

**COMMISSION RECOMMENDATION****of 27 April 2004****on some contents of the simplified prospectus as provided for in Schedule C of Annex I to Council Directive 85/611/EEC***(notified under document number C(2002) 1541/2)***(Text with EEA relevance)**

(2004/384/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular Article 211, second indent, thereof,

Whereas:

- (1) In order to enhance effective investor information, provisions concerning the simplified prospectus were introduced in Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investments in transferable securities (UCITS)<sup>1</sup> by Directive 2001/107/EC of the European Parliament and of the Council<sup>2</sup>. The simplified prospectus is designed to provide clear information about the essentials the investor should know before investing in a fund, and be easily understood by the average retail investor. The simplified prospectus is also designed to facilitate the cross-border marketing of units of UCITS, and be used as a single marketing tool throughout the Community. Those provisions themselves stress that host Member States are not permitted to ask for any additions or modifications except translation.
- (2) In order to ensure the effectiveness of this key element of investor protection, it is desirable to clarify the contents and presentation of some of the elements of information which have to be included into the simplified prospectus pursuant to Schedule C of Annex I to Directive 85/611/EEC. This is critical to ensuring a common reading of the contents of Schedule C, and has to be achieved in the most appropriate and timely way available, taking into account the recent transposition process in the Member States and the need for appropriate implementation.
- (3) For that purpose, the mere clarification of definitions relating to the contents of the relevant indents of Schedule C would not be sufficient to achieve the necessary level of harmonisation, which is, in particular, intrinsically linked to the choice and

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<sup>1</sup> OJ L 375, 31.12.1985, p. 3; Directive as last amended by Directive 2001/108/EC of the European Parliament and of the Council ( OJ L 41, 13.2.2001, p. 35).

<sup>2</sup> OJ L 41, 13.2.2001, p. 20.

definition of some ratios relating to economic information (i.e. costs and portfolio turnover). Setting those ratios, which are critical to investor information, does not fall within the regulatory powers conferred upon the Commission by Article 53a of Directive 85/611/EEC. Since the implementing powers conferred upon the Commission by the Directive do not include the choice and structure of ratios, a Commission recommendation is for the moment the only available instrument to support a common, comprehensive reading of the relevant contents of Schedule C.

- (4) The description of the UCITS' investment objectives should inform investors about the investment goal the UCITS intends to pursue. Therefore, it is desirable that the simplified prospectus contain, in a concise form, an appropriate description of the outcomes sought for the investment, information on any third-party guarantees which protect investors, for example against a downfall or on a minimum level of increase of the value of their investment and information on index-tracking objectives.
- (5) In conformity with the requirements set forth under Article 24a(1) and (2) of Directive 85/611/EEC, the description of the UCITS' investment policy in the simplified prospectus should allow the average investor to understand the manner and method by which the investment goal is expected to be achieved and draw investors' attention on the UCITS' relevant characteristics. Therefore, it is desirable that the simplified prospectus briefly make clear the main categories of eligible instruments, the portfolio management strategy of the UCITS, by drawing attention to possible risk-concentration profiles where relevant, and the key characteristics of the bonds in which the UCITS invests. It is also desirable that the simplified prospectus contain information on the financial derivative instruments, the management style and the strategy to achieve the index-tracking objective in the case of index-tracking funds.
- (6) 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 comprehensible description, in narrative form, of all the risks 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.
- (7) To avoid misleading information for investors on historical performance and to advance the comparability of UCITS for investors within the Community, it is necessary to clarify the way past performance should be presented.
- (8) For the sake of clarity and concision of the simplified prospectus, it is desirable that information on the tax regime be limited to the tax regime applicable to the UCITS in its home Member State. To facilitate proper investor information, it is however appropriate that this information be supplemented by a warning that further taxation may apply to the individual investor taking into account that the taxation of individual investors will depend on the fiscal regulation applicable in their personal or particular case.

- (9) 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 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 be 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.
- (10) In view of the current differences in market practice on fee-sharing agreements and comparable fee arrangements, it is appropriate that these be adequately disclosed to investors. To improve transparency for investors, it is therefore necessary that the simplified prospectus indicate the existence of any such agreements or arrangements. It is also advisable to invite investors to consult the full prospectus for detailed information on this kind of arrangement, which should enable them to understand to whom the expenses are paid and whether possible conflicts of interest will be resolved in their best interest.
- (11) The understanding of investors' needs in terms of product information and cross-border comparability has to be made subject to further progress, also in the light of consumer studies on national markets, in order to underpin the completion of a true, investor-friendly, internal market for UCITS. Member States should therefore carry out, in so far as possible, further testing of measures taken in this field, in particular following this recommendation, and to report accordingly to the Commission. The Commission may consider in due time whether there is a need to propose legislative measures to leverage on experience and Member States' feedback on the implementation of this recommendation,

HEREBY RECOMMENDS:

**1. As regards the investment information referred to in the second heading of Schedule C in Annex I to Directive 85/611/EEC it is recommended that Member States apply the following interpretations.**

*1.1. Interpretation of 'short definition of UCITS' objectives'*

In the first indent, Member States are recommended to interpret 'a short definition of UCITS' objectives' as meaning the following information:

- (a) a concise and appropriate description of the outcomes sought for any investment in the UCITS;
- (b) a clear statement of any guarantees offered by third parties to protect investors and any restrictions on those guarantees;
- (c) a statement, where relevant, that the UCITS is intended to track an index/indices, and sufficient indications to enable investors both to identify the

relevant index/indices and to