Consultation on Key Investor Information disclosures (KII) for UCITS

Initial comments from JPMorgan Asset Management

JPMorgan is a leading global financial services firm with assets of nearly two trillion dollars and operations in more than 50 countries. The firm is a leader in investment banking, financial services for consumers and businesses, financial transaction processing, asset and wealth management and private equity.

Our businesses operating in Europe include **JPMorgan Asset Management**, a global fund manager with over $1 trillion in funds under management covering all main asset classes (equity, bond, money market, real estate, hedge, private equity and currency). **JPMorgan Worldwide Securities Services** is one of the largest providers of fund services in Europe and provides its clients with a wide range of related services. **JPMorgan Investment Bank** advises on corporate strategy and structure, equity and debt capital raising, sophisticated risk management, research and market-making in cash securities and derivative instruments around the world, as well as participating in proprietary investment and trading.

JPMorgan aims to play an active role in public policy debate in Europe and is particularly engaged in current discussions on UCITS reform. We welcome the interest that the European Commission and the Committee of European Securities Regulators are taking in developing a true single market in investment funds and fully support this work. In particular, we would like to congratulate CESR for applying the conclusions of the work it has done on UCITS distribution to the KII, as Chapter 3 clearly and correctly describes the wider context in which the KII would be used.

We are broadly in favour of CESR's recommendations concerning the form and contents of the KII. However, we would like to emphasize the following points:

- **The KII is a product document, not a marketing document**. The Consultation Paper is generally in agreement with this point, stating that the KII should not "primarily be a marketing or investor education document" (Article 6). However, it is important to remember that a product document does not include local marketing information that could potentially vary between Member States (as suggested in Article 4.35), and should not be subject to Host Member State approval (as suggested in Article 4.29)

- **Maximum harmonization is essential for the KII to succeed**. Should the KII not be completely harmonized across the European Union, it will not be possible to attain CESR's goal of enabling "comparisons to be easily made between different offerings" (Article 1). Additionally, costs would be incurred across the funds industry to convert to a KII that would potentially provide no cost savings relative to the current Simplified Prospectus (SP)

- **The legal liability of the KII must be limited**. We agree with CESR's proposals that the legal liability be limited to cases where information is "misleading, inaccurate or inconsistent with the full prospectus" (Article 4.6). However, we are unclear if civil liability can be covered by the UCITS Directive, as this is the domain of domestic common law. On a related point, we would also like to mention that "pre-contractual" does not have a common meaning across Europe

- **There should be no requirement to prepare or deliver a KII to non-retail clients**, as mentioned in the Commission's Exposure Draft this spring, rather than a requirement to opt-out. This would still be consistent with the framework for CESR's advice as delivered by the Commission, which requests a document that is "understandable to retail investors" (Article 4.4)

Our detailed responses to the questions in the Consultation Paper are shown on the following pages.

1. *Are respondents aware of other research which is relevant to the market and regulatory failures associated with the SP?*

No, we are not aware of other relevant research that covers the simplified prospectus.

2. *Do respondents consider CESR's proposals would address the regulatory failures associated with the SP?*

Yes, these proposals would address the regulatory failures, provided that the implementation of the KII correctly covers the four points mentioned on the previous page

3. *Do respondents think that CESR has accurately described the context in which KII is likely to be used, and has correctly identified outstanding issues?*

Yes, we think that CESR has accurately described the context in which the KII is likely to be used. We would particularly like to agree with the fact that the delivery of KII "in good time" (and not "in due time" as mentioned in the Consultation) by a company that is in-scope of MiFID and distributes UCITS funds is particularly problematic. "In good time" would seem to mean that investors need to have sufficient time to read and evaluate the KII document, whereas Article 33 of the UCITS Directive only specifies that "The simplified prospectus must be offered to subscribers free of charge before the conclusion of the contract."

We would appreciate some clarification on the interaction between these MiFID and UCITS requirements in the Commission's upcoming Vademecum.

