

ZENTRALER KREDITAUSSCHUSS

MITGLIEDER: BUNDESVERBAND DER DEUTSCHEN VOLKSBANKEN UND RAIFFEISENBANKEN E.V. BERLIN · BUNDESVERBAND DEUTSCHER BANKEN E. V. BERLIN
BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS E. V. BERLIN · DEUTSCHER SPARKASSEN- UND GIROVERBAND E. V. BERLIN-BONN ·
VERBAND DEUTSCHER PFANDBRIEFBANKEN E.V. BERLIN

Response of Zentraler Kreditausschuss (ZKA)¹ to CESR Consultation Paper on content and form of Key Investor Information disclosures for UCITS

Ref.: CESR/07-669

¹ The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)*, for the cooperative banks, the *Bundesverband deutscher Banken (BdB)*, for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands (VÖB)*, for the public-sector banks, the *Deutscher Sparkassen- und Giroverband (DSGV)*, for the savings banks financial group, and the *Verband deutscher Pfandbriefbanken (VDP)*, for the mortgage banks. Collectively, they represent more than 2,500 banks.

I. General remarks

The ZKA welcomes the opportunity to comment on the content and form of the future Key Investor Information (KII) disclosures for UCITS. We note that the revision of the simplified prospectus is a key measure in the reform of the UCITS Directive.

In general terms, we think that the proposals presented by CESR go in the right direction. We agree with CESR that KII should include the essential elements for making informed investment decisions. Furthermore, we support that KII should be available in a single document covering maximum two pages of A4. Taking into account the role of the KII in the selling and distribution process it becomes even more obvious that the document needs to be short, summarized and understandable.

Moreover, we understand that the European Commission wants to introduce consumer testing as a new instrument in the Lamfalussy procedure. This is a general question of fundamental importance but here not to discuss. Testing procedures will probably not give representative results or substitute political means. With regard to the novel market testing of the KII, we suggest that CESR and the Commission inform market participants on the progress of the consumer testing process. Additionally, we suggest, that the results deriving from market testing will be consulted with market participants prior to CESR preparing its final advice and the market participant consultation thereof. Especially when it comes to the synthetic risk indicator, the creation of such a core concept for investment advice cannot be left to consumer organizations alone. In principle, we share the view that a quantitative approach is necessary in parallel to the narrative one. Neither CESR nor the financial markets can afford a flop of this concept. For these reasons, we propose a close cooperation of the industry and CESR with the objection of a well prepared and tested common approach.

II. Remarks on individual sections

As regards the individual questions posed by CESR we would like to comment as follows:

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

The document, which CESR refers to, summarizes the existence of the regulatory failures associated with the SP.

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

The proposals aim in the right direction. However, it should be stressed that in the past, the divergence of standards within the group of CESR members or respective member states accounted for most of the additional costs and different formats (e.g. “gold-plating”) of the SP.

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?

The description of outstanding issues appears correct and complete.

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

The described purpose of the KII aims in the right direction. It should be stressed that comparability of the format is essential, especially against the background of creating a “level-playing field”. Definitely, the new KII format should avoid any additional national gold-plating. This includes that any additional information for international distribution (e.g. paying agents, local publishing modalities, medium of NAV-reporting etc.) should be excluded from this document. In the past, additional authorisation procedures for implementation of exactly these changes into the SP always proved to be burdensome red-tape with the home supervisory authority and caused distribution delays and costs for the investors.

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

Primary target for the information of the new format should be the retail investor. Therefore other investors should definitely be permitted to opt out or should be excluded from the outset. However, as the KII is designed to be a pre-contractual document, retail investors should also have the right to opt-out of receiving the physical document. We would like to stress that any “opt-out” scenario has to be in line with MiFID to avoid inconsistencies between the two directives. Pursuant to the current standard that there is no obligation to provide the investor with a copy of the SP, this standard should not be changed with the introduction of the KII. There would be no knowledge disadvantage for the investor. The management company should only be obliged to offer the information provided by the KII but the choice should be up to the investor whether he/she would like to receive a physical copy of the KII. Where additional specific information on the product is

required for an investment the decision to purchase a product, the full prospectus has proved to be the preferred source of information for investors interested in detailed product information.

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

The proposal on general presentation appears appropriate.

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?

The new format must be based on standardised templates with rather few options as otherwise implementation will be as divergent as in the past (e. g. implementation of recommendation 2004/384/EC). The fewer options are provided, the more comparability of documents will be achieved.

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

The minimal set of items pursuant to Option A (4.23 of consultation paper) is favourable as the key information is included in this option and this will probably not overload the intended compact format. However, the indication in which languages the KII is translated, should not be an obligation as the customer in the specific country will probably only read a translated version in the respective accepted language. Knowledge on other possible translated formats will not add any benefit for the investor. The additional information of Option B would limit valuable space that is needed to provide the rather important information for the customer decision making process. If this additional information (e.g. auditors, supervisory authority) is of particular interest for the investment decision, this information is provided completely in the full prospectus.

