



Association of the Luxembourg Fund Industry  
Association Luxembourgeoise des Fonds d'Investissement

Luxembourg, 11 September 2009

**Response to CESR consultation papers 09-552 and 09-716  
CESR's technical advice at level 2 on the format and content of Key Information Document (KID)  
disclosures for UCITS**

**Introduction**

ALFI represents the Luxembourg investment management and fund industry. It counts among its membership asset management groups from various horizons and a large variety of service providers. According to the latest CSSF figures, on 30 June 2009, total net assets of undertakings for collective investment were EUR 1.631 billion.

There are 3,435 undertakings for collective investment in Luxembourg, of which 2,057 are multiple compartment structures containing 10,794 compartments. With the 1,378 single-compartment UCIs, there are 12,172 active compartments in Luxembourg.

We thank CESR for the opportunity to participate in this consultation on the technical issues relating to Key Information Document ("KID") disclosures for UCITS. We welcome CESR's interest in this matter and we share CESR's desire for clear and accurate disclosure of information to retail investors in a form that helps them to understand a fund and to compare it to other funds that might be available to them. We consider our response to this consultation to be a continuation of our response to consultations CESR/07-6691 and CESR/09-047.

In this paper we present short answers to the questions that CESR asked in its consultation paper and some additional comments, which we hope CESR will find helpful. We have included references to relevant pages and paragraph numbers in CESR's paper.

# FORM AND PRESENTATION OF KEY INVESTOR INFORMATION

## SECTION 1: TITLE OF DOCUMENT, ORDER OF CONTENTS AND HEADINGS

### Q1: Do you agree with the proposals in Box 1?

We disagree with CESR's proposal to use the name of the UCITS or the investment compartment. (Box 1, Point 3.) We believe that the KID should display the full legal name of the fund, e.g., "XYZ Fund SICAV, 123 Sub-fund". Of course if there is no umbrella then the name would simply be "XYZ Fund SICAV".

We believe that the requirement to indicate the group to which a management company belongs is impractical given the reality of industry practice. (Box 1, Point 4.) For example, some large asset management groups operate at arm's length from their owners. They do not wish and they should not be obliged to imply a link between a management company and its ultimate parent company. At the other end of the spectrum, some funds employ independent management companies that are part of very small groups, which will be unknown to all but a few industry specialists. Naming such groups will mean nothing to the investor reading the KID.

In addition to our comment above, we agree that if a UCITS or a management company wishes to state its association with its owner (e.g., "XYZ Promoter, a Group 123 company") then it should be permitted to do so.

We agree that the KID should carry the UCITS or management company's brand. However, brand identities are concerned with more than just a logo, and will inform the use of font, layout and colour. We think that these are compatible with the KID's objectives and should be permitted.

We think that the KID should state an "as at" publication date, being 31 December of the relevant calendar year, and that fund promoters should otherwise be required to respect the KID publication deadlines. (Box 1, Point 11.)

We think that CESR should consider making it mandatory to display the fund code (i.e., ISIN) on the KID. (Box 1, Point 12.)

In other respects we agree with the proposals in Box 1.

### Q2: Should the information referred to in point 9 of the box be called 'Practical Information'?

Yes.

## SECTION 2: APPEARANCE, USE OF PLAIN LANGUAGE AND DOCUMENT LENGTH

### Q3: Do you agree with the proposals in Box 2?

Yes.

### Q4: In particular, do you agree that the maximum length of the document and the minimum acceptable point size for type should be prescribed at Level 2?

Yes.

If CESR is determined that the KID should be 2 sides of A4 for every KID (3 sides for structured products) then it should prescribe that limit. Similarly, we agree that CESR should prescribe a minimum font size. However, we reiterate the concern that we expressed in previous KII/KID consultations: we question

whether it is possible to include all of the required information in a KID without it appearing to the consumer to be a densely packed "small print" document.

**Q5: Are there any other rules that should be prescribed in relation to the appearance of the KID?**

We acknowledge CESR's wish that colour should not be part of the prescription for the design of the informational elements of the KID (e.g., colour should not be used to indicate increasing levels of risk) but we believe that colour should be permitted insofar as it is consistent with the promoter's brand or design preferences. (Page 14, 2nd and 3rd paragraph.) We agree with CESR's opinion that these should not be used in a manner that would distract the reader.

**SECTION 3: PUBLICATION WITH OTHER DOCUMENTS**

**Q6: Do you agree with the proposals in Box 3?**

Yes.

