



Association of the Luxembourg Fund Industry
Association Luxembourgeoise des Fonds d'Investissement

Luxembourg, 17 December 2007

Response to CESR consultation paper 07-6691 Content and form of Key Investor Information disclosures for UCITS

Introduction

ALFI represents the Luxembourg investment management and fund industry. It counts among its membership asset management groups from various horizons and a large variety of service providers. According to the latest CSSF figures, on 5 December 2007, total net assets of undertakings for collective investment were EUR 2,059,144 billion.

There are 2,501 undertakings for collective investment in Luxembourg, of which 1,543 are multiple compartment structures containing 9,457 compartments. With the 958 single-compartment UCIs, there are 10,415 active compartments in Luxembourg.

According to 2006 EFAMA figures, Luxembourg's fund industry holds a market share of 25.4% of the EU fund industry, and according to 2006 PWC/Lipper data, 75.6% of UCITS that are engaged in cross border business (not including round-trip funds) are domiciled in Luxembourg. As one of the main gateways to EU and global markets, Luxembourg is the largest true cross border fund centre for promoters from diverse origins.

We thank CESR for the opportunity to participate in this consultation on the content and form of Key Investor Information ("KII") disclosures for UCITS. We welcome CESR's interest in this matter and we share CESR's desire for clear and accurate disclosure of information to investors in a form that helps them to understand a fund and to compare it to other funds that might be available to them. We congratulate CESR for preparing such a comprehensive consultation on this broad and complex subject.

In this paper we present short answers to the questions that CESR asked in its consultation paper and some additional comments, which we hope CESR will find helpful. We have included references to relevant pages and paragraph numbers in CESR's paper.

We note that CESR's paper used the terms "operator", "provider" and "promoter". In each case we have taken the term's meaning as best we can from its context, which we assume is governed by MiFID. In our response we have generally used the term "promoter".

Question 1

We are not aware of other research that is relevant to the market and regulatory failures associated with the simplified prospectus ("SP").

Question 2

We support the idea that greater consistency (as opposed to strict uniformity) in the content and length of SPs or KII would aid readability and comparability between UCITS and we therefore support many of the principles (if not the specific prescriptions) in CESR's paper. However, we believe that the improvements that the Commission seeks can be achieved within the current legal and regulatory framework and in co-operation with industry associations and individual UCITS. We believe that matters would be much simpler if SPs (and KIIs if the Commission imposes them) were treated entirely as regulatory documents under the sole authority of the home state regulator.

Our members have found SPs to be very expensive to design, produce and maintain. They believe that KII will involve similar costs and that the case for moving from SP to KII cannot be made on grounds of cost benefit.

Question 3

We think that CESR has described well the context in which KII might be used and it has correctly identified the issues. We have given our opinion on a number of the issues described in Chapter 3 later in this paper.

Question 4

We agree with some of the points that CESR made on the scope and purpose of the KII and we applaud its good intentions. For example, we agree that KII should be short and be focussed on investors' needs (page 18, para 4.4). But we do not see what prevents SPs from doing the same.

We are cautious about the Commission's objective that KII should provide "short, meaningful explanations of the risks ... and expected outcomes" (page 18, para 4.4). We have explained the reasons for our caution in our answers to other questions below.

We do not believe that the KII described in CESR's paper will be any easier to produce than the SPs and we do not share CESR's optimism that fund managers' ongoing costs will fall (page 18, para 4.5).

We agree with CESR's opinion of what the KII should not be (page 18, para 4.6).

We understand that KII are conceived as pre-contractual documents for use at the point of sale and that CESR believes that promoters that deal directly with investors have an obligation to deliver relevant KII to those investors, not only to offer them (page 19, paras 4.8 and 4.9). We have two questions:

- Does CESR expect promoters to maintain records to demonstrate that every investor from whom they directly accepted an initial subscription was provided with the relevant KII before that subscription was accepted?
- Does CESR expect promoters to refuse or suspend initial subscriptions until the promoter can demonstrate in each case that the relevant KII were delivered to the investor?

These are potentially expensive and disruptive requirements for dubious improvements to investor protection.

We disagree with CESR's recommendation that KII be prepared for every UCITS fund, including those that are sold only to institutional investors. If a UCITS intends to offer its units for sale only to institutional

investors, we think that it should be free to decide whether or not to produce KII.

