

November 2016

QUESTIONS & ANSWERS

CHANGE TO PERFORMANCE FEES

From 1 January 2017 we will be making changes to the way that we calculate performance fees on the **Threadneedle UK Extended Alpha Fund** and the **Threadneedle UK Absolute Alpha Fund**. This document aims to answer some of the questions you may have relating to these changes. A glossary of terms used within this document is included in Appendix 1.

Q. What changes are you making to the Funds?

We are changing the way performance fees are calculated on two of our funds:

I. Threadneedle UK Extended Alpha Fund – addition of *Excess Return* test

Currently, a performance fee is payable on the Threadneedle UK Extended Alpha Fund when the *Share Class Return* exceeds the performance of the FTSE All-Share Index (with income reinvested) by more than 2% over a *Performance Period* (typically a calendar year).

From 1 January 2017, an additional condition – an *Excess Return* test – will be applied to ensure that a performance fee will not be applicable unless any *Underperformance* from 2016 or future years has been recovered in full.

II. Threadneedle UK Absolute Alpha Fund – change to *Performance Benchmark*

Currently, a performance fee is payable on the Threadneedle UK Absolute Alpha Fund when a *Share Class Return* exceeds the return from cash, measured as the Sterling 3-month London Inter-Bank Offered Rate with income reinvested (the “*Performance Benchmark*”), over a *Performance Period* (typically a calendar year).

From 1 January 2017, the *Performance Benchmark* will be amended to be the greater of either the Sterling 3-month London Inter-Bank Offered Rate with income reinvested, or 0%.

Q: Are any other funds affected by the changes?

No. The changes specified will apply to all share classes of the following funds to which performance fees are applicable:

- Threadneedle UK Extended Alpha Fund
- Threadneedle UK Absolute Alpha Fund

Q: Why are you making the changes?

We are making these changes to improve consistency of performance fee calculation methodology across our fund range and, in the case of the Threadneedle UK Absolute Alpha Fund, in recognition of the possibility of negative interest rates in the current low interest rate environment.

We believe that these changes will result in a fairer and more consistent performance fee structure across our fund range and are therefore in the best interests of clients.

Q: When will the changes take place?

The changes will be effective from 1 January 2017.

Q: Do I need to take any action?

No, you do not need to take any action as a result of these changes. Where a performance fee is applicable it will continue to be deducted automatically from the value of your investment as it is currently.

Q. What is a performance fee?

A performance fee is a charge that may be applied to a fund if the fund reaches or exceeds stated performance targets or hurdles and meets certain conditions over a stated period of time (usually a calendar year).

Q: What are the performance fees for these Funds?

Should the conditions be met for the performance fee to be payable, the charges will be as follows:

- Threadneedle UK Extended Alpha Fund: 20% of the *Excess Return* gained over the FTSE All-Share Index (with income reinvested) plus 2%.
- Threadneedle UK Absolute Alpha Fund: 20% of the *Excess Return* gained over the *Performance Benchmark*.

Q: When will I have to pay a performance fee?

I. Threadneedle UK Extended Alpha Fund

Currently, a performance fee is due in the event that the *Share Class Return* exceeds the Fund's *Benchmark Hurdle* over a *Performance Period* of typically one calendar year. For this Fund, the *Benchmark Hurdle* is the FTSE All-Share Index (with income reinvested) plus 2%.

If this condition is met, a performance fee would be deducted from the value of your investment at 20% of the difference between the *Share Class Return* and the *Benchmark Hurdle Rate* (i.e. 20% of the *Outperformance*).

For example, if the FTSE All-Share Index (with income reinvested) returned 3% over a calendar year, the *Benchmark Hurdle* would be 5% (3% + 2%). If in the same year the *Share Class Return* was 7%, the *Outperformance* over the *Benchmark Hurdle* would be 2% (7% - 5%). The performance fee due would be 20% of this outperformance, totalling 0.4%.

From January an additional condition – an *Excess Return* test – will be applied to ensure that a performance fee will not be taken until any *Underperformance* from 2016 or future years has been recovered in full.

If these conditions are met, the performance fee will be payable in the January after the end of the calendar year.

For more information on the application of the new performance fee conditions for this Fund, including illustrations please see Appendix 2.