**CONTENT OF KEY INVESTOR INFORMATION**

**SECTION 4: OBJECTIVES AND INVESTMENT POLICY**

**Q7: Do you agree with the proposals in Box 4?**

**Q8: In particular, do you agree that the information shown is comprehensive and provides enough detail to ensure comparability between KIDs?**

We think that the proposals are comprehensive but we have some concerns, which are described in our comments below.

We find it hard to see how the description of the objectives, policy and (by reference to the 4th paragraph of the explanatory text on page 19) the investment strategy will be anything but a verbatim copy of what is in the main prospectus, particularly when the proposed civil liability statement on page 50 is so onerous. (Box 4, Point 1.a.)

We also would like to reiterate our concern that the design constraints of the KID (length and minimum font size, plain language) are likely to be incompatible with the quantity of information that CESR requires promoters to disclose. (We also note that the information prescribed by Box 4 is extended by other parts of CESR's paper, for example page 32, paragraph 2.iii and page 64.)

We recommend that CESR clarify how much detail would be acceptable when describing a financial instrument. (Box 4, Point 1.b.i.) For example, would it be enough to say "bonds" if the portfolio is also likely to include convertible bonds? Would it be enough to say "financial derivatives" or would it be necessary to declare credit default swaps, interest rate swaps, total return swaps, asset-backed and mortgage-backed securities, etc? Would it be necessary to declare American depository receipts and German depository receipts?

Each of these instruments is a technical term, none of which could be considered plain language. There will be no room in the KID to describe what the terms mean. To maintain comparability and ease of use, we strongly recommend that CESR co-operate with the industry to prepare a pan-European glossary to which promoters can refer investors for a plain-language explanation of the terms that are commonly used within the fund industry. We recommend that CESR produce the master edition of the glossary in English and that

each Member State produce a faithful translation in its official languages. We recommend that every language edition be made available on a European Union website, the address of which should be printed on every KID.

We recommend that CESR include in its glossary information that will help investors to understand the difference between bonds issued by governments, their agencies, and supra-national bodies. (Box 4, Point 1.b.iii.) We also recommend that CESR include in its glossary a brief explanation of credit ratings.

We understand CESR's phrase "pure discretionary choice" to mean "unconstrained". (Box 4, Points 1.b.iv and vi.) We think that terms such as this and "passive", "active", "relative", "absolute return", "total return", "growth", "value", "quality", "defensive", etc., should be included in its glossary of terms.

Whilst we think that it is sensible to refer the investor to the main prospectus for certain information (such as a structured product's algorithm), we draw CESR's attention to its proposal that only the KID need be translated into a local language and that the main prospectus need only be published in its original language. (Box 4, Point 1.b.v.)

We do not disagree with the requirement to explain hedging strategies but we note that it will make it more difficult to use a representative share class in a KID if the scope of the KID includes hedged foreign currency share classes. (Box 4, Point 1.b.vii.) In any case, promoters will also understandably be very careful in their explanation of the hedging process, for example, to describe that the hedging strategy is intended to maintain parity of performance between the base currency share class and the foreign currency share class, excluding the effect of interest rate differentials and other factors such as the cost of hedging and total expense ratios. (We recommend that CESR include all of these terms in its glossary.) The description will almost certainly include a statement that the success of the hedging strategy is not assured, and it might include a statement that a hedged foreign currency share class does not protect the investor from currency exposures within a multi-currency portfolio of investments. With the present text of the liability notice that CESR has proposed on page 50 of its paper, these would seem to be reasonable disclosures for a promoter to make but we cannot see how this is compatible with CESR's design objective for the length of the KID.

A statement that the investor may redeem units upon demand upon each dealing day should be in the section "Practical Information", not in this section. (Box 4, Point 1.c.) We also think that a statement on the minimum recommended investment period should be in the section "Practical Information".

We remind CESR of our response to its consultation 09-047, in which we disagreed with CESR's proposal to exclude back-tested representations of performance, and expressed significant concerns with using performance scenarios and probability tables. (Box 4, Point 1.e.) It remains our opinion that there are no good reasons to exclude back-tested representations from the KID and we recommend that CESR permit them in this section of its Level 2 advice.

#### **Q9: Are there any other matters that should be addressed at Level 2?**

We cannot recommend any.

### **SECTION 5: RISK AND REWARD DISCLOSURE**

#### **Q10: What are your views on the advantages and disadvantages of each option [narrative and synthetic risk reward descriptions] described above?**

We continue to acknowledge the appeal of a risk/reward methodology that helps consumers to compare one fund with another and to choose a fund based upon its position on a synthetic scale. However, we remain concerned that no single indicator can adequately summarise a fund's risk and return, and we think that it is unwise to offer consumers an abstract risk indicator that seems to offer empirical authority in which they can take comfort when there are likely to be circumstances in which it is misleading.