Question 5

If CESR decides to implement a KII scheme that requires UCITS to deliver KII to non-retail investors, we think that the investors should be permitted to opt-out (page 19, para 4.11).

We think that it would be better that UCITS should not be obliged to produce or deliver KIIs to anyone but retail investors and we agree with CESR's view that, "KII should fundamentally be a tool for helping retail consumers to reach informed investment decisions" (page 3, para 6). In those circumstances, non-retail investors need not opt-out of a scheme that does not apply to them.

Questions 6 and 7

In the question of the maximum length of KII (page 19, para 4.14) and notwithstanding their preference for brevity and plain language, our members held polar views:

- Rather than say how long or short a document should be, and prescribe or proscribe the contents of the KII to the extent that CESR's paper does, some of our members preferred a principle-based approach.
- A problem with the principle-based approach is that it makes cross-border UCITS subject to host state authorities' varying interpretations of European and national law, which renders them unable to produce standard editions of many documents for which the only modification necessary for cross-border use would be foreign language translation (these problems were considered in some detail during CESR's consultation on the notification procedure). In the light of that experience, we are not surprised that some of our members would like to see maximum harmonisation of European practice, even to the extent that the formats of documents such as KII are strictly prescribed.

In general, we prefer a principle-based approach to regulation but in the question of KIIs (if they replace SPs), we would be willing to accept harmonised prescription in return for materially easier access to cross-border markets. We also think that CESR's "comply or explain" approach is sensible.

We know that some of our members have published one sheet (two-sided) SPs that satisfy most of CESR's specification for the KII, albeit they had to use a character size that CESR might consider to be "small print" (page 19, para 4.14). We make this point for two reasons: we think that it confirms what we said in our answer to Question 2 above, and it shows that there are limits to how much information can sensibly be published on one sheet if it is not to be criticised as an exercise in "small print". It is in that context that we have prepared the following comments.

We do not think that the KII should bear a statement about the provider's legal liability for its contents (page 4, para 9; page 20, para 4.16 and page 21, para 4.23A). Firstly, as a general principle of law, UCITS' directors have a responsibility to ensure that its documents are correct; it need not be stated in the KII. Secondly, our members do not agree that they should be liable for some of the prescriptions that CESR has made in its paper (for example the synthetic risk indicator). We have explained the reasons why in our answers to other questions below.

A single document such as the KII cannot sensibly provide "practical" information about where and how to buy or sell units in the UCITS that would be relevant to the circumstances of every point of sale in the distribution network (page 4, para 9 and page 21, para 4.23A). A typical cross-border UCITS has a large heterogeneous distribution network. Similarly, a statement about where to find more information about the UCITS cannot sensibly give more than a Web site address and the address and telephone number of the UCITS' central administration, plus something like an invitation to "ask your financial advisor" (c.f. page 22, para 4.26) and to consult the full prospectus.

In respect of other prescriptions on pages 20 et seq, we have the following comments:

- We believe that the difficulty of implementing a reliable risk/reward section has been underestimated.
- If a UCITS decides to produce KII's at a share class level, it might be helpful to print the relevant ISIN on each.
- We agree that the competent authority should be named on the KII together with the UCITS' domicile.
- We think that the KII should refer investors to the full prospectus and a Web site for the details of the depository and auditors.
- We agree with CESR's reservations about the publication of "where to complain" information. We do not think that it can sensibly be published in KII.
- We do not think that the UCITS' launch date need be explicitly stated in the KII. The fund's performance record will provide sufficient information about its history.
- We think that UCITS should be free to decide whether to produce a separate KII for each share class or to show information about several share classes on one KII document. We do not think that CESR should impose an obligation to show all share classes on a single KII; some of them will have restricted distribution and will be irrelevant to most of the investors who receive them.

Question 8

We prefer Option A (a minimal set of items, taking into consideration our response to Question 7). However, if any UCITS is part of an umbrella vehicle that does not function as a protected cell, we believe that the KII should say so.

Question 9

Please see our answer to Question 49.

Question 10

Subject to our answers to Questions 6 and 7, we believe that Option A reasonably strikes a balance between reducing the information provided and ensuring that investors receive the key information that they need before they make their initial investment.

Question 11

We agree that the competent authority should be named on the KII together with the UCITS' domicile.

We think that tax is too complex a subject to be included in KII. It depends as much on the investors' circumstances (i.e., host state regime) as the funds' (home state regime) and it is one of the least harmonised aspects of the European Union. It is also not simple to describe: there are capital gains, net wealth, securities trading, withholding and value-added taxes to name just a few. However, we do think that the KII should say whether the UCITS falls in or out of the scope of the European Savings Directive.

