

10 September 2009

CESR
11-13 Avenue de Friedland
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France

Dear Sirs

IMA response to CESR Consultation Paper on technical issues relating to Key Information Document (KID) disclosures for UCITS

The IMA represents the UK-based investment management industry. Our Members include independent investment managers, the investment management arms of retail banks, life insurers and investment banks, and the in-house managers of occupational pension schemes. They are responsible for the management of over £3 trillion of funds, including authorised investment funds, institutional funds, private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds (ie authorised unit trusts and open-ended investment companies).

It is in their capacity as providers of authorised funds (and, in particular, UCITS) that our Members have a keen interest in this consultation paper and the proposals for the KID.

We welcome the opportunity to comment on the proposals contained in CESR's draft technical advice on the format and content of the Key Information Document (KID) to the European Commission. We continue to support the overall aim of producing a clear concise document that will enable investors to make informed investment decisions. It is equally important that the production of the KID is subject to maximum harmonisation so that investors can reliably compare UCITS cross-border. CESR's proposals go a long way toward meeting this aim, although we would caution against any further modification at local level.

In welcoming the proposals we have some concerns over certain aspects of the document, either where we are not fully supportive of the proposal or where we believe that modification of the proposal would make the KID more effective. We have detailed our concerns in the attached response to the questions posed in the Consultation Paper.

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In summary:

- IMA does not support the proposal for a synthetic risk reward indicator. It is our view that such an indicator is potentially misleading and could lead to unsustainable expectations in the minds of the prospective investor. Our preferred option would be the use of a narrative as a method of explaining risk and reward.
- However, we acknowledge CESR's proposal to recommend such a synthetic risk reward indicator to the Commission and recognise that this may be adopted as a requirement. We would, therefore, draw CESR's attention to a body of research commissioned by the IMA and the Association of British Insurers (ABI), which proposes an alternative methodology for assessing risk. An embargoed copy of this research has been sent to CESR under separate cover.
- We have some concern over the proposal to display past performance prior to a material event in the absence of any guidance as to the nature and substance of what constitutes a material event.
- We do not support the proposal to disclose charges in cash terms as we believe that the reliance upon assumptions would make the figures presented misleading to the investor.

We would be happy to discuss this submission, and the IMA/ABI research on risk rating methodology, with you.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Andy Maysey', with a long horizontal flourish extending to the right.

Andy Maysey
Senior Adviser – Retail Distribution

CESR's Consultation paper on technical advice at level 2 on the format and content of Key Information Document disclosures for UCITS

IMA's Response to the Questions in the Paper

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

Do you agree with the proposals in Box 1?

We agree with the proposals in Box 1. It is most important that the document should have a common running order, consistent headings and be capable of offering the consumer a method of making fair comparison between funds. The sections headings have been debated previously and we have nothing further to add to previous responses.

Should the information referred to in point 9 of the box be called "Practical information"?

We agree that section 9 should be included as part of this document as it further enables the consumer to understand the nature of the investment and where to obtain relevant information. However, we have some concerns that the provision of "locally specific" information could erode the over-arching requirement that the document be subject to the maximum harmonisation procedure. Therefore we would urge CESR to be more specific about the information permitted.

It is difficult to identify an appropriate heading for such a section and we acknowledge that testing has identified that consumers find the heading "additional information" as unhelpful. Intuitively, the term "Practical information" does not seem very much better although we recognise CESR considers that this descriptor is the most helpful title for investors. Perhaps the section heading could be enhanced by the inclusion of the word "Relevant".

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

Do you agree with the proposals in Box 2?

Previous submissions from the IMA have fully supported the concept that the KID should be clear, succinct and useful to the consumer, enabling the consumer to make an informed investment decision. Therefore we support the proposals regarding the document's appearance and use of plain language.

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?

To achieve maximum effect, and to be consistent with maximum harmonisation, the length of the document and point size should be prescribed at level 2. However, we have some reservations about the flexibility over document size where incorporating

scenarios for structured funds. We recognise that it would be impossible to accommodate such information within a two page document but are of the view that, where the flexibility offered to extend the document to three pages is adopted by a firm, this should be prescribed as a maximum.