**Q11: Do you agree that Option B (a synthetic risk and reward indicator accompanied by a narrative) should be recommended in CESR's final advice? Respondents are invited to take due account of the methodology set out in Annex 1, as supplemented by the addendum to be published by the end of July, when considering their view on this question.**

Opinion amongst our members on whether to recommend Option A or B varies considerably. Some of our members acknowledge improvements in the quality of CESR's proposal for a synthetic risk/reward indicator and are prepared to accept it and its limitations, whilst others remain concerned that CESR has developed a method without resolving the fundamental concern of basis risk, and they strongly prefer only to use the narrative approach. It is clear to us that within Luxembourg and the wider European fund industry the matter is as controversial now as it was when CESR first presented it – arguably more so. Amongst our members, we can say that some support CESR's proposals whilst others, to the extent that they are moving towards acceptance of the synthetic risk/reward indicator, are doing so more with a sense of pragmatism – a policy of engagement to make the best of what seems an inevitable outcome – rather than from any enthusiasm for the proposal itself. Beneath that engagement lie serious concerns about the wisdom of adopting the scheme that CESR has put forward, and indeed any scheme that aims to express all forms of risk, no matter for what fund and in what circumstances, through a single abstract indicator. This is not simply about principles: this has been an unusually protracted and technical debate, in which numerical risk assessment techniques have been at the centre.

Given that the fund industry remains so seriously concerned about the proposal for the synthetic risk/reward indicator, we believe that CESR should reconsider with the greatest care their estimate of whether such an indicator can be implemented free from fundamental basis risk. We think that it cannot.

Notwithstanding what we have said above and as with our response to CESR/09-047, we have provided what we hope are constructive responses to the following questions on the synthetic risk/reward indicator.

We recommend CESR to prescribe the language with which it says the KID should declare the following items (Page 83, paragraph 61):

- Historical data are not reliable indicators for the future.
- The risk category of a fund is not a target or a guarantee, and may shift over time.
- The lowest risk category does not mean that the fund offers a risk-free investment.

We think that CESR should consider making it a requirement for the KID to indicate that the fund's risk category is determined by an official European Union classification scheme, perhaps by citing the European regulation under which it is prepared or a European web site at which it is described.

**Q12: Do you agree with the proposals for presentation of risk and reward in Box 5A?**

Yes.

**Q13: Are there any other issues that CESR should consider if it decides to recommend this approach to the disclosure of risk and reward?**

We think that significantly more work needs to be done to develop more detailed guidelines to ensure that the narrative method is applied consistently by promoters in every Member State. We also think that terms such as "risk free rate" should be defined more clearly. (Page 27.)

**Q14: Do you agree with the proposals for presentation of risk and reward in Box 5B?**

Reading Box 5B, it is hard to avoid the conclusion that CESR's Option B entirely incorporates Option A. (Box 5B, Point 1.) We are concerned that the phrase, "supplemented by a narrative description of the main

risks" is too general to be practically useful to fund promoters and their regulators, and we would like CESR to explain its intention more clearly, hopefully in a way that encourages brevity.

If CESR intends to include in its Level 2 advice a requirement that the KID must contain a narrative description of the limitations of the synthetic risk indicator (which CESR has sponsored and defined) then it must prescribe exactly what that text must be and make it available in every European language. (Box 5B, Point 3.) We think that it is essential that every promoter's KID should carry exactly the same statement of limitation.

**Q15: Does the methodology proposed by CESR work for all funds? If not, please provide concrete examples.**

*(Respondents are invited to take account of the methodology set out in Annex 1, as supplemented by the addendum to be published by the end of July, when considering their view on the questions above.)*

No. We have some serious concerns about the application of the scheme to more complex funds and whether it can practicably be sustained in production. Even for market risk funds, in which volatility could be seen as a reasonable proxy for risk in some circumstances, we would prefer to present the computed volatility rather than to translate it into an abstract scale in the range 1 to 6.

If CESR intends to recommend the scheme to the Commission, we in turn recommend CESR to (1) convene a technical workshop with asset managers' risk specialists to review and adjust the design of the methodology and (2) sponsor a pilot scheme as soon as possible, inviting regulators and fund promoters to produce KIDs for a relatively large sample of real funds, so that the methodology can be properly tested and debugged. For example – and this is not the only one – we are not sure exactly how to measure the "pro-forma asset mix that is consistent with and representative of the fund's investment policy". (Page 80, paragraph 40.b.) We do not think that the methodology should be recommended to the Commission until its practicality has been properly tested using real funds, promoters and regulators.

