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**CESR's technical advice to
the European Commission on
the level 2 measures related
to the format and content of
Key Information Document
disclosures for UCITS**



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Introduction and Executive Summary

Background

1. In March 2007, the European Commission set out its proposals for a series of targeted enhancements to the UCITS Directive. One of these proposals was to replace the Simplified Prospectus (SP) for UCITS with Key Investor Information (KII) disclosures. The KII is intended to be a concise and focused presentation of the information that it is important for a prospective investor in a UCITS fund to have, covering largely the same general areas as the SP.
2. The SP, the concept of which was introduced by the UCITS Management Directive (2001/107/EC) in 2002, is widely seen as having failed to achieve its objectives. In particular, there is considered to be 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 Member States; and they do not assist comparisons between funds, particularly when cross-border sales are involved.
3. The recast UCITS Directive was formally adopted by the Council on 22 June 2009. Articles 78 to 82 of that version contain the provisions on KII. In particular, Article 78(2) states:

Key investor information shall include appropriate product information about the essential characteristics of the UCITS concerned, which is to be provided to investors so that they are reasonably able to understand the nature and the risks of the investment product that is being offered to them and, consequently, to take investment decisions on an informed basis.

4. The level 1 provisions will be supplemented by implementing measures at level 2, the precise scope of which is set out in Article 78(7). The implementing measures are to cover the detailed and exhaustive content of the KII to be provided to investors and the specific details of the form and presentation of that information. The Commission first sought CESR's technical advice on the aforementioned implementing measures via a request for assistance in April 2007; this was followed by a further request for assistance received in February 2009 (see paragraph 13 below).

CESR's work on the KID

5. Since the Commission requested CESR's assistance on developing KII disclosures in April 2007, CESR has been working intensively to prepare its response, in parallel with the finalisation of the revised Directive. A sub-group of CESR's Expert Group on Investment Management (IMEG), which is chaired by Mr Lamberto Cardia, Chairman of the Italian securities regulator, the Commissione Nazionale per le Società e la Borsa (CONSOB), was formed to consider the detail of KII and to develop a recommendation on CESR's response. This sub-group is jointly chaired by the UK FSA and the French AMF and includes representatives of eight other Member States.
6. The first output of CESR's work was a set of advice that was submitted to the Commission in February 2008 (Ref. CESR/08-087). CESR received a significant amount of feedback to the consultation from external stakeholders, including retail investors'

representatives. The Commission used CESR's advice as the basis for the investor testing exercise it carried out from March 2008 to May 2009. CESR was closely involved in both the design and roll-out of the testing process, as well as the analysis and interpretation of results.

Consumer testing

7. As noted above, the Commission used the advice submitted by CESR in February 2008 as the basis for the testing exercise it subsequently carried out. Seven Member States were covered by the testing: Ireland, Spain, Germany, Sweden, Italy, Hungary and Poland. The testing was split into two phases: in the first phase, investors were asked to compare individual sections of the KID (e.g. the past performance or charges sections) and answer a series of questions; in the second phase, investors saw two different versions of a full 'mock-up' of the KID. The testing also covered a selection of intermediaries in each country with a view to getting reaction from advisers who would be using the new document with real-life investors.
8. The testing was a very valuable exercise to which CESR has paid careful attention when developing its final advice. References to specific findings are included in the relevant sections of this paper. The full report of the contractor that carried out the testing on behalf of the Commission is available on the Commission's website.¹
9. CESR notes that the testing exercise brought to light the difficulties many retail investors have when interpreting financial disclosures, even when that information is presented in a relatively clear and accessible way. On that basis, it is important to bear in mind other elements that are needed to allow investors to make informed investment decisions, including good-quality advice (in the case of an intermediated sale) and improved levels of financial literacy. CESR is of the view that the KID represents a considerable enhancement of disclosures for UCITS but recognises the fact that it will not, on its own, solve the problem of informed decision-making by retail investors.

Technical work

10. In the February 2008 advice, CESR identified a number of technical issues arising from its work that merited further consideration. The issues identified fell under three of the broad disclosure headings which make up the KID: i) risk and reward; ii) past performance and iii) charges. The work was to cover a wide spectrum of issues, ranging from development of a harmonised calculation methodology for an SRRI to treatment of past performance information for years in which the fund did not exist.
11. CESR established three separate technical working groups to analyse these issues in more detail. A selection of external stakeholders agreed to join the groups in order to provide additional expertise and a broader perspective. As with the work on the advice delivered in February 2008, the drafting groups prepared a set of recommendations for CESR's Expert Group on Investment Management.
12. In light of the recommendations prepared by the groups, CESR published a consultation paper (Ref. CESR/ 09-047) in March 2009 in which views were sought on these technical issues. CESR received 41 responses to the consultation². The views expressed were taken into account in the preparation of the final advice and are referred to in the relevant sections of this document.

¹ http://ec.europa.eu/internal_market/investment/investor_information_en.htm

² The responses are available here: <http://www.cesr.eu/index.php?page=responses&id=134>

13. Taking into account the results of the consumer testing exercise and the responses to the technical consultation, CESR prepared its draft final advice and published it for consultation on 8 July 2009 (Ref. CESR/09-552). CESR received 50 responses from a range of external stakeholders, including retail investors' representatives.

Provisional request for assistance

14. As noted above, CESR's early work on the KID was based on the initial request for assistance received in April 2007, which was itself based on the Commission's initial orientations on amendments to the UCITS Directive of March 2007. Once political agreement was reached between the European Parliament and the Council on a compromise text of the new Directive, the Commission prepared a new provisional request for assistance that reflected the latest draft of the legislation, including the revised provisions on KII. CESR has worked on the basis of the latest legislative position in developing this advice. The provisional request sets a deadline of 30 October 2009 for the submission of CESR's advice on KII.

Areas covered by this Paper

15. Throughout this document, reference is made to the powers and duties of the management company of the UCITS. For UCITS which are investment companies and do not have a designated management company, all such references should be read as applying to the investment company itself.

Format and presentation

16. The introduction of the KID is designed to bring about a step change in the quality of UCITS disclosures compared to the Simplified Prospectus. With a view to facilitating such a change, CESR sets out its advice on the format of the KID, the use of plain language and the length of the document.

Objectives and investment policy

17. CESR's advice proposes that the KID should describe the objectives and investment policy of each UCITS in plain terms, not necessarily repeating the description in its prospectus. CESR also recommends adding a statement that investors may redeem their units on request, since the consumer testing exercise showed that a significant number of investors failed to understand this essential feature of all UCITS.

Risk and reward

18. CESR's advice recommends the adoption of a synthetic risk and reward indicator (SRRI) supported by a narrative explanation of the limitations of the indicator and the material risks relevant to the fund which are not fully captured by the methodology for the synthetic indicator. This option is preferred to a purely narrative approach taking into account a range of factors, in particular improved comparability of funds.
19. CESR recognises it is not possible to recommend the adoption of an SRRI without also agreeing the details of the underlying methodology. CESR first sought views on its proposed methodology via the technical consultation mentioned above; in light of responses received, the methodology was refined for the purposes of the consultation paper published in July. As a number of elements of the methodology had still to be finalised, CESR worked further on certain aspects; this resulted in publication on 4 August of an addendum to the July consultation (Ref. CESR/09-716).
20. CESR received eight responses specifically on the addendum, as well as a number of responses which gave feedback on both the July consultation and the addendum. In

order to carry out a full analysis of the detailed comments received and give due consideration to the points made, CESR will deliver its final advice on the methodology to the Commission by the end of 2009.

Charges

21. CESR considered a range of options for charges disclosures during its work on the KID. CESR advises that the KID contain a table setting out clearly the different elements of the charging structure (in percentage terms). CESR considered accompanying the table by a simple summary measure of charges presented in narrative terms and including a cash figure. However, in light of responses received, CESR has not retained this option in its final advice.
22. Annex 2 of the July consultation included a detailed proposal for the methodology for calculation of the ongoing charges figure. Stakeholders provided a significant amount of detailed feedback on this proposal in their responses. Therefore, in line with the approach that will be taken to the methodology for the synthetic risk and reward indicator, CESR will carry out further work with a view to finalising the methodology for the ongoing charges figure and submitting it to the Commission by the end of 2009.
23. The advice also addresses the handling of new funds, material changes to the charging structure and keeping the charges information in the KID up to date.

Past performance

24. CESR advises that presentation of past performance be based on use of a bar chart displaying up to ten years' performance, where available. In addition, CESR recommends that a KID can only display performance information where at least one calendar year's data is available. There are also specific requirements on how to calculate the past performance information.
25. Other issues covered under this part of the advice include the annual revision of the past performance record (CESR recommends a deadline of 35 calendar days for updating the information), handling of material changes and inclusion of a benchmark.

Practical information

26. In line with the proposals published for consultation in July, CESR's final advice envisages a significant reduction in the amount of information to be included in this section of the KID. This position was reached taking into account the results of the investor testing, which showed that consumers tend not to use this section of the document, while respecting the minimum requirements set out in the Directive.

Circumstances in which the KID should be revised

27. The Directive obliges UCITS management companies to keep the essential elements of the KID up to date. CESR's final advice is aimed at simplifying the requirements and clarifying what should be taken into account in deciding whether and when a revision is needed.

Special cases – how the KID might be adapted for particular fund structures

28. Taking into account the wide range of structures that exist in the UCITS sphere, CESR identified a number of situations in which a bespoke approach to the content of the KID might be necessary. CESR's input in relation to these structures was also explicitly requested in the provisional request for assistance of February 2009, which itself reflects the Directive text. CESR's advice is designed to ensure that investors are provided with an appropriate level of information for all UCITS, regardless of the structure.

29. In this context, CESR considered the content of the KID for structured, capital-protected and other comparable UCITS. The particular challenge of these funds is that the display of past performance information is generally not appropriate, given the limited subscription periods associated with these funds. As an alternative, CESR recommends the inclusion of performance information (in the form of prospective scenarios) in the objectives and investment policy section of the KID. These scenarios are designed to illustrate the potential performance of the fund under a range of market conditions.

Other issues

30. The provisional request for assistance referred to in paragraph 14 also invited CESR to give advice on implementing measures that might be adopted under Articles 75(4) and 81(2) of the revised UCITS Directive. Those articles permit the Commission to define the specific conditions that need to be met when providing key investor information and the prospectus in a durable medium other than paper. CESR's advice in this area takes account of responses to the July consultation and confirms an approach based closely on the equivalent provisions in the Markets in Financial Instruments Directive (MiFID) and the Distance Marketing Directive (DMD). In this section, there is also consideration of topics that could be covered at level 3.

Areas not covered by this advice

Applicability to other products

31. The Commission's original request for assistance of April 2007 noted that the outcome of the work on KII could be seen as a benchmark for disclosures for other investment products. The potential use of the KID as a benchmark was also noted in the Commission's Communication on Packaged Retail Investment Products, published in April 2009, although it was made clear that the content of the KII would need to be adjusted to reflect the particular features and legal forms of other products. Throughout its work on developing the format and content of the KID, CESR has focused its attention on developing appropriate disclosures for UCITS and has not considered the potential impact on other products. CESR will monitor closely the further developments flowing from the Commission's Communication.

Delivery to investors

32. In the February 2008 advice, CESR made reference to the interaction between MiFID and the UCITS Directive in relation to provision of the KID to investors. In particular, it was noted that delivery of the SP to the investor would allow the distributor to satisfy its obligations under MiFID to disclose information on the investment strategy, risks and charges of the UCITS; but that MiFID did not require that information to be disclosed under the specific format of the KID. CESR notes that this potential gap in the requirements has been filled via Article 80 of the recast UCITS Directive, which imposes an obligation on both UCITS management companies and intermediaries to provide the KII to investors in the case of a direct sale.



Form and presentation of Key Investor Information

Section 1: Title of document, order of contents and headings

Extract from the level 1 text

Article 78(1): “Member States shall require that an investment company and, for each of the common funds it manages, a management company draw up a short document containing key information for investors. This document shall be referred to as “key investor information” in this Directive. The words “key investor information” shall be clearly stated in that document, in one of the languages referred to in point (b) of article 94(1).”

Article 78(3): “Key investor information shall provide information on the following essential elements in respect of the UCITS concerned:

(a) identification of the UCITS;

Extract from the Mandate of the Commission

“CESR is invited to advise the Commission on the following questions: To what extent and in what way should level 2 measures harmonise the detailed presentation of key investor information (such as the layout of the document, its length, headings to be used for sections, etc.)?”

Level 2 advice

Box 1

The key investor information for each UCITS shall consist of the sections set out below, and shall present those sections in the following order. No other information or statements shall be included.

1. Title

The title of the document shall be ‘Key Information Document’. This title shall appear prominently at the top of the first page of the document.

2. Explanatory statement

Immediately underneath the title, the following statement shall appear:

‘This document provides you with key investor information about this fund. It is not marketing material. The information is required by law to help you understand the nature and the risks of this fund. You are advised to read it so you can make an informed decision about whether to invest.’

3. Name and identification of UCITS by code number

The full name of the UCITS, including the investment compartment thereof, shall be stated prominently. For an investment compartment, the name of the UCITS shall follow the compartment name, for example ‘123 Fund, a sub-fund / compartment of XYZ Fund SICAV’.



Where a code number identifying the UCITS, investment compartment or share class exists, it shall be included.

4. Name of management company

For a UCITS which has a management company, the name of the management company shall be stated.

If the management company forms part of a group of companies for legal, administrative or marketing purposes, the name of that group shall be stated.

The KID may include corporate branding provided it does not hinder a potential investor from understanding the key elements of the investment or diminish their ability to compare investment products.

5. Objectives and investment policy

A section entitled 'Objectives and investment policy', containing the information set out in section 3 below.

6. Risk and reward profile

A section entitled 'Risk and reward profile', containing the information set out in section 4 below.

