIFM Rules") states that an AIFM must make available to AIF investors "a description of all fees, charges and expenses and of the maximum amounts thereof which are directly or indirectly borne by investors". In the case of other funds (i.e., non AIFs), there is a general disclosure obligation within the Investment Funds Act 2006 (the "IFA") regime: • In particular, section 7 of the Fund Prospectus Rules 2007 (made pursuant to section 38 of the IFA) ["Additional Information"], states that "The operator of a fund shall also include in the prospectus any other material information which is within its knowledge or which it can obtain by making reasonable enquiries,

[20] E.g. Monetary Authority of Singapore (MAS), Code on Collective Investments, Section 3.6

[21] Non-exhaustive list of examples. It is recommended to refer to the original legal texts/documents for further analysis.

Jurisdiction	Summary of legislation/principles
	being information which investors would reasonably require for the purpose of making an informed judgment about the merits of investing in the fund." • It is the regulator's position that investors require information on fees / expenses to be able to make an "informed judgment on the merits of investing" in a fund – thereby establishing an obligation for such information to be disclosed to investors in a fund's prospectus.
Canada	**Public alternative funds in Canada** are basically subject to the same rules as other investment funds with regards to the regulation of fees and expenses. Key aspects: • For the offering document (i.e., the prospectus), alternative funds have to file a prospectus that complies with the provisions of Regulation 41-101 respecting general prospectus requirements. − The format is prescribed in *Form 41-101F2 – Information Required in an Investment Fund Prospectus*. Information on fees must be disclosed in the summary of the prospectus (item 3 of 41-101F2) and there must be a section dedicated to the fees and expenses of the fund (item 10 of 41-101F2). − *Note: The prospectus requirements for alternative funds are currently under review (11-20116) in the CSA's current consultation on alternative funds.* • Continuous disclosure: Alternative funds have to comply with Regulation 81-106 respecting investment fund continuous disclosure: Disclosure of detailed information about their fees in the annual and interim financial statements (part 3 of Regulation 81-106) and in the annual and interim Management Report of Fund Performance (item 3 of part B of Form 81-106F1 of Regulation 81-106) • Incentive fees: Compliance with the provisions of Part 7 of Regulation 81-102 regarding investment funds (also includes provisions that cover fee increases in part 5) • Conflicts of interests: Regulation 81-107 (independent review committees for investment funds) covers conflicts of interests related to fees and expenses paid by a fund to its investment fund manager and other related parties • Sales practices and incentives in the sales of alternative funds: Dealers and members of the fund organization must comply with the provisions of Regulation 81-105 respecting mutual fund sales practices • Fees of dealers: Regulation 31-103 (registration requirements, exemptions and ongoing registrant obligations) includes detailed requirements relating to the disclosure of dealer fees and other compensation (part 14 of Regulation 31-103). *Note: The Canadian regulators are currently examining embedded compensation in mutual funds (see notice issued on June 29, 2016 regarding launch of a consultation on the option to discontinue embedded commissions for investment fund products)* **Alternative funds that are sold to accredited investors** and that are not reporting issuers (private funds) have to comply with certain provisions of Regulation 81-106, among other things, the provisions related to the detailed disclosure of fees and expenses in their financial statements (part 3 of Regulation 81-106).
European Union	Alternative Investment Fund Managers Directive: Article 23 (Disclosure to investors): (…) for each alternative investment fund (…) (i) A description of all fees, charges and expenses and of the maximum amounts thereof which are directly or indirectly borne by investors; (…)
	Undertakings for Collective Investments in Transferable Securities (UCITS): Article 78: Key Investor Information: (…)

