THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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CESR Consultation Paper on content and form of Key Investor Information disclosures for UCITS

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SUMMARY AND OUTLINE OF PROPOSALS

1. The European Commission has asked CESR to provide advice on the form and contents of Key Investor Information (KII), which it proposes to introduce as a replacement for the Simplified Prospectus. CESR has considered the factors that are likely to make disclosures of product information useful to consumers – in particular, the need for such information to be short, focused, expressed in plain language, and presented in a way that enables comparisons to be easily made between different offerings. In this document, CESR makes specific recommendations on certain points, and in some areas proposes alternative options where testing on consumers is required to ascertain better how consumers would understand and react to particular elements.

Wider context in which KII would be used

2. The operator of the UCITS fund will be responsible for preparing the KII, and for distributing it to any investor who deals directly with him. He would not be responsible for delivery to customers who deal through a third-party distributor, although he will have to respond to requests from such distributors to be supplied with up-to-date versions of the KII. CESR supports the delivery of KII to all investors who do not hold units in a wrapper, irrespective of the method of distribution or the status of the distributor.

3. UCITS are frequently sold within wrappers, which in many cases impose extra charges or modify the results of investing in the fund so that the use of KII may not be appropriate. Generally, the provider of the wrapper will be responsible for information about it, but in some cases – where the wrapper does not alter the features of the UCITS – further work could be done to decide whether the KII might still be used. If so, the KII would remain distinct, relating only to the fund and not to its wrapper.

4. CESR considers there are no major conflicts between the KII proposals and other applicable Directives (such as Distance Marketing Directive[1] or E-Commerce Directive[2]). Although the Commission has indicated the need for some minor amendments to the Markets in Financial Instruments Directive (MiFID)[3], CESR notes that its provisions would not guarantee that all retail clients would receive KII from MiFID-regulated distributors.

5. The various Directives have slightly differing provisions about the medium and timing of delivery of consumer information, which may require further consideration for providers and distributors to satisfy their obligations under Community law.

Objectives and scope of KII

6. CESR believes that KII should fundamentally be a tool for helping retail consumers to reach informed investment decisions. Since evidence suggests complicated documents do not inform investment decisions effectively, KII should contain only the essential elements for making and carrying out those decisions, and should not be encumbered with information serving only legal or regulatory requirements. Nor should it primarily be a marketing or investor education document. Since its use is limited to providing pre-contractual information, it need not address investors' information requirements on an ongoing basis after they have invested.

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[1] Directive 2002/65/EC

[2] Directive 2000/31/EC

[3] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial
Instruments, Commission Directive 2006/73/EC of 10 August 2006 and Commission Regulation (EC) No 1287/2006
of 10 August 2006

7. KII should be produced for all UCITS funds, and delivered to all investors in those funds. However, non-retail investors should be able to opt out of receiving KII if it is not relevant to their needs.

Format and general content, presentation

8. In terms of format and presentation of the KII, CESR recommends it should be presented in a single document, no more than two pages (one sheet) in length unless there are unusual features that require extra explanation. There should be a standardised list of permitted contents appearing in a fixed order and hierarchy, but avoiding over-prescription in relation to, for example, the design of the template or length of items, in the interests of allowing product innovation. Some options, for elements such as risks and charges disclosure, will require greater prescription than others.

9. The following elements should appear in KII in a fixed order and hierarchy; although CESR's recommendations for the final order have not been finalised, the following is suggested:

- names of the fund, manager, and promoter/group;
- fund objectives and investment strategy;
- material risk / reward factors likely to affect the fund;
- indication of past performance;
- summary of charges payable directly and indirectly by the investor;
- treatment of income (whether paid out or capitalised)
- practical information (e.g. where / how to buy and sell units, frequency of NAV calculation);
- brief details of the fund's Home State taxation regime;
- indication of provider's legal liability for contents of KII;
- where / how to obtain further information (prospectus, reports and accounts etc);
- identity of competent authority responsible for the fund;
- date of preparation of the KII.

10. The fund's Home State taxation regime and its competent authority may be less useful and should be specifically tested with consumers. CESR notes in this context that information on the tax regime applying to the fund should in any case be available from other sources, such as the website of the fund provider; an appropriate reference could therefore be included under the 'where/how to obtain further information' element. Other items of information, such as details of the depositary and auditors, or how to make a complaint, might also be useful for investors, and it is recommended that two alternative formats be consumer-tested – one with only the core elements listed above, and a second with additional information. Consumers should be invited to indicate which elements they find most or least useful.

11. Details of the practical information will vary from one Member State to another, but it should be entirely harmonised so that no further information can be required to be shown. An alternative option would be to omit all specific local information and replace it with a general invitation to consult a website where the details for each Member State would be displayed.

12. CESR does not entirely support the concept of using 'building blocks' that might allow different elements of the KII to be presented separately or combined with other disclosures. It believes that this would detract from the clarity and simplicity of presentation that is required by retail investors, and would make useful comparisons impossible.

13. KII may require certain modifications when provided for a fund of funds, an umbrella fund, or a fund with multiple share classes. For a fund of funds, the charges of the underlying funds need to be taken into account. In the case of an umbrella, separate KII should be produced for each sub-fund, although there may be some scope for a consolidated version to be produced covering the whole umbrella. Where there are several share classes in a fund, the provider could provide a separate KII for each one or could use the class with the highest charges as a representative for the others. Information on different classes could be combined into a single KII provided it does not make the document too long or complex.

Investment objective and strategy

14. Information about the fund's investment objectives and its strategy for achieving them should be presented jointly. CESR suggests testing a version with a description which covers:

- main categories of assets that may be held;
- any sector / market /geographic specialisation;
- if bonds may be held, what types;
- details of any benchmark or index being tracked;
- details of the nature, timing and extent of any capital guarantee;
- whether the fund is likely to be unsuitable for investors wishing to redeem their holding within a certain period; and
- whether the fund has been designed for non-sophisticated investors.

Risk factors

15. The description of risk factors and presentation of the relationship between risk and reward is a particularly difficult issue. CESR recommends testing two high-level approaches – one which is based on a purely narrative description of risks (a qualitative assessment), and one which uses a synthetic indicator to evaluate the level of risk that investment in the fund would represent (a quantitative assessment). There has been support from consumer representatives for the use of a synthetic indicator.

16. The narrative approach used in existing disclosures could be improved through application of a set of principles, to ensure the description focuses on material issues, gives the investor a reasonable and balanced view, and assists comparisons between different KII.

17. The use of synthetic risk indicators has already been endorsed by the regulators of some Member States, or adopted by individual firms, using a variety of methodologies and presentational formats. There are a number of complex issues that would have to be resolved in relation to developing a methodology and presenting the results, including whether it could capture all relevant risks and whether it may be unsuitable for certain types of fund. CESR has not had sufficient time or resource to assess existing methodologies in order to recommend a preferred one, but considers that consumer testing will clarify whether a synthetic indicator, despite its possible limitations, is likely to improve investors' perception of risk and reward.

18. Furthermore, a set of criteria for the assessment of methodologies (a draft of which is set out in Annex 5 to this paper) could be proposed. They might then be used to identify or develop a common methodology at European level, to be built either by regulators or by industry participants.

19. Any synthetic indicator would still require appropriate explanatory text, addressing such points as what the indicator means, why the fund has been classified in that category, and what its limitations are (e.g. not a guarantee, may not hold true in adverse market

conditions). Such text could also indicate in broad terms the connection between risk and reward. A numeric scale (e.g. from 1 to 5) should be tested against other possibilities (words such as 'high risk' or 'low risk', or graphics / icons). Alternatively, if the indicator cannot be adapted to a particular fund the KII should explain this. Special considerations might apply to formula funds, where the use of prospective scenarios might help investors to understand potential outcomes, but more work is needed in this area.

20. CESR considers that even though no preferred methodology has yet been identified, it is still possible, and indeed necessary, to test certain aspects of whether consumers understand the use of a synthetic indicator. Further work on methodological issues, involving industry practitioners and other stakeholders, can proceed in parallel with the first phase of consumer testing.

Past performance

21. Information about the fund's past performance is a key focal point for investors and should be included in the KII. The MiFID standards are a starting point, but are not sufficiently detailed to ensure a consistent approach and prevent consumers from misunderstanding the information. In terms of presentation, the proposals to be tested are for:

- use of a bar chart layout;
- use of percentages, not cash figures;
- showing average yearly (net) performance;
- including a prominent warning that past performance is not a guide to the future; and
- showing the performance of the benchmark, if the fund is managed against one.

22. When calculating past performance:

- figures net of charges should be shown;
- up to 10 years' data should be included if available (and not less than 1 year), indicating if material changes to the fund could make the data misleading;
- calendar years should be used rather than accounting periods (audited data is not necessary); and
- simulated performance should be allowed only in limited cases, e.g. fund mergers.

Charges

23. Evidence suggests that consumers can misunderstand even relatively simple information about charges. Consequently, two options are proposed for testing the presentation of fund charges – one of them an improved version of the existing Simplified Prospectus disclosure, the other giving the same information but adding a single 'summary' figure.

24. The charging structure should be shown in a simple way, grouped into a standardised format and order consisting of subscription and redemption charges, ongoing charges taken from fund assets, and contingent charges (such as performance fees). CESR supports the use of percentages as a presentational option for the 'summary' illustration of charges, but views of stakeholders should be sought on whether amounts should be shown as monetary figures instead. Calculation of ongoing fund charges should be harmonised, and the portfolio turnover rate dropped. The figures should be accompanied by messages making clear what is and is not included in each of the charges.

25. Further consideration needs to be given to whether figures should be calculated on an ex-ante or ex-post basis. Respondents to the consultation will be asked to comment specifically on whether or not portfolio transaction costs should be included in the ongoing fund

charges; the way in which performance fees are disclosed; and how material changes to charges should be communicated.

26. It is recommended that where charges may vary to take account of any special arrangements for certain distribution channels, maximum charges should be shown. Views should be sought on whether firms might be allowed some flexibility to produce different versions of a fund's KII for use in different channels if they wish.

Testing the proposals

27. Consumer testing of the various proposals should both establish consumers' preferences and provide objective evidence as to whether they have understood the disclosures. A focus on consumers' ability to understand and use the information appropriately will help demonstrate whether the KII represents a real improvement over the Simplified Prospectus, thereby addressing the regulatory failure.

Public consultation

28. The European Commission has asked for CESR's advice by early 2008 on the content and form of 'Key Investor Information' disclosures for UCITS (KII), to replace the Simplified Prospectus. To obtain further input from external stakeholders, CESR is holding a short consultation on the draft advice it has prepared. This will be revised in the light of responses to the consultation and the discussion at an Open Hearing to be held on 23 November at CESR's headquarters in Paris.

29. It has been decided that to minimise duplication of work, the consultation document should take the form of a draft of the submission to the Commission, with the addition of consultation questions at the end of each section. All the questions are listed again in Annex 1 to the paper.

RESPONSES TO THIS CONSULTATION SHOULD BE SENT TO CESR BY 17 DECEMBER 2007.

CHAPTER 1: INTRODUCTION

1.1 In March 2007 the European Commission requested assistance from CESR with its work on upgrading the disclosures provided by UCITS providers to help informed decision-making by potential retail investors. This paper summarises the work CESR has done in response to this request and sets out its initial conclusions, including a range of options for the content and form of Key Investor Information (KII) documents for consumer and industry testing by the Commission during 2008. CESR is grateful to the many stakeholders from consumer bodies and the industry who have contributed to this work.

Background

1.2 The UCITS Management Directive (2001/107/EC), which was formally adopted in 2002, introduced the concept of a simplified prospectus (SP). This is a document, prepared by the UCITS provider and aimed at prospective investors, which presents the principal features of the fund, such as its investment aims, charging structure and risks. It is meant to be in a readily understandable format, so that it can be used prior to any sale to make comparisons between UCITS funds, whether the investor is using an adviser or acting on an execution-only basis.

1.3 Although the SP came into full use only in late 2005, it has become clear that it is not achieving its purpose. Member States (MS) have not been consistent in making rules about its use (a Commission recommendation on the detailed contents of the SP[4] was published in 2004 but not all MS have incorporated it into their rules or adopted it in the same way, and some have introduced additional requirements). The result is that the SP is largely ineffective as a tool for comparing funds based in different jurisdictions. In addition, the tendency of UCITS providers to include too much detail in the document, often in legalistic language, makes many SPs too long and complex for the majority of retail investors to understand or readily engage with.[5]

1.4 The Commission recognised these concerns in its White Paper on Enhancing the Single Market Framework for Investment Funds[6] and is seeking to address them as part of a series of targeted enhancements to the UCITS Directive announced in March 2007[7].

The Key Investor Information proposal

1.5 The Commission's proposal is to scrap the existing legislative material on the SP and replace it with the concept of KII. This is intended to be a concise and focused presentation of the information of which it is important for a prospective investor in a UCITS fund to be aware, covering much the same general areas as the SP. The KII will also include essential practical information such as how units may be bought and sold. The UCITS provider would be required to translate the KII (though not the full prospectus) into an accepted language of each MS in which it is to be marketed.

CESR's work on KII

1.6 The Commission has consulted on revising the existing (Level 1) Directive to include a fairly high-level statement of the purpose and characteristics of the KII. More detailed provisions about content, presentation and distribution of the KII will be contained in a Level 2 Directive. This will ensure that, once new measures are agreed, they will be implemented consistently by MS, thus achieving the objective of comparability between funds marketed cross-border.

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[4] Recommendation 2004/384/EC
[5] Chapter 2 of this paper provides more detail on the SP regulatory failure.
[6] http://eur-lex.europa.eu/LexUriServ/site/en/com/2006/com2006_0686en01.pdf
[7] http://www.ec.europa.eu/internal_market/investment/legal_texts/index_en.htm#ini

1.7 The Commission will not issue a formal mandate to CESR to provide advice on the Level 2 Directive until its work on revisions to the Level 1 Directive is complete. However, it considered it desirable for technical groundwork on the detailed provisions to begin straightaway, so that the critical issues can be considered at the same time as work is progressing on Level 1. The Commission therefore made a request to CESR for assistance, and a sub-group of the Investment Management Expert Group (IMEG) was formed to consider the detail of KII and to develop a recommendation to IMEG on CESR's response to the Commission. This sub-group is jointly chaired by the UK FSA and the French AMF and includes representatives of eight other MS.

1.8 The Commission has undertaken to carry out consumer and industry testing before KII is introduced, to ensure that it represents a sufficient improvement to existing investor disclosures to justify the cost of replacing the SP. Some draft mock-ups of KII are therefore being developed in sufficient detail for testing, containing initial options for the presentation of elements such as charges and risk rewards.

1.9 This work has been carried out in accordance with CESR's new guidelines for applying an impact assessment methodology. Each proposal contains an analysis of the expected costs and benefits, in order to justify the change to existing provisions. Representatives of ECONET, the body which developed the methodology, have participated in the work of the sub-group.

1.10 As requested by the Commission, a number of consumer and industry representatives have been involved in its work; and CESR has carried out three related calls for evidence, to which a good number of firms, trade associations and consumer bodies have responded. The responses received (which are available on CESR's website) have been analysed and taken account of in developing its proposals.

Structure of this paper

1.11 The rest of this paper is structured as follows.

- **Part I** describes the background to the KII proposal and discusses the key issues raised by the context in which this document would be used.
- **Part II** sets out CESR's recommendations on the format, content and presentation of KII.
- **Part III** discusses how the benefits and costs of the KII should be assessed, including consumer testing.
- The **Annexes** contain further background information and detail supporting the analysis in the main paper. The final annex includes illustrative mock-ups of KII documents.

1.12 CESR would be pleased to provide further information to the Commission on its work and the range of options identified for KII, and to provide assistance during the subsequent stages of this exercise.

PART 1: BACKGROUND AND ISSUES RELATING TO KII PROPOSAL

Part I of this paper describes the background to the KII proposal and discusses the key issues raised by the context in which this document would be used.

CHAPTER 2: SUMMARY ANALYSIS OF SP REGULATORY FAILURE

2.1 The Simplified Prospectus was introduced to address a market failure in relation to the sale of Directive-harmonised UCITS products to consumers – namely that consumers possess relatively little information or knowledge in relation to UCITS products, when compared to those selling the products or manufacturing them. This created an information asymmetry capable of distorting the pattern and nature of investments, potentially limited the effectiveness of the UCITS Directive[8] within the retail market and impeded cross-border business.

2.2 Although the Commission did not carry out a detailed analysis of the effectiveness of different regulatory tools that might be used to address this market failure, it concluded that introducing a simpler document than the Prospectus, focused on the key issues that should inform consumers' buying decisions (such as fund objectives, risk factors and charges) would be a necessary regulatory step. This was endorsed by MS through the adoption of the UCITS Management Directive (2001/107/EC) which, amongst other matters, introduced the Simplified Prospectus (SP). The Commission also published a Recommendation (2004/384/EC) to encourage MS to approach key elements of the SP in a consistent manner.