Are there any other rules that should be prescribed in relation to the appearance of the KID?

See above.

Section 3: Publication with other documents

Do you agree with the proposals in Box 3?

We agree with the proposals in Box 3.

Section 4: Objectives and Investment Policy

Do you agree with the proposals in Box 4?

We agree with the overall approach proposed, particularly with reference to the need for the KID to set out in plain and concise language what the fund aims to do and how it will go about achieving this. In the UK, work carried out by the FSA has demonstrated that information contained within the simplified prospectus has on occasion been dense and poorly written, and consumers have found difficult to understand. We welcome the proposal both to aid clarity for the consumer and simplicity for the fund manager.

However, we have some reservations about the inclusion of any warning as to suitability for the investor, particularly in giving a warning to investors who may wish to redeem their investment after a short period. Whilst there is some merit in the inclusion of such a “warning” the KID was never intended to be an educational document. The question of whether the investment is suitable should be addressed by a professional adviser or the consumer being directed to information about investing in general.

In particular, do you agree that the information shown is comprehensive and provides enough detail to ensure comparability between KIDs?

Providing the information is produced in a consistent and prescribed manner there is no reason to assume that consumers could not make direct comparisons across each document.

Are there any other matters that should be addressed at Level 2?

None identified at this stage.

Section 5: Risk and reward disclosure

What are your views on the advantages and disadvantages of each option described above?

It is interesting to note that, for each of the options described in the CP the advantages of each proposal are outweighed by the disadvantages.

The IMA does not support the idea of a synthetic risk indicator as a method of calculating and displaying risk to a consumer. We regard such a method as potentially misleading and would prefer the use of narrative as a method of explaining risk and reward to consumers. This position was communicated to CESR in our response to “Consultation Paper on technical issues relating to Key Information Document (KID) disclosures for UCITS” on 15 May 2009 and has not changed.

However, as also referred to in that response, the IMA, together with the Association of British Insurers (ABI), jointly commissioned Fathom Consulting to conduct research into whether there exists a way of developing a risk rating methodology which is simple and reliable, and whether this could be used to categorise different fund types.

The following comments are informed by this research, which will be published in October.

Do you agree that Option B (a synthetic risk and reward indicator accompanied by a narrative) should be recommended in CESR's final advice?

Given the above comments, we do not agree that Option B 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?

See response below.

Option A: Presentation of the enhanced narrative approach

Do you agree with the proposals for presentation of risk and reward in Box 5A?

We agree with the proposals for presentation of risk and reward through an enhanced narrative approach. This support would be consistent with representations made previously by IMA in response to “Consultation Paper on technical issues relating to Key Information Document (KID) disclosures for UCITS” on 15 May 2009. The proposals as presented in Box 5A seem to cover the salient points.

Are there any other issues that CESR should consider if it decides to recommend this approach to the disclosure of risk and reward?

Given the limited space available on the KID we recognise that it will be particularly important that the information supplied will need to be succinct. There may be some terminology used which may not be clear for the average investor.

We would suggest that CESR should consider the inclusion of a short note which directs the consumer to seek professional advice if there are any parts of the document they do not understand.

Option B: Presentation of the synthetic risk and reward indicator complemented by narrative explanations

Do you agree with the proposals for presentation of risk and reward in Box 5B?

We do not agree with the proposals for presentation of risk and reward in Box 5B.

We note that this approach is CESR's preferred option and, following this consultation, could result in being recommended to the Commission.

We would, therefore, draw your attention to the research work commissioned by the IMA and the ABI to consider whether there exists a simple and reliable measure of investment risk and how this could be used to categorise funds. In our response to the CESR Consultation paper on technical issues relating to Key Information Document (KID) disclosures for UCITS, the results of this work was explained more fully.

In that response the IMA supported CESR's preference for the use of standard deviation over VaR type measures for funds with normal characteristics.

However, we proposed that the chosen methodology should be asset class based, leading to a rating system that could then be used to rate all fund types, as a significant proportion of their risk will be dependant on the asset classes in which they invest. This was further supported by discussion with a number of fund management companies which indicated that the basis of their own risk rating methodology was the risk inherent in asset classes.

