



Market Supervision

Key Investor Information Documents (KIID) of Finnish investment funds – some improvement in clarity still needed

Finnish investment funds' key investor information documents generally meet the requirements. But many management companies still need to make improvements, inter alia, as regards the clarity of the description of investment policy.

The description of a fund's investment policy should state in a clear and comprehensible manner how and where the fund invests its assets. The focus should be on the actual nature of the fund's investments at given times. Descriptions should not be overloaded with details of what the fund is allowed to do under its rules and regulations but what the fund is actually not doing. The description of investment policy is not yet sufficiently clear and accurate in all the examined key investor information documents. In some key investor information documents, the description of investment policy includes terms that are often unfamiliar to consumers as well as inaccurate means of expressions.

Management companies must also pay attention to the recommended holding periods presented in the key investor information document. Some management companies do not state the holding period using the wording of the European Commission's Regulation. Moreover, many management companies had recommended a five-year term for holding units in equity funds, irrespective of the markets in which the fund invests. In FIN-FSA's view, the recommended holding period should be based on fund-specific documented risk assessments and should realistically describe the fund-specific risks. Based on the recommendation, the customer should get an idea of the length of time he should be prepared to wait for the investment's risk and reward profile to reach a reasonable level with sufficiently high probability. FIN-FSA urges management companies to conduct fund-specific examinations and assessments of the applicability of their recommended holding periods in light of the markets in which their investment funds are investing.

In their descriptions of risk and reward profiles in key investor information documents, many management companies also describe risks that are not necessarily material to the specific fund. Management companies should in future keep in mind that this section must focus on risks that are material to the fund's investments.

In the Charges section of the key investor information document, many management companies mention the TER (total expense ratio), which was used in simplified fund prospectuses, whereas in the key investor information document this was replaced by the ongoing charges ratio. The TER is not part of the key investor information document; the only ratio to be used in the key investor information document is the ongoing charges ratio. FIN-FSA recommends that management companies use the ongoing charges ratio also in a fund's prospectus and marketing material.

FIN-FSA examined the key investor information documents of 84 funds, including at least one fund from each Finnish management company. The key investor information replaced the simplified fund prospectus when the UCITS IV Directive on investment



Market Supervision

funds entered into force in summer 2011. Investment funds had to introduce the key investment information document by 1 July 2012.

The key investor information document is a standardised document that is provided to investors, which describes the particular characteristics of a fund. It describes in clear and succinct language the fund's investment policy, risks, charges, past performance and other matters important to the investor.

The European Commission's Regulation¹ specifies the content of the key investor information document. The purpose of the Directive is to ensure that information on investment opportunities is consistent and comparable. The Committee of European Securities Regulators (CESR), predecessor of the European Securities and Markets Authority (ESMA), has also issued detailed guidelines on the content of the key investor information document.

1 Description of investment policy

1.1 Requirement of the Regulation

The key investor information document should state in a clear and comprehensible manner how and where the fund invests its assets. The focus should be on the actual nature of the fund's investments at given times. Descriptions should not be overloaded with details of what the fund is allowed to do under its rules and regulations but what the fund is actually not doing. In the description of investment policy, only those financial instruments are to be mentioned that have a material impact on the fund's performance, not all the instruments in which the fund could invest under its rules and regulations.

1.2 Findings

In all the examined key investor information documents, the description of investment policy is not yet sufficiently clear and accurate. For example, key investor information on mixed funds does not always include the ranges of the fund's investment weights for different assets. Repeating the ranges stated in the fund's rules and regulations does not always give a sufficiently accurate picture of the fund's actual investment policy.

In addition, many key investor information documents included the expression "the fund can use derivatives to hedge against foreign exchange risk". This does not inform the investor with sufficient precision whether the fund as a rule protects its investments always or occasionally or whether it is only a possibility provided by the fund's rules and regulations which is however not used.

Some key investor information documents used terminology that is standard for the financial sector but unfamiliar to the customers. These terms included credit rating limits and risk indicators such as duration and modified duration.

¹ Commission Regulation (EU) No 583/2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website.



Market Supervision

As regards the fund's benchmark index, the key investor information document generally only states the name of the index and whether it is a performance index.

Moreover, many management companies begin the description of investment policy by stating that the fund's investments accord with the Mutual Funds Act and the rules and regulations of the fund.

1.3 FIN-FSA's view

The purpose of the key investor information document is to describe in a clear and comprehensible manner how and where the fund invests its assets. It does not describe at length the fund's investment opportunities but rather the fund's actual investment activities at given times. The description should not begin by stating that the fund invests in accord with the rules and regulations and the Mutual Funds Act; it should first list the fund's most important investment instruments. The expressions used must be as specific and unambiguous as possible. For example, it is not sufficient to present a list of credit ratings. It is advisable to explain the importance of credit ratings (eg loans with a high credit rating or high-risk loans). Difficult terminology, eg duration and modified duration, should be explained in plain language if such terms are used.

The fund's benchmark index should also be described, instead of just stating the name of the index. The customer should know what kind of a market the benchmark describes (eg the shares of small European companies or Japanese high-risk corporate loans). In addition, it should be stated whether the index is a performance or price index and what that means.

