



ASSOGESTIONI

associazione del risparmio gestito

Milan, 22nd September 2015

**IOSCO – International Organization
of Securities Commissions**

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Spain

Our ref: 336/15

Your ref: CR06/2015

**Assogestioni's reply to IOSCO's Consultation Report on Elements of
International Regulatory Standards on Fees and Expenses of Investment Funds
(CR06/2015)**

Assogestioni¹ welcomes the opportunity to respond to IOSCO's Consultation Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds (CR06/2015).

We support IOSCO's overarching objective to identify global common principles in relation to information on fees and expenses for collective investment schemes whose shares or units are permitted to be sold to retail investors. We believe that IOSCO's Committee on Investment Management's (C5) action helps ensuring consistency amongst different regulatory standards and convergence of requirements in relation to fees and expenses, with the aim to also create a level playing field.

**Q1: Are there any other developments that C5 should take into account when
formulating good practices regarding fees and expenses of CIS?**

We believe that IOSCO's assessment of regulatory developments – as explained throughout the Consultation Report – duly consider the regulatory trends and approaches matured after the 2004 Final Report was released.

In this context, it is worth recalling that the European regulatory interventions have offered a significant contribution to these developments and that due consideration should be given by IOSCO to the experience gained in the European Union,

¹ Assogestioni is the trade body for Italian investment management industry and represents the interests of members who manage funds and discretionary mandates around € 1,718 billion (as of August 2015).



especially in relation to the UCITS legislative and regulatory framework, where the KIID (Key Investor Information Document) represents a well-tested and reliable source of easy-to-understand information for retail clients. These standards aim at ensuring a harmonized approach on fee and expense to also enhance disclosure, allowing investors to compare UCITS more easily.

Q2:

- **If you think defining permitted and prohibited costs is useful, should this be done by the regulatory authority or the CIS operator?**
- **What types of costs should be permitted and/or prohibited to be charged?**
- **Are there alternatives to prohibiting certain fees and expenses and if yes, what are they and why are they effective?**

It is our belief that defining permitted and prohibited costs should be done by the regulatory authorities and not by the CIS operator itself.

We therefore support a list of negative fees and expenses that cannot be deducted from the CIS assets, such as the list indicated in paragraph 25 of the Consultation Paper². In our view, such a list should be exhaustive in order to avoid regulatory arbitrage.

As for the proposed standard in paragraph 26(c) of the Consultation Paper, while we agree that the CIS operator should not deduct a new type of fee from the assets of a CIS or increase the management fees unless, at a minimum, the responsible entity approves such fees, we express our concern on the principle that introduces possible breakpoints to the CIS management fee in case of economies of scale. Indeed, the pricing policy, including the decision on the appropriateness of breakpoints to the management fee, should be a discretionary decision of the fund manager, as part of its commercial strategy and thus be left to the CIS operator, rather than being suggested (or imposed) by means of regulatory measures. The amount and the structure of fees is subject to different commercial pressures and offset costs related not only to the asset manager's activity, but also to the overall management of the CIS. Those costs are usually expressed as a percentage of the total assets rather than a fixed amount (for example, costs to enhance the quality of distribution). Hence, we suggest that such an indication should be deleted from the future standards.

² These are: a) costs associated with the formation of the CIS; b) mergers, restructurings, or transfer from one operator to another; c) expenses or losses resulting from the failure of the CIS operator to meet its obligations (e.g. sanctions for breaching laws or regulatory standards, interest paid on delayed settlement of payments due to investors); d) advertising and promotional activities; e) expenses which have not been disclosed in the legal CIS documents.



Q3:

- Which do you consider to be the most appropriate method of performance fee calculation currently employed and why? Are there methods other than a fulcrum fee or “last in, first out” that are more effective?
- What other requirements might curb incentives for excessive or inappropriate short-term risk taking? Should there be specific recommendations as to how the calculation, benchmark, and target of a performance fee are disclosed? What further disclosures could be recommended?

As a general remark, we believe that, as mentioned in IOSCO’s assessment contained in paragraph 30 of the Consultation Paper, performance-related fees “*can be more effective than a standard, ad valorem fee in aligning the interest of the operator and the investors*”.