Question 12

We think that UCITS should be free to quote ISIN numbers or similar identifiers.

Question 13

We agree with CESR (page 22, para 4.24) that it is not easy to show the breakdown of fees shared between the distributor and the promoter and that KII should not do so. The amount varies for good reason in different parts of the distribution network and cannot sensibly be disclosed by the promoter in a centrally-produced KII. We believe that under MiFID it should be for the party at the point of sale to disclose to the customer how much commission will be paid initially and during the lifetime of the investment in respect of the specific purchase that the customer is contemplating.

Question 14

We agree with CESR's opinion (page 22, para 4.26) that a single KII should not list all possible local contact details in various member states. However, we do not think that the inclusion of such information becomes any easier if the scope is limited to a single host country. The distribution network would still be too large to describe in the space available on the KII. We also think that it is beyond the reasonable means of promoters to produce specific editions of KII tailored for the many hundreds of branches in a typical large cross-border distribution network.

We think that local information could be provided in a number of ways (where in each case the content should be subject to the restrictions that CESR describes (page 22, para 4.28)):

- Through the publication of a country-specific addendum to the KII. We do not think that this option should be adopted because it would effectively split the KII into several parts: a common part for the home state and a local part for each of the host states. We are opposed to the idea of any host-state intervention in the KII and we would like to see a single KII document for a single European market (with foreign language translation being the *only* modification required, and the faithfully translated copy being permitted in any member state in which that language is spoken, officially or otherwise, and without the prior consent of that member state's authorities).
- Through the publication of local information on a Web-site, the address of which should be printed on the KII (we acknowledge CESR's concerns about this method (para 4.30) but we think that they could be overcome). We recommend this option.
- By preserving a space on the KII to which such information may be added (whether by over-printing or by fixing an adhesive printed label) by the distributor at the point of sale.

In order not to repeat the unhappy experience of the simplified prospectus, we think it essential that the KII be submitted only to the supervision of the home state authority. Anything more would make it unlikely that Europe would ever see standard editions of KII for which the only modification necessary for cross-border use would be foreign language translation.

Question 15

We do not favour a "building block" approach.

Question 16

We agree that a fund of funds should be treated as a single fund that happens to invest in a portfolio of other collective investment funds (page 24, para 4.37) and that investors in funds of funds need not be informed in detail about the underlying funds.

We agree that some form of consideration of underlying funds is sensible (page 24, para 4.38).

Question 17

The Directive might not preclude the possibility of producing a single KII document for an entire umbrella fund (page 24, para 4.39), but we cannot imagine circumstances in which our members would want to do so.

Subject to our view that a UCITS ought not to be obliged to produce a KII if they are to be sold exclusively to financial institutions, we agree that separate KII should be produced for each sub-fund of an umbrella fund (page 24, para 4.41).

We note CESR's view on the production of a compendium of KII of the sub-funds of an umbrella fund (page 24, para 4.42). Insofar as the compendium is only a collection of KIIs, each of which could stand alone and satisfy CESR's requirements then we see no harm in it and we think that it should be permitted provided that individual KII must be delivered to an investor upon request. Insofar as a sub-fund's KII could not stand apart from the compendium we share CESR's concern and we think that it should not be permitted.

Question 18

Our members would like to be free to decide whether to prepare a single KII for each one, more than one or all of the share classes of a sub-fund (page 25, para 4.49). If one or more share classes are omitted from a KII, we think that a footnote should say so and say that further information is available from the promoter. We therefore broadly agree with CESR's view that it should be permissible to use one share class as a representative for the others that are absent from the KII (page 25, para 4.50) but we do not think that it should be compulsory. In other words, if a promoter elects to use a share class as a representative, it should explicitly declare it and then obey CESR's rules.

We refer CESR to our comments above on the facility for certain investors to choose not to receive KII and on the circumstances in which we think a UCITS need not produce KII (page 25, para 4.48).

We doubt that a KII that uses the most expensive share class as a representative for all share classes will create a sales bias in favour of that class (page 26, para 4.52).

Questions 19 and 20

We broadly agree with CESR's observation on investment objective and strategy (page 28, para 5.2). We prefer the KII to cite the UCITS' investment objective exactly as it is written in the full prospectus.

