



Date: 13 April 2007
Ref.: CESR/07-241

KEY INVESTOR DISCLOSURES FOR UCITS

CALL FOR EVIDENCE

Background:

The UCITS Directive (85/611/EEC) requires the use of simplified prospectus (SP) for the purpose of informing clients before they invest in UCITS. The current content and format of the SP is considered not to have achieved its initial objectives, since documents are often overly long and technical, and difficult for the average investor to understand and use. There have also been problems with the consistency of the information contained within SPs, making it harder for consumers to compare between funds, particularly where cross-border sales are involved. The full Prospectus is also considered to be too long and technical for the average investor.

In its UCITS White Paper, the Commission proposed developing a new document which is practical and user-friendly. CESR is now keen to seek the views of consumer representatives to better understand what key investor information (KII) can better meet consumer needs.

On 11 April 2007 CESR received from the Commission a letter requesting CESR's assistance on detailed content and form of key investor disclosures for UCITS (see Annex 1). The request clarifies the purpose and objective of the request, the focus of the work to be undertaken by CESR and the proposed organisation of the work and the time-table.

Calls for evidence:

CESR is inviting all interested parties to submit their views regarding the request for assistance received from the Commission.

Furthermore, since it is extremely important to collect detailed information at the early stage of the project, CESR would like to conduct, in parallel to the general call for evidence, two specific calls for evidence:

a) Specific call for evidence for consumers and representatives of individual retail investors

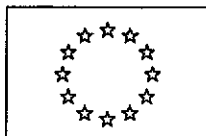
A questionnaire on the simplified prospectus for retail investors has been prepared (see Annex 2 – Ref. CESR/07-214)

b) Specific call for evidence on UCITS distribution

A specific document has been prepared for this purpose (see Annex 3 –Ref. CESR/07-205)



All contributions can be submitted online via CESR's website under the heading Consultations at www.cesr.eu by **25 May 2007**. They will be made available in the CESR web-site after the deadline.



EUROPEAN COMMISSION

Internal Market and Services DG

The Director-General

11.04.07 1413

Brussels,
MARKT G/JH D(2007) 4563

Mr Eddy Wymeersch
Chairman
Committee of European Securities
Regulators
Avenue de Friedland
F-75015 Paris

Subject: Request for assistance on detailed content and form of key investor disclosures for UCITS

Dear Mr Wymeersch,

I write to request the assistance of CESR with a new work-stream to upgrade disclosures provided by UCITS fund managers to help informed decision-making by potential investors in their funds.

Responses to the Green Paper on Asset Management and the report of the European Parliament have highlighted the shortcomings of the simplified prospectus. As currently implemented, the simplified prospectus does not provide an effective basis for informing the retail end-investor about the relevant considerations associated with a proposed fund investment – such as the cost of the investment, investment policy and associated risks. This results from a lack of clarity as regards the purpose of the document, inappropriate content and untimely delivery, as well as the divergences that have arisen in national implementation.

In the White Paper, the Commission undertook to launch remedial work on the simplified prospectus. Consumers need understandable and reliable disclosures which allow them to assess the risk-reward profile of the proposed investments. In its White Paper, the Commission indicated that this work will require amendments to the UCITS Directive 85/611/EEC (Level 1) to clarify the fundamental objectives and guiding principles of the simplified prospectus. As part of that modification, the Commission will also provide for the adoption of legally binding implementing measures (Level 2) to give effective and uniform expression to those principles across the EU.

The overarching objective for this work is to replace the existing simplified prospectus with short, meaningful explanations of the risks, costs and expected outcomes associated with investment in a UCITS fund/sub-fund. In achieving this objective, this work should also reduce the costs for fund managers of producing and publishing investor disclosures.

Commission work on the modification of UCITS provisions to clarify the rationale for and the content of useful investor disclosures has recently been set in motion. On March 22nd, DG MARKT published an extensive body of material as a basis for public consultation on the shape of the guiding principles governing revamped fund disclosures. This preliminary consultation material will provide for the adoption of implementing legislation to give effect to such principles. The formal Commission proposal to modify the relevant UCITS provisions is scheduled for publication towards the end of 2007/early 2008.