7. Charges

A section entitled 'Charges for this fund', containing the information set out in section 5 below.

8. Past performance

Except where indicated in section 13, a section entitled 'Past performance', containing the information set out in section 6 below.

9. Practical information

A section entitled 'Practical information', containing the information set out in section 7 below.

10. Authorisation details

A statement that 'This fund was authorised in [name of Member State] on [date] and is regulated by [identity of competent authority]'. Where the UCITS is managed by a management company exercising rights under Article 16, an additional statement shall be included that '[name of management company] is authorised in [name of Member State] on [date] and regulated by [identity of competent authority]'.



11. Date of publication

A statement that the information contained within the KID is accurate as at [31 December 20xx]

Explanatory text

CESR considers that it is necessary for all KIDs to consist of the same contents and for there to be a common running order and consistent headings, to aid comparability. The order proposed takes account of responses to the consumer testing in which investors indicated which parts of the document they regard as most and least important.

For point 3, CESR's view is that the International Securities Identification Number (ISIN), or some other code or number with a similar purpose, is an additional and helpful identification tool for investors. Any such number or code should be included.

For point 4, the purpose of identifying the group to which the management company belongs is to enable investors to know whether the management company is independent or is linked to other entities with which they may be more familiar. The use of corporate branding is commented on in section 2.

For point 9, the consumer testing exercise tested examples of KIDs in which this section was titled 'Additional information'. The testing revealed that many consumers felt the word 'additional' created the impression that it was not key information and could be ignored. CESR considered various alternatives that were suggested in response to the consultation and decided that 'Practical information' is likely to be the most helpful title for investors.

For point 10, the competent authority may be identified either by its name in the official language (or one of the official languages) of its Home State, or by a translation of that name, or by some other unambiguous designation such as 'the [name of Member State] financial regulator'.



Section 2: Appearance, use of plain language and document length

Extract from the level 1 text

Article 78(5): “Key investor information shall be written in a concise manner and in non-technical language. It shall be drawn up in a common format, allowing for comparison, and shall be presented in a way that is likely to be understood by retail investors”.

Article 78(7): “The Commission shall adopt implementing measures which define the following:

(c) the specific details of the format and presentation of the key investor information to be provided to investors as referred to in paragraph 5.”

Extract from the Mandate of the Commission

“Article 78(5) of the new UCITS Directive imposes additional challenges requiring KII to be written in a brief manner, in non-technical language, drawn up in a common format, allowing for comparison. Information should be presented in a way likely to be understood by retail investors. The aim is to ensure that KII is consistently and effectively produced by different fund managers across different jurisdictions by harmonising the standard or quality of these documents. CESR is therefore encouraged to reflect on possible ways to assist the KII producers in practically observing these rules. The Commission considers this to be a very important aspect in ensuring the effectiveness of the KII proposals.”

Level 2 advice

Box 2

1. A Key Information Document (KID) shall be:
 - (a) Presented and laid out in a way that is easy to read, using characters of readable size for every item.
 - (b) Clearly expressed and written in plain language as far as possible. Plain language can be defined as communicating in a way that facilitates the investor’s understanding. It is clear, succinct and comprehensible and avoids the use of jargon. Technical terms should be avoided when everyday words can be used instead.
 - (c) Focused on the key information the investors need.
2. The KID shall be prepared and published (or made available so as to be reproducible from a durable medium other than paper) on two pages of A4-sized paper (i.e. the front and back of one sheet of paper). Potential investors shall be given the KID in this format.
3. For structured UCITS, for which performance scenarios shall be provided in accordance with Box 22, the KID may be prepared and published so as not to exceed three pages of A4-sized paper.
4. The KID shall be published and provided in a context that enables potential investors to distinguish it from other material. In particular, it shall not be presented or delivered in a way that is likely to lead investors to consider it less important than other information about the UCITS, its risks and benefits.

Explanatory text



Feedback from consultation and consumer testing has shown the difficulty in providing investors with information in common everyday language they can easily understand.

CESR notes that previous attempts to achieve this objective have not generally met with success. Research indicates that levels of investment knowledge and financial capability are generally very low. This reinforces not only the need for clear and simple disclosures, but also the importance of efforts to enhance investors' ability to understand financial information.

Presentation and layout

The KID should be presented and laid out in a way that is easy to read, not confusing to investors, easy to understand and engages its readers. It should make good use of white space on every page to ensure this. The type used should be an appropriate size that is not too small and does not make the information appear as 'small print'. Type size which makes the KID difficult to read should be avoided. CESR recommends type size smaller than 8 points should not be used.

Design techniques may be used to improve the extent to which a disclosure document engages retail investors. The use of colour should be permitted insofar as it is consistent with the company's brand or design preferences. However, as KID may be printed and/or photocopied in black and white, understanding of the contents should not depend on the use of colours.

The design may reflect the corporate branding of the management company or the group to which it belongs, provided it is unobtrusive – for example, a small corporate logo at the head of the document. Any branding that is so large as to distract the reader, or which obscures text (e.g. a 'watermark' logo overlaying text) would not be acceptable.

Use of plain language

Plain language should be used to convey information in a way that is likely to be understood by the retail investor. The needs and abilities of the retail investor should be considered to ensure that the content of the information is relevant, the organization of the information is logical and the language appropriate.

CESR has considered feedback from the consumer testing which indicated that many investors find it difficult to understand the terminology used in financial services documents, even where firms have made reasonable efforts to eliminate the use of technical terms and jargon. Two different pieces of work could be done in the context of level 3 to address this problem.

CESR could develop a guide for UCITS providers, offering guidelines on the use of plain language and adoption of harmonised definitions of certain terms, in order to foster comparability between the offerings of different providers. CESR would also consider developing templates or "mock-up" examples of how a KID might look. CESR would aim to complete this work in line with the Commission's deadline of 1 July 2010 for adoption of level 2 implementing measures.

In conjunction with this, CESR could undertake further work involving industry and consumer representatives, to provide a consumer-friendly glossary of terms to assist the education of investors. This would need to be available by the time that use of the KID begins in July 2011.

Information should be key to investors' decision-making

The information presented in the KID should consist only of information that potential investors need to make an informed investment decision. It should avoid containing information that is not relevant to decision-making, such as information related to the sales process.

Length of the KID



Feedback from consultation and consumer testing has shown wide support for standardization and reduction in the length of the document.

CESR notes that it might not be easy to sum up the features of some specific, complicated funds within one sheet, but this has to be weighed against clear feedback from consultation and consumer testing that investors may be less likely to read documents more than two pages long. In particular, CESR is aware that the recommendation to use performance scenarios to illustrate the features of structured UCITS³ with complex risk and reward profiles, requires additional space. However, a satisfactory presentation for such UCITS should be achievable in a document of no more than three A4 pages.

Translation

In order to achieve consistency, CESR recommends that all headings and statements in the KID follow prescribed wording. To the extent that this prescription is reflected in implementing measures, a translation of each term will be supplied in the official languages of the European Union. CESR recommends that once the implementing measures are published, competent authorities should give further consideration to ensuring that common terms are translated in a harmonised manner, especially where a language is common to two or more Member States.

Publication with other documents

It is important that not only the design and presentation of the KID itself, but the context in which it appears, supports the objective of delivering key investor information effectively.

CESR's recommendations for the KID envisage it as a single document of two (or at most three) pages. However, the KID may be attached to another document when it is given to the potential investor. This can be allowed provided the KID is sufficiently prominent to ensure that a potential investor is likely to see it and understand that it contains important information and is not just an item of promotional literature.

³ Structured UCITS typically promise predetermined pay-offs at given dates (fixed investment horizon), which may depend on computations (formulas) elaborated on certain parameters, such as financial indexes as well as single given instruments or other assets. Moreover, the techniques used often require closing the offering of the shares of structured UCITS within a limited period from its initial launch (generally up to six months for formula funds). Hence, by nature there is no past performance.



Content of Key Investor Information

Extract from the level 1 text

Article 78(2): “Key investor information shall include appropriate information about the essential characteristics of the UCITS concerned, which is to be provided to investors so that they are reasonably able to understand the nature and the risks of the investment product that is being offered to them and, consequently, to take investment decisions on an informed basis.”

Article 78(7): “The Commission shall adopt implementing measures which define the following:

(a) the detailed and exhaustive content of the key investor information to be provided to investors as referred to in paragraphs 2, 3 and 4;”

Extract from the Mandate of the Commission

“CESR is invited to advise the Commission on the following questions: What is the KII to contain and how should this be harmonised at level 2? How should level 2 measures fulfil the requirements of the UCITS IV Directive to specify the content and form of KII in a detailed and exhaustive manner such that the document is sufficient for investors to make informed decisions about planned investments? This should be taken to include the methodologies CESR considers necessary for delivering the information disclosures CESR proposes for the KII (e.g. the methodologies for risk, performance and charges disclosures). CESR should be clear as to the requisite degree of harmonisation it considers necessary for these supporting methodologies”

Section 3: Objectives and investment policy

Extract from the level 1 text

“Article 78(3): Key investor information shall provide information on the following essential elements in respect of the UCITS concerned:

[.....]

(b) a short description of its investment objectives and investment policy;

Level 2 advice
Box 3

1. The section headed 'Objectives and investment policy' shall include a joint description of the objectives and policy of the UCITS, setting out in plain and concise language what the fund aims to do and how it will go about achieving that aim so that investors can distinguish between the two elements.
2. This description shall include essential features of the product which a typical investor should know, even if they do not form part of the description of objectives and policy in the prospectus. In particular, it shall state:
 - (a) the main categories of eligible financial instruments that are the object of investment;
 - (b) whether the UCITS has a particular target in relation to any industrial, geographic or other market sectors or specific classes of assets, such as investment in financial instruments of emerging countries;
 - (c) whether the UCITS' management style is a pure discretionary choice within the investment universe, or whether it contemplates some reference to a benchmark (and if so, which one); if the latter, giving an indication of the degree of freedom available in relation to this benchmark (such as passive, moderate or active) and in particular whether the UCITS has an index tracking objective;
 - (d) that the investor may redeem units on demand, qualifying that statement with an indication of the frequency of dealing in units;
 - (e) whether dividend income is distributed or reinvested.
3. The description shall include the following information where it is applicable or material:
 - (a) if it is the case that the UCITS invests in bonds, an indication of whether they are corporate or government issues, and if applicable, any minimum rating requirements;
 - (b) if it is the case that the UCITS offers a pre-determined pay-off after a certain term, based on an algorithm applied to market data, then all elements necessary for a correct understanding of the pay-off and the expected performance drivers should be explained in simple terms (and signposting if necessary that the algorithm details appear in the prospectus);
 - (c) if it is the case, that the choice of assets within the investment universe is guided by specific criteria such as 'growth', 'value' or 'high dividends';
 - (d) if it is the case that assets are managed with a specific hedging, leveraging or arbitrage strategy, the expected performance drivers should be explained in simple terms;
 - (e) if it is the case that the impact of portfolio transaction costs on returns is likely to be material due to the strategy adopted by the fund, an explanation shall be included that the portfolio transaction costs are paid from the assets of the fund in addition to the charges set out in the "Charges for this fund" section.
 - (f) if it is the case that the UCITS or its management company specifies a minimum recommended term for holding units (either in the prospectus or in any marketing document), or that a minimum holding period is an essential element of the investment strategy, a prominent statement in the following terms:

'Recommendation: this fund may not be appropriate for investors who plan to withdraw their money within [period of time]'.
 - (g) For structured UCITS, a presentation of performance scenarios in accordance with Box 22.



4. Whether or not specific mention is made of an investment strategy, the information given in this section should distinguish between the investment universe an asset manager operates within (paragraphs 2(a) and (b) and 3(a) above), and their management styles, i.e. the way they intend to select particular assets within this universe (paragraphs 2(c) and 3(b) to (d) above).
5. Any material change to the matters covered in this section should be reflected by a prompt revision of the KID.

Explanatory text

The prospectus of each UCITS will contain a full description of the objectives and investment policy of the fund. The purpose of this section of the KID is not simply to reproduce that description but to set out in plain and concise language what the fund aims to do and how it will go about achieving that aim. Article 79 makes it clear that a different form of words may be used in the KID providing the resulting description is not inaccurate, misleading or inconsistent with the prospectus.

A clear statement of the objective (e.g. mainly aiming to achieve capital growth or preservation, paying out or re-investing dividends) must be given so that investors can easily see whether or not the fund is likely to be suitable for their needs. The statement should indicate whether the returns can be expected in the form of capital growth, payment of income, or a combination of both.

A description of the investment policy is likely to be more complex, but it should be possible to indicate to the investor at least how the objective is to be achieved, e.g. by exposure to specific markets or instruments, or the application of a specific formula. A description of the investment strategy may be included as well, if the management company considers it is likely to remain in force for a sufficiently long time to be relevant to prospective investors.

The following paragraphs provide some detail on the substance of the information that should be included in the objectives and investment policy section. The list is not exhaustive. Management companies should use their discretion in deciding which items are applicable. CESR may address these items further, through Level 3 guidelines if necessary.

In relation to 2(a), only those financial instruments which have a potentially material impact on the fund's performance need be mentioned, rather than all possible eligible instruments.

In relation to 2(c), CESR recognises that information about benchmarks can be important for understanding the performance of funds, most obviously where they are managed in relation to a benchmark. For this reason, CESR recommends the mandatory inclusion of benchmark information for those funds whose objectives and investment policy indicates that they are managed in relation to a benchmark. This is not to limit the capacity of funds to include benchmarks in other circumstances, so long as these are 'clear, fair and not misleading' in relation to the performance data, and are appropriate to the fund.

CESR considered whether it should deliver guidelines regarding the choice of a benchmark in the section of the prospectus describing the investment objectives and policy of a UCITS. However, it was agreed that this was out of the scope of the current work on the KID.