Question 21, 22, 23 and 24

We think that the excerpt of the Commission Recommendation given by CESR (page 28, para 5.3) is reasonable and we agree that CESR has appropriately struck out parts of it.

We agree that a KII should clearly say whether a return is guaranteed (page 29, paras 5.5 to 5.8). Unfortunately, debate lies not in the simple case where a true guarantee exists subject to certain conditions – in which case the reserved word "guarantee" may be applied according to some rule and any conditions can be described – but in the case where UCITS seek to protect shareholder principal through special investment techniques. In the latter cases, UCITS offer no guarantee and will not use that word. But would CESR agree that they could talk about an objective to "protect" shareholder value or "secure" a return, *whilst plainly saying that there is no guarantee of a particular outcome*? We think that CESR should, and that investors are capable of discriminating between promises and aims in this way.

We agree with CESR's view on the investment horizon (page 29, para 5.9) and think that a statement like, "the fund may be suitable for investors with an investment horizon of [x] to [y] years", would be enough.

We think that it is important to understand what "sophisticated" and "non-sophisticated" means when those terms are applied to investors and to funds. There exist investors who by virtue of their professional status, knowledge, high net worth or some other qualifying attribute are considered "sophisticated" (the word is admittedly a colloquialism). They are eligible to invest in funds that would not qualify as UCITS. In a separate sense there exist UCITS that by virtue of their use of derivatives must be managed by means that the asset management industry presently considers "sophisticated". (We think that this sophistication will become routine in the future.) They are nevertheless UCITS and as such are designed for retail distribution and for all types of investor. We therefore do not want to discriminate between investors and funds under the UCITS Directive and we think that CESR ought not to do so (page 30, para 5.12).

Question 25

We very much prefer to use a narrative description of the risks because we think that it is the most effective way to explain to investors what risks they take when they invest in a fund. We acknowledge that the success of the narrative depends upon the clarity and simplicity of its words and the avoidance of jargon that is common in the industry, but we think that it is not difficult to write well.

The compromise in CESR's own words ("detailed qualitative appraisal of concrete possibilities ... a broad sense of the probability", page 32, para 6.7) shows how unsatisfactory the debate about risk is. Does CESR want detail or summary; qualitative or quantitative assessments; concrete assurances or estimates? We don't think that a synthetic risk indicator will help to resolve that debate and we don't think that it will be better understood by retail investors.

If CESR meant to ask whether a synthetic risk indicator should be introduced only if it has received favourable feedback from consumer testing, we would answer yes. If CESR meant to ask whether the tests should presume that a synthetic risk indicator would inevitably be introduced and attend only to the matter of what form it should take, we would answer no.

Question 26 and 31

If a synthetic risk indicator really must be imposed, we would prefer it to use a numeric scale rather than ideograms. However, CESR having taken a page simply to introduce the concept of a synthetic risk/reward indicator, we do not see how KII could effectively present the "possible limitations of the information being shown" in the synthetic indicator (page 34, para 6.18), no matter how skilful the author. For example, we might paraphrase CESR's prototype warning on page 36, para 6.29 to say, "this risk indicator works, except when it doesn't." Moreover, what is a "negative consequence" other than a euphemism for a loss, and what is a "deep market trend"? We think that CESR's prototype warning for funds that can't employ a risk indicator (bottom of page 36) points to the real problem: no risk/reward profile can easily be summarised in one figure. The problem with CESR's prototype on page 73 is that, despite its likely consumer appeal, it is not so much simple as simplistic. Quantitative indicators are not as reliable as their "science" might lead consumers to suppose.

Question 27

Ordinarily we would favour self-regulation but in this case we would prefer regulators (through CESR) to define a common European methodology with standard explanatory text in each of the official European languages and to apply the same uniformly in every state, without exception. We do not think that CESR's Option B3 (page 37, para 6.33) is feasible if it hopes for a greater degree of uniformity than presently exists between SPs.

Question 28

There is no specific calculation methodology that we wish to propose.