While the Commission proposal is a work in progress, we believe that groundwork could already usefully start on the detailed content and form of appropriate investor disclosures (cost, risk, (past) performance presentation and other investor-relevant disclosures) that should be provided once the amended UCITS provisions are in place. Work on the design and content of enhanced disclosures should in our view not be delayed until the new legislative provisions come into effect. This groundwork will take considerable time to prepare and test with market participants and investors before being finalised. Our current working estimate is that this process could take two years to complete – if all goes smoothly.

It may also be possible to bring some elements of any agreed new disclosures into effect in advance of the legislative provisions on a non-binding basis. However, a decision on whether this will be possible, worthwhile or commercially sensible must wait until work on the revision of the simplified prospectus is more advanced.

Given these considerations, the Commission would therefore like to set this work in motion now. We would request CESR assistance in undertaking technical groundwork in respect of key investor disclosures. This would enable the Commission and CESR to give early effect to new UCITS provisions in this area once they enter into force. Work undertaken on the basis of the present request for assistance could form the basis for CESR response to a future formal mandate to CESR for technical advice on implementing measures following future amendments to the UCITS Directive.

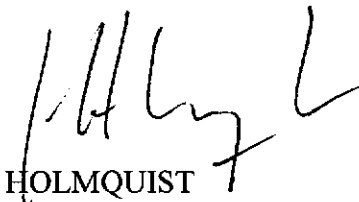
The Commission believes that the close involvement of national enforcement authorities is indispensable to the successful conclusion of this challenging and demanding work. Several CESR members have been at the forefront of efforts to enhance investor disclosures. It would be extremely valuable if these experiences and expertise could be harnessed from the outset of the envisaged work on revised UCITS disclosures.

The requested groundwork would involve development of mandatory investor disclosures to be delivered by fund managers in respect of the UCITS they manage. This would include defining the key items to be disclosed: notably, investment policy/objectives, costs and charges associated to the investment, risk/reward profile of the proposed investment, as well as the form and methods for providing the disclosures. The requested work would have to take into account the different sales channels and methods for distributing UCITS (direct sales, intermediated sales, wrapping or structuring of UCITS in other products), bearing in mind that the ultimate purpose is to provide adequate information to retail investors to enable them to take an informed investment decision. Finally, adequate investor disclosures should be usable for a wide range of existing funds both on a national basis and on a cross-border basis within the European Union.

The annex to this letter sets out in more detail the areas where CESR assistance would be most helpful and an indicative programme for organisation of the work. This documentation lays great emphasis on the need to involve stakeholders in this process from the outset. Active involvement of stakeholders will ensure that work on UCITS disclosures is informed by a sophisticated understanding of the real needs of investors, and the capabilities of fund managers and distributors/advisors. The Commission stands ready to assist in supporting the market testing of preliminary outputs (through financing of supporting surveys etc).

We recognize that this is an ambitious and complex project. However, providing for adequate investor disclosures can make an important contribution to the efficient functioning of the UCITS market. Faced with greater diversity of UCITS investment styles and performance, increased product complexity and changing distribution channels, there will be a greater need for effective, meaningful and relevant product disclosures to support fund sales/advice and self-directed investments. The requested work is an essential part of our drive to improve point of sale transparency and regulation. It could serve as a benchmark for comparable saving products. This is a flagship project in the area of investment funds and investor protection. The Commission looks forward to working closely with CESR on this important initiative.

Yours sincerely,



Jörgen HOLMQUIST

Enclosures: Request for assistance on detailed content and form of key investor disclosures for UCITS

Cc: L. Cardia, Chairman, CONSOB, V. Conti, Deputy Commissioner, CONSOB, N. Giusto, CONSOB, F. Demarigny, SG CESR, C. Comporti, Deputy SG CESR

Annex

REQUEST FOR ASSISTANCE ON DETAILED CONTENT AND FORM OF KEY INVESTOR DISCLOSURES FOR UCITS

1. BACKGROUND TO REQUEST FOR ASSISTANCE:

The present call for assistance to CESR follows the Commission commitment to revise the UCITS simplified prospectus as announced in its White Paper on enhancing the single market for investment funds (15th November 2006). The option of discarding the simplified prospectus has been examined but rejected. Consumers need understandable and reliable disclosures which allow them to select competitive products offering the most attractive risk-return combinations.