In relation to 2(d), consumer testing indicated a degree of uncertainty about investors' ability to access their money. It cannot be assumed that the average retail investor is familiar with the essential features of a UCITS such as the ability to redeem units on request, so this should be made clear, reflecting the specific frequency of dealing (daily, weekly, fortnightly etc.).

In relation to 3(b), if it is the case that the pre-determined pay-off is available only to those investors who buy units at a certain point and hold them until a certain date, this should be made clear and an explanation given of what happens when investors buy and sell units at other times (e.g. they receive the then current NAV of the units). If a guarantee from an independent third party is offered, its operation should be explained in this section.

In relation to 3(d), the expected performance drivers might be simply explained as (e.g.) ‘taking a view on whether asset prices are likely to fall’, or ‘taking advantage of inefficiencies in market pricing of related financial instruments’. The impact of such strategies on the UCITS’ risk and reward profile would be disclosed in the risk and reward section.

In relation to 3(f), the second phase of the testing exercise indicated that some consumers were confused by a message relating to a suggested minimum holding period, and misunderstood it to mean that they would be unable to redeem their investment before the end of the stated period. CESR suggests that by slightly modifying the wording of the message, and placing it adjacent to a statement about redemption on demand, the purpose of the message should be made clear.

In relation to 3(g), see section 13 of this paper which discusses how the possible future returns of structured UCITS might be presented.

In relation to (5), a material change to this section is most likely to occur as a result of a change to the fund rules, instrument of incorporation, or prospectus of the UCITS. Such changes would automatically prompt a corresponding revision of the KID (see Box 17). There may be other changes, e.g. in relation to investment strategy, which are not reflected in other documents but are material for the purposes of the KID. CESR recommends that any such change should be regarded as material, and thus requiring a prompt revision of the KID, unless the management company can justify to the competent authority of the UCITS why that is not in fact the case.

Section 4: Risk and reward profile

Extract from the level 1 text

Article 78(3): “Key investor information shall provide information on the following essential elements in respect of the UCITS concerned:

[.....]

(e) risk/reward profile of the investment, including appropriate guidance and warnings in relation to the risks associated with investments in the relevant UCITS.”

Extract from the Mandate of the Commission

“CESR is invited to advise the Commission on the detailed and exhaustive manner of this section of the KII such that the document is sufficient for investors to make informed decisions about planned investments. This should be taken to include the methodologies CESR considers necessary for delivering the information disclosures CESR proposes for the KII. CESR should be clear as to the requisite degree of harmonisation it considers necessary for these supporting methodologies⁴.”

Options for risk and reward disclosure

The initial request for assistance from the Commission to CESR explicitly asks CESR to deliver on possible ways to improve risk and reward disclosure by ensuring that only relevant risks are mentioned and explained, and to consider whether a synthetic indicator should be required. In its February 2008 advice on risk and reward disclosure, CESR explored two options:

- to enhance the current purely narrative approach;
- to require a synthetic indicator with accompanying explanatory text.

Since the publication of that advice, CESR has considered further how a synthetic indicator might work, carrying out further work with experts from industry and publishing a technical consultation in that respect. CESR has taken account of the results of the consumer testing and the responses to the technical consultation which presented the merits and limits of each option⁵.

⁴ In addition, the initial request for assistance on detailed content and form of key investor disclosures for UCITS which have been delivered to CESR by the Commission in March 2007 provided that:

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

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

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

This should include the following elements:

- Review and streamlining of the list of risk factors currently detailed in the Recommendation 2004/384/EC in order to ensure that firms highlight the most important factors for their funds.

Possibly, developing a methodology to give an indicator of the risk appetite and/or uses for which a UCITS is suitable.

⁵ The feedback on CESR's consultation will include a detailed presentation of the results of this work.

Consumers expressed a strong preference for the synthetic indicator over the purely narrative approach (better engagement). Respondents liked the visual nature of the indicator, which is less intimidating than the narrative alternative, and said that it made the risk profile easier to understand, especially for non-experienced investors. In particular, there are indications that it does improve understanding of the risk and reward profile (over a narrative variant). Some respondents mentioned that the indicator could be improved by more detail on the fund, in particular why the fund was in a certain category, in the accompanying explanation (along the lines of the narrative description).

CESR considers that a synthetic risk indicator permits a harmonised presentation of risks which should foster comparability of funds. It is easy to use as a tool for decision-making. However, appropriate wording should be used to avoid consumers being misled about the limits of the information shown. The methodology may not capture certain risks. Therefore the indicator should be accompanied by a narrative description of the material risks which are not captured by the methodology.

CESR is aware that further fine tuning and refinement of the methodology proposed in the consultation at Annex 1 is needed on the basis of the responses to the consultation. CESR will provide to the European Commission by the end of December 2009 the methodology in relation to the synthetic risk and reward indicator.

Level 2 advice

Box 4

1. Disclosure of the risk and reward profile shall take the form of a synthetic indicator supplemented by :
 - (a) a narrative explanation of the main limitations of the indicator.
 - (b) a narrative presentation of the material risks relevant to the fund which are not fully captured by the methodology for the synthetic indicator.
2. The synthetic indicator shall take the form of a numerical scale. Its presentation shall comply with the following requirements:
 - (a) the scale shall show a sequence of whole numbers in ascending order, from left to right, representing the levels of risk and reward, from lowest to highest;
 - (b) it shall made clear on the scale through graphic presentation, for example, the use of arrows, that lower risk entails potentially lower reward and that higher risk entails potentially higher rewards;
 - (c) no colours shall be used for the scale.
3. The narrative explanation of the limitations of the synthetic indicator shall address the following items:
 - (a) that historical data is not a reliable indication for the future;
 - (b) that the risk category of a fund is not a target or a guarantee and may shift over time;
 - (c) that the lowest category does not mean a risk-free investment;
 - (d) why the fund is in a specific category;
 - (e) details of the nature, timing and extent of any capital guarantee or protection including the potential effects of redeeming the investment outside of the guaranteed or protected period.

4. The narrative presentation for material risks which are not fully captured by the methodology shall be presented in such a way that the risk and reward section of the KID is fair, clear and not misleading. In particular, it shall:
 - (a) present the key categories of risk that are not captured in full by the methodology and which are relevant to the fund's overall risk profile, such as credit risk, counterparty risk, liquidity risk, and operational risk;
 - (b) where a significant level of investment is made in debt securities, characterise the credit risk;
 - (c) where a significant level of investment is made in financial instruments that are likely to have a relatively low level of liquidity, characterise the liquidity risk;
 - (d) where financial techniques such as derivative contracts are used to obtain, increase or reduce exposure to underlying assets, indicate their likely impact on the fund's risk profile;
 - (e) where a fund is backed by a guarantee from a third party, or where its investment exposure is obtained to a material degree through one or more contracts with a counterparty, characterise the counterparty risk.
5. The risks which are not captured by the synthetic indicator methodology shall be identified and presented by the management company for each UCITS that it manages, consistently with its internal process for identifying, measuring and monitoring risk (as imposed by other level 2 measures).
6. The description shall be limited in size, both in terms of the amount of space it occupies within the KID and the density of text, and be presented in a way that is likely to engage the attention of the retail investor. It shall use plain language, avoiding specialist terms whose meaning the general population is unlikely to be familiar with, so that the description is always focused on the likely outcome for the investor.
7. Any material change to the matters covered in this section should be reflected by a prompt revision of the KID. If the change is the expected result of a decision by the management company, a revised KID should be made available before the change comes into effect.



Explanatory text

As noted above, CESR recommends the use of a synthetic risk and reward indicator complemented by a narrative explanation of the main limitations of the indicator and a narrative presentation of the material risks relevant to the fund that are not fully captured by the methodology for the synthetic indicator.

CESR considers that a common methodology is required to assign a risk category to each UCITS fund. In addition, CESR suggests that one single numeric scale, for all funds, should be appropriate as it would be simple to understand and meaningful for investors (i.e. conveying the meaning of different categories in terms of potential gains or losses).

The methodology for the risk and reward indicator is based on historical volatility and, for structured UCITS, on volatility as computed through reverse engineering from a value-at-risk (VaR) measure. CESR notes that a methodology based on volatility may not capture all risks. For instance, the impact of some specific risks (such as credit, counterparty and operational risk) on the fund's risk profile might not be fully captured by the synthetic risk indicator. For some complex and/or structured UCITS, CESR notes that a methodology based on a VaR measure might not capture all risks such as tail or event risks.

This will have to be addressed through appropriate wording that can be understood by investors. As noted in section 2, CESR may undertake further work at level 3 to develop a glossary of terms for use by asset management companies, and a version for consumers to assist their understanding.

The narrative explanation should also ensure clarity regarding the limitations of the indicator. In particular, the narrative explanation should explain:

- That historical data is not a reliable indication for the future;
- That the risk category of a fund is not a target or a guarantee and may shift over time;
- That the lowest category does not mean a risk-free investment;
- Why the fund is in a specific category;
- Details of the nature, timing and extent of any capital guarantee or protection including the potential effects of redeeming the investment outside of the guaranteed or protected period.

The narrative presentation of the material risks which are not fully captured by the methodology of the synthetic indicator shall be fair, clear and not misleading.

In relation to the non-exhaustive list of additional risks detailed in (4) which are not captured by the synthetic risk and reward indicator, CESR recommends that disclosure should focus on the additional risks that may have a material impact on the risk and reward profile of the UCITS. It might be possible to use signposts to the prospectus of the UCITS where full details of the risks of the UCITS are disclosed. If certain risks are considered to have a minimal impact on the risk and reward profile of a UCITS, for example liquidity or operational risk, no disclosure is necessary in the KID.

The management company should decide on a case-by-case basis which risks should be disclosed in a narrative form, by analysing the particular characteristics of each fund. The specific analysis of each fund should then lead to the characterisation of the risks that are not fully captured by the synthetic indicator.

In relation to liquidity risk, disclosure of the risk should take account of the fact that all UCITS are intended to have a high level of liquidity, in order to meet their obligation to allow

redemption on request. The presentation should nevertheless give some indication of where each UCITS stands in relative terms, so that (for example) an investor can appreciate that a fund investing in short-term money-market instruments or government bonds is likely to be more liquid than one that invests in emerging markets. The significance of this information depends to some extent on the frequency at which units can be redeemed; a fund which offers fortnightly or monthly dealing may be able to hold less liquid instruments than a fund offering daily dealing, without any impairment to the level of liquidity risk which it presents to investors.

In relation to counterparty risk, disclosure should focus on the consequences to the fund if that counterparty should default on its obligations under the contract. Counterparties include groups of related counterparties and entities that are closely linked.

The firm should ensure that those disclosures have some consistency with the firm's internal modelling. Clearly, the language which firms use in their internal process may be far too complex for an average investor to understand, but firms should at least ensure that where marketing or sales personnel have prepared disclosures of fund risk, the risk management function is given the opportunity to review and comment on those disclosures prior to publication, and to warn senior management if they have expressed concerns that were not promptly addressed.

In relation to (6), some examples of the type of terminology that may cause difficulties for the average investor include 'OTC derivative', 'index' or references to specific indices, 'benchmark', 'arbitrage', 'relative price value' and 'protected maturity price'.

In relation to (7), it is clearly important that the risk profile of the fund is kept up to date so that any significant change is promptly incorporated into the KID. Such changes may be inadvertent, in which case the management company must adjust the KID on an ex-post basis. In particular, inadvertent changes to the synthetic indicator should be carried out according to the procedure in the detailed methodology. When changes to the risk and reward section are the result of a decision by the management company, these changes should not come into effect until a duly revised KID has been prepared and made available.

Section 5: Charges

Extract from the level 1 text

Article 78(3): “Key investor information shall provide information on the following essential elements in respect of the UCITS concerned:

[.....]

(d) costs and associated charges;”

Level 2 advice

Box 5

Presentation of the charges

1. The charges section of the KID shall state that the charges an investor pays are used to pay the costs of running the fund, including the costs of marketing and selling. It shall also state that charges reduce the growth of the investment.
2. The charging structure shall be shown in a table using the following structure:

One-off charges taken before or after you invest	
Entry charge	[]%
Exit charge	[]%
This is the maximum that might be taken out of your money [before it is invested] [before the proceeds of your investment are paid out]	
Charges taken from the fund over each year	
Ongoing charge	[]%
Charges taken from the fund under certain specific conditions	
Performance fee	[]% a year of any returns the fund achieves above its benchmark, the [insert name of benchmark]

A percentage amount shall be indicated for each of these charges.

3. In addition to the table showing the amounts of the charges, the KID shall include brief narrative explanations of each of the charges, as specified in (a), (b) and (c) below.
 - (a) *Entry and exit charges.*
The entry charge and exit charge shown shall each be the maximum percentage which might be deducted from the investor’s capital commitment to the fund. It shall be made clear that in some cases the investor might pay less. The KID shall provide a statement that the investor can find out the actual entry and exit charges from their financial adviser or distributor.
 - (b) *Ongoing charges paid out of the fund’s assets each year.*
 - (i) A single figure representing all annual charges, and other payments taken from the assets of the UCITS on a periodic basis, shall be shown. It shall be referred to as the ‘ongoing charges figure’. It shall be calculated using the methodology set out in Annex 2.

- (ii) There shall be an explanation that
 - the ongoing charges figure is based on the expenses for the year ending [month/year]; and
 - (if it is the case) this figure may vary from year to year.
- (iii) The ongoing charges figure does not include portfolio transaction costs, except in the case of an entry or exit charge paid by the UCITS when buying or selling units in another UCITS or collective investment undertaking. Where these costs are not included and their impact on returns is likely to be material due to the strategy adopted by the fund, this shall be stated within the Objectives and investment policy section.
- (iv) The ongoing charges figure shall exclude performance fees. Performance fees shall be disclosed according to (c) below.
- (c) *Contingent charges taken from the fund from time to time.*

The KID shall include a statement which explains what each charge is, the basis for charging and when it will apply. In the case of a performance fee, the amount charged in the fund's last financial year shall be included as a percentage figure.
- 4. All the elements of the charging structure shall be presented clearly and as simply as possible to allow investors to consider for themselves the combined impact of the charges.
- 5. The charges section of the KID shall also include a signpost to where the more detailed charges information within the fund prospectus can be found, including detailed information on performance fees and how they are calculated.

