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Response to CESR consultation paper on technical issues relating to Key Information Document disclosures for UCITS

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We are grateful for this opportunity to comment on the consultation paper and will focus our comments on one specific area of disclosure: fund charges (Chapter 3).

58. Do you think a summary measure of charges would help investors to understand the overall cost of investment in a UCITS?

Our understanding of consumer testing on this, and other, occasions is that many retail investors do not understand percentage figures. However, it cannot be the role of the KID to provide mathematics lessons in addition to basic information on any give UCITS. Therefore a summary figure in cash terms should not be used to make up for this.

If there is sufficient space in the KID to explain the way in which charges in general impact on all funds' performance (i.e. the cumulative effect over time), then a reasonable case for this can be made. But to apply this educational explanation to a specific fund is likely to mislead, partly because the summary calculation will combine real data with hypothetical assumptions, and partly because investors may well assume that the scenario will occur — rather than that the summary simply aims to show how charges *may* impact on performance.

A distinction should be made between, on the one hand, the practical information of what a fund's charges are and, on the other hand, the educational information of how charges impact on an investment. There may not be space — or it may well not be appropriate — for both elements to be included in the KID.

59. Which presentation would be preferable: using a narrative with a percentage figure or a table of cash figures?

In addition to the answer to question 58, we would add that a table of cash figures for a specific fund would be preferable to help investor understanding ***if*** the actual future impact of charges on a fund's future performance could be known. But it cannot.

In our opinion, a figure combining one-off and ongoing charges has a different objective from presenting separate figures. The former tries to make it clearer to investors why charges matter — for the same reason this measure is also presented in absolute cash amounts rather than as a percentage — in contrast, the disclosure of separate figures focuses on which charges are applied and in what way they are applied.

With this in mind, while disclosure requirements should try to make it as easy as possible for investors to understand charges, there will be an inevitable limit to matching simplicity with accuracy. For example, the maximum initial charge quoted by a product provider will often not reflect the charge actually paid by the investor. Similarly, if a period of years is used in the projection for a combined charge summary, how will this number be agreed upon?

A projected combined charge summary might impact investors' views on how long they should hold a fund and it will have difficulties including the variable impact of any performance-related fees that may be in place.

Finally, in the UK a combined figure (Reduction in Yield) was also introduced to enable easier comparisons between financial products (i.e. pensions, investment bonds and collective funds). This objective might not match that for UCITS-specific regulation.

60. Do you agree that Option 1, using a single ex-post figure, is the best one?

Yes, this is the best of the three options.

A few additional comments:

Option 2 suggests that the inclusion of charges information alongside that for past performance "may reduce investors' perception of the cumulative impact of charges…" While it is understandable that CESR uses cautious language, there can be little doubt that it *will* reduce investors' perceptions of this cumulative effect when performance information is shown on a discrete year basis.

Option 3 suggests that last year's performance fees can be shown. Please note, this possibility need not be exclusive to option 3.

Option 3 suggests that an ex-post figure may be seen as reflecting composite 'overall' charges disclosure. This accusation can be equally levelled at an ex-ante figure.

Option 3 notes that an ex-post figure including performance fees may be misleading. It is worth adding that an ex-ante figure cannot include the impact of performance fees charged at all.

61. Do you agree with the proposed methodology in Annex B for identifying which items should be included in the ongoing charges figure and for harmonising the calculation?

Annex B appears to be reasonable and broadly reflects the current recommendations. A few clarifying comments are set out below.

1.4. Entry/exit charges. It might be useful to clarify the reference to "charges payable to distributors", i.e. annual distribution fees should be included in the TER.

1.7. The reference to a "substantial proportion" of a UCITS investing in another UCITS or CIU will certainly need to be clarified, as the consultation paper suggests.

1.7. e) Presumably any reduction in TER levels on this basis would be reflected in a fund's report and accounts, and so will be in line with standard TER calculations.

