

REPLY TO CESR'S CALL FOR EVIDENCE ON KEY INVESTOR DISCLOSURES FOR UCITS

EFAMA¹ welcomes the possibility to comment on investor disclosure, an issue which is crucial for the industry. However, we believe that CESR should have allocated a longer period to reply to the three Calls for Evidence, in view of the fact that the time table proposed by the Commission gives CESR time until the end of 2007 to provide advice. The Calls for Evidence are extremely detailed, and it was difficult to comment in detail on all issues, in spite of the preparatory work that EFAMA had already completed last year. We are planning to carry out further work on the Key Investor Information concept, and hope that further input on some details can be provided to CESR before the draft advice is subject of Consultation later in the year.

Regarding the content of the Simplified Prospectus/Key Investor Information, we are including in Annex I the results of EFAMA's work on the subject carried out last year.

In this reply we will focus primarily on the Request for Assistance submitted to CESR by the European Commission, but we would like to make three comments on CESR's **Call for Evidence on UCITS Distribution**:

- 1) In para. 5 CESR presents three scenarios for distribution, with different degrees of involvement by the fund provider. We disagree with CESR's analysis in Para. 6 regarding the sales made by a company or agent in the same group. Except in the case of direct sales to investors and of sales through tied agents employed directly by the UCITS management company, in all other cases the fund provider does not have direct control over the entire content of the information and its provision to investors. It is irrelevant whether the distribution happens via third parties or via group companies: the entity responsible for the disclosure is the distributor, and the only compliance duty at group level is to manage possible conflicts of interest that may arise from the intra-group relationship.
- 2) EFAMA does not believe that distributors should "tailor the key investor information they receive from providers", unless the purpose is to provide local information regarding contact points, marketing, etc., or unless the UCITS is sold in a wrapper.
- 3) Lastly, we disagree with the equation of funds of funds and "packaging", as a fund of funds is a separate product, where investors can not only diversify their

¹ EFAMA is the representative association for the European investment management industry. Through its 23 national member associations and over 40 corporate members, EFAMA represents about EUR 15 trillion in assets under management, of which EUR 7.5 trillion managed by around 46,000 investment funds. For more information, please visit www.efama.org.

holdings, but also obtain the services of active fund selection and allocation by a fund manager, which are usually not available in wrappers. Furthermore, the costs of a UCITS fund of funds are entirely transparent, and there is already a requirement to provide a simplified prospectus.

GENERAL COMMENTS ON KEY INVESTOR DISCLOSURES FOR UCITS

During the past decade EFAMA has consistently promoted the idea of a simplified prospectus as necessary information tool for retail investors, and produced already years ago a concise two-page model of key disclosure document. Unfortunately, the implementation has failed to achieve its aim, particularly due to extensive goldplating at Member State level, and the result is a document which in most cases is too long and complicated for retail investors.

In spite of its implementation failure, EFAMA believes that the concept should be retained, and welcomes the willingness by the Commission and all European legislative bodies to make the simplified prospectus what it should be. In view of past experiences, however, we believe that binding legislative proposals are necessary, and that they should be sufficiently detailed (through Level 2 implementing measures), thus ruling out any national additions.

A broad majority of EFAMA members considers that the simplified prospectus should:

- Target retail investors;
- Provide product information and not investor education;
- Allow for comparability (full harmonisation of information to be included but leaving some flexibility to the management company regarding layout and wording);
- Focus on the information an investor needs to make a considered investment decision.

Role of the Simplified Prospectus

The simplified prospectus should be retained. However, its role must be clearly defined, as the attempt to play too many roles has so far led only to failure. It must return to its original aim, i.e. to provide easily understandable and comparable information with some standardisation where necessary, to enable investors to take informed investment decisions and to facilitate cross-border marketing of funds.

The simplified prospectus should not aim at providing basic financial education for investors. Such information should be provided separately, either by industry or – preferably – by national authorities.

The simplified prospectus should be offered to retail investors in the pre-contractual phase of sales and it should be regarded as sufficient information to conclude the contract. It should be part of the documents constituting the fund, but at the same time have a different purpose from the full prospectus and not be considered as its substitute.

There should be no obligation to produce a simplified prospectus for institutional investors. Its focus must be to deliver essential information to the average investor in

a simple, understandable language, not providing information to regulators. It should be possible to use the simplified prospectus in any Member State without modifications, although a translation would be required.