While the additional revenue opportunities should be balanced and appropriate to avoid excessive risk taking, we believe that such an objective can be reached through different methods. In this regard, it is worth noting that some jurisdictions, including Italy, in line with IOSCO 2004 standards, have provided a detailed set of measures to discipline how performance fees can be levied (for example, the Italian Authority has introduced the principle of compensation of positive over-performance with negative underperformance³). While encouraging IOSCO to take into account the different existing best practices, we believe that the Committee should refrain from indicating a specific model, such as the fulcrum fee referred to in paragraph 36(3) of the Consultation paper, or a specific methodology (paragraph 36(4)). We are of the view that general principles should rather be provided, in line with the 2004 standards, to ensure that performance fee structures: (i) are consistent with the fund investment policy; (ii) do not create an incentive for the fund operator to take excessive risks to increase its performance fee; and (iii) use methods that guarantee an equal treatment of all investors.

In any case, we continue assuming that the reference to “benchmark” in paragraph 36(4) of the Consultation paper is a general definition, which also includes other parameters, such as a hurdle rate or a high water mark, in line with the 2004 Recommendations.

As for disclosure of performance fees, we share IOSCO’s view that sufficient information should be provided to investors to allow them understand how performance fees will be generated and to make, thus, better informed investment decisions. In this sense, we would like to draw IOSCO’s attention to the current disclosure requirements on performance fees established under the UCITS KIID Regulation (Regulation (EU) No. 583/2010). This level of pre-sale information combined with a more detailed description in the fund’s constitutional documents on how the fee is calculated provides disclosure to retail investors and represents an appropriate set of requirements to meet the objective to provide clear and not

³ See Bank of Italy Regulation on collective management service, Title V, Chapter I, Section II, paragraph 3.1.1.1.



misleading information on fees and expensive, while at the same time not creating an excessive level of details which does not benefit clients' understanding.

Q4: Do summary documents present the right amount of information about fees and expenses and in a way that is useful for investors?

Experience gained in the EU with the implementation of the UCITS Directive (directive 2009/65/EC) has shown that summary documentations (i.e. the UCITS KIID), are a useful tool for investors, through which the essential information on the product is conveyed to them in a simple way. In our opinion, this represents an appropriate benchmark for IOSCO to consider when designing its best practice.

As a general remark, it is our belief that when assessing the appropriateness of summary information to be relayed by investors in a simple, understandable and not misleading way, the risk to occur in over-simplification should be avoided: too much aggregated information on costs, especially on contingent costs such as transaction costs and performance fees, can be detrimental to retail investors' understanding.

We recommend that sufficient granularity is maintained in the representation of the cost indicator if the transaction and performance fees are to be included. It may be difficult for investors to understand that a summary cost indicator not only includes recurrent costs but also contingent ones (i.e. transaction costs and performance fees), which reflect the asset management strategy and cannot be exactly asserted in the ex-ante disclosure.

In this sense and pending the implementation of MiFID II (directive 2014/65/UE) and PRIIPs Regulation (Regulation (EU) No. 1286/2014), it is our opinion that, while distinguishing between one-off entry costs and ongoing costs, a differentiation should be made in the summary indication of costs between those costs that are recurring and those that are only contingent, which should be displayed separately. Such differentiated cost information, in addition to the aggregated figure, make the pre-sale documents not misleading and enables investors better appreciate the specific figures, and at the same time understand the different circumstances of their application.



Q5:

- Should regulators do more – and if so, what – to make disclosures to investors about fees and expenses:
 - easier to understand?
 - more prominent?
 - more easily accessible?
- Is it necessary to expand the standard “Information delivered must be simple, concise and set out in clear language”? Would you find it helpful to have recommendations on (for example) the use of easy-to-read formats (font size, using tables/charts/graphs) or the use of uniform terminology?
- Does a standardized fee table, if applicable, provide sufficient information regarding certain fees and expenses?
- Are there specific sub-categories (e.g. management fee, transaction costs) that should be disclosed separately?

