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Mr. Carlo Comporti
Secretary General

CESR the Committee of European
Securities Regulators
11-13 avenue de Friedland
75008 Paris
FRANCE

CESR consultation paper on technical issues relating to Key Information Document (KID) disclosures for UCITS (CESR/09-047)

Dear Mr. Comporti,

BVI[1] welcomes the opportunity to issue comments on CESR proposals for technical details of the Key Information Document for UCITS. In our view, the KID debate is of utmost relevance for the public perception of UCITS and the fund industry in general. Therefore, while appreciating the transparent regulatory policy adopted by CESR in other cases, we are highly disappointed about the late involvement of the industry in the development of technical elements to the KID. With regard to the risk and reward indicator in particular, it must be regretted that the industry has not been given the opportunity to comment on fundamentals of the chosen methodology, thus allowing CESR to make proper adjustments at an earlier stage of discussion and avoiding time pressure built up by the tight deadline for the final CESR advice.

General remarks

Premises of the KID approach

Concerning the broad concept of the KID, we would like to emphasize that UCITS, even though not among the most complex financial products, involve still a significant level of complexity. Making this complexity understandable

[1] BVI Bundesverband Investment und Asset Management e.V. represents the interest of the German investment fund and asset management industry. Its 92 members manage currently assets of nearly EUR 1.5 trillion both in mutual funds and mandates. For more information, please visit www.bvi.de.

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for the average retail investor by means of a two-pager is a worthwhile objective, but requires considerable allowances in terms of accuracy and extent of information. Hence, in order to provide investors with an adequate picture of a specific fund investment, any simplification or shortening of information should be very carefully assessed taking into account the danger of misapprehension by investors.

Implications for civil liability

Moreover, the current CESR proposals involve many assumptions and estimations to be made in specific situations about the particulars of the KID. In our view, presentation of estimated data does not provide investors with reliable information, but is likely to draw a distorted picture of the overall investment and hence, might be treated as misleading for liability reasons. As the level 1 UCITS Directive does not provide for limitation of liability in case of misleading information, we urge CESR to duly take into account possible implications of the suggested estimations and assumptions in respect of civil liability for the KID content. In case the respective proposals are upheld, the EU law should as a minimum provide for binding rules on calculation and disclosure of any estimated data, wherever possible by way of standard models of application. This pertains in particular to calculation of ongoing costs for newly launched funds and to the summary measure of charges currently under discussion.

Issues of level playing field

When determining the specific features of the KID for UCITS, CESR should bear in mind that the KID concept is meant to apply in a mid to longer term also to other comparable retail investment products. In the Communication on Packaged Retail Investment Products recently adopted by the EU Commission, the KID model for UCITS is being declared a clear benchmark in terms of disclosure standard for other investment products available to retail investors such as unit-linked insurance contracts or structured securities[2]. **Thus, it is of utmost importance that the finally adopted technical standards relating e.g. to performance presentation or calculation of the risk and reward indicator be in their validity not limited to UCITS, but allow for broader application on a cross-sector basis.**

Moreover, the transitional period to come with the KID requirements applying only to UCITS puts high pressure on the fund industry as regards its competitive position in relation to other product providers. Therefore, we would like to encourage CESR to voice the fund industry's expectations in

[2] Cf. Communication from the Commission to the European Parliament and the Council on Packaged Retail Investment Products dated 30. April 2009 (COM(200) 204 final), page 7 and 10.

terms of swift progress towards common standards for product-related disclosure in its final advice to the Commission.

References to sales prospectus

The KID should in its generality make clear that it provides only a summary disclosure of the essential elements of an investment. Therefore, selective references to specific parts of the prospectus should be avoided as they might be suggestive of completeness in relation to KID sections not covered by the reference. Instead, the part on additional information should make unmistakably clear that the KID contains only a brief description of essential characteristics of a UCITS and that further information can be found in the fund prospectus which is obtainable from a specific source.

Clarification of terms

Lastly, there is the need for clarification of terms as regards the new concept of investor information. According to the level 1 UCITS Directive, the document containing key information for investors shall be referred to as "key investor information" and shall be clearly labelled as such[3]. As the text of the new UCITS Directive has already been voted by the EU Parliament, it is not practicable to push for any changes in terminology. Therefore, CESR should abandon the term "Key Information Document" which is clearly inconsistent with the level 1 requirements. Nevertheless, for clarity reasons, we will be referring to the information document as KID for the purpose of the present consultation.