Explanatory text

CESR's recommendation for the disclosure of charges information is for a table with prescribed headings to be used.

Entry and exit charges

Any one-off charges, such as entry and exit fees, should be disclosed. This figure should be the maximum percentage the investor might pay. In some Member States, funds may offer ongoing subscription plans in which a higher percentage of the charge is taken in the early stages of the plan. Where such a plan is offered, a warning should be included to explain that if there is a premature interruption to the payment of subscriptions, investors may end up paying a higher charge in proportion to the amount of capital actually invested into the fund. As noted in previous consultations, key information disclosures are not intended to be tailored to individuals and as such, in order to avoid the information being misleading, the maximum percentage should be shown. The KID should state, in any case, that the investor may in fact pay less than the stated percentage and should provide information about how to find out exactly what the charges will be.

Methodology for the ongoing charges figure

In its technical consultation, CESR identified three possible options for harmonising the calculation of the ongoing charges figure:

- (a) show the ongoing charges figure based on ex-post figures;
- (b) same as option (a), but show additional ex-post data for multiple years alongside or as part of the past performance chart; and

- (c) show the ongoing charges through two figures rather than one - an ex-ante estimate and an ex-post figure.

The benefits and drawbacks of each option were assessed. The use of option (a), a single ex-post figure, which offers simplicity of presentation and a single focal point, was strongly supported by CESR and by most respondents to the technical consultation. It is relatively easy to explain and to supervise (using fund accounts), relatively easy to apply consistently to funds as an overall measure of funds' costs, and it has been strongly supported by the industry, building on the existing TER methodology.

CESR consequently recommends the use of a single ex-post methodology. Although there is the possibility that investors may not understand that the total amount of charges can vary from one year to another, CESR suggests this drawback can be overcome by the use of a warning. All respondents to the technical consultation agreed with CESR's proposal to include a warning that, where it is the case, ongoing charges may vary from year to year.

The methodology proposed by CESR for identifying which items should be included in the ongoing charges figure and for harmonising the calculation was agreed by almost all respondents to the technical consultation. The main points to note are that:

- there is a presumption that all costs borne by the fund must be taken into account unless they are explicitly excluded;
- performance-related fees and most transaction costs are among the costs excluded from the calculation (as are entry and exit charges borne by the investor);
- an ex-post calculation based on published fund accounts should be used wherever possible; and
- adaptation of the methodology is necessary where a new fund is to be launched, or where there is a significant change to the costs of an existing fund.

Portfolio transaction costs

CESR has not developed specific proposals for the detailed disclosure of portfolio transaction costs, for the reasons explained in its March 2009 consultation paper⁶. This analysis was supported by the majority of respondents to the consultation. CESR recommends that where the potential impact of those costs on investment returns is known or considered likely to be material, it should be highlighted in the Objectives and investment policy section as required by Box 3.

However, CESR notes that greater clarity and transparency would be desirable in this area. In this regard, further work might be considered with a view to developing an improved disclosure of transaction costs. If a satisfactory solution can be found, an improved disclosure of transaction costs could be incorporated into the KID or related disclosures at a later date.

Performance fees

Phase 2 of the consumer testing exercise revealed that performance fees are not well understood, even by experienced investors. Only a quarter of consumers tested realised that performance fees could be the differentiating factor between the charges of two funds. The testing did not reveal any firm conclusions about how to deal with ambiguity surrounding performance fees. On this basis, CESR recommends that the KID should disclose an ongoing charges figure which excludes performance fees. Those fees should instead be explained clearly and as simply as possible through a narrative description.

⁶ Ref. CESR/09-047, Chapter 3, paragraphs 30-34.

A number of issues regarding the details and viability of such an approach were discussed by CESR and alternative options were also explored. There was concern, for example, that investors should be able to use figures provided in the KID as a good guide to future charges, and that in some circumstances ex-post figures would not necessarily be such a good guide.

Disclosure of charges in cash terms

The consumer testing exercise presented investors with different examples of information on fund charges. In the second phase of testing, investors were presented with:

- a version containing a section called the 'Illustration of the charges' in a text format, expressing charges as a percentage; and
- a version containing the 'Illustration of the charges' in a table format, expressing charges in monetary figures.

The results of the consumer testing revealed that consumers' preferences regarding charges disclosure were mixed. In Phase 1 of testing, investors expressed a clear preference for an 'Illustration of charges' in a table format. They felt it was clear, facilitated comparability and disclosed more information.

Phase 2 of testing demonstrated that, despite consumer preferences in the early testing, the 'Illustration' in table format did not really improve comprehension levels. When comprehension was tested in Phase 2, the version with the 'Illustration' generally proved inferior to the version without it. However, Phase 2 of testing also revealed that the 'Illustration' was valuable in that it greatly aided investors in estimating the charges they would pay in the years explicitly listed in the table.

The feedback received to the technical consultation from industry participants showed a strong lack of support for a summary measure of charges using cash figures. The main concerns expressed were that a summary measure would be based on too many assumptions, could never be sufficiently accurate, and could mislead investors into thinking the charges presented were absolute and that certain returns were therefore guaranteed.

CESR discussed the possibility of improving the tested 'Illustration' by explicitly including charges for ten years of investment rather than just three selected years. However, it concluded that the arguments advanced in the consultation feedback were too strong to justify recommending an 'Illustration' or other summary figure of charges in table format, either in the form tested or an enhanced form.

Circumstances in which ex-post figures might be inapplicable

Level 2 advice

Box 6

New funds

1. In the case of new funds, the use of an ex-post calculation of the ongoing charges figure will not be possible and the following procedure shall be adopted.
2. For funds which charge a fixed, all-inclusive fee (i.e. where the figure is set at a level expected to cover all charges and expenses, and the management company absorbs any consequent profit or loss), that figure shall be displayed.

3. For funds which set a cap or maximum on the amount that can be charged, that figure shall be disclosed if the management company gives a commitment to respect the published figure and to absorb any costs that would otherwise cause it to be exceeded.
4. In all other cases, an ex-ante figure shall be estimated, based on the expected total of charges. These estimates shall be fair, clear and not misleading.

Explanatory text

Most respondents to the technical consultation agreed with CESR's proposal for dealing with ongoing charges for new funds.

In determining whether an estimated ex-ante figure is fair, clear and not misleading, the following should be considered:

- Fee payments on an ad valorem basis should either be taken into account on a purely ex-ante basis or an attempt should be made to estimate their likely impact, based on a view of what the fund's average NAV might be over its initial period.
- A more complex variation involves two or more tiers bearing ad valorem fees. This is usually organised so that the first tier attracts the higher fee, with assets in excess of that value paying a lower fee. Where a tiered fee structure is in place, it should be assumed for the purpose of the calculation that the fees applicable to the lowest tier are charged, unless the management company has valid grounds for believing a higher tier will apply.
- The impact of flat fees on the disclosure figure will require an assumption to be made about the level of the fund's NAV, as discussed below.
- Fees charged per transaction or per account (e.g. shareholder registration fees) should only be taken into consideration if estimates of the likely number of transactions/accounts are made ex-ante. For portfolio transactions, the investment manager should be able to make an estimate based on the fund's investment strategy and target assets. For numbers of accounts, the manager may have experience of similar funds, or the administrator / transfer agent may be able to assist, based on experience with other funds.

During the initial period of a new fund's existence, there is an issue about the extent to which realistic assumptions can be made about the average level of its NAV. There are some situations in which predictions can confidently be made about initial assets under management:

- Where the first property of the new fund is to come from the transfer of assets from another fund (or funds) being wound up.
- Where there is a firm commitment for monies under the control of the management company or its associates to be transferred (e.g. discretionary managed portfolios within the same group).
- Where the management company has a contractual commitment with a third party to manage that party's assets within the new fund (e.g. target fund for a fund of funds).

In each of these cases, it is reasonable for the anticipated level of investment to be used as a basis for estimating an average NAV. If none of them is applicable, the management company or an associate in its group may be willing to commit an amount of seed capital for a certain period. This may also be suitable for estimating the NAV, although it is more open to manipulation (for example, the money might be withdrawn so that the fund would contract in size and incur higher charges than are stated in the KID). If there is to be no seeding, a sensible assumption about the



likely level of investment into the fund is required and this should be conservative, not just a sales target.

Level 2 advice**Box 7****Material changes to the charging structure**

1. The management company shall establish procedures to ensure that the charges figures disclosed in the KID are kept under regular review, so that they remain fair, clear and not misleading at all times.
2. The information on charges shall properly reflect any change to the charging structure that results in:
 - (a) an increase in the maximum permitted amount of any one-off charge payable directly by the investor;
 - (b) an increase in any charge levied by the management company or its associate, or the introduction of a new charge payable to either of those persons, that would cause the published ongoing charge figure, if it were to be recalculated using the revised level of charges, to increase by 5% or more of its current value;
 - (c) any other material change in the charging structure that would cause the published ongoing charge figure, if it were to be recalculated using the revised level of charges, to increase or decrease by 5% or more of its current value.
3. When (2b) or (2c) apply, the management company shall estimate an ongoing charge figure that it believes on reasonable grounds will be indicative of the amount likely to be charged to the UCITS in future. This change of basis shall be labelled as follows:

‘The ongoing fund charge shown here is an estimate of the charges. [Insert short description of why an estimate is being used rather than an ex-post figure.] The fund’s annual report for each financial year will include detail on the exact charges made.’
4. In the case of (2a) and (2b) above, and where the timing of a change in (2c) is within the control of the management company, the KID reflecting that change shall be published no later than the date on which the revised charge comes into effect. In all other cases, the KID shall be revised as soon as reasonably practicable after the management company becomes (or should have become) aware of the change.

Explanatory text

For a fund where a charge is to be, or has already been, increased, the effect of that charge will not be reflected in ex-post data for some time to come (e.g. in cases when the annual management charge has been altered in the course of the fund’s accounting year). If the change is of sufficient magnitude to alter the overall figures materially, the continued use of the ex-post figure might be misleading to investors. An estimated figure should be used instead. The proposed wording was agreed by CESR.

It was agreed by all respondents to the March 2009 technical consultation that a harmonised definition of ‘materiality’ would ensure better comparability across Member States. CESR received some suggestions as to how materiality should be defined – these included using a percentage of fluctuation of the ongoing charges or following accounting or auditing standards. CESR considered these options and decided that a fixed percentage of the fluctuation in the ongoing charges figure was the best option.

CESR considers a figure of 5% to be a reasonable minimum level of materiality where the charge is payable to the management company or its associate. So (for example) an increase in the

annual management fee that causes the ongoing charges figure to increase from 1.00% a year to 1.05% a year would be considered material.

A number of respondents to the consultation suggested that it would be unreasonable to expect a management company to revise the KID every time a change of 5% not within its control takes place, and asked for a higher figure to be substituted. The respondents making such comments did not supply CESR with sufficient evidence of their claims to demonstrate that the proposal should be modified; nevertheless, CESR notes that the Commission's impact assessment exercise has enquired specifically about this issue, so further evidence may be forthcoming to indicate whether or not the current proposal is proportionate.

Revisions should happen only where there is a material change, but a change to any one section requires the whole of the KID to be revised as appropriate, except for past performance information which must only be revised annually.

Level 2 advice

Box 8

Periodic review of charges information

1. The accuracy of the ongoing charges figure shall be reviewed at least annually and, if that calculation results in a change to the published figure, the KID shall be revised accordingly.
2. If a review is carried out at any other time and that review shows that the new figure varies by 5% or more from the value of the published figure, it shall be treated as a material change in accordance with Box 7 above and the KID shall be revised promptly.
3. If the new figure varies by less than 5% from the value of the published figure, the new figure shall be published when the KID is next revised in accordance with Box 17.

Many respondents to the latest consultation pointed out that the impact of CESR's proposals on materiality of changes to charges and past performance would result in most KIDs having to be revised on at least two separate occasions in each calendar year. The difficulty arose from the proposal that the charges figure should be based on audited accounts, whose timing in turn depends on the accounting year-end date of the UCITS, whereas past performance updates are linked to the calendar year. CESR has taken note of these representations and now proposes a procedure that does not require the use of audited figures. The management company will be under an obligation to ensure the figures used are fair, clear and not misleading, so it is unlikely that the risk to investors is increased by not requiring the figures to be audited.

Section 6: Past performance

Extract from the level 1 text

Article 78(3): “Key investor information shall provide information on the following essential elements in respect of the UCITS concerned:

[.....]