**Q16: Are there any other issues that CESR should consider if it decides to recommend this approach to the disclosure of risk and reward?**

We think that the role of counterparty risk in structured funds merits further consideration.

## **SECTION 6: CHARGES DISCLOSURE**

**Q17: Do you agree with the proposals in Box 6?**

**Q18: In particular, do you agree the table showing charges figures should be in a prescribed format?**

We continue to think that the proposed design of the charges table is too simplistic, or that CESR has not described clearly enough how the table may be adapted to suit a fund's circumstance. For example, if an investor must pay a charge upon the conversion of a holding from one share class to another, where should it be presented in the table? Is it to be treated as a special form of entry charge or should the promoter describe it on a separate line in the "one-off charges" section of the table?

We remind CESR of our response to its consultation 09-047, in which we said that the investment management charge, being typically the largest contributor to a fund's total expense ratio and being generally fixed (notwithstanding any performance fee) should be presented separately. The separation would also make it much simpler to update the KID intra-year in the event of any change in the investment management charge.

We doubt that the requirement to post a comment about significant portfolio transaction costs in the Objectives and Investment Policy section would achieve anything but confusion; amongst fund promoters, regulators and auditors, who would have to interpret CESR's "likely to be material" criteria; and amongst consumers, whose understanding of the comment is likely to be superficial. (Box 6, Point 2.iii.)

**Q19: Do you agree with the methodology for calculating the ongoing charges figure?**

CESR's requirement that the ongoing charges be calculated "generally with reference to the last **audited** annual accounting period of the UCITS" is incompatible with its requirement that the KID be updated industry-wide each calendar year, within a prescribed period of the end of the year. (Page 87, paragraph 10.) The problem is twofold:

- Many funds' accounting years are materially offset from calendar years. If all promoters must use audited data, they will not be drawn from the same time period, which militates against coherence and comparability between KIDs. Since promoters typically keep records of expenses as they manage their daily business, we think that it would be better to publish ongoing charges based on operational data that are available at the end of the calendar year. (We also think that CESR should remove the comment on page 87, paragraph 12 that the ongoing charges "should be those set out in the UCITS' statement of operations for the relevant accounting year".)
- Fund audits can take several months to complete, and audited data are unlikely to be available in time to permit the annual revision of KIDs within the timeframe required by CESR. Furthermore, CESR's suggestion that a UCITS should publish a revised KID each year using estimated data and then republish it with audited data when they become available is unreasonable, and will be punitively expensive.

We made similar comments about audited data in our response to CESR/09-047 and 07-6691. Our comments were made in the interest of the practical success of the KID and not in pursuit of vested interest. CESR's focus on audited data in this respect of the KID is impracticable. Since the production process for a document as important as the KID is in any case likely to be reviewed by the UCITS' auditors, we think that it should be enough that the KID is produced using **unaudited** data under the control and responsibility of the UCITS' directors. UCITS' semi-annual reports and accounts are produced in this manner (using **unaudited** data, within **two months** of the end of the accounting period) and the process works very well.

**Q20: Do you agree with the proposals in Box 7?**

No.

We said in our response to CESR's previous consultations on KII and KID (CESR/07-6691, question 40, and CESR/09-047, question 59) that we did not think that options for disclosure in cash terms should be considered further. That remains our firm view.

We do not think that this form of disclosure is reasonable because it relies upon a predicted growth rate that will contain subjective assumptions about the future. We think it would put UCITS operators into an invidious position: who could expect them to make anything other than optimistic assumptions for fear that unrealised pessimism would put them at a disadvantage in the market? We also think that most investors would be unaware of the nature of the assumptions and their effect on the prediction.

**Q21: In particular, do you agree that CESR should not prescribe a specific growth rate in the methodology for calculating the illustration of the charges?**

If CESR retains this proposal in its Level 2 advice, we would rather it prescribed the number of years and the growth rate to be used in the statement.

**Q22: Do you agree with the proposal in Box 8?**

Yes.

**Q23: Do you agree that a variation of 5% of the current figure is appropriate to determine whether a change is material?**

No. We believe that it would be better to say that the KID should be updated in the event of any discretionary *increase* in any charge or cap that is defined in the prospectus (whether defined by monetary value or by rate, at a prescribed value or as a limit). We think that no update should be mandated in the event of a discretionary decrease in any charge.

In respect of other incidental changes (for example, in the event that the total assets under management of a fund fall very significantly, as they did in late 2008, with a consequential rise in the total expense ratio) we do not think that the KID should be updated.