Specific comments

As regards technical details of the KID elements covered by the current consultation, we would like to provide CESR with the following comments:

Chapter 1: Risk and reward disclosure

Narrative approach versus synthetic indicator

In accordance with the scope of consultation determined by CESR, we will for the time being take no stance on the general approach to risk and reward disclosure preferable to BVI members. Hence, our following remarks should be understood as suggestions for improvement of the synthetic approach in case it should at the very end of the discussion be deemed more appropriate for the purpose of investor information.

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[3] Cf. Art. 78 para. 1 of the UCITS Directive.

In our view, however, further development of the narrative approach has not been treated with the same level of regard as progress in terms of the synthetic indicator. This must be regretted, especially in light of the severe shortcomings in the calculation methodology highlighted below. Therefore, we would like to assure CESR of the industry's commitment to provide any due assistance to proper enhancement of the narrative approach within the tight time frame for the final CESR advice.

Implications in terms of perception of risks

The risk and reward indicator proposed in the consultation paper reflects an entirely new concept of risk perception with reward elements being assigned considerable weight. In the current practice of the German industry, indicators are being used in order to illustrate the risks of a fund investment which means especially the risk of losses to the invested assets. Under the risk and reward approach, on the other hand, lack of participation in potential market opportunities is also treated as a category of risk resulting in guarantee funds being classified as potentially risky products. From the viewpoint of an average retail investor, these findings are rather bewildering and entail at least a considerable shift in paradigms regarding risk appraisal which requires significant educational efforts both for investors and distributors.

Indeed, funds offering hard and unconditional guarantee on full return of the invested assets at a predetermined date are generally considered risk-free and therefore, are marketed in direct competition to saving accounts, fixed-term bank deposits or government bonds. All these products share common features in terms of capital guarantee, limited to none opportunities to benefit from positive market trends and some kind of pre-determination in terms of pay-off profile. Unfortunately, investor information for these products is subject to divergent standards without any prospect of alignment even in light of the newly launched EU initiative on packaged retail investment products[4]. **From the viewpoint of the German fund industry, any risk and reward classification of guarantee funds higher than level 1 or accompanied by a warning modifier would bring about grave competitive disadvantages at distribution level and hence, is strictly not acceptable.** In order to warrant proper balance in terms of cross-sector competition, we suggest to systematically assign guarantee funds to the lowest risk and reward category or alternatively to create a new category of null which would apply only to funds with full guarantee on capital return.

[4] According to the Communication on Packaged Retail Investment Products, the initiative covers only products offering exposure to underlying financial assets and hence, does not extend e.g. to investments in plain-vanilla saving accounts or government bonds.

Fundamental requirements for a risk and reward indicator (section 1.2.1)

In terms of the general criteria applicable to a synthetic indicator, we miss the requirement that the indicator should allow for an adequate assessment of risks and rewards. Indeed, in our view this should be the overarching goal of the risk and reward presentation and any methodology delivering an inaccurate picture of possible risks and rewards must be deemed not acceptable. Ensuring comprehensive applicability, easy implementation, effective supervision and other criteria proposed by CESR are clearly inferior to appropriate and correct investor information and should only be used as a corrective for choosing the right approach to accurate disclosure of risks and rewards.

Moreover, BVI members are of the opinion that stability and robustness of categorisation do not constitute a desirable objective in itself. It is much more important to provide investors with an accurate impression of expected risks and rewards than to construe an indicator which is stable over years, but does not adequately reflect the effective risk and reward profile of an investment. In order to ensure transparency over possible variations in the risk and reward categorisation of a fund, however, the results of past years' calculations should be kept available at a source specified in the KID.

The proposed methodology (section 1.2.3)

Q1: *Would the proposed calculation methodology lead to a categorisation of funds' potential risk and reward profiles which is clear, appropriate, comprehensive and easy to implement?*

Q2: *To what extent does it provide a comprehensive approach to risks, including liquidity risk, counterparty risk etc.?*

As already pointed out in general terms, the most important premise for introducing a synthetic risk and reward indicator from the viewpoint of BVI members is its capability of transmitting appropriate information on the level of expected risks and rewards. This can only be assumed if the indicator is calculated in accordance with the state-of-the-art methods of risk measurement and concurrently provides investor with intelligible information in a clear and precise manner.

Following this line of thoughts, we do not think that the volatility of past returns proposed by CESR as the basis for calculation methodology would generate appropriate results. Volatility reflects the margin of fluctuation during a specific time frame in the past and hence, provides only a snapshot of possible risks and rewards which is too limited and fortuitous to ensure adequate investor information. A volatility based calculation methodology would have produced disastrous results in the current crisis as many funds holding "toxic" papers have not displayed any peculiar features in terms of volatility until the beginning of the market downturn.