4. *Do respondents agree with the proposed purpose and scope of KII?*

While we generally agree with CESR's proposed purpose and scope of the KII, we would like to mention three points:

a. CESR states that the KII "should be conceived as pre-contractual information". However, as pre-contractual does not have the same meaning in different Member States, similar distribution practices in multiple jurisdictions could potentially result in widely different legal liability.

b. Additionally, while we would like to limit the liability to the cases elaborated by CESR in Article 4.6, our response to the UCITS proposals questioned if this was indeed possible:

> *"We are unsure if civil liability can be covered by the UCITS Directive, as this depends upon domestic common law."*

c. Finally, we understand that CESR does not want the KII to "be primarily a marketing tool." We strongly recommend that the status of the KII as a <u>product</u> document be clarified. As we stated in our response to the UCITS proposals:

> *"What is the status of the Key Investor Information document if it is produced in stand-alone form: product document or marketing document? If a stand-alone Key Investor Information document were to be considered a product document, it would not be subject to host Member State regulator oversight. As such, it would not be modified after submission to the home Member State regulator. However, if a stand-alone Key Investor*

Information document were to be considered a marketing document, it would be subject to host Member State regulator approval. This could mean that marketing could be suspended to check the Key Investor Information document and not because of unsatisfactory marketing arrangements."

Considering that the KII is a product document would imply that CESR's question as to which competent authority should review the local information section (as stated in Article 4.29 of the Consultation Paper) is not valid. Only the home Member State regulator would have authority over the contents of the KII.

However, we strongly agree with the proposal stated in Article 4.30, which refers investors to a website for local information.

5. *Should non-retail investors be permitted to opt out of receiving KII?*

As we stated in our response to the UCITS proposals:

"The exposure draft refers to the possibility to not prepare such documents for professional investors; however, this does not figure in the legislative proposals. In conjunction with the work that we are currently undertaking on a harmonized European private placement regime, we feel strongly that such an exemption should be put in Level 1 legislation

Additionally, we mentioned:

…producing a Key Investor Information document should not be required for professional investors. Such clients can directly contact the fund promoter or refer to the prospectus for additional information."

This would mean that there should be no requirement to prepare or deliver a KII to non-retail investors (according to the MiFID classification), not a need for such investors to certify their opt-out.

6. *Do you think that CESR's proposals on general presentation are appropriate?*

We agree with the general proposals, as outlined in Articles 4.12 through 4.15. Our comments on the remaining articles, including the need to define a precise template and which items to include, can be found in the responses to the following two questions.

7. *Should CESR propose adopting a more prescriptive approach, for instance using detailed templates, or should it support a less prescriptive, more principles-based approach?*

We strongly recommend that CESR adopt a more prescriptive approach, as we stated in our response to the UCITS proposals:

"… the fact that there will be maximum harmonization as to the type of information that needs to be included is quite critical. This should help resolve some of the problems mentioned above, since the rules-based system clearly did not work."

8. In relation to the proposals on content, should Option A (with fewer items) be favored compared to option B?

We are generally favourable to Option A, though with the following caveats:

- The tax regime of the fund may often not be understood by the individual investor, let alone be relevant in many cases
- The identity of the competent authority presumably refers to the authorising Member State regulator. While consumers would most likely be more interested in where to complain, as CESR correctly states in Article 4.23 B), this solution would indeed be tremendously problematic to implement. Instead, investors can contact the entities listed in the "practical information" section in the first instance, i.e. the Management Company, or the local representative / local distributors
- Adding the name of the depositary can help with investor confidence, given that this entity is responsible for the safekeeping and control of assets. We do not feel that the mention of the auditor would contribute in the same way to bolster investor confidence

We have the following comments on additional items in Option B:

- The cut-off time is only helpful for orders sent directly to the Management Company, as other investors may have to meet distributors' individual cut-off times that may be earlier
- Mentioning other share classes that are created for retail investors could be helpful, particularly if performance data is only shown for one share class (please refer to our response to Question 18 for more information)
- Mentioning if assets are not ring-fenced is important. As we mentioned in our response to HM Treasury's Consultation on better regulation in the UK, *"…we agree that OEIC umbrellas should be required to clearly disclose their status should a protected cell regime be introduced. This disclosure could be accomplished in the umbrella's prospectus and other mandatory disclosure documents."*
- Investors should be able to know when the fund was first created

9. How should both options best be tested with consumers?

The options should be tested by consumer focus groups conducted by independent parties.