Information on the tax regime should not be included in the KII as information on the tax regime of the home member state of the respective investor is of little value for the investor. In the event the investor may wish to make a tax based investment decision, she/he will need more thorough information than a rather abbreviated description of the tax regime the KII could possibly provide. Moreover, tax implications may be different for different investors even within the same tax regime based on the investor's individual situation. Thus, general information on the tax regime may be even misleading for the investor. Additionally, as tax laws in certain jurisdictions may be subject to frequent changes, information on the tax regime could also bear the risk of being misleading with regard to future changes in tax law.

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

Testing procedures may not produce representative results. However, national authorities may use sample documents in their jurisdiction without obliging the industry to create additional documents parallel to the already existing SP format as this would create additional costs without necessarily creating a benefit for the other investors that do not belong to the testing group. Consumer testing on a broad national basis will probably result in confusion for the investors with respect to the fact which document is the valid official document format.

We also refer to our general comment on market testing in section I. above.

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

We believe the limitation of information aims in the right direction.

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

See question 8.

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

We believe the core elements of necessary information are comprised in the proposal.

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

Distribution costs apart from subscription charges should not be unbundled within the KII. This information obligation will already be handled by the point of sales according to national implementation of other provisions, such as national rules implementing the MiFID. All possible variants of distribution costs concepts cannot be described thoroughly in a standardised format of the KII with very limited space. Apart from that, the drafting management company may not have an overview of the cost concept charged by every sub-distributor.

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?

See question 4.

The more radical approach (e.g. signposting to a website or and additional local document) is definitely preferable since currently the “gold-plating” of this type of information is hindering non-bureaucratic cross-border distribution. Besides that, it is causing additional work for both the management company for redrafting/amending the SP and the local authority in case of the obligation to get a new passport for the amended document.

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

Although flexibility is always preferable the building block approach may rather cause confusion for the investor due to the reasons CESR has already described. Especially for a notification procedure, the building block approach would probably prove to be a major disadvantage as the necessary information documentation may have to be presented by more than just one compact document.

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

A detailed “look-through” approach concerning the fund of funds should not be necessary as the investment policy description will usually provide information on the composition of the portfolio.

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?

There should be enough room for flexibility with regard to some umbrella funds. In certain cases joint description in one document of at least some sub funds (e.g. with the same investment policy) makes sense, whereas in cases of umbrella funds with specific investment strategies it may be preferable to use separate documents.

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?

A separate KII for each share class is not necessarily a benefit for the investors in terms of costs and advantages compared to a joint description in one document giving a hint to the various options/other share classes. Comparability may be even enhanced if the different share classes are perceived in one document. However, this should be handled in a flexible manner because it may make sense to have also different KII e.g. for share classes reserved for institutional clients (in case the KII would be considered a mandatory document for this group of investors).

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

The proposal on presentation of the strategy and objectives of a fund seem feasible.

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

Strategy and objectives are usually linked to each other. Therefore, merging it into one generic item should not pose a problem in terms of clarity for the investor. However, this should be handled flexible.

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 inappropriate if any, design also for retail non-sophisticated investors?

Adding an item on guarantees may be valuable for the investor as this is usually a vital decision component for retail investors. Specifics to a recommended or minimum holding period are not useful as this may lead to false conclusions for some investors as described in the consultation paper. In addition, holding periods may also be different depending on the investor's objective with the specific investment. Sometimes good performance of a product may not be sufficiently valued by an investor because he may have refrained from investment due to holding period specifications. Therefore, a minimum holding period should definitely not be a mandatory element of the coming format.

The classification of the product as designed for a certain group of investors of typical investor specification is not adding any benefit for the investor as a standard for classification cannot be found easily. Additionally, an investment advisor at the point of sale may run into a liability issue if he recommends a product designed just for a certain group of investors to an investor not

belonging to this category. Evaluation of the suitability of the product for a certain investor must be carried out at the point of sale by the customer advisor and should not be up to the product designer/manager himself. For execution only clients this does not constitute a disadvantage as they have voluntarily agreed on taking their investment decision without prior consultation of an expert.

Therefore neither a description of a minimum recommended investment period nor of the typical/sophisticated investor should be added to the future format.

22. More specifically, do you agree that it should be required that in case the capital is not legally guaranteed, the term ‘guaranty’ should not be used in the KII, and it should be shortly 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?

We agree to all questions within in this item.

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?

Please see above (question 21). This clarification is not necessary as there is no common rule e.g. that an equity fund is not useful for a short term investor. In cases of investment advice according to Art. 19 section 4 MiFID, this should be taken into account by the investment advisor (“know your customer, know your product”). A qualification within the product documentation is not necessarily creating a benefit for the investor and may rather be misleading.