Also, historical volatility as a risk and reward measure fails with regard to certain types of funds such as structured funds and other funds with a dynamic frame for asset allocation. For these products, CESR itself admits that "no return history can be deemed representative of the fund's current allocation or suitable for the estimation of its volatility" (para. 58 of the consultation paper). Thus, a methodology based on historical volatility is not comprehensive in the sense that it does not allow for calculation of an indicator for all types of UCITS.

Due to these insufficiencies, BVI members suggest replacing the calculation method based on volatility by a Value at Risk (VaR) approach. The major benefits of a VaR based calculation can be summarised as follows:

- It is a comprehensive measure allowing for consistent application to all types of UCITS and thus, warranting comparability between funds,

- It avoids arbitrary treatment of certain fund types (like general assignment to category 7, use of risk add-ons),

- It is consistent with the applicable approach to UCITS risk management which allows for utilisation of existing systems and facilitates cost savings,

- As measure for probability of losses on a portfolio over a given time horizon, VaR is also more compatible with the general concept of KID which is meant to provide investors with a prospective view on the envisaged fund investment,

- Lastly, VaR is more sensitive to changes in market environment and therefore, is capable of providing an accurate and exhaustive indication of risks.

In view of BVI members, volatility measure for the synthetic indicator can be replaced by a calculation methodology based on VaR. In order to warrant comparability between the risk and reward classification of UCITS, it is important that the method for computing VaR is insofar as possible defined at EU-level. This should at least involve standardisation of underlying parameters such as confidence interval and time horizon.

As regards calculation of VaR, an ex-ante approach would be most appropriate to provide investors with a prospective view on potential risks and rewards. Nonetheless, BVI members are aware of the difficulties in agreeing on assumptions and parameters for the applicable ex-ante risk models which in the end might not be capable of full standardisation. Indeed, in our view, significant further efforts are necessary in order to reach a satisfactory level of standardisation in terms of the risk and reward indicator whilst avoiding overly prescriptive treatment of VaR for the purpose of risk management. However, we think that CESR should accept this challenge for the sake of warranting accuracy and clarity of the UCITS risk and reward classification and ensuring compliance with the state-of-the-art methods of risk measurement. In this respect, we would like to assure CESR of the industry's willingness to provide every due assistance in order to arrive at a sound and sustainable solution.

In our opinion, VaR of a fund portfolio can be conveyed on the risk and reward indicator by stipulating VaR "buckets" as suggested for the volatility approach in para. 88. In this regard, BVI members would prefer using a non-linear scale with smaller VaR intervals for the lower categories of risk and reward which should increase toward the upper end of the scale.

Moreover, as highlighted above, we strongly urge CESR to warrant adequate disclosure of the risk and reward profile of guarantee funds either by recommending their general classification into the lowest category or by introducing a separate category of null reserved for funds providing a hard and unconditional guarantee on return of the invested capital.

Our comments above render many questions in the risk and reward section obsolete. With regard to the remaining issues, we would like to respond as follows:

Merits and drawbacks of the methodology (section 1.2.8)

***Q12:** How easy would the methodology be for UCITS providers to implement and for regulators to supervise?*

A shift to the VaR methodology suggested above would require moderate additional efforts. German management companies, as other EU fund managers, are already equipped with systems for computing VaR for the purpose of risk management. The employed processes would only need to be adapted to the standards for VaR calculation stipulated at EU level. Likewise, supervisory authorities are already familiar with VaR as a method of risk measurement and should be able to comprehend and reproduce the results of VaR calculation.

Presentation (section 1.2.9)

***Q14:** Do you agree with the proposed scale and that the number of categories should be 7?*

BVI members agree with the proposed numeric grid of 7 categories, even though some of them think that reducing the scale to 5 would also produce appropriate results.

Q15: *How should the methodology define appropriate volatility "buckets"? Do you agree that a non-linear scale might be needed to tackle issues of stability, granularity and fair distribution of funds along the scale? Would it be sufficient to prescribe numeric parameters to each "bucket" or would additional definitions be necessary?*

Q16: *Which form of non-linear scale would be the most appropriate? What would be the merits and drawbacks of such a scale?*

As explained above, we suggest defining a non-linear scale for presentation of the VaR indicator. The buckets in terms of VaR should be tighter for the lower categories of risk and reward and should increase towards the upper end of the scale. In our view, it should be sufficient to define VaR intervals applicable to each risk and reward category.

