

Workshop on simplified prospectus

2nd Meeting

11th July 2006

Annotated Agenda

08:45 – 09:00 Arrival

09:00 – 09:15 Opening Address (*Commission – D. Wright or Niall Bohan*)

09:15 – 10:15 Cost disclosure approach

- Presentation by E. Moisson (Lipper Fitzrovia) : TER issues cross-border and cost/volatility issues
- Presentation by G. Prache (FAIDER) : Cost disclosure from investor's point of view, including some lessons to be drawn from the US experience
- Open debate

The UCITS provides in Schedule C of its Annex I that the following costs should be disclosed in the simplified prospectus:

- entry and exit commissions;
- other possible expenses or fees, distinguishing between those to be paid by the unit-holder and those to be paid out of the unit trust's/common fund's or the investment company's assets.

Recommendation 2004/384/EC of 27 April 2004 (the "Recommendation") states in its Recital 9, that "to ensure effective investor protection and enhance investor confidence in the fund industry, it is desirable that the simplified prospectus provide for full transparency of all the costs actually borne by the investors in relation to their investment. To this end, it is necessary to disclose a total expense ratio (TER) calculated as an indicator of the fund's total operating costs. It is therefore also necessary to clarify how the TER should be calculated. Since entry and exit commissions and other expenses directly paid by the investor are not included in the TER, it is desirable that they are shown separately as well as all the other costs not included in the TER, including disclosure of transaction costs when these are deemed to be available by the home Member State competent authorities. In any case, it is desirable to disclose the portfolio turnover rate calculated on a standardised basis, as an additional indicator of the relevance of transaction costs". Recital 10 then further insists on disclosure of fee sharing agreements and comparable fee arrangements.

Q1. What does the investor need to know / what does he/she want to know?

- Who is being paid what out of fund assets?
- What are these payments for?
- What are they called?

Q2. Is the total expense ratio (TER) the right cost disclosure method or should other charge disclosure approaches be envisaged?

In respect of use of TER, see below under Q3.

Other charge disclosure approaches could be devised which include all relevant product and fund charges within a single figure or set of figures.

In the insurance sector (unit-linked life insurance contracts) disclosure of the projected insurance benefits at maturity prior to the conclusion of the contract is made, using a "zero percent scenario" (amount of contributions minus fund value at zero percent yield). This allows insurance clients to compare the different unit-linked policy providers in terms of costs and also is the standard method for providers of neutral product comparisons (rating agencies etc.) for making cost comparisons (*source: German Insurance Association*)

See also: FSA short note outlining some thoughts on charges disclosure intended solely for the purpose of initiating a discussion about how to show charges for UCITS (29.06.06) – copy attached.

Q3. If TER is used, what should be the components thereof? What should be the level of breakdown of expenses? Is the current calculation method provided for in Annex I of the Recommendation 2004/384/EC sufficient?

The total expense ratio (TER) is calculated as an indicator of the fund's total operating costs. It should be calculated as indicated in Annex I to Schedule C of the UCITS Directive ("Annex I"), except for newly created UCITS where a TER cannot be calculated.

The TER is equal to the ratio of the UCITS' total operating costs to its average net assets calculated as specified in paragraph 3 of Annex I.

The total operating costs are all the expenses which come in deduction of a UCITS' assets. The expenses are gross of tax, and the average net assets are derived from the NAV for the scheme without taking account of tax relief.

Paragraph 2 of Annex I specifies which costs are included/excluded. They **include** any legitimate expenses of the UCITS, whatever their basis of calculation, such as: management costs (including performance fees), administration costs, fees linked to depositary duties, audit fees), payments to shareholder services (including payments to UCITS' transfer agent and to brokers-dealers that are record owners of the UCITS' shares and that provide sub-accounting services for the beneficial owners of the

UCITS shares), payments to lawyers, any distribution or unit cancellation costs charged to the fund, registration fees, regulatory fees and similar charges, and any additional remuneration of the management company (or any other party) corresponding to certain fee-sharing agreements (further specified in paragraph 4 of Annex 1). They **do not include**: transaction costs (such as brokerage fees, taxes and linked charges), interest on borrowing, payments incurred because of financial derivative instruments, entry/exit commissions or any other fees paid directly by the investor, soft commissions.