2.3 The SP was implemented in all MS with effect from 2005. The Commission was not able at the time to conduct consumer testing of its proposals prior to their introduction, but actively sought feedback on the effectiveness of its approach.[9]

2.4 The initial evidence it received indicated that:

- there is a continuing lack of transparency about UCITS, especially their costs and risks;
- the information given in the SP is not easily understood and used by the average retail investor;
- the SP is too lengthy and technical;
- its production is costly and time-consuming;
- SPs often exceed the Directive requirements;
- their content is not consistent in all MS; and
- they do not assist comparisons between funds, particularly when cross-border sales are involved.

2.5 This evidence led the Commission to conclude that retail investors are still not being provided with the information they need in a form they can use to make well-informed buying decisions. The SP therefore represents a regulatory failure in the sense that it has not produced the net benefits that it was intended to achieve, including promoting the smooth functioning of the single market.

2.6 The Commission's conclusions about the SP are supported by the findings of other research into the characteristics of successful, and unsuccessful, consumer disclosure documents in relation to products of this kind.[10]

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[8] Directive 85/611 EEC

[9] Through its Green Paper on the enhancement of the EU framework for investment funds, by asking CESR to undertake a review of Member States' implementations of the Simplified Prospectus, and also by staging two workshops during 2006 See http://ec.europa.eu/internal_market/securities/ucits/index_en.htm#simplified

2.7 Some of the key findings of this research are as follows.

- In general terms, it shows that investors find many key messages about charges, fund risks and features difficult to understand under many existing disclosure regimes.
- Consumers rely on a range of information sources other than official disclosure documents when making investment decisions, including a significant reliance on the advice of others, including salespersons. In general, many factors can play an important role in consumer decision-making, including emotion (e.g. intuition), and personality (e.g. over-confidence). Consumers can exhibit a range of biases when making decisions, such as wrongly discounting information, or overly relying on poorly understood or misunderstood disclosures (such as taking past performance information to be more representative than it can possibly be). Some evidence suggests consumers do not necessarily alter their behaviour or understanding, even where exposed to good-quality disclosure documents.
- Having said this, it is clear that investors would like the format and content of disclosures to be carefully designed to promote accessibility and readability. Research has found that, generally speaking, consumers prefer short, well-laid out and plainly worded documents, without 'legalistic' language or marketing material. The information investors are seeking typically is focused on investment returns, along with information about risks and costs (including fund fees, expenses and distribution costs).
- It appears that most investors, although open to electronic disclosure, still prefer to obtain fund information in paper form (particularly mutual fund investors) or from a professional financial adviser, rather than online, prior to purchasing. Oral disclosure can also be an important means of providing investors with information that is integrated into the sales process.

2.8 The current review of the UCITS Directive is intended to correct this regulatory failure and identify options for an improved version of the SP. In developing its advice, CESR has paid close attention to all the available evidence relating to the failure of the SP and, in line with the 3L3 Impact Assessment Guidelines developed jointly by CESR, CEBS and CEIOPS, has placed strong emphasis on systematically analysing the pros and cons of the options it has considered.

[10] A sample of research includes AMF, *Investigation of investment information and management processes and analysis of disclosure documents for retail investors* (TNS Sofres, November 2006), Richard Deaves, Catherine Dine, William Horton, *How are Investment Decisions Made* (May 24, 2006), ICI *Understanding Investor Preferences for Mutual Fund Information* (2006), UK FSA *Consumer Research* series, for example *Informed decisions? How consumers use Key Features: a synthesis of research on the use of product information at the point of sale* CR5 (November 2000), *The development of more effective product disclosure* CR18, (March 2003), and *Investment Disclosure Research*, CR55, (November 2006).

Questions for the CESR Consultation

1. Are respondents aware of other research which is relevant to the market and regulatory failures associated with the SP?

2. Do respondents consider CESR's proposals would address the regulatory failures associated with the SP?

CHAPTER 3: THE WIDER CONTEXT IN WHICH KII WOULD BE USED

3.1 This chapter considers the context in which Key Investor Information is likely to be used and some of the issues that may arise, namely:

- the responsibilities of the UCITS operator and other regulated entities involved in the operation, distribution or promotion of the UCITS;
- the circumstances in which UCITS are sold within a 'wrapper'; and
- how the requirements of other relevant Directives would interact with the KII proposals.

3.2 These are, for the most part, matters which are not addressed by the UCITS Directive and which lie outside the current remit of CESR. Nevertheless, CESR considers it desirable to comment on these topics in order to identify where further benefits to consumers might be achieved through the use of KII, and where potential obstacles to its successful implementation might occur. At this stage CESR has not consulted with other Committees outside CESR, or with other Expert Groups within CESR. It would be for the Commission to decide whether to pursue any of these matters through other initiatives.

Operator and distributor responsibilities

3.3 CESR notes the increasing trend for intermediation in the marketing, sale and administration of holdings of units in UCITS. Although a significant number of investors continue to interact directly with the UCITS provider, whether through a branch network, a tied sales force, direct marketing initiatives or the firm's website, there is also a wide range of ways in which distributors may play a role.

3.4 The distributor may offer a variety of services to the investor. It may act as an adviser only, recommending a product and arranging the purchase, either in response to a particular need or as part of a broader financial planning service. It may provide a service (on either an advised or a non-advised basis) such as a fund supermarket that allows the investor to hold the funds of different providers side by side, or it may offer ongoing services such as providing consolidated information about an investor's holdings in both UCITS and other products.

3.5 The third party might be part of the same group as the provider, but acting at arm's length in a non-exclusive relationship (that is, it may sell the products of other groups). On the other hand, it may be an entity that is completely unaffiliated with the provider. There may be a specific agreement between the provider and the distributor under which the UCITS of the former are actively marketed by the latter, or alternatively the distributor may be acting without reference to (and potentially without the knowledge of) the UCITS provider.

3.6 The draft Directive amendments envisage that the investment company or UCITS management company will be responsible for:

- drawing up KII in respect of each UCITS it manages;
- providing KII to investors to whom it sells UCITS directly or through a tied agent;
- providing KII to product manufacturers and intermediaries selling or advising investors on UCITS or products offering exposure to such UCITS.

3.7 CESR considers that where the UCITS provider is selling units directly or through a tied sales agent, its responsibilities are clearly articulated by the draft Level 1 text. It is assumed that where the operator outsources customer administration and dealing functions to a third party, the delegation agreement will specify any responsibility the administrator may have for ensuring delivery of the KII.

3.8 Where units are sold through a third party, CESR's understanding of the intended legislative changes is that the distributor, rather than the UCITS provider, would have responsibility for delivering the KII to its customers. The draft amendments to the Directive acknowledge that it is no longer sufficient to mandate providing information to 'unitholders', since in many cases where units are sold through a distributor, the unitholder will be a nominee of the distributor, and not the actual investor.

3.9 In situations where other Directives are applicable (e.g. in relation to insurance products), CESR is unable to make specific recommendations because the interactions between the various Directives raise issues that require broader consideration, as indicated in the final part of this chapter.

3.10 The UCITS provider would fulfil its duty to make KII publicly available by responding to requests from other regulated entities to provide them with sufficient copies, but it would not be obliged to take active steps to ensure that any and every potential distributor has copies (since the management company might not be systematically informed that its funds are marketed by some distributors). However, where a specific bilateral or multilateral distribution agreement is in place, it could be expected to address the delivery of KII and delineate the respective responsibilities of the parties.

3.11 The provider would also have a duty to take reasonable steps to ensure that distributors are informed when a revised version of the KII is made available, so they in turn can be sure they are providing the most up-to-date version to their customers.

KII for UCITS packaged in a wrapper

3.12 In many cases the investor will not purchase units as a direct investment, but will hold them through the medium of another product or wrapper. The provider of the wrapper may be the UCITS provider itself, or an associated company in its group, or an independent third party. In each case, the wrapper will have its own terms and conditions, which may include the payment of a fee by the customer for the provision of services.

3.13 The nature of such wrappers may vary considerably. They typically include arrangements designed to enable UCITS (and possibly other types of investments) to receive tax concessions at either the fund level or the investor level, or to receive ancillary investor services, such as statements and valuations consolidating the investor's holdings in multiple products. They may be in the form of a product designed under national law to provide for retirement; or an investment management agreement; or a life assurance contract by which UCITS can be selected as 'units' by the investor, in order to gain favourable tax treatment after a certain holding period. They may also take the form of structured products, which might require specific presentation features to be accommodated in disclosures to investors.[11]

3.14 CESR notes that in most cases the KII of a UCITS may not be suitable for customers who invest in a product or wrapper. This is because the wrapper will either bear its own charges, in addition to those arising from the fund, or in some way modify the results of investing in the fund. In such situations, the provider of the wrapper should have sole responsibility for providing relevant product information to investors.

3.15 Where a UCITS is sold within a wrapper that does not modify its characteristics, so that the information in the KII would still be relevant for investors, further work could be done to determine whether KII could still be used. CESR wishes to emphasise its understanding of

[11] Structured funds are funds that are not directly invested in the underlying assets (such as bonds or equity), but that are offering a determined pay-off at a certain date depending on market conditions, following a pre-defined algorithm. They are very common in some Member states, where they draw in a substantial part of retail investments. They have a specific risk/reward profile that requires particular features and layout for correct disclosure.

the effect of the relevant Directives, in such a case, to be that the fund provider would only be responsible for consumer information relating to the UCITS itself. Accordingly, the KII could address only the features of the UCITS, without modification by the company responsible for the wrapper. In addition, the wrapper provider might choose (or be required by national regulation) to produce aggregated information, showing the overall performance and charges figures for the UCITS when held within the wrapper, for which it would then take responsibility.

3.16 A requirement for separate presentation of information about the UCITS and the wrapper in which it may be held has a clear benefit in terms of informing the investor of any potential extra costs associated with the use of the wrapper. It may also assist comparability between funds. The foreseeable drawback of such an approach is that the investor will need to consider two sets of information rather than one. He might be confused about which set of product information is relevant to him, and might disregard the KII because it does not provide all the information in which he is interested.

3.17 CESR also notes that some wrappers, such as a pension savings plan, may offer a choice between many different funds, probably from multiple providers. Some professionals in certain Member States have adopted the practice of delivering a Simplified Prospectus covering every fund available through the wrapper. CESR believes that, except where the client is acting on a non-advised basis and requires information on each possible fund choice, this practice is likely to overload the client with irrelevant information and would not be consistent with the aims of KII.

Interaction with other directives

3.18 CESR notes that the articulation between the UCITS Directive and other applicable Community law raises very different issues depending on the other Directives considered:

1. *to be dealt with in the short term* – the major issue of the articulation between MiFID and UCITS as far as delivery of KII is concerned;

2. *to be taken into account for the fine-tuning of UCITS law and its concrete implementation* – the issues raised by the interaction of delivery requirements for disclosure material under UCITS law and the Distance Marketing Directive (DMD), MiFID and the E-Commerce Directive; and

3. *wider issues of global consistency between disclosure requirements across products* – which would require a more in-depth exercise involving several Directives.

The issue of different information layers

3.19 After an initial high-level review, and without prejudice to the findings of a more in-depth analysis, no major conflicts have been identified between other applicable Directives (such as Distance Marketing Directive, E-Commerce Directive, Life Insurance Directive and Insurance Mediation Directive) and the proposals for the KII.

3.20 Indeed, the KII might well be used for the purpose of complying with some of the requirements of other Directives and which are applicable to distributing entities or within distributing channels. However, KII will not of course include all specific information that might be required by this other legislation. For this reason, a fund's KII will then have to be complemented with information on the distributor and, as the case may be, on specific features of the contract.

3.21 As a consequence, CESR notes that several layers of disclosure may have to be brought together.

Articulation between MiFID and UCITS as far as delivery of KII is concerned

3.22 MiFID includes a number of requirements relating to disclosures for financial instruments. These requirements are high-level in form, and are designed to apply to a wide range of potential investments and services. They cover such types of information as the nature and risks of an investment, the total cost of a transaction, the status of the intermediary and any conflicts of interest they may have, and the appropriateness of the investment for the client.

3.23 While MiFID provides that the delivery of the Simplified Prospectus (or, if it is adapted in due course, of KII) would allow the distributor to satisfy its obligations to disclose information on the UCITS, MiFID does not require that information to be disclosed under this format.

3.24 As a result, CESR notes that within the current framework and taking into account the amendments suggested at this stage, there would be no guarantee that retail clients would receive KII in the standardized format that CESR has been working on.

Fine-tuning delivery conditions: medium and timing under MiFID, DMD and E-Commerce

3.25 MiFID requires delivery of information to clients '**in due time**' and '**in a durable medium**'.

3.26 The DMD lists information that must be communicated to the consumer on paper **or in another durable medium**, and made available **in good time** before the consumer is bound by any distance contract or offer.

3.27 The E-Commerce Directive requires that contract terms and general conditions provided to the recipient must be made available in a way that allows him **to store and reproduce them**, and **prior to subscription** for the service or product.

3.28 In the current version of the UCITS Directive, the Simplified Prospectus must be **offered prior to subscription**.

3.29 For the purpose of allowing providers and distributors to satisfy their obligations under other distribution-specific Community law, CESR notes that the conditions of delivery of KII under various conditions have not yet been specified.

3.30 As far as **timing** is concerned:

- The outcome sought for consumers is that they should have enough time to consider the information within the KII before they enter into a commitment in relation to the UCITS; this is, after all, 'pre-contractual' information. Current practice shows that when the Simplified Prospectus is effectively offered, this often happens simultaneously with the conclusion of the contract. At this stage, the meaning of 'in due time' within MiFID, and the way it will be applied to the delivery of KII under different subscription situations (notably in the cases of advised sales and execution-only subscriptions through a website), has not been specified.

3.31 As far as the **medium** is concerned:

- the implications of the requirement to deliver disclosure in a 'durable medium' in different cases of a subscription to a UCITS, especially in the case of on-line subscriptions, have not yet been defined.

Wider issues of consistency of disclosure across products: Consolidated Life Directive, Insurance Mediation Directive, substitutable products under the Prospectus Directive

3.32 In some jurisdictions, significant volumes of UCITS retail business may be conducted by repackaging the UCITS as a life insurance product.

3.33 In such a case, unless provided for in national law, CESR is aware that KII would **not** be delivered, even if the characteristics of the investment were mostly unchanged by the life insurance wrapper.

3.34 Furthermore, while CESR has focused on the disclosures relevant for the average investor buying UCITS, CESR is aware that UCITS do not simply compete with one another, but also with products governed by other requirements such as the Prospectus Directive, under which there is no harmonized and detailed set of disclosure requirements comparable to KII.

3.35 Both subjects have multiple implications that could not be thoroughly considered within CESR's remit, and might not be easily tackled within the current framework of changes to be made to the UCITS Directive.

Questions for the CESR Consultation:

3. Do respondents think that CESR has accurately described the context in which KII is likely to be used, and has correctly identified outstanding issues?

PART II: RECOMMENDATIONS ON THE FORMAT, CONTENT AND PRESENTATION OF KII

4.1 This part explains CESR's recommendations on the scope of the KII, the considerations relevant to its format and presentation, and the key areas of its contents. Chapter 4 contains an overall analysis of these issues, while the following chapters consider in turn some of the most significant and complex elements comprising the KII.

4.2 The recommendations address the degree of prescription and harmonisation that might be necessary to achieve effective KII, both in terms of the set of items to be included and how they should be presented.

CHAPTER 4: GENERAL OPTIONS FOR FORMAT AND CONTENT OF KII

4.3 Chapter 4 sets out CESR's views on:

- the purpose and scope of KII;
- the desirable format of KII, including length, order of contents and presentation;
- what categories of information are appropriate and necessary;
- how KII might need to be adapted to accommodate particular fund structures.

Recommendations on purpose and scope of KII

4.4 The letter from the Commission to CESR clearly sets the framework for CESR's advice:

'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 [...] in short and simple form, understandable to retail investors'

4.5 In other words, KII should be shorter and better focused on retail investors' needs than the simplified prospectus. In achieving this objective, this work should also reduce the ongoing costs for fund managers of producing and publishing investor disclosures.

4.6 To achieve this goal, CESR considers it important to clarify the purpose of the KII. CESR considers that in replacing existing disclosure documentation, it should be made clear that the KII should **not**:

- be primarily a marketing tool, although it can be used as one;

- be a tool for providing regulator-to-regulator information; regulators should not expect KII to deliver all the information likely to be required in the notification procedure;

- be filled with legalistic disclosures, since its liability will be restricted to cases where the information delivered would be misleading, inaccurate or inconsistent with the full prospectus;

- have to explain all concepts used, or seek to remedy all possible gaps in investors' understanding of financial matters.