10. Has CESR correctly struck the balance between reducing the information provided and ensuring investors receive the key messages they need?

Please refer to our response to Question 8.

11. Should the competent authority of the fund and the tax regime of the fund in its Home Member State be included?

Please refer to our response to Question 8.

12. Do you think other items of information are necessary? If so, which ones in particular?

ISIN numbers may be helpful for investors wishing to subscribe to the fund.

13. Do you agree that distribution costs should not be systematically 'unbundled' within KII? Should there be flexibility to allow this where appropriate?

We strongly agree with CESR's analysis in Article 4.24 concerning the separation of the KII, a product document produced by the fund provider, and its delivery by the distributor to the end client. As we stated in our response to the UCITS proposals

> *"It is therefore not possible for the fund producer to provide a distributor with Key Investor Information document by channel, or targeted to a particular clientele, since the fund producers do not have the contact with the client. Instead, fund producers can only provide information on the UCITS itself"*

As such, distribution costs should not be unbundled in the KII.

14. Does the proposed approach of local information (a harmonized section for local information within KII that would be precisely delineated) achieve a correct balance between the need for local information and the smooth functioning of the passport? Is a more radical approach (i.e. signposting local information to a website) feasible and appropriate?

As we mentioned in our response to Question 4, local information has absolutely no place in a product document. This was previously stated in our response to the UCITS proposals, where we questioned

> *"Whether the presentation of marketing arrangements in the Key Investor Information document will be subject to host Member State rules. If so, this could only serve to legitimize the extra work that we are currently doing and defeat any improvements in the product-related content. For example, in Denmark[1], we are obliged to obtain tax advice to classify each one of our funds in a tax category. In France, we need to come up with a table listing all of the sub-funds in the umbrella and the date when each sub-fund was authorized. In Greece, we need to give a list of all distributors and specify each share class that is available at a given distributor. As each one of these requests is personalized, we end up adding a substantial amount of additional, country-specific work for what should be a harmonized pan-European document"*

15. Should a 'building block' approach be permitted, whereby providers can produce different parts of the KII separately?

While we were initially favourable towards having flexibility in communicating the KII, we agree with the arguments against such an approach that CESR presents in Articles 4.32 and 4.33.

16. Do respondents agree with the proposed treatment of funds of funds?

Yes, we agree with the proposed treatment of funds-of-funds.

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[1] *Our response to the UCITS proposals mentioned Belgium, but Belgium has since removed the requirement and Denmark has instated it.*

17. Should separate KII be produced for each sub-fund of an umbrella? Should providers be permitted to produce a compendium for all the sub-funds of an umbrella if they wish?

We would prefer to produce a separate KII for each sub-fund.

However, providers should be able to produce a compendium of all the sub-funds of an umbrella in a ring binder should they so wish. This would allow investors to clearly identify their fund – for example, by placing it in the front of the binder- but allow the client to have information on other funds should they want to switch at a later date.

18. Do respondents agree with the proposals for treatment of unit / share classes? In particular, should providers be permitted to produce KII featuring a representative class?

Yes, we agree with the proposal to allow providers to produce a KII featuring a representative share class.

19. Do you think that CESR's proposals on the presentation of the strategy and objectives of a fund is appropriate?

Please refer to our responses to the Questions 20 through 24 inclusive.

20. In particular, is it relevant to merge strategy and objectives into one generic item?

Yes, we agree that it is relevant to merge strategy and objectives into one generic item. However, we would like to note that we will most likely continue to copy these directly from the prospectus if the legal liability point is not correctly worked out (please refer to our response to Question 4, part a).

21. Is the streamlining of the current applicable Recommendation relevant for the purpose of focusing the description on key elements? Do you agree with the addition of new key items to mention within that section: guarantee, period of holding appropriate if any, design also for retail non-sophisticated investors?

We agree with adding if a fund has a guarantee as per CESR's proposals and particularly commend the distinction made between guaranteed and protected for its clarity. We are also favourable towards including the minimum investment period.