**Q24: Do you agree with proposal in Box 10?**

We think that it should be enough to say that the accuracy of the ongoing charges figure should be reviewed at least annually. We think that the reference to audited annual accounts should be removed.

**SECTION 7: PAST PERFORMANCE PRESENTATION**

**Q25: Do you agree that the above CESR proposals on past performance presentation are sufficient and workable? If not, which alternative approach would you prefer?**

We think that it is important to show the annual performance of a UCITS, so that one KID can be compared to another. However, we think that the proposal to use only a bar chart with annual figures is simplistic: the information rate is far too low for it to be of practical use. We believe that a combination chart of annual and NAV performance would allow the KID to display investment returns on a comparable annualised basis and provide consumers with a visual representation of volatility, which they will intuitively understand. We presented some ideas about how this might be done in our response to CESR/09-047.

We note that CESR requires performance numbers to be rounded to one decimal place (Box 11, Point 5) and we recommend that the chart in Box 11 be updated to comply with that requirement.

We would like CESR to prescribe the language that should be used to satisfy the warning on the limitation of past performance as a guide to future performance. (Box 11, Point 6.a.)

In respect of charges that have been included or excluded from the performance, we recommend CESR to prescribe the language that should be used. Since the performance should only be a function of the NAV, perhaps it would be simply enough to say that the chart is based upon the net asset value per share published by the UCITS on each relevant day in the year? (Box 11, Point 6.b.)

**Q26: Do you agree that the above CESR proposals on past performance calculation are sufficient and workable? If not, which alternative approach would you prefer?**

Yes.

**Q27: Do you agree that the above CESR proposals on material changes are sufficient and workable? If not, which alternative approach would you prefer?**

The deadline for the annual production of a revised KID (within 25 business days of 31 December each year) is unfeasibly short. In many parts of the industry January is the busiest month of the year. We strongly recommend that CESR modify its Level 2 advice, to say that revised KIDs should be published by the last day of February each year.

We agree with CESR proposition. We understand that the proposed methodology is not compulsory and is to be considered as an example of good practice. We think that that the fund promoter should be permitted

present the information in other ways (for example, by marking the chart with tags, which refer to footnotes in which an event is described).

**Q28: Do you agree with this approach? If not, which alternative approach would you prefer?**

We recommend that CESR extend its Level 2 advice to incorporate the principle (described in its explanatory text) that a UCITS may display a benchmark alongside past performance even if the benchmark is not named in the objectives and investment policy section of the KID. (Box 15, and explanatory text on page 45.)

**Q29: Do you agree that the above CESR proposals on the use of 'simulated' data for past performance past performance presentation are sufficient and workable? If not, please suggest alternatives?**

Yes.

**SECTION 8: PRACTICAL INFORMATION**

**Q30: Do you agree with the proposals in Box 17?**

The Level 2 advice says that the KID should "indicate in which languages [the prospectus and periodic reports and accounts] are available". (Box 17, Point 1.) We think that the reference should be limited to the relevant languages. For example, if the master documents are available in English and the KID is published in Italian, we think that it should be enough to say, "Further information, including the prospectus and the reports and accounts, are available at [URL] in [English only] / [Italian and English and several other major European languages]".

We think that CESR's proposed statement of civil liability has an unnecessarily litigious tone. (Box 17, Point 2.) Rather than the phrase "may be held liable in law", we would recommend using the phrase "is responsible for", which we think would be consistent with the purpose and spirit of this statement as CESR represented them in its earlier consultations. We do not concur with CESR's statement 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".

Whilst we accept the point that the KID should not differ materially from the prospectus, it remains the fact that the prospectus is a comprehensive document containing many pages of important disclosures and the KID is constrained to two sides of A4 paper. The KID will inevitably not provide the same information as the prospectus, and we think that the statement of civil liability must also clearly say that the prospectus is the legally binding document.

We note that the CESR working group's proposal to drop the date upon which the fund was created (Page 50, explanatory text, 4th paragraph) is incongruous with CESR's Level 2 advice at Box 11, Point 6.c. We think that it is important to say in the KID when the fund (or share class) was launched.

In other respects, we agree with the proposals in Box 17.

**Q31: Do you agree with the proposals in Box 18?**

Whilst we accept the point that the objective of the KID is to help investors to understand what they are investing in, it is important to reiterate our concern that the KID can never be as comprehensive as the prospectus, and that there is a material risk that the KID, which is required to provide a substantial amount of information in a very short space, cannot contain everything that is fundamental to the investors' understanding of the investment. It only takes a moment's reflection on the events of the last 18 months to understand that peripheral information can become fundamentally important in severe market conditions. (Box 18, Point 1.)

