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Asset management/ UCITS

Response to CESR's consultation on technical advice at level 2 on the format and content of Key Information Document (KID) disclosures for UCITS

Key Points:

- **The EBF considers most of CESR's proposals appropriate and expects that the KID will be a highly useful information document for retail investors.**
- **The Federation welcomes in particular that the use of a synthetic risk-reward indicator is now only considered in conjunction with a narrative explanation.**
- **The EBF also welcomes that CESR recommends allowing the presentation of performance scenarios for structured funds. Additional consistency of KIDs for different fund types might be achieved by allowing the display of performance scenarios for classical funds.**
- **The Federation's main remaining concern is with regard to the different methodologies proposed for the synthetic risk indicator for different types of funds. The potential distortions arising from such divergent approaches underlie all the more the need for an additional narrative section.**

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Related documents: CESR consultation paper, <http://www.cesr.eu/popup2.php?id=5789>

General remarks

1. The European Banking Federation welcomes the opportunity to comment on CESR's draft technical advice to the European Commission on the format and content of Key Information Document disclosures for UCITS. **The EBF welcomes the development of CESR's thinking since previous proposals on a number of important aspects, notably on the presentation of risks and rewards, on the display of performance scenarios, and on the use of VAR for the calculation of the synthetic indicator.**
2. The EBF **supports that CESR's work has focused exclusively on product disclosures for UCITS**, in spite of the Commission's consideration that the work on the UCITS KII could be seen as a benchmark for **disclosures for other investment products. The EBF has shared with the Commission some important reservations** about this statement, which risks to ignore the important differences between different kinds of investment products. General aspects of the UCITS KII, such as the length and way of presentation, may be a useful starting point for disclosures for other types of products. However, such an approach might be misleading for specific elements of the UCITS KII document which would in many instances be of less relevance for differently functioning products.

Specific comments

Form and presentation of Key Investor Information

Do you agree with the proposals in Box 1? Should the information referred to in point 9 of the box be called 'Practical information'?

3. The EBF agrees with CESR's proposals for the general presentation of the KII and with the proposed sections to be included in this document.
4. The EBF does not have any objections to the reference to 'practical information' under point 9. However, it must be clear that the KII is a fully harmonised document across EU Member States – i.e. this section could not include any details that would vary depending on the distribution chain of the fund or depending on the country where the fund is distributed.

Do you agree with the proposals in Box 2? In particular, do you agree that the maximum length of the document and the minimum acceptable point size for type should be prescribed at Level 2? Are there any other rules that should be prescribed in relation to the appearance of the KID?

5. The EBF agrees with the proposals made in Box 2. In particular, the **flexibility proposed for structured funds is welcomed**, which will allow the presentation of scenarios to be made in different boxes.
6. At the same time, it **might be considered to also allow the presentation of scenarios for classical funds**. This would on the one hand enhance comparability between different types of funds. On the other hand, the presentation of scenarios for classical

funds would make yet clearer for retail investors the uncertainty of fund performance, and its inter-dependence with the general economic climate.

7. The degree of harmonisation proposed for the characters and the font size seems appropriate, in that it leaves some choice on the presentation, whilst ensuring readability of the document.
8. As regards the requirements for clear expressions and use of plain language, the Federation agrees in principle with CESR's considerations. However, it must be noted that **technical terms are to some extent unavoidable**. Many retail investors find it difficult, in general, to understand financial matters. This is a more fundamental difficulty that must be addressed in parallel, through increased efforts to raise the level of financial literacy. Such efforts are currently being undertaken at national level, and often with the support of the banking industry.¹

Do you agree with the proposals in Box 3?

9. The EBF agrees with this proposal and welcomes CESR's clarification that the KID may be attached to, or form an integral part of, another document.

Content of Key Investor Information

Objectives and investment policy

Do you agree with the proposals in Box 4? In particular, do you agree that the information shown is comprehensive and provides enough detail to ensure comparability between KIDs? Are there any other matters that should be addressed at Level 2?

10. The EBF agrees with these proposals. However, CESR's proposals also highlight the difficulties of refraining from any use of technical terms or "jargon", for example where it should be spelled out (under 1.b (vi) of CESR's proposals) if the choice of assets is guided by such criteria as 'growth' or 'value' stocks.

Risk and reward disclosure

What are the advantages and disadvantages of each option described above? Do you agree that Option B (a synthetic risk and reward indicator accompanied by a narrative) should be recommended in CESR's final advice?