Points to be considered:

- Pro's and con's of using TER (see Q2.).
- Improved breakdown and disclosure of expenses might encourage institutional investments in UCITS – and subsequent economies of scale could be passed on to retail investors BUT research (*source: FSA*) shows that breaking down charges into its constituent elements makes it difficult for investors/consumers to interpret the overall impact of charges.
- Consistent disclosure of TER components helps UCITS to calculate consistent TERs (e.g. Lipper Fitzrovia ensures consistency by using audited financial statements and apply their consistent methodology of the last 12 years).
- *Management fee*. Consistent disclosure of what a quoted management fee consists of would be of benefit to industry and investors, e.g. in some domiciles such fee covers administration expenses, in other domiciles it can cover virtually all operating expenses.
- *Performance Fees*. Are they to be included in the TER / to be mentioned separately / to be included in TER and mentioned separately?
- *Brokerage commissions*. In the US brokerage commissions are excluded from the TER as they are buried within the overall profit/loss figures on a fund's capital account. Therefore, where they do record this in an expense statement, it is excluded for consistency. In addition, the operating expenses of a fund (TER) are those that an investor could reasonably expect to pay each year - as brokerage is activity-related, this is not an operating expense per se.

The TKA (Totalkostnadsandel) in Sweden includes brokerage commissions. Question: Are the resulting figures more volatile (and therefore less useful for investors)? How feasible would it be to calculate such figures across European domiciles?

- *Fee sharing agreements / soft commissions*. Approach to be followed?

Q4. What other costs - not included in the TER – should be disclosed?

According to the Recommendation, these include entry and exit commissions, other expenses directly paid by the investor, and other costs not included in the TER (e.g. transaction costs).

- What should they include (transaction costs, distribution costs, other)?
- What about local costs (difficulty of including this in a harmonized document)?
- What does the consumer want/need to know?

Q5. Need to disclose portfolio turnover rate?

Member States are recommended to disclose – as an additional indicator of the importance of transaction costs, the portfolio turnover rate, calculated as shown in Annex II of the Recommendation.

- Relevance of such disclosure to consumer?
- Some respondents to the Green Paper pointed out that the definition of portfolio turnover rate in the Recommendation is unsatisfactory and that it should be changed to the conventional US definition of portfolio turnover? Any views on this?

Q6. Is full disclosure of fees relating to product/fund distribution in the simplified prospectus desirable/feasible?

Q7. Who should be responsible for disclosing which type of charges?

The current UCITS disclosure regime, and in particular the simplified prospectus, relies more on the product manufacturer. Should more focus be placed on the distributor (i.e. in respect of disclosure of "retrocession fees"/ fee-sharing arrangements, transaction costs, soft commissions)?

Q8. Will investor awareness of fees/charges inverse competitive pressure on fund promoters and distributors?

For further background information: see Issues Paper first SP Workshop, Section 6.3, Q2.

10:15 – 11.15 Risk disclosure approach¹

- Presentation by G. D'Agostino (CONSOB): synthetic risk indicators
- Presentation by M. Denkers (AFM) on risk indicators used in The Netherlands
- Presentation by J. Vander Stuyft (KBC Asset Management) and T. Wilkinson (BNP Paribas Luxembourg): views of industry
- Open debate

¹ Some useful information can be found in the ICI study "Shareholder Assessment of Risk Disclosure Methods" http://www.ici.org/pdf/rpt_riskdiscl.pdf

The UCITS Directive provides in Schedule C of its Annex I that the simplified prospectus should contain – apart from a description of the funds investment policy – a brief assessment of the fund's risk profile (including, if applicable, information according to Article 24a of the UCITS Directive and by investment compartment).