Question 29

We think that the criteria described in Annex 5 (not Annex 4) of CESR's paper are generally good. We think that many of them are easy to describe but will be difficult to satisfy. In particular:

- We think that it will be difficult to reflect individual perception of risk when it is subjective and can vary greatly from one person to another and likewise between markets.
- We do not think that a synthetic risk indicator (including the mock-up at Annex 8) will satisfy the penultimate criterion on page 64 ("risk rating must provide as sufficient as possible information in relation to the particular risks of the fund").
- We do not see how the criterion at the top of page 65 ("significant limitations of the rating ... including the range of funds covered and why excluded funds are excluded") can be satisfied in a particular instance of a KII. Does CESR intend to produce an investor's guide to the synthetic risk indicator?
- The second subsidiary criterion at the top of page 65 ("a simple presentation will not allow all risks to be taken into account ... liquidity risk ... inflation risk ... currency risk") begins to get to the heart of our concerns: there are so many specific risks, many of which are not easy to forecast, that a synthetic indicator is unlikely to do more than represent the most general principle that even novice investors grasp early: the reward of an investment tends to increase with the degree of risk taken but that as risk increases so does the probability of serious loss.
- Some of the criteria ("the behaviour of funds given the same ratings must be consistent", bottom of page 65, and "emerging markets [equity] funds should not be classified in the same category as blue chip equity funds", page 66) are reasonable provided that CESR accepts that a fund's behaviour is affected by more than just the class of securities in its portfolio.

Question 30

We think that a narrative explanation remains the most effective means to inform investors about a fund's investment risk and that it will mitigate the weaknesses of the synthetic risk indicator.

Question 32 and 33

Our concern is that no single quantitative indicator can adequately summarise any fund's risk, the nature of which varies considerably with each fund's investment objective and strategy; with the particular composition of its portfolio, which changes over time; with market conditions and the portfolio manager's view of them; with investor sentiment, which affects subscriptions and redemptions. For example, we doubt that a single indicator could have sensibly warned of the interest-rate risk that reduced the relative returns of enhanced cash funds in the first half of this year, or of the credit risk that since August has seriously affected funds that invest in asset-backed securities. We therefore think that it is unwise to offer consumers a risk indicator that seems to offer empirical authority in which they can take comfort when in fact its assessment is likely to be flawed.

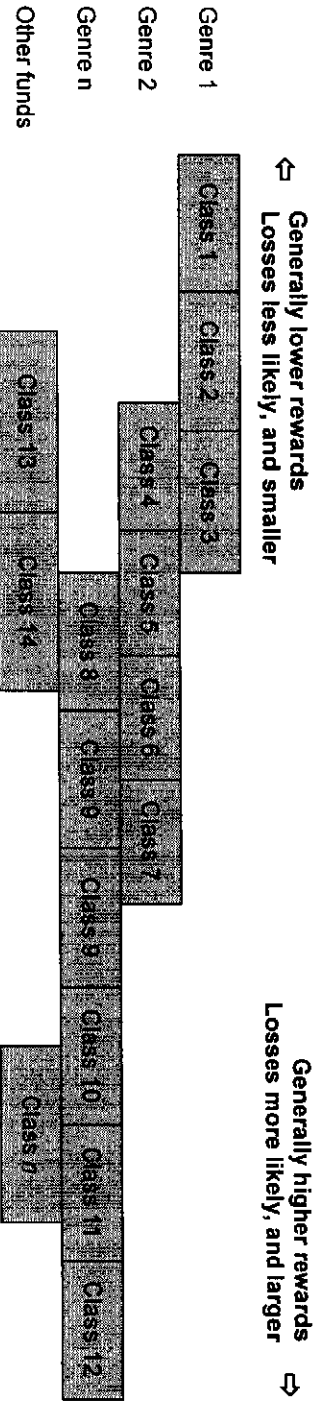
We believe that our concerns can be resolved if CESR considers a scheme that retains the advantages of the approach that it has proposed (principally that it is easy for investors to understand), and removes the basis risk of a single quantitative indicator, replacing it with a classification that the fund's directors can determine objectively in a manner that regulators or their agents can verify and which is likely to remain true for as long as the fund's investment objective and investment strategy remains materially unchanged. The

following rudimentary example shows what the scheme might look like:



Warning: the rewards and risks of a specific fund or class of funds changes with market conditions.
You should diversify your investments in order to reduce your specific risk.

or, separating classes of fund more clearly by genre, like this:



Warning: the rewards and risks of a specific fund or class of funds change with market conditions.
You should diversify your investments in order to reduce your specific risk.