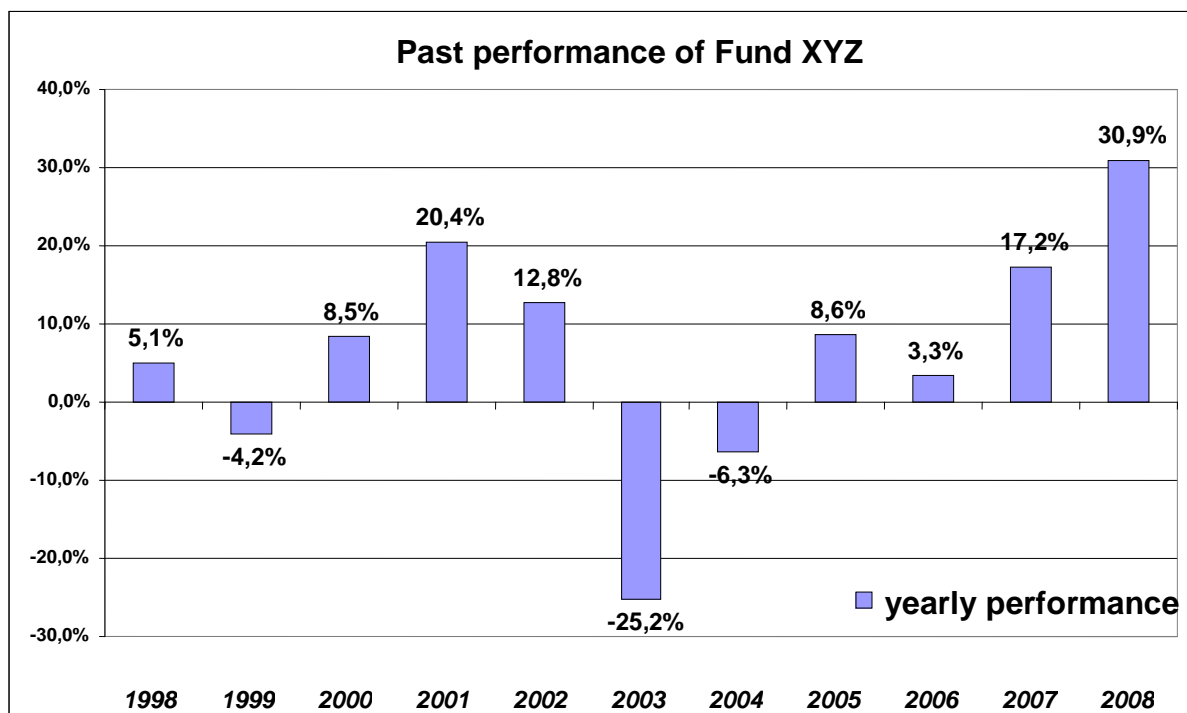
(c) past-performance presentation or, where relevant, performance scenarios;”

Level 2 advice

Box 9

Presentation of past performance for UCITS for which past performance exists or where simulated performances are permitted

1. For all UCITS other than structured UCITS, this section of the KID shall include information about the past performance of the fund. For structured UCITS, past performance presentation is not appropriate and the display of performance scenarios shall be required in accordance with Box 22.
2. The past performance information shall be presented in a bar chart, as shown in the following example:



3. Funds with a track record of less than 5 complete calendar years shall use a presentation template with slots for the last 5 years only. For any year for which data is not available, the year shall be shown as a blank slot with no annotation other than the date.

4. A UCITS which does not yet have performance data for one complete calendar year shall not comply with (2) and (3). Instead, the KID shall contain a brief statement under the heading, explaining that there is insufficient data to provide a useful indication of past performance to investors.
5. The Y-axis scale of the bar chart shall be linear, not logarithmic. The scale used shall be adapted to the span of the bars shown and shall not compress the bars so that fluctuations in returns are hard to distinguish. The X-axis shall be set at the level of a 0% performance. A percentage label shall be added to each bar indicating the return that was achieved. Performance figures shall be rounded to one decimal place [the nearest – up or down as appropriate].
6. The bar chart layout shall be supplemented by a prominent narrative text to:
 - (a) warn about its limited value as a guide to future performance;
 - (b) indicate which charges and fees have been included or excluded from the calculation of past performance (for ‘no-load’ funds, there is no need to include reference to entry/exit fees);
 - (c) indicate the year in which the fund came into existence.
 - (d) indicate the currency in which past performance has been calculated.
7. The size of the performance bar chart should allow for legibility but should not exceed half a page in the KID.

Explanatory text

Evidence suggests investors can misunderstand the limits of past performance information. However, investors typically view the information as key and are likely to seek it out. CESR questioned in its preliminary advice whether past performance information should in fact be included in the KID but on balance it considered that it should.

CESR took as a starting point the approach adopted by MiFID. As the MiFID requirements in this area are relatively high-level and do not require a harmonised presentation of past performance information, CESR recommended that they should be supplemented by additional requirements specific to the KID. In addition, the current UCITS Directive requires the simplified prospectus to contain information about the historical performance of the fund and a warning that this is not an indicator of future performance. A Commission Recommendation details 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 to a benchmark where this is appropriate.

Consequently, CESR recommended 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, given the limited space available to present it in the KID. However, this does not prevent firms presenting performance in other documents which comply with MiFID requirements.

Presentation of past performance

As regards consumer testing, both formats took the same approach to displaying past performance information in that they used a bar chart approach. However, one format showed past performance data over a 10-year period while the other variant showed past performance over 5 years.



Findings from consumer testing revealed a strong preference among consumers and intermediaries for showing 10 years of past performance data and suggest there is no adverse impact on their ability to interpret charts. On the contrary, it appears to improve their ability to compare ‘steadiness’ of performance. The majority of respondents did not have difficulty understanding that data is missing for years before the fund launch.

A reasonable proportion of those tested continue to compare performance based on length of bars (without reference to scale) – but addition of labels to bars in Phase 2 improved understanding over Phase 1 testing. However, it is inevitable that past performance will be interpreted to some extent as indicative of future performance.

CESR considered the merits of prescribing the exact size and format of the bar chart. There should be a general requirement of legibility, and the past performance section should take up no more than half a page of the KID. Standards of good practice regarding fair presentation of graphs, including specifications for the scale and axis could be recommended at level 3.

The bar chart should not be required to show a negative scale on the Y-axis if there is no negative performance. CESR does not consider that the positive and negative portions should be symmetrical (e.g. if +90% is shown, -90% must also be shown) since many funds are designed to achieve only low positive returns.

Level 2 advice

Box 10

Past performance calculation methodology

The calculation of past performance shall be made in accordance with the following requirements:

- (a) past performance figures shall be based on the net asset value of the UCITS;
- (b) past performance information shall be displayed on the assumption that any distributable income of the fund has been reinvested.

Explanatory text

CESR saw merit in clarifying some harmonised calculation rules for the past performance shown in the KID to improve comparability. As set out above, technical work has been undertaken in this area in order to provide a further standardisation.

Level 2 advice

Box 11

Maintaining the past performance record

1. Information about past performance shall be revised annually, following the end of each calendar year, so as to show the net return of the fund for that year. A duly revised KID shall be published no later than 35 business days after 31 December each year.
2. This requirement does not apply to a UCITS until the end of the first calendar year in which it has a track record for the whole year.
3. A KID shall not contain any record of past performance for any part of the current calendar year.

Explanatory text

CESR's views on how management companies should ensure that a KID is kept up to date, are set out more fully in section 8. CESR considers that, in order to ensure a consistent presentation of past performance information, there should be complete harmonisation of the process for bringing it up to date. On one hand, firms should not be obliged to incur the costs of frequent revision to the information; on the other hand, they should not revise the KID solely to take advantage of good short-term performance.

CESR recommends that every past performance record is revised annually at the end of the calendar year, so that each bar on the chart shows a complete 12 months of data.

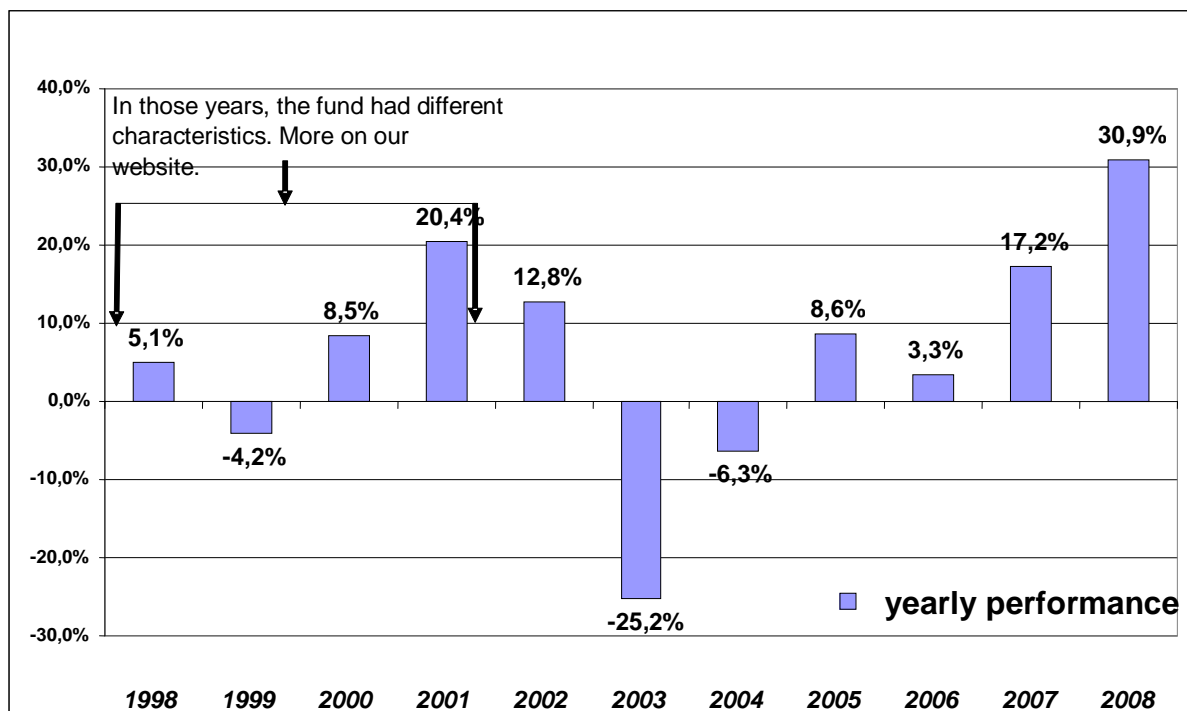
The revision should be carried out promptly to ensure, as far as possible, that all KIDs contain comparable track records. Therefore, a maximum period of 35 business days should be allowed to carry out the work and issue the revised document.

Level 2 advice

Box 12

Impact and treatment of material changes

Where a material change has occurred to a UCITS' investment objectives and investment policy during the period displayed in the bar chart, the past performance that was achieved prior to this material change shall be retained. The period prior to the material change shall be indicated on the bar chart and labelled with a prominent warning that the performance was achieved in circumstances that no longer apply. An example of such a presentation is given below:





Explanatory text

Member States and data providers have developed quite different approaches regarding ‘material changes’. Taking this into account, CESR discussed the opportunity and feasibility of issuing harmonised guidelines.

The majority of stakeholders agreed that it would be useful to issue such guidelines but views differed on the possibility of adopting a common definition of ‘material changes’ and whether this would be feasible within the current time frame. In particular, it was made clear that harmonisation of the definition of material changes might be a demanding and time-consuming task that might not be achievable at CESR level. For that reason, CESR agreed that the issue of material changes should be addressed as far as possible independently from other related topics at national level. CESR also agreed that illustration of ‘material changes’ in the different Member States could be provided at level 3.

Concerning the treatment of material changes, CESR recommends that past performance that was achieved prior to a material change shall be retained in the performance bar chart, with the inclusion of a prominent warning that it was achieved in circumstances that no longer apply.

Level 2 advice

Box 13

Inclusion of a benchmark alongside the fund's past performance

1. If the objectives and investment policy section of the KID makes reference to a benchmark, a bar representing the performance of that benchmark shall be included in the chart alongside each bar showing the fund's past performance.
2. For UCITS which do not have past performance data over the required five or ten years, the benchmark shall not be used for years in which the fund did not exist.

Explanatory text

CESR considered whether it should deliver guidelines regarding the choice of a benchmark in the section of the prospectus describing the investment objectives and policy of a UCITS. However, it was agreed that this would be out of the scope of the current work on the content of the KID.

As regards the treatment of income in benchmarks, it was discussed whether the current position in the CESR advice (i.e. past performance information shall be displayed on the assumption that any distributable income of the fund has been reinvested where the fund reinvests income, and that any linked index or benchmark should be shown on the same basis) would give sufficient guidance in all cases. It was considered that even if the advice was not clear as regards what happens when the fund does not reinvest income, there was a clear incentive for firms to show any linked index or benchmark on the same basis, so that it was unnecessary to be more specific. It was agreed that no further specifications were needed beyond the current CESR advice.

CESR also considers that it should not look to resolve in the KID any difficulties that might be raised by the impact of taxation on the fund or the investor, and therefore that investors should be warned to consider their own tax circumstances before investing.

Level 2 advice

Box 14

The use of 'simulated' data for past performance

1. Where the past performance data of the UCITS or investment compartment or share class thereof is not available over the full required period of five or ten years, no other data shall be substituted in the blank slots.
2. By derogation from the general principle in (1), a simulated performance record for the period before data was available shall be permitted (but not required) in the following circumstances, provided that its use is fair, clear and not misleading:
 - (a) a new share class of an existing fund or sub-fund may use the performance of another class, provided the two classes do not differ materially in the extent of their participation in the assets of the fund;
 - (b) a feeder UCITS may use the performance of its master UCITS, provided:
 - (i) the feeder's strategy and objectives do not allow it to hold assets other than units of the master and ancillary cash; or
 - (ii) the feeder's characteristics do not differ materially from those of the master.

3. In all cases, following MiFID standards, there shall be prominent disclosure in the performance bar chart itself that this performance has been simulated.
4. A UCITS changing its legal status (for instance from common fund to investment company) but remaining established in the same Member State may retain its performance record, to the extent that the competent authority of the Member State can reasonably assess that the change of status would not impact the fund's performance.
5. In the case of fund mergers through absorption, only the past performance of the receiving UCITS shall be maintained in the KID.

Explanatory text

CESR considered circumstances and conditions under which the use of 'simulated' data shall be allowed.