Format of the Simplified Prospectus

The format of the simplified prospectus should be standardised where appropriate and feasible, with a translation of the standard terminology available in all languages. Regulation of the content should be prescriptive enough so as to avoid any addition by national authorities, including the home Member State authority. Full harmonisation of information to be included is necessary to achieve a level playing field for investment funds in Europe, and for investors to be able to compare funds from different countries. However, some flexibility should be left to the management company regarding layout and wording.

Liability attaching to the Simplified Prospectus

At the same time, the liability deriving from the simplified prospectus should be limited following the example of the Prospectus Directive, which regulates the publication of a full prospectus and of a summary (Articles 5 and 6). Art. 5(2)(d) limits the liability attached to such summary. The same limitation of liability should apply to the simplified prospectus, where a warning should state that any liability claims should be based on the consideration of the full prospectus, referring investors to it.

Approval of the Simplified Prospectus

Lengthy and burdensome procedures with respect to the approval of the simplified prospectus by the home state regulator should be avoided. Therefore, the simplified prospectus should simply be filed and no prior approval by the authorities – be it the home or the host state regulator – should be required. Only material changes to the simplified prospectus would require an amended filing with the regulators, and such material changes should be clearly defined to avoid diverging interpretations by regulators. Updates of regularly changing information (i.e. performance) should not qualify as material changes.

Updates

In order to serve as a marketing document, the simplified prospectus should become a “living document” that contains regularly updated information (for example, performance figures), as long as the frequency of updates is left to the discretion of the fund management company (beyond the minimum of once a year). It could then be used also in place of a fact sheet, and that would represent an added value both for industry (cost savings) and investors (one single document would be less confusing than several).

Consumer testing

Any future proposal should be tested with consumer panels before implementation, in order to avoid the same mistakes and another failure, in the interest of investors as well as the industry.

SPECIFIC COMMENTS ON THE COMMISSION'S REQUEST FOR ASSISTANCE

We broadly agree with the Commission's Request for Assistance to CESR, but have some detailed comments.

The Commission in its Exposure Draft and in this Request for Assistance has opened the discussion on the need for one single document, as well as on the format of disclosure for UCITS as underlyings in different wrappers.

One document or information building blocks?

In spite of the flexibility of the "building block" approach, EFAMA is in favor of one document, as the possibility to "tailor" the information could lead to requests to modify the Key investor disclosure according to the wishes of each distributor, reducing comparability and adding significantly to costs. Furthermore, should the disclosure information be used in marketing materials, it would become subject to scrutiny by regulators in host Member States during the notification procedure, possibly leading to requests of modification or additions, also to the expense of simplicity and comparability.

Disclosure for UCITS as underlyings in different wrappers

Regarding Key investor disclosure for UCITS in wrappers, no additional requirements should be imposed on UCITS vis-à-vis non-UCITS funds, otherwise UCITS would be disadvantaged and other funds would be chosen as underlyings.

It is also very important to avoid imposing burdens on UCITS managers which do not provide any tangible benefit to investors: the obligation to produce a Key Disclosure document without the obligation to deliver such information to the final investor would be a useless – but very costly – exercise. Under a worst-case scenario, it is possible that the final investor could receive only the Key investor disclosure for the fund(s), without any further information about the wrapper, or at least its costs. As the wrapper costs often are much more significant than the costs of the underlying fund(s), the Commission proposal could lead to investors receiving not only incomplete, but misleading information.

EFAMA therefore does not agree with the Commission's approach to start with new requirements in a modified UCITS Directive to bring about improved disclosure for wrappers. We believe that the opposite approach should be followed, namely to start by requiring disclosure for all wrappers in the applicable Directives, and – if necessary – to require the provision of the necessary information when it is certain that it will be used, and then not only from UCITS.

The goal should be to provide Key investor disclosure equivalent to that provided for UCITS, but the extent of the information and the format required to do so for wrappers might not always be the same as what needs to be disclosed to a retail investor purchasing units in a UCITS. In particular, the practical/local content might not be the same, so the only information to be provided regarding the UCITS would relate to product characteristics and cost.

