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Summary of key points for retail investors arising from CESR consultation on key investor information disclosures for UCITS

Introduction

1. CESR published a consultation paper (CP) on 16 October 2007 setting out its proposals on key investor information (KII) disclosures for UCITS funds¹. The background to the work on KII, which would replace the current Simplified Prospectus², is set out in detail in that document. This summary is designed to highlight the main points of interest in the CP from the perspective of retail investors, with a view to encouraging such stakeholders to respond to the consultation ahead of the deadline of 17 December. Selected questions from the CP are included at the end of the relevant sections below.
2. The aim of the consultation is to help CESR decide on the content of the advice on KII that it will provide to the Commission in early 2008. The Commission will then carry out testing of different options for KII with retail investors and other market participants. Retail investors are encouraged to use this summary paper as an aid to understanding the CP, but should note that it is not a comprehensive alternative to that document.

Key topics

Format and general presentation of KII

3. CESR recommends that the KII 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.³ There should be a standardised list of permitted contents appearing in a fixed order. Some options, for elements such as risks and charges disclosure, would require greater prescription than others.
4. Although CESR's recommendations for the final order of the elements have not been finalised, the following is suggested for page 1:
 - names of the fund, manager, and promoter/group;

¹ Ref: CESR/07-669, available on the CESR website (www.cesr.eu) under 'Consultations'.

² For more information on the Simplified Prospectus, see Chapter 2 of the CP.

³ Annex 8 of the CP contains a 'mock-up' designed to give an idea of what the final document might look like; please note that this example is for indicative purposes only.



- 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;

Page 2 would contain other elements including practical information (e.g. where /how to buy and sell units) and where to obtain further information.

5. 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 (such as marketing material). 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.

Key questions on general format and content of KII (Chapter 4 of CP)

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?

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

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

Investment objectives and strategy

6. Information about the fund’s investment objectives and its strategy for achieving them should be presented together. 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.

Key questions on investment objectives and strategy (Chapter 5 of CP)

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

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?

Risk-reward disclosure

7. CESR recommends testing two high-level approaches to risk-reward disclosure – one which is based on a purely narrative description of risks (a qualitative assessment), and one which uses a synthetic risk-reward indicator (SRI) to evaluate the level of risk that investment in the fund would represent (a quantitative assessment). An SRI might, for example, consist of a numeric scale (e.g. from 1 to 5), although this should be tested with consumers against other possibilities (words such as ‘high risk’ or ‘low risk’, or graphics / icons).
8. 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.
9. An SRI 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 of performance, may not hold true in adverse market conditions). Such text could also indicate in broad terms the connection between risk and reward. Alternatively, if the SRI cannot be adapted to a particular fund, the KII should explain this.
10. The CP does not identify a preferred methodology for calculating an SRI.

Key questions on risk-reward disclosure (Chapter 6 of CP)

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

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

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?

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

Past performance

11. 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 for up to 10 years if available (and not less than 1 year);
- 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.

Key questions on past performance (Chapter 7 of CP)

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?

Charges

12. 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.
13. It is envisaged that the charging structure would 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).

The summary figure would combine all of these elements.

14. CESR supports the use of percentages as a presentational option, but views of stakeholders are sought on whether amounts should be shown in cash terms instead. The figures should be accompanied by messages making clear what is and is not included in each of the charges.
15. 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 are 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.

Key questions on charges (Chapter 8 of CP)

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?
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?

Public consultation

16. CESR would welcome retail investors' views on the proposals set out in the KII CP and would be happy to receive such responses in any official EU language. The deadline for responses, which should be submitted via the CESR website (www.cesr.eu), is 17 December 2007.