Fund objectives working group – second meeting

Comparability of fund objectives

The first meeting covered issues around the meaning and usefulness of fund objectives. The second will move on to cover comparability and how we might expect fund objectives and investment policies (OIPs) to change to enable greater comparability.

The purpose of short-form consumer disclosures (i.e. the UCITS KIID and the PRIIPs KID) is set out in the recitals to the relevant regulations as being to enable investors to compare products. The documents are required to be produced in a standard format, within a template, and with information produced using standard methodologies.

However, there appear to be a number of issues that mean that disclosures of OIPs do not appear to be comparable in practice and do not necessarily enable investors to identify which product is likely to be suitable for their needs. This session is not looking to consider the issues of comparability around the other standardised information (on risk, performance or costs) required by the UCITS KIID / PRIIPs KID.

In this meeting we seek to gain a greater understanding of these issues and in particular to identify the barriers to making OIPs more comparable.

How can fund objectives and investment policies be made more comparable?

Background

The KIID regulation sets out the purpose of this section of the KIID:

"This Regulation specifies the content of the information on investment objectives and the investment policy … so that investors can easily see whether or not a fund is likely to be suitable for their needs. … The description of the investment policy should indicate to the investor what the overall aims of the UCITS are and how these objectives are to be achieved."[1]

"This regulation should ensure that the KIID is able to engage investors and aid comparisons…"[2]

PRIIPs contains similar language:

"Retail investors should be provided with the information necessary for them to make an informed investment decision and compare different PRIIPs …"[3]

"… the description of how the investment targets are achieved, including the description of the financial instruments used, avoids financial jargon and terminology which is not immediately clear to retail investors."[4]

"under a section titled 'What is this product?', the nature and main features of the PRIIP, including:…

(ii) its objectives and the means for achieving them …"[5]

"In order to ensure that retail investors understand and compare the economic and legal features of the PRIIP, as well as to provide them with an appropriate overview of the investment policy and strategy of the PRIIP, the key information document should contain standardised information concerning the type of the PRIIP, its investment objectives and how they will be achieved …"[6]

These make it clear that information in this section needs to help retail investors understand the product, including what its aims are and how they are to be achieved, and enable comparison. It also needs to be in plain language and targeted at retail investors.

<u>'What' versus 'how'</u>

As was discussed in the previous session, information in the OIP is about the 'what' and the 'how.' Each of these might be usefully compared by a potential investor. 'What' is typically classified in terms of sectors or similar categorisations. 'How' might at a high level be classified as active and passive. Within these there are different investment strategies. This session will seek to explore both the 'what' and the 'how' in terms of comparability.

[1] Recital 5 of EU Regulation 583/2010
[2] Recital 4 ibid
[3] Recital 15 of EU Regulation 1286/2014
[4] Recital 14 ibid
[5] Article 8(3)(c) ibid
[6] Recital 4 of EU Delegated Regulation 2017/653

Questions for discussion

'What'

Background

The most commonly used classification of funds is the 'IA sectors'. Some information providers, such as Morningstar, have their own classification systems, and some distributors use other categories to classify funds. There are currently 38 IA sectors and over 300 Morningstar categories. The IA sectors primarily classify funds according to the asset classes the fund invest. This may help investors identify the set of funds that track or will give exposure to a particular category of investments.

Sector classifications

How do sector classifications help or hinder comparisons? Are there specific elements of classifications which are helpful or unhelpful in enabling comparisons?

Are there sub-divisions of classifications that are used by industry professionals that might help retail investors better categorise funds?

How do classifications influence manager behaviour? Do they encourage managers to manage money in particular ways that may not deliver the best outcomes for consumers?

'How'

Background

Typically little information is provided about a fund's investment strategy. Where it is provided it tends to be described in very general terms.

Fund investment strategies can vary significantly among funds with similar objectives and invested in the same asset class. Some funds may be managed with few constraints, while others may have much tighter limits on their investments relative to a benchmark. Some funds may adopt a long-term, low turnover approach, while others may seek to generate returns more opportunistically. Retail investors may not be able to identify the approach the fund will take. Where information is given there is often little consistency in what is provided, making comparability difficult.

Investment strategies / approaches

Are there classifications of investment strategies that might be useful as the basis of comparisons?

How can investors ensure they are comparing funds with similar broad approaches?

Should information about the level of constraints on a fund be explained? If so, how?

In factsheets and other marketing material, many funds seem to provide a more detailed description of what they are doing. However, these are inconsistently presented, are described under different headings and do not form part of the KIID. This information might help a consumer compare between different funds. Why is information presented in this way and not in the KIID?

Quantitative information

What quantitative information should be available to retail investors to explain the characteristics of different types of funds?

Potential outcomes

Would presenting the range of likely outcomes assist consumers in comparing funds? If so, how can these be explained?

Following up on our previous discussion, how comparable are funds with outcome-focused targets? Is it possible to understand from the OIP what the difference is between different funds in this sector? If so, what lessons might be learned for the broader industry? If not, what could be done in this area to improve disclosure?

Barriers

What are the barriers to greater comparability?