We believe that the EU legislative and regulatory framework provides a relevant standard for IOSCO to take into consideration: the provisions on disclosure to investors about fees and expenses stemming from the UCITS Directive and the UCITS KIID Regulation ensure that information to investors about fees and expenses is easier to understand, more prominent and more easily accessible while also providing easy-to-read standardized formats (table). In this sense, we believe that the proposed IOSCO standard requiring that “*information delivered must be simple, concise and set out in clear language*” is in line with the EU’s own requirements to ensure that information is “accurate, fair, clear and not misleading” and that no further expansion is needed.

In order to guarantee that disclosure fulfills its objective to convey simple and easy-to-understand information (last sub-question), it is our opinion that a proper differentiation should be made between recurrent and contingent costs. Such a differentiation requires that these types of costs should be disclosed separately, in order to make investors understand the different nature and cases of their occurrence and enable them to better consider the different items of the product’s cost structure (please also refer to our response to Q4).



Q6:

- Should there be a standard regarding the frequency of updating of fees and expenses information in disclosure documents?
- How often should historical information on fees and expenses be updated?
- In which situations (e.g. where historical information on CIS does not exist) should disclosure on an anticipated basis be obligatory?
- What is the most accurate or representative methodology for calculating performance fees and expenses on an anticipated basis (i.e. one that reduces the chances of over-estimates or under-estimates)?
- How should material changes to the fees and expenses of a CIS be treated in terms of historical/anticipated disclosure requirements?
- In cases where the information can only be provided on an anticipated basis to begin with, should the disclosure be updated later with historical information?

We share IOSCO's consideration that it does not seem appropriate to propose specific standards preferring the use of historical and forward-looking information and we agree with the proposed standard requiring that the information should be kept up to date and disclosed adequately.

In case a standard on the frequency of updating fees and expenses information in disclosure documents is nevertheless introduced, we suggest to consider the already existing provisions under the UCITS framework, which sets requirements to update the document at least annually.

Pending the results of the debate on the EU regulatory framework under MiFID II and PRIIPs on the disclosure requirements on contingent fees (transaction costs and performance fees), we deem that for new funds, where historical information on the CIS does not exist, reasonable estimations should be done only for recurrent cost. An appropriate description of the performance fee structure and a statement of the possible effect of transactions costs on the performance can be provided.

Where historical costs are instead available, we generally believe that ex ante figures of costs should be presented using actually incurred costs as a proxy for the expected costs and charges. However, if material changes to expenses occur by decision of the CIS operator, reasonable estimations of these costs should be used. Since the ex-post reporting on costs in the annual report will be different from the ex-ante estimation (especially for contingent costs), we deem that these type of costs should be displayed in the pre-sale documents in a separate way and that an appropriate disclaimer should be included to inform investors that market developments and/or the fund strategy could impact the amount of the cost items in the future.



Q7:

- Is it desirable to add a standard recommending the use of electronic media for fees and expenses disclosure documents? What are the reasons for your view?
- How can the CIS and the CIS operator ensure that electronic disclosures are received and accessed by investors?
- What could constitute approval from investors?

We support IOSCO's proposal to introduce a standard for the use of electronic media for fees and expenses disclosure documents, as this can reduce costs for the CIS operator while also allowing investors a possible faster access to updated information.

We highlight that, in line with what prescribed by the UCITS KIID Regulation⁴, the provision by the investors of an email address can be considered as an appropriate tool to ensure that electronic disclosure are received and accessed by them.

Q8:

- Should there be a standard definition of what transaction costs are? If so, which types of cost should be included in, or excluded from, such a definition and why?
- What are the most effective ways of determining the value and impact of transaction costs in a CIS?

Under the EU legislative framework of MiFID II and PRIIPs, discussions are still ongoing on the identification and calculation of the types of costs that should be included in the definition of transaction costs.

In relation to the list of costs that IOSCO accounts as costs to be included in the definition of transaction costs (paragraph 53 of the Consultation Paper) we do not agree with IOSCO's inclusion of market impact and opportunity costs.

Market impact reflects the change in the market price due to supply/demand imbalances as a result of a trade and, hence, should be rather assessed as part of market risk if a transaction as such moves the market. The same goes to opportunity costs, if perceived as the costs of a missed opportunity.

As regard the most effective ways to determine the value and impact of implicit transaction costs and in the absence of shared and well-tested approaches for their estimation, we have difficulties to finalize, in our response, what a suitable, simple and sufficiently correct modeled cost method could be used.

