CFA INSTITUTE

Setting the global standard for investment professionals

Carlo Comporti
The Committee of European Securities Regulators
11-13 Avenue de Friedland
75008 Paris
France

London, 17 December 2007

Dear Mr. Comporti,

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

The CFA Institute Centre for Financial Market Integrity ("CFA Institute Centre") welcomes the opportunity to comment on the Committee of European Securities Supervisors' (CESR) Consultation Paper on content and form of Key Investor Information (KII) disclosures for UCITS (the "Consultation").

We are very supportive of the objectives and ambitions behind the KII Consultation. The KII document should be short, and only contain information that adds to the investor's decision making process. We propose that all generic explanatory information is transferred to a separate "knowledge base" document (which could be accessed by the web) that references each section of the KII. This separation of generic explanation from the KII allows the KII more space to offer more informative content to the investor. We strongly believe that the KII should be a passportable document, where local information is entirely separated but referenced by the KII, or confined to a supplementary and prescribed sticker on the KII.

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[1] The CFA Institute Centre develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct, Global Investment Performance Standards ("GIPS®"), and the Asset Manager Code of Professional Conduct ("AMC"). It represents the views of investment professionals and investors before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and the transparency and integrity of global financial markets.
[2] CFA Institute is best known for developing and administrating the Chartered Financial Analyst curriculum and examinations and issuing the CFA Charter.

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I attach our response that addresses the questions of the consultation paper. Please do not hesitate to contact me, should you wish to discuss any of the points raised in our response.

I would also like to acknowledge the contributions made by Jean-Francois Bouilly, CFA, Advocacy Chair and Past President of the French CFA Society, and Peter Jakobus, CFA, Advocacy Chair of the German CFA Society, in the crafting of this response.

Yours faithfully

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GENERAL COMMENTS

The CFA Institute Centre strongly supports the Commission's initiative to produce a Key Investor Information (KII) document which will be more meaningful for retail investors and addresses the identified drawbacks of the Simplified Prospectus (SP); namely inconsistent rules of use, too much detail and unhelpful legalised boilerplate. We concur with the view that the KII should be a simple document providing pre-contractual information to help retail consumers reach well-informed investment decisions on non-complex financial instruments. In addition the KII will greatly help investors compare products that offer similar investment objectives.

Our primary concern with the proposal is the potential for incompatibility between constructing a short document that contains meaningful information, which simultaneously is understandable by all investors. If the document caters for the 'lowest common denominator' of investor understanding, its will be of little value to the average and more knowledgeable investor. To raise the standard of content from this level would require extended explanations that will squeeze out useful UCITS specific information or exceed the KII's two-page objective.

Our solution is to propose that as much generic explanation content as possible is transferred to a separate "knowledge base" document. This knowledge base would support each specific item on the KII and could be accessed via the internet. The knowledge base content in referencing a specific part of the KII would provide a brief explanation of a few sentences to address 95% of investor needs, followed by a more detailed explanation to address the needs of the enthusiast.

As a short harmonized document, we see the KII as a major opportunity to increase transparency across the UCITS market. We believe that the commonality of presentation offered by the KII for UCITS would encourage investors to seek greater knowledge by referencing a parallel knowledge base document. This would allow CESR the opportunity to elevate the KII's content quality, allow investors to make better choices, and provide a much needed educational opportunity.

Part I - Background and issues relating to KII proposal

<u>Chapter 2 – Summary analysis of SP regulatory failure</u>

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

We are not aware of other relevant research.

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

We believe that the KII will address the SP drawbacks and enable retail investors to reach well-informed investment decisions provided that it remains short, focused, understandable by retail investors, and enables comparisons between different offerings.

<u>Chapter 3 – The wider context in which KII would be used</u>

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

Yes, the KII, as envisaged, certainly serves the role of providing 'pre-contractual' information to UCITS investors. We have some concern that the objectives of KII might be compromised by incompatible goals from related legislation. We therefore urge that the KII document remains pure to its goals and not distracted to become a vehicle for satisfying regulatory requirements that do not add to the investor's comprehension of the underlying UCITS.

Part II – Recommendations on the format, content and presentation of KII

Chapter 4 – General options of format and content of KII

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

We believe that the KII should remain a short and focused document providing investors with the meaningful information required for making well-informed investment decisions; yet investors should understand the information and be empowered to obtain more details when desired. Hence, the CFA Institute Centre strongly encourages the creation of a 'knowledge base' supplement that provides simple and detailed explanations to generic ideas, terms and concepts, linked to each section of the KII. The KII should then indicate the existence of the "knowledge base" document, recommend that it should be read in conjunction with the KII, and advise the means to access it (e.g. internet link).

