INVERCO REPLY TO THE CESR CONSULTATION PAPER ON TECHNICAL ISSUES RELATING TO KEY INFORMATION DOCUMENT (KID) DISCLOSURES FOR UCITS

1.- INTRODUCTION

INVERCO (Spanish Association of Collective Investment Schemes and Pension Funds) represents more than six thousands Collective Investment Schemes and more than 1,300 Pension Funds, with assets under management over EUR 303 billion.

INVERCO congratulates CESR for its excellent work on Key Investors Information disclosures, that clarifies, explains and systematizes the options available in the areas of risk and reward, past performance and charges.

INVERCO appreciates opportunity offered to industry practitioners to make comments and to contribute, giving additional points of view, with respect to CESR's consultation paper issues.

In section 2, INVERCO expresses its general comments, in order to avoid risks overestimates and adapt matters referred to calculation of the ongoing charges figure.

2.- GENERAL COMMENTS

As a general approach to CESR's consultation paper, INVERCO proposes the following issues:

1) It should be avoided overestimating risks of certain types of funds.

CESR's document distinguishes the following types of funds: market funds, strategy funds (absolute return funds, total return funds and life cycle/target maturity funds) and structured funds (including guaranteed funds).

It is proposed that, when full T-period return history is available and the fund's investment policy has not been revised during this period, market funds estimate the annualised volatility according to the general formula.

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However, there are specific methodologies to estimate volatility of market funds (when market funds are new or have revised their investment policy substantially), strategy funds and structured funds. Additionally, some of this kind of funds:

- may be assigned automatically to the highest risk category;
- may be moved to a category higher than its volatility history would require (applying a risk "add-on");
- may have a "modifier" to the assigned category, represented by an exclamation mark after the number, to show that it has particular risk characteristics.

Specific methodologies and the other proposed corrections could lead this kind of funds to a level of risk, that could not be appropriated. For example, it is proposed that market funds, that are new or have revised their investment policy substantially, estimate their volatility by using approximations based on market fund's representative index, portfolio mix or benchmark. When a large part of the market fund's return history is derived from a proxy, a risk "add-on" may be applied by placing the fund one risk category higher than implied by the historical volatility. This increase of risk category could overestimate risks of market funds, when they have established a low risk investment policy recently.

<u>This situation requires a revision of specific methodologies and the other proposed corrections, in order to avoid overestimating risks of market funds (when market funds are new or have revised their investment policy substantially), strategy funds and structured funds.</u>

2) ***It is necessary some explanation about calculation of the ongoing charges figure.***

Annex B proposes charges that should be taken into account in the amount to be disclosed as ongoing charges in the KID or not:

- Section 1.3. It should be included in the amount to be disclosed, if they are passed as debits through the balance sheet of a UCITS, for example, "*all payments to the operator of the UCITS, directors of the UCITS if an investment company, the depositary, the custodian(s)* and *any investment adviser"* and *"any costs of distribution or unit cancellation".* The list contained in section 1.3 is indicative but not exhaustive.

- Section 1.4. Certain charges and payments do not form part of the of the amount to be disclosed, such as "*entry / exit charges or commissions, or any other amount paid directly by the investor (e.g. charges payable to*

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distributors)"… and "*payments necessarily incurred in connection with the acquisition or disposal of any asset for the UCITS' portfolio, whether these payments are explicit (e.g. brokerage charges, taxes and linked charges) or implicit (e.g. costs of dealing in fixed-interest securities, market impact costs)".*

- Section 1.5. It establishes that *"the exclusion for transaction-related costs does not extend to transaction-based payments made to the operator, depositary or custodian, or anyone acting on their behalf; all such amounts must be taken into account in the disclosure figure".*

In redaction of these sections, it should be clarified that certain charges must not be a part of the amount to be disclosed such as <u>cost of distribution that are paid by management company</u> and <u>portfolio transaction costs that are received by operator, depositary or custodian, or anyone acting on their behalf</u>:

- In Spain, in *"management fee model"*[1], <u>costs of distribution</u> are never paid by investors in Collective Investment Schemes because these cost are paid by the asset management company. In these cases, information related to intermediary costs must be omitted, because it could be misunderstood by Spanish CIS investors that could wrongly believe that they incur such distribution-related costs.

  To contemplate this proposal, section 1.4 of Annex B could refers to exclusion of "*entry / exit charges or commissions, or any other amount paid directly by the investor <u>or by the asset management company</u> (e.g. charges payable to distributors)".*

- <u>Portfolio transaction costs</u> must be excluded in any case, irrespective of the recipient. If it is considered arguments similar to those mentioned in section 3.3.2 of chapter 3, including disclosures of transaction costs received by operator, depositary or custodian, or anyone acting on their behalf has the

[1] In Spain, at least, two different models for the distributor´s remuneration can be distinguished. In the first model, that could be called the *"subscription and redemption fee model",* such subscription and/or redemption fee, usually established as a percentage of the net asset value, is received by the distributor as a remuneration for the provision of the distribution service. In the second model, that could be called the *"management fee model",* the distributor receives a percentage of the management fee from the management company. A "mixed model" is also possible, whereby the distributor receives a subscription fee, as well as a percentage of the management fee.

Most of the distribution agreements in Spain fit the "management fee model", while the "subscription and redemption fee model" is rarely used.

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significant downside of treating different recipients in an uneven way, which is likely to distort comparisons between funds.

To clarify this aspect, section 1.3 of Annex B should refer to inclusion of *"all payments, excluding those necessarily incurred in connection with the acquisition or disposal of any asset for the UCITS' portfolio, to the operator of the UCITS, directors of the UCITS if an investment company, the depositary, the custodian(s)* and *any investment adviser"* and section 1.5 of Annex B should be eliminated.

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