4.7 Instead, CESR considers that KII should be fundamentally a tool to provide retail consumers with the necessary information on which to base an informed investment decision, having used it to compare products if they wish to. Each item in the KII of a UCITS should be:

- essential for making a decision on whether or not to invest in this fund; or
- essential to enable the investor to execute his investment decision and receive further information about the fund; or

- necessary for legal reasons, even after the proposed modification of its legal status.

4.8 Furthermore, KII should be conceived as pre-contractual information, focused on investors' needs at the point of sale, and not as a tool for addressing their information needs on an ongoing basis after they have invested.

4.9 The draft changes to Level 1 of the UCITS Directive indicate that the management company must provide KII to investors it deals with directly. CESR understands this to mean that there is an obligation to deliver the KII to the investor, not merely to offer him the choice whether or not to receive it.

4.10 Although the KII is required to be 'understandable to retail investors', that does not mean that it is inherently unsuitable for other investors. CESR recommends that KII should be produced for every UCITS fund, including those which in practice do not promote the sale of units to the public. It is not practical to try to define a sub-group of funds which conform to the requirements of Article 2.1 of the UCITS Directive, but which would be subject to special provisions under certain other Articles of the Directive.

4.11 Nevertheless, there is little point in obliging such information to be provided to non-retail investors where it does not meet their particular needs. CESR recommends that there should be flexibility for non-retail customers to indicate that they do not wish to receive KII, and for providers and distributors to be relieved of any obligation to deliver KII in such cases. Such investors might be defined as those falling within the MiFID definitions of 'professional client' or 'eligible counterparty', in order to maintain consistency between Directives.

Options for the format of the KII

4.12 In line with feedback from its consultation with investors and professionals, CESR considers that the KII should:

- include only the main information on the product;
- be a single document;
- follow a consistent overall format so it is easy to compare;
- be produced according to a relatively prescriptive and standardised approach.

4.13 CESR considers there is potential benefit for consumers in prescribing the order of material, the degree of harmonization and the maximum length of the document, and limiting the extent to which the document contains technical financial terms and legal jargon.

Maximum length

4.14 CESR considers that it is appropriate, in order to ensure that the document is short, to prescribe the number of pages, and **limit it to one sheet** (that is back and front of a single page[12]), while requiring the use of characters of readable size for every item (so as to avoid the inclusion of 'small print'). CESR also proposes a 'comply or explain' approach for funds having difficulties in limiting their key information to one sheet.

Prescribing the order and hierarchy of items to establish a logical and consistent structure

[12] CESR notes that it might not be possible to sum up the features of some specific, complicated funds within one sheet; yet this length should be the general reference to be aimed at. Moreover, CESR considers that specific disclosure requirements might be necessary for certain range of funds such as structured funds with complex risk/reward profile and noticeably for formula funds. This would entail specific presentation of risk/reward features.

4.15 CESR considers it useful to have a 'hierarchy' of information within KII as regards the order in which the items are presented, so as to ensure the essential elements are given appropriate prominence, and so as to facilitate comparisons between KII for different funds.

4.16 In order to highlight the most important features, CESR recommends the following structure:

Preferably page 1	– name of the fund / management company / promoter or group; – strategy and objectives; – risk/reward; – past performance; – charges (although this may be moved to page 2 if it is not possible to include on page 1).
Preferably page 2	– distribution or capitalization of dividends in case this is not covered by the objectives; – practical information, most importantly how to buy and sell units in the fund, i.e. frequency of NAV especially when not daily / where a current redemption price and other information might be obtained / contact details to send direct redemptions or subscriptions; – information on tax regime of the fund in its Home member state; – statement on liability attached to KII, and indication of the existence of the full prospectus and where to obtain it; – identity of the competent authority; – other possible items (see options below); – date of preparation of prospectus / KII.

4.17 CESR would not at this stage recommend defining very precisely a template to be applied, for instance setting up the space devoted to each major item, prescribing specific wordings for the description of funds features, etc.

4.18 Indeed, CESR notes that that a 'one size fits all' approach might not be suitable for innovative products (especially for structured funds that might require specific items to be added). It could even encourage a tick-box approach that does not fully capture the essence of the UCITS, thereby reducing the relevance of the document. CESR also notes that, in the case of the Commission's proposals to introduce UCITS feeder funds, further consideration will need to be given as to how key information about the master fund might be conveyed in the KII of the feeder itself.

4.19 However, CESR recommends that the Commission consider some elements of 'branding' for the KII beyond the simple hierarchy of items, such as the prescription of the titles of the main items. Likewise, some of the elements of information, such as risk, charges and past performance, are likely, as discussed in Chapters 6, 7 and 8, to require prescriptive standardisation in elements of presentation as well as calculation.

Plain language requirements

4.20 CESR considers that there is a need, as much as possible, for the KII to be written in plain language, avoiding technical financial terms and legal jargon. CESR notes that previous attempts to achieve this objective have not generally met with success.

4.21 Once the KII has been implemented, and after a first assessment of the new KII disclosure regime, CESR proposes the publication of a guide to good practice which might help firms comply with these requirements.

Options for the content of the KII

4.22 Given the clearer purpose of the KII, and evidence regarding the difficulties consumers face in using longer documents, CESR considers there is definite scope to reduce the content of the KII compared to what currently appears in the SP, and that there is potential benefit in dropping some of the less relevant information. This requires finding an adequate compromise between the need to limit the number of items to be communicated, in order to ensure key messages are received, and ensuring investors receive enough information in order to make their decision and act on it, while satisfying legal requirements.

4.23 Having carefully assessed the pros and cons of keeping each item currently required by the Commission Recommendation, and having considered items mentioned in disclosure documents produced in non-EU jurisdictions, CESR recommends testing two broad options for the amount of information contained in the KII with consumers:

A) *A minimal set of items:*

- name of the fund / the management company / the promoter or group;
- strategy and objectives;
- risk/reward;
- past performance;
- charges;
- practical information: how to buy and sell i.e. frequency of NAV especially when not daily / where redemption price and other items of ongoing or specific information (e.g. annual reports, change of fund rules) are available / contact details to send direct redemptions or subscriptions;
- distribution or capitalization of dividends;
- information on tax regime of the fund in its Home member state;[13]
- statement on liability attached to KII, and indication of the existence of the full prospectus, where to get it and in which language it is available;
- identity of the competent authority;
- date of prospectus.

B) *Testing the relevance of some items in the preferred set, and of further items to add*

It should be tested whether stakeholders actually find added value in having:

- the name of the competent regulatory authority;
- information on the tax regime of the fund in its Home member state.[14]

It should also be tested whether stakeholders would find it useful to add to the preferred list:

- the name of the depositary;
- the name of the auditors;
- where to complain (although such information was mentioned as important by consumer representatives, CESR notes that it might be problematic achieving a common solution given the complexity of the picture once cross-border sales are

[13] as the tax regime of the investor in its Host member state, although it is of significant interest to the subscriber, may depend on various factors and cannot be encompassed in a document drafted in the Home member state.

[14] CESR notes that additional information on the tax regime of the fund in its Home member state will be available from other sources, such as the website of the fund provider; an appropriate reference to such information could therefore be included in the relevant part of the KII.

taken into consideration: different contacts might be relevant in relation to potential complaints, such as mediation bodies at company or at national level, the competent authority of the fund or of the company, and that the entity responsible will depend on whether the complaint affects the fund itself or the way it was sold by the intermediary);

- the cut-off time for dealing instructions;
- information on the existence of other classes of shares;
- (in the case of relevant umbrella funds) information on the existence of other compartments if they are not segregated, and a warning that assets of each compartment are not ring-fenced / within a protected cell structure;
- the date on which the fund was created.

4.24 CESR also points out that distribution costs might vary between Member States and distribution channels, so that it may not be easy to include the breakdown of fees between the distributor and the asset manager in KII, particularly given that the KII will be the responsibility of the asset management company which may not have responsibility in relation to particular distribution arrangements. This issue is discussed again in the section on charges disclosure in Chapter 8.

Local information

4.25 Practical information on how to buy and sell (contact details, cut-off time, where NAV is available) is useful and should be included in KII, as mentioned above. While these items of information might, in many cases, vary from one Member State to the other, the inclusion of this information within the KII should not impact the smooth functioning of the passport.

4.26 CESR does not recommend that a single KII should list all possible contact details in various Member States, as this would be space-consuming and burdensome.

4.27 The section dedicated to local information within KII is meant to be very short, and entirely harmonized, so that no additional information could be required by the Host Member State, and that no obstacle to the notification procedure due to different domestic requirements should arise.

4.28 It would be precisely restricted to:

- contact details for submitting subscription / redemption orders within the host Member State (paying agent);
- specific cut-off time (if any) within the host Member State for receiving orders to be dealt at the fund's next valuation;
- where to find ongoing information about the fund, e.g. redemption price, prospectus, annual and interim reports, notification of changes in fund rules.

4.29 At this stage CESR has not examined which competent authority (home or host Member State) should be in charge of the review of this part of KII.

4.30 During the discussions a more radical approach was suggested, to exclude all local information from the document, signposting the whereabouts of the information on a website. This would allow the same document to be used cross-border, subject only to translation, speeding up the European passport. On the other hand, this would make the KII document itself less useful for investors and less capable of functioning as a stand-alone document. Basic information essential for effecting subscription or redemption would no longer be included. Signposting to a website might raise language issues, unless the website information is translated into an accepted language of each Member State where the fund is distributed.

Summary of options to test with consumers

- A two-page document (possibly with 'comply or explain' approach) with only the items under (A) above.
- A two-page document (possibly with 'comply or explain' approach) including both the items under (A) and the further items mentioned under (B).

Use of building blocks

4.31 The Commission's request for assistance suggests that the KII might be structured as a series of 'building blocks' which can each be free-standing from the others but which, as a whole, provide the overall picture that the investor needs to know. The main advantage of such an approach would be the flexibility available to providers and distributors to organise the information within a broader marketing strategy, whether paper-based or electronic. For example, KII relating to the fund's risk factors could be presented as part of a more general explanation of risk and reward, or past performance data could be shown in a separate context, updated more frequently than other parts of the KII. A further advantage would be to allow more flexibility when firms wish to combine the KII of the UCITS itself with information about the wrapper in which it is to be held, or with any disclosures required by other Directives, as discussed above.

4.32 The main drawback to such arrangements would, in CESR's view, be the loss of the ability to see all the relevant information 'at a glance' in a single, concise context, and consequently the difficulty that investors and their advisers would experience when trying to compare different product offerings to determine which is the most suitable. CESR has discussed this proposal with representatives of consumer bodies and industry participants, but neither group was strongly in favour of it. CESR has also paid attention to concerns expressed by market professionals that the splitting and recombining of KII contents would cause difficulties in relation to the degree of legal liability that attaches to KII as a whole.

4.33 CESR believes that in order to prevent the loss of comparability, it is essential for the description of the primary characteristics of the UCITS – its investment objectives, the risk factors affecting it and the charging structure, as well as information on past performance – to be presented as a single unit. An important consideration in forming this view is that the contents of these sections of the KII are largely common to all investors, regardless of the distribution arrangement. The exception is potentially where charges are concerned, but if we follow the course recommended in Chapter 8 (charges), then consistency can be maintained.

4.34 CESR also considers that all elements of the practical information in the KII should be presented as a whole. The case for requiring them to do so is less compelling, in that the information is not critical for making an investment decision, but is likely to be most helpful to consumers when shown in a single context.

Fund structures

4.35 The Commission asked CESR to consider how the proposals for KII might be adapted to take account of certain structural features common to many UCITS funds – the fund of funds model, the use of an umbrella / sub-fund structure, and the issue of units / shares in multiple classes. CESR was also asked to consider how the proposals for the introduction of UCITS feeder funds might be reflected in KII.

Funds of funds

4.36 When devising KII for a fund of funds, the particular consideration will be the extent to which 'look-through' to its underlying portfolio is appropriate. Some market participants see the fund of funds as a kind of 'wrapper' which can be used to gain access to a range of funds, and have suggested that information on those underlying funds should be disclosed to investors in the fund of funds.

4.37 CESR recommends that, with the exceptions noted below, the Commission should treat a fund of funds as a single fund which happens to invest in a portfolio of other collective funds, as opposed to a portfolio of securities. The KII of a fund of funds should be constructed with no expectation that the investor will either wish or need to be informed in detail about each of the underlying funds (especially given that these are likely to vary from time to time as the manager adjusts the portfolio).

4.38 However, in order to deliver effective disclosure of the risk factors and charging structure of the fund of funds, it may be necessary to 'look through' to the characteristics of its underlying funds. We comment on these points in more detail in Chapters 5 and 8.

Umbrella funds

4.39 CESR notes that many UCITS, especially those constituted as an investment company, have adopted the umbrella structure. In addition, many Member States recognise the 'protected cell' structure which ensures segregation of the assets of each sub-fund within the umbrella. The Directive requires the full prospectus and periodic reports and accounts to be issued for the umbrella as a whole, and does not preclude the possibility of producing a simplified prospectus for the whole umbrella as well.

4.40 However, since the umbrella is primarily a means of organising the fund structure efficiently, the fund operator will generally promote one or more individual sub-funds, rather than the umbrella as a whole. Likewise, many investors will be interested in specific sub-funds and will not necessarily want information about the complete range of funds within the umbrella.

4.41 The detailed information about investment objectives, risk factors, charges and past performance that we recommend in the following chapters will clearly be specific to each separate sub-fund. In order to achieve the expected benefits of KII, CESR thinks it is desirable for a separate and stand-alone KII document to be produced for each individual sub-fund. This will enable investors to see the essential information about the fund at a glance, provided the recommendations on format and presentation are consistently applied, and will facilitate comparison between funds provided by two or more different operators.

4.42 CESR does not in principle favour the production of a document in which the separate KII disclosures of each sub-fund are compiled so as to appear one after the other. This is because, in CESR's view, providing the investor with a document that combines the details of numerous sub-funds is likely to detract from the impact of the information about each particular sub-fund, so that the investor may fail to appreciate its significance when compared with the same information provided for a single, stand-alone fund. However, CESR notes that such an approach may be necessary where local marketing regulations require it. Nor, subject to national legislation, does CESR see any objection to either a UCITS operator or a distributor producing marketing documents that show a summary of the features of two or more sub-funds in an umbrella, provided such documents are in addition to the KII, not in substitution for them.

4.43 It is acknowledged that this approach, as compared with a compendium document, will result in a degree of duplication, especially in relation to elements of the KII contents that are common to every sub-fund in a particular umbrella. As part of its process of consultation with stakeholders, CESR seeks further comment on the extent to which firms wish or need to produce combined KII for all the sub-funds of an umbrella.

4.44 A statement explaining whether or not the umbrella has a 'protected cell' structure, and the significance of this, could be included in the version to be tested with consumers to ascertain whether they find it helpful and significant in making their investment decision.

Unit / share classes

4.45 Probably the majority of UCITS funds make some use of share classes in their structure, and many have relatively complex structures using several different classes. CESR's call for evidence has confirmed that the main uses of share classes are to provide alternatives in relation to:

- distribution channels;
- fee structures;
- the currencies in which investors deal;
- investor tax status; and
- treatment of fund income.

4.46 These elements can be combined in a variety of ways, so a UCITS might have, for example, separate sets of classes for retail and institutional investors, with each set offering Euro, Sterling and US Dollar classes, possibly with a choice of hedged and unhedged strategies, and some or all of them further divided between a dividend-paying class and an income-capitalising class.

4.47 It is important to note that although a UCITS may have numerous classes, not all of them will necessarily be available to any one investor. Institutional classes with lower fees will normally have very high minimum initial investment levels to prevent retail investors from accessing them. Some classes may be offered only through a particular distributor (e.g. a 'white labelling' exercise) or a specific channel (e.g. for internet transactions). Where a fund is being marketed cross-border, the operator may decide to make only certain classes available to investors in that jurisdiction.

4.48 The starting assumption is that the KII requirements will be applicable to every class within the UCITS. It is noted that for a class aimed at institutional investors, each potential investor may opt not to receive them, but that would not relieve the UCITS provider of its obligation to prepare them. Possible exceptions might be made if a class is no longer available to new investors, or if it is designed for and sold only in a jurisdiction outside the Community, where local disclosure regulations may override the UCITS requirements.

4.49 CESR has considered whether providers should be required to produce a separate KII for each class of units available to investors. Although some providers might wish to do so, others might prefer to combine the information about two or more classes into a single KII. We believe it is reasonable to combine information where the presentation continues to meet the requirements set out in the next chapter, and does not make the KII too complex as a result. For example, where the investor has a choice between a class from which income is paid out, and a class in which the income is capitalised, this can be stated simply as part of the practical information.

4.50 Providers may also wish to use the KII of one class on a representative basis for other classes. CESR recommends that this should be permitted subject to the following conditions:

- the description of risk factors does not omit any material risk applicable to any of the other classes;

- where charging structures differ between classes, the class with the highest overall charge (and therefore the weakest past performance record) is selected to represent the others;
- reference is made to the fact that other classes are available, with an indication of where information about them can be found.