The important point is that we agree that the categorisation of funds would be helpful if combined with a general, non-numeric indication of relative risk, but that a "scientific" scale that relies upon some dubious algorithm would not be. In such a scheme as we have described above, we think that the following design issues should be considered:

- The scheme should use nouns for each class rather than a numeric scale ("money market", "bond" and "equity", to give some very simple examples).
- CESR should prescribe how many classes of fund the scheme should contain, what they should be, and in what order (from left to right) they should be arranged. CESR might find the work of EFAMA's European Fund Classification Forum useful in this respect.
- CESR should define objective criteria that determine the class to which a fund would belong.
- CESR should prescribe the relative risk descriptors (the text above the scales in our examples) and the warnings (the text below the scales in our examples).
- CESR should ensure that its members universally adopt the scheme without modification.

Question 34

We think that Principle 2 (page 32, para 6.9) could more simply say that the reward of an investment tends to increase with the degree of risk taken but that as risk increases so does the probability of serious loss. We are uncertain how CESR would like to see this principle incorporated into a narrative. Should every KII carry an industry-standard warning about risk and reward or should promoters take this into account when they write a fund's risk disclosure?

We do not agree with Principle 3 (page 33). A promoter should be obliged to describe clearly what the objective of an investment fund is and what strategy it will use. An investor may form an opinion on the

investment objective and the strategy and the investment manager (whether by looking at past performance or by other means) and decide to invest or not. We do not think that regulators should compel promoters to predict the probability and severity of profits and losses. No such prediction can safely be made and investors could not rely upon it.

Principle 6 (page 33) is pointless. CESR has already said that the KII should be limited to one page (two sides). It is obvious, taking into account the other things that CESR would like the KII to include, that there will be very little space available for the risk/reward section.

If CESR believes that "good practice guides" (page 33, para 6.10) would foster common practice, what is to prevent them from doing the same for the SP?

Question 35 and 36

We think that some past performance data should be included in the KII.

We would not expect the inclusion of past performance data to be treated as marketing material, but as a record that is included as a regulatory obligation. We do not think that promoters should have the right to opt out of including past performance data (page 42, para 7.10).

We think that past performance data are best represented by a line graph (page 41, para 7.3 and page 43, para 7.19), which will provide a contiguous and more informative record rather than the "snapshot" that a bar chart would give. If CESR believes that a year-on-year comparison is important (for example, by giving average yearly performance), it could be printed on the line chart.

We would prefer to show only 5 years' performance (page 6, para 22; page 41, para 7.3 and page 43, para 7.22). We think that it would still be a sufficiently long period for an investor to form an opinion on the investment manager's ability to sustain reasonable performance. It would also be consistent with MiFID Art 27(4)(b) and it would reduce the administrators' data processing burden.

We do not think that there should be "narrative text to contextualise" performance information but we do agree that there should be a short, standard notice to say that past performance is not a guide to future performance (page 43, para 7.19).

We agree that the comparison of KII will be made easier if performance data are reported by calendar year and we think that KII should be prepared accordingly (page 6, para 22 and page 43, para 7.22). Regardless of whether their accounting and calendar years are co-terminus, we do not think that funds should be compelled to use audited past performance data in their KII.

We are not sure, when CESR said that the "benchmark should be disclosed" (page 43, para 7.22), whether it meant to say that it should be plotted on the performance chart or whether it should simply be named on the KII. We would be happy to name and plot benchmarks for funds that have only one, and we would agree that a fund without a benchmark need only say so, but we think that more thought should be given to the treatment of funds that have composite or multiple benchmarks, which might complicate the chart.

We agree that the KII should declare any material change to the fund's investment policy or manager in the 12 months prior to its publication.

We agree that simulated performance should be permitted in certain cases (page 6, para 22 and page 44, para 7.22). Simulated or "chain-linked" performance is a specialised subject. It is presently managed satisfactorily by the industry. Unless CESR or the Commission has clear evidence that there is a market failure in this part of the industry, we think that they should regulate it with a light touch (i.e., make no change).

Question 37

We think that past performance data should represent the performance of the net asset value of the fund (i.e., we agree with page 6, para 22) with appropriate treatment for funds that pay dividends. We do not think that the performance data can sensibly show the effect of subscription and redemption charges (page 43, para 7.22) but we do think that such charges should be disclosed in the KII (see our answers to Chapter 8, below).

Question 38

We think that CESR's discussion of the options available for disclosing charges is reasonable.