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 missellings, especially in the case of ‘execution only’ subscriptions?

The prevention of missellings or to flag funds for sophisticated investors should rather be an obligation of the respective investment advisor at the point of sale than of the management company. Execution only clients have renounced professional advice by an investment expert voluntarily. Therefore, it should not be an obligation of the management company to make up for possible knowledge deficiencies which an execution only investor may still have. The description of the investment policies (including the investment instruments or focus and risk-reward

disclosure) should be a sufficient hint for even these investors to decide whether the respective product suits their investment/risk philosophy. If in addition professional advice is needed, every potential investor is free to seek such advice at the point of sale.

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

See above under I. General remarks.

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

Risk description should be based purely on narrative as in the past. Only the typical and specific risks of a product should be described in order to not confuse investors and to stay within the limits set by the two page format. The selection concerning typical risks should not have any effect on liability (according to the newly proposed liability regime concerning the KII) as long as these descriptions are not misleading and consistent with the full prospectus.

Again, synthetic risk indicators can be considered not to be a transparent means of displaying risk-reward scenarios properly. They usually do not take into account all possible components of risks and therefore may be misleading and even create overconfidence or excessive focus on risks. The synthetic risk indicator cannot simply be displayed without any descriptive narrative and even this narrative would probably have rather the format of a disclaimer for deficiencies of the displayed indicator. In the event no narrative description would be given with regard to a synthetic risk indicator, such indicator would be of lesser value to the investor than only a narrative description of risks, as the investor would not know, which risks were taken into account in the methodology underlying the synthetic risk indicator. In addition, it seems unlikely that a common standard/formula for the creation of the synthetic risk indicator will be uniformly accepted throughout the EU which would on the other hand be a prerequisite for the comparability of funds from different jurisdictions. A narrative risk presentation based on high level principles usually gives the investor a compact and better idea of possible risks with signposting to a more detailed description in the corresponding full prospectus.

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

See above under I. General remarks. In the event CESR should favour the synthetic risk indicator, regulators should be as prescriptive on the methodology as possible as otherwise a common standard will not be found and comparability the KII is aiming at will not be achieved.

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

We are aware of existing methodologies but do not think of a recommendation. The existing calculation methodologies (e.g. Dutch model etc.) for synthetic risk indicators are mainly based just on volatility of the product which gives a rather misleading picture for possible risks of a product. Incorporating all specific risks in a synthetic indicator is hardly achievable by any kind of calculation formula.

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

The assessment grid at Annex 7 identifies in the section on particular criteria some criteria (e.g. “are consumers confused if different funds use different methodologies and presentations”) that actually thwarts the idea of creating a common standard for the methodology in order to enhance comparability. Consumer testing without prior having agreed on an underlying methodology does not seem to make sense: Consumer understanding of the underlying methodology cannot be achieved if the consumer cannot evaluate which risks are taken into account and which risks cannot be evaluated according to the displayed methodology.

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

This can hardly be achieved. A pure calculation formula will take into account all possible risk factors (Annex 5 identifies correctly several technical problems/criteria that can hardly be taken into account equally without having to make a lot of compromises to result in just one standardised methodology). Adding any additional descriptive narrative or even narrative containing disclaimers for the deficiencies of the calculation method will not be a benefit compared to a pure narrative based on high level principles with signposting to more detailed risk description in the full prospectus.

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

No. Textual warnings are more likely to confuse the investors as to the extent of dependability of the presented indicator. The proposed wording in the first frame stressing the display of medium-term view is likely to create overconfidence. The message of proposed wording in the second frame indicates that the synthetic risk indicator is not an appropriate means to display risks/reward at all. Therefore, this stresses the fact that synthetic risk indicators are not an appropriate means to describe risks/rewards properly.

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

All funds and especially formula funds or funds with hidden inherent risks which occur just in special scenarios.

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?

Disclosure should definitely be made in a harmonised way. Otherwise comparability of products will not be achieved. Displaying scenarios or tables illustrating specific behaviour of formula funds may have misleading effects or may be mistaken as a guarantee because the displayed scenario/table is likely to create limited apprehension of the variety of possible different scenarios.

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

The description of high-level principles as narrative combined with signposting to the full prospectus appears to be a good compromise between the obligation to point out apparent and typical risks and to stay within the suggested limited format.

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

Information of past performance has proved to be one essential element in the decision making process of potential investors. The longer periods are displayed the more information on the quality of the fund management can be drawn from the description how the fund performance reacted in

certain market situations. Besides that, rules regarding past performance should be in line with MiFID.

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

The key elements have been identified.

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

Description should be based on the net asset value (NAV) development of charges as this gives the investor a better idea of the quality of past portfolio management.