4.51 The last condition is also applicable to situations where details of other classes cannot be combined into a single KII without making the document unacceptably long or complex.

4.52 CESR notes the possibility that presentation of the highest-charging class on a representative basis raises the risk that it might bias investors and advisers towards the purchase of units in that class, rather than another offering lower charges. CESR invites comments from stakeholders on whether they consider this to be a significant risk.

Feeder funds

4.53 As part of its orientations on possible amendments to the UCITS Directive, the Commission proposes to allow a UCITS to be a feeder fund directed into a UCITS master fund, provided at least 85% of the feeder fund's assets are invested in the master fund. The proposals would require investor information to refer to both the feeder and the master, and they state specifically:

> *'The updated key investor information of the master UCITS shall form an integral part of the feeder UCITS' key investor information...'*

4.54 The explanatory comment on this paragraph notes that investors in a feeder fund need to receive adequate information on the master fund, and to obtain information on the impact of a second fund layer, in particular as regards charges and taxation (given that the proposals would allow the feeder and master funds to be in different Member States).

4.55 The use of a feeder / master structure has implications for the presentation of the KII, and for the description of risk factors, charges and past performance, which are considered in more detail in the following chapters.

Questions for the CESR Consultation

4. Do respondents agree with the proposed purpose and scope of KII?

5. Should non-retail investors be permitted to opt out of receiving KII?

6. Do you think that CESR's proposals on general presentation are appropriate?

7. Should CESR propose adopting a more prescriptive approach, for instance using detailed templates, or should it support a less prescriptive, more principles-based approach?

8. In relation to the proposals on content, should Option A (with fewer items) be favoured compared to option B?

9. How should both options best be tested with consumers?

10. Has CESR correctly struck the balance between reducing the information provided and ensuring investors receive the key messages they need?

11. Should the competent authority of the fund and the tax regime of the fund in its Home Member State be included?

12. Do you think other items of information are necessary? If so, which ones in particular?

13. Do you agree that distribution costs should not be systematically 'unbundled' within KII? Should there be flexibility to allow this where appropriate?

14. Does the proposed approach to local information (a harmonized section for local information within KII that would be precisely delineated) achieve a correct balance between the need for local information and the smooth functioning of the passport? Is a more radical approach (e.g. signposting local information to a website) feasible and appropriate?

15. Should a 'building block' approach be permitted, whereby providers can produce different parts of the KII separately?

16. Do respondents agree with the proposed treatment of funds of funds?

17. Should separate KII be produced for each sub-fund of an umbrella? Should providers be permitted to produce a compendium for all the sub-funds of an umbrella if they wish?

18. Do respondents agree with the proposals for treatment of unit / share classes? In particular, should providers be permitted to produce KII featuring a representative class?

CHAPTER 5: DESCRIBING THE FUND'S OBJECTIVE AND STRATEGY

5.1 This chapter examines options for presenting the investment objectives and strategy of a UCITS fund. It proposes detailed requirements in this area, including specific indications of the existence of any guarantee, of whether the suggested holding period might be inappropriate for some investors, and of who the target investors are.

UCITS' objective and strategy

5.2 CESR considers that the distinction between strategy and objectives is in many cases very theoretical and leads to redundancies such that joint presentation might be preferable. However, this joint presentation should allow investors to distinguish between fund objectives (mainly achieving capital growth or preservation, paying out or reinvesting dividends, and so forth) and the means used to reach them (such as by exposure to some specific markets or instruments).

5.3 As far as the content of these items is concerned, one option would be to start from the set of elements which are currently required in the Commission Recommendation 2004/384/EC 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 (the 'Commission Recommendation'), when drafting the material for testing, but removing less relevant details and adding some new elements which are important for the investor decision-making progress, as indicated in the strikethrough text below:

'Member States are recommended to interpret «the unit trust's/common fund's or the investment company's investment policy» as meaning the following information, provided it is material and relevant:

(a) the main categories of eligible financial instruments which are the object of investment;

(b) whether the UCITS has a particular strategy in relation to any industrial, geographic or other market sectors or specific classes of assets, e.g. investments in emerging countries' financial instruments;

~~(c) where relevant, a warning that, whilst the actual portfolio composition is required to comply with the broad legal and statutory rules and limits, risk-concentration may occur in regard of certain tighter asset classes, economic and geographic sectors;~~

(d) if the UCITS invests in bonds, an indication of whether they are corporate or government, ~~their duration~~ and the rating requirements~~;~~

~~(e) if the UCITS uses financial derivative instruments, an indication of whether this is done in pursuit of the UCITS' objectives, or for hedging purposes only;~~

(f) whether the UCITS' management style contemplates some reference to a benchmark with an indication of the degree of freedom towards this benchmark (such as passive, moderate or active); and in particular whether the UCITS has an «index tracking» objective, ~~with an indication of the strategy to be pursued to achieve this;~~

~~(g) whether the UCITS' management style is based on a tactical asset allocation with high frequency portfolio adjustments.~~[15]

[15] Sub-items (a), (b), (f) are the core elements of description and might be left untangled, with the exception of the following.
(f) where the strategy to track the index is a technical point of little interest to investors;
(c) is a specific risk warning redundant with risk presentation and might be deleted;
(e) is to a certain extent out of reach of average investors and in all cases redundant with risk presentation: if the UCITS uses financial derivatives to get leverage, this might be addressed within the risk/reward section. Deletion is proposed.
(d) is a technical approach (government bonds or corporate, level of rating requirements) that might not be relevant for retail investors. The strategy of a bond fund should be expressed in plain language, referring to

5.4 In addition, CESR considers that the Commission Recommendation should be complemented by the three following elements:

Capital guarantee

> *'(g) when there is a capital guarantee, the mention of the existence of the capital guarantee, an indication of whether it is a 100% guarantee or not, whether the benefit of the guarantee is unconditional or subject to certain conditions, whether this is a legal guarantee or not (with indication of the guarantor in the first case), and the time of validity of the guarantee (a single date, a certain period or the entire life of the UCITS).'*

5.5 CESR is aware that the concept of guarantee should be carefully defined. Two cases should be distinguished:

- funds with a legal guarantee
- funds offering a capital protection as a mere 'investment objective' aimed at through various financial techniques, that is in fact not legally guaranteed (there is an operational risk that these financial techniques fail to provide the protection of the capital).

5.6 Thus, CESR recommends requiring that in case the capital is not legally guaranteed, the term 'guarantee' should not be used in the KII and it should be briefly mentioned to investors how the protection is achieved. In case the capital is legally guaranteed, the guarantor should be mentioned. Nevertheless, CESR is aware that investors could be confused about such technical information, the implications of which are not straightforward, so that appropriate consumer testing should be carried out to identify how to best convey a sense of the guarantee respectively the capital protection.

5.7 CESR recommends that the information on whether there is a capital guarantee should not be included when the UCITS does not offer a capital guarantee, and therefore should only be provided where the UCITS offers such guarantees.

5.8 CESR recommends feedback should be sought on this precise point.

Information on the minimum investment period

> *'(h) whether it would not be appropriate for the investor to invest into the UCITS if he anticipates the need to redeem within a [defined time period, to be mentioned].'*

5.9 The rationale behind this wording is that the investment horizon is one of the important features an investor and a management company should be looking at; yet requiring a minimal holding period to be displayed might lead to misunderstandings, with investors believing they can only redeem their units after the holding period has passed, or that they would get some optimal return at the end of this period. Thus, CESR proposes to present this feature the other way round.

Information on the type of investor

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the consequences in term of risk and reward, without referring to technical features of targeted bonds. Deletion is proposed.
(g) high frequency portfolio adjustments are of little interest to the investor. They have or may have consequences on performances and on fees and should be addressed in these sections. It might also be considered that they should be mentioned in the risk section since there is a risk that performance might be affected by high turnover rates. Deletion in the 'investment policy' section and transfer to another one is proposed.

'(i) whether the UCITS has also been designed for non-sophisticated investors'

5.10 This wording could replace the current requirement for a 'typical investor's profile'. In fact, the information currently provided under that item is often redundant given the other items disclosed within current Simplified Prospectuses (e.g. the typical investor's profile for an equity fund would be: 'investor looking for exposure on the equity market'). However, when management companies use this item to highlight the fact that only sophisticated investors would be in a position to correctly understand the risks incurred by their investment, this is a valuable piece of information which has been welcomed by some investors during the consultation.

5.11 The wording 'designed for' refers to a very general assessment to be made by the management company, and does not interfere with suitability or appropriateness for a specific investor, which would be tests that are to be carried by an intermediary where relevant.

5.12 Moreover, it must be pointed out that the information on whether the UCITS has been designed or not for a non-sophisticated investor would have no legal consequences as such. Non-sophisticated investors would still be able to buy these funds if they wish to do so, and advisers can recommend them to do so if the suitability test leads them to this conclusion. The reference to non-sophisticated investors, which is not a legal category under any Directive, (as opposed to qualified or professional investors) is made on purpose. Finally, this possibility would introduce no legal distinction within UCITS products as regards their public, since UCITS have been globally conceived as retail products.

5.13 As a matter of fact, focusing the current concept of 'investor profile' to the distinction between products designed for non-sophisticated investors or not, aims at giving the management company the possibility to flag some funds, for instance funds with unusual risk-profiles, so as to give a first hint to advisers and to investors that are used to buying on an execution-only basis.

5.14 Both information on the minimum investment period and on the type of investor could be presented under a common headline

5.15 CESR has considered the opportunity to take a more 'principles-based' approach on how to describe the strategy and objectives, such as the one adopted recently within MiFID. This would potentially avoid the development of a 'tick box approach' which might not be suitable for certain funds or in light of certain innovations in the industry. However, CESR has reached the view that such high-level principles (e.g. 'the presentation should make the investor *reasonably able to understand the nature of the strategy and objectives pursued, in particular the main categories of eligible financial instruments*') would be too general to be relevant, and that trying to draft more specific ones would result in a framework very similar to the one proposed above.

Summary of recommendation

5.16 A detailed requirement based on the modification of the current recommendation wording, aiming at:

- Focusing descriptive elements on the core of the strategy of the UCITS (broad categories of financial instruments used, sector covered, use of benchmark if any).

- Giving a clear indication of the guarantee, the holding period that would be inappropriate (if any), whether the fund has also been designed for non-sophisticated investors.

Questions for the CESR Consultation

19. Do you think that CESR's proposals on the presentation of the strategy and objectives of a fund is appropriate?

20. In particular, is it relevant to merge strategy and objectives into one generic item?

21. Is the streamlining of the current applicable Recommendation relevant for the purpose of focusing the description on key elements? Do you agree with the addition of new key items to mention within that section: guarantee, period of holding inappropriate if any, design also for retail non-sophisticated investors?

22. More specifically, do you agree that it should be required that in case the capital is not legally guaranteed, the term 'guarantee' should not be used in the KII, and it should be briefly mentioned to investors how the protection is achieved ? In case the capital is legally guaranteed, do you agree the guarantor should be mentioned? Do you agree that it is not necessary to mention explicitly that a fund is not capital guaranteed?

23. Do you agree that mentioning whether it would not be appropriate for the investor to invest into the UCITS, if he anticipates the need to redeem within a defined time period to be stated, is the appropriate way to deal with time horizon issues without leading to misunderstandings ?

24. Do you agree that giving management companies the opportunity to flag funds that have not been designed for non-sophisticated investors, with no legal consequences, would help in preventing missellings, especially in the case of 'execution only' subscriptions?

CHAPTER 6: RISK DISCLOSURE

6.1 The Mandate from the Commission explicitly requires CESR to deliver advice on possible ways to improve risk/reward disclosure by ensuring that only relevant risks are mentioned and explained, and to consider whether a synthetic indicator could be required.

6.2 Indeed, CESR is aware of the limits of the current situation where a list of all possible risks is provided for legal reasons,[16] but does not provide useful information to investors. This is clearly one of the major shortcomings of the current simplified prospectus.

6.3 CESR considers that possible options include:

A). Not requiring a synthetic indicator, and trying to enhance the current pure narrative approach.

B). Requiring a synthetic indicator, but with an accompanying explanatory text.

A). *Improving current narrative risk-reward presentation*

6.4 CESR considered many ways to improve the current listing of risks.

6.5 Possible improvements examined have included the possibility of restricting the current list of risks to 'the most relevant ones'. Doubts were expressed on the practical impact of this recommendation since it could be difficult to distinguish relevant risks from less relevant ones. Recent developments show that risks considered as very unlikely, and which have not crystallised in the past, such as liquidity risk for 'dynamic' money market funds, can have a massive impact on the fund's value and ability to redeem shares.

6.6 Since a detailed list does not convey a sense of the overall underlying risk/reward profile, this might be better achieved through more high-level principles. MiFiD requirements might be a good starting point to this extent. More specifically, article 19(3) of the Level 1 Directive provides for a general information requirement including description of the risks, which should make the investor 'reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered' and, consequently, to take investment decisions on an informed basis.

6.7 Furthermore, the current narrative risk sections use standardized wordings such as 'the value of your investment may go up or down depending on market conditions'. Improving the narrative section probably requires a more detailed qualitative appraisal of concrete possibilities of risk and reward, capable of conveying to an investor a broad sense of the probability of losses and gains and of their size.

6.8 CESR also considered the possibility of limiting the size of the risk disclosure section to force asset management companies to summarize the risk /reward in terms of direct impact on yield and to avoid lengthy, detailed descriptions. CESR also recommends that a narrative approach would need to address some specific concerns, such as the use of derivatives and the general link between risk and reward.

6.9 As a result, the following principles have been identified to enhance pure narrative disclosure:

- **Principle 1:** the disclosure of risk/reward should enable the investor to reasonably understand the overall effect of the risk factors associated with investment in the UCITS.
- **Principle 2:** appropriate wording should make a link between risk and reward, and make clear that there is a general correlation between possibilities of gains and possibilities of losses.

[16] The existing list of risks accounts for 7 specific market risks and 6 horizontal risks factor (see Annex 2 for the relevant extract of the Recommendation).

- **Principle 3:** it should convey, in qualitative terms and based on qualitative assessment, the likelihood of loss or gain and of the size of these.[17] For instance, it might be mentioned if the probability of heavy losses is high or low, and the same for the probability of strong gains. Where there is a material risk to the original investment, this should be clearly communicated (although CESR notes that this might be easier to do for funds pursuing straightforward and simple investment strategies than for most complex funds).
- **Principle 4:** in case funds clearly target some specific markets, the risk/reward section should mention when financial techniques are used to increase or to reduce the exposure to the underlying assets. Their impact matters more than the detailed description of their functioning.
- **Principle 5:** the wording should foster comparability between products, for instance including references to the risk profile of other fund types, guaranteed funds, risk-free investments.
- **Principle 6:** the section dedicated to risk/reward presentation should be limited in size.
- **Principle 7:** it should be mentioned that the risk assessment has been done taking into account only usual risks.

6.10 'Good practice' guides might be issued to foster common practices in this area.

B). *Implementing a synthetic risk/reward indicator with some explanatory narrative*

6.11 CESR has considered this option under the following headings:

1. Clear potential benefit brought by a synthetic risk/reward indicator
2. Criteria for assessment of possible methodologies.
3. Possible guidelines on the wording supplementing the indicator
4. Presentation
5. Degree of harmonisation of methodology

1. Clear potential benefit brought by a synthetic risk/reward indicator

6.12 Respondents to the CESR's consultation were mixed in their support for a synthetic risk/reward measure, although there was significant support from the investors' side.

6.13 Some Member States have used the possibility offered by the Commission Recommendation to require synthetic risk indicators, mostly based on volatility of the relevant asset classes. In other cases, some asset managers have introduced in-house calculated risk indicators on a voluntary basis, or make use of third-parties calculated ratings, using them also as sales tools. In order to understand the challenges raised by the calculation of synthetic risk/reward indicators, CESR has considered some of the existing methodologies fostered by regulators, but has not as yet analysed approaches adopted by industry or third party agencies.

6.14 Indeed, there can be many ways to define risk and reward. Is risk/reward the uncertainty about the precise level of the return, as measured by volatility? Is risk the maximum amount that could be lost under certain circumstances? And how can the link between risk and reward best be conveyed?

6.15 The calculation of a risk/reward indicator can avoid the off-putting effect of a risk-only presentation, but this might lead to complex calculation issues and raise difficulties of understanding. One possible way forward might be to have calculations focused on risks, while elaborating in an explanatory text on the link between risk and reward.

6.16 There are basically 3 types of issues raised by the use of quantitative measures:

[17] Some concerns have been expressed that this might not be done on a qualitative basis, and that doing it on a quantitative basis would lead back to the introduction of a synthetic risk indicator.

- **Issues of pure presentation**: how many categories should be defined, how should they be labelled and presented to investors (using icons, figures, scales…), and how should the explanatory text be drafted – although general guidelines may be provided at this stage, the presentational approach might best be found out through consumer testing, and based on existing national research, independently from a consideration of the calculation methodology which would underpin the indicator. It is important that this testing addresses the question of how consumers use or understand the information being presented, and in particular its limits, such that some elements of the presentation may depend on the nature of the underlying methodology.