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

The CFA Institute Centre considers that non-retail investors should be given the opportunity to opt-out of receiving the KII. The challenge is to make the content useful to non-retail investors. Again, we believe that the potential incompatibility between meaningful an understandable information could be solved through the creation of a "knowledge base". For further detail we refer to our general comments. One further point is that if there is an "alternative/additional" document available for non-retail investors, disclosure of that document should be mentioned in the KII. On the basis of equality of treatment, this document should also be available for retail investors should they wish to consider its content.

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

We consider that the CESR proposals are appropriate. On the specific point of local information, we believe that the document should be standardised at the EU level and should not include local features, though this could be referenced in the "knowledge base" document. It will remain the responsibility of the distributor to provide this information during the advice process.

The "knowledge base" document would appear as a suitable platform to convey a check list of generic local information that the investor should consider, especially those who do not make use of a distributor.

If CESR decides to include some sort of local information despite the above mentioned concerns, we would then suggest displaying it vertically along the left page boarder, or in the form of a sticker, as described in our answer to question 13.

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

We agree with the prescriptive content structure tabulated in the box below paragraph 4.16. The investor's comparative utility of the KII undoubtedly increases if the content is standardised on each side of the sheet (the investor can compare several documents at once if they all contain the same style of information on one page). We also agree with paragraph 4.17 that the space for each item and its wording is not predefined. This would allow editorial flexibility to maximise pertinent information about the product to the investor.

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

The CFA Institute Centre would favour Option B with a reduction in the number of items included. Specifically, we do not consider it necessary to add items which do not add value to the investors' decision, such as the name of the depository and the name of the auditors. On the other hand, we believe that the KII should include the following items: the cut-off time for dealing instructions; and information on the existence of other classes of shares. In addition we feel that the fund's creation date and the size of the funds raised at the inception date are also features investors would find useful.

As concerns the information about where to complain, we consider that this topic should be dealt with separately due to its complexity and local characteristics (complaints would appear to fall into two classes fund mismanagement and fund mis-selling). Our preference would be the creation of an EU centralized repository for financial-related complaints across the different sectors; in that case, the KII could include the information on how to access this resource (e.g. internet link) vertically along the left boarder of the document.

As concerns umbrella funds, we refer to our answer to question 17.

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

The CFA Institute Centre would suggest the use of focus groups, which are exposed to some progressive training. Hence, we suggest starting off with a representative group of the population and, after being asked for initial impressions, testing if they can raise their comprehension over time and come up with more informed investment decisions.

We would like to stress that the KII should be a useful tool for retail investor decision-making process. Ideally we would like the document content to a standard of information that would fulfil the needs of knowledgeable investors.

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

We consider that CESR has struck a good balance subject to the final prescriptive content to be agreed. As mentioned in our answer to question 8 above, we would support content based on a modified version of option B.

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

Yes. We consider that this information could be displayed vertically on the left boarder of the document. This positioning of vertical text provides a good reference point for regulatory information, hence our suggested location of advice on complaints, referenced in our answer to question 8 above, is consistent with this idea.

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

We suggest that the KII includes personal or organizational changes which could materially affect the performance of the fund (e.g. such as change in the fund manager – from who to who, or material change in the management team), a disclosure required by our AMC and the GIPS standards.

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

The CFA Institute Centre believes that distribution costs should be unbundled. Indeed distribution costs might vary between member states and channels. It would not be easy to include these features in a harmonised KII document. If local information is part of the finalised KII we would recommend that a prescribed space and content is defined at the end of the second page where a 'sticker' of local information could be applied. This could carry pertinent information on the distributor and any additional distributor fees. The vacant area should carry a comment that local information and charges could apply and that the distributor is obliged to provide this information in this space.

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

We consider that the signposting of local information to a website is preferable. The alternative risk is of overloading the KII with information that does not add value to the decision-making process, as well as countering its aim of becoming a passportable harmonized document. We envisage that much of the local content serves the interest of the distributor, so we believe that the distributor would be more than willing to furnish that information to the investor, preferably in a separate document.

We concur with CESR's 'radical' suggestion of excluding all local information and signposting its whereabouts on a website. We would suggest posting the following information on the distributor website: the name of the organization, contact details and the complaints process in the case of mis-selling. All this could be referenced by posting the web link vertically along the left hand boarder of the KII.

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

We believe that a "building block" approach should be ruled out to avoid undermining the comparability of the KII.

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

The CFA Institute Centre agrees with CESR proposal in paragraph 4.37 that "The KII for funds of funds should be constructed with no expectation that the investor will either wish or need to be informed in detail about each of the underlying funds…" However, we stress that this should be compensated by appropriate comment in the strategy and objectives section of the KII.

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

We consider that there should be a separate KII for each sub-fund of an umbrella fund.

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

The CFA Institute Centre agrees with CESR proposal, stated in paragraph 4.49, that "it is reasonable to combine information where the presentation continues to meet the requirements set out in the next chapter…" (Objective and Strategy) for treatment of unit/share classes.

