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Consultation paper of the Committee of European Securities Regulators (CESR) on "CESR's technical advice at level 2 on the format and content of Key Information Document disclosures for UCITS"

Dear Sirs,
the mentioned paper represents a significant enhancement with respect to CESR/09-047, confirming the validity and efficiency of the operating method the Committee decided to follow.
In this note I will be glad to reply to the questions raised by this new paper and I advice to read the present contribution jointly with my answers to the questions asked in the methodological **Addendum** (CESR's Consultation paper 09-716).

As a general comment, I have noticed that, at this moment, the KID proposal presents just one synthetic indicator despite of my personal opinion that, in order to offer a complete representation of the risk-reward profile of a mutual fund, the indicator should provide also information on UCITS's distribution of risk-adjusted returns and minimum recommended holding period.
By considering the heterogeneity of the proposals on the KID and, overall, the fact that only some general positions seems fully shared by the regulators involved in the KID working group, I would suggest - in agreement with the general principles of the UCITS IV directive - to recommend the KID as a minimum common basis for all European countries.
In this way any regulator would be able to implement - given a common denominator - the transparency rules most consistent with the proprietary surveillance model adopted and, as a consequence, any Authority would guarantee a level of investors' protection in line with the tools and techniques of surveillance that it has defined inside its borders.

In the following, I will identify the questions with the page in which they appear but for ease of reference I suggest to number them in the future as done in the old paper and the Addendum.

Q. p. 12
I agree.
I suggest the name "**Additional information**" given that all KID has been thought as a "practical" information device to help investors in their decision process.

Q. p. 15
I agree

Q. p. 16
I agree

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Q. p. 20
I agree with many points of Box 4. However, it could be useful to provide investors with an **overall** representation of the risks, costs and potential returns of the UCITS. This could be achieved by requiring **always** a **minimum recommended holding period** so that the three dimensions of costs, risks and likely performance of the UCITS can be synthetically referred into such time period.
In a prudential perspective, the recommended holding period should represent the minimum time interval within which the NAV of the fund recovers both the initial and ongoing costs charged to the investor with a reasonably high confidence level (e.g. 95%).
A stochastic methodology to calculate this holding period could be easily provided.
Less expensive / less risky funds will have (ceteris paribus) a lower minimum recommended holding period.

Q. p. 25
The great disadvantages of Option A (i.e. narrative approach) are its arbitrariness and its absence of readability and synthesis.
Option B (i.e. synthetic risk-reward indicator based on the volatility of the NAV returns and complemented by narrative explanations) should be not just recommended but the only possibility accepted by CESR in order not to repeat the failure of the Simplified Prospectus, and also in order to provide potential investors with a disclosure on the fund's risk level backed by a simple and meaningful quantitative measure.
In this respect, I note that, as a result of the testing exercise, both investors and distributors expressed a clear preference for a synthetic indicator.

Q. p. 28
No. See above.

Q. p. 30-31 and Annex 1
The proposed methodology in terms of volatility of fund's returns r_f is certainly a useful device to provide a practical, effective and significant measure of risk for UCITS.
This indicator should be more properly called Synthetic Risk Indicator (SRI) and there is no doubt that the main end of KID (as well the main concern of regulators) is a proper information on the risk dimension rather than a refined assessment on expected returns.
Clearly, the fundamental assumption of a positive relation between risk and returns applies.
However, to strengthen the risk disclosure on the UCITS - and also considering the risk-reward dimension of a proper Synthetic Risk Reward Indicator (shortly, SRRI) - the information offered in the qualitative scale could be usefully supplemented by the one provided by a table which synthesises the distribution of the fund potential (risk-adjusted) returns at the end of the minimum recommended holding period by indicating, for a few, meaningful events, the corresponding probability together with a value representative of the risk-adjusted and therefore cross-comparable performance which can be realized by the fund if each event does occur.