2 Recommended holding period

2.1 Requirement of the Regulation

The recommended holding period must be stated only where term for holding units in the UCITS is stated either in the prospectus or in any marketing documents, or where it is stated that a minimum holding period is an essential element of the investment strategy.

Where the recommended term for holding units is mentioned in the key investor information document, it must be stated using the wording defined in the Commission's Regulation No 583/2010:

"Recommendation: this fund may not be appropriate for investors who plan to withdraw their money within [period of time]".

2.2 Findings

Many management companies stated the holding period using wording other than that in the European Commission's Regulation.



Market Supervision

Moreover, many management companies had recommended a five-year term for holding units in all equity funds, irrespective of the market in which the fund is investing.

2.3 FIN-FSA's view

The recommended holding time must be stated in the manner specified in the Regulation.

The recommended holding period should be based on a fund-specific documented risk assessment, and it must realistically describe the fund-specific risks. Based on the recommendation, the customer should get an idea of the length of time he should be prepared to wait for the investment's risk and reward profile to reach a reasonable level with sufficiently high probability. FIN-FSA urges management companies to conduct fund-specific examinations and assessments of the applicability of their recommended holding periods in light of the markets in which their investment funds are investing.

3 Risk and reward profile

3.1 Requirement of the Regulation

A fund's risk and reward profile must be defined in accordance with the guidelines issued by the Committee of European Securities Regulators (CESR), the predecessor of the European Securities and Markets Authority (ESMA).²

Management companies must monitor on an ongoing basis the volatility of the synthetic risk and reward indicator (SRR). The SRR must be revised if its relevant volatility has fallen outside the bucket corresponding to its previous risk category on each weekly or monthly data reference point over the preceding 4 months.

The risk and reward profile is complemented with a written description of risks material to the fund and risks that the risk and reward profile does not sufficiently take into account.

3.2 Findings

To be on the safe side, many management companies list as risk a large number of various types of imaginable risk.

3.3 FIN-FSA's view

Management companies must analyse for each fund the material risks related to the funds' investments. For example, a fund's counterparty risk or operational risk must be material if it is disclosed in the key investor information document.

The inclusion of general risks that fall in the category of "unexpected events" should also be avoided in the risk descriptions.

² CESR/10-673 CESR Guidelines – Methodology for the calculation of the synthetic risk and reward indicator in the Key Investor Information Document.



Market Supervision

If an investment fund lends securities it owns, the key investor information document must disclose the risks related to the lending arrangements and the risk management arrangements. A reference to the prospectus can be made in the key investor information document, where necessary.

4 Presentation of charges

4.1 Requirement of the Regulation

From the Charges section, the customer must be able to get a clear understanding of the fees levied from customer or on the fund's capital. All of the elements of the charging structure shall be presented as clearly as possible to allow investors to consider the combined impact of the charges.

4.2 Findings

Many management companies mention the TER (total expense ratio) in the Charges section.

4.3 FIN-FSA's view

The TER is not part of the key investor information document; the only ratio to be used in the key investor information document is the ongoing charges ratio. FIN-FSA recommends that management companies use the ongoing charges ratio also in a fund's prospectus and marketing material.

If a fund's charges are presented in a prospectus or marketing material, all of the elements of the charging structure must be presented clearly to the customer. Funds that charge a performance fee have to disclose not only the basis on which the charge is calculated but also the amount of the performance fee charged during the UCITS' last financial year as a percentage figure.

In its earlier recommendation FIN-FSA stated that management companies should give, in simplified prospectuses, examples of the basis on which the performance fee is calculated. As simplified prospectuses are no longer prepared, FIN-FSA recommends that management companies include in the fund prospectuses examples of the basis on which the performance fee is calculated. It is also advisable to mention in the key investor information document that additional information on performance fees is available in the prospectus.

In addition to the examples, the amount of performance fee should be illustrated by including in the prospectus information on performance fees charged in past years.

If due to the fund's short history or changes in another factor, the actual charges do not describe reliably the fund's charging structure, this must be disclosed to the customer.

As to funds investing in other funds, it is not sufficient to disclose in the marketing material only the fees charged by the feeder fund. Management companies must inform the customer clearly of the fund's total burden of charges, taking into account the fees of the underlying fund.



Market Supervision

5 Past performance

5.1 Requirement of the Regulation

The information about the past performance of the fund shall be presented in a bar chart covering the performance of the fund for the last 10 years. UCITS with performance of less than 5 complete calendar years shall use a presentation covering the last 5 years only. For any years for which data is not available, the year shall be shown as blank with no annotation other than the date.

The graph is to show only complete calendar years.

5.2 Findings

In some key investor information documents, the bar charts do not show the calendar years or incorrectly state the number of years.

5.3 FIN-FSA's view

A fund's past performance must be presented in accordance with the requirements of the Regulation.

6 Follow-up

FIN-FSA considers it important that management companies take FIN-FSA's findings and views into account and update their key investor information documents where necessary.

Moreover, FIN-FSA recommends that management companies take into account, particularly in the key investor information documents of index-replicating UCITS, the ESMA Guidelines on ETFs and other UCITS issues, which were published on 18 December 2012 and entered into force on 18 February 2013.