The Recommendation indicates in its Recital 6, that "in keeping with the safeguards provided for in Article 24a(1) and (3) of Directive 85/611/EEC, the **average investor** should be enabled to understand the risk profile of a UCITS and be adequately informed of relevant risk characteristics. It is therefore desirable that the simplified prospectus contain a **brief and easily comprehensive description, in narrative form**, of all the risk **material** and **relevant** to the UCITS. It is also advisable to encourage Member States, where they deem it relevant in the light of customary disclosure practice and existing investor protection standards, to require that this information be supplemented by a **quantitative risk indicator** based on the UCITS volatility, but subject to further convergence work on such risk indicators".

Paragraph 1.4 of the Recommendation clarifies the overall structure of the information to be provided and gives some precisions regarding the textual description of some specific risks, horizontal risk factors and possible prioritisation of information disclosure.

Q1. What is the best method for "consumer-friendly" risk disclosure?

- Use of risk indicators (e.g. medium risk, low risk, high risk)
- Use of common definitions?
- Disclosure of a synthetic risk indicator?
- Signposting to full prospectus?

Q2. What does the investor need to know / what does he/she want to know?

- How to present information on risk to the average investor in a brief and easily comprehensive description? Is narrative disclosure the right way? Should other methods be envisaged (use of absolute figures/examples or graphs/pictures – cf. AFM Financial Information Leaflet)?
- Risk categorization/standardisation?
- Prioritisation in presentation of information?

Q3. What is the respective role of the distributor/financial advisor and the fund manager?

- Product regulation vs. suitability advice / investor education

11:15 – 11:30 Coffee break

11:30 – 12:15 Performance issue

- Presentation by T. Wilkinson (BNP Paribas Luxembourg)
- Open debate

The UCITS Directive provides in Schedule C of Annex II that the simplified prospectus should contain the "historical performance of the unit trust/common fund/ investment company (where applicable) and a warning that this is not an indicator of future performance. Such information may be either included in or attached to the prospectus".

The Recommendation (paragraph 5) clarifies the meaning thereof and provides further guidance on the disclosure of past performance (use of a bar chart showing annual returns for the last 10 full consecutive years; comparison with past performance of benchmark if UCITS is managed according to a benchmark or if its cost structure includes a performance fee depending on a benchmark); disclosure of cumulative (average) performance; and exclusions of subscription and redemption. It also invites Member States to consider as a possible option requiring disclosure of a benchmark for all UCITS authorised in their jurisdiction, regardless of the fact that the UCITS does not explicitly refer to a benchmark.

Q1. What does the investor need to know in terms of performance?

Q2. How to present past performance?

Bar chart versus line chart? On the basis of a calendar year, fiscal year or year to date (comparability issue)? What should be the reporting currency? Currency of the fund versus currency of the investor (as demanded in certain Member States)? Comparison to past performance of benchmark (same bar chart/separate chart)? Audited figures only?

Q3. How to present cumulative (average) performance?

Which periods of time? Comparison to benchmark?

See also: Swiss Funds Association SFA – Guidelines on the calculation and publication of fund performance data (27 July 2004) – copy attached.

12:15 – 13:00 Cross-product approach: unit linked life insurance products/ structured products

- Presentation by C. Kenny (ABI): comparison unit-linked life insurance products to UCITS (in the UK).
- Open debate

Q1. Are these products actually in competition with funds? If so, which ones in particular?

Q2. Are differences in disclosure standards really distorting competition with these funds? Is there a real "disclosure gap" than needs to be rectified in its own right (because of the danger of mis-selling)?

For further background information: see Issues Paper first SP Workshop, Section 4.3.

13:00– 13:45 Lunch

13:45 – 15:15 Ways to move forward: What can be improved to current standardised disclosure?