Using asset class data would, in turn, make it relatively easy to risk rate new or relatively new funds and would be relatively simple to apply to multi-asset class funds. It would also enable independent verification of funds' categorisations, which would assist regulators.

In particular, is the proposed methodology in Annex 1 capable of delivering the envisaged benefits of a synthetic indicator?

See also our response to the addendum (below).

The proposed methodology in Annex 1 (as supplemented) appears capable of delivering a set of numbers which could be used to categorise funds to "buckets". However, it is still unclear how specific intervals of volatility correspond to the different risk classes.

The addendum offers two proposals for setting the volatility boundaries, referred to as "volatility intervals". Each proposal sets out the minimum and maximum volatility boundaries for each of six risk categories. The first set of intervals (Box 1, Option A page 4) has been designed using a stochastic "optimisation process" to minimise the migration of funds from one category to the next over 3/5 years. The second

approach produces a similar looking set of volatility intervals (Box 2, Option B page 5), but where the boundaries have been drawn to “avoid (the) excessive bunching” of funds into just one or two risk categories.

It is difficult to comment upon the actual volatility intervals presented in each box without sight of the empirical study. But we have two issues:

- the number of migrations of funds in each of the Lipper categories used for the experiments and presented in the Appendix to the Addendum seem extremely high, especially given the fact that this represents migrations over just three years, albeit including the particularly volatile year of 2008.
- we have identified in our research that volatility can rise and fall significantly from year to year. Given this, how will these numbers be updated from year to year? By contrast, relative risk rankings between asset classes remain very stable from year to year over a much longer period of time than used in the experiments by CESR.

Does the methodology proposed by CESR work for all funds? If not, please provide concrete examples.

Absolute Return Funds

It is suggested that monthly returns on absolute return funds be used to calculate the historic volatility of these funds. However, the vast majority of these funds do not have a sufficient return history, most having only recently been launched. CESR recognises this and suggests that the proposed VaR limit – as advertised by the product provider – should be used instead, appropriately transformed into a volatility calculation.

Given the infant nature of this investment sector, this approach could be open to abuse:

- What proof is there that fund managers can keep the returns of their funds within their targets?
- Why not just allow long only fund managers to propose a target VaR and allow them to use this as the basis for their fund's risk rating? In fact, many long-only fund managers already manage their funds with a target VaR value in mind.
- What safeguards would be in place? What would there be to stop the manager of, for example, an absolute return fund based on small cap Japanese equities from claiming that the VaR target of the fund is in line with a cash investment, thus allowing the fund to be mis-categorised as a low risk fund?

An asset class-based approach, with an adjustment for leverage would clearly prevent the possible misrepresentation of absolute return funds.

Structured Funds

It is proposed to include these products in the same risk continuum as the more straightforward, long-only investment products. The suggestion is that a 95% VaR

can be calculated for these products and that this VaR can then be transformed into a measure of standard deviation. It is possible to do this, but we have reservations about this approach.

It is suggested that the volatility of the underlying financial market index could be calculated over a five-year historic period. The volatility of this index could then be combined with the other elements of the product along with a “pricing model” to simulate the probable performance of the product over the previous five years. From this simulation it would be relatively easy to estimate a 95% VaR value for a one-year holding period, since the investment product could be surrendered before it matures. Adapting this process a little would allow the product provider to estimate the volatility of the product under the assumption that it is held until maturity and therefore to calculate a second 95% VaR value corresponding to this alternative investment horizon. The addendum suggests that both VaR values could be presented to investors.

There are number of problems with this approach:

- With regard to historic simulation, the economic conditions that give rise to the launch of a structured fund today may not have existed in the past. The launch of these funds is often very dependent upon the complex relationship between option premia, corporate bond spreads, and money market rates that exist at the time of the launch. Historic simulation may therefore be ‘creating’ a fund that could not have existed in the past.
- Under the proposals every fund provider would be at liberty to use their own “pricing model”. These could vary greatly between one provider and another. The existence of possible multiple pricing models would clearly make a like-for-like comparison of these products across different providers difficult, if not impossible.