II. Threadneedle UK Absolute Alpha Fund

Currently, a performance fee is due in the event the *Share Class Return* exceeds the return of the Fund's *Performance Benchmark*, the Sterling 3-month London Inter-Bank Offered Rate (with income reinvested) over a *Performance Period* (typically a calendar year).

If this condition is met, a performance fee will be deducted from the value of your investment at 20% of the difference between the *Share Class Return* and the *Performance Benchmark* return (i.e. 20% of the *Outperformance*).

From 1 January 2017, the *Performance Benchmark* will be amended to be the greater of either the Sterling 3-month London Inter-Bank Offered Rate with income reinvested, or 0%.

If these conditions are met, the performance fee will be payable in the January after the end of the calendar year. If these conditions are not met, no performance fee will be due.

For example, if the Sterling 3-month London Inter-Bank Offered Rate (with income reinvested) (3 Month LIBOR) return was -2% over a calendar year, and the *Share Class Return* was 1%, the *Excess Return* would be calculated using a *Performance Benchmark* of 0% (as it is greater than the 3 Month LIBOR in this calendar year). This would give an *Excess Return* of 1%, and a performance fee would be collected as 20% of this value, i.e. 0.2%.

For more information on application of the new performance fee conditions for this Fund, including illustrations, please see Appendix 3.

Q: What happens if the Funds do not reach their performance hurdle or target?

A performance fee will not be charged unless the stated conditions are met and the *Performance Period* will continue into the next calendar year.

Q. Where can I find out further information?

If you are unclear about any of the details relating to the changes, or have any further questions, please contact us in the UK on 0800 953 0134* (available from 8:00am to 6:00pm, Monday to Friday) or contact your financial adviser.

If you do not have a financial adviser you can find one in your area at www.unbiased.co.uk (Please note we do not endorse this site or advisers found on it).

*Calls may be recorded.

Appendix 1: Glossary of Terms

Benchmark Hurdle – the percentage return the *Share Class Return* must exceed before a performance fee is payable.

Benchmark Return – calculated on each *Dealing Day* as the percentage difference between the Benchmark on such *Dealing Day* and the Benchmark at the beginning of the *Performance Period*.

Dealing Day – Monday to Friday, excluding public and bank holidays in England and Wales, and other days at the discretion of Threadneedle Asset Management Ltd.

Excess Return – calculated on each *Dealing Day*, this is the difference between the *Share Class Return* of the relevant Share Class and the *Performance Benchmark* or *Benchmark Hurdle* return for the UK Absolute Alpha Fund or UK Extended Alpha Fund respectively. If on any *Dealing Day* the difference between the *Share Class Return* and the *Performance Benchmark / Benchmark Hurdle* is zero or negative then there will be no Excess Return.

Outperformance – in the context of this document, this refers to the difference between the *Share Class Return* and the *Performance Benchmark* or *Benchmark Hurdle Return* for the UK Absolute Alpha Fund and UK Extended Alpha Fund respectively. Where the *Share Class Return* is greater than the *Performance Benchmark/Benchmark Hurdle Return*, the share class has outperformed, the value of the difference being the *Excess Return*.

Performance Benchmark – the benchmark against which the performance of the Share Class is measured. For the UK Extended Alpha Fund, this is the FTSE All-Share Index (with income reinvested).

From 1 January 2017, the *Performance Benchmark* for the UK Absolute Alpha Fund will be the greater of either the Sterling 3-month London Inter-Bank Offered Rate (with income reinvested), or 0%.

Performance Period – the period of time used to calculate performance of the Fund or Benchmark. Each *Performance Period* starts on the day immediately following the end of the previous *Performance Period*, except that the first *Performance Period* shall start on the date of the first issue of the Shares in the relevant Class.

Each *Performance Period* ends on the first subsequent 31 December at which there is an *Excess Return** (unless 31 December is not a *Dealing Day*, in which case the *Excess Return* applicable shall be that calculated on the last *Dealing Day* of the calendar year).

*Prior to these changes the *Performance Period* for the UK Extended Alpha Fund would end on 31 December of each year, regardless of whether there was an *Excess Return*.

Share Class Return – calculated for each Share Class on each *Dealing Day*, this is the percentage difference between the Net Asset Value per Share on such day and the Net Asset Value per Share at the beginning of the *Performance Period*.