Q17: *Do you agree that the categories should not carry any descriptions other than a number (and the "!" modifier if appropriate)?*

Q19: *For funds which have a specificity in terms of risk, do you agree that the modifier should take the form of an exclamation mark (!)? Does an exclamation mark have an overall meaning which might be contrary to the above-mentioned purpose for the general public in some Member States? If so, is there any other type of warning presentation that would be more appropriate?*

We agree with the presentation approach outlined in question 17. Also under the VaR approach, there might be cases where VaR calculation will not adequately reflect all types of risks relevant to the UCITS portfolio. This can pertain in particular to counterparty risk, liquidity risk and risks embedded in certain types of options. In such circumstances, it would be appropriate to highlight the additional risks by means of a modifier and provide further information in the accompanying narrative. In order to make sure that investors recognise the warning character of the modifier, however, the exclamation mark could be presented in a triangle frame which should induce associations with the traffic sign internationally in use as a warning against danger[5].

<u>*Disclaimers and explanations to a synthetic risk and reward indicator (section 1.2.10)*</u>

Q20: *Do you agree with the proposed list of disclaimers to be used in relation to the synthetic risk and reward indicator?*

Q21: *Are any of the disclaimers not directly useful or helpful?*

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[5] Cf. http://de.wikipedia.org/wiki/Datei:Zeichen_101.svg.

Q22: *Can you suggest any other warnings that are missing from the proposal?*

As regards CESR proposals for disclaimers to accompany the risk and reward indicator, we would like to make the following comments:

- Disclaimer no. 1 should be kept in line with Art. 27 para. 4 (d) of MiFID level 2 Directive and state that “historical data is not a **reliable** indication for the future”,

- Disclaimers no. 4 and 6 should be deleted as they do not reveal any additional information which might be of value to investors – there is no need to explain non-applicable categories of risk and reward and explanation of the specifically applicable category in the mock-ups for consumer tests only replicates details of the fund’s investment strategy,

- Details of any capital guarantee or protection (disclaimer no. 8) should be comprehensively addressed in the investment objectives and strategy section which would increase clarity of information and help to save valuable space,

- A warning about potential unsuitability of a fund investment (disclaimer no. 9) should be abolished since it might cause the misleading impression that any investment exceeding the specified time limit would produce desirable results.

In addition, BVI members would like to see a disclaimer regarding the validity of data used for calculation of the synthetic indicator. The respective text could be phrased as follows: “The underlying data were valid on [specific date]”.

Chapter 2: Past Performance

As regards the KID section on past performance, we would like to submit the following comments:

<u>Funds for which past performance exists or a proxy can be used (section 2.2)</u>

Q23: *Is the proposed framework of general requirements for the presentation of past performance with a bar chart sufficient and appropriate?*

We agree with the suggestions for past performance presentation, except for the principle on handling of new funds (para. 6, fourth bullet point). According to the current proposal, performance of new funds could only be shown after performance data for a full calendar year has become available. For funds launched in February, this means an effective ban of performance presentation within KII for a period of 23 months! In our view, this outcome has the effect of depriving investors of information relevant for their investment decision and might be even deemed violation of client information duties before civil courts.

Hence, we once again urge CESR to allow for earlier display of past performance figures in case of newly launched funds. In our view, this should be permitted after six months of a fund's existence and accompanied by a clear statement that the short performance history is of fairly limited significance for future developments.

In addition, we think that all funds should be allowed to present investors with a complete picture of past performance even if it implies deviations from annual performance figures for the year of a fund's launch. Marketing experience clearly shows that investors are very interested in obtaining full performance data and should, therefore, not be referred to sources outside the KID. Moreover, the loss of comparability between funds appears marginal and will be fully outweighed by gains in terms of adequate investor information.

Q24: *To what extent is there a risk of divergent practices in different countries so that comparability of UCITS across the EU would be hampered?*

Q25: *Should CESR recommend a more prescriptive approach in terms of bar chart presentation?*

From the German perspective, we see no risk of divergent practices emerging in different Member States on the basis of CESR proposals for past performance disclosure. In our view, there is therefore no need to adopt a more prescriptive approach regarding the presentation of bar charts.

Q29: *Is the proposed framework on past performance calculation sufficient and appropriate to allow comparability?*

Q30: *In particular, are the proposed technical recommendations concerning the inclusion of charges and fees, the display of currency, the selection of the NAV date and the treatment of income helpful, workable and sufficient?*

Q31: *Do any other issues need to be addressed to achieve a sufficient level of harmonisation?*

BVI members strongly recommend further, if possible extensive, harmonisation of methodology for past performance calculation. Agreement on common standards for certain aspects of calculation is helpful, but not sufficient in order to warrant comparability between performance figures of funds domiciled in different Member States.