Otherwise, we agree with the proposals in Box 18.

## **SECTION 9: CIRCUMSTANCES IN WHICH A KID SHOULD BE REVISED**

### **Q32: Do you agree with the proposals in Box 19?**

Provided that CESR makes clear that a "review" need not inevitably require a new edition of the KID to be published, we agree that the KID should be reviewed when the fund's major documents are changed. Of course, we agree that the KID should be updated if a change would have a material effect upon it. (Box 19, Point 2.b.i.)

This provision at Box 19, Point 2.b.ii is misplaced in Level 2 advice that defines how a KID should be revised. If a fund is absorbed by another fund then its KID should be withdrawn (and in any case the fund will no longer be available for investment). We can see no reason why the absorbing fund should revise its KID. The fact that the fund promoter or management company should ensure that the investors of the absorbed fund are provided with the KID of the absorbing fund is a concern for another part of the Directive (i.e., that dealing with mergers).

There seems to be a typographic error in Box 19, Point 2.b.iii, which should refer to point v rather than iv. Other than that, we simply cannot understand what this part of the Level 2 text means.

(Box 19, Points 2.c, 3.c, 4 and the entire box.) We think that this entire section of the Level 2 advice is poorly drafted. There are so many references that it is hard to read and it is hard to understand what further guidance the draft seeks to provide beyond that which was given more competently in other sections.

The requirement to publish a revised KID no later than 12 months after the publication of the revised version is repetitive and inconsistent with the principle that the KID will in any event be republished with performance and ongoing charges data as at 31 December, within a prescribed limit of the end of each year. One possible interpretation of the 12-month rule would be that, if a company publishes a KID 10 days after the end of a particular year and has no cause to revise it during the next year, then it would be obliged to publish it no later than 10 days after the end of that year, irrespective of the prescribed limit provided elsewhere in the Level 2 advice. We recommend that CESR delete Point 4.iii of Box 19.

## **SPECIAL CASES – HOW THE KID MIGHT BE ADAPTED FOR PARTICULAR FUND STRUCTURES**

### **SECTION 10: UMBRELLA STRUCTURES**

#### **Q33: Do you agree with the proposals in Box 20?**

The reference to compartmental segregation "by law" is perhaps too precise and the phrase "by law" could be deleted.

We would expect the explanation of how the investor might be affected by compartmental segregation to be a simple statement such as: "[Fund] is a compartment of [Umbrella] but [Fund's] assets and liabilities belong exclusively to its shareholders."

We note that the Level 2 advice says that any switching charge between the units of different compartments within an umbrella fund should be stated separately in the "Charges" section. The Level 2 advice at Section 6 (page 31 to 34) did not contain advice on how such charges should be represented, for example, whether it should be included within the narrative part of the table shown on page 31 or whether it should be in a

footnote to the table. We would welcome clearer advice in this respect and in respect of the description of other charges, such as contingent deferred sales charges.

## **SECTION 11: SHARE CLASSES**

### **Q34: Do you agree with the proposals in Box 21?**

We think that CESR should delete from the draft Level 2 advice the text, "is satisfied on reasonable grounds that to do so". In other words, representative share classes should be permitted "provided it is fair, clear and not misleading to prospective investors" in the other classes for which the published share class is a proxy.

We think that CESR should delete the second sentence of Point 1.b: "The UCITS or its management company shall keep a record of which other classes are represented by the selected class, and the grounds justifying that decision." The requirement is bureaucratic. The test of "fair, clear and not misleading" is a good one and it should be obvious whether or not that is the case without creating paper trails that have no purpose other than to satisfy this regulation.

We note that there is no requirement in the Level 2 advice to say clearly what other share classes the KID represents. We think that there should be.

We agree with the Level 2 advice that the KID should indicate, if applicable, where investors can obtain information about the other classes of the UCITS that are available in their own Member State. We wish to reiterate our position that the KID must be a pan-European document created under the exclusive supervision of the UCITS' Home Member State. In other words, we believe that foreign language translation should be the only modification required for a KID to be used in another Member State in which that language is spoken, and that Host Member States should be prohibited from requiring any other modification to the KID, regardless of whatever national marketing regulations they might wish to apply to it. We would be very grateful if CESR would reflect these principles in its Level 2 advice.

Therefore, we think that the information requirement of Point 3 of Box 21 should be capable of being satisfied by a reference to the fund's website.