2.3. Further clarifications on the presentation of share class specific TERs will be needed.

2.6. The "relevant date" should be specified: a sensible minimum would be in line with annual and/or semi-annual accounting dates.

62. Do you agree with the proposals to:
i) Show the ongoing fund charges figure excluding performance fees?

If only one TER is to be shown, then excluding performance-related fees must be the correct approach.

One correction/clarification is necessary: the current European Commission recommendation (2004/384/EC) does not require a single figure, but instead states: "Performance fees should be included in the TER and should also be disclosed separately as a percentage of the average net asset value."

ii) Explain performance fees through a narrative description?

For investors to understand the fee structure their fund is using, a narrative description of a performance fee is the only means to do this. Please note that a narrative description should not be devoid of numbers in order to properly summarise the fee structure.

While possibly outside the scope of the current consultation paper, guidelines on the clear and consistent explanation of performance fees would be useful for investors and, when looking across Europe as a whole, is currently lacking.

iii) Not show an actual figure for the amount previously charged?

Some investors may find this information useful, but if the intention of this is to show how large (or small) a performance fee may be in terms of net assets (i.e. what has been charged, rather than the fee structure), then this could equally be covered in a narrative description.

63. Do you agree with the proposal to signpost where more detailed information can be found?

This proposal is essential in light of the limited space available in the KID.

64. Do you agree with the proposal to highlight the potential impact of portfolio transaction costs on returns through a warning in the charges section and, in certain circumstances, the strategy/objectives or risk and reward sections of the KID?

Without agreement by fund practitioners as to how to achieve this by others means, this must be the route to take.

65. Do you agree with the proposal to include this warning? (i.e. 'The ongoing charge is based on the expenses for the [year]. These can vary slightly each year.')

We would note that TERs *can* vary dramatically between two years, although as a general comment the second sentence is correct.

66. Are there circumstances not covered by the proposals which could lead to investors being misled about potential increases in charges?

The most likely circumstances — a new fund launch, a change of management fee, a fixed fee being dropped — are all covered later in the consultation paper.

One other circumstance to bear in mind is if there was a dramatic change in a fund's assets under management.

The reference to "passing through all charges" might be clarified. This need not relate to all charges outside the pure management fee. Perhaps: "Charging some or all expenses outside the quoted management fee (without reference to an expected maximum charge)."

67. Have all the relevant issues in estimating an ex-ante ongoing charges figure for a new fund been identified?
68. Do you agree with the proposed manner of dealing with these issues?

Inasmuch as an estimated TER for a new fund launch must be flagged as an estimate, then all relevant issues seem to have been identified.

69. Do you agree with the proposal to replace an ex-post figure with an estimated ex-ante figure where there are material changes in the charging structure?

In principle, yes. However the consultation paper clearly explains how defining a "significant" material change will be difficult.

70. Do you agree with the proposed wording to explain the estimated figure?

In principle, yes. One suggestion would be to remove the reference to a fund's annual report as this will not be relevant for a prospective investor. The fund's annual report will only reflect the new ex-post operating expenses in the future, potentially in one year's time. As a result, this reference adds wording (making it less simple) without notably helping an investor's decision process. Importantly, a general reference to a fund's annual report will hopefully be made elsewhere in the KID.

71. Can you suggest how materiality should be defined in the context of changes to the disclosed charges figure?

In our opinion, any change in the annual management fee should be deemed to be significant enough to warrant flagging this in the KID. Adjusting the current ex-post TER to account for the management fee change would seem to be reasonable, for example, an ex-post TER of 1.87% (including a management fee of 1.25%) could be shown on ex-ante basis of 2.12% if the management fee were to rise to 1.50%.

This approach would also mean that existing investors in a fund could be provided with the updated KID as a succinct means to update them on the fund's charging structure.

An assessment of materiality relating to other operating expenses will be difficult to define without adding significant complexity. For example, a fund that is very small and bears a disproportionately large TER should not be allowed to show an ex-ante TER on the basis that fund assets are expected to increase (except for new fund launches where ex-post calculations are not possible).

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