efama
European Fund and Asset Management Association

EFAMA Reply to CESR's technical advice at level 2 on the format and content of Key Information Document disclosures for UCITS (CESR/09-552)

EFAMA[1] strongly supports the creation of a short Key Information Document to provide key product information in an easily understandable, short format and to help consumers compare funds. We congratulate CESR for its long and hard work on the KID, which we believe paves the way for much improved investor information.

Section 1: Title of document, order of contents and headings

Q1: *Do you agree with the proposals in Box 1?*
Q2: *Should the information referred to in point 9 of the box be called 'Practical information'?*

EFAMA agrees with the key elements of BOX 1, although we would recommend moving the section on Past Performance after the Risk and Reward profile, as the two are closely linked.

Section 2: Appearance, use of plain language and document length

Q1: *Do you agree with the proposals in Box 2?*
Q2: *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?*
Q3: *Are there any other rules that should be prescribed in relation to the appearance of the KID?*

EFAMA agrees with BOX 2, but we have some reservations regarding the proposal for a glossary on page 14. While on one hand it would help investors, we believe that if it is pursued, it should be prepared by a "neutral" source such as CESR (and could be made available via its website and national regulators' websites). Its role should also be clarified, and specifically it relationship to the KID.

At the current stage, EFAMA believes it would be more helpful to clearly define the KID. We believe that mock-ups should be added to the Level 2 text and will therefore produce some, to submit them to CESR and the Commission.

Some of our members believe that it should be clarified whether or not other information can be added voluntarily to the KID by the Management Company.

[1] EFAMA is the representative association for the European investment management industry. It represents through its 26 member associations and 44 corporate members approximately EUR 11 trillion in assets under management of which EUR 6.1 trillion was managed by approximately 53,000 funds by the end of 2008. Just over 37,000 of these funds were UCITS funds. For more information about EFAMA, please visit www.efama.org.

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Section 3: **Publication with other documents**

Q: *Do you agree with the proposals in Box 3?*

EFAMA agrees.

Section 4: **Objectives and investment policy**

Q1: *Do you agree with the proposals in Box 4?*
Q2: *In particular, do you agree that the information shown is comprehensive enough detail to ensure comparability between KIDs?*
Q3: *Are there any other matters that should be addressed at Level 2?*

EFAMA agrees with BOX 4, with the following exceptions:

Para. 1 (b) (iii): Add to the mention "*and any minimum rating requirements*" the words "*if applicable*". Ratings should be referred to only if mentioned in the prospectus, and reliance on ratings should be reduced.

We recommend moving the mention of the redemption frequency to the section "Practical information".

Almost all EFAMA members believe that it should be up to the Management Company to specify a minimum recommended holding period. They therefore agree with part of Para. 1 (d), but the part of the sentence "*or that a minimum holding period is an essential element of the investment strategy*" should be deleted. The mention of a minimum recommended holding period could mislead investors into believing that a positive return would be guaranteed if the fund is held as long as recommended, and in any case the appropriateness of the investment must be seen in reference to each investor, not to the product per se.

Section 5: Risk and reward disclosure

Q1: *What are your views on the advantages and disadvantages of each option described above?*
Q2: *Do you agree that Option B (a synthetic risk and reward indicator accompanied by a narrative) should be recommended in CESR's final advice? Respondents are invited to take due account of the methodology set out in Annex 1, as supplemented by the addendum to be published by the end of July, when considering their view on this question.*
Q3: *Do you agree with the proposals for presentation of risk and reward in Box 5A?*
Q4: *Are there any other issues that CESR should consider if it decides to recommend this approach to the disclosure of risk and reward?*
Q5: *Do you agree with the proposals for presentation of risk and reward in Box 5B? In particular, is the proposed methodology in Annex 1 capable of delivering the envisaged benefits of a synthetic indicator?*
Q6: *Does the methodology proposed by CESR work for all funds? If not, please provide concrete examples (Respondents are invited to take account of the methodology set out in Annex 1, as supplemented by the addendum to be published by the end of July, when considering their view on the questions above).*
Q7: *Are there any other issues that CESR should consider if it decides to recommend this approach to the disclosure of risk and reward?*

Some EFAMA members favour the narrative approach (5A), as a risk reward indicator does not correctly convey the risks, and would mislead investors into a false sense of security.

Others favour a synthetic risk reward indicator (5B) because narrative is unable to convey the magnitude and probability of risks and is not understood by retail investors.On the contrary, an indicator – although not perfect –better conveys the risk level of a product and offers comparability between products.