In summary, calculating the risk of these funds is the easy part, standardising that VaR and subsequent volatility calculation, however, is the hard part. CESR’s proposals with regard to these products would therefore almost certainly violate one of the main aims of its work, which is to standardise the risk rating of investment products.

Section 6: Charges disclosure

Presentation of the charges

Do you agree with the proposals in Box 6?

We agree with the proposals to show the three types of charges separately. The figures to be presented are easy to understand, properly represent the nature of charging structures employed and do not rely on assumptions. We agree with the proposal to show narrative explanations of each of the charges. The figures included in the KID according to the proposals will be a good guide for investors to assess future charges.

Entry and exit charges: We accept the need to show the maximum charge, but we believe the KID should indicate to investors how to find out what the actual entry

and exit charges will be for themselves in addition to the statement that their financial adviser or distributor can find this out.

Ongoing charges: In our opinion this figure is an improvement on the existing TER figure. We support the recommendation of option (a) of the three harmonisation options. We agree with the continued exclusion of portfolio transaction costs which are more appropriately included as part of portfolio return information. Generally historical ongoing charges figures will be a good guide to the level of future charges; the same is not true of portfolio transaction charges which will vary considerably according to transaction volumes and asset allocation decisions. It is therefore sensible that the impact of portfolio transaction charges is dealt with in relation to the investment policy.

Performance fees: We strongly agree with the change to exclude performance fees from the ongoing charges figure. The existing practice of including it can be materially misleading where, for example, a fund achieves exceptional out performance of its benchmark which results in a TER that would be considerably higher than its peer group. Removing this distortion suitably reflects that past performance is not necessarily a guide to the future. In our opinion the proposed disclosures in relation to performance fees are appropriate.

In particular, do you agree the table showing charges figures should be in a prescribed format?

We agree with the prescribed format for the table which is clear and easy to understand. It facilitates ready comparison between funds. In order to keep the presentation simple it would be helpful to clarify how the presentation should be displayed in cases where not all types of charges are relevant.

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

The methodology for calculating the ongoing charges figure improves on the existing UK TER methodology. There are, however, a number of points of clarification that would be helpful in the detail of the proposed text of annex 2.

We welcome the clarification of the management company's responsibilities, the requirement to establish procedures and the period for which records must be retained. We are pleased to note that the current requirement for the TER calculation method to be validated by the fund's auditors is to be removed. However, we are concerned that the unnecessary use of the word 'audited' in paragraph 10 might be ambiguous in this respect.

The definition of ongoing charges is more robust and the clarifications in paragraph 5 concerning the extent to which transaction related costs can be excluded and in paragraph 7 concerning substantial investment in collective investment undertakings are helpful.

Paragraph 7(c) requires the use of the 'best estimate of the maximum charges' where there is no 'reasonable substitute' for the ongoing charges figure of an underlying fund. We believe it would be more appropriate to require a best estimate of the actual *ex post* ongoing charges based on the prospectus and the report and accounts. This would help to avoid overstating the synthetic ongoing charges figure

where, for example, the underlying fund prospectus provides for a cap on the maximum level of charges.

We agree with the introduction of paragraph 7(e) allowing for the reduction in the ongoing charges to account for fee rebates in respect of underlying funds. We also agree with the exclusion of subscription and redemption fees and the treatment of these as transaction costs. It would be helpful to clarify that these should be stated in the Objectives and Investment Policy when appropriate in accordance with paragraph 3(b)(iii) in Box 6.

More generally we are concerned that the term 'collective investment undertaking' is used throughout paragraph 7 but is not a clearly defined term. For example, closed-ended investment companies are CIU even though they may be a form of CIU that is beyond the investment permissions of a UCITS. UCITS can invest in such companies only when they are transferable securities dealt on regulated markets. This raises the question of whether a published ongoing charges figure for such a CIU should be included in the synthetic figure for the UCITS. Considering the proposals in isolation, the absence of clarity regarding the definition of CIU would wrongly lead to the conclusion that it should be included.