Jurisdiction	Summary of legislation/principles
	(d) costs and associated charges; (…)
	Markets in Financial Instruments Directive II (MiFID II) (application date: 3 January 2018) • Abolishment of the bundling of payments for research with dealing commissions • Managers either have to pay for research (as an expense to the management company) or set up research payment accounts (RPA) for each client/fund • Applicable to asset managers authorised in the European Union to provide investment advice and portfolio management for Alternative Investment Funds (AIFs) and/or UCITS (within the definition of a MiFID investment firm) *Observation: The MiFID II approach is likely to be included in the AIFM and UCITS Directives when they are next revised in 2019.*
Hong Kong	Fund Manager Code of Conduct ("FMCC") (Paragraph 8 on Fees and Expenses) (a) Disclosure of Charges Paragraph 8.1 of the FMCC provides that a licensed fund manager should disclose to the client the basis and amount of its fees and charges. (b) Fair and Reasonable Charges Paragraph 8.2 of the FMCC provides that all charges, fees and mark-ups affecting a client should be fair and reasonable in the circumstances, and be characterized by good faith. In connection with mark-ups levied on transactions on behalf of a client, where the licensed fund manager is: i. acting as agent, such mark-ups are prohibited; ii. acting as principal, the circumstances should be disclosed in the client agreement and transactions reported in periodic statements. **Observations:** • The requirements on fees and charges apply to SFC-licensed fund managers only. • The SFC does not directly regulate funds which are not authorised for distribution to the public. • There are separate requirements relating to cash rebates and soft commissions (e.g. paragraph 8.3).
	The Product Key Facts Statement (KFS) sets out the disclosure requirements for investment products marketed to the public in Hong Kong, including fees and charges. See Appendix C.3 for an overview of fee and expense related disclosures.
International Organization for Securities Commissions (IOSCO)	IOSCO Final report on Good Practice for Fees and Expenses of Collective Investment Schemes (CIS) **Chapter II: Fees and Expenses for Operating A Collective Investment Scheme (CIS)** • Good Practice 1: Regulators may decide to specify, or give guidance on, fees and expenses that cannot be deducted from the assets of the CIS (…) • 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 objective of the CIS and should not create an incentive (…) to take excessive risk (…) • Good Practice 4: Principles covering the calculation of performance fees under different methods (…) • Good Practice 5: Adequate information for investors on the existence of performance fees and their potential impact on returns

Jurisdiction	Summary of legislation/principles
	Chapter III: Disclosing Fees and Expenses • Good Practice 6: Adequate disclosure of fees and expenses to existing and prospective investors • Good Practice 7: (…) information should be delivered using a *standardised fee table* that discloses the Total Expense Ratio (TER) of the CIS or a comparable calculation (…) • Good Practice 8: Enabling investors to understand the impact of fees and expenses on the performance of the CIS (…) and a description of cost structure (e.g. the management fee and operational costs such as custody fees) • Good Practice 9: Historical and forward-looking information on fees and expenses • Good Practice 10: Enabling comparison of fees and expenses between different CIS • (…) **Chapter IV: Transaction-based Fees and Expenses** • Good Practice 12: Regulators could define what is meant by transaction cost, (…) alternatively, the regulator could specify the types of payment that should not be charged to the assets of a CIS (…) • Good Practice 13: (…) the fact that Transaction costs are incurred should be disclosed to investors (incl. to the extent known) a detailed description of the CIS's fees and expenses (…) • 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 interest of investors • Good Practice 15: Transactions should be entered into for the benefit of the CIS and its investors (…) • Good Practice 16: If soft commission arrangements are permitted, they should not be the sole or primary criterion when a CIS operator chooses an intermediary to perform or arrange execution • (…) • Good Practice 17: Disclosure of hard and soft commission arrangements to investors **Chapter V: Other Issues** Areas covered include CIS that invest in other vehicles (incl. fund of funds), disclosure of synthetic TER for double fee structures, conflict of interest avoidance, disclosure of other share classes for multi-share class CIS, changes to fees and expenses