EFAMA members that favour Option 5A suggest that the narrative should be more standardized, and some propose the establishment of a glossary (at Level 3) defining the main risk types to facilitate convergence of the narrative description. Furthermore, the reference in Para. 1 (c and d) to the "*likelihood and potential magnitude of gains and losses*" should be deleted, especially if the methodology for determining these risk attributes is not harmonized.

If CESR and the Commission choose the risk reward indicator option, EFAMA believes that it must be supplemented by some additional narrative, as CESR proposes in Box 5B (para. 1). **However, we would appreciate from CESR more clarity in the advice regarding the type of "additional narrative" it recommends.** Almost all EFAMA members agree with the idea of an additional description of the main risks relevant to the fund's profile and/or of risks which may not be captured by the risk reward indicator (besides some disclaimers), but it should be made absolutely clear by CESR in the advice, whereas now the message is rather mixed. We agree to some disclaimers, but feel that CESR should not be prescriptive for the additional text – it should be up to the Management Company which risks it chooses to highlight, depending on the type of fund.

For example, CESR in the explanatory text (end of page 29-beginning of page 30) mentions some points that look rather like disclaimers, while confusingly stating that the additional text should also fulfil almost all the requirements of BOX 5A. In Annex 1, CESR also states in Para. 60 and 61 (p. 83) the disclaimers that should accompany the indicator, again not mentioning any "true" additional text.

However, we believe that the requirement at the end of page 29-beginning of page 30 for the description to "*fulfil the requirements under paragraph 1 (from b) to e) and g)) in Box 5A*" is too extensive and should be deleted, as there is no need to replicate the entire content of BOX 5A if an indicator is used.

With regard to the methodology proposals (in the first Consultation Paper and in the Addendum), a large majority of EFAMA members agree with CESR's proposal, but most have some technical comments and proposals to modify some aspects. We are unable to summarize the different proposals, which will be sent directly to CESR by our members.

We would like, however, to comment on the reduction of risk categories from 7 to 6: many EFAMA members disagree, as it would lead to more crowding of funds into one category. For example, with six categories all equity funds managed by one manager would be ranked in the same category, whether European or emerging markets funds, whereas 7 categories would allow for a differentiation.

Some empirical tests have been done by our members, and the findings are that 7 categories not only reduce crowding, but are stabler than 6. Migration issues should be reduced through migration rules and appropriate risk calculation methodology, not by reducing the number of categories. If the choice was not made for methodological reasons, it should be the result of consumer testing by the Commission – but that is not the case as far as we know. Above all, we believe that a good and well-founded explanation should be given by CESR for such a modification, whereas none was provided.

We strongly encourage CESR to organize technical workshops to finalize the methodology, inviting stakeholder participation. EFAMA offers its full assistance.

If the Risk Reward Indicator is considered the preferred option, it is important that the methodology be included at Level 2, to achieve harmonization and avoid the possibility of differences in implementation at national level.

Section 6: **Charges disclosure**

Q1: *Do you agree with the proposals in Box 6?*
Q2: *In particular, do you agree the table showing charges figures should be in a prescribed format?*

EFAMA agrees with CESR's proposals in BOX 6 regarding the presentation of entry/exit, ongoing and performance charges in percentage terms. However, some of our members consider that the performance fee for the fund's last financial year should not be shown, as it might mislead investors into believing that the charge will be repeated. For ongoing charges we agree with single ex-post figures.

Most EFAMA members find that the statement on Page 33 regarding funds that allow ongoing subscription plans is highly unclear. If such a warning is included, it should be very specific and only required when higher charges are actually possible. If the fees are not specific to the product but related to the plan and applicable to any securities, then they should not be included in the KID.

Moreover, the requirement in BOX 6 (3) (a) "it should be made clear that the investor might pay less" and statements in mockups used in consumer testing such as "Ask your financial advisor or distributor whether you will pay less" could be mistaken by investors for an invitation to negotiate the level of entry charges with the intermediary and are not acceptable in the KID. What should be made clear is that the figures disclosed are the maximum applicable charge (as already indicated in the table), and that the intermediary should disclose the actual level of charges (as required by MiFID).