The use of a benchmark to represent the fund's past performance

In considering whether to require or permit the benchmark's performance to be displayed for the years before the fund existed, CESR took into account the pros and cons of such an approach. It results from this work that investors risk mistaking the benchmark's performance in the past for the actual performance of the fund, without a proper understanding of the possible drift between the fund and its benchmark. The addition of a specific wording in the KID in order to mitigate such risk may not be sufficient. Therefore, CESR advises that displaying a benchmark for past performance for years in which the fund did not exist should not be allowed.

The use of a track record extension

CESR considers that the use of a track record extension would be possible under some specific circumstances, such as the creation of a new share / unit class alongside existing classes, or the creation of a feeder fund linked to an existing master fund, provided certain conditions are met. CESR favours an approach whereby continuity of the strategy and objectives between two funds is ensured not only by an assurance from the management company but is the consequence of a legal connection between the UCITS wishing to extend its track record and the UCITS from which this extension would be derived.

In the case of master-feeder arrangements and new share classes, there may be a built-in guarantee that the performances will be closely linked, insofar as the new share class or the feeder are, by design, invested in the same assets as the other class / fund. A track record extension can be envisaged as long as the characteristics of the feeder UCITS or new share class do not result in a change compared to the master UCITS or original class. In order to assess this, reference could be made to the concept of material change as expressed above.

If the only difference between the feeder and master UCITS were the existence of a minimal pool of cash in the feeder to manage the subscriptions and redemptions, a track record extension would be considered permissible. However, in the case of a feeder investing only 85% of its portfolio in the master, with the remaining 15% invested in financial instruments offering the ability to modify the fund's characteristics (as provided for in Article 58 of the revised Directive), it should not be permissible to use the past performance of the master. Similarly, a new share class offering a different currency hedging policy to other fund classes could not refer to the past performance of those classes.

CESR is of the view that using the past performance of the master as a simulated past performance for the feeder would be misleading if additional fees are charged at the level of the

feeder. The same is true for share classes with a different charging structure. Box 21 contains further analysis of how the past performance record of a feeder UCITS may be shown.

In the case of ‘parent and child’ or ‘predecessor and successor’ funds, there is merely a commitment by the asset manager of the new fund to mirror the strategy of another fund. When it comes to ‘parent and child’ funds, there can be ongoing monitoring of this commitment by data providers, since both funds continue to exist; but it would be difficult for regulators to carry out such monitoring. As regards ‘predecessors and successors’, this monitoring appears to be more difficult since the original fund ceases to exist, although data providers have developed processes to address this. It is noted that mergers through dissolution and creation of a new fund, which will be allowed under the revised Directive, would be comparable to a predecessor and successor scheme to that extent.

However, CESR acknowledges that when a UCITS simply changes its legal form – for instance from contractual form to company status for tax reasons – track record extension might also be allowed.

This should not open the door to track record extensions in all cases of parent and child or predecessor and successor schemes on the grounds that they all imply a change of legal status. In some Member States it is not possible to change the legal status of a fund; in others, a change of legal status might trigger other consequences, including tax issues. Moreover, it would be difficult for one Member State to determine whether a new fund asking for authorisation should be allowed to claim the performance of another fund originally located in another domicile. However, some Members favour an even more open approach where track record extension could be allowed even if the fund changes domicile.

CESR agrees that the handling of track record extensions in past performance sources other than the KID may be based on different requirements carried out by data providers, provided the conditions set out under MiFID are met.

In light of the above, CESR is of the view that a UCITS changing its legal status but remaining established in the same Member State may retain its performance record, to the extent that the competent authority of the Member State can reasonably assess that the change of status would not impact the fund’s performance.

Fund mergers and track record extension

Evidence shows that management companies tend to merge funds with a poor track record into funds with better past performance. Unit holders of the disappearing fund(s) are sometimes confronted with a display of past performance which does not reflect their actual experience. At first sight, this might not be a big issue since the KID is primarily meant to help future investment decisions, and not to serve as an ongoing information tool for an investment made in the past. However, the overall assessment of the quality of the asset management by unit holders browsing through the range of funds operated by a management company might also be biased, since poorly-performing funds disappear without leaving any trace. Thus, CESR considered that the current situation is also unsatisfactory as an aid to the decision-making process.

Simulated past performance could help in solving this problem. In the case of a merger through absorption, CESR considers that only the past performance of the absorbing (receiving) UCITS would be maintained in the KID.

CESR considered whether a disclosure to investors, such as ‘On [date] the fund [X] absorbed fund [Y]’, would be effective. This information does not seem likely to help investors to make a better-informed decision. It is not essential for investors, when deciding whether or not to invest in the



existing fund, to know that it has previously absorbed other funds. CESR recommends that the information should nevertheless be available through other sources (prospectus or website).

CESR also discussed the case of mergers through dissolution and creation of a new fund and saw similarities with predecessor and successor schemes. Although it is understandable that the management company might want to maintain one track record irrespective of how the merger occurs, due to national practice, there is a risk of manipulation if a track record is allowed in that case. CESR considers that this issue could be covered at level 3.

Section 7: Practical information

Extract from the level 1 text

Article 78(4): “Key investor information shall clearly specify where and how to obtain additional information relating to the proposed investment, including but not limited to where and how the prospectus and the annual and half-yearly report can be obtained on request and free of charge at any time, and the language in which such information is available to investors.”

Level 2 advice

Box 15

Contents of ‘Practical information’

1. The section of the KID entitled “Practical information” shall consist of information that is relevant to investors in every Member State in which the UCITS is promoted to the public.
2. For each UCITS, this section shall state:
 - (a) The name of the depositary;
 - (b) Where and how to obtain further information about the UCITS, and in particular copies of its prospectus and its latest annual report and any subsequent half-yearly report, stating in which language(s) those documents are available, and that they may be obtained free of charge;
 - (c) Where and how to obtain other practical information (which may be generally applicable or specific to one or more Member States), such as where to find the latest prices of units;
 - (d) A statement that the fund’s Home State taxation regime may have an impact on the personal tax position of the investor.
 - (e) A statement regarding civil liability in the following terms:

“[Insert name of investment company / management company] may be held liable in law for any statement contained in this document that is misleading, inaccurate or inconsistent with the relevant parts of the prospectus for the fund.”
3. A KID for an investment compartment of a UCITS shall state in this section the information about that UCITS specified in Box 18, including investors’ rights to switch between compartments.
4. Where applicable, this section shall state the information about other available share classes required by paragraph 5 of Box 19.
5. Any change to the information in this section shall be regarded as material and shall require the KID to be revised promptly.

Explanatory text

As part of Phase 2 of the consumer testing exercise, two alternative formats of additional information within the KID were tested – one with only core items and the other with additional items of information. Consumers were asked a series of questions in order to ascertain in which format the additional information was the most useful and easiest to understand.



For both the long and short versions, only 3% of all the consumers tested found the additional information section the easiest section of the KID to understand. When consumers were asked which section of the KID they would pay the most attention to when selecting a fund, only 1% said they would pay most attention to the additional information section and 68% said they would pay least attention to it. Most of the rest of the sample paid very little attention to it.

In addition, the results of the intermediary testing revealed that the additional information section was too long and this was particularly so for complex funds. Intermediaries also felt the additional information was unnecessary and the least likely of all the sections to be read in light of the fact that investors could refer directly to the source of additional information.

CESR discussed these results and decided to improve the section by shortening the list of additional information. It was agreed that the following items, previously proposed for inclusion, should be dropped:

- Where to get further information, specific to the investor's country of residence;
- The name of the fund auditor;
- The date the fund was created;
- Information about how to buy and sell units in the fund;
- How to make a complaint in relation to the management of the fund.

On the whole, respondents to the final consultation agreed with these changes. However, it was suggested by numerous respondents that a statement regarding any potential impact of a fund's Home State taxation regime should be retained. As such, CESR recommends including this.

CESR also agreed that the initial text referring to the NAV calculation should be changed to a reference to the frequency of redemption and subscription, and that both it and the information on treatment of income should be moved to the Objectives and Investment Policy section.

It was also agreed that the civil liability statement that was proposed in the versions of the KID that were tested, would be more effective if redrafted as a more positive statement of investor rights rather than a disclaimer. Some respondents to the final consultation suggested the civil liability statement should match the wording in Article 79(2). As such, CESR has redrafted the statement which now paraphrases the wording used in Article 79(2) and omits the word 'materially'. CESR's view is that this drafting is clearer while remaining consistent with the Directive.

As discussed in section 1, many consumers who took part in the consumer testing exercise felt the word 'additional' created an impression that the information within that part of the KID was not key and could be ignored. CESR received some alternative suggestions for the heading of this section in its final consultation, including 'Important Practical Information', 'Practical and Legal Information' and 'How to obtain further important information'. CESR recommends that 'Practical Information' is maintained.

Use of signposting to other sources of information

Extract from the level 1 text

Article 78(3): "Key investor information shall provide information on the following essential elements in respect of the UCITS concerned:

[.....]



These essential elements shall be comprehensible to the investor without any reference to other documents.”

Extract from the Mandate of the Commission

“CESR is invited to advise the Commission on the following questions: What sort of cross-references to other documents or “signposts” might be permitted, apart from those which are directly referred to in the Directive?”

Level 2 advice

Box 16

1. In order not to undermine the ability of the KID to provide the necessary disclosures in a stand-alone manner, signposts to other sources of information shall be permitted as long as the referenced material is not fundamental to investors’ understanding of the essential elements of the investment.
2. These other sources of information may include sources other than the prospectus and annual/half-yearly reports. Cross-references to the website of the UCITS or the management company (in addition to a part of it containing the prospectus and the periodic reports) shall also be permitted.
3. The number of cross-references shall be kept to a minimum, although it shall be acceptable to include several different signposts within the KID, rather than a single, general reference to the prospectus and annual/half-yearly reports. These signposts shall direct the reader to the specific section of the relevant source of information; for example, for performance fees, the cross-reference from the Charges section of the KID would indicate the section of the prospectus dealing with charges.

Explanatory text

CESR considers that it should be possible to include signposts or references to other information in a way which does not compromise the ability of the investor to understand in full the essential elements listed in Article 78(3).

In formulating its advice, CESR has taken account of the following considerations:

- The purpose of including the final sentence in Article 78(3) is to ensure that the KID works as a stand-alone document for the retail investor when making an informed investment decision, which should not be undermined by excluding pertinent information through the use of signposting.
- The Commission had stated that in the co-legislators' views, the use of references in the essential information part of the KID might undermine the extent to which the KID functions effectively in a stand-alone manner, particularly where the referenced material can be considered essential for understanding the investment proposition.

There is a difference between sign-posting to information which might be useful to the investor (but which would not be required or necessary for the investor to understand the essential elements), and sign-posting to important information to such a degree that comprehension of the essential elements without it would not be possible.

If sign-posting to other sources of information is used, it should be done in such a way as to make clear that the prospectus and periodic reports are the primary sources of information for investors, and should not downplay their significance.

As to keeping cross-references to a minimum, CESR recommends that as far as reasonably possible there should not generally be more than one cross-reference appearing in each section of the KID.

Most respondents to the final consultation provided general agreement to the proposals in Box 16.



Section 8: Circumstances in which a KID should be revised

CESR has addressed what might constitute a material change to each of the principal sections of the KID, and what action should be taken in response to such a change. CESR has also considered what measures should be taken to ensure the KID is kept up to date, whether or not there are any material changes.

Level 2 advice

Box 17

1. The management company shall review the KID of each UCITS as frequently as is necessary to ensure that it continues to meet the requirements for key investor information specified in Articles 78(2) and 79(1).
2. As a minimum, a review in accordance with (1) shall be carried out:
 - (a) prior to or following any material change, as specified in each of sections 3 to 7;
 - (b) prior to a proposed change to the fund rules, instrument of incorporation or prospectus not covered by (a);
 - (c) every twelve months unless (a) or (b) apply during that time.
3. The management company shall promptly publish a revised version of the KID, taking such steps as are necessary to ensure that it is made available in compliance with Article 80, in the following circumstances:
 - (a) for funds other than structured funds, in accordance with Box 11;
 - (b) following any review in which the management company has identified a change necessary for compliance with (1).
4. For the purposes of (3), 'promptly' shall mean:
 - (a) in relation to (2a), within the timescale specified in sections 3 to 7 respectively;
 - (b) in relation to (2b), so that the existing version is replaced by the revised version no later than the date on which the change comes into effect;
 - (c) in relation to (2c), so that the revised version is published and made available no later than twelve months after the date of publication of the existing version.

Explanatory text

A management company is under a general obligation to ensure at all times that each KID is kept sufficiently up to date to comply with Articles 78 and 79. Furthermore, it is free to revise each KID as frequently as it wishes, subject to any specific restriction (e.g. not showing past performance history for part of the current calendar year). Nevertheless, there needs to be some definition of this obligation, to ensure management companies are not forced to carry out excessively frequent minor revisions of their KIDs.

In addition to the events identified as material changes, CESR considers that there are other events for which it is important to ensure that the KID is up to date and accurate. Any change to the fund rules, instrument of incorporation or prospectus should prompt a review of the KID to ensure there are no consequential changes that need to be signalled to prospective investors. However, carrying out a review does not imply that there must be a consequential revision on every occasion; a review is an internal process which may conclude there is no need for an actual revision at the present time.

Such a review should be carried out in good time so that, if a revision of the KID is necessary, the revised version is available to coincide with the implementation of the change (or sooner, if national rules impose a requirement to inform prospective investors of changes that have not yet come into effect).

CESR considers that as a matter of good practice, it would be sensible for management companies to review the KID before entering into any initiative that is likely to result in a significant number of new investors acquiring units in the fund. Such initiatives might include:

- a fund merger, where the unit-holders of the merging UCITS have to be given a copy of the KID of the receiving UCITS in order to decide whether they wish to remain invested in the fund;
- a notification to market units in another Member State, especially where a new translation of the KID needs to be prepared.