Q32: *Regarding the display of past performance that occurred prior to a material change, do you think that both options (good practice 1 and good practice 2) should be allowed?*

Q33: *Or, for the sake of comparability should only one good practice be retained? If so, which one?*

BVI members have a clear preference for option 1 which maintains past performance occurred prior to a material change together with an adequate warning in this regard. They fear that option 2 might open the door for undue manipulations in terms of effectuating material changes in case a fund performs unfavourably and thus, induce “cherry-picking” of past performance data. Furthermore, they favour stipulation of only one applicable approach at EU level in order to enhance comparability of past performance presentation.

Q34: *Is there a need for harmonised guidelines at European level concerning the definition of material changes or do you think that it should be addressed by each Member State at national level?*

In our view, provision of EU-wide harmonised guidelines for definition of material changes is essential in order to ensure comparability of KID. This applies in particular in case good practice 2 should be acknowledged as an equally legitimate option of performance disclosure. The circumstances under which fund providers should be allowed to delete past performance must be unambiguously stipulated at European level.

Q35: *Do you see any other issues that should be taken into account as regards the presentation of past performance where there are materiality changes?*

BVI members are concerned about possible impact of the proposed treatment of material changes on funds with longer performance history. Depending on criteria to be adopted as regards definition of materiality, it might be very difficult, if not impossible, to establish whether and at what point of time material changes have occurred in the past. In many cases, records on events concerning the fund might not have been kept for a period of preceding ten years or their anew evaluation would produce efforts out of all proportion to the expected results. Moreover, it might cause significant irritations among investors if the fund they stayed invested in for a longer time were out of the sudden to highlight material changes to its past performance history.

For these reasons, we strongly request CESR to adopt a pragmatic approach to the presentation of material changes by long existing funds. A possible solution might be to require flagging of material changes in the performance chart only in case these take place after implementation of the UCITS IV rules at national level.

Q36: *Are the conditions identified by CESR, under which inclusion of a benchmark alongside the fund performance could be allowed, sufficient and appropriate? In particular:*

i) Do you agree that a UCITS should no be required to display a benchmark unless one is identified in the fund's objectives and strategy? Is it appropriate to permit a benchmark to be displayed in other cases?
ii) Is there a need for harmonised guidelines regarding the choice of a benchmark in the "strategy and objectives" or can this continue to be left to the discretion of each Member State?

Q37: *Should any other issues be taken into account regarding the inclusion of a benchmark alongside the fund performance?*

We share CESR's view that inclusion of a benchmark should be required only in case a benchmark is identified in the strategy and objectives section of KID. Also, we consent to CESR's view that where a performance fee is calculated by reference to a benchmark, but that benchmark is not mentioned in the strategy and objectives of the fund, the KID should not require the benchmark's performance to be displayed. Otherwise, for the sake of comparability in terms of investor information, presentation of a benchmark alongside the fund performance should not be permitted.

In our view, there is no need for EU harmonised guidelines concerning the choice of an appropriate benchmark for fund performance. This decision depends to a large extent on the strategic orientation of a fund and hence, should be best left to the discretion of its respective management company.

Q38: *Does the proposed recommendation rejecting the use of a benchmark as a proxy for non-existent performance data provide appropriate investor protection?*

Q39: *To what extent could the lack of inclusion of a benchmark for years in which the fund did not exist hamper the disclosure of the risk and reward profile of the fund?*

Q40: *Are there conditions under which such a practice could be allowed without prejudicing investor protection?*

We fully support CESR's view that the use of a benchmark as a proxy for non-existent performance data raises significant concerns in terms of investor protection and should, therefore, not be allowed. In fact, it must be feared that an average retail investor will not be able to distinguish properly between the realised fund performance and the performance of a benchmark, especially in cases where the latter represents the only displayed source of data. Potential strategic benchmark mismatches and unusually high active risks (security selection, temporary factor riming) might even drive a wedge between the proxy and the actual fund performance. Hence, the proxy use of a benchmark might have misleading effects on investors. Moreover, licence fees payable to the benchmark provider for the years in which a fund did not exist would produce unreasonable costs which in the end, would be borne by the fund investors and would negatively influence the actual performance of a fund.