Q3: *Do you agree with the methodology for calculating the ongoing charges figure?*

Some EFAMA members do not agree with CESR's proposals on the methodology to calculate ongoing charge figures for funds of funds, as the information on ongoing charges for underlying funds is often not available or is outdated. Many assumptions would be required, high costs would ensue, while there would be no additional benefit for investors and they might mistake the estimate for actual costs. This requirement would also potentially create a bias against investment in funds, as well as towards in-house funds to the detriment of open architecture. Should the requirement be retained, it should be sufficient as an alternative to reflect in the ongoing charges for the fund of funds either the annual management fee of the underlying funds, or the maximum allowable ongoing charges for the underlying funds (if available). The quality of information would be comparable to CESR's proposal, but at a much lower cost.

The provision regarding transaction-based payments (point 5 on Page 86) is unclear. The current wording might be interpreted as re-including transaction costs in the calculation method for ongoing charges in case the operator, depositary or custodian or anyone acting on their behalf is party to the transaction. The new text excluding payments "*for which the recipient is not accountable to the UCITS*" creates additional uncertainty in the case of contractual funds, where transactions are concluded with the management company and there is generally no accountability to the UCITS. We believe it is necessary to clarify the provision, and suggest the following new wording:
"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, ***which are not necessarily incurred in connection with the acquisition or disposal of any assets for the UCITS portfolio****; (…)"*

Q4: *Do you agree with the proposals in Box 7?*
Q5: *In particular, do you agree that CESR should not prescribe a specific growth rate in the methodology for calculating the illustration of the charges?*

EFAMA disagrees with CESR's proposal to present a summary measure of charges in the fund currency. Although we understand that many consumers react positively to it, this figure does not seem to improve investors' ability to compare costs, and it is likely to prove very confusing and misleading, as too many assumptions are required.
Should CESR prescribe or not a specific growth rate for the calculation?

- Should CESR choose NOT to prescribe it, the figures for different funds would no longer be comparable;
- on the other hand, if the same rate of return is prescribed, it will be very confusing for investors and will probably never be correct for the fund at hand.

Either way, we do not recommend including the example in the KID.

Q6: *Do you agree with the proposals in Box 8?*

Many EFAMA members agree with CESR's proposal. However, a considerable number of our members are of the opinion that it should not be required to make ex-ante estimates about ongoing charges for new funds. Such estimates would not be feasible due to a variety of unforeseeable factors, and would be misleading for investors, who might think they cannot be exceeded. In case the ex-post fees are actually higher, investment managers could also potentially be held liable under civil law. It should be sufficient for new funds to display the annual management fee together with a clear warning about the impact of possible further costs.

EFAMA believes that the disclaimer recommended by CESR in BOX 9 (3) should also be foreseen for BOX 8.

Q7: *Do you agree that a variation of 5% of the current figure is appropriate to determine whether a change is material?*

A large majority of EFAMA members do not agree with CESR's proposal to choose a specific percentage (5%) as the threshold for a material change, triggering an update in the KID.

We believe that the review should be triggered only by a conscious decision by the management company (active trigger), not by a passive change (for example a change in custody fees triggered by an evolution of assets). Furthermore, such an update trigger should not apply during the first year of life of a fund, and it should also not apply if the fee maximum/cap remains unchanged.

For some EFAMA members, if a specific percentage is retained as a threshold, it should be set at a higher level.

Furthermore, Para. 1 (c) (ii) is very ambiguous and too broad, so it should be either eliminated or clearly explained/defined.

Q8: *Do you agree with the proposals in Box 10?*

CESR proposes to review the KID content on charges at least annually, in connection with the preparation of audited annual accounts. EFAMA understand the rationale, but the audited annual figures are available up to four months after the end of the fiscal year. Even for funds whose fiscal year coincides with the calendar year, it will be impossible to review the KID only once a year unless the deadline in BOX 13 is extended. Should two revisions of the KID be necessary (one for performance and one charges information), costs will increase substantially (or less savings will be realized).

The text of BOX 10 should also reflect our comments regarding BOX 9 (5% threshold for material change).

Section 7: **Past performance presentation**

Q1: *Do you agree that the above CESR proposals on past performance presentation are sufficient and workable? If not, which alternative approach would you prefer?*
Q2: *Do you agree that the above CESR proposals on past performance calculation are sufficient and workable? If not, which alternative approach would you prefer?*
Q3: *Do you agree that the above CESR proposals on material changes are sufficient and workable? If not, which alternative approach would you prefer?*
Q4: *Do you agree with this approach? If not, which alternative approach would you prefer?*
Q5: *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?*

Most EFAMA members broadly agree with CESR's approach in BOX 11.