The Commission would like to get a sense of the improvements to be made to the simplified prospectus in respect format, design, content etc. Based upon the discussions held at the first workshop, the Commission has therefore identified a (non-exhaustive) package of elements which could be changed. The proposed changes relate to more general issues (e.g. liability regime, delivery methods, role of home state regulator) as well as to more detailed elements of content of the simplified prospectus (following the current structure of Schedule C of Annex I of the UCITS Directive).

First part:

Based upon the discussions at the first workshop, we first would like to ask consumers/investors participants to give their feedback on the various models of "simplified prospectus" (or analogous concepts) which have been distributed prior to or at the first workshop:

- Financial Information Leaflet (AFM);
- KeyFacts Quick Guide (FSA);
- EFAMA models;
- Prospective Spanish Simplified Prospectus;
- US/NASD Profile Plus;
- the French "free form" prospectus (in French language).

We also enclose three additional example disclosure documents provided to us by FSA. These documents and the KeyFacts Quick Guide concept were not put forward as a disclosure model for adoption, but were designed solely to give an indication of what a short and simple document using plain language, Q&A format and tabular layout might look like.

Second part:

In a second part, participants are invited – by way of a 'tour de table' - to express their views on the Commission's first assessment of possible changes to be made to the current standardised disclosure regime (as outlined in Section 2 of the Issues Paper 2nd SP Workshop). We would ask participants to consider the following points:

Q1. What elements should be changed to achieve the guiding principles listed in Section 1 of the Issues Paper 2nd SP Workshop? Do participants agree/disagree with (some of) the proposed changes? What are the views of the different constituencies?

Q2. Are there any additional points participants would want to cover?

Note: Participants can use the overview in table format, provided to them together with the Issues Paper 2nd SP Workshop, as a working document to prepare this Section. It lists the proposed changes to be considered and also contains some blank space to add in additional items.

For further background information: see Issues Paper 2nd SP Workshop – Section 2

15:15 – 15:30 Coffee Break

15:30 – 16:45 Ways to go forward: How to achieve the proposed changes: methodology

This Section aims at getting the participants' views on how to achieve the proposed changes, i.e. which methodology is best used. The various options which the European Commission considers as possible ways of moving forward to ameliorate standardised disclosure are:

- Abandon the simplified prospectus.
- Rely on self-regulation.
- Soft law harmonisation: Adopt level 3 measures (i.e. CCSR guidelines) / modify the existing Commission Recommendation on simplified prospectus.
- Agree on more harmonised level 2 measures (i.e. clarification of definitions by means of secondary legislation pursuant to Article 53a of the UCITS Directive).
- Change the UCITS Directive (level 1 measure).
- A combination of some of the above.

The various options presented above rank from the most radical measure, i.e. abolishment of the simplified prospectus, to the measure that would provide the highest degree of harmonisation, i.e. amendment of the existing UCITS Directive. Section 3 of the Issues Paper 2nd SP Workshop gives a short description of each option, indicating the pro's and con's thereof.

First part:

In a first part, the Commission will present its initial assessment of the various options to move forward, on the basis of the discussions held in the first workshop/morning session of the second workshop.

Second part:

In a second part, the Commission would like to get participants' reactions and input by way of a 'tour de table' & open debate. Participants are in particular requested to focus on how to

balance the pro's / con's of each option taking into account the basic principles to be achieved through standardised disclosure (as set out in Section 1 of the Issues Paper 2nd Workshop).

Note: Participants can use the overview in table format, provided to them together with the Issues Paper 2nd SP Workshop, as a working document to prepare this Section. It lists the proposed changes to be considered and the various options to do so (excluding "abolish the SP" since such choice would make redundant the proposed changes). It also contains some blank space to add in additional items.

For further background information: see the Issues Paper 2nd SP Workshop.

16:45 – 17:00 Concluding remarks/Operational conclusions

Annexes:

1. FSA short note outlining some thoughts on charges disclosure (29.06.06)
2. Swiss Funds Association SFA – Guidelines on the calculation and publication of fund performance data (27 July 2004)
3. Three additional example disclosure documents provided by FSA (illustrative documents only).