<u>Chapter 5 – Describe the fund's objective and strategy</u>

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

The CFA Institute Centre agrees with CESR's proposal with the exception of including indications on whether the fund is designed for non-sophisticated investors. There should not be a new client classification under MiFID. Given that UCITS are considered as non-complex instruments under MiFID, it would be inappropriate to introduce the concept of UCITS designed for non-sophisticated investors.

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

We agree with the proposal to merge strategy and objectives in one generic item. The distinction between them is often blurred and its presentation under a generic item would avoid unnecessary redundancies.

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

The streamlining of the current application is relevant and we agree with the addition of the above-mentioned key items with the exception of the non-sophisticated investor concept (for further detail we refer to our response to question 19, and the more precise definition of "guarantee" discussed in our response to question 22 below).

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

We consider that the term "guarantee" should not be used if the capital is not legally guaranteed, as it just adds to confusion. At the same time, the name of the guarantor should be mentioned if the capital is legally guaranteed. The guarantor's credit worthiness/rating, which if available should be mentioned, is it a risk feature that investors should consider.

We agree that it is not necessary to mention explicitly that a fund is not capital guaranteed.

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

There is a real value in reminding retail investors that time horizon aspects should be taken into account in their investment decisions. At the same time, a proper and detailed explanation could overload the KII with too much information. Hence, we suggest including a reminder that an investor should be in a low-risk investment (as indicated in the risk indicator) if there is a liquidity need for immediate use in the next 12 months. We believe that generic information and discussion on the time horizon concept is best placed in our proposed "knowledge base".

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

We disagree with this approach and consider that this is something which should be described as part of a risk disclosure section and using a different language (to avoid confusion on whether UCITS are aimed for non-sophisticated investors).

<u>Chapter 6 – risk disclosure</u>

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

We fully agree with this approach.

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

While we see merits on a single dimension horizontal 5 box scale, our recommendation is a two dimensional chart containing the annualised standard deviation of returns for the fund over say 1, 5, and 10 years across the horizontal axis. This would incorporate vertical traffic light stripes signifying increasing levels of risk. The vertical axis would display the matching returns, net of charges. We would suggest a caution statement stating that this is a historical measure and may not reflect future performance. This information would be complemented by the index or composite returns on the same chart. We would suggest tabulating the annual numerical returns of the fund and the index/composite adjacent to this chart. Please refer to our more detailed comments on performance presentation below.

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

The CFA Institute Centre prefers Option B1 (par. 6.33), namely a common methodology defined by regulators at European level which should comply with a table of criteria. As the explanation is generic text we feel this could be carried over to our proposed "knowledge base", freeing up space for more specific information on the UCITS.

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

Our preferred measure of risk is the annualised standard deviation of return on the underlying asset, index or composite of asset indices. The composite should be constructed from a model based on strategic asset allocation between asset classes. We recognise that the structure of the composite is open to the interpretation of the fund manager. However once the fund manager has identified the composite, this should be fixed over the life of the fund, unless there is a change in the investment strategy.

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

[We assume that there has been a typographical error and that reference is to Annex 5 not 4].

Yes, we would add in the case of new funds which do not have an investment history that the risk should be reflected by the historical behaviour of the benchmark index/composite. Reference should be made that this measure is in place of actual historical performance, and that it is only an indication of how the fund could be expected to perform. Please refer to its presentation in the answer to question 26 above.

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

The potential limitations of a synthetic indicator will very much depend on the level of the understanding of the information being displayed. We have flagged (above) our suggestions for a caveat disclosure which would note that historical performance may not be indicative of the future.

We consider it essential that the investor is empowered to learn how to interpret more complex financial terms and concepts. As advocated above we feel that generic explanations ought to be presented in a separate "knowledge base" document, where the consumer could obtain more detailed information about the use and limitations of the risk indicator.

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

We agree with CESR's proposed textual risk-reward warnings described below paragraph 6.29. We have reproduced these warnings with some suggested slight <u>underlined</u> modifications.

"Warning: This synthetic risk/reward indicator takes into account most of the usual situations that face this investment. Unexpected major events, as well as unusual market situations, might have negative consequences not <u>described by</u> this indicator.

Remember that generally, higher possible gains are a counterpart to a higher risk of losses. This indicator offers a <u>historical</u> view, but this might be modified through the operation of deep market trends".

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

Apart from possible issues of liquidity and counterparty risks, we believe that all funds and risks should be captured by this methodology since risk is the volatility of the expected return. With regards new funds which do not have an investment record, please refer to our answer to question 29.

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

We strongly oppose the display of scenarios or tables and support CESR's observations. We believe scenario presentations could be misleading, manipulated, and interpreted as holding some type of guarantee where there is none. Furthermore, scenario presentation for formula funds, given the potential flaws described above, sets a precedent to encourage the introduction of scenarios, and their potential flaws, throughout the UCITS business.