We agree with the methodology for calculation and we find the reference to the accounting period to be an improvement compared to the fiscal year used in the UK's current TER methodology.

We are concerned that the requirement to express the ongoing charges as a percentage to two decimal places suggests a spurious level of accuracy. The performance record is required to be rounded to one decimal place. It is illogical then to report charges that manifest as a reduction in performance to be presented with a different apparent level of accuracy. If the value of a fund can rise or fall by 20 or 30 percent in a year, is an investor really interested in whether the charges are 1.75% or 1.8%. The materiality threshold proposed in Box 9 further invalidates the use of two decimal places (see our later answer to the question of materiality).

Disclosure of charges in cash terms

Do you agree with the proposals in Box 7?

We do not agree with the disclosure of charges in cash terms. While investors might find comfort in the presentation of cash amounts and a 'single figure for all charges' we believe the level of reliance on assumptions about the holding period and growth rate make the figures presented at best irrelevant to any investor and most likely misleading. The feedback from the technical consultation in this respect leads to the question of whether investor appetite justifies the provision of potentially misleading information that is neither relevant in its assumptions nor appropriate in its apparent simplification of the charging structure.

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

Notwithstanding our views described above, if the proposal to require the illustration of charges is enacted the appropriate growth assumptions for one type of fund may

be very different to another fund. Different growth rates would therefore appear to be required. However, such variation would seem to eliminate any useful comparisons that could be made, and might lead to flawed conclusions been drawn from comparing illustrations with different underlying assumptions.

New funds

Do you agree with the proposals in Box 8?

Overall we find the proposals concerning new funds to be helpful. In particular we agree with items 1 and 2. However, we believe item 3 will make management companies reluctant to set a cap or maximum charge because to do so will require a higher ongoing charges figure to be disclosed under item 3 than would be the case under item 4. This would serve to remove an element of investor protection. Item 3 should be deleted and made an optional disclosure in addition to the estimate calculated in 4.

The explanatory text contains a substantial body of useful guidance on the assessment of whether the estimate is appropriate and on the assumptions about the level of the NAV. In order to facilitate consistency it would be helpful to incorporate some of this text in Annex 2, and the advice in Box 8 should make reference to that Annex.

Finally, we recommend the use of a range of ongoing charges that would deal with the fixed cost element where the NAV is not known. For example, "Ongoing charges are expected to be in the range 1.6% – 1.8%"

Material changes to the charging structure

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

The guidance for incorporating material changes to the charges structure is helpful and will contribute to more consistent information being provided.

However, if this is defined at Level 2 it will invalidate the requirement (in Annex 2 paragraph 9) to express the ongoing charges figure as a percentage to two decimal places. It is not uncommon to have ongoing charges of 1.75%. Materiality of 5% means that two decimal places suggest a spurious level of accuracy: this figure is anywhere between 1.66% and 1.84%.

Annual review of charges information

Do you agree with the proposals in Box 10?

It is unclear who is responsible for reviewing the ongoing charges figure, and it could be interpreted that the figure should fall within the scope of the audit of the annual accounts. The use of the word audited is unnecessary because Article 73 of the UCITS Directive requires annual accounts to be audited.

In reality the proposal requires the ongoing charges figure to be recalculated when the annual accounts are prepared. The KID would then be updated at the

appropriate time. Our concerns about the use of a 5% threshold expressed above also apply here.

Section 7: Past performance presentation

Presentation of past performance for funds for which past performance exists or where simulated performance is permitted

Do you agree that the CESR proposals on past performance presentation are sufficient and workable?

We agree that the proposals are sufficient and workable. However, we continue to have reservations regarding the use of bar charts. Recent research carried out by the Association of British Insurers has identified that they may not be the most effective way of communicating comparative information to consumers.

We also have concerns about the proposals in Para. 4 of Box 11 which recommend that performance information can be shown only for a complete calendar year. Where a fund is launched early in a calendar year this could lead to performance information is not being shown for up to 23 months.

This would also lead to funds being unable, on a permanent basis, to display performance for the partial first year.