As a final but relevant remark, being the risk-reward profile of funds crucially affected by the underlying financial structure, I suggest to review the classification of the funds essentially in line with the three types presented in letters (a) to (c) of par. 3.2. of the **Addendum** and to insert this information at the beginning of the KID section on the *Objectives and the Investment Policy* of the UCITS, or even in the section on the UCITS *Risk and reward profile*.

Specifically, while the three general types of funds (market / strategy / structured) contained in this paper are not completely understandable, the distinction introduced in par. 3.2. of the **Addendum**

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has the advantage of being more clear, exhaustive and logical. In fact, it distinguishes between relative and absolute target funds, the latter to be split in Target-return / Target-risk funds. Therefore the three classes should be:
- **Relative funds** (or **Benchmark funds**, essentially the market funds of the paper)
- **Target-return funds**
- **Target-risk funds**
and the correspondence is: letter (a) for Target-risk, letter (b) for Target-return, letter (c) for Relative.
For example, "absolute return funds" are **Target-risk funds,** while "Guaranteed / protected funds" and "total return funds" are **Target-return funds**.

Q. p. 34
I agree.

Q. p. 36
No.
I would include a Synthetic Cost Indicator (as required for example by the Italian regulation of Pension funds: see www.covip.it) computed as the difference (over different horizons) between the IRR excluding costs (but including taxes) and the IRR including all costs, assuming a given, constant rate of return of the fund (e.g. 4%).
This will assure a full comparability among funds and can be applied to new funds with no problem.

As a more refined alternative, the charges of the fund should be summarised in a table ("Charges and components") containing also the investment components, if any, of the UCITS. All the figures in the table could be determined as the discounted average of their Monte Carlo simulated values at the end of the minimum recommended holding period.
This alternative would have the advantage to be consistent with the information contained in the probability table illustrating the potential performances of the fund and promptly obtained once the probability scenarios have been determined.

Q. p. 37
I agree but see above.

Q. p. 39.
I agree.

Q. p. 42-43
I agree but it must be stressed that, **for all types of funds**, "past performance is not necessarily indicative of future results".

Q. p. 45
No.
If "material changes" have occurred (however defined), the performance is, by definition, no longer comparable over time. The option to remove past performance information (with specific disclosure) seems preferable.

Q. p. 46, 49, 51, 52, 54, 57, 59, 60,62
I agree.

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Q. p. 67
I agree with Option B proposed by the CESR on performance scenarios.
Option A falls short of meeting the main objective of KID, which is "*appropriate product information about the essential characteristics of the UCITS concerned*" in such a way that investors "*are reasonably able to understand the nature and the risks of the investment product that is being offered to them and, consequently, to take investment decisions on an informed basis*".
The use of exogenous scenarios (favourable, adverse, average) is arbitrary both in their definitions (e.g. favourable to the product?, favourable to the market in general?, favourable to the product's underlying?) and in their quantification. In addition, it does not provide any indication on the scenario's probability so that an implicit and misleading assumption of uniform distribution could erroneously be induced.
Option B, clearly explained in Annex 4, should be preferred non only for the reasons of economy, theoretical foundation, practical diffusion and coherence with the risk management tools used in financial markets as well as by independent advisors.
It also allows a proper comparison with a common, objective, and well known investment opportunity, the risk-free asset, so that the fund's risks can be quantified and made understandable, an easy **comparison** between alternative products is guaranteed, the reading of results via **probability tables**, as documented in the testing phase, is preferred to other devices, the approach can be evenly extended to all non-relative funds.
For example, two different life-cycle funds, with different trigger events can be compared using Option B approach.

Option B should therefore be recommended by CESR as the preferred approach. If, however, the general opinion continues to be split, the final choice between Option A and B could be left, for all UCITS marketed within its borders, to each Member State, appreciating both the technical levels of its financial intermediaries and the monitoring ability of its supervisors.

Q. p. 70-71
I agree

With my best regards,

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