For funds (other than structured UCITS) that will be required to show a past performance record, CESR recommends that it is sufficient to revise that information on an annual basis, on the completion of each calendar year. The revision will be required to be completed by the 35th business day of each calendar year to ensure as much consistency as possible in the data shown in all KIDs.

For funds whose ongoing charges figure is liable to vary slightly from year to year, as a result of fluctuations in the amount of expenses charged to the fund, CESR considers that a management company may treat as immaterial any change that results in a fluctuation of less than 5% of the published figure. So in such cases, it is not necessary to publish an immediate revision of the KID. Nevertheless, where a figure varies from the previous year, the new figure must be shown to ensure the KID is fair, clear and not misleading. This should be done on the next occasion the KID is revised for some other purpose, or at the next periodic review, whichever is the sooner.

CESR therefore recommends that, unless a material change or other significant event has occurred, it should be sufficient to review and revise a KID once every 12 months to keep it up to date. This should enable many management companies to carry out a single annual review of the whole KID to coincide with the annual revision of its past performance record, thus avoiding unnecessary duplication of work.

Some respondents to the most recent consultation suggested that each revision of the KID should be communicated to existing investors in the fund. CESR has not had regard to such comments since the Directive makes it clear that key investor information is pre-contractual in nature. The nature and timing of communications by a UCITS to its existing investors are not within the scope of CESR's present mandate, so there is no requirement for revised versions of a KID to be provided to those investors who received a previous version.



Special cases - how the KID might be adapted for particular fund structures

Extract from the Mandate of the Commission

“According to Article 78(7)(b), due regard must be given to UCITS having different investment compartments, offering different share classes, or having fund of funds structures, master-feeder structures or where the UCITS is structured, capital protected or takes some other comparable form. KII should properly reflect these specificities.

“CESR is invited to advise the Commission on the following question: How should the KII reflect all the characteristics of the special cases outlined under Article 78(7)(b) that are relevant for the retail investor making an investment decision, for instance the characteristics of master-feeder structures?”

Section 9: Umbrella structures

Extract from the level 1 text

Article 78(7): *“The Commission shall adopt implementing measures which define the following:
[.....]*

(b) the detailed and exhaustive content of the key investor information to be provided to investors in the following specific cases:

(i) for UCITS having different investment compartments, the key investor information to be provided to investors subscribing to a specific investment compartment, including how to pass from one investment compartment into another and the costs related thereto;

Level 2 advice

Box 18

Where a UCITS consists of two or more investment compartments:

1. A separate KID shall be produced for each individual compartment.
2. Each KID shall indicate, as part of the ‘Practical information’ section:
 - (a) that it describes a compartment of a UCITS and, if it is the case, that the prospectus and periodic reports are prepared for the entire UCITS named at the beginning of the KID;
 - (b) whether or not the assets and liabilities of each compartment are segregated by law and how this might affect the investor;
 - (c) whether or not an investor has the right to exchange his investment in units of one compartment for units of another compartment, and if so, where to obtain information about how to exercise that right.
3. If the management company sets a charge for the investor to exchange his investment in accordance with 2(c), and that charge differs from the standard charge for buying or selling units, the charge shall be stated separately in the ‘Charges for your fund’ section.



Explanatory text

Many UCITS, especially those constituted as an investment company, have adopted the umbrella structure whereby a single UCITS may consist of two or more compartments (also known as sub-funds) that each have individual investment objectives.

For the purposes of producing the prospectus and the periodic reports and accounts, the Directive treats the umbrella UCITS as a single entity. However, since the umbrella structure is primarily a means of organising the investment vehicle efficiently, the management company will typically market specific investment compartments rather than the entire range comprising the umbrella UCITS. Likewise, many investors will be interested in receiving information about one particular compartment and will not necessarily want to know about the rest of the umbrella.

CESR recommends that a single (i.e. individual) KID be produced for each investment compartment. This will enable investors to see the essential information about the compartment at a glance, and will facilitate comparison between funds. It will also help management companies who have notified some but not all compartments of an umbrella to be marketed in another Member State.

CESR considers that the Directive requirement for a single document would not permit the production of a single KID document for an umbrella UCITS in which the separate disclosures for each compartment are compiled in sequence. A document that combines the details of several compartments is more likely to detract from the impact of the information about each particular compartment, than a stand-alone KID. As a result, the investor might be deterred from reading the document or might fail to appreciate the significance of the information.

However, subject to national marketing regulations, a compilation document may be permissible as long as it is produced in addition to the KID, not in substitution for it. Similarly, a management company or a distributor may produce marketing documents that summarise the features of two or more compartments of the same umbrella.

The statement that the KID is describing a compartment of an umbrella UCITS is required to identify the UCITS, as noted in section 1 above. The investor needs to know the name of the umbrella in order to be able to request copies of its prospectus and periodic reports.

Many Member States recognise a ‘protected cell’ structure which ensures segregation between the assets of individual compartments, so that the failure of one would not affect the other compartments in the same UCITS. However, since this structure does not apply universally, CESR recommends that the KID should make clear whether or not it is applicable in each case.

Article 78(7)(b)(i) requires the key investor information to include information about ‘...how to pass from one investment compartment into another and the costs related thereto’. This can be fulfilled by adding to the ‘Practical information’ section a reference to the right to switch between sub-funds, where such a right exists. The section should also contain, if relevant, a signpost to where details of the switching procedure can be found (this is likely to be part of the description of how to buy and sell units which will already be signposted in this section of the KID). The costs of switching, if they differ from the costs of buying and selling units, should be explained in the ‘Charges for this fund’ section of the KID under the appropriate heading in the table prescribed in Box 5.

Section 10: Share classes

Extract from the level 1 text



Article 78(7): “The Commission shall adopt implementing measures which define the following:

[.....]

(b) the detailed and exhaustive content of the key investor information to be provided to investors in the following specific cases:

(ii) for UCITS offering different share classes, the key investor information to be provided to investors subscribing to a specific share class;

Level 2 advice

Box 19

1. Where a UCITS consists of more than one class of units or shares, the management company shall ascertain the information required by Article 78 (3) in relation to each class.
2. The management company shall prepare a KID for each class, based on the information ascertained in (1), except as permitted by the following paragraphs:
 - (a) the key investor information pertinent to two or more classes of the same UCITS may be combined into a single KID, provided that the resulting document fully respects all other requirements relating to length and presentation.
 - (b) the management company may select a class to represent one or more other classes of the UCITS, provided the choice is fair, clear and not misleading to prospective investors in those other classes. A KID based on the representative class may be provided to investors in the other classes so represented in satisfaction of the requirements of the Directive relating to the duty to provide key investor information.
3. Under no circumstances shall specific features of different classes be selected and combined into a composite profile of a representative class.
4. The UCITS or its management company shall keep a record of which other classes are represented by the representative class, and the grounds justifying that choice.
5. If applicable, a KID shall indicate in the “Practical information” section:
 - (a) which class has been selected as representative, using the term by which it is designated in the UCITS’ prospectus;
 - (b) where investors can obtain information about the other classes of the UCITS that are promoted to the public in their own Member State.

Explanatory text

It is likely that the majority of UCITS make some use of share class structures, and many have relatively complex structures in order to accommodate differences relating to:

- distribution channels;
- fee-charging structures;
- currencies in which units are dealt;
- investor tax status; and
- treatment of fund income.

Although a UCITS may have numerous classes, not all of them will necessarily be available to any one investor. For instance, some classes may be offered only through a particular

distribution arrangement, or may be restricted to either the home Member State or a specific host Member State.

The question of whether a share class designed for institutional investors is being promoted 'to the public' is not one which this Advice can answer definitively. If such a class is being promoted to the public, a KID must be available to be provided to investors, even if potential institutional investors opt not to receive the document.

As previously explained in its February 2008 advice to the Commission, CESR believes that where possible, the management company should not be obliged to produce a separate KID for every class, in order to avoid imposing unnecessary additional costs on providers. The details of two or more classes could be combined into a single KID if this can be done without making the document too complicated or crowded. The management company could also be permitted to select a representative class in cases where there is sufficient similarity between classes.

In determining whether the use of a representative class would be fair, clear and not misleading, the UCITS management company must consider which is the most suitably representative class having regard to the characteristics of the fund, the nature of the differences represented by each class, and the range of choices on offer to each investor or group of investors. The management company should ensure in particular that the description of risk factors does not omit any material risk applicable to any of the other classes.

Where charging structures differ between classes, and a particular class can be clearly identified as having the highest overall charge, CESR considers there should be a presumption that that class will be the most suitable. Using it as the representative class would avoid the risk of the charges likely to be incurred by an investor being understated (and correspondingly would avoid the fund's past performance being overstated). A management company would have to be able to justify why any other class could be selected as representative.

However, it may be the case that no single class can unambiguously be said to have the highest overall charge (for instance, because one class has a higher initial charge whereas another has a higher ongoing charge). If so, CESR recommends that the management company should take account of other factors; for example, if the KID states explicitly that the fund may be unsuitable for investors who plan to hold it for less than a specified period, then the most suitable class might be the one that represents the lowest overall cost if held throughout that stated period.

It is also necessary to consider whether all classes have been available throughout the history of the UCITS, as this is relevant to the past performance record. If the highest charging class has not been available throughout the period covered in the past performance presentation, then it cannot be used as a representative class. Either a class which was in existence throughout that period should be considered instead, or it must be concluded that no class is suitably representative.

The management company would also need to consider whether selecting a representative class with high costs might mislead prospective investors. This could happen if investors fail to realise that a class with a lower charging structure is available. There may be other bases for choosing the representative class, e.g. the difference between distributing and accumulating classes in an income-generating fund.

When considering the use of a representative class, the management company will need to take account of which classes are marketed to the public in which Member States. It would be possible, for example, for a class to have its own KID in one Member State and be represented by another class in another Member State.



CESR may consider it useful to issue further guidelines at level 3 on the application of the fair, clear and not misleading test to the selection of a representative class.

Section 11: Fund of funds

Extract from the level 1 text

Article 78(7): “The Commission shall adopt implementing measures which define the following:

[.....]

(b) the detailed and exhaustive content of the key investor information to be provided to investors in the following specific cases:

(iii) for fund of funds structures, the key investor information to be provided to investors subscribing to a UCITS, which invests itself in other UCITS or other collective investment undertakings referred to in point (e) of Article 50(1);”

Level 2 advice

Box 20

1. For the purpose of this Advice, CESR regards any UCITS that invests a substantial proportion of its assets in other UCITS or collective investment undertakings, and is therefore subject to Article 50(3) of the Directive, to be a fund of funds structure.
2. The description of the objectives and investment policy of a fund of funds shall comply with Box 3 paragraphs 2(a) to (c) and 3(a) to (e) by explaining briefly how the other collective undertakings are selected and their performance is assessed.
3. The narrative description of the risk factors of a fund of funds shall take account of the risks posed by each underlying collective undertaking, to the extent that these are likely to be material to the UCITS as a whole.
4. The description of the charges that investors will incur shall take account of any charges that the UCITS will itself incur as an investor in the underlying collective undertakings, in accordance with Box 5 paragraph 3 and the methodology set out in Annex 2. Specifically, any entry and exit charges and ongoing charges levied by the underlying collective undertakings shall be reflected in the UCITS’ calculation of its own ongoing charges figure.

Explanatory text

The essential difference between a fund of funds and other UCITS is not in the structure of the fund but the nature of its investment objective and policy. Consequently, CESR recommends that, with the exceptions noted in Box 20, a fund of funds should be regarded as a single fund that invests in a portfolio of other collective undertakings, as opposed to (e.g.) a portfolio of securities or money-market instruments. Its KID should be prepared on the basis that the investor does not wish or need to be informed in detail about the individual features of each of the underlying collectives, which in any case are likely to vary from time to time if the UCITS is being actively managed.

However, in order for the KID to deliver effective disclosure of the fund of funds’ objective and investment policy, risk factors, and charging structure, it is necessary to ‘look through’ to the characteristics of its underlying funds, in the manner described in Box 20.



CESR's recommendations are prepared on the basis that they will apply to a UCITS that invests substantially in other collective undertakings. Thus, the measures in Box 20 may be relevant not only to a UCITS that is dedicated to investing in other collective undertakings, but also to a UCITS that invests in a mixed portfolio of collective undertakings and other asset classes, where exposure to the collective undertakings is sufficiently substantial to influence the characteristics of the key features of the UCITS itself. Annex 2 specifically addresses the calculation of the UCITS ongoing charges figure for a UCITS not fully invested in other collective undertakings⁷.

The description of the fund of funds' objective and investment policy should briefly explain the manager's approach to the selection of underlying financial instruments to achieve the fund's objectives, but any generalised statement that (for example) 'the fund selects the most appropriate funds after careful quantitative and qualitative assessment' should be avoided. The description could, where appropriate, reflect that some asset managers adopt a purely quantitative approach, selecting the funds with the best risk-adjusted performance in the past (e.g. based on their Sharpe ratio). Others may build a real 'fund portfolio' with the aim of avoiding correlations between funds, or they may select only funds paying high dividends.

CESR does not envisage that any special measures are required in relation to the "Past performance" or "Practical information" sections of a KID for a fund of funds.

Section 12: Feeder funds

Extract from the level 1 text

Article 78(7): "The Commission shall adopt implementing measures which define the following:

[.....]

(b) the detailed and exhaustive content of the key investor information to be provided to investors in the following specific cases:

(iv) for master-feeder structures, the key investor information to be provided to investors subscribing to a feeder UCITS;"

The concepts of a feeder UCITS and a master UCITS are defined in Article 58. By requiring the feeder to invest at least 85% of its assets in the master UCITS, the feeder's characteristics and behaviour will be substantially similar to those of the master.

Although Article 63 stipulates that the prospectus of a feeder must describe the feeder's features compared with its master, this Article does not address the key investor information of the feeder. Nor is there any provision in the Directive requiring investors in a feeder to be provided with the KID of the master, whereas that document must be attached to the information pack that the feeder provides to its competent authority.