Recent workshops organised by the Commission (May/July 2006) bringing together various stakeholders (fund managers, distributors, regulators and investors) confirmed that there is strong support for standardised off-the-shelf fund disclosures and identified some of the areas in which the simplified prospectus / (standardised) investor disclosures needs improvement.

In the White Paper, the Commission indicated that it will propose amendments to the UCITS Directive 85/611/EEC (Level 1) to clarify the fundamental objectives and guiding principles of the simplified prospectus. It will also provide for the adoption of legally binding implementing measures (Level 2) to give effective and uniform expression to those principles across the EU. This should reduce costs of producing overly detailed and complex documents, and ensure that investment in producing simplified prospectus or other investor disclosure information delivers a real return in terms of better informed decisions by investors.

On March 22nd, DG MARKT launched a consultation process on the broad outline of possible legislative amendments – including the possible modification of the provisions (section VI) of the UCITS Directive relating to the simplified prospectus. This work will be subject to public consultation until 15th June. In the light of reactions to the preliminary text, the Commission will come forward with its proposal to modify the UCITS Directive by end 2007/early 2008. The co-decision procedure for adoption of these amendments could then commence and hopefully be concluded (at least first reading) by end-2008.

The simplified prospectus, as currently implemented does not provide an effective basis for informing the retail end-investor about the relevant considerations associated with a proposed fund investment – such as the cost of the investment, investment policy and associated risks. This results from a lack of clarity as regards the purpose of the document, inappropriate content and untimely delivery, as well as the divergences that have arisen in national implementation. The simplified prospectus tries to do too many things at the same time: provide regulatory information (get a higher degree of comfort in the cross-border notification process), marketing tool, and financial education.

Work on the form and content of enhanced disclosures should not be delayed until new legislative provisions come into effect: time-frames for remedying the shortcomings of the current simplified prospectus will be very long – at least two years on a conservative estimate to complete the work envisaged under the present request for assistance.

The Commission considers it useful to commence work forthwith on developing effective investor disclosures. The present request for assistance seeks to launch the details and time-consuming groundwork to prepare effective fund disclosures in parallel with the preparation and negotiation of the modifications to the related UCITS provisions.

2. PURPOSE AND OBJECTIVE OF REQUEST FOR ASSISTANCE:

UCITS are now a widely-retailed, cross-border product. Effective, concise and meaningful disclosures of the essential characteristics of the proposed investment fund and associated costs can make an important contribution to sound investment decisions and objective investment recommendations.

The present request seeks to mobilise CESR expertise and assistance in elaborating requirements that succinctly communicate meaningful information on cost, risk and potential benefits of proposed UCITS investment in a manner which is helpful and comprehensible to a potential retail investor. As a secondary objective, work to correct the deficiencies of the simplified prospectus as currently implemented should seek to simplify the costs for fund managers of producing and publishing this document and/or other meaningful investor information.

Through this request, the Commission calls on CESR to propose a set of requirements to replace the existing simplified prospectus in order to provide retail investors with short, meaningful explanations of the risks, costs and expected outcomes associated with investment in a UCITS fund/sub-fund. An important point of reference for CESR work are the proposed orientations for modification of the UCITS provisions on simplified prospectus as set out in the recent DG MARKT consultation documents. The envisaged adjustments would entail important changes compared to existing provisions governing the simplified prospectus. The latter would be referred to as "key investor information", which should not necessarily take the form of a specific document. The relevant provisions of the UCITS Directive are to be remodelled around key principles, leaving issues of implementation to be completed through detailed implementing legislation. This legislation will be completed on the basis of advice from CESR – of which work under the present request for assistance will be a fore-runner.

The present request for assistance provides significant latitude to propose new approaches to the form and content of effective and meaningful investor disclosures. In fleshing out the guiding principles, CESR will be able to draw on international and national experience, and have the opportunity to test options through consultation and survey-work.