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

We strongly endorse the use of a synthetic indicator. We consider that narrative descriptions cannot adequately convey the message in the final expose.

The principles aim to enhance narrative disclosures, however we believe that comprehensive delivery would be difficult within the document's textual constraints. For instance: principles 3 and 5 are difficult to express and open to interpretation; principle 4 would be very verbose; principle 7 lacks of precision; and principle 6 is incompatible with the other six principles given that it is hard to convey with all the other information in a finite space.

Chapter 7 – Past performance

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

We consider it essential that information about past performance is included in the KII. For better or worse investors tend to form their expectations of the future on the basis of past performance. Therefore it is important that the information presented is set within a context that is fair, accurate, and transparent. We offer for CESR's consideration the Global Investment Performance Standards (GIPS®) developed by CFA Institute as a performance presentation methodology. This methodology has been adopted in 30 countries to date.

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

We concur with CESR's standardized approach to calculation methodologies: the handling of charges, the time periods shown, the yearly periods shown, the handling of new funds, the handling of material changes, and the handling of simulated data. We suggest that CESR refers to this web link (www.gipsstandards.org/governance/pdf/archive/ReportFinal.pdf) for a more comprehensive discourse on this question.

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

We have recommended standards that answer this question, please refer to www.gipsstandards.org/standards/guidance/archive/pdf/FeesGuidance.pdf)

Chapter 8 - Charges

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

We concur with CESR's identification of the best overall options.

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

We consider that a “consolidated” charges disclosure should be included in the KII and described in the form of the option A below paragraph 8.21 in CESR’s consultation document. We feel investors will benefit from a table that displays initial charges, exit charges, ongoing charges, and any other charges.

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

We do not consider that the disclosure of charges in cash terms would be helpful, and rather could create confusion since investors would need to recalculate their charges when considering different levels of investment. Furthermore, investors could obtain this information through their financial adviser, or calculate the monetary value themselves.

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

We consider it essential to keep the disclosure very straightforward and suggest using CESR’s option A below paragraph 8.21. This disclosure should include more detailed disclosure on the calculation of ongoing charges, specifically the frequency, timing, and percentage value of collection from the fund, i.e. quarterly, semi-annually and annually.

Otherwise, we suggest locating the numerical values at the end of the table, i.e. the right hand side (rather than the middle as it stands now).

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

Accurate disclosure of charges should include the use of both ex-post and ex-ante figures. The GIPS® standards relating to fees advise where these should be ex-anti or ex-post. Explaining the reasoning behind these two types of presentation could be textually consuming, though generic to all KII documents. This again supports the development of our proposed “knowledge base”. We feel that most investors would understand that initial charges and exit charges are based on current investment values, and likewise ongoing charges. Though as mentioned in our answer above, we feel it is important to describe the frequency, timing, and percentage value of ongoing charges.

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

We consider that the KII should be updated before the instigation of new charges. Furthermore, existing investors should be warned in advance that they will be subject to a change in charges before they take place.

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

We consider that portfolio transaction charges should be excluded from ongoing fund charges, since they are included in the fund overall net and gross performance. The investor's central concern lies with the value of the investment and its performance. We feel that by buying an UCITS investors have delegated the management of the assets and operational charges to the manager.

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

We would strongly recommend that performance fees are described in narrative with more disclosure describing the "high watermark" over which the investor will only participate in 1-x% of the return. In general the presentation of performance fees can be very complicated with multiple interpretations of inputs and multiple presentations of methods. This area could be very textually consuming, and specific to each UCITS, where applicable. This indirectly supports our "knowledge base" proposal, because it frees up space in this context for specific performance fee discourse.

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

We consider that charges should be disclosed on a maximum basis with the exception of distribution fees which should be disclosed separately by the distributor as part of its advice process. We consider that the KII should remain an EU harmonized document and, therefore, not include local information. Instead we recommend including a warning flag that additional charges may be applied at local level by distributors and it is strongly recommended to request them in advance.

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

We can not think of other options and would like to stress again that local information should not be included in the KII.

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

We disagree with this proposal and believe that if a two-tier fee structure exits; this should be disclosed to investors.

Part III – Benefits and costs of KII proposal

<u>Chapter 9 – Benefits and costs of KII proposal</u>

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

We consider that the learning effects of using the KII should be tested in the user focus groups. The results should be taken into account to ensure that the KII does not rapidly become obsolete and instead raise its utility as investors increase their comprehension. For further detail, we refer to our general comments.

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

No comment.

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

No comment.

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

We consider that there should not be any transitional arrangements.

53. Is the gradual introduction of KII feasible?

We consider that it would be feasible but not preferable.

17 December 2007