We would recommend that the recommendation should be more in line with MiFID and that performance information should be based on complete 12-month periods.

Past performance Methodology

Do you agree that the CESR proposals on past performance calculation are sufficient and workable?

We agree with proposals on past performance calculation.

Maintaining the Past Performance Record

We have concerns regarding the proposal that performance information should be revised at year-end and the results published within a timescale of 25 days. This would present certain challenges for larger funds sold across a number of jurisdictions. We would therefore suggest that this period be extended to two months. This would also offer the possibility of audited accounts being available and the charges figure being updated at the same time.

Impact and treatment of material changes

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

We have concerns about aspects of the proposed performance disclosure guidelines for KIDs, specifically in the event of a material change in a UCITS. In summary:

- We are concerned specifically about the like-for-like comparability of UCITS and the need to take into account in an accurate and consumer-friendly way the presentation of fund peer groups;
- We believe that consumers and their advisers will, in respect of their choice of funds, receive poorer quality information generally should the current CESR proposal be adopted;
- We believe that the adoption of CESR's current proposal would provide consumers and their advisers with a significantly skewed, and therefore inaccurate, picture of comparative fund performance.

We therefore urge CESR to reconsider its proposal and instead adopt the other option considered during its review, which removes past performance information but under the condition of specific disclosure.

We are aware that there may be some concerns amongst regulators that the option to remove the track record will be difficult to implement and that, moreover, this option would prevent consumers and their advisers from being able to access the full performance history of a fund should they choose to do so. These concerns are legitimate but not well-founded. The UK sector system, and possibly that of other countries, has provided both sets of information to consumers and their advisers for many years. The data vendors retain full information about funds but can and do, with regard to like-for-like comparisons, suppress information that is irrelevant. To that extent, the latter option does not change the *status quo* and also acts to make available the fullest range of information in the most desirable manner for consumers.

IMA has operated sectors for investment funds for over a decade. The purpose of sectors is to help consumers and their advisers to select funds that are suitable for their purpose. The sector definitions seek to divide the universe of investment funds available in the UK for purchase by retail investors by asset type, by the aim of providing income or capital growth, and in some cases by the nature of the investment strategy employed. The aim is as far as possible to allow funds invested in broadly similar assets to be compared on a like-for-like basis.

The Performance Category Review Committee (PCRC) provides guidance to fund managers (whether or not they are IMA members) and to data vendors on the appropriate classification of funds and the disclosure of performance and other related data, including yields, charges and prices. In particular, the PCRC makes decisions about performance track record retention for funds which have undergone a fundamental change (significant change in fund objective and/or benchmark).

The guiding principle in relation to performance issues, which was agreed in co-operation with the FSA, is that the data provided to the consumer must be clear, fair and not misleading. In particular, the PCRC has as its principle remit:

"IMA sector classification is aimed at the needs of the consumer. Customers have a legitimate desire to be able to compare like for like. The primary purpose of the IMA's approach to sector classification is to provide groups of similar funds whose performance can fairly be compared by consumers and their advisers."

The UK has operated its current process to assess the relevance of track record since at least 2002 when the IMA introduced its sector monitoring programme. However, over the longer period of IMA's involvement in sector classification of funds we have acquired a good understanding of the track record issues which arise as a result. Current practice was discussed and agreed with the FSA and involves the IMA making an assessment of where a material change¹ has occurred and of the impact on performance disclosure. When a decision is reached that a track record is no longer relevant based on material change, the firm in question and the data vendors are advised that performance disclosure should be suppressed. This ensures that comparability is maintained with like-for-like funds and the investor is not misled.

There is less of an issue when showing a fund's performance in isolation, since this documents historical fact. However, when comparison is introduced, the performance data has to be presented on a like-for-like basis. A material change obviously impacts the ability to make these comparisons. Notes and annotation advising an investor of lack of comparability are, in our members' experience, insufficient. We understand that independent research commissioned by regulators has from time to time has also indicated that disclosure is generally an inferior regulatory tool, requiring as it does substantial further work (and understanding) on the part of the consumer.

Any change to well-established current practice also risks introducing confusion to both investors and fund management firms.