Work to be undertaken should also take into account the different sales channels and methods for distributing UCITS. Product disclosures are used in different ways, by different users, in different sales contexts. This might be through self-directed investment decision (direct sales from fund manager to retail investor/'execution-only' sales via broker); bank/advisor intermediated sales; or sale of fund through another wrapper (life insurance contract, tax wrapper). CESR should also set out how its proposal would work in the different ways in which UCITS are sold to investors: for example a fund with multiple sub-funds all marketed together, a fund with different share classes, a fund of funds, a master-feeder fund, or a tax wrapper or savings plan. The work should therefore consider and reflect different investment scenarios including:

- Where investor purchases fund units directly from the fund manager;
- Self-directed investment (execution-only) via a fund supermarket or internet bank;
- Advised or intermediated sales through a bank or other financial intermediary.

UCITS legislation can only impose direct obligations on UCITS managers and their competent authorities to ensure that the mandated disclosures are published as required. However, these product disclosures will only be effective if this information is used in a timely and effective way by the intermediaries who sell or recommend UCITS. There is therefore a need to ensure an articulated approach between rules governing the publication of product disclosures by the UCITS regulated fund manager and those governing the provision of relevant information by the fund distributor/advisor when selling or recommending UCITS to the end-investor. Consideration should be given to establishing a coherent approach building on a combination of revised UCITS provisions (governing the disclosure obligations of the UCITS manager) and relevant MiFID provisions (which impose requirements on investment firms to provide appropriate information to (potential) clients, allowing them to rely on the UCITS product disclosures where relevant, and clarify responsibility for disclosures of different fees and commissions in case of intermediated sales). Another issue which will warrant consideration is whether similar levels of disclosure can be introduced when UCITS are sold through non-MiFID distribution channels. These considerations point to the need for complementary work on EU legislation which regulates 'point of sale' obligations for the principal distributor/advisor networks through which UCITS and UCITS-based investments are sold. While these issues fall beyond the scope of the envisaged adjustments to the UCITS Directive, and steps to ensure their effective implementation, they should inform the work undertaken under the present request for assistance.

3. FOCUS OF THE WORK TO BE UNDERTAKEN IN RESPONSE TO THE REQUEST FOR ASSISTANCE:

3.1. Guiding principles for work under the request for assistance:

Through this request, the Commission calls on CESR to propose a set of requirements to replace the existing simplified prospectus in order to provide retail investors with short, meaningful explanations of the risks, costs and expected outcomes associated with investment in a UCITS fund/sub-fund. The proposed level 2/3 work should reflect the following basic principles:

- provide essential/key information on investment policy and potential benefits, risks, charges of the proposed fund;
- be in short and simple form, understandable to retail investors;
- have a comparable content and format across EU;
- serve as a support for self-directed investments and/or advised sales;
- EU-wide use without further modification/approval.

Pre-contractual information: The revised key investor information should be conceived as pre-contractual information which should be provided to retail investors prior to subscription – also having regard to relevant requirements laid down in MiFID. Although it can be used for marketing purposes, it should not as such be conceived as a marketing tool.

To be looked at in a changing context: The proposals should relate to fund information (i.e. product information required by an investor to take an informed decision and practical information necessary for an investor to enable it to exercise its rights) but also set out how they would be applied alongside requirements for disclosure in relation to any product wrapper (e.g. for fund of funds/master feeders/tax wrapper/savings plan) or

other distributor disclosures. This should clearly reflect the MiFID requirements for disclosure by distributors. In addition, the impact of the use of other distribution mechanisms (such as fund supermarkets, internet) on the content of key investor information should also be considered. The possible use of different "building blocks" of information for different sales contexts could also be considered.

3.2. Detailed content of disclosure

In response to this request for assistance, CESR is invited to submit fully developed recommendations in respect of all of the following headings.

The key investor information should clearly communicate the following information to retail investors:

- the proposed investment objectives and strategy in plain language;
- whether return of their capital is guaranteed or the capital is at risk;
- where an investment was intended for the long term and the reason why (this would not necessarily imply a precise number of years where there was no defined product term);
- the overall charge for the fund and/or for the product/service they are purchasing.