The ongoing discussions at the European level on the detailed rules of MiFID II and the PRIIPs clearly demonstrate that much subjective interpretation and subjective calculations are needed to come up with a cost measure for implicit transactions cost. Such difficulties impair the possibility to convey meaningful information to

⁴ Article 38(3) of the UCITS KIID Regulation (Commission Regulation (EU) No 583/2010).



investors and allow comparison between CIS managed by different asset managers. In this sense, we still question the potential added value for investors that such type of cost disclosure can produce.

However, should such disclosure be made, we believe that an “*actual costs model*” can prove very burdensome for manufacturers and subjective. A model adding to the explicit (historical) known costs the implicit cost of financial instruments, calculating the latter by multiplying the standard transaction cost for a turnover rate, may be a preferred solution. In this case, both the standard transaction costs for the different asset classes and the turnover rate methodology will need to be provided by regulators.

The methodology should also take in due consideration that, for open-ended CIS, transaction costs arise not only for active management but also from subscriptions or withdrawals.

Q9:

**- Which costs, especially implicit costs, can be accurately quantified after the event?
- If they cannot be accurately measured, can they be reliably estimated instead and how useful are such estimates to investors? Could such estimates be helpful to investors in considering their investment decision making process when comparing different methodologies? What methodologies could be used?**

The value of transaction costs incurred can be accurately quantified only for explicit transactions costs. For the implicit ones, the impracticalities raised in our response to Q8 occur. Even in case the number and the value of the transactions are known, the identification of the implicit costs will depend on the methodology used for the estimation.

As expressed in our reply to Q8, an actual cost model is very subjective, prone to possible arbitrage opportunities and burdensome. Differently, a standardized model represents an easier and objective method, able to improve comparability between CIS, although the estimation are per definition not perfect.

One should consider whether such estimations are helpful for the investment decision and whether they can represent an appropriate tool in alternative to a narrative disclosure on the potential impact of transactions cost on investors return.

In any case, we reiterate our suggestion to illustrate transaction costs, and more generally contingent costs, separately from recurring costs.



Q10: To what extent can the total amount of transaction costs be predicted for future periods? Are there standards of good practice that could be applied to such disclosures? What are the risks of using past information in this context?

While understanding the possible mismatch in information deriving from the use of past information to show the amount of transaction costs to investors, we believe, in general, that such a method is nevertheless the most appropriate, as it takes account of the historic track. In order to smooth potential changes in transaction costs, we suggest to compute the relevant figures as an annual average of costs incurred for a longer period of time (for example, the last three years). In addition, such a mismatch can be addressed through the inclusion of meaningful disclaimers in the product information document.

Q11: What experience have CIS operators and investors had of funds which apply a single fee that includes transaction costs? Has the level of transaction costs changed as a result of introducing this model? Are there any disadvantages for investors?

We are not aware of CIS operators applying a single fee that includes transaction costs.

Q12: What disclosure methods are appropriate for transaction costs? If disclosure is in a numeric form, what other pieces of information will help the CIS or its investors to understand the impact of these costs on investment returns?

For the extensive reasons given above, we recommend that a separate presentation should be given of transaction costs from recurrent costs included in the ongoing charge.

If a numeric form is used, we suggest to include appropriate disclaimers to highlight the contingent nature of these costs. An excessive load of information to investors risks that such a disclosure does not produce the intended enhanced understanding of the CIS.

Q13: What is the most appropriate comparison method to ensure the transaction produced value for money?

As a general consideration, there should be a link between transaction costs and performance: transaction activities in an investment fund are driven to produce added value.

We therefore believe that the appropriate comparison method is, at the minimum, a presentation of past performance.



Q14:

- What are the most effective ways of mitigating conflicts of interest relating to soft commission arrangements?
- Do list of forbidden or permitted goods and services give enough certainty to CIS operators and investors about what can be paid for in this way?
- What other steps might regulators and/or CIS operators take, to enable goods and services provided by the sell side to be paid for in an efficient way that does not adversely affect the interests of CIS investors?

