



**SUBMISSION TO THE
COMMITTEE OF EUROPEAN SECURITIES REGULATORS (“CESR”):
CONSULTATION ON KEY INVESTOR INFORMATION**

1. CONTEXT AND OVERVIEW

The Asset Management and Investment Funds Group at Matheson Ormsby Prentice welcomes the opportunity to comment on CESR’s Consultation Paper on Content and Form of Key Investor Information (“KII”) Disclosures for UCITS (the “Consultation”).

We have summarised our views on specific aspects of the Consultation under the following headings:

- Liability for KII
- Exclusions from KII, Scope and Distribution Matters
- Content and Presentation of KII
- Risk Reward Indicator
- Consumer Testing

In supporting the work and initiatives of the Commission and CESR in this area, we acknowledge the challenge of striking the correct balance between remediating aspects of the simplified prospectus (“SP”) regime on one hand, and presenting an efficient and workable new model for industry to adopt on the other. We note that in order for KII to successfully replace the SP, it must constitute a meaningful replacement with tangible improvements on the current structure.

This memo has been drafted for presentation to CESR on the basis that it is representative of the views of the Asset Management and Investment Funds group at Matheson Ormsby Prentice. Please do not hesitate to contact Michael Jackson, James Scanlon or Elizabeth Grace if further detail in relation to any aspect of this memo is required.

2. LIABILITY FOR KII

“Misleading, inaccurate or inconsistent with the full Prospectus”

We note CESR’s statement that liability for KII would be restricted to cases where the information delivered through KII would be misleading, inaccurate or inconsistent with the “full” Prospectus.

Whilst we agree with CESR that liability for KII must be limited, we submit that the current scope of proposed exclusion is too narrowly drawn and that an appropriate limitation of liability must take into account the intrinsic disconnect between KII as an A4 summary sheet and a full length UCITS Prospectus.

On an application of the current proposal for liability, it is not difficult to conceive a strong case to answer that a short and succinct KII could well be inconsistent with, or misleading or inaccurate in

comparison to, the full Prospectus - simply by virtue of the informational disparity between the full Prospectus and the KII document. Based on the test for liability as currently framed, this could be the case whether or not that excluded information had been deemed by the proposed legislation as "key" or non-"key".

Whilst we recognise the benefits of a two page single sheet A4 document presenting core information, we submit that this cannot be at the expense of increasing the liability of the directors of the fund. This is a real concern, particularly when one considers the margin for over-reliance/sole reliance on KII disclosure by consumers without reference to the full Prospectus.

Submission on Standard for Liability for KII

In view of the above comments, we advocate that the standard for liability for KII should be set to reflect an appropriate level of recourse to a fund and its directors.

In terms of formulating an appropriate test, consideration might be given to the proposal that liability for KII should only attach where there has been gross negligence, bad faith, wilful misfeasance or wilful non-feasance on behalf of the fund in terms of non-compliance with the requirements for KII, in circumstances where loss alleged by an investor is caused by that non-compliance.

In the alternative, a test for liability for content within KII might be appropriately developed to only cover information disclosed through KII which is not further detailed in the full prospectus. It would not be intended however that this carve out from liability would apply where the information disclosed through KII serves to materially distort what is represented in the full prospectus, and where such distortion is a result of the gross negligence, bad faith, wilful misfeasance or wilful non-feasance on the part of the fund in terms of non-compliance with the requirements for KII.

In terms of any discussion in relation to liability for KII, we would raise the general point that in addition to any cause of action potentially applying between fund producer and consumer, a fund and its directors will also be exposed with respect to the consequences of non-compliance with KII requirements on a regulator/regulated entity level.

Finally, in the context of this submission, we note that the US securities and exchange commission ("SEC") has recently proposed the use of a "summary prospectus" providing key information for mutual funds to investors at pre-contract stage, with very similar objectives to KII. In terms of liability provisions, we understand that the US proposals on liability are to the effect that once the summary prospectus has been provided in good faith, the fund would be able to rely on section 19(a) of the Securities Act 1933 against a claim that the summary prospectus did not include information that is disclosed in the statutory prospectus (whether or not the fund incorporates the statutory prospectus by reference into the summary prospectus). Section 19(a) protects a defendant from liability for actions taken in good faith conformity with any rule of the SEC. We mention this for comparative purposes in the context of the formulation of a liability test for KII, as we understand that the rationale behind the introduction of the US summary prospectus is equivalent to the objective and purposes of KII.