Question 39

We understand CESR's definition of "consolidated" to mean the "illustration of the charges" that is defined in Option B (page 49, para 8.22 et seq; page 50 example) and discussed in more detail at Annex 6 (pages 67, 68). We do not think that this form of disclosure is reasonable because it relies upon a scenario that contains subjective assumptions about the fund's and the investor's future circumstances. We think that would put promoters into an invidious position: who could expect them to make anything other than optimistic assumptions? We also think that most investors would be unaware of the nature of the assumptions and their effect on the consolidated statement.

We prefer CESR's example Option A (page 48). We think that the KII should disclose subscription and redemption charges, management fees, performance fees and (in a single figure) other expenses.

Question 40

We do not think that options for disclosure in cash terms should be considered further.

Question 41

We acknowledge that it is not easy to define a standard table because the circumstances of one fund can differ so much from another's. We think that CESR's Option A (page 48) is a good initial design. If you consider CESR's text and our own example below (which we offer as an aid to the discussion and with the caveat that we have not had time to consider it fully) we have the following comments:

- Charges are often specified in more than two decimal places, and sometimes in as many as five. We would expect the charge to be shown exactly as it is printed in the full prospectus.
- We agree with the general classes of charge ("one-off charges which you pay directly", "charges taken from the fund each year" and "charges taken from the fund from time to time").
- We agree with the terms "initial charge" and, subject to our comments below, "exit charge".
- We think that the section "ongoing charges" is sufficiently general that it could accommodate the disclosure of all other charges and the last section ("charges taken from the fund from time to time") would never be used. We don't think that this was CESR's intention and nor do we think that it would be affected greatly by the ex-post/ante discussion. Our example below shows how we think that the table might otherwise be designed.
- We understand that brevity is one of CESR's goals and we agree with it but we think that the description of each charge in CESR's example is perhaps too brief. In our example below we have proposed alternative descriptions.

- We think that if a charge is not applied, as in CESR's example where the exit charge is "NIL", then the table should say so but that the description should be omitted. This should apply equally to the initial charge and perhaps to the performance fee.
- Some flexibility might be needed to accommodate charges that are a feature of some funds but not of others. One example would be charges applied upon the conversion of holdings from one class of share to another.
- Where a charge can vary between different parts of the sales network, we think that the maximum rate should be shown; it should be qualified as such, and the investor should be referred to the salesman or financial advisor who can say what the exact charge will be.
- Where a charge can vary with time, as exit charges can, we think that the period in which the charge may be levied should be declared and the narrative should say that the charge is contingent and that the liability to pay it reduces to zero over time.

One-off charges taken directly from you		
Initial charge	up to [n.nnnnn]%	This charge may vary between points of sale. It is deducted before your money is invested in the fund. Please ask your salesman or financial advisor to say how much you will be charged.
Exit charge	[n.nnnnn]% falling to zero over [n] years	This charge will only apply if you withdraw your money within [n] years of investing it. Please refer to the full prospectus or ask your salesman or financial advisor for more information.
Annual charges taken from the fund, typically daily at a rate equivalent to the annual rates shown		
Investment management charge	[n.nn]% per annum	This fixed charge pays for the investment management service. It is taken directly from the fund's assets.
Other charges taken from the fund		
Administration expenses	[n.nn]% per annum	This charge pays for the fund's operating expenses as they arise and is taken directly from the fund's assets. It is not a fixed charge; the amount shown represents the expenses that arose in the last calendar year, which was a typical year.
Performance fee	up to [n]% of excess performance	This charge will apply only if the investment manager exceeds the fund's performance target by more than a specific amount for more than a specific period. Please refer to the full prospectus or ask your salesman or financial advisor for more information.

We note that, with only a few changes, our example is significantly longer than CESR's Option A and therefore less compatible with the objective to keep the KII's length to one page (two sides).

Question 42

We think that a single figure shown in CESR's examples (Options A and B) is certainly workable but that it could only be done on an ex-post basis because of the nature of variable expenses, such as transaction costs. The KII would therefore need to contain some statement qualifying the figure. Of the options that CESR described (page 48, para 8.19) for describing ongoing charges, we think that:

- The first (show only ex-post TER and say that the figure might change from year to year) is workable. Investors would have enough information to decide whether to buy the fund but they would not see even a basic breakdown of its charges. We think that's less tenable than it once was.
- The second (show ex-ante and estimate future expenses) should be avoided, principally because we would prefer not to estimate future figures when we can show verifiable ex-post figures from the

previous year. However, we think that it would be a viable approach and should be permitted if the fund applies a "fixed administration expenses" or "capped administration expenses" policy, which can be disclosed ex-ante with confidence.