- **Issues related to the 'fine-tuning' of a methodology**: for instance, defining the time period for observations and calculations, which leads to a trade-off between having stable risk categories, which might be expected by the consumer, and quickly reflecting changes in the policy of the fund, which might be more accurate to reflect the fund's behaviour. This raises issues in relation to the prospective time period for which the risk/reward indicator should be calibrated. Moreover, where a long track-record is required on which to base the indicator, the question arises of benchmark accuracy and relevance in relation to the fund in question. However, these are mostly technical issues for which the best solution might be identified once the decision is taken to move forward.

- **Issues that lie at the heart of building the methodology**: is there a technical possibility to take most of usual risks and rewards into account, and to calculate a synthetic indicator for most funds, with limitations that are likely to be understood by investors, with implementation costs which are acceptable for management companies and no grounds for manipulation by management companies eager to achieve a particular value of the indicator? CESR recommends a focus on clarifying these subjects in the short term in order to make consumer testing more accurate.

6.17 Indeed, synthetic risk/reward measures face many challenges raised by specific situations, stemming from market inefficiencies (inflation, liquidity, counterparty…, when they are not appropriately discounted into market prices), or by particular funds (flexible, protected…), as well as timing issues (i.e. on which period should the risk calculation calibrated).

6.18 There might be a way to address these challenges, in particular through effective presentation of the possible limitations of the information being shown. Yet consumers might then be confused about the accuracy of the synthetic indicator and either:

- develop overconfidence in the indicator despite the wording; or
- lose confidence in the indicator if they are told that it is not entirely comprehensive.

6.19 Due to the nature and the time constraints of its remit, CESR was not in a position to conduct an in-depth assessment of existing methodologies, nor to recommend the use of a specific methodology over others. Some Member States are confident that the case of most funds can be addressed; others still have concerns considering the range of UCITS they experience on their domestic market.

6.20 CESR agrees that possible limitations have to be balanced against the clear improvement of global risk/reward perception that might be brought to investors in the vast majority of cases. Consumer testing should effectively bring greater clarity to such a balanced judgement.

	A) Not require a synthetic indicator and try to enhance the current pure narrative approach	B) Require a synthetic indicator with explanatory text

	with high-level, qualitative principles	
Pros	No methodological issues Low cost for firms	Easy to use as a tool for decision-making Technically possible for many funds, with experiments in some Member States
Cons	Current situation leads to useless lists of risk with little comparability and no clear message on the overall level of risk/reward. High-level principles might not succeed in changing this practice, and certainly would raise supervisory challenges which would need further thought. In this case, investors might end-up with no idea at all of the level of risk/reward. Effectiveness might be hard to test with consumers.	Level of cross-border and cross-firms comparability depending on what entity would be in charge of developing the methodology Consumers may be confused regarding the limits of the information being shown; possible limitations still to be identified. They will have to be addressed with adequate wording. Consumers might then be confused about the real accuracy of the synthetic indicator Possible higher implementation costs (yet tools might be made available to address this)

6.21 Considering the pros and cons summarized in the table above, CESR recommends the adoption of a synthetic risk/reward indicator as a preferred option for testing with stakeholders and consumers. CESR stresses the need to increase common understanding of existing methodologies and assess to what extent their limitations can be identified, possibly reduced and appropriately disclosed.

6.22 CESR also recommends that the option of having an improved narrative approach should not be abandoned at this stage, and should be tested alongside the synthetic risk/reward indicator.

2. Criteria for assessment of possible methodologies.

6.23 CESR is committed to delivering as much evidence as possible on the issue of synthetic indicator calculation and presentation to the Commission, beyond the straightforward conclusions regarding the broad options available which should be further tested with consumers and stakeholders.

6.24 In particular, it is therefore considered useful to provide the Commission with a grid of criteria that any calculation methodology and presentation of a synthetic risk/reward indicator should comply with. A draft grid for that purpose is provided as annex 5 to this paper.

6.25 CESR invites respondents to help in assessing:

- whether these criteria are appropriate and sufficient; and

- to what extent existing and possible methodologies might comply with these.

6.26 Such criteria might then be used either to identify or develop a common methodology at European level, to be built either by regulators or by the industry.

*3. **Possible guidelines on the wording supplementing the indicator***

6.27 CESR has reached a consensus that where a synthetic risk/reward indicator is adopted, appropriate explanatory text should supplement it to avoid or at least limit misunderstandings. Proposals along these lines should also allow for easier testing of practical mock-ups with investors.

6.28 CESR recommends that such an explanatory text should include:

1. an explanation of what is to be understood under the attributed risk level, and in simple terms why the fund has been classified in this category.

2. a wording explaining what is the connection between risk and reward in case the quantitative indicator would not adequately reflect it, and so as to avoid off-putting effects.

3. an explanation of the limitations of the synthetic indicator: mention that some situations might be not be covered where relevant, or (in simple language) that the indicator does not guarantee that the performance of the fund will fall within certain boundaries.

4. an adequate wording for funds that could not be classified.

5. where relevant, a warning on the possibility that the value of the indicator might be modified depending on market conditions, and that the investor should monitor this and possibly adapt their investment strategy.

6.29 As a basis for discussion for some of these items, the following text is proposed (no wording can be proposed at this stage under point 1. since it would depend on the methodology chosen):

'Warning: This synthetic risk/reward indicator takes into account most of the usual situations that face this investment. Unexpected major events, as well as unusual market situations, might have negative consequences not anticipated in this indicator. Remember that generally, higher possible gains are a counterpart to a higer risk of losses. This indicator offers a medium-term view, but this might be modified through the operation of deep market trends'

'Due to specific features, the risk/reward profile of this fund could not be evaluated according to the common methodology. This does not mean that it is more or less risky than funds where this calculation was possible, but that its risk/reward profile cannot be easily summarized in one figure'

4. Presentation

6.30 Considering the timetable, CESR has not conducted an extensive review of possible presentation schemes for synthetic indicators. Some high-level guidelines are proposed in the criteria table in the annex.

6.31 The presentation of a qualitative indicator can be done in many different ways: scales, icons, words (from low to high risk). In view of the possible different understandings that might be observed in presentations using icons or adjectives, CESR suggests that one single (numeric) scale for all funds if possible (e.g. 1 to 5) might be the most appropriate. This has to be challenged in consumer testing compared to other possible approaches.

6.32 If it appears that a separate, parallel scale is necessary for the ranking of guaranteed and other non-linear funds, this should be clearly disclosed to the investor in a way that does not bring any confusion.

5. Degree of harmonisation of methodology

6.33 As mentioned before, there are several variants within option B of having a synthetic risk indicator.

B1) Requiring a synthetic indicator with a common methodology defined by regulators at European level, and with an explanatory text (this methodology should comply with a table of criteria for which a basis for discussion is provided in the annexes).

B2) Requiring a synthetic indicator, also with explanatory text, and defining the criteria methodologies should comply with (see also proposed table in the annexes), but leaving the onus on the industry to build a common methodology which is compliant with these criteria.

B3) Requiring a synthetic indicator, also with explanatory text, and defining the criteria methodologies should comply with, but allowing different compliant methodologies to coexist (although Member State might impose a specific calculation at their national level).

Addendum : the case of formula funds

6.34 CESR notes that formula funds and comparable funds raise specific concerns.

6.35 Formula funds (such as 'fonds à formule' in France; other names might be encountered in different jurisdictions) are funds offering a pre-determined pay-off at a certain time horizon, entirely depending on certain parameters such as the evolution of a given index. In other words, any assumption made on the value of these parameters allows calculation of the subsequent value of fund at the end of its given time horizon.

6.36 Indeed, the risk/reward profile of such funds is impacted by discontinuities. Specific thresholds might trigger partial or total guarantee mechanisms. Especially in the case of complex formulas, it might be difficult for investors to get a correct picture of what their return might be.

6.37 CESR observes that some Member States have implemented specific disclosure requirements to convey a better understanding of the risk/reward trade-offs for formula funds. These include:

- the display of prospective scenarios showing the return of the fund under either favourable, adverse, or average market conditions. This raises specific issues:

- Without guidelines as regards the choice of the various scenarios, comparability would not be ensured and the scenarios could be used in a manipulative way, so that their use should be specifically monitored by regulators

- Yet defining such guidelines might lead to difficult methodological issues

- the display of tables showing the probability of some events (such as triggering the guarantee or achieving a better return than the risk-free rate).

6.38 CESR is aware that requiring prospective scenarios in KII would raise issues of harmonization of the presentation.

6.39 The use of such prospective scenarios or tables raises further issues:

- **Why should they be limited to formula funds?** In fact, because there is a direct relationship between the value of a set of parameters and the value of the fund at the end of the given time horizon. Although it might be argued that scenarios or likelihood tables could convey some understanding of any fund's risk profile, requiring them for other funds than formula funds would imply a completely different process, based on extrapolation of historical data, raising many concerns.

- **Is the display of such scenarios or tables for formula funds misleading?** Is there a possibility that they might be misinterpreted? For example, investors could wrongly conclude that the return displayed in the 'negative scenario' is a guaranteed minimum, or that they are very likely to get the return delivered in the 'medium scenario'.

6.40 Therefore, CESR recommends consulting on the use of prospective scenarios for formula funds and to do further research, especially concerning the understanding of consumers in this respect (e.g. consumer testing), in close connection with the questions raised by a synthetic risk/reward indicator.

Risk/reward presentation: summary of options

Option A: narrative description based on high-level principles (comparability, sense of the link between risk and reward, general idea of possible gains and losses and their probability, purpose of use of derivatives, specific size limit).

Option B: synthetic indicator with explanatory text

Questions for the CESR Consultation
25. Do you agree that the presentation of a synthetic indicator should be favourably tested with stakeholders and consumers? 26. What specific presentation (icon, wording, numeric scale…) should be favoured and on what basis? 27. How prescriptive should regulators be on the choice of a methodology, given that it should take into account commonly shared risk management practices and suit investors' perception of risks? 28. Are you aware of any specific existing calculation methodology that should be proposed? 29. Is the suggested assessment grid at Annex 4 for methodological and presentation issues appropriate and sufficient for identifying a relevant methodology? 30. How could the potential limitations of the quantitative calculation of a synthetic risk/reward indicator be further mitigated? 31. Do you agree that the possible limitations to a risk/reward indicator might be effectively communicated to consumers through textual warnings? Is the proposed wording appropriate? 32. Which funds or which risks might not be adequately captured by a quantitative methodology? 33. Could the display of scenarios or tables illustrating the behaviour of formula funds enhance the information disclosed for those funds? Do you think that such presentations should be limited to formula funds? Do you think that such presentations might have some misleading effects, might be manipulated, or mistaken for a guarantee? How could these be addressed and reduced? Do you think that such disclosure should be made in a harmonised way? What could be possible ways of showing prospective scenarios? 34. On the narrative side, do you agree with the suggested high-level principles?

Implication for testing with consumers and further work to be undertaken

6.41 CESR considers that many aspects of consumer's reaction to a synthetic indicator can be tested without precisely defining the underlying methodology. Yet consumer testing should also allow in-depth testing of consumer understanding. This can only be fully achieved after a methodology has been chosen, with a specific definition of risk, and a clear vision of risks that would be captured or not.

6.42 For that reason, CESR considers that it might be useful to explore further methodological issues in parallel to the process of finalizing the advice given to the Commission after consultation. The answers of professionals to some of the questions raised in the consultation will provide a valuable starting point for addressing methodological issues. Based on these answers, CESR proposes to examine how further work might be undertaken in connection with stakeholders, gathering evidence and comments from the industry and possibly from other experts.

CESR

CHAPTER 7: PAST PERFORMANCE

7.1 Evidence shows that past performance is one of the key focal points for investors within product information. However, the correct interpretation of this information can be very difficult even for sophisticated investors, particularly given the potential for this information to be misleading.

Existing Disclosures and Commission's Mandate to CESR

7.2 Schedule C to Annex I of the UCITS Directive requires the provision within the SP of information about the 'historical performance of the unit trust/common fund/investment company (where applicable) and a warning that this is not an indicator of future performance'.

7.3 In order to promote greater harmonisation in this information, the Commission recommended to Member States detailed methods for calculating and presenting past performance, including the use of net annual returns presented through a bar chart for up to ten years, and with a comparison with a benchmark where this is appropriate.[18] Member States were also invited to consider presenting cumulative or cumulative average performance.

7.4 Currently there is a significant degree of variation between firms in how past performance is shown, reducing comparability between funds.[19]

7.5 The Commission asked CESR to develop concrete proposals for the handling of past performance information in relation to the KII. The Commission emphasised that the 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'.

7.6 The Commission has been clear that the work should take MiFID requirements as a starting point and consider whether any further requirements are needed to ensure consistency of calculation or presentation.

Summary of CESR work

7.7 Evidence suggests investors can misunderstand the limits of past performance information. They can see the information as 'factual' and trustworthy.[20] Even where warnings prominently state that past performance is not a guide to future performance, investors can discount these, for instance seeing them as simply designed to avoid liability.

7.8 Many investors take past performance to be a good predictor of future performance, even though research suggests this is often not the case.[21]

7.9 Past performance information can thereby become a false focal point for investors. Where the information is contained within an apparently impartial or 'official' document, this effect might be accentuated; the fact of the mandatory disclosure can appear to sanction the view that it is important for considering whether to invest in a fund.

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[18] http://eurlex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=en&model=guicheti&numdoc=32004H0384R.

[19] A discussion on this topic at the workshops held by the Commission in 2006 can be found at: http://ec.europa.eu/internal_market/securities/ucits/index_en.htm#simplified.

[20] Consumer research by the UK FSA on this area can be found here: http://www.fsa.gov.uk/pubs/consumer-research/crpr21.pdf.

[21] See for instance http://www.fsa.gov.uk/pubs/occpapers/OP09.pdf.

7.10 CESR approached the handling of past performance information from a radical starting point: should it be included at all? A range of options were apparent, running from:

- banning the inclusion of past performance within the KII;
- making the information optional but with requirements which standardise the presentation of past performance information where included within or (possibly) alongside the KII; to
- requiring the inclusion of standardised past performance information in the KII.

7.11 Evidence suggests investors typically view the information as key, and so are likely to seek it out, and so it might make sense to integrate the information in a consistent and standardised way into the KII rather than ban it. This is supported by the likelihood that the information would be included in other marketing material forming part of the sales process.

7.12 Consequently, while removing past performance information from the KII might reduce the tendency for consumers to focus on the information, on balance CESR considered the information should be included within the KII, a view which the extended groups of investors' representatives and market practitioners endorsed.

7.13 Having agreed that past performance information should not be excluded from the KII, CESR considered further how the information should be shown and how it should be prepared. It has taken as a starting point the approach adopted by MiFID.

Supplementing the MiFID Standard

7.14 The MiFID requirements in this area are relatively high-level,[22] and focus on:

- presentational elements – regarding prominence, warnings and contextualisation, designed to reduce a misleading focus on past performance information, and
- calculation elements – designed to ensure the information is prepared and broken down by periods in a similar manner by different firms.

7.15 The high-level nature of the MiFID requirements means they do not bring consistency to past performance information. This means, for instance, that some firms could show figures net of charges, others gross, while different firms could choose different periods for their presentations (potentially emphasising stronger periods). Different presentational techniques are also possible, such as the use of cumulative graphs which can reduce the visibility of volatility.

7.16 This is important given the evidence that consumers find the information particularly difficult to interpret and use appropriately. Evidence suggests that some techniques designed to increase the prominence and accessibility of past performance information (including, for instance, the use of bar charts or line graphs) can promote an emotional response from investors, where they are less likely to appraise rationally the information they are seeing, but focus instead, for instance, on the potential for upside or growth in exceptional years.

7.17 Different forms of presentation can also alter the overall impression data gives; for instance, cumulative performance presented using cash terms might (misleadingly) highlight the upside of an investment and its growth potential, while a presentation of average growth over a year using percentage figures might bring the focus more squarely on volatility.

[22] These can be found in the MiFID implementing directive under Article 27 (4): http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_241/l_24120060902en00260058.pdf.

7.18 There was consensus within CESR, given these issues, that several aspects of the MiFID standard should be supplemented by additional requirements, in order to promote the ability of investors to compare between UCITS and in order to minimise the scope for investors to misunderstand the information.

7.19 CESR recommends therefore that a presentational approach should be tested with consumers to examine the effectiveness of the following features:

- a bar chart layout;
- using percentages;
- showing average yearly (net) performance; and
- including prominent narrative text to 'contextualise' the information and warn about its limited value as a guide to future performance.

7.20 The focus of the consumer testing should be on whether these presentational techniques aid consumer understanding of the appropriate use of past performance data.