However, **EFAMA is still very concerned about the recommendation in Para. 4 that no performance can be shown for UCITS without "*performance data for a complete calendar year*".** This goes beyond MiFID's requirements, which are that "*performance information must be based on complete 12-month periods*" and might result in the prohibition to show any performance for up to 23 months, as well as in the impossibility to show performance during the first partial year of existence on a permanent basis. Almost all EFAMA members believe that, in line with MiFID, as soon as performance is available for a twelve-month period, at least the (partial) performance for the first year could be shown. If it is deemed necessary, in line with the labelling used for material changes, there could be an indication on the chart or below that the first column does not reflect a full-year performance. Some are of the opinion that as soon as audited accounts are available, performance figures for the partial first year could be shown in the KID, even if performance is not available for a complete 12-month period.

Not showing any performance at all is likely to be much more confusing to investors, who might think it was withheld to mislead them, and it could subject the UCITS to legal action by investors.

We remain concerned that the blank slots for years when the fund was not in existence will be misunderstood by investors.

Regarding Para. 6 (b), it is sufficient to mention only which charges have been included, otherwise the text would be too long.

BOX 13 – As already stated in our comments on BOX 10, **the deadline of 25 days after the end of the calendar year to revise the KID is too short. Large Management Companies distributing funds into many EU jurisdictions will need to cope with updates (and translations) of potentially hundreds of KIDs. In order to try and achieve a single KID review per year for at least a considerable number of funds, the deadline must be extended.**

Many EFAMA members suggest extending the deadline to a maximum of two months after 31 December, while others believe that three months are more realistic or that the deadline should be related to the availability of audited reports. That way the audited annual accounts might be available and the charges figure could also be updated at the same time.

Some EFAMA members disagree with the prohibition to show any past performance for part of the current calendar year, and would prefer being able to show it, in line with MiFID. CESR should consider allowing part-year performance (for example semi-annually) to be shown also in the KID, as it is shown in MiFID-regulated marketing materials.

A large majority of EFAMA members agrees with CESR's proposals in BOX 14, but favors a more harmonized approach to material changes. We therefore encourage CESR to work at Level 3 on guidance on material changes.

EFAMA believes that there should be no retroactivity for the rules on material changes. First of all, it might be very difficult to establish whether and when in the past there have been material changes. Furthermore, it would be very confusing to investors if material changes previously not flagged were suddenly highlighted.

EFAMA agrees with BOX 15.

Almost all EFAMA members agree with CESR's proposals in BOX 16.However, some of our members consider that track record extensions should be allowed in cases of transfers of fund domicile to another Member State, or in case of a new clone, where an existing fund has been set up in a different domicile for distribution reasons but is otherwise identical in all material respects, including charges.. Some of our members are also of the opinion that track extension should be allowed and would not be misleading if the additional fees (e.g. at feeder fund level or at share class level as mentioned on page 47) were duly taken into account in the simulated past performance.

Section 8: **Practical information**

Q1: *Do you agree with the proposals in Box 17?*

EFAMA agrees with part of CESR's proposals in BOX 17, but disagrees with the wording proposed for the civil liability statement. We suggest it should be re-drafted on the basis of the Level 1 text: "[NAME OF INVESTMENT COMPANY OR MANAGEMENT COMPANY] *will not incur civil liability solely on the basis of this Key Information Document, unless it is misleading, inaccurate or inconsistent with the relevant parts of the prospectus.*"

We also find the requirement in Para. 3 too broad, as some of the changes should not be considered automatically as material. On the contrary, changes should be reviewed in order to determine their materiality.

Q2: *Do you agree with the proposals in Box 18?*

EFAMA agrees.

Section 9: Circumstances in which a KID should be revised

Q1: *Do you agree with the proposals in Box 19?*

EFAMA agrees with BOX 19, but we find the proposal in Para. 2 overly bureaucratic. It should be significantly simplified, providing only for an annual review and otherwise modifications in case of material changes. In particular, no review of the KID should be required in case of notification in another Member State.

Some EFAMA members disagree with Para. 4 (iii), and believe that the requirement for publication of a revised KID "*no later than twelve months after the date of publication of the existing version*" should be deleted as it is too restrictive. Please see our comments on BOX 13 regarding the deadline for revisions of the KID.