We urge CESR again to re-consider the implications of its current proposals in the context of performance disclosure in KIDs and to adopt an alternative option.

Inclusion of a benchmark alongside the fund past performance

Do you agree with this approach? If not, which alternative approach would you prefer?

If past performance is retained in the event of a material change in a fund the comparison against a benchmark (if the benchmark has changed) may help to clarify the position for the investor.

IMA concerns are in relation to a fund which may have experienced a material change but the benchmark has not changed. For example a fund which has moved from passive to active management within the same asset category. This could impact a consumer's ability to interpret past performance information.

We reiterate that we would prefer to see the removal of past performance information in the event of a material change.

1. Material change - The IMA is of the opinion, developed and applied over many years, that in general a fund should retain its performance history. In instances where a significant restructuring of the portfolio takes place, the IMA will carefully review that position on a case by case. Typically, restructurings would be deemed significant only if there are changes which have required a unit holder meeting, or where specific notice of the changes have been sent to investors in the fund in question.

The use of “simulated” data for past performance

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

We are concerned about the nature of the proposals on the table for the introduction of performance disclosure guidelines in Key Investor Documents, specifically in the event of fund mergers through absorption (Q4).

In summary:

- We believe that consumers and their advisers will, in respect of their choice of investment funds, receive poorer quality information generally should CESR's current proposal be adopted;
- We believe that the adoption of CESR's proposal will change well-established current practice in the UK which risks introducing confusion to both investors and fund management firms.

The guiding principle in relation to performance issues should be that the data provided to the consumer must be clear, fair and not misleading.

Fund mergers

Merging funds could be from different sectors or from within the same sector. Where funds merging come from different sectors and the merged fund will continue in one of these sectors, then the most relevant performance history for the merged fund going forward will be that of the merging fund from the same sector.

Where the merging funds are coming from different sectors and the merged fund is to be classified in another sector, then in general it would be inappropriate for the merged fund to carry over the performance history of any of its constituents unless it can be demonstrated that the performance history of one of the funds being merged remains relevant - for example, where one of the merging funds has been meeting the requirements of the receiving sector.

Where merging funds are from within the same sector, we apply the following guidelines in approving the choice of the appropriate performance history, generally giving greater weight to the points higher up the list:

- The investment objectives and policy of the funds;
- The relative sizes of the funds over recent history, e.g. the previous 12 months;
- The number of unit holders;
- Continuity of fund manager;
- The ages of the funds.

This performance history may need to be adjusted to reflect any differences in charges. It would be inappropriate, for example, to use a history of an institutional fund for the retail share class of the new fund without adjustment for charges. IMA seeks to ensure that fund performance visible on the data providers' systems is that which is the most relevant.

We would strongly advocate that CESR considers these issues in producing guidelines for KIDs. We urge CESR to reconsider its proposal and instead consider a set of guidelines such as those set out above.

Section 8: Practical information

Do you agree with the proposals in Box 17

See our response in Section 1.

Do you agree with the proposals in Box 18?

We agree with the proposals in Box 18. Signposting is an accepted and legitimate way of drawing consumer's attention to additional relevant information.

Section 9: Circumstances in which a KID should be revised.

Do you agree with the proposals in Box 19?

We agree with the proposals in Box 19.

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

Section 10: Umbrella structures

Do you agree with the proposals in Box 20?

We agree with the proposals in Box 20 regarding the production of a KID for each compartment in the Umbrella fund. However, we would suggest that the information regarding the cost of switching should be included here rather than in the charges section.

Section 11: Share classes

Do you agree with the proposals in Box 21?

We agree with the proposals regarding the production of KIDS for different share classes or, where appropriate, a representative share class.

Section 12: Fund of funds

Do you agree with the proposals in Box 22?

We agree with the proposals in Box 22.

Section 13: Feeder funds

Do you agree with the proposals in box 23?

We agree with the proposals in Box 23.

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

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.

We agree with the CESR proposals on performance scenarios although we have some reservations generally over the space that such disclosure will take up and the need for extending the KID beyond a two-page document. We particularly welcome the requirement that the scenario should contain an explanation of how the formula works or how the pay-off is calculated.