7.21 Information about benchmarks can be important for understanding the performance of some UCITS, particularly where they are managed in relation to a benchmark, so CESR recommends testing a presentation which includes the benchmark for comparison, but only where the UCITS' investment policy indicates that it is managed in relation to a benchmark. In the case of the proposal for UCITS feeder funds, CESR suggests that the performance of the master fund should not be shown in addition to that of the feeder, but if the master fund itself has a benchmark, that benchmark should be shown alongside the performance record of the feeder.

- CESR agreed it was important for reasons of consistency that where the fund reinvests income, any linked index or benchmark shown should be shown on the same basis.

7.22 CESR has also considered the calculation methodologies, and agreed that there should be further standardisation compared with MiFID in this area:

- *the handling of charges* – only figures net of charges are shown (in general, all charges the customer is likely to face should be covered; CESR seeks views on this, for instance on whether subscription and redemption fees should be taken into account);
- *the time periods shown* – testing variants showing as much data as is available up to a total of ten years;
- *the yearly periods shown* – to aid comparison, the same annual calendar period should be shown. However, since different funds use different accounting years, audited figures only need be used where they coincide with the standardised period;
- *the handling of new funds* – past performance can only be shown where at least one year of data is available; any years where data is not available to be clearly indicated; where the fund is to be managed against a benchmark, the benchmark should be disclosed (but clearly identified as the benchmark);
- *the handling of material changes to management or investment policy* – there may be cases where past performance figures might be considered misleading, as material changes to the investment policy or manager have occurred, and CESR considers that any such changes should be clearly identified;

- *the handling of 'simulated' data* – follow the MiFID standard, where such data can only be used in very circumscribed cases e.g. where funds have merged, or where a fund tracks an index.

Brief Assessment of Standardisation of Past Performance

Benefits

- Improves comparability of information between UCITS, potentially improving competition.
- Ensures information is available in a format which is less likely to be misunderstood by investors, reducing potential for mis-buying or selling.

Costs

- There may be costs for firms where systems for providing past performance data need to be revised.
- Standardised layouts are likely to incur minor incremental costs for firms.
- Including past performance data at all may increase some investors' focus on information they are poorly equipped to use, leading to some mis-buying or selling over and against a document which excludes past performance data. However, such data would likely be readily available elsewhere, such that excluding the information from the KII itself might not reduce such potential mis-buying or selling.

Questions for the CESR Consultation

35. Is CESR correct to recommend that information about past performance be included in the KII?

36. Has CESR identified the right areas and ways in which this information should be standardised?

37. Which charges should performance figures take into account? For instance, should figures include allowance for subscription and redemption fees?

CHAPTER 8: CHARGES

8.1 Information about charges is crucial for retail investors making investment decisions, and provides a basis for the investors (and their advisers) to compare different products. Despite the importance of charges, investors are often unfamiliar with how different charges work.

Existing Disclosures and Commission's Mandate to CESR

8.2 Schedule C to Annex I of the UCITS Directive requires the provision within the SP of information about entry and exit commissions and other possible expenses and fees.[23] In order to promote greater harmonisation in this information, the Commission recommended to Member States methods for calculating summary figures (the Total Expense Ratio (TER) and the Portfolio Turnover Rate (PTR)), and called for separate disclosure of remaining charges and costs, including the charging structure on an ex-ante basis.

8.3 Problems have already been identified with these recommendations and their implementation across Member States.[24] These problems cluster into two broad areas:

- Concerns that the required information does not provide adequate transparency. For example, the description of TER as a 'total expense ratio' can lead some investors to interpret this as including all the costs they should take account of.[25]

- Evidence that TER, PTR and other charges elements are calculated and presented inconsistently, limiting comparisons between funds and products.[26]

8.4 In response to these problems, the Commission indicated a number of options it wished CESR to explore:

- the development of a summary figure (e.g. a TER or similar figure) to show overall fund charges, including the handling of performance, transaction, entry and exit and distribution charges in relation to this;

- the elaboration of options for the presentation of the overall effect of all the charges in cash terms; and

- the exploration of options for a summary figure suited to comparisons, summarising all charges the investor is likely to face, including entry and exit charges.

Summary of CESR work

8.5 Evidence suggests that low levels of financial capability and the impact of investor biases can lead investors to misjudge and misunderstand even relatively simple information about charges.[27] Investors can find existing disclosures difficult to use:

[23] http://eurlex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=en&model=guicheti&numdoc=32004H0384R.
[24] There were substantive discussions on these issues at the second workshop held by the Commission during summer 2006. Further detail, including background briefings and annotated conclusions can be found here: http://ec.europa.eu/internal_market/securities/ucits/index_en.htm#simplified.
[25] See http://www.fsa.gov.uk/pubs/consumer-research/crpr18.pdf and http://www.fsa.gov.uk/pubs/consumer-research/crpr34.pdf.
[26] More detail can be found in http://ec.europa.eu/internal_market/securities/docs/ucits/simplified-prospectus/summary_2st_workshop_en.pdf.
[27] See http://www.fsa.gov.uk/pubs/consumer-research/crpr47.pdf for evidence of relatively low levels of financial capability in the UK, including some exploration of the kinds of misunderstanding this can generate.

- The scope of different charge disclosures and the combined effect of multiple charges can be difficult to understand; it can be difficult to distinguish which charges will apply in a particular context.

- TER can be misleading for investors since the reference to 'total' can imply that it includes all the other charges being disclosed.

- Comparability between different funds can be poor where information is provided in different forms. Also, investors appear to have a limited capacity to compare products with multiple charges which vary (e.g. where both TERs and entry fees vary).

- Information provided in relation to a fund may form only part of a larger picture, with discounts or specific distribution charges applying which modify the information shown about the fund itself.

8.6 In the light of these challenges, CESR has focused in the first instance on the general issue of what information should be included on charges and how it should be presented. However, some provisional thinking regarding the different methodologies for calculating the information shown can be found in Annex 6.

Presentation of charges

8.7 In general terms, two ways of presenting charges are common: through the use of percentages, and by showing figures in terms of cash. Research shows that investors relate differently to information when presented in cash terms rather than in percentage terms (e.g. cash presentations lead to a more direct and personal response), and that many investors have difficulties properly registering the scale of impact of charges expressed in percentage terms.[28]

8.8 CESR has considered options for showing charges in cash terms. Most existing implementations appear to depend on showing the impact of charges on a specimen investment given an assumed rate of growth; such approaches have been used in various jurisdictions to illustrate the charges for life insurance policies, and are also used to illustrate charges under prospectus requirements for mutual funds in the USA.[29] (The assumed growth rate could be the risk-free rate or some other indicative long term rate, and it can be possible to show monetary figures without assuming a growth rate at all.)

8.9 In general terms, CESR viewed such an approach as too elaborate for UCITS, and felt that a projection element would run the risk of being considered by investors as a promise of potential returns. CESR also noted that there is no single currency within the European Union. For these reasons, there was a large degree of consensus that the Commission should concentrate on presentations using percentages.

8.10 However, taking account of existing evidence that a presentation in monetary terms may be more accessible for investors; the fact that a number of other jurisdictions have focused on monetary disclosures; and the Commission's explicit request that CESR examine options in this area, CESR would like to seek the views of stakeholders as to whether there are any techniques whereby such a presentation could be transparently and effectively used.

Detailed options examined

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[28] See for instance http://www.dfes.gov.uk/research/data/uploadfiles/RR490.pdf.
[29] See for instance http://www.sec.gov/about/forms/formn-1a.pdf. Recent proposals for regulatory mutual fund disclosures by the Canadian securities regulators have included figures in monetary terms, covering distribution and other intermediation costs. See https://www.csa-acvm.ca/pdfs/81-406_Proposed_Framework-Paper.pdf.

8.11 Building on the work already done and the responses to the CESR call for evidence, CESR has identified two clear high-level options for the presentation of charges on which it wishes now to seek feedback:

Option A – An improved version of the current approach, which seeks to aid consumer comprehension through a structured and streamlined presentation of charges which separately outlines charges paid by the investor, ongoing charges paid out of the fund's assets, and contingent charges.

Option B – The addition to Option A of a summary measure of charges, which seeks to combine into a single disclosure both the charges borne directly by the investor and the ongoing fund charges.

8.12 CESR has presented these options to two extended groups, one comprising of investors' representatives, the other of market practitioners. There was a clear difference in response from these groups; the investors' representatives supported option B, while the market practitioners preferred option A.

8.13 CESR has considered what should be shown in the KII separately from issues regarding the calculation of the figures being shown, as the latter depends on the former. However, CESR would like to note that it strongly recommends that the Commission should harmonise the calculation of charges information, in order to promote comparisons between UCITS.

Option A – An improved version of the current approach

8.14 This option focuses on improvements to the presentation of existing charges disclosures and a rationalisation of the information shown, by:

- showing clearly the charging structure, including how the different charges fit together, (CESR has considered standardising the presentation to aid comparisons by grouping the charges into separate sections covering those paid directly by the investor, 'ongoing charges' taken from the fund and, finally, contingent or other 'additional charges' which might apply, such as performance fees);

- removing information which is immaterial for the average retail investor or which is covered by other disclosed charges (CESR considers PTR and underlying detail regarding different components of the 'ongoing charges' are not necessary for the KII); and

- making clearer what disclosed charges do and do not cover (e.g. clearly identifying the limits of each disclosure, including the appropriate labelling of the disclosure and the inclusion of narrative text to be clear as to what is or is not included; the detail of this will depend on final recommendation as to underlying calculation methodologies).

8.15 Note that this option aims simply to expose the elements of the charging structure as clearly and simply as possible (subject of course to consumer testing), and the investor (or his adviser) will have to consider for themselves the combined impact of the charges or how those charges might apply to a particular transaction or pattern of transactions.

8.16 The aim is to show only such information as is necessary for an investor to be able to understand the charging structure, in as clear a fashion as possible for the needs of the average investor.[30]

8.17 CESR is interested in stakeholders' views on how the different elements of the charges should be labelled (e.g. the labelling of the different elements shown such as 'ongoing charges' or

[30] Given that UCITS typically have a relatively simple charging structure, such a presentation may be adequate; however, for other competing financial products, charging structures might be more complicated. More complicated 'reduction in yield' or similar disclosure techniques may be necessary for these.

'initial charges,' and the labelling of types of charges, such as 'One-off charges which you pay directly' or 'Charges taken from the fund each year'). CESR is also interested in stakeholders' views on surrounding messages regarding what is included or excluded from these charges. CESR considers these should be clear and not misleading, but that it is also important to keep the overall disclosures as succinct and simple as possible.

The handling of ex-ante and ex-post figures and the level of detail to include

8.18 Some charges (e.g. initial charges) are fixed and can be accurately disclosed in advance, while others (e.g. audit fees) may vary according to the expenses actually incurred. In the case of an annual management charge, the percentage rate is known in advance but the method of calculation may mean that the amounts actually deducted, in relation to the net assets at the year end, do not correspond exactly to the stated rate. One approach to this issue is to show ex-ante and ex-post figures separately (for instance, both ex-ante (AMC and initial charges) and ex-post (TER) information).

8.19 Given the aim of the KII to show in a concise way only key information, CESR seeks views as to the basis for showing figures under the proposed 'Option A'. For instance, a spectrum of options are possible for showing ongoing fund charges:

- to show only ex-post figures (i.e. the TER), with a statement to the effect that this figure may change year to year;
- to show only an ex-ante figure, but include an estimate of future expenses;
- to show only ex-post figures for ongoing fund charges, but adjusted for any known material discontinuity in the charging structure going forwards and appropriately labelled; and
- to show both ex-ante and ex-post figures, for instance a harmonised 'TER' disclosure alongside the ex-ante AMC.

8.20 CESR is interested in stakeholders' views before finalising its recommendations.

8.21 The examples we have included in this consultation document have been prepared on the basis that only a single set of figures is shown, but this has only been done to illustrate how this might appear, and CESR has not finalised its recommendations in this area. Messages provided alongside the charges disclosures, explaining what they do and do not cover, might need to be different depending on whether ex-ante or ex-post or both kinds of figures are included.

Example of an approach to Option A

One-off charges which you pay directly		
Initial charge	4.00%	of your investment at most (the remainder is invested)
Exit charge	NIL	of your investment at most
Charges taken from the fund each year		
Ongoing charges	1.90%	of the value of your investment every year
Charges taken from the fund from time to time		
We take no other charges		

The ongoing charges shown here are on the basis of the figures for last year.

[These charges may vary each year.]

Brief Assessment of Option A

Brief Assessment of Option A

Pros

- May be easier and cheaper for firms to introduce than an option which includes entirely new measures, though increased standardisation in presentation will likely incur some incremental costs.

- A simplified and more consistent presentation of charges may improve transparency and aid competition. Some investors may find a presentation solely focused on the actual charging structure easier to apply to their particular circumstances than a presentation which also summarises or illustrates that structure's potential overall effect.

Cons

- Some consumer research evidence suggests investors do not appropriately understand the combined impact of charges where these are presented solely through a series of separate figures. (Testing with consumers should be able to clarify whether additional disclosures of charges are necessary to make them accessible.)

- Since no overall figure which illustrates the combined effect of the charges is provided, under some circumstances it may not effectively aid comparisons between funds with different charging structures.

- Where maximum figures are provided and significant discounting applies, some investors may find it difficult to apply the figures to their particular circumstances.

Option B – Including a summary measure of charges

8.22 As noted, evidence shows many investors find comparing products with different charging structures or different initial charges difficult where the charges are presented in a disaggregated manner,[31] such that they may opt for potentially misleading shortcuts, such as focusing on a fund's Annual Management Charge (AMC) or TER and thereby disregarding initial, exit and other charges. Consolidated or summary measures of charges appear to make it easier for investors to compare funds.[32]

8.23 In the light of this evidence, CESR has designed Option B to test whether a prominently presented combined charges disclosure, aimed at overcoming these shortcomings, would help consumers to grasp better the overall effect of multiple charges.

8.24 This option supplements the detailed disclosures included in option A, rather than replacing them entirely with a single disclosure, since understanding the actual charging structure (including levels of ongoing and initial costs) can be material for some investment decisions.

8.25 We include some discussion of different options for the underlying methodology for the combined disclosure in Annex 6.

[31] See Marco Bertini and Luc Wathieu, 'The Framing Effect of Price Format,' June 2006.

[32] E.g. the research already mentioned above and below, which shows that consumers found it easier to rank funds for overall cost over a particular time horizon where charges were presented using a 'composite' measure than otherwise. It would appear to be for these reasons that Danish competition authorities have recently encouraged the Danish fund industry to adopt a composite measure.

Example of an approach to Option B

Detailed Charges		
One-off charges which you pay directly		
Initial charge	**4.00%**	of your investment at most (the remainder is invested)
Exit charge	**NIL**	of your investment at most
Charges taken from the fund each year		
Ongoing charges	**1.90%**	of the value of your investment every year
Charges taken from the fund from time to time		
We take no other charges		
Illustration of the Charges		
To help you understand the combined effect of these charges, we can give an example of their overall impact. If you paid the maximum amounts shown above, and held the investment for **five years** their combined effect would be equivalent to a charge of **2.7%** of the value of your investment each year.		

The ongoing charges and illustration of the charges shown here are on the basis of the figures for last year.

[These charges may vary each year.]

Brief Assessment of Option B

Pros

- Some consumer research evidence suggests a composite measure is easier for investors to grasp than charges presented separately. CESR recommends explicitly testing whether consumer understanding is improved by including a composite measure.

- Where subscription and redemption fees are not being significantly discounted, their impact can be considerable, but this can be difficult for investors to appropriately take into account.

Cons

- Requires some assumptions to be made, in particular in regard to holding periods, as the overall charge will generally vary according to holding period. Consequently, any figures can only be illustrative, and may not accurately apply to a particular investor or transaction.

- Depending on the calculation methodology, it may not take account of all charges the customer is likely to bear (such as performance fees).

- There is potential for the addition of a composite measure to confuse some investors. Consumer testing should clarify whether or not such information is useful for investors.

- As a new disclosure, incremental costs may be higher.

8.26 CESR recommends that the Commission should test both of these presentations of charges with consumers to assess their relative effectiveness in aiding the consumer's understanding of charges, and in particular to establish whether the addition of an illustration of the charges offers an incremental improvement in consumer understanding.

Other Issues

8.27 CESR has also examined a number of other issues. Stakeholders' views are sought in particular in relation to:

- portfolio transaction costs;
- performance fees;
- funds of funds and feeder funds;
- distribution issues; *and*
- options for achieving a more harmonised approach to the calculation and presentation of charges information.

Portfolio transaction costs

8.28 There is a general consensus within CESR that the PTR currently disclosed in an SP should be excluded from the KII, on the grounds that the average consumer is not well equipped to interpret this rate.

8.29 CESR explored views, given the absence of PTR, as to whether portfolio transaction costs should be explicitly disclosed or included in the disclosure of ongoing fund costs.