## **SECTION 12: FUND OF FUNDS**

### **Q35: Do you agree with the proposals in Box 22?**

We do not think that there is sufficient space in the KID to describe "how the other collective undertakings are selected and their performance assessed". (Box 22, Point 1.) Moreover, we do not think that there is good reason to treat a fund of funds different to other funds in this respect. We do, however, believe that it is important that the KID informs investors if the underlying funds are managed by the same investment manager as the fund of funds.

We are uncertain what Point 2 of Box 22 adds to CESR's previous advice on the use of narrative expansions to the synthetic risk/reward indicator, and we think that it could be removed in the interest of brevity.

## **SECTION 13: FEEDER FUNDS**

**Q36: Do you agree with the proposals in Box 23?**

Yes.

## **SECTION 14: STRUCTURED FUNDS, CAPITAL-PROTECTED FUNDS, AND OTHER COMPARABLE UCITS**

**Q37: Do you agree with the above CESR proposals on performance scenarios? In particular which option (A or B) should be recommended? If, not please suggest alternatives.**

We continue to hold the view (as we did in our response to CESR/09-047) that back-testing can provide investors with an illustration of how a structured fund would have performed under historical market conditions. We would much prefer to do that than to be drawn into the subjective judgement necessary to construct the scenarios upon which both of CESR's present options depend.

Notwithstanding these comments, we prefer Option A (Box 24A) over Option B (Box 24B). We agree with CESR's opinion (page 65, 8th paragraph) that more detailed Level 3 guidelines will be necessary to make this workable across the industry.

## **OTHER ISSUES**

### **SECTION 15: MEDIUM AND TIMING OF DELIVERY, INCLUDING USE OF DURABLE MEDIUM**

**Q38: Do you agree with the proposals in box 25? If not, what alternative approach would you suggest?**

In principle, we agree, subject to the following comments.

It appears to us that since it was first proposed, the KID has evolved from the status of a "pre-contractual" document (in the sense that it was not intended to be contractually binding) into a contractual foundation document (in the sense that the management company will be at risk unless it can prove that the document was delivered to the investor before a subscription was made). We anticipate the following consequences, for which we expect no effective improvement in investor protection (because we do not believe that there is significant malpractice within the industry today):

- Promoters will be obliged to maintain records to demonstrate that every investor from whom they directly accepted an initial subscription was provided with the relevant KID before that instruction was accepted.
- Promoters will refuse or suspend (at the investor's risk) initial subscriptions unless and until they can demonstrate that the relevant KID was delivered to the investor.
- Promoters will require their intermediaries/agents to do the same.

With transactions in large fund complexes being made directly and indirectly, through tied agents and independent advisors, by solicited and unsolicited means, by individual beneficial owners and through nominee omnibus accounts, through small platforms and global custodians, on secondary markets beyond the sight or control of the fund promoter and its management company, and by parties within and without

the scope of MiFID, we think that the Level 2 advice that CESR provided in Box 25 is unlikely to prove satisfactory in practice, and we recommend that CESR reconsider it.

Notwithstanding our comments above, we think that a management company should be required to store and make available to the public in physical and electronic form every edition of a KID that it has produced. We think that this obligation should survive the liquidation of the relevant fund or share class for the period that is required by the law governing commercial record-keeping in the Member States in which that fund or share class has been sold. We think that this principle should be enough to satisfy the requirement of Article 80(1) of the directive.

## **SECTION 16: OTHER POSSIBLE LEVEL 3 WORK**

### **Q39: Do you agree with the approach to transitional provisions set out above?**

Yes.

We would support a recommendation that a new UCITS that is launched during the transition period should be required to issue a KID rather than a simplified prospectus from its first day.

We do not think that the launch of a new share class during the transition period should oblige a UCITS to convert its simplified prospectus into a KID.

We do not think that a UCITS should be required to convert its simplified prospectus into a KID if an event occurs that under the old regime would simply require it to update its simplified prospectus.

### **Q40: Are there any other topics, relating to KII or use of a durable medium, not addressed by the consultation, for which CESR might undertake work on developing Level 3 guidelines?**

We cannot suggest any.

## **ADDENDUM (CESR/09-716)**

We are concerned that the methodology as it has been developed is a synthetic *risk* indicator. We cannot see how it takes account of the potential *reward* of an investment in a fund. It is therefore mis-named (it is not an SRR1). We are also concerned that, even in respect of risk and despite clear labels, investors will misinterpret the indicator as the product of a *trustworthy* link between a fund's position on the SRR1 scale and the *absolute* risk and reward of the fund, rather than as an *estimate relative to other funds* of the probability that they will lose or gain money.