As far as information for the type of investor is concerned, we would like a clearer understanding of the relationship between "sophisticated investor", "retail investor / professional client / eligible counterparty [under MiFID]" and "sophisticated / non-sophisticated UCITS [under UCITS]" and "complex / non-complex products [under MiFID]" before making a recommendation on point (i).

22. More specifically, do you agree that it should be required that in case the capital is not legally guaranteed, the term 'guarantee' should not be used in the KII and it should be briefly mentioned to investors how the protection is achieved? In case the capital is legally guaranteed, do you agree the

guarantor should be mentioned? Do you agree that it is not necessary to mention explicitly that a fund is not capital guaranteed?

Yes, we agree with the proposals concerning guarantees and protection, as stated in the response to the previous question. There should not be any reason to precisely state that a fund is not guaranteed, nor should the term 'guaranteed' be used unless the capital is legally guaranteed.

23. Do you agree that mentioning whether it would not be appropriate for the investor to invest into the UCITS, if he anticipates the need to redeem within a defined time period to be stated, is the appropriate way to deal with time horizon issues without leading to misunderstandings?

Yes, we agree with the proposals concerning investment horizon, as mentioned in the response to Question 21.

24. Do you agree that giving management companies the opportunity to flag funds that have not been designed for non-sophisticated investors, with no legal consequences, would help in preventing misselling, especially in the case of 'execution only' subscriptions?

Please refer to our response to Question 21 for our questions regarding including such a description. Additionally, as we stated in our response to Question 4, we query the applicability of "no legal consequences" as mentioned in this question.

25. Do you agree that the presentation of a synthetic indicator should be favourably tested with stakeholders and consumers?

We are not opposed to testing a synthetic indicator with stakeholders and consumers. However, prior to testing any type of synthetic indicator, it would be necessary to 1) develop a clear methodology that can be broadly applied and 2) write the explanation of that methodology to consumer test at the same time.

Additionally, in conjunction with the European Commission's current Call for Evidence on competing products, we would like to know if such an indicator would be applied across all retail investment products or only for UCITS.

26. What specific presentation (icon, wording, numeric scale…) should be favoured and on what basis?

A numeric scale from 1 to 5, as shown in the mock-up in Annex 8 at the end of the Consultation Paper, would seem to be the clearest and least patronizing. Such a scale would need to be defined so that not all funds are clustered at one end of the rating spectrum or the other.

As we mentioned in our response to the previous question, the written explanation of the scale should be presented next to the numeric rating.

27. How prescriptive should regulators be on the choice of a methodology, given that it should take into account commonly shared risk management practices and suit investors' perception of risks?

As CESR considers that the KII "should be produced according to a relatively prescriptive and standardised approach" (Article 4.12), we do not understand why different methodologies should be allowed across Europe. Using different methodologies would completely eliminate the possibility to compare funds from different markets, and could lead to investor confusion.

28. Are you aware of any specific existing calculation methodology that should be proposed?

No, we are not aware of an existing calculation methodology that should be proposed. Most calculations of risks are based on volatility, but even existing risk measurements such as VaR can be calculated in a variety of ways. Investors seem to be quite concerned with potential loss of capital, but we are unclear as to how to make the link between this point and volatility or VaR.

29. Is the suggested assessment grid at Annex 4 for methodological and presentation issues appropriate and sufficient for identifying a relevant methodology?

Yes, we agree that the grid in Annex 5 would help to identifying a relevant methodology.

30. How could the potential limitations of the quantitative calculation of a synthetic risk / reward indicator be further mitigated?

We feel that it is necessary to determine the methodology, the robustness of the indicator and the coverage of the funds universe prior to opining on mitigating limitations.

31. Do you agree that the possible limitations to a risk / reward indicator might be effectively communicated to consumers through textual warnings? Is the proposed wording appropriate?

While we agree with the use of a disclaimer, we question the proposed wording as follows:

- What does 'usual situations' mean?
- Any unexpected events, even minor ones, could potentially have an impact on the fund
- What is the difference between 'unusual market situations' and 'unexpected event'? Presumably, an unusual market situation would be an unexpected event
- What does medium-term view mean in this context? Does that mean that the indicator should be valid for a 3-5 year period?
- What are 'deep market trends'?
- Who will determine whether a fund has got specific features or not?