8.30 While portfolio transaction costs may be relatively easy to account for when examining equity-based funds, transaction costs relating to other asset types may not be transparent. There was no clear consensus in CESR on this area, or on the materiality of portfolio transaction costs to the TER of a fund. Various disclosure options exist, including the use of a narrative warning for funds where transactions costs might be a drag on performance, given that past performance figures themselves will expose the impact of transaction costs.

8.31 CESR seeks further views on this. In particular, where respondents consider that we should not require transaction cost disclosure or inclusion in ongoing charges figures, we are interested in their reasons for thinking so.

Performance fees

8.32 CESR considers that performance fees are important and should be disclosed within the KII. However, since the KII is intended to be a short document which provides key messages in a simple manner, it is unlikely to offer adequate space to fully describe some performance fee structures.

8.33 Given this, stakeholders are invited to comment on how performance fees might be included alongside the other charges disclosures. One option is to include performance fees within KII, both on an ex-post basis within the ongoing fund charge, and through a simple statement of their existence and basis, with a detailed description signposted elsewhere.

Funds of funds

8.34 CESR recommends that for a fund of funds, there should be 'look-through' to include the charges of the underlying funds. This is already in place in the SP, and unless there is any reason to think the current methodology is unsatisfactory, it would be sensible to use it as a basis for the KII, adapted as appropriate to the final decisions on charges calculation and presentation.

Feeder funds

8.35 CESR suggests that in the case of Option B, the summary measure of charges should combine the charges of the feeder fund and its master. This is preferred for reasons of simplicity, and because it is in line with the proposed disclosures in the feeder fund's report and accounts, but CESR notes that the resulting disclosure may lack clarity about the relative costs of the feeder and the master. Stakeholders are invited to comment on whether separate summary charges for the feeder and the master would be preferable in the KII.

Distribution issues

8.36 We have already outlined a number of issues raised by the variety of arrangements which exist for the distribution and sale of UCITS. It has been argued within CESR and by stakeholders that this can mean that the charges disclosed on a generic document (which cannot take account of different distribution arrangements) might be significantly different to those which the customer actually pays.

8.37 To enable a generic document to apply across a wide range of potential distribution arrangements while keeping the document simple and concise, CESR proposes that all charges in the KII are included on the basis that the maximum level is shown, with a clear indication that these are maximum figures and lower figures may apply.

8.38 However, CESR is keen to receive feedback from stakeholders on whether there are any ways in which more precise information might be provided.

8.39 For instance, options might include stripping out all distribution costs from the KII (though this may be difficult to achieve in a consistent manner which is easy for investors to interpret across Member States), or allowing the flexibility for channel-specific KII disclosures.

Harmonised approach

8.40 There has been consensus in CESR that it should recommend developing a harmonised approach to the calculation of charges information, to enable effective comparisons between charges information. CESR would like emphasise that, in developing detailed proposals, care will be needed to ensure there is an appropriate level of technical rigour. There may also be significant work ahead in identifying areas where reporting and other standards vary so as to make consistency in disclosures more difficult to achieve.

8.41 A harmonised approach to calculation could include achieving consensus around the methods for including different expenses and charges within the different presentational options, including consistent calculation methods for ongoing fund charges, whether on an ex-ante or ex-post basis.

8.42 Detailed requirements may also imply the need for an ongoing programme of technical work to ensure their continued relevance and effectiveness. This may require arrangements in due course for appropriate Level 3 engagement between supervisory authorities.

Questions for the CESR Consultation

38. Has CESR identified the best overall options for including information about charges in the KII?

39. Should a 'consolidated' charges disclosure be included, and how should it be described?

40. Should options for the disclosure of charges in cash terms be explored further?

41. Do you have any comments on how charges should be organised (e.g. between charges relating to subscribing and redeeming units, ongoing fund charges, and contingent charges), labelled (e.g. 'initial charges,' 'exit charges,' 'ongoing charges') and the accompanying narrative messages regarding what they include or exclude? How much detail is necessary in a document like the KII?

42. In relation to the handling of ex-post and ex-ante figures, is it appropriate to include only a single figure for ongoing fund charges in the KII, and if so, on what basis? Do stakeholders have any particular views as to the handling of such information?

43. How should situations where there is a material change in charging levels be addressed?

44. Should portfolio transaction charges be included or excluded from the disclosure of ongoing fund charges? If they should be included, how should assets for which transaction charges are not readily available be handled?

45. Has CESR identified the best option for handling performance fees in the KII?

46. Do you agree that CESR should recommend that charges are disclosed on a maximum basis?

47. Are there any options for providing more accurate information, in a way which consumers might understand, about charges under different distribution arrangements?

48. Do you agree that CESR should recommend that charges for a feeder fund and its master be combined into a single disclosure in the KII?

PART III: BENEFITS AND COSTS OF KII PROPOSAL

CHAPTER 9: TESTING THE BENEFITS, AND ASSESSING THE COSTS OF KII

9.1 This chapter considers what should be done to consumer-test KII and to assess the cost/benefit implications of replacing the SP. This analysis will be an essential input into the Commission's decisions on KII.

Consumer testing of KII

9.2 In its request for assistance, the Commission indicated that it planned to test proposals for the KII with consumers.

9.3 CESR strongly welcomes this commitment, and considers such testing to be vital in further developing proposals for the KII which effectively provide consumers with the information they need in a way they can understand.

9.4 The testing is likely to contribute by:

- helping clarify which of a range of options is most effective – for instance, different proposals for showing information about charges; and

- demonstrating that the overall package of proposals will lead to improving consumer decision-making, when compared to existing requirements (this will aid the development of the *ex ante* assessment of costs and benefits).

9.5 As outlined in our analysis of the underlying regulatory failure and the objectives of the KII proposals in relation to the identified failure, these objectives are unlikely to be met if the KII is not appropriately used by investors within their decision-making processes.

9.6 For this reason, CESR considers that the testing must not only seek to establish consumers' preferences in relation to the proposals, but also objectively seek to establish whether the proposals can be understood by consumers and will be used by them. For example, a stated preference for a particular way of showing information about charges does not mean that that information will be appropriately understood or relied on as part of the decision making process. Further detailed suggestions for testing KII are included in Annex 7.

9.7 By focusing on the extent to which consumers are able appropriately to interpret and use the information provided in the KII, the testing will drive the fine-tuning of the KII and help demonstrate that the final proposals are capable of contributing to better decision-making by investors.

9.8 CESR recognises, however, that this testing will be challenging, not least because of the variety in consumer experience of the UCITS market across different Member States.

Costs of KII

9.9 In its request for assistance, the Commission indicated that achieving its objectives for KII (in particular more standardisation and better comparability) should also reduce the costs for fund managers of producing and publishing investor disclosures.

9.10 It is therefore important that the one-off and on-going costs of replacing the SP with KII are assessed as accurately as possible, to inform the Commission's decision. CESR's proposals have not yet been sufficiently developed to enable costs to be estimated with any precision and this will not be fully possible until the range of options have been narrowed down through the first phase of consumer testing.

9.11 It would be useful, however, to have any general comments at this stage on the likely costs of introducing KII along the lines set out in this paper, as well as any observations on transitional issues.

9.12 Areas to consider include:

- One-off cost of moving from SP to KII
- On-going costs
- Scope for transitional arrangements
- Benefits for consumers and UCITS market
- Further work required to provide full Impact Assessment data

Questions for the CESR Consultation

49. Do respondents have any comments on the proposals for consumer testing?

50. Do respondents have any initial views on the one-off costs of replacing the SP with KII?

51. Do respondents have any initial views on the on-going costs of KII, compared with those currently included in producing the SP?

52. What, if any, transitional arrangements should there be if the SP is replaced with KII?

53. Is the gradual introduction of KII feasible?

ANNEX 1

Questions for the CESR consultation

Chapter 2

1. Are respondents aware of other research which is relevant to the market and regulatory failures associated with the SP?

2. Do respondents consider CESR's proposals would address the regulatory failures associated with the SP?

Chapter 3

3. Do respondents think that CESR has accurately described the context in which KII is likely to be used, and has correctly identified outstanding issues?

Chapter 4

4. Do respondents agree with the proposed purpose and scope of KII?

5. Should non-retail investors be permitted to opt out of receiving KII?

6. Do you think that CESR's proposals on general presentation are appropriate?

7. Should CESR propose adopting a more prescriptive approach, for instance using detailed templates, or should it support a less prescriptive, more principles-based approach?

8. In relation to the proposals on content, should Option A (with fewer items) be favoured compared to option B?

9. How should both options best be tested with consumers?

10. Has CESR correctly struck the balance between reducing the information provided and ensuring investors receive the key messages they need?

11. Should the competent authority of the fund and the tax regime of the fund in its Home Member State be included?

12. Do you think other items of information are necessary? If so, which ones in particular?

13. Do you agree that distribution costs should not be systematically 'unbundled' within KII? Should there be flexibility to allow this where appropriate?

14. Does the proposed approach of local information (a harmonized section for local information within KII, that would be precisely delineated) achieves a correct balance between the need for local information and the smooth functioning of the passport ? Is a more radical approach (i.e signposting local information to a website) feasible and appropriate ?

15. Should a 'building block' approach be permitted, whereby providers can produce different parts of the KII separately?

16. Do respondents agree with the proposed treatment of funds of funds?

17. Should separate KII be produced for each sub-fund of an umbrella? Should providers be permitted to produce a compendium for all the sub-funds of an umbrella if they wish?

18. Do respondents agree with the proposals for treatment of unit / share classes? In particular, should providers be permitted to produce KII featuring a representative class?

Chapter 5

19. Do you think that CESR's proposals on the presentation of the strategy and objectives of a fund is appropriate?

20. In particular, is it relevant to merge strategy and objectives into one generic item?

21. Is the streamlining of the current applicable Recommendation relevant for the purpose of focusing the description on key elements? Do you agree with the addition of new key items to mention within that section: guarantee, period of holding inappropriate if any, design also for retail non-sophisticated investors?

22. More specifically, do you agree that it should be required that in case the capital is not legally guaranteed, the term 'guaranty' should not be used in the KII, and it should be shortly mentioned to investors how the protection is achieved ? In case the capital is legally guaranteed do you agree the guarantor should be mentioned? do you agree that it is not necessary to mention explicitly that a fund is not capital guaranteed?

23. Do you agree that mentioning whether it would not be appropriate for the investor to invest into the UCITS, if he anticipates the need to redeem within a defined time period to be stated, is the appropriate way to deal with time horizon issues without leading to misunderstandings ?

24. Do you agree that giving management companies the opportunity to flag funds that have not been designed for non-sophisticated investors, with no legal consequences, would help in preventing missellings, especially in the case of 'execution only' subscriptions?

Chapter 6

25. Do you agree that the presentation of a synthetic indicator should be favourably tested with stakeholders and consumers?

26. What specific presentation (icon, wording, numeric scale…) should be favoured, and if so on what basis?

27. How prescriptive should regulators be for the choice of a methodology, given that it should take into account largely shared risk management practices and suit investors' perception of risks?

28. Are you aware of any specific existing calculation methodology that should be proposed?

29. Is the suggested assessment grid Annex 4 for methodological and presentation issues appropriate and sufficient for identifying a relevant methodology?

30. How could the potential limitations of the quantitative calculation of a synthetic risk/reward indicator be further mitigated?

31. Do you agree that the possible limitations to a risk reward might be effectively communicated to consumers through textual warnings? Is the proposed wording appropriate?

32. Which funds or which risks might not be adequately captured by a quantitative methodology?

33. Could the display of scenarios or tables illustrating the behaviour of formula funds enhance the information disclosed for those funds? Do you think that such presentations should be limited to formula funds? Do you think that such presentations might have some misleading effects, might be manipulated, or mistaken for a guarantee? How could these be addressed and reduced? Do you think that such disclosure should be made in a harmonised way? What could be possible ways of showing prospective scenarios?

34. On the narrative side, do you agree with the suggested high-level principles?

Chapter 7

35. Is CESR correct to recommend that information about past performance be included in the KII?

36. Has CESR identified the right areas and ways in which this information should be standardised?

37. Which charges should performance figures take into account? For instance, should figures include allowance for subscription and redemption fees?

Chapter 8

38. Has CESR identified the best overall options for including information about charges in the KII?

39. Should a 'consolidated' charges disclosure be included, and how should it be described?

40. Should options for the disclosure of charges in cash terms be explored further?

41. Do you have any comments on how charges should be organised (e.g. between charges relating to subscribing and redeeming units, ongoing fund charges, and contingent charges), labelled (e.g. 'initial charges,' 'exit charges,' 'ongoing charges') and the accompanying narrative messages regarding what they include or exclude? How much detail is necessary in a document like the KII?

42. In relation to the handling of ex-post and ex-ante figures, is it appropriate to include only a single figure for ongoing fund charges in the KII, and if so, on what basis? Do stakeholders have any particular views as to the handling of such information?

43. How should situations where there is a material change in charging levels be addressed?

44. Should portfolio transaction charges be included or excluded from the disclosure of ongoing fund charges? If they should be included, how should assets for which transaction charges are not readily available be handled?

45. Has CESR identified the best option for handling performance fees in the KII?

46. Do you agree that CESR should recommend that charges are disclosed on a maximum basis?

47. Are there any options for providing more accurate information, in a way which consumers might understand, about charges under different distribution arrangements?

48. Do you agree that CESR should recommend that charges for a feeder fund and its master be combined into a single disclosure in the KII?

Chapter 9

49. Do respondents have any comments on the proposals for consumer testing?

50. Do respondents have any initial views on the one-off costs of replacing the SP with KII?

51. Do respondents have any initial views on the on-going costs of KII, compared with those currently included in producing the SP?

52. What, if any, transitional arrangements should there be if the SP is replaced with KII?

53. Is the gradual introduction of KII feasible?

ANNEX 2

Commission Recommendation of 27 April 2004 on contents of the simplified prospectus

1.4. Interpretation of «a brief assessment of the fund's risk profile»
In the second indent, Member States are recommended to interpret «a brief assessment of the fund's risk profile» as meaning the following information:
1.4.1. Overall structure of the information provided;
(a) a statement to the effect that the value of investments may fall as well as rise and that investors may get back less than they put in;
(b) a statement that details of all the risks actually mentioned in the simplified prospectus may be found in the full prospectus;
(c) a textual description of any risk investors have to face in relation to their investment, but only where such risk is relevant and material, based on risk impact and probability.
1.4.2. Precisions regarding the textual description of risks
1.4.2.1. Specific risks
The description referred to in point 1.4.1.(c) should include a brief and understandable explanation of any specific risk arising from particular investment policies or strategies or associated with specific markets or assets relevant to the UCITS such as:
(a) the risk that the entire market of an asset class will decline thus affecting the prices and values of the assets (market risk);
(b) the risk that an issuer or a counterparty will default (credit risk);
(c) only where strictly relevant, the risk that a settlement in a transfer system does not take place as expected because a counterparty does not pay or deliver on time or as expected (settlement risk);
(d) the risk that a position can not be liquidated in a timely manner at a reasonable price (liquidity risk);
(e) the risk that the investment's value will be affected by changes in exchange rates (exchange or currency risk);
(f) only where strictly relevant, the risk of loss of assets held in custody that could result from the insolvency, negligence or fraudulent action of the custodian or of a subcustodian (custody risk);
(g) risks related to a concentration of assets or markets.
1.4.2.2. Horizontal risk factors
The description referred to in point 1.4.1. (c) should also mention, where relevant and material, the following factors that may affect the product:
(a) performance risk, including the variability of risk levels depending on individual fund selections, and the existence, absence of, or restrictions on any guarantees given by third parties;
(b) risks to capital, including potential risk of erosion resulting from withdrawals/cancellations of units and distributions in excess of investment returns;
(c) exposure to the performance of the provider/third-party guarantor, where investment in the product involves direct investment in the provider, rather than assets held by the provider;
(d) inflexibility, both within the product (including early surrender risk) and constraints on switching to other providers;
(e) inflation risk;
(f) lack of certainty that environmental factors, such as a tax regime, will persist.
1.4.2.3. Possible prioritisation of information disclosure
In order to avoid conveying a misleading image of the relevant risks, Member States are also recommended to consider requiring the presentation of the information items to prioritise, based on scale and materiality, the risks so as to better highlight the individual risk profile of the UCITS.
1.4.3. Additional disclosure of a synthetic risk indicator
Where the UCITS has been set up at least one year before, home Member States are also invited to consider as a possible option requiring that the description referred to in point 1.4.1.(c) be supplemented by a synthetic indicator of risk in just one figure or word, based on the volatility of the UCITS' portfolio, in which case:
(a) the volatility of the UCITS' portfolio should be intended as measuring the dispersion of the UCITS' return;
(b) the UCITS' return should be calculated taking into account all the UCITS' net asset values (NAVs) of the period, e.g. daily NAVs where this is the normal frequency of NAV calculation as

approved by the UCITS competent authorities, computed by assessing the UCITS assets on that same frequency.