Statement regarding Liability within KII

We believe that it is necessary to retain the use of a statement within KII (a) noting the exclusion of liability for the KII presentation; (b) advising investors that they may want to review the fund's full prospectus and take independent financial advice and (c) incorporating a link to the full Prospectus.

This suggestion is consistent with our over-arching view that a consumer should not be drawn into a misconception that KII could be a substitute for reviewing the Prospectus in full, or taking professional advice in relation to the fund product. It is possible for the wording of such disclaimer to be standardised.

Confirmation of Status of KII

In the context of the discussion on liability for KII, whilst we understand that KII will not be regarded as being part of/linked to the full Prospectus, we note from CESR's Consultation that it does not view KII primarily as a marketing tool/investor education document either. We would request that the status of

KII should be expressly clarified – is KII a marketing document, a part of the Prospectus or is it in a *sui generis* category?

3. EXCLUSIONS FROM KII, SCOPE AND DISTRIBUTION MATTERS

We note CESR's advice that non-retail investors should be permitted to opt out of receiving KII if it is not relevant to their needs. We submit that KII would not apply at all in the case of institutional or professional investors, instead of there being an opt-out provision for those investors. If it is not possible to achieve a full opt-out in this regard, we would argue that an opt-out for the fund should at least apply in the case of structured UCITS products which are designed for institutional investors only, as otherwise the obligation on the fund to provide KII might, in this context, be regarded as excessive.

In terms of clarifying the extent of a fund's obligation to deliver KII, the fund's responsibility to deliver KII to investors should only extend to circumstances where it is selling directly to investors. Where the fund has a contractual relationship with a distributor or intermediary, it ought to be made clear that the fund satisfies its obligations once it has delivered up to date KII to its distributor or intermediary.

With respect to issues surrounding proposed use of KII by distributors at point of sale, a conclusive analysis of the interaction and/or overlap with MiFID and other relevant directives is required with a clarification of the extent to which the UCITS directive would seek to appropriately apply not only to fund producers but also to product intermediaries in the context of KII requirements. We acknowledge that it will be challenging to apply and enforce KII around the point of sale, bearing in mind the different channels and packages through which the fund product may ultimately be marketed and sold.

A specific clarification which we would welcome relates to the obligation regarding KII in countries outside of the EU. On the basis that a fund will be obliged to comply solely with local requirements in relation to distribution, we would request clarification that there is no need to deliver KII in those jurisdictions.

4. CONTENT AND PRESENTATION OF KII

In terms of the proposals for content and presentation of KII, we would make the following comments:

It is essential to endeavour to strike a balance between an overly prescriptive and a principles-based approach with respect to the content requirements for KII. We recognise the benefits of mandatory content from the perspective of ease of cross border registration. We also acknowledge however the advantage of developing a standardised list of permitted contents appearing in a fixed order/hierarchy, whilst retaining flexibility for innovative products. This would be appropriate bearing in mind the varying degrees of sophistication across the spectrum of UCITS.

The means by which we would envisage an element of flexibility being incorporated within the KII framework would be to develop a prescriptive "standard" KII, but to also allow for an alternative, non-standard option which could accommodate the disclosure requirements of more sophisticated products such as structured UCITS. The non-standard option would not be left as an open-ended matter however, with the alternative non-standard model providing for additional flexibility, but in a structured manner. We would put this twin track approach to the CESR for consideration.

We submit that the required content for KII should retain disclosure of the home state's tax regime and identification of home state regulator.

We support electronic delivery of KII (to incorporate appropriate safety measures), with copies of the full Prospectus to be made available on request (either by email or in hard copy, as requested), and the use of hyperlinks and signposting where appropriate. We understand that the possible use of building blocks to satisfy KII is unlikely to proceed. As mentioned above, we support the use of a signpost/hyperlink from the KII document to the full Prospectus. Links to the full prospectus must be one mouse click away and if it the link is to a table of contents, then the user must be able to reach the relevant section in no more than two mouse clicks in total.