Jurisdiction	Summary of legislation/principles
Singapore	A hedge fund can be classified as an open-ended or closed-ended fund. An investment in a hedge fund can be classified as a collective investment scheme (CIS) if the fund is an open-ended fund. A hedge fund that is a CIS and is offered to retail investors as an authorized CIS is subject to the Code on Collective Investments (CIS Code). **Chapter 1: Interpretation**: d) Expense Ratio (reference to the guidelines issued by the Investment Management Association of Singapore) Chapter 3: The Manager • *Notification of significant changes:* 3.2 (d)(iii) notification to authorities of significant changes, which includes an increase in any other fees or charges payable by the scheme that are substantial (…) • *Performance Fees:* 3.6 sets out the requirements for performance fees (calculation method, crystallization, disclosure) • *Reports:* 5.2. i) Expense ratio disclosure • In Appendix 3 of the CIS Code, there is a requirement under para 7.12 to disclose the fees and charges payable in all marketing materials: *Marketing material:* 7.12 All marketing material for a single hedge fund or FOHF should state: a) the fees and charges payable… In relation to CIS, Section IX in the Third Schedule of the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 also sets out the requirements for fees and charges of the hedge fund to be disclosed when preparing the prospectus of a CIS.
USA	Investment Advisors Act of 1940 (last amendments approved on January 3, 2012) Investment Advisory Contracts (Sec. 205) • Sec. 205(a)(1) generally restricts an investment advisor from entering into, extending, renewing or performing any investment advisory contract that provides for compensation to the adviser based on a share of capital gains on, or capital appreciation of, the funds of a client [Congress restricted these compensation arrangements (performance fees) in 1940 to protect advisory clients from arrangements it believed might encourage advisors to take undue risk with client funds to increase advisory fees.] • Sec. 205(e) authorises the Commission to exempt from the performance fee prohibition advisory contracts with persons with sufficient financial sophistication, net worth etc.
	Investment Company Act of 1940: Form N-1A (item 3), which is generally used by mutual funds to file registration statements (e.g. prospectuses) with the SEC, includes an overview of fees and expenses of the fund. It includes one-off Shareholder fees (such as sales charges and redemption fees) and ongoing fund operating expenses payable each year (including management fees, distribution fees, other expenses). Appendix C.1 includes a detailed overview of the items included in the Form N-1A Filing.
USA – California Alternative Investment Fee	Disclosure of fees paid by California public pension and retirement systems ("PPPs") to private equity funds, venture funds, hedge funds, absolute return funds (effective 01 Jan 2017). Areas covered: i. fees paid by the PPP to the fund, the manager or related parties ii. PPP's pro-rated share of fees paid from the fund to the manager and related parties iii. PPP's pro-rated share of carried interest iv. PPP's pro-rated share of aggregate fees and expenses paid by all of the portfolio companies held by the fund to the fund manager or related parties

Jurisdiction	Summary of legislation/principles
Disclosure Bill [22]	v. Information required under California Public Records Act (CPRA) Fee disclosures in raw US$, not percentages, at least annual disclosure by funds, claw-back provisions are not explicitly accounted for. *The Alternative Investment Fee Disclosure Bill stands out in that it requires public retirement systems to disclose the fees paid to alternative investment fund managers, in turn requiring the relevant managers to make all the relevant information (absolute amounts) available to investors on a per individual investor basis rather than in aggregate terms (e.g. per share class).*

[22] Summary: https://corpgov.law.harvard.edu/2016/10/03/californias-new-fee-disclosure-law-for-public-pension-plans-investing-in-alternative-investment-vehicles/

Appendix C:
Examples of standardised fee tables for mutual funds[23]

1. US SEC: Form N-1A (item 3)

Form N-1A is generally used by mutual funds to file registration statements (e.g. prospectuses) with the U.S. Securities and Exchange Commission. Included below is an overview of the information requirements in relation to fees and expenses of the fund.

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 discounts 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	_____%

23

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:	$	$	$	$
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

2. European Union: Undertakings for Collective Investment in Transferable Securities (UCITS) Key Investor Information Document[24]

One-off charges taken before or after you invest		
Entry Charge Exit Charge	[]% []%	The entry and exit charges shown are maximum figures. In some cases you might pay less – you can find this out from your financial advisor.
Charges taken from the fund over a year		
Ongoing Charges[25]	[]%	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 cost26. For more information about charges, please [see pages x to x / section x] of the fund's prospectus, which is available at [web address].
Charges taken from the fund under certain conditions		
Performance Fee	[]% a year of any returns the fund achieves above the benchmark for these fees [insert name of benchmark]	

3. Hong Kong SFC: Key Fact Statement (KFS)

The KFS sets out the disclosure requirements for a range of investment products marketed to the public in Hong Kong, namely funds, investment-linked assurance schemes (ILAS) and unlisted structured investment products.[27] Included below is the summary of the disclosure requirements in relation to fees and expenses, the full sample KFS for general funds is available here.