Underperformance – in the context of this document, this refers to the difference between the *Share Class Return* and the *Performance Benchmark* or *Benchmark Hurdle Return* for the UK Absolute Alpha Fund and UK Extended Alpha Fund respectively. Where the *Share Class Return* is less than the *Performance Benchmark/Benchmark Hurdle Return*, the share class has underperformed. The value of the difference between the two is also known as the “relative return”.

Appendix 2. Performance fee calculation and accrual on the Threadneedle UK Extended Alpha Fund.

1. Performance Fee Calculation and Accrual

The performance fee is calculated as follows: the performance fee rate of 20% is multiplied by the *Excess Return*, multiplied by that *Dealing Day's* Net Asset Value for that Share Class. The performance fee is re-calculated each *Dealing Day* to reflect the performance of the Net Asset Value per Share against the *Benchmark Hurdle* Return from the beginning of the *Performance Period* to the applicable *Dealing Day*.

An accrual for the performance fee is calculated on each *Dealing Day* and forms part of the Net Asset Value for each Share Class and therefore the performance fee accrual is reflected in the price of the Shares. The accrual is calculated on the basis of the performance of the Share Class from the beginning of the *Performance Period* to the *Dealing Day*. Any performance fee accrual made on a *Dealing Day* is superseded by any accrual made on the following *Dealing Day* until such time as the performance fee becomes payable. Any accrual for a performance fee shall be prorated to reflect any material movements in the number of Shares in issue.

The performance fee is only chargeable at the end of any *Performance Period* (i.e. 31 December). If no performance fee has been charged since the launch of the Share Class, no performance fee will be payable until such time as there is an *Excess Return* and there is a performance fee accrual at the end of the *Performance Period*.

2. Performance Fee Illustrations - UK Extended Alpha Fund

To illustrate the potential application of the performance fee and by way of example only, four possible scenarios are set out below and in Figure 1.

Year 1 – Between launch and 31 December, the FTSE All-Share Index (with income reinvested) goes up by 10% and in that same period the Net Asset Value per Share of the UK Extended Alpha Fund goes up by 20% in comparison with the Net Asset Value per Share at launch.

A performance fee will be payable at the end of Year 1 because the Fund has outperformed the *Benchmark Hurdle* over that *Performance Period*. The performance fee will be calculated as follows:

The *Excess Return* on 31 December is 8% (i.e. 20% - 10% - 2%). The actual performance fee rate will be the *Excess Return* of 8% multiplied by 20%. This means that the performance fee payable will be 1.6% of the Net Asset Value of the relevant Share Class.

Year 2 – Because a performance fee has been charged at the end of Year 1 a new *Performance Period* will begin from 1 January in Year 2. Between 1 January and 31 December of Year 2 the FTSE

All-Share Index (with income reinvested) goes up by 10% and in that same period the Net Asset Value per Share of the UK Extended Alpha Fund goes up by 5% in comparison with the Net Asset Value per Share at the beginning of Year 2.

No performance fee will be paid even though the performance of the UK Extended Alpha Fund has been positive and the *Performance Period* will continue into Year 3.

Year 3 – Because no performance fee was charged in Year 2 the performance of the Fund will continue to be measured from 1 January of Year 2. If between 1 January of Year 2 and 31 December of Year 3 (a two year period) the overall performance of the FTSE All-Share Index (with income reinvested) goes down by 10% and over that same period the Net Asset Value per Share of the UK Extended Alpha Fund goes up by 5% in comparison with the Net Asset Value per Share at the beginning of Year 2 then a performance fee will be payable when *Underperformance* in Year 2 has been recovered.

The *Excess Return* of the relevant Share Class over the *Performance Period* is equal to 13% i.e. (5% - (-10%) - 2%). On the basis of the formula used for Year 1 the performance fee chargeable at the end of Year 3 will be: $13\% \times 20\% = 2.6\%$ of the Net Asset Value of the relevant Share Class.

Year 4 – In year 4, the FTSE All-Share Index (with income reinvested) goes down by 6% and the performance of the UK Extended Alpha Fund goes down by 3%. Although the Fund has negative performance, a performance fee will be payable because the Fund has outperformed the *Benchmark Hurdle* over the relevant *Performance Period*.