32. Which funds or which risks might not be adequately captured by a quantitative methodology?

We are not aware of any types of funds, apart from guaranteed funds, that would not be captured by a quantitative methodology.

33. Could the display of scenarios or tables illustrating the behaviour of formula funds enhance the information disclosed for those funds? Do you think that such presentations should be limited to formula funds? Do you think that such presentations might have some misleading effects, might be manipulated, or mistaken for a guarantee? How could these be addressed and reduced? Do you think that such disclosure should be made in a harmonised way? What could be possible ways of showing prospective scenarios?

We do not feel that displaying scenarios enhances information disclosure, as they are often quite complex and therefore not accessible to the end client. As investors tend to purchase formula funds for the capital guarantee, not the potential investment upside, we feel that a clear description of the guarantee is much more useful.

34. On the narrative side, do you agree with the suggested high-level principles?

Apart from the comments made in our response to Question 31, we agree with the suggested high-level principles.

35. Is CESR correct to recommend that information about past performance be included in the KII?

An argument could certainly be made that a product document does not necessarily need to include any performance information. Such information could be included with local marketing requirements on a website (as indicated in Article 4.30).

Since CESR states that past performance is "one of the key focal points for investors within product information", we can only question if CESR intends to apply this rule for all financial products purchased by retail investors.

36. Has CESR identified the right areas and ways in which this information should be standardised?

We fully agree with CESR's recommendations to fully standardize performance information, particularly as compared with MiFID. To date, we have noticed wide dispersions between local interpretations of the MiFID rules relating to performance information.

37. Which charges should performance figures take into account? For example, should figures include allowance for subscription and redemption fees?

Performance figures should be shown net of any charges that are taken out of the fund, i.e. the TER and performance fees. This would imply calculating performance based on NAVs, as is currently the case.

Subscription and redemption fees are often shown as maximum possible values and, as explained in Chapter 8 of the Consultation Paper, aggregating these charges results in "illustrative" figures (Article 8.25). If subscription or redemption fees were to be included in the performance figures, investors would not be able to accurately compare the historical performance of several funds.

38. Has CESR identified the best overall options for including information about charges in the KII?

Yes, we feel that CESR has identified the best overall options for including information about charges in the KII.

39. Should a 'consolidated' charges disclosure be included, and how should it be described?

Above all, a 'consolidated' charges disclosure should be tested with consumers, to verify that this type of disclosure helps them to understand the charging structure of their fund purchase.

Provided that this is the case, we would recommend that a 'consolidated' charges disclosure have the following characteristics:

- This disclosure would have to be accompanied by initial charge disclosure and annual fee disclosure, since 'consolidated' charges would assume that the maximum initial charge is applied and this is not always the case
- The investment horizon used to calculated the 'consolidated' charge would have to be equivalent to the horizon stated elsewhere in the KII
- The text would have to be completely harmonized across all Member States, to enable cross-border comparability
- The performance fee should be included in the 'other charges' section and not the 'consolidated' charges disclosure; however, a reference to the fact that a performance fee exists should be put in the 'consolidated' charges disclosure text. Performance fees can vary quite widely from one year to the next, depending upon market returns and investment manager performance
- Calculation of the TER would need to be harmonised, as recommended by CESR in Article 8.40

40. Should options for the disclosure of charges in cash terms be explored further?

No, we do not believe that the options for the disclosure of charges in cash terms should be explored further. Provided that it is possible to show a harmonized 'consolidated' charges disclosure, as explained in the previous question, investors will be able to make comparisons between funds. Additionally, it could be argued that an investor needs to have a certain financial capability in order to understand their investment in a mutual fund, and this would include a basic understanding of percentages.

41. Do you have any comments on how charges should be organised (e.g. between charges relating to subscribing and redeeming units, ongoing fund charges, and contingent charges), labelled (e.g. 'initial charges', 'exit charges', 'ongoing charges') and the accompanying narrative messages regarding what they include or exclude? How much detail is necessary in a document like the KII?