### **Q1: Do you agree with the criteria considered by CESR to formulate its proposals regarding the volatility intervals? Are you aware of any other factors that should be considered?**

Yes, and we cannot recommend any other factors to consider.

### **Q2: Which option (A or B) do you see as more appropriate for the KID?**

Option A.

### **Q3: Would you like to propose any other alternative for the volatility intervals? If so, please explain your reasoning.**

We do not wish to propose alternative volatility intervals.

**Q4: Do you agree that introducing some rules for assessing migration is desirable?**

Yes.

**Q5: If so, which option (2 or 3) do you think is more appropriate?**

Opinion amongst our members is split between Options (rules) 2 and 3.

**Q6: Would you like to propose any other rule for assessing migrations? If so please explain your reasoning.**

A combination of rules 2 and 3 would be useful.

**Comment on Section 3.1 (new funds with insufficient history: the case for market funds)**

We support the general approach for market funds that have insufficient history to compute their volatility by CESR's standard method. However, we do not understand the solution of "last resort" in circumstances when there are no suitable portfolio models or proxy indices or benchmarks available. The root of our problem is that we simply do not understand the second paragraph at the top of page 10 (we can guess at two substantially different interpretations) and we would be grateful if CESR would clarify what it meant.

**Q7: Do you agree with CESR's proposal concerning the methodology to compute the SRRI of structured funds? If not, please explain and, if possible, suggest alternatives.**

We still have some concerns. The method still provides opportunity for subjective input. However, we think that it is a conservative framework for calculating a synthetic risk(reward) indicator for structured funds.

**Q8: Do you agree with CESR's proposal to use VaR as an (intermediate) instrument for the measurement of volatility? Is the proposed VaR-based approach appropriate to convey correct information about the relevant return volatility of structured funds?**

Yes. We share CESR's view that VaR offers advantages and drawbacks, but we think that CESR's proposal is reasonable.

**Q9: Do you share the view that the solution proposed by CESR is flexible enough to accommodate the specific features of all (or most) types of structured fund? If not, please explain your comments and suggest alternatives or explain how the approach could be adjusted or improved.**

Please see our response in the red box on page 6 of this paper, in which we recommended CESR to hold a technical workshop and run a pilot.

**Q10: Do you agree with CESR's proposal concerning the methodology to compute the VaR-based volatility of structured funds over a holding period of 1 year? If not, please explain your comments and suggest alternatives.**

Yes.

**Q11: Do you agree with CESR's proposal concerning the methodology to compute the VaR-based volatility of structured funds at maturity? If not, please explain your comments and suggest alternatives.**

Yes, insofar as it agrees with the assumption that structured product investors general intend to hold the fund to maturity.

**Q12: Do you agree with CESR's decision not to promote further the adoption of the delta representation approach for the computation of volatility of structured funds?**

Yes.

**Q13: Do you share the view that CESR's current proposal represents an improvement with respect to the delta representation approach? If not, please clarify why you believe that the delta representation approach may be more suitable to estimate the volatility of structured funds.**

Yes.

**Q14: Do you consider it possible and appropriate to allow the use of Monte Carlo simulations for the computation of the SRRI of structured funds? If yes, please explain whether these methods are more suitable for the computation of VaR or, directly, for that of volatility measures.**

Yes.

Monte Carlo simulation is appropriate for funds that contain complex financial derivatives that cannot be modelled using VaR (e.g., options). However it is resource-intensive. If the underlying components in a structured fund have limited return histories, the historical simulation becomes difficult to compute. In these situations, we think that Monte Carlo simulation could give a more accurate return distribution by creating additional samples from the available history if (importantly) the distribution of the available returns is representative.

**Q15: Do you believe that it would be possible to avoid significant differences in the outcome of such simulations across management companies? What should be the key methodological requirements needed to avoid such divergences?**

We think that it would be possible to avoid significant differences by ensuring some of the following requirements are applied to each method:

- A minimum amount of actual return history must be included in the historical simulation and the Monte Carlo methods. In the absence of actual return history, the use of proxy history should be allowed, provided that the proxies are highly correlated with the asset that they are substituting.
- A minimum number of Monte Carlo simulations to calculate the return distribution.
- When little actual return history exists, CESR could consider disallowing such a product to claim a risk category in the lowest two of the six available categories – regardless of the actual simulated results – until sufficient actual history accumulates. We think that a reasonable minimum actual historical period could be 156 weeks.

Please see our response in the red box on page 6 of this paper, in which we recommended CESR to hold a technical workshop and run a pilot.