The *Excess Return* of the relevant Share Class over the *Performance Period* is equal to 1%. The return from the *Benchmark Hurdle* is -4% (i.e. (-6% (Benchmark performance)) + 2% (Benchmark Hurdle Return)). Because the *Excess Return* of the Fund is 1%, the actual performance fee rate will be the *Excess Return* of 1% multiplied by 20%. This means that the performance fee payable will be 0.20% of the Net Asset Value of the relevant Share Class.

You should note that, as shown in the Year 4 scenario above, a performance fee is still payable where the value of your investment has gone down, provided that the performance of the *Benchmark Hurdle* has gone down more.

There is no maximum value on the performance fee that could be taken.

Figure 1. Performance fee illustrations – Threadneedle UK Extended Alpha Fund

Year 1	Annual returns	Performance Period 1	
Share Class Return*	20%		
Benchmark** Return	10%		
Benchmark Hurdle return (Benchmark** + 2%)	12%		
Outperformance / Underperformance (Share Class Return – Benchmark Hurdle Return)	+8% (Excess Return)		
Performance fee (20% x Excess return)		1.60%	Performance fee taken – new Performance Period starts 1 Jan Year 2.
Year 2	Annual returns	Performance Period 2 [Year 2 + Year 3]	
Share Class Return*	5%		
Benchmark** Return	10%		
Benchmark Hurdle return (Benchmark** + 2%)	12%		
Outperformance / Underperformance (Share Class Return – Benchmark Hurdle Return)	-7% (Underperformance)		
Performance fee (20% x Excess return)			No performance fee taken - Performance Period rolled on to include Year 3.
Year 3	Annual returns		
Share Class Return*	0%	5% [5% + 0%]	
Benchmark** Return	-20%	-10% [10%+(-20%)]	
Benchmark Hurdle return (Benchmark** + 2%)	-	-8% [10%+(-20%) +2%]	
Outperformance / Underperformance (Share Class Return – Benchmark Hurdle Return)	-	+13% (Excess Return)	
Performance fee (20% x Excess return)		2.6%	Performance fee taken – new Performance Period starts 1 Jan Year 4.
Year 4	Annual returns	Performance Period 3	
Share Class Return*	-3%		
Benchmark** Return	-6%		
Benchmark Hurdle return (Benchmark** + 2%)	-4%		
Outperformance / Underperformance (Share Class Return – Benchmark Hurdle Return)	1% (Excess Return)		
Performance fee (20% x Excess return)	0.20%	0.20%	Performance fee taken – new Performance Period starts 1 Jan Year 5

*The movement in the Net Asset Value per share over a Performance Period equals Share Class Return.

**FTSE All-Share Index (with income reinvested)

Appendix 3: Performance fee calculation and accrual on the Threadneedle UK Absolute Alpha Fund

1. Performance Fee Calculation and Accrual – UK Absolute Alpha Fund

The performance fee is calculated as follows: the performance fee rate of 20% is multiplied by the *Excess Return*, multiplied by that *Dealing Day's* Net Asset Value for that Share Class. The performance fee is re-calculated each *Dealing Day* to reflect the performance of the Net Asset Value per Share against the *Benchmark Return* from the beginning of the *Performance Period* to the applicable *Dealing Day*.

An accrual for the performance fee is calculated on each *Dealing Day* and forms part of the Net Asset Value for each Share Class and therefore the performance fee accrual is reflected in the price of the Shares. The accrual is calculated on the basis of the performance of the Share Class from the beginning of the *Performance Period* to the *Dealing Day*. Any performance fee accrual made on a *Dealing Day* is superseded by any accrual made on the following *Dealing Day* until such time as the performance fee becomes payable. Any accrual for a performance fee shall be prorated to reflect any material movements in the number of Shares in issue.

No performance fee will be charged until any *Underperformance* during the *Performance Period* has been fully recovered. The term “*Underperformance*” means that the difference between the *Share Class Return* of the relevant Share Class and the *Benchmark Return* is either nil or negative with no *Excess Return*.

The performance fee is only chargeable at the end of any *Performance Period* i.e. 31 December, and will be paid within one month of that date. If no performance fee has been charged since the launch of the Share Class, no performance fee will be payable until such time as there is an *Excess Return* and there is a performance fee accrual at the end of the *Performance Period*.