The requested work should further consider which elements of the current Schedule C of Annex II are necessary for an investor to take an informed decision. In particular, the following items of information could be considered as less important for retail investors and therefore would not need to be in the top layer of information disclosed:

- when the UCITS was created;
- identity of depositary;
- expected period of existence;
- portfolio turnover rate (as it is very hard for consumers to know what to do with such information);
- commercial information (provided this is given somewhere).

3.2.1. Risk disclosure

The results of the SP workshops have shown that plain-language narrative description of the key risks identified by management companies is not necessarily effective. This is to ensure that the overall information given contains a balanced representation of the potential benefits and the risks involved.

The requested work should reflect on how risk disclosures can be improved and propose a common EU-wide approach. This should be done in the context of the sales/distribution process taking into account MiFID conduct of business obligations imposed on intermediaries (suitability/appropriateness of the product for the investor).

One possible route could be to develop EU guidelines to ensure that the narrative description clearly and concisely explains the potential consequences of the risks on the performance and capital invested.

This should include the following elements:

- Review and streamlining of the list of risk factors currently detailed in the Recommendation 2004/384/EC¹ in order to ensure that firms highlight the most important factors for their funds.
- Possibly, developing a methodology to give an indicator of the risk appetite and/or uses for which a UCITS is suitable.

3.2.2. *Cost disclosure*

The requested work should focus on developing an EU-wide standardised calculation method of Total Expense Ratio (TER), or similar composite measure, to be applied in a harmonised way by all Member States. This cost disclosure should be as comprehensive as possible. It should inter alia clarify the following points:

- Treatment of entry/exit fees;
- Treatment of transaction costs;
- Treatment of distribution costs (taking account of new obligations imposed on intermediaries by MiFID).

Cost disclosure by percentage rates is to be maintained. However, as retail investors often find it easier to understand cash figures rather than percentage rates, the work under the request should develop a common method of showing effect of charges in cash terms – in an illustrative manner only – in the key investor information.

A synthetic indicator combining the effects of front-end loads and management fees to be applied by all Member States could be considered as a possible option.

3.2.3. *(Past) performance presentation*

The requested work should consider whether disclosure of (past) performance should be mandatory, accompanied by appropriate disclaimers. If past performance is to be retained, it should concentrate on developing a common standard of presenting (past) performance to retail investors, in a manner which can be understood by them.

This work should take as a starting point the MiFID requirements for past performance disclosures and consider whether any further requirements are needed to ensure consistency of calculation or presentation.

It should also consider the following issues raised in the SP workshops:

- use of figures, bar charts or line charts;
- to be calculated on a comparable basis (preferably annual);
- consider frequency of updating of information;
- develop guidelines for backfilling data for new funds.

¹ Commission Recommendation of 27 April 2004 on some contents of the simplified prospectus as provided for in Schedule C of Annex I to Council Directive 85/611/EEC.

3.3. Presentation of information

The requested work should develop guiding principles for the presentation of the information, which might involve specifying a structure and format of the key investor information taking into account the following principles:

- maximum length (taking into account sub-fund structure and the distinction between plain vanilla funds and funds relying on complex formulae for the calculation of return);
- need for the overall information and its presentation to be clear, fair and not misleading;
- need to accommodate electronic/web-based delivery (e.g. through fund supermarkets) as well as paper;
- need to accommodate compendium documents covering multiple sub-funds / share classes;
- need to accommodate or work effectively alongside other mandatory disclosures, notably those relating to the overall 'product' or other aspects of distributors' services envisaged by MiFID.

3.4. Specific issues

3.4.1. Practical / Local information

The requested work should exhaustively list the types of practical / local information that a fund manager could be expected to provide in view of placing funds on its market or on a partner country market so as to enable an investor to duly exercise its rights. It should also consider how such information could be packaged in a manner so that it does not give rise to any administrative obstacles to marketing funds in other Member States. In particular, it should consider how to structure this information as one of the building blocks of the key investor information to be provided by the fund manager to the investors/intermediaries.