Regarding the question as to whether "local" information (eg how to buy and redeem shares, availability of NAV) should be excluded from KII, we are in favour of exclusion. In order for it to meet its objectives, KII must be a succinct pre-contractual summary document providing information about the most important features of the product in order to help a potential investor decide to buy or not. As KII is to fit into a single A4 sheet, the exclusion of local information will leave more room for essential information of this nature. The use of a signpost or hyperlink to local information would be appropriate.

5. RISK REWARD METHODOLOGY

Preferred Option: Use of Narrative

The discussion within CESR's Consultation regarding the possibility of using an SRI (synthetic risk-reward indicator) as opposed to a risk narrative approach warrants attention. Based on the observations summarised below, we do not believe that the use of an SRI (such as a 1 – 5 scale) is the best means by which to proceed, from either a consumer or industry standpoint.

Our reservations regarding the use of an SRI are summarised as follows:

- It is difficult to envisage a synthetic scale adequately capturing all or even most of the risks associated with the product;
- The omission of a qualitative presentation operates to the detriment of the consumer in terms of the primary objective of KII which is to provide the consumer with what he needs to know in order to make a well-informed investment decision;
- We believe that the use of a flat or linear scale will attract over-reliance, to the extent that it will be viewed by consumers as rendering a review of the full Prospectus unnecessary;
- In terms of cross-border product comparisons, it is difficult to envisage an SRI methodology that will secure absolute standards of consistent application across different jurisdictions;
- Linked to the foregoing point, there is the risk that peer group influence and scale "clustering" will occur intra or inter jurisdiction. If this is the case, it is not difficult to anticipate product comparisons becoming either distorted or worthless, which we believe is unacceptable for a harmonised product class.

Other perceived issues relate to the difficulties in building an appropriate SRI methodology and the emergence of reverse engineering.

We take the view therefore that the SRI option would (a) most likely become a meaningless tool for consumers or (b) lead to levels of over-confidence and over-reliance in consumers without a closer look at the particular risks embedded within a product offering as enumerated in the full Prospectus. Both outcomes represent failure, the latter could lead to possible arguments around mis-selling.

In light of these considerations, our preferred option is the disclosure of risk within KII on a narrative/qualitative basis. Disclosure within KII on this basis should include a description of the main risks, and where deemed necessary by the fund, there should be signposting to the full Prospectus for more comprehensive information on the risks involved.

Hybrid Option

If it is the case that the extent of support for the SRI option means that it will proceed as the first choice, we would strongly advocate the inclusion of narrative textual warnings alongside the SRI presentation in order to put into context for the consumer the scope and operation of the chosen SRI; to highlight its possible limitations; to refer to any risks that are not covered by the SRI; and to explain the impact of the fund's classification within its parameters. Signposting to the full Prospectus for comprehensive risk disclosure would be appropriate, together with a recommendation to engage an

independent adviser for own investment advice. In terms of testing, we would ask that this “hybrid” approach is tested with consumers during proposed consumer SRI testing phases.

6. CONSUMER TESTING

We note that CESR proposes to engage consumer testing in relation to KII proposals in order to establish consumers’ preferences, provide objective evidence as to whether they have understood the disclosures and to demonstrate whether the KII represents a real improvement over the SP. Whilst we support consumer testing in this regard, we would mention that in relation to an area of testing such as the establishment of whether there is a preference for SRIs over a narrative/qualitative approach to risk reward, it might be expected that an option such as a 1 – 5 scale or traffic lights will be far more attractive to consumers than a qualitative or narrative approach, simply because it offers a basic and less onerous approach. We would submit that subjective factors on the consumer side such as this would be duly weighted and borne in mind in the final analysis.

7. CONCLUSION

The work on how best to improve upon the failed SP regime must be supported, and we have actively encouraged our clients to participate in the KII dialogue and the Consultation instigated by CESR.

We believe that resolving the tension between a fund producer facing uncertain liability for content of a mandatory “key features” document, and the high probability of the same summary document operating as an incentive for the consumer not to read the full Prospectus, is vital to the success of KII for industry and consumers alike. We have endeavoured to set out in this note the manner in which this dichotomy might be addressed and, in our view, the appropriate use of liability provisions is fundamental in this regard.

Yours faithfully



MATHESON ORMSBY PRENTICE

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