2. Performance Fee Illustrations

To illustrate the potential application of the performance fee and by way of example only, three possible scenarios are set out below and in Figure 2.

Year 1 – Between launch and 31 December the Benchmark, the Sterling 3-month London Inter-Bank Offered Rate with income reinvested (3 Month LIBOR), goes up by 2% and in that same period the Net Asset Value per Share of the UK Absolute Alpha Fund goes up by 3% in comparison with the Net Asset Value per Share at launch.

A performance fee will be payable at the end of Year 1 because the Fund has outperformed the index over that *Performance Period*. The performance fee will be calculated as follows:

The *Excess Return* on 31 December is 1% i.e. 3% - 2%. The actual performance fee rate will be the *Excess Return* of 1% multiplied by 20%. This means that the performance fee payable will be 0.2% of the Net Asset Value of the relevant Share Class

Year 2 – Because a performance fee has been charged at the end of Year 1 a new *Performance Period* will begin from 1 January in Year 2. Between 1 January and 31 December of Year 2, 3 Month LIBOR goes up by 4% and in that same period the Net Asset Value per Share of the UK Absolute Alpha Fund goes up by 3% in comparison with the Net Asset Value per Share at the beginning of Year 2.

No performance fee will be paid even though the performance of the UK Absolute Alpha Fund has been positive and the *Performance Period* will continue into Year 3.

Year 3 – Because no performance fee was charged in Year 2 the performance of the Fund will continue to be measured from 1 January of Year 2. If between 1 January of Year 2 and 31 December of Year 3 (a two year period) the overall performance of the 3 Month LIBOR (with income reinvested) goes up by 5% and over that same period the Net Asset Value per Share of the UK Absolute Alpha Fund goes up by 6.5% in comparison with the Net Asset Value per Share at the beginning of Year 2 then a performance fee will be payable but only when the *Underperformance* in Year 2 has been recovered

The *Excess Return* of the relevant Share Class over the *Performance Period* is equal to 1.5% i.e. (6.5% - 5%). On the basis of the formula used for Year 1 the performance fee chargeable at the end of Year 3 will be: $1.5\% \times 20\% = 0.3\%$ of the Net Asset Value of the relevant Share Class.

There is no maximum limit to the performance fee that could be charged.

Figure 2. Performance fee illustrations – Threadneedle UK Absolute Alpha Fund

Year 1	Annual returns	Performance Period 1	
Share Class Return*	3%		
3 Month LIBOR** Return	2.0%		
Outperformance / Underperformance (Share Class Return – Benchmark Return***)	+1.0% (Excess Return)		
Performance fee (20% x Excess return)		0.2%	Performance fee taken – new Performance Period starts 1 Jan Year 2.
Year 2	Annual returns	Performance Period 2 [Year 2 + Year 3]	
Share Class Return*	3.0%		
3 Month LIBOR** Return	4.0%		
Outperformance / Underperformance (Share Class Return – Benchmark Return***)	-1.0% (Underperformance)		
Performance fee (20% x Excess return)	None		No performance fee taken - Performance Period rolled on to include Year 3.
Year 3	Annual returns		
Share Class Return*	3.5%		
3 Month LIBOR** Return	1.0%		
Outperformance / Underperformance (Share Class Return – Benchmark Return***)	+2.5%	+1.5% (Excess Return) [-1.0% + 2.5%]	
Performance fee (20% x Excess return)		0.3%	Performance fee taken – new Performance Period starts 1 Jan Year 4.
Year 4	Annual returns	Performance Period 3	
Share Class Return*	0.0%		
3 Month LIBOR** Return	-1.0%		
Outperformance / Underperformance (Share Class Return – Benchmark Return***)	0.0%		(Calculated with a Benchmark of 0% as it is greater than the 3 Month LIBOR rate)
Performance fee (20% x Excess return)		0.0%	No performance fee taken - new Performance Period starts 1 Jan Year 4.

*The movement in the Net Asset Value per share over a Performance Period is also known as the Share Class Return.

**Sterling 3-month London Inter-Bank Offered Rate (LIBOR) with income reinvested.

***From 1 January 2017, the Benchmark is the greater of Sterling 3-month (LIBOR) with income reinvested, or 0%.

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