3.4.2. Language

The requested work should consider local language requirements provided for in the initial orientations on possible adjustments to the UCITS Directive, in particular the requirement to provide key investor information in the local language. In the light of this, it should consider whether the use of hyper-links could be permitted and any relevant conditions that might be attached to their use (e.g. should the document to which a link is provided be in the same language as the document which provides the link).

4. PROPOSED ORGANISATION OF WORK AND TIME-TABLE:

In order to ensure that it meets the needs of investors, and that the relevant disclosures can be cost-effectively delivered by the industry, work undertaken in response to this request for assistance should be prepared in close co-operation with stakeholders (fund managers, distributors and investors) from its inception. To this end, the Commission invites CESR to establish a structured dialogue with disclosure specialists from the relevant stakeholder groups (fund managers, distributors and investors) from the very outset of the work.

This could be used to validate the feasibility, relevance and effectiveness of the proposed new investor disclosure requirements in the initial preparatory phases. The Commission considers the early and effective involvement of fund managers, distributors and investors as critical in the conception and elaboration of investor-relevant, investor-friendly and meaningful disclosures.

Results of a first preparatory phase, leading to concrete suggestions for enhanced fund disclosures, should be tested with investors across the EU, and subjected to comment through open consultation of stakeholders. The Commission has foreseen the launch of a survey by an independent consultant to test the effectiveness of new disclosures across the EU: this study could be used as the vehicle for consumer testing of the results of the initial phase of CESR work.

Following testing and consultation, CESR advice and output could be finalised and transmitted to the Commission. Final CESR submission should include clearly articulated and fully specified proposals for revised requirements, with accompanying material set out below. The Commission would also welcome any explanatory comment and recommendations that CESR, as a committee, may wish to express in respect of the proposed new investor disclosure requirements and the conditions needed to ensure its effective implementation. The Commission would also welcome the views of CESR as to the extent to which elements of the proposed new disclosure requirements could be brought into effect on the basis of the existing UCITS Directive and Recommendation.

Proposed time table and phasing of work:

It is suggested that CESR organise its work in three phases, as described below. CESR is requested to submit its recommendations and proposal in response to this request for assistance by 1st March 2009.

Phase 1: The operational objective of work under phase 1 of the request for CESR advice is to codify – against the backdrop of the changing context described above - an "ideal" set of requirements which succinctly and effectively communicates risks, costs and possible outcomes to the end-investor. The review of the simplified prospectus and the establishment of revised investor disclosure requirements / relevant key investor information (whether or not laid down in a mandatory document) should be based upon the guidelines set out above.

Work in this phase would deliver a specification of the key investor information and the basis for calculating it. It would also provide advice on how the question of format and structure should be treated, including consideration of whether a mandatory document is needed.

The advice provided should, taking account of all requirements and obligations imposed by relevant EU legislation (UCITS, MiFID etc.), state:

- a. Who is required to provide what information to whom;
- b. When, and how disclosures should be made;
- c. Whether the proposals relate to disclosures about the fund/sub-fund only or about the overall product wrapper and/or distributor information
- d. How its proposal would work in the different ways in which UCITS are sold to investors: for example a fund with multiple sub-funds all marketed together, a fund of funds, a master-feeder fund or a tax wrapper or savings plan.

Different proposals or variants could be put forward. The first phase of the work should be completed by end of 2007.

Phase 2: This phase would involve consultation on and rigorous testing of the envisaged new disclosures – with a particular emphasis on consumer/investor testing. There will be a need for systematic testing of the proposed disclosures – to ensure that they effectively deliver the agreed disclosures for the retail investor population. It will also be necessary to verify that the envisaged disclosures are suitable/viable in different Member States/languages.

The organisation of this testing phase should be the object of further discussion. It could include (1) testing and validation of the envisaged new disclosures (with different variants) through an external research agency; and (2) following consideration of the findings from the independent survey, open consultation of stakeholders following established working methods.

This survey and the consultation phase could take 10-12 months to complete (estimate) and process.

Phase 3: Finalisation of CESR recommendations/proposals, following consultation and consumer testing, in the period to 1st March 2009.