11. The EBF **welcomes that CESR would now consider the use of a synthetic risk-reward indicator only in conjunction with a narrative explanation**. The Federation has previously underlined the many difficulties and possible mis-understandings around a synthetic indicator.

¹ The EBF has recently produced a report on the initiatives taken by EBF member associations and their member banks to enhance financial education, "EBF Report on Financial Literacy": <http://www.ebf-fbe.eu/content/Default.asp?PageID=226>

12. In response to CESR's spring consultation on possible implementing measures concerning the future UCITS Directive (CESR Ref. 09-179), the Federation furthermore highlighted serious disadvantages of the synthetic risk indicator. Being build on past data, such an indicator would risk being misleading as past data can only be a useful indicator of future risk levels over limited periods of time. Furthermore, CESR's proposal of measuring risk on the basis of past volatility is only useful for traditional types of funds, but could not be used for, for example, guaranteed funds.
13. The EBF's preference so far has therefore been **in favour of a purely narrative description**. The EBF notes that its concerns have to some extent been taken into account, and that CESR now considers an approach based on Value at Risk (VaR) for funds with markedly asymmetrical return distributions.
14. However, European banks are concerned that **a distinction between different types of funds means breaking with the principle of using a single methodology for all UCITS funds** and risks leading to distortions. This is also in opposition to CESR's own consideration that "a common methodology (is) required to assign a risk category to each UCITS fund". While the EBF recognises the difficulty of finding a single indicator that would be well applicable to all types of funds, this shortcoming all the more highlights the necessity of an additional narrative explanation.
15. With regard to the addendum to the consultation paper containing specific methodological proposals for the computation of the indicator, the EBF has a preference for option A over option B. Whilst option A is designed to represent the actual risk level of funds on the basis of empirical data, i.e. relies on real probabilities, option B relies on the assumption of risk-neutral probabilities. This would lead to additional distortions of the indicator as opposed to classical funds, for which such a simplifying assumption is not made.
16. However, in order to introduce an additional distinction between relatively high-risk funds the EBF would suggest that it be considered to introduce an additional risk class for sigmas over 25%.

Do you agree with the proposals for presentation of risk and reward in Box 5A? Are there any other issues that CESR should consider if it decides to recommend this approach to the disclosure of risk and reward?

17. **The EBF would support these proposals for an enhanced narrative approach to presenting risks and rewards.** Whilst CESR is right to point to the danger of different approaches in practice towards the narrative risk-reward-representation, its proposals for reducing the scope of differences are helpful in this respect. Importantly, the Federation agrees that the notion of 'risk-free' investments must be given particular attention.

Do you agree with the proposals for presentation of risk and reward in Box 5B? In particular, is the proposed methodology in Annex I capable of delivering the benefits of a synthetic indicator? Does the methodology proposed by CESR work for all funds? If not, please

provide concrete examples.

18. As per our remarks above, the EBF is **concerned about the scope for misunderstanding of a synthetic indicator**, as well as about the distortions that would arise from using different indicators.
19. However, should CESR nevertheless decide to recommend a synthetic indicator then the **narrative description would have to be very clear on the limitations of such an indicator**.
20. Furthermore, the Federation would recommend that the **link between risk and reward be made more explicit** than currently the case in CESR's consultation paper.

Charges disclosure

Do you agree with the proposals in Box 6? In particular, do you agree that the table showing charges figures should be in a prescribed format? Do you agree with the methodology for calculating the ongoing charges figure?

21. The EBF **agrees with the proposals set out in Box 6 for the presentation of charges**, including on the table presentation on charges figures.

Do you agree with the proposals in Box 7? In particular, do you agree that CESR should not prescribe a specific growth rate in the methodology for calculating the illustration of the charges?

22. The EBF continues to believe that a **summary charges measure is likely to be misleading, as many investors would not understand its illustrative nature**. However, if it is to be introduced then the Federation would agree that the assumption of a common growth rate would be meaningless.

Do you agree with the proposals in Box 8?

23. The EBF agrees.

Do you agree that a variation of 5% of the current figure is appropriate to determine whether a change is material?

24. 5% of variation appears too low a threshold to require KID updates. The EBF would instead suggest a threshold of 10%.

Do you agree with the proposals in Box 10?