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

Both options seem feasible. However, Option A is preferable as the suggested consolidated figure of charges of Option B may be misleading because not all possible costs are incorporated in this figure whereas the wording suggests that the annualised figure contains all costs over the certain period of time. Besides, 2.7 % is strictly speaking not precise in the mathematical sense. The look through process for fund of funds should not be enhanced compared to current standards.

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

See question 38.

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

No. This type of disclosure may be misleading and does not produce any additional benefit for the investor. The depiction of a certain cash amount with a presumed annualised performance and according charges may even be misunderstood as a certain minimum return on investment over a certain period of time.

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?

The charges enumeration in the proposed Option A seems a feasible way of showing both ongoing charges and one time charges (initial and exit) and performance fees. Any other charges as e.g. other distribution charges should already be disclosed at the point of sale according to MiFID. Therefore the KII should not be the place to disclose them. The detail given in Option A seems feasible because the characteristic form of product related charges are displayed and the format of the depiction seems appropriate as well.

42. In relation to the handling of 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?

The use of ex-ante figures seems appropriate as this is consistent with the usual management regulation or contractual terms of the respective fund. Newly established funds certainly cannot display ex-post figures anyhow.

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

If a material change in charging levels occurs then the KII should be updated similar to the current procedure with regard to the SP. The information on charges displayed in the KII has to be correct at the time of issue of the KII. If material changes occur afterwards then the document should be updated for the sales desk.

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?

Portfolio transaction charges may vary significantly from fund to fund and according to the market situation. A uniform figure like a percentage can only be determined on an ex-post basis. Certainly a figure as the portfolio turnover rate (PTR) should not be disclosed in a format as the KII since this figure is not likely to be understood by the average investor and does not add any transparency to any fee disclosure. A hint in the charges section that transaction fees may come on top would be rather sufficient but should, however, not be an obligation.

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

Performance fee disclosure on an ex-post basis does not work for new established funds. For the same reason a cumulative charges depiction as suggested in Option B will not work on an ex-ante basis. However, the ex-post disclosure concerning the effect of charges is already presented in the reports/accounts, therefore there is no need to require an additional ex-post disclosure in the KII.

Nevertheless, a simple statement of the existence of a performance fee and its basis with signposting to a rather thorough description e.g. in the full prospectus seems an appropriate way of disclosure.

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

The disclosure on a maximum basis seems the only feasible way since not all possible forms of deviations (e.g. initial charges rebates) may be disclosed properly within the limited space of the KII format. Displaying the maximum charges in addition is not a disadvantage for the investor as it displays a worst case scenario. Any rebates given are plus for the investor and therefore do not necessarily need to be disclosed for the purpose of investor protection.

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

The KII is not the place for disclosure of charges handling according to all the different distribution arrangements. Appropriate charges disclosure is already covered by MiFID and should therefore not be an obligation in the KII.

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?

The Option B disclosure in which CESR suggests the combined charges disclosure for feeder fund and its master is not preferable compared to Option A (as indicated above). Disclosure should just be required on the separate fund level as the relative costs of feeder and master can hardly be disclosed transparently in one figure. In the KII of the master fund a general hint may be included with regard to additional charges of the feeder fund (maybe with signposting to the respective prospectuses).

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

Any proposals put to test should be appropriately finalised in order to produce adequate results. Especially if a decision should be taken for including a synthetic risk indicator then this indicator should only be tested if the technical calculation methodology has previously been tested and agreed on. It is of no use to present the investor some kind of visualised indicator without being able to describe the precise methodology behind it and to give adequate information of the still existing technical limitations of such a disclosure or even describe thoroughly the different categories of such an indicator.

Consumer testing is only as good as the picture resulting from it is a representative picture. CESR has certainly put great efforts in describing what should be achieved by consumer testing and what should be tested but the exact method how consumer testing will take place has unfortunately not been revealed so far. Therefore, it is not clear if there will be a broad scale consumer testing (e.g. with parallel documents of SP and KII) or just a pre-selected small group of individuals is chosen. As CESR points out that the analysis will cause essential input into the Commission's decision the methodology of consumer testing will be essential as well. Therefore, additional disclosure on the procedure of consumer testing will be required especially in order to estimate possible costs and impacts.

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

Estimation of costs will require more precise disclosure on the probable procedure of the introduction of the KII and transitional provisions and the method of consumer testing of course.

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

Estimates depend on the agreed format (e.g. costly elements as the implementation, updating and controlling of a technical synthetic risk indicator will certainly boost costs upon introduction).

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

Transitional arrangements should be put in place as the new format will have to be promoted with the investors and layout and format of the new KII will have to be prepared (Marketing, printing, electronic formats) for each company.

53. Is the gradual introduction of KII feasible?

A gradual introduction makes sense as the obligation to convert to a new format at once will certainly cause problems with resources calculation in the affected management companies.