ANNEX 3

Extract from the Commission's letter to CESR

The Commission's letter gives a few hints in order to achieve the goal of selection of the most relevant information:

'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).'*

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ANNEX 4

Analysis of existing interaction between UCITS and other directive disclosure requirements

UCITS – Current situation							
		Within wrapper					
	Single UCITS	In mandates	In fund of fund	In master-feeder fund	In other wrapper changing risk profile	In other wrapper preserving risk profile	
Within life insurance							
Outside life insurance							
Product disclosure	Simplified Prospectus	Not relevant	Not detailed info on underlying funds	national provisions on master feeders	Prospectus Directive	Prospectus Directive	Life Insurance Directive + national provisions
Wrapper disclosure	Not relevant	Not relevant	Simplified Prospectus if fund of fund is also UCITS	national provisions on master feeders	Prospectus Directive	Prospectus Directive	Life Insurance Directive + national provisions
Distributor disclosure *NO*	national provisions related to non-MiFiD distributors	Not relevant : mandate only possible within MiFiD	national provisions related to non-MiFiD distributors	national provisions related to non-MiFiD distributors	national provisions related to non-MiFiD distributors	national provisions related to non-MiFiD distributors	**Insurance Mediation Directive** + national provisions
Is distributor a MiFiD regulated entity? *YES*	**MiFiD** disclosure rules related to the **distributor**	**MiFiD** disclosure rules related to the provider and the content of the service of portfolio management	**MiFiD** disclosure rules related to the **distributor, AND to the fund of fund** (if it is not a UCITS)	**MiFiD** disclosure rules related to the **distributor AND to the product**	**MiFiD** disclosure rules related to the **distributor AND to the product**	**MiFiD** disclosure rules related to the **distributor AND to the product**	Not relevant
Use of distance marketing	Additional disclosure requirements on the **contract** required by **Distance Marketing Directive** (mostly addressed either by MiFiD or by UCITS when these are also applicable)						Additional disclosure requirements on the **contract** required by **DMD**
Web-based subscription	Additional disclosure requirements on the **contract** required by **E-commerce Directive**						Additional disclosure requirements of **E-commerce Directive**

ANNEX 5

KII Risk ratings

Criteria

Aim

- Provide an objective indication of a particular fund's potential risk and preferably also the reward trade-off, which can be consistently applied to different funds across different jurisdictions, and which can be shown to better inform consumers than a purely narrative approach.

General criteria

- The presentation should be geared to the perception of risk of investors

- Consumer testing must be able to demonstrate that the presentation is appropriately understood by investors

- Should be applicable to most/all funds

- Calculation methodology must be robust (not easy to manipulate by firms seeking a particular rating for their products)

- Should be easy to implement by the industry

- No liability for the regulated (e.g. in case of rare risk)

- Should not be misleading for investors, for instance by being misinterpreted as a guarantee

- Supported by consumer testing (i.e. clearly show an improvement in understanding)

- Easy to supervise

Presentation

- A synthetic indicator that can be presented in a simple manner.

    - Complicated information (e.g. explicit disclosure of probabilities, or a 'matrix' approach which shows different types of risks separately) unlikely to be practical due to space constraints on what can be included and dangers of misleading investors.

    - Should seek to limit perception of spurious accuracy, and clearly communicate its status as a guide to risk rather than a guarantee of future performance characteristics,

    - While other information about risk is likely to be available for the investor -- e.g. fund sheets from rating agencies, other advertising material, the full prospectus, information from regulators and other third parties – the risk rating must be able to provide as sufficient as possible information in relation to the particular risks of the fund.

    - There should be one single scale for all funds if possible. (Separate, parallel scales may be necessary for the ranking of guaranteed and other non-linear funds, but where this is the case this should be clearly disclosed to the investor and tested to show that there is no confusion.)

- Significant limitations of the rating must be clearly disclosed to investors, including the range of funds covered and why excluded funds are excluded.
    - For funds whose risk profile may not be adequately captured by the methodology, there would be a greater probability of discrepancy between a fund's ranking and the actual behaviour of the fund, so we may need to develop clear criteria for excluding some funds. The presentation of excluded funds should not distort the perceptions of investors, for instance by implying these are more (or less) risky than rated funds.
    - Since a simple presentation will not allow all risks to be taken into account it is important it does not give the appearance of doing so (for instance, a performance risk indicator rooted in volatility data may not address liquidity risk for funds investing in illiquid assets, inflation risks for funds investing in bonds, currency risk).
    - Given the limitations of a simple presentation, additional messages may be needed in the KII, but the overall risk presentation must remain focused and simple to understand. Criteria in regards additional messages must be clear and capable of being applied consistently.
- Presentation must be capable of clear and simple explanation. (What is it? Are there guarantees or not?).
- Under any circumstances where more than one potential methodology might co-exist at the European level, should such options be developed, any common presentational approach must not, by virtue of its harmonisation, confuse or mislead investors in regards the differences between the underlying methodologies. (For instance, it must be clear that different underlying methodologies might apply, and that the rating shown may only be compared directly with ratings produced according to the same methodology).

Technical features

- It should be objective.
    - It must be able to be applied consistently across different MS, with a clear methodological basis [calculations which can be independently verified?] and data sources which are consistent.
    - Any assumptions required (for instance, regarding the statistical properties of distributions) must be clearly justifiable, and should in general be reflective of the reality of the actual behaviour of the fund. (Funds for which there would be reasonable assessment that such assumptions would not be adequate would be excluded from the rating.).
    - Ideally, it should convey a sense of the link between risk and reward (taking into account both tails of the distribution of results). If this turns out to be impossible, the accompanying wording should make this link clear in order to avoid the off-putting effect of an indicator that would be only calculated taking into account worst cases. The link can also be made clear by looking at the KII as a whole.
- The behaviour of funds given the same rating must be consistent. The rating of a fund must be stable (given certain tolerances) under a wide range of foreseeable systemic conditions.
    - The time period used should be such that the information is not misleading given typical holding periods for the fund.
- It should be sufficiently sensitive to extreme (but not improbable) events, and, in line with a focus on the perceptions of investors, should adequately capture downside risk.

- The allocation of funds to categories should be relatively stable over time, and the distribution of funds across the scale should be appropriate for the UCITS universe. In particular, the scale should allow clear discrimination by customers between funds with obviously different risk levels (e.g. equity funds from emerging markets should not be classified in the same category as blue chips equity funds).

    - There should be a clear, consistent and practical solution for addressing material changes in a fund (e.g. changes in underlying asset backing) which impact the rating.
    - The range of funds included or excluded (e.g. new funds or possibly formula/structured funds) must be clearly defined and the boundaries capable of consistent application.

ANNEX 6

Miscellaneous technical issues with charges options for KII

Methodologies for combining one-off and ongoing charges into a single disclosure

CESR has not yet considered the details of a methodology for producing a consolidated disclosure, as discussed under Option B, and makes no recommendations in this area, although a brief high-level exploration has been undertaken of some of the pros and cons of different approaches.

The key methodological difficulty faced by a consolidated charges measure is that it depends on making assumptions. This is necessary so that the combined impact of different elements of a charging structure can be shown, since the impact of these elements can vary depending on the period over which the investment is held or the performance of the investment. Very broadly, the most significant factor is that the longer the assumed holding period, the lower the impact one-off charges will have on the overall charges measure.

A number of possible approaches can be identified. These include:

- assuming a specimen investment and growth rate, and showing the effect charges might have in monetary terms for various holding periods (an approach which is currently common for many insurance-based investment contracts);

- assuming a specimen investment, growth rate, and holding period, and showing the effect charges might have on the yield (an approach which has been used in some jurisdictions to provide a single figure for comparing the impact of charges for contracts with very different charging structures, such as substitutable life-based and non-life based contracts);

- assuming a holding period or periods, but not assuming a growth rate, and simply 'amortising' one-off charges to combine them with ongoing charges.

All of these approaches require assumptions to be made regarding the holding period, while some also requires an assumption regarding the growth rate.

- Approaches which include growth rate assumptions can effectively take account of the timing of charges by accounting for the time value of money.

- However, approaches which depend on growth rate assumptions are potentially harder to explain, more complicated and, where the presentation shows prospective monetary charge amounts for the fund as well as charges, they can appear to forecast future performance.

- Despite the technical robustness of approaches which assume a growth rate, applying an approach which simply amortises initial charges over a defined holding period produces materially very similar results for products such as UCITS.

An example of a simple approach to a consolidated charges disclosure brought to CESR's attention is that fostered by the Danish competition authorities, which does not require a growth assumption. The Danish measure has the following key features:

- it is calculated ex-post;
- it includes all ongoing costs reported in the annual accounts for Danish UCITS;
- it includes initial and other transaction costs borne directly by the investor, by simply amortising them over a seven year period; and
- it does not appear to be channel specific.

ANNEX 7

Detailed suggestions for testing KII

This section summarises the areas where CESR recommends that consumer testing be used to further clarify options, with some initial suggestions as to particular elements which might be focused on.

Area	Options to be tested	Particular Criteria
Items to be included-overall presentation	• A -- shorter list of items • B -- enhanced list with further items • Both options : 2 pages so long as possible (comply or explain) and characters of readable size	• Start from option A for testing. Do consumers really need all items within that option? Does the addition of items under B help consumers? • Are consumers satisfied with a shorter document or do they feel they may be loosing some information they need, compared to the baseline of existing prospectuses?
Strategy and objectives	• A -- detailed requirements based on the simplification of the current recommendation, adding features on guarantee and inappropriate holding period	• Are the detailed guidelines (option A) helping consumers in understanding the strategy and objectives compared to high-level principles? • Do consumers agree that it is not necessary to flag that a product is not guaranteed and that it has no benchmark? • Do consumers find it useful to know that some products were not designed for retail, non-sophisticated investors?
Risks	• A -- presentation based on high-level principles • B -- use of a synthetic indicator with some narrative	• Do consumers find added value in a synthetic indicator and in the proposed explanatory text? • Do they understand the possible limitations of the indicator, or do they develop overconfidence and misunderstandings? Is the proposed wording helpful for that purpose? (Note: this might best be tested once a specific methodology is retained) • Do consumer favour some presentation techniques (numeric scale, words, icons)? Do some techniques help in avoiding

		misunderstandings, excessive focus, or overconfidence? • Does the addition of scenarios or probability tables enhance the understanding of the risk profile in the case of formula funds? Do these techniques lead to possible misinterpretations? • Are consumers confused in case the wording points out that not all risks are taken into account? • Are consumers confused if different funds use different methodologies and presentations?
Charges	• A -- Improved version of current disclosures	• Does the option aid consumers in comparing between products (e.g. between options A, B and the existing baseline)? • What is the best layout for showing the charges information? Should a standardised layout be adopted? How much detail should be included? • Do consumers understand details in relation to performance fees?
	• B -- Addition to option A of a summary charges measure	• Does the addition of the information aid in making comparisons? • Are consumers confused by what the additional information is showing them?
	• Potential for a variation to option B including monetary presentation	• Do consumers find a presentation in monetary terms easier to use than a presentation in terms of percentages? • Are consumers confused by what this information is showing them?
Past Performance	• A single option, but with some minor variants to elements as described below.	• To what extent does the overall presentation and surrounding warnings aid consumers in understanding what the information is showing them, compared with the MiFID standard?

	• The minor variants are: o showing either five or ten years data; o placing the information in different places on a two-sided KII (front page or back page); o using a bar chart presentation or a table of figures in percentage terms.	• When shown longer periods, do consumers better grasp or understand volatility and performance characteristics? • Does the position of the past performance information on the KII effect the extent to which consumers rely on it? • Does a bar chart presentation aid or hinder consumer understanding?
Whole package	o Options to test will need to be established during earlier phases of testing.	• Do the overall proposals for the KII improve understanding when compared with a baseline of the current regime?

ANNEX 8

KII Mock-up

This mock-up is designed to give an indication of the sort of document the KII might be.

CESR

Radical mock up

Key Investor Information

This document provides you with key information about this fund, which you should read before deciding whether to invest.

Name of Fund	rpq Equity Fund
Management Company	DEF Mutual Funds, GHI Group

Strategy and Objectives

The investment strategy aims at selecting securities which offer the best growth potential without regard to allocation by geographical zone, sector or size. The portfolio is mainly invested in equities quoted on emerging countries' stock exchanges. At least 60% of the assets are permanently exposed to equities. The objective of the fund is to outperform its performance indicator while trying to ensure more steady performance than this indicator, the Morgan Stanley Capital Invesment Emerging Markets Free.

Upto 40 % of assets may be invested in fixed income products for the purposes of risk diversification in the event of negative movements on the equity markets.
It is aimed at all types of investors, including retail investors who are willing and able to take the specific risk of emerging markets -- ask your adviser to check if it is suitable for your needs.

Risk and Reward Profile

1	2	3	4	5

What does it mean ?

A **Class 5** fund has **no capital guarantee**, with the highest potential level of gain or loss, and with the possibility for the amplification of trends due to the impact of financial techniques such as leverage.

Class 1 funds have capital guarantees and are mostly invested in assets whose value does not rise or fall rapidly or by much.

Why is this fund in this category?

This fund is likely to use leverage and mainly invests in shares in emerging markets that are more likely to experience sharp rises and falls in value.

Are there any other particular risks?

Investments in other countries can be effected by exchange rate risks, particularly with some emerging markets where the currencies may be subject to periods of weakness.

How long should I stay invested ?

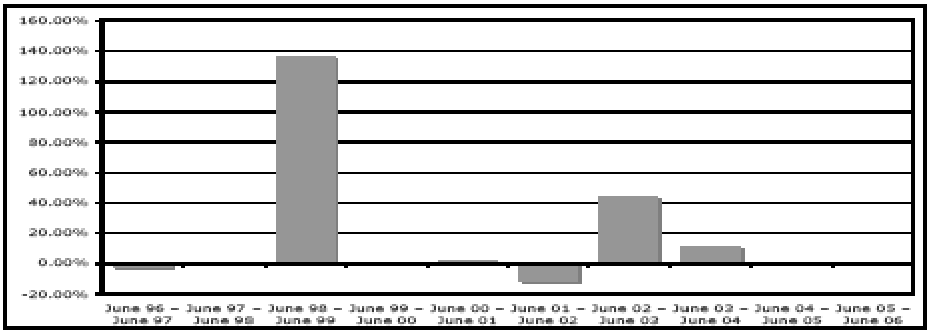
The minimum recommended investment period for this fund is **5 years**. For funds invested in shares, a longer holding period generally increases the probability of a positive return, but does not guarantee it. This minimum holding period is only a suggestion, and there is no guarantee that this would be the most suitable length of time to hold the investment.

This rating indicates how this fund might perform and whether your capital is at risk. For more detail about risks, please see [reference to full prospectus / website].

Past performance

Please be aware that performance in the past is not a reliable indicator of future results.

Percentage growth for Fund



These figures show by how much the fund increased or decreased in size during the year being shown.

Charges for this Fund

We make deductions from your investment to cover the costs of running the fund including the costs of marketing and selling. These reduce the returns you might make.

The Charges in Detail

One-off charges which you pay directly		
Initial Charge	4.00%	of your investment, at most, before we invest it
Exit Charge	n/a	
Charges taken from the fund each year		
Ongoing charges	1.90%	of your investment every year
Contingent charges		
Performance fee A fee of 20% is charged where the fund does better than its index, MSCI Emerging Markets Free. This fee is taken from the amount by which the performance of the fund exceeds that of the index.		

The ongoing charges shown are on the basis of the expenses for last year, but take into account the charges we expect to be making in the future.

Example

We have combined the charges in the table on the left into a single figure to provide an example of the overall effect these charges could have, based on the figures for last year

It shows the equivalent charge you might pay each year if you held the investment for the number of years shown, and can be used to compare this fund with others.

Yearly cost of your investment	
If you held the investment for 1 year	**5.8%**
If you held the investment for 5 years	**2.7% each year**
If you held the investment for 10 years	**2.3% each year**

Additional Information

Will this fund pay me any income?

- This fund does not distribute income, but instead reinvests it to grow your capital, in line with its stated objectives.

How do I invest in this fund?

- You can invest by submitting an order by fax, telex or post, either to the fund or an authorised distributor.
- [Distributor details may be inserted here].

How can I find out how much my investment is worth?

- You can find out the value of your investment from the Administration Agent [contact details inserted here], or by consulting websites such as Reuters or national newspapers which contain information about fund prices.

How can I find out more information about the fund?

- You can obtain copies of the full prospectus, annual and half-yearly financial reports at any time, free of charge. To do so contact us on xxx or online at http://www.investorswebsite.xx/reports
- You can obtain further information about this fund by calling us on xxxx or online at http://www.investorswebsite.xx/

Dates of publication

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Date of preparation and publication of this KII: 5th July 2007

[Limitation of liability statement.]

[NOTE: the inclusion of competent authority / nationality of fund details here is subject to discussion.]