We are of the view that an effective way to tackle the issue of possible conflicts of interests arising from soft commissions would be to assess them in the light of the potential benefits for investors deriving from such arrangements. To achieve such an objective, the establishment of internal measures and procedures to correctly identify, classify and evaluate payments received, while periodically controlling their appropriateness help CIS operators appropriately address such issues. In addition, a guidance of examples of goods which are permitted or forbidden helps CIS operators legitimately operate and investors understand the way soft commissions are treated.

For both organizational requirements and the scope of application of the discipline, we believe that self-regulation can play an important role. In this respect, we would like to draw IOSCO's attention to the recent *Guidelines on Inducements* that Assogestioni issued and that were "validated" by the Italian competent Authority. The Guidelines aim at providing a stable and clear set of requirements on business conduct and internal procedures for CIS operators when dealing with soft commissions, while also identifying a list of soft commissions that are and are not to be considered legitimate. In this respect, the Guidelines provide a list of goods and services that are to be considered admissible, such as investment research, technical services and information technology, provided that certain requirements are fulfilled. In addition, a negative list of goods and services that are not to be considered legitimate, where these are received as dealing commissions, is also indicated (for example, travel, accommodation and entertainment costs).

Q15: What types of disclosure concerning hard and soft commission arrangements are most useful to the board of directors of a CIS, and/or investors in a CIS?

Generally, we agree with the IOSCO's proposed standard on disclosure: disclosure should be clear, comprehensive, accurate and understandable. We invite IOSCO to take stock of the current discussions under MiFID II related to disclosure on inducements.

As for disclosure relating to research and in relation to the principle contained in paragraph 94(b) of the Consultation paper, we highlight that by means of self-regulation, Assogestioni's Guidelines provide that the CIS operator should specify the object of the benefits provided and the essential terms of the arrangements. In particular, the economic relevance for the CIS managed must be subject to



disclosure. In this regard, the criteria used to determine the economic value of the research when applying the transmission policy can be used.

In case of summary format, CIS operators report a summarized description of the research received, the reasons the manager would utilize this, the economic nature of the soft commission provided and the specification that the relevant economic impact is incorporated in the total commission paid to the broker.

Q16:

- Are current disclosure requirements about fees and expenses, for funds investing in other vehicles, appropriate to assist investors in making an informed decision?
- Are disclosure requirements about fees and expenses enough to manage potential conflicts of interest arising from investment in other vehicles? What other requirements might help to mitigate those conflicts of interest?

We agree with the principles set forth by IOSCO. The EU legislative framework already contains strong conduct of business rules and disclosure requirements concerning such type of fees. With the introduction of the UCITS KIID, it is the regulatory standard in the EU that UCITS “*substantial proportion of its assets in other UCITS or collective investment undertakings*” shall account for the management fee and other ongoing charges of those target funds when calculating their ongoing charges figure.

To enhance CIS comparability, a definition of “*substantial proportion*” could be introduced. For example, this could occur when a CIS invests at least 10% of assets in other CIS. The value of this threshold is not related to the assets held by the CIS at any particular time or within a certain timeframe, as it is rather connected to its investment policy. This would make the presentation of CIS’ costs more stable in time.

Q17:

- Are you aware of problems in identifying what constitutes a change in the main characteristics of a CIS in relation to fees and expenses?
- Should there be more specific standards of good practice concerning disclosure of changes, e.g. a minimum period of prior notice, and the ability of investors to respond to such changes? Please give examples of appropriate measures, if possible indicating the likely costs they would involve.

We support IOSCO’s proposal to introduce a specific standard on disclosure of changes in the main characteristics of a CIS and we suggest that it should take into account the current standard in Europe under the UCITS KIID Regulation.



Q18: Which other areas of the 2004 report, if any, do you believe should be updated and/or amended? Please provide any suggested changes to specific standards of good practice or definitions of key terms set out in Annex A, including drafting proposals and rationale.

We do not see the need for further updates or amendments to the 2004 IOSCO Report.

Q19: Does the report cover all of the key issues on standards regarding fees and expenses of CIS? Are standards needed to address any additional issues? Please provide a summary of the issue and suggest wording for the proposed standards.

We believe that the report covers all key issues on standards regarding fees and expenses of CIS, and that no standards are needed to address additional issues.

The Director General