Such product information would be either already available in the Key investor information document for retail investors (when the UCITS is distributed also without the wrapper), or it could be provided to the wrapper creator in an equivalent format without imposing filing obligations on the UCITS manager, and thus preserving the level playing field between UCITS and non-UCITS. After all, asset managers already provide extensive information to institutional investors when they manage discretionary portfolios, but without specific filing or approval obligations.

The Commission should first carefully study how the level of investor disclosure for all wrapped products under MiFID, the Prospectus Directive and under the IMD for unit-linked insurance products can be brought up to the UCITS standard, and impose further obligations on UCITS managers only if it proves to be necessary, in the context of a regulatory upgrade of disclosure obligations for wrappers.

Cost disclosure

EFAMA believes that MiFID disclosure of distribution costs is not possible via the Key Investor Disclosure for UCITS, as the information varies from distributor to distributor, and the format might vary from country to country. Furthermore, such an approach would essentially result in the imposition of MiFID obligations on UCITS management companies. EFAMA believes that any disclosure requirement relating to distribution costs can be made exclusively by the distributor, which is also the only entity under such legal obligation.

Presentation of information

EFAMA supports the possibility to electronic/internet delivery of the key disclosure information besides physical delivery.

“Expected outcomes”

EFAMA wishes to warn against a discussion in the Key Investor Disclosures for UCITS of “expected outcomes”², as no guarantees of performance can be given (except for guaranteed funds), and all possibility of extrapolation from past performance should be clearly excluded.

Lastly, we would like to have clarity on the future of existing national formats for investor disclosure, after the adoption of new Key investor disclosure regulation.

We remain at CESR’s disposal for any clarification.

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² 4th Paragraph, page 5.

ANNEX I

STRUCTURE & CONTENT OF THE SIMPLIFIED PROSPECTUS

EFAMA is of the opinion that the content of Schedule C of Annex I of the UCITS Directive should be reviewed and conform to the following principles:

- The simplified prospectus should focus on essential information. Signposting should refer the investor who wishes further (or more detailed) information to the full prospectus and/or to other sources.
- There should be one simplified prospectus for each sub-fund within an umbrella and there should be flexibility regarding the number of share classes included in the simplified prospectus at the issuer's option.
- Local content items (e.g. local distribution information, price publication) of the simplified prospectus should be adapted to each individual market.
- The simplified prospectus should state the total expense ratio (TER) of the fund, the management fee and (if applicable) performance fees. TER calculation should be harmonized. The simplified prospectus should also provide subscription/exit fees in the form of maximum fees, not of local market fees (the multiplicity of fee arrangements at distribution level makes it impossible). Although it seems that some investors have difficulty understanding percentages, most EFAMA members believe that they remain the best way to show costs, and that there are problems presenting some fees (performance fees, exit fees) as cash costs.
- Regarding performance presentation, a bar chart is deemed the best way to present annual performance, and at the same time it provides a good graphic representation of the fund's possible downside risk.

This presentation should be based on annual (i.e. 12-month) performance figures. In order to achieve full comparability of figures among different funds, calendar-year performance figures should be used. This was also the standard used in the FEFSI model of 2002. If the fund's fiscal year does not coincide with the calendar year, performance figures should not require auditing.

Besides annual performance, cumulative average returns for 3, 5 and 10 years should be shown. The management company should have the flexibility to choose between cumulative periods calculated on a calendar year basis or year-to-date (YTD). It should also be optional to add YTD performance figures to the bar chart for the current year, making the simplified prospectus a "living document" really comparable to a fact sheet.

A comparison against a benchmark should be mandatory only if said benchmark was mentioned in the fund's investment policy, otherwise representation of the benchmark should be optional.

- Regarding risk disclosure, EFAMA has come to the conclusion that a verbal description of the risks is more appropriate than any graphic representation such as "risk meters". Furthermore, the simplified prospectus should contain a short verbal description only of the most relevant risks, and the risk description should be complemented by a reference to the full prospectus (or other documentation) for full disclosure.

- An indication regarding the suggested minimum holding period may be provided on a discretionary basis. Such a holding period may also be expressed in generic terms (short, medium, long term).

Some information currently included in the simplified prospectus should be dropped as it is either not interesting or confusing for retail investors, for example:

- Names of auditors and of the depositary,
- Profile of the typical investor (a segmentation of retail investors is not necessary. Under MiFID the advisor should help the investor choose the appropriate product mix),
- Turnover rate.