Level 2 advice

Box 21

1. A separate KID shall be produced for each feeder UCITS, describing all of the relevant features of the feeder mentioned in Article 78 (3). It is not sufficient to mention only those points where the feeder differs from its master UCITS.

⁷ As explained in the Introduction, CESR will deliver the methodology for calculation of the ongoing charges figure to the Commission by the end of 2009.

2. The description of objectives and investment policy shall explain that the UCITS is a feeder and will invest 85% (or some higher percentage as stated in the prospectus) of its assets in a named UCITS. This shall be supplemented with a description of the master UCITS' objectives and investment policy, either indicating that the feeder UCITS' investment returns will be very similar to those of the master UCITS, or else explaining how and why they may differ.
3. Where the risk and reward profile of the feeder UCITS differs in any material respect from that of the master, this fact and the reason for it shall be explained in the "Risk and reward profile" section.
4. Section 6 applies to a feeder UCITS with the following differences:
 - (a) the past performance information shall be specific to the feeder UCITS, and shall not simply reproduce the performance record of the master UCITS;
 - (b) a feeder UCITS may show the past performance of its master UCITS as a benchmark;
 - (c) where the feeder was launched as a feeder UCITS, at a later date than the master UCITS, and where Box 14 permits, a simulated performance may be shown based on the past performance of the master UCITS for the years before the feeder existed;
 - (d) where the feeder UCITS has a past performance record from before the date on which it began to operate as a feeder of the master UCITS, its own record shall be retained in the bar chart for the relevant years, with the material change annotated as required by Box 12.
5. The section on charges shall reflect both the costs of investing in the feeder UCITS and any costs and expenses that the master UCITS may charge to the feeder UCITS. The ongoing charges figure for the feeder UCITS shall combine the costs of both feeder and master in accordance with the methodology set out in Annex 2.
6. The section on practical information shall be specific to the feeder UCITS as the information will, in most respects, differ from that of the master UCITS. It shall state, in addition to the information required for all UCITS:
 - (a) that the master UCITS' prospectus, KID, and periodic reports and accounts, are available to unitholders of the feeder UCITS upon request, how they may be obtained, and in which language(s);
 - (b) whether the items in (a) are available in paper copies only or in a durable medium, and whether any fee is payable for items not subject to free delivery in accordance with Article 63(5);
 - (c) if it is the case, that the master UCITS is established in a different Member State to the feeder UCITS and that this may affect its tax treatment.

Explanatory text

The description of the feeder UCITS' risk and reward profile should not be materially different to that of the corresponding section in the master UCITS' KID. Indeed, it should be possible for the feeder to copy information from the KID of the master wherever it remains relevant. However, it should be supplemented by a statement that any ancillary assets held by the feeder could slightly modify its risk profile compared to the master, and a warning specific to any risks inherent to these assets, such as the use of derivatives. In addition, the liquidity risk for investors in the feeder UCITS should be mentioned, explaining the alignment with the purchase / redemption arrangements in place for the master UCITS.



The past performance record of a feeder UCITS should, for the period that it has been feeding into the master UCITS, show the performance of the feeder itself and not that of its master. Where a new fund is authorised from the outset as a feeder UCITS, linked to an existing master, CESR considers it is reasonable for the feeder KID to show the prior performance record of the master, provided the conditions set down in Box 14 for use of a simulated performance record by a feeder are complied with.

This does not apply where the feeder was previously in existence, either as a conventional (non-feeder) UCITS or as a feeder linked to a different master. In those cases, the prior record of the feeder should be retained as required by Box 12, with the change of investment objective and policy indicated in the bar chart as a material change.

The provision on charges is intended to ensure that the combined costs of investing in the feeder and the master are disclosed to investors in the feeder. Although a master UCITS cannot charge subscription or redemption fees to the feeder, the feeder may incur other costs associated with buying or selling units of the master, which should be reflected in the aggregate charges figure. The ongoing charges figure must also be aggregated.



Section 13: Structured funds, capital protected funds and other comparable UCITS

Extract from the level 1 text

Article 78(7): “The Commission shall adopt implementing measures which define the following:

[.....]

(b) the detailed and exhaustive content of the key investor information to be provided to investors in the following specific cases:

(v) for structured, capital protected and other comparable UCITS, the key investor information to be provided to investors in relation to the special characteristics of such UCITS;

In its initial advice to the Commission, CESR noted that past performance was not adapted to all types of UCITS, especially for structured funds such as formula funds, capital protected funds and comparable funds. These funds raise specific concerns regarding the type of information which must be disclosed to investors and the corresponding illustration techniques.

Level 2 advice

Box 22

The presentation of performance scenarios for structured UCITS

1. For structured UCITS, the presentation of past performance is inappropriate. For these funds, the objectives and investment policy section of the KID shall instead include an explanation of how the formula works or how the pay-off is calculated. The explanation shall be clear, fair and not misleading.
2. The explanation shall be accompanied by an illustration, presented through at least three scenarios of the fund's potential performance. The aim of these scenarios is to provide support to the investor and help him understand the mechanism of the formula in various market circumstances. The scenarios shall be chosen appropriately to show how the formula generates a low, a medium or a high return (and including a negative return where applicable) for the investor in different market conditions.
3. These scenarios shall:
 - (a) enable the investor to understand fully all the effects of the calculation mechanism embedded in the formula;
 - (b) be based on reasonable and conservative assumptions about future market conditions and price movements. However, whenever the formula exposes investors to the possibility of extreme losses, for instance through a capital guarantee that functions only under certain circumstances, these losses shall be appropriately illustrated, even if the probability of the corresponding market conditions are low;
 - (c) be presented in a way that is fair, clear and not misleading, and that is likely to be understood by the average retail investor. In particular, they shall not artificially magnify the importance of the final performance of the fund; and
 - (d) be presented in accordance with the detailed guidelines set out by CESR.
4. It shall be clearly stated that these scenarios are examples and are purely indicative, in order to illustrate the formula's mechanism. It shall be made clear that the examples shown may not have an equal probability of occurrence.

Explanatory text

The use of prospective scenarios involves calculating the expected return of the fund under favourable, adverse, or average hypotheses regarding market conditions (this approach is generally referred to as the 'what if?' representation). The methodology is based on the application of the formula on which the fund functioning is based, to certain market conditions that would trigger a positive, neutral or negative return for the investor. This is intended to give the investor a better understanding of how the fund works by providing a simple answer, in the form of examples, to the question 'how much would I get if a certain event happens?'

Prospective scenarios should represent information which is complementary to and consistent with the information addressed in other sections of the KID. The examples should help to illustrate how a relatively complex or sophisticated fund will work in practice.

The scenarios shall be selected to illustrate how the fund would function under different market conditions, including extreme circumstances which an average investor might not have considered. Such circumstances would include those which trigger the disapplication of a conditional capital guarantee or other capital protection mechanism.

In order to ensure comparability between funds, there will have to be consistency in the choice of prospective scenarios used and the precise presentation of those scenarios. CESR will develop level 3 guidelines for harmonising the selection of scenarios by the deadline of 1 July 2010 for adoption by the Commission of level 2 measures.

CESR formed the view that the presentation of scenarios in a table would be more understandable than through a graph. A table allows easy comparison with possible outcomes from investment in a risk-free asset which is a clear illustration, for instance, of the opportunity costs of investing in a guaranteed fund. However for a structured UCITS with a complex formula, graphs may be more appropriate than a presentation in a tabular form.

Concerning the detailed presentation of the scenarios, they should ensure an adequate presentation of the information. If a graphic presentation is used instead, the detailed graphics, the scales used in the graphs and the presentation of final performance should all be chosen to deliver a fair, clear and not misleading message to the investor. Notably, the scales and fonts used for the presentation of the final performance should not artificially magnify the importance of the final performance of the fund. The performance shown on the graph or as a commentary should include, wherever possible, the annualised final performance and not only the capitalised final performance.

Other Issues

Section 14: Medium and timing of delivery, including use of a durable medium

Extract from the level 1 text

Article 2(1)(m): “ ‘durable medium’ means an instrument which enables an investor to store information addressed personally to that investor in a way that is accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored;”

Article 81(1): “Member States shall allow investment companies and, for each of the common funds they manage, management companies, to provide key investor information in a durable medium or by means of a website. A paper copy shall be delivered to the investor on request and free of charge.

“In addition, an up-to-date version of the key investor information shall be made available on the website of the investment company or management company.”

Article 81(2): “The Commission may adopt implementing measures which define the specific conditions which need to be met when providing key investor information in a durable medium other than on paper or by means of a website which does not constitute a durable medium.(...)”

Article 75(2): “The prospectus may be provided in a durable medium or by means of a website. A paper copy shall be delivered to the investors on request and free of charge.”

Article 75(4): “The Commission may adopt implementing measures which define the specific conditions which need to be met when providing the prospectus in a durable medium other than paper or by means of a website which does not constitute a durable medium.(...)”

Extract from the Mandate of the Commission

“CESR is invited to advise the Commission on:

- the specific conditions which need to be met when providing KII in a durable medium other than on paper or by means of a website which does not constitute a durable medium (Article 81(2) of the UCITS Directive);*
- the specific conditions which need to be met when providing the prospectus in a durable medium other than on paper or by means of a website which does not constitute a durable medium (Article 75(4) of the UCITS Directive).”*

Level 2 advice**Box 23****Conditions under which a durable medium might be used and requirements to be met when using the internet**

1. Investment companies or management companies ('firms') may provide investors or intermediaries with KID and/or the prospectus in a durable medium other than on paper only if:
 - (a) the provision of that information in that medium is appropriate to the context in which the business between the firm and the client is, or is to be, carried on; and
 - (b) the person to whom the information is to be provided, when offered the choice between information on paper or in that other durable medium, specifically chooses the provision of the information in that other medium.
2. Where investment companies or management companies provide investors or intermediaries with KID and/or the prospectus by means of a website and that information is not addressed personally to the client, the following conditions must be satisfied:
 - (a) the provision of that information in that medium is appropriate to the context in which the business between the firm and the client is, or is to be, carried on;
 - (b) the client must specifically consent to the provision of that information in that form;
 - (c) the client must be notified electronically of the address of the website, and the place on the website where the information may be accessed;
 - (d) the information must be up to date;
 - (e) the information must be accessible continuously by means of that website for such period of time as the client may reasonably need to inspect it.
3. These conditions shall apply to intermediaries, when providing KID to their clients or potential clients in a durable medium other than on paper or by means of a website.
4. For the purposes of this Article, the provision of information by means of electronic communications shall be treated as appropriate to the context in which the business between the firm and the client is, or is to be, carried on if there is evidence that the client has regular access to the internet. The provision by the client of an e-mail address for the purposes of the carrying on of that business shall be treated as such evidence.

Explanatory text

A definition of 'durable medium' has been provided in the revised UCITS Directive (Article 2(1)(m)).

When defining conditions under which a durable medium might be used and requirements to be met when using the internet, CESR recommends retaining the same definition laid down in MiFID level 2 provisions. This is in line with the Commission's request for advice, which suggests such an approach as a matter of consistency.

Moreover, it might be useful to give examples to illustrate this definition. Indent number 20 of the Distance Marketing Directive adds that: '*durable mediums include in particular floppy discs, CD-ROMs, DVDs and the hard drive of the consumer's computer on which the electronic mail is stored, but they do not include internet websites unless they fulfil the criteria contained in the definition of a durable medium*'. It might be necessary to update this list. For instance, a file



(PDF, Word or other formats that prevent alteration, modification or falsification) that can be downloaded from the website could be a durable medium for that purpose.

In its request for advice, the Commission reminds CESR of the obligation of the management company to:

- provide investors with the KID in good time before the investment (Article 80(1));
- provide the KID to product manufacturers and intermediaries selling or advising investors on potential investments in UCITS or in products offering exposure to UCITS upon their request (Article 80(2)).

The Commission indicates that Article 81 specifies that the delivery could be done in a durable medium or by means of a website. Moreover, co-legislators agreed a requirement that an up-to-date version of the KID should always be published on the website of the investment company or a management company.

The advice on Articles 75(2) and 81(1) is intended to specify the minimum requirements that investment companies or management companies and intermediaries must comply with, when providing with KID and/or the prospectus on a medium other than paper, so that it can be considered as a 'durable medium' as referred to in the above level 1 provisions. In particular, it shall specify the requirements to be met by management companies or intermediaries using a website to make the KID available, so that this means can be considered as equivalent to a durable medium.

Indeed, where the KID is to be delivered in a durable medium other than paper or by a website which does not constitute a durable medium, additional safety measures to those used when delivering the paper form may be necessary to maintain the integrity of the information, prevent alterations that undermine its comprehensibility and effectiveness, and avoid manipulation or modifications by unauthorised persons, or any other interventions which may have a negative effect on the content, availability and durability of the information.

Section 15: Other possible level 3 work

CESR notes that there may be other aspects of the revised Directive which touch on the provision of key investor information, and for which further level 3 measures may be desirable.

Transitional provisions

Article 118 provides for a special transitional provision in relation to KII. A further 12 months after the implementation date of the measures is allowed for UCITS to replace their simplified prospectus with KII. During that time, competent authorities must continue to accept the SP for both domestic and inwardly-passporting UCITS.

Although no implementing measures are provided for Article 118, some further consideration will be needed as to how this provision can be interpreted consistently. For example:

- Does it apply to new UCITS launched during the 12-month transitional period, or must they use a KID from the outset?
- What about the launch of a new share class within an existing fund?
- Can an existing fund revise its SP during the period or does the requirement to produce a KID take effect as soon as the current SP becomes out of date, for whatever reason?

It is suggested that these considerations should be addressed by CESR in the form of level 3 guidelines in good time to assist management companies in the consistent implementation of the KID in 2010/11.