Q41: *Has CESR correctly identified all the conditions under which a track record extension could be allowed? In particular:*

- *i) Do you foresee any other situations where a track record extension could be used?*
- *ii) Is there a need for harmonised guidelines at European level concerning conditions under which a track record extension could be used?*
- *iii) Regarding new classes or shares of an existing fund or sub-fund, is CESR's approach sufficient and appropriate?*
- *iv) Regarding feeder funds, what are the merits and limits of each of the two above options? Which one should be retained?*

Q42: *Do you agree with CESR's approach that track record extension should be allowed when a fund changes its legal status in the same Member State? If this were to be addressed by each Member State at national level, how great a risk is there of divergence and lack of comparability? Should the approach be more prescriptive in this case? If so, please explain why.*

As regards track record extension, we agree with CESR's recommendations presented in para. 41 provided the following:

- In case of new share classes, track record extension should require adequate adjustments for material variations in terms of costs if a separate KID is to be produced for the newly introduced class of shares,

- For feeder funds, we favour option 1 due to its specific criteria which should be easier to assess by regulators and provide more legal certainty to fund managers,

- In case of changes to the legal status of a fund, we agree with CESR that track record extension should be allowed provided that it has no impact on the fund's performance. Due to the divergent national regimes for corporate law and taxation of funds, it appears not feasible to provide a detailed set of rules governing the circumstances in which track record extension could apply. However, it might be helpful for CESR members to agree on common principles as guidance for supervisory assessment at national level.

- In addition to modifications in terms of legal status, BVI members also wish to show simulated past performance in case of changes to the fund domicile (e.g. a fund is liquidated in Member State A, but the assets are 1:1 transferred to a newly founded fund in Member State B) and regarding fund clones established in different jurisdictions. Also in these circumstances, extension of track records should be conditional upon the lack of relevant impact on the fund performance.

Beyond the aforementioned aspects, we see no need for further harmonisation of conditions for track record extension.

Q43: *Has CESR identified the right conditions under which track extension for fund mergers could be allowed?*

Q44: *Should any other issues be taken into account regarding track extension for fund mergers?*

We agree with CESR's views on track record extension for fund mergers and would like to voice a preference for option C presented in para. 44 which requires disclosure of past performance data only for the absorbing fund.

Funds for which past performance or a proxy cannot be used (structured and guaranteed funds) (section 2.2)

As regards this section of the consultation paper, we would like to abstain from responding to specific questions raised by CESR and instead, confine ourselves to comments on the broad concept of performance scenarios.

BVI members reject the use of performance scenarios for several reasons. Statements on prospective performance are necessarily based on a number of assumptions pertaining to future events. Their use might convey to investors a false sense of security by suggesting a guarantee or higher probability for the illustrated developments. Also, there will be no comparability between structured and other types of investment funds which will display past performance instead of simulation of future events.

Another issue to be taken into account is the entirely unclear differentiation between structured funds which should be required to display performance scenarios and plain-vanilla UCITS meant to show past performance figures. The definition proposed by CESR in para. 47, footnote 5 is rather an illustration of typical features associated with structured funds, but does not account for all possible variations in terms of product set-up. Given the continuous product innovation in the field of structured funds, it should be virtually impossible to find valid criteria for distinguishing these products from other types of UCITS.

In view of BVI members, the shift of methodology for calculation of risk and reward indicator to a VaR-based approach as suggested above would ensure that each type of UCITS is assigned to a specific risk and reward category in accordance with the VaR of its portfolio. In these circumstances, the reasonability of performance scenarios deemed to provide an ex-ante view on the risk profile of only certain fund types appears highly questionable. This is even more true as the value of past performance figures is not only limited in case of structured and guaranteed funds, but may also be challenged for other UCITS based on dynamic mix of assets such as total return and life cycle funds.

For these reasons, we call upon CESR to refrain from the suggested use of performance scenarios and instead, to allow presentation of past performance for all types of UCITS. For the purpose of Article 78 para 3 (c) of the Level 1 UCITS Directive, CESR should declare that due to the use of VaR as a comprehensive measure for the risk and reward indicator, it recommends not to define any relevant cases of application in respect of performance scenarios.

Nevertheless and only in case CESR should insist upon the relevance of performance scenarios for structured funds, BVI members would prefer the table variant being currently tested with consumers (cf. table in annex C), but without the probability elements proposed in para. 66. The content and calculation of such a table would need to be specified in detail by binding European legislation, preferably by providing a standardised model for presentation, in order to avoid civil liability on grounds of potentially misleading information.

Chapter 3: Charges

Recommended options for consumer testing (section 3.1)

Q58: *Do you think a summary measure of charges would help investors to understand the overall costs of investment in a UCITS?*

Q59: *Which presentation would be preferable: using a narrative with a percentage figure or a table of cash figures?*

BVI members decidedly reject option B conveying a summary measure of charges due to its potential to mislead investors. This approach is based upon arbitrary assumptions pertaining to the amount of invested capital, holding period and average yearly growth and thus, is never capable of providing an appropriate picture of investment costs. The inaccuracy of such presentation is further aggravated by variability of subscription and redemption fees of which the highest possible amounts shall be taken into account for the purpose of calculating the cash figure pursuant to the methodology proposal in Annex A. Accordingly, in our view, a summary measure of charges is nothing more but a meaningless example of possible effects of charges and bears no relevance for the individual investor.