25. The EBF agrees.

Past performance presentation

Do you agree that the above CESR proposals on past performance presentation are sufficient and workable? If not, which alternative approach would you prefer?

26. The Federation **welcomes CESR's consideration that performance scenarios might be required for structured funds**, to replace the presentation of past performance which is indeed not meaningful for structured funds.

Do you agree that the above CESR proposals on past performance calculation are sufficient and workable? If not, which alternative approach would you prefer?

27. As noted above the EBF believes that it should also be **considered to allow the presentation of performance scenarios for classical types of funds**. Performance scenarios would make it very clear and visible to retail investors that past performance is not indicative of future performance. It would also enhance comparability between different types of funds.

28. Besides, in point 1 of Box 13, CESR states that "(a) duly revised KID shall be published no later than 25 business days after 31 December each year". This requirement cannot be met in those countries where fund figures must be audited. Instead, the Federation would suggest that this requirement should be formulated as "25 business days after signing (or publication) of the annual report".

Do you agree that the above CESR proposals on material changes are sufficient and workable? If not, which alternative approach would you prefer?

29. The proposed approach is workable and clear, in the view of the EBF.

Do you agree with the proposed approach on the inclusion of a benchmark alongside the fund past performance? If not, which alternative approach would you prefer?

30. The EBF agrees that benchmarks should be displayed if the objectives and investment policy section of the KID makes reference to such a benchmark.

Do you agree that the above CESR proposals on the use of 'simulated' data for past performance presentation are sufficient and workable? If not, please suggest alternatives?

31. The EBF welcomes and supports CESR's suggestions in this respect.

Practical information

Do you agree with the proposals in Box 17 for the content of 'practical information' disclosure?

32. The Federation agrees.

Do you agree with the proposals in Box 18 with regard to the use of signposts or references to other information?

33. The EBF agrees.

Circumstances in which a KID should be revised

Do you agree with the proposals in Box 19 with regard to the timing of reviews of the KID?

34. The EBF agrees.

Special cases – how the KID might be adapted for particular fund structures

Umbrella structures

Do you agree with the proposals in Box 20 with regard to adaptations of the KID for umbrella structures?

35. The EBF agrees.

Share classes

Do you agree with the proposals in Box 21 with regard to adaptations of the KID for UCITS offering different share classes?

36. The EBF agrees.

Fund of funds

Do you agree with the proposals in Box 22 with regard to adaptations of the KID for funds of funds?

37. The EBF agrees.

Feeder funds

Do you agree with the proposals in Box 23 with regard to adaptations of the KID for feeder funds?

38. The EBF agrees with CESR's proposals; including that a separate KID should be produced for each feeder fund.

Structured funds, capital protected funds and other comparable UCITS

Do you agree with the above CESR proposals on performance scenarios (Boxes 24A and B)? In particular, which option (A or B) should be recommended? If not, please suggest alternatives.

39. The EBF **welcomes CESR's suggestion of displaying performance scenarios for structured funds**. The Federation would **support option A** for the presentation of performance scenarios for structured funds, i.e. an explanation of the formula or the

calculation of the pay-off, supported by performance scenarios for favourable, adverse and flat market conditions, respectively.

40. Whilst option B is theoretically also meaningful, it requires a substantially greater level of financial literacy to be correctly understood by potential investors. It also raises questions about the appropriate risk-free rate against which to compare the results of the fund. This is also in consideration of the fluctuations of risk-free rates which would have to be ignored in a document that is normally only updated yearly or would otherwise give rise to further confusion by investors.
41. CESR is however right to point to the important scope for different assumptions underlying performance scenarios. The EBF would expect that **work at Level 3 will have to be undertaken to reduce divergences** across countries and across asset management companies as much as possible.

Other issues

Medium and timing of delivery

Do you agree with the proposals in Box 25 on the conditions under which a durable medium might be used and requirements to be met when using the Internet?

42. The EBF agrees with CESR's suggestions. In particular, the Federation welcomes CESR's clarification that the provision of information by means of electronic communications shall be treated as appropriate if there is evidence that the client has regular access to the internet; and that the provision by the client of an e-mail address for the purposes of carrying on that business shall be treated as such evidence.

Other possible Level 3 work

Do you agree with the approach to transitional provisions set out above?

Are there any other topics, relating to KII or use of a durable medium, not addressed by this consultation, for which CESR might undertake work on developing Level 3 guidelines?

43. The EBF agrees.