[24] Source: Investment Association template for a KIID: http://www.theinvestmentassociation.org//assets/files/consumers/2015SampleKIID.pdf . The table originates from CESR's template for the Key Investor information document (CESR/10-1321). Also see FCA Handbook: COLL 4.7 Investor information and marketing communication: https://www.handbook.fca.org.uk/handbook/COLL/4/7.html

[25] Formerly known as Total Expense Ratio (TER)

[26] Except in the case of an entry/exit charge paid by the UCITS when buying or selling units in another collective investment undertaking.

[27] An overview of the different KFS for different product types is available at http://www.sfc.hk/web/EN/regulatory-functions/products/product-authorization/products-key-facts-statements.html

Charges payable when dealing in the units of the fund:

- Subscription fee
- Switching fee
- Redemption fee

Note: If there are other fees that investors have to pay when dealing in units of the fund have to be disclosed as well.

Ongoing fees payable by the fund:

- Management fee
- Custodian fee
- Performance fee (incl. computational basis)
- Administration fee

Note: Other ongoing fees need to be disclosed.

4. Investment Management Association of Singapore (IMAS) Guidelines for the Disclosure of Expense Ratios[28]

$$Expense\ Ratio\ (\%) = \frac{Total\ Operating\ Expenses}{Average\ Net\ Asset\ Value} * 100$$

Notes:

- To be calculated for preceding 12 months
- Expense ratio to be annualised for funds that have been in existence for less than a year. Formula:

$$\frac{Total\ Operating\ Expenses * \frac{365}{N}}{Average\ NAV} * 100\%$$

N= Number of days in period post its fixed offer
Average NAV= Average Net Asset Value during that Period

- Operating Expenses:
  - Management fee
  - Trustee fee
  - Administration fee
  - Accounting and Valuation fees
  - Custodian, sub-custodian and depository fees
  - Registrar fees
  - Legal and professional fees
  - Printing and distribution fees
  - Audit fee
  - Amortised expenses
  - Performance fee
  - Goods and Service Tax (GST) on expenses

- The following expenses may be excluded from the computation of the expense ratio:
  - Interest expense
  - Brokerage and other transaction costs associated with the purchase and sales of investments (such as registrar charges and remittance fees)

[28] IMAS Guidelines: http://www.imas.org.sg/uploads/media/2012/10/25/19_200505_-_IMAS_Revised_Guidelines_on_Expense_Ratio.pdf

- Foreign exchange gains and losses of the fund, whether realised or unrealised
- Tax deducted at source or arising on income received, including withholding tax
- Front end loads, back end loads and other costs arising on the purchase or sale of a foreign unit trust or mutual fund, including any costs arising where a Singapore feeder fund invests into an off-shore parent-fund. Such expenses would generally be capitalised into the cost of the investment and will subsequently be reflected as a diminution in net asset value when the investment is first marked to market after purchase
- Dividends and other distributions paid to unit-holders

- Certain funds may include a performance-related fee payable to the fund managers. If a performance-related fee is paid to the portfolio manager, both
  - The expense ratio excluding this remuneration, and
  - The expense ratio including this remuneration should be disclosed

- For funds with several classes of units and where there are class specific expenses, such as different management fee structures, a separate expense ratio must be calculated for each class of unit

- Average net asset value is defined as the average of net asset value computed based on all valuation days of the fund for the period of the ratio. Semi-annual reports or annual reports should use the 12 month ended on the reporting date

Appendix D
Working Group Members

Name	Title	Entity
Joshua Barlow	Head of Accounting & Operational Due Diligence	PAAMCO
John-Allan Dacres	Director, External Portfolio Management – Public Markets	Caisse de dépôt et placement du Québec
Brad Gilbert	Director, Hedge Funds	Teacher Retirement System of Texas
Christophe Juhem	Executive Director, Head of Operational Due Diligence, Cross Asset Solutions	Unigestion
Daniel Leader	Head of Fund Accounting and Valuation, Senior Vice President	Winton Capital
Angela Borrett, Jose Jimenez	Due Diligence Analyst Due Diligence Analyst	Albourne Partners
John Richardson	Chief Operating Officer and General Counsel	Ionic Capital Management
Sherri Rossoff	Managing Director	The Rock Creek Group