— The third is difficult to understand and we are not sure that we do.

— The fourth is perhaps what we have shown in our table above. We think that it is the best option provided that charges are consolidated according to their nature, using perhaps no more categories than we used.

Question 43

We think that material changes in charges could be appropriately addressed by updating the KII immediately upon any change to the initial charge, the exit charge, the investment management charge and the performance fee, and by updating the KII annually to incorporate recent ex-post data. We think that KII should show the date of publication.

As a general rule, we think that KII should be updated annually within four months of the calendar year end using unaudited data.

Question 44

We do not think that brokerage fees, taxes and linked charges arising directly from portfolio transactions should be included in the disclosure of funds' charges, but we do think that the depository fees arising from such transactions should be incorporated on an ex-post basis into the "administration charges" that we showed in our table above.

We acknowledge the implication (page 51, para 8.30) that some of CESR's members would like investors to discriminate between funds by taking into account their securities trading activity, the cost of which can impair performance if it is mismanaged. We don't think that the KII, in which space is scarce, is a good place to do it. We also agree with CESR's view (page 51, para 8.28) and the Commission's view (Annex 3, page 62) that it is very hard for consumers to know what to do with such information, whether it's shown as the portfolio turnover rate or the expense incurred.

We think that CESR's question about how to handle assets for which transaction charges are not readily available goes far beyond the scope of this consultation and the UCITS industry. If a fund purchases a derivative in which the cost of the transaction is factored into the bargain (as it might be in a total return swap), it will not pay and cannot report an explicit charge. In mitigation, the value of the asset and its implied transaction cost are included in the fund's net asset value. For the KII, we think that matters should be left as they are for the moment but we would be willing in the future to participate in a consultation on this matter together with our colleagues in other sectors of the financial services industry.

Question 45

We have considered how performance fees might be shown in the KII (page 51, paras 8.32 and 8.33) by including them in our example above. We agree with CESR's opinion that the KII is unlikely to offer adequate space to describe fully some performance fee structures and we think that it is best to refer investors to the full prospectus or to their salesman or financial advisor. Since the performance fee can be summarised on an ex-ante basis, we would prefer it to be disclosed as such.

Question 46

We agree that in some circumstances it is right to disclose charges on a maximum basis. Our example table of charge disclosures above did that for the initial charge and the exit charge. However, if charges are

likely to vary, we think that the KII should say so.

Question 47

The ideas that we presented in our answer to Question 14 (particularly the idea that some space might be reserved on KII, to which local information could be added by over-printing or by fixing an adhesive label) might be useful when considering how to disclose specific charges at a specific point of sale.

Question 48

Master-feeder funds are not permitted under the UCITS III Directive and so cannot be incorporated into KII. We would be happy to consider this question if these funds are permitted in the future.

Question 49

We welcome the commitment to consumer testing. We hope that CESR will recommend to the Commission that the broadest possible range of prototype KII be submitted to consumer testing in several stages including:

- A preliminary stage, in which prototype components (e.g., various forms of performance charts, risk indicators and narratives, charge tables, key agents, etc) are tested individually and in combination.
- A developmental stage, in which the preferred components and combinations from the preliminary stage are developed into more competent designs.
- A confirmatory stage, in which the best prototype from the developmental stage is completed and confirmed as the preferred design.

We think that consumer testing should be planned and conducted by an appropriately specialised firm and that it takes particular care to run an open and unbiased process. We are particularly concerned that Annex 7 (page 69, particular criteria column) contains biased or "leading" questions.

We think that it's essential that consumer testing include investors, industry representatives and regulators.

Question 50

We estimate that the KII will cost between five and ten thousand euro to introduce for each fund (meaning each sub-fund if the fund is part of an umbrella fund), even in the cases where promoters have developed systems and processes to produce short SPs that are similar to the proposed KII.

Question 51

We estimate that the KII will be no cheaper to maintain than the SP.

Question 52

If KII must replace SP, we think that the industry should be given at least two years' notice, so that they can acquire or modify the necessary systems. We would like all member states to adhere to common transitional arrangements.

Question 53

The gradual introduction of KII is feasible. We think that it's vitally important that, if the home member state approves a KII, every host member state must be compelled to accept that KII in lieu of the SP that it replaced. In other words, we cannot tolerate a situation where KIIs are permitted in one member state but SPs only are permitted in another.