Section 10: Umbrella structures

Q1: *Do you agree with the proposals in Box 20?*

EFAMA agrees with BOX 20, but the requirement to have an indication (Para. 2) "*whether or not the asset and liabilities of each compartment are segregated by law and how this might affect the investor*" is hardly feasible in the limited space of the KID. As an alternative, EFAMA suggests having a statement only where it would be relevant, that is when the compartments are NOT segregated.

Section 11: Share classes

Q1: *Do you agree with the proposals in Box 21?*

EFAMA agrees, and appreciates CESR's comment regarding the possibility for institutional investors to opt not to receive the KID. However, we still believe that the preparation of a KID for such investors should not be necessary.

Section 12: Fund of funds

Q1: *Do you agree with the proposals in Box 22?*

EFAMA agrees with BOX 22. However, **s**everal EFAMA members do not agree with CESR's proposal to show a synthetic measure for charges for Funds of Funds that takes into account the charges of the underlying funds (see also Annex II). The information required will often not be available, so such calculation will entail many assumptions and might only be prepared on a "best endeavour" basis. The result will be misleading to investors, who might mistake it for the sum of actual costs. It should therefore be sufficient to disclose the charges for the fund of funds.

Section 13: Feeder funds

Q1: *Do you agree with the proposals in Box 23?*

We agree with BOX 23. Some EFAMA members disagree with CESR's proposal to combine the costs of master and feeder as per Annex I.

Para. 4: Some EFAMA members believe that only newly created feeder funds should be able to show the performance of the master UCITS for the years before they existed. Such possibility should not be allowed when a feeder already operated, and then converted to feeder status.

Furthermore, the text in Para. 5 should reflect the prohibition in Art. 66 (2) of Level 1 for the master to charge entry or exit fees to the feeder.

Section 14: Structured funds, capital protected funds and other comparable UCITS

Q1: *Do you agree with the above CESR proposals on performance scenarios? In particular which option (A or B) should be recommended? If not, please suggest alternatives.*

A large majority of EFAMA members disagrees with CESR's proposals on structured funds (BOXES 24 A and B) as performance scenarios are not helpful to investors and are likely to mislead them into believing the funds are guaranteeing certain results – especially if they can be understood as an indication of future performance.

However, if CESR decides nonetheless to recommend them, we agree that they should be moved to the section of the KID on objectives and investment policy. Option A is preferred by almost all EFAMA members if a scenario is to be shown in the KID. Within Option A, most EFAMA members support the use of tables to display scenarios.

With regard to probability tables, we reiterate the reservations regarding Option B we presented in our reply to the last consultation, and we maintain them. First of all, it is the most likely to be misinterpreted by investors as a promise or guarantee of future performance. Secondly, a large majority of EFAMA members consider that it is methodologically flawed as it is based on risk-neutral probabilities that lead to a mispricing of risk, and that real probabilities should be the base for the methodology.

If performance scenarios are to be included, then it is very important that the choice of the format and the definition of the scenarios should be included at Level 2 to guarantee a harmonized implementation.

We reiterate our encouragement to CESR to organize technical workshops to finalize the methodology, inviting stakeholder participation.

Section 15: Medium and timing of delivery, including use of a durable medium

Q1: *Do you agree with the proposals in Box 25? If not, what alternative approach would you suggest?*

EFAMA does not agree with CESR's proposals in BOX 25. We believe that CESR in its advice should not go beyond the Level 1 requirements to provide the KID and the prospectus on paper. We are not concerned with investor requests for paper copies, which are clearly provided for in the level1 text. However, there should be no obligation to provide the KID to product manufacturers and intermediaries on paper, and a copy in electronic form should be sufficient. Especially for product manufacturers and intermediaries with which the UCITS or the Management Company have no contractual relationship, there should not be any such obligation. An updated version of the KID must be provided on the website of the UCITS/management company, and that should be sufficient. For intermediaries with contractual relationship to the UCITS/ Management Company, the medium for the provision of the KID should be left to contractual agreement.

Section 16: Other possible Level 3 work

Q1: *Do you agree with the approach to transitional provisions set out above?*
Q2: *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?*

Page 71 – EFAMA agrees, but believes that the rules relating to the transitional period should be included at Level 2, not at Level 3.

EFAMA Reply to the Addendum to CESR's consultation paper on the format and content of Key Information Document disclosures for UCITS (CESR/09-552)

Many EFAMA members agree in principle with most of CESR's proposals, but some have detailed comments and suggestions regarding the methodology, which they will submit directly to CESR.

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11 September 2009