We feel that the approach to Option B outlined on page 50 is relatively clear, both in terms of presentation and terminology. Contingent charges should be referred to as 'other' charges, as we are unsure that all investors completely understand what 'contingent' might mean for a financial product.

42. In relation to the handling of the ex-post and ex-ante figures, is it appropriate to include only a single figure for ongoing fund charges in the KII, and if so, on what basis? Do stakeholders have any particular views as to the handling of such information?

Yes, we feel that what is currently termed Total Expense Ratio (ex-post) should be included as the ongoing fund charges. Our simplified prospectuses currently state that the information included therein is accurate at the date of publication, so investors are aware that this is historical data.

43. How should situations where there is a material change in charging levels be addressed?

Any material change in charging levels should be clearly disclosed within the KII. This cannot be included in an ex-post ongoing fund charge; however, the disclosure that this figure is likely to be materially different going forward should be right next to the percentage.

Additionally, the KII should be updated whenever there is a material change to the fund and annually otherwise.

44. Should portfolio transaction charges be included or excluded from the disclosure of ongoing fund charges? If they should be included, how should assets for which transaction charges are not readily available be handled?

We would like to differentiate between two different types of portfolio transaction costs:

1. Brokerage and associated costs incurred when purchasing a security. These costs are reflected in the purchase price of the security and automatically figure in the NAV

2. Costs per transaction charged to the fund by the fund manager whenever there is portfolio turnover. Not all UCITS apply these costs; however, there is uneven disclosure of these costs across Europe according to domicile

For the first type of portfolio transaction costs, it is clearly not in the investment manager's best interest to use brokers who apply excessive brokerage costs, as that would lower the fund's return and therefore the investment manager's fees. Additionally, investment managers who are in-scope of MiFID are obliged to apply best execution rules to all of their investment management activities, including UCITS. Therefore, we do not see how disclosure of such costs could potentially benefit the end investor.

For the second type of portfolio transaction cost, the fund's return may be lowered but the charges which cause this are going directly to the fund's manager. These charges should be disclosed as part of the 'ongoing charges', as they are a potential source of conflict of interest (i.e. they are part of the fees which consumers are paying to the fund's manager).

45. Has CESR identified the best option for handling performance fees in the KII?

In Article 8.33, we do not agree with including performance fees within the ongoing fund charge, as we stated in our response to Question 36.

46. Do you agree that CESR should recommend that charges are disclosed on a maximum basis?

Yes, we agree that CESR should recommend that charges are disclosed on a maximum basis.

47. Are there any options for providing more accurate information, in a way which consumers might understand, about charges under different distribution arrangements?

We strongly disagree with the notion that consumers should be informed about distribution arrangements in a product document. Please refer to our response to Question 13 for more information on this subject.

48. Do you agree that CESR should recommend that charges for a feeder fund and its master be combined into a single disclosure in the KII?

Yes, we agree that CESR should recommend that master and feeder fund charges should be combined in a single disclosure for the feeder's KII.

49. Do respondents have any comments on the proposals for consumer testing?

No, we do not have any additional comments on consumer testing other than our response to Question 9.

50. Do respondents have any initial views on the one-off costs of replacing the SP with KII?

No, we do not have any initial estimates of the cost of replacing the SP with the KII, especially as the final mock-up of the KII is not available.

51. Do respondents have any initial views on the on-going costs of KII, compared with those currently included in producing the SP?

If the KII is not completely harmonized across Member States, it will most likely be as expensive to produce as the SP.

52. What, if any, transitional arrangements should there be if the SP is replaced with KII?

There should be a standard transitional period across all Member States of between 12 and 18 months immediately following the common transposition deadline.

53. Is the gradual introduction of KII feasible?

Once the transitional arrangements are completed, we feel that there should be a common KII across all countries and not a mix of SP and KII. If this is not the case, CESR's goal of presenting this information "in a way that enables comparisons to be easily made between different offerings" (Article 1) will most certainly not be attained.

JPMorgan Asset Management would welcome the opportunity to discuss any of the points covered in this note. In the first instance please contact:

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