On balance we would support the recommendation for Option A.

Other Issues

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

Do you agree with the proposals in box 25? If not, what alternative approach would you suggest?

We agree with the proposals in Box 25.

Section 16: Other possible Level 3 work

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

We agree with the approach to transitional provisions.

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?

None identified at this time.

Addendum to CESR's consultation paper on the format and content of Key Information Document disclosures for UCITS

IMA's response to the questions in the Addendum

Methodological elements for the computation of the synthetic risk and reward indicator

Do you agree with the criteria considered by CESR to formulate its proposals regarding the volatility intervals?

We agree that the key issues for determining the volatility intervals are potential bunching and potential migrations. Our research confirms that migration is a significant issue if data for too short a period are used. This is supported by CESR's own analysis as shown in the tables in the Appendix to the Addendum. We are therefore puzzled by the statement on page 19 that the findings of CESR' analysis provide "*sufficient comfort in this specific respect, as only few funds experienced migrations, and in any case no more than four, across risk classes during the observation period.*"

Too frequent migrations will cause a lack of consumer confidence in the KID and may give rise to issues for advisers in establishing and monitoring suitability.

Which option (A or B) do you see as more appropriate for the KID?

The addendum offers two proposals for setting the volatility boundaries, referred to as "volatility intervals". Each proposal sets out the minimum and maximum volatility boundaries for each of six risk categories. The first set of intervals (Box 1, Option A page 4) has been designed using a stochastic "optimisation process" to minimise the migration of funds from one category to the next. The second approach produces a set of volatility intervals (Box 2, Option B page 5) where the boundaries have been drawn to "avoid (the) excessive bunching" of funds into just one or two risk categories.

We favour an approach that would avoid excessive bunching problems. These could be caused by the stochastic "optimisation process" used in the addendum. In this respect, Option B is better than Option A. However, it may be the case that the risk characteristics of the current UCITS population do lead to bunching. Moreover, if the methodology is to be applied in future to a wider range of packaged retail investment products (PRIPs), then designing the boundaries to take account solely of the UCITS universe may result subsequently in bunching across the wider PRIPs universe

These considerations aside, as they are currently formulated, we have reservations about both Option B and Option A:

- First, as external research has demonstrated (footnote ABI/IMA research), longer time periods for volatility measurement are likely to result in more stable rankings. We believe that the proposed 3 to 5 years is too short. Indeed, the number of migrations of funds in each of the Lipper categories used for the three year experiments presented in the Appendix to the Addendum seem extremely high across a range of equity funds. Internal IMA research based on member

data confirms this danger of high migrations over 3 and 5 year periods. Clearly, however, the migration problem will not be eliminated by simply extending measurement periods. CESR will therefore need also to consider the timing of classification: it may prove inappropriate to undertake annual reviews of volatility if the result is consumer confusion over movement in the risk ranking of the product they have purchased, or wish to purchase.

- Second, this longer time period will prove difficult to implement if the methodology is based on fund-level volatility. The nature of fund launch activity will inevitably mean that new and more recently launched funds will create a methodological challenge for the risk classification. It is partly for this reason that the independent ABI/IMA research has suggested that asset classes offer a far more dependable and operable solution to risk classification.

Would you like to propose any other alternative for the volatility intervals?

We would be happy to discuss further the issues arising from the points above and their implications. In methodological terms, we would favour an alternative approach using underlying asset class volatility, longer assessment periods and volatility intervals based on meaningful risk buckets rather than optimisation to minimise migrations. Such an approach, in addition to minimising migrations would readily allow for independent verification – by regulators and the market – of fund ratings produced by managers.

Do you agree that introducing some rules for assessing migration is desirable?

We would support the introduction of rules for assessing migration to achieve a consistency of approach across Member States.

If so, which option (2 or 3) do you think is more appropriate?

On balance we support option 3 as this appears to give greater stability over time.

Would you like to propose any other rule for assessing migrations?

No comment.

Absolute Return/Structured Funds

Questions 7- 15.

Please see responses in Section 5 above.