Should option B be further explored, however, we strongly request CESR to prompt amendments to the table currently in use for consumer testing in order to account for the assumed level of growth also in the column displaying investment figures. As it stands, the table produces the strong impression that the amount of charges accumulated over years will lead to significant losses in terms of invested capital.

Moreover, it has to be taken into account that on the basis of MiFID, investors are often being confronted with monetary disclosure of costs at distribution level. Under MiFID, the relevant costs of fund distribution comprise a possible entry fee and parts of the annual management fee retroceded to the intermediary. Thus, there is a danger that investors will simply add the figures from the illustration table to the distributor's remuneration which would result in a totally distorted picture of the overall costs of fund investment.

For all these reasons, we deem the summary measure of charges not eligible for the purpose of clear and unambiguous disclosure and would like to urge CESR to advocate narrative disclosure of costs in percentage terms as a preferable option for investor information.

<u>Overall presentation of charges (section 3.2)</u>

Q60: *Do you agree that Option 1, using a single ex-post figure, is the best one?*

We support CESR's suggestion to show a single ex-post figure in order to inform investors about charges taken from the fund on a regular basis. However, BVI members have reservations against labelling these costs as "ongoing charges", especially in connection with the explanatory text "charges taken from the fund over each year" used in the mock-ups for consumer tests. The term "ongoing charges" as well as its explanation suggest continuity in the applicable amount and can have a misleading effect on investors. Thus, we would prefer using another complement such as "periodic" or "regular" in order to distinguish these charges from one-off entry fees.

In this context, we would also like to draw CESR's attention to some ambiguities in the explanation of the entry charge found in the KID mock-ups for consumer tests. The sentence “Ask your financial adviser or distributor to find out whether you will pay less” might be mistaken by investors for an invitation to negotiate the level of entry charge with the intermediary. Obviously, this goes beyond information on essential elements of a fund investment and hence, cannot be deemed a legitimate purpose of KID. Therefore, we are strongly in favour of rephrasing the text in a more neutral way such as: “Ask your financial adviser or distributor to find out about the applicable level of entry charge”.

Methodology for ongoing charges figure (section 3.3)

Q61: *Do you agree with the proposed methodology in Annex B for identifying which items should be included in the ongoing charges figure and for harmonising the calculation?*

While being in general supportive of the notion to harmonise calculation of the “ongoing charges figure”, we think that the fund industry should have been given more time in order to conduct proper analysis of the current practice and to submit substantiated comments on this highly relevant issue.

Regarding particulars of the calculation methodology proposed in Annex B, we would like to make the following remarks:

- Costs of all transactions pertaining to the UCITS’ portfolio must be unequivocally excluded from the calculation of ongoing charges. In this respect, CESR should clarify that the limitation in para 1.5 must not be interpreted as a partial inclusion of transaction costs in case the operator, depositary or custodian or anyone acting on their behalf is party to the transaction. Rather, para. 1.5 shall apply only to transaction-based payments made to the aforementioned entities beyond the context of trade execution.

- The method for calculating ongoing costs of target funds proposed in para. 1.7 and 2.6 is not acceptable to BVI members. The proposed approach provides no added value to investors as it is based on a snapshot of a UCITS’ portfolio at the date of calculation and makes too many allowances in terms of actually incurred costs. Moreover, it has the potential to discriminate against funds of funds set up in open architecture and thus, selecting their target investments among a broad variety of providers. It must be anticipated that these funds would encounter significant difficulties when making “best estimates” of ongoing charges at the level of target funds in contrast to fund managers operating within one financial group. This outcome would discourage open structures within funds of funds which would be counterproductive in terms of protecting investors’ interests.

  On the other hand, an accurate calculation of ongoing costs occurred at the level of underlying funds is not feasible from the practical point of view. Charges of target funds bought or sold in the course of an accounting year would need to be accounted for in relation to the specific holding period. Moreover, there are continuous fluctuations in the share of individual target funds in the UCITS portfolio which also imply modifications to the effect of respective charges. Another range of difficulties pertains to possible deviations in the accounting years which render it impossible to use applicable figures for calculation at the fund of funds level. But even in case of identical accounting periods, the actual charges of a target fund will as a rule not become available in time for the fund of funds to account for respective figures in its annual report.

To sum up, we see no possibility to adequately reflect the actual charges at the level of underlying funds in the fund of funds' KID. Instead, we would like to suggest disclosing to investors the maximum allowable ongoing charges figure for underlying funds in order to qualify them as eligible investments. To our knowledge, this practice has already been adopted in some Member States.

However, should calculation of an ongoing charges figure for target funds become obligatory, we prefer a separate method of presentation as suggested in para 2.6 b), second clause.

Q62: *Do you agree with the proposals to:*

- *i)* *Show the ongoing fund charges figure excluding performance fees?*
- *ii)* *Explain performance fees through a narrative description?*
- *iii)* *Not show an actual figure for the amount previously charged?*

Q63: *Do you agree with the proposal to signpost where more detailed information can be found?*

We agree with the proposed approach to presentation of performance fees.

Q64: *Do you agree with the proposal to highlight the potential impact of portfolio transaction costs on returns through a warning in the charges section and, in certain circumstances, the strategy/objectives or risk and reward sections of the KID?*

BVI members support the concept of highlighting the potential impact of transaction costs on the fund's performance by means of a narrative warning. In case of expected material impact of transaction costs, however, we would welcome precise criteria being established at EU level for more distinct information of investors in order to avoid liability disputes before the courts.

Q65: *Do you agree with the proposal to include this warning?*

Q66: *Are there circumstances not covered by the proposals which could lead to investors being misled about potential increases in charges?*

We refuse the limitation of the proposed warning to "slight variations". The term "slight" is very vague and subject to divergent interpretations which might give rise to disputes before civil courts. Moreover, there can be more than slight variations in the ongoing charges stemming from unpredictable events like e.g. expensive court proceedings on behalf of fund investors. For such increases, no ex-ante estimation or adjustment of the disclosed figures can be made.

Circumstances in which ex-post figures might be inapplicable (section 3.4)

Q67: *Have all the relevant issues in estimating an ex-ante ongoing charges figure for a new fund been identified?*

Q68: *Do you agree with the proposed manner of dealing with these issues?*

BVI members strictly reject the proposition requiring new funds to make estimates about the ongoing charges figure. The majority of UCITS launched by German fund providers does not set any limitations to the maximum amount of chargeable fees. Previous experiences from such cases show that a sensible assumption on the level of a fund's NAV is simply not feasible due to a number of unforeseeable factors such as investors' preferences and future market conditions. Moreover, presenting investors with an estimated figure might lure them into thinking that the stipulated amount may not be exceeded and thus, raise problems in terms of misleading effects of information and attaching civil liability. Therefore, it appears more appropriate for new funds to display the ex-ante amount of annual management fee alongside a clear warning about the possible impact of further costs to be taken from the fund.

Q69: *Do you agree with the proposal to replace an ex-post figure with an estimated ex-ante figure where there are material changes in the charging structure?*

Q70: *Do you agree with the proposed wording to explain the estimated figure?*

Q71: *Can you suggest how materiality should be defined in the context of changes to the disclosed charges figure?*

Also in case of material changes to the charging structure, BVI members are of the opinion that any requirement to replace the ex-post figure with an ex-ante prognosis of future charges would constitute an obvious discontinuity in the methodology of cost disclosure and should, therefore, be abandoned. Even though better practicable than in case of new funds, estimation of charges will never provide a valid number due to fluctuations in the fund's NAV and possible variations in the ancillary costs of fund management. Furthermore, it would necessitate extensive explanations towards investors in order to enable them to properly assess the relevance of the displayed data.

Nevertheless, should the proposal on estimation of next year charges be retained, it must be made unmistakably clear that the requirement of estimation applies only to the modified elements of charges and does not affect the remaining calculation which should be based on accounted figures.

In this case, we also think that the definition of materiality should refer to a percentage change in terms of the last applicable annual fee as it is the modification of the charging structure, not its implication for the fund performance which should be decisive for the underlying assessment. In our view, an increase or decrease of annual management fee by 10 percent should be considered material. In any case, it is essential to provide for an EU-wide harmonised understanding of circumstances constituting material changes in order to avoid distortions in the disclosure of charges towards investors.

We hope that our comments and suggestions provide some assistance to CESR's further work on development and refinement of the KID concept for UCITS. In this respect, we remain at CESR's disposal for further in-depth discussion of the issue at hand or any questions pertaining to our reply.

Yours sincerely

BVI Bundesverband Investment und Asset Management e.V.

Signed:	Signed:
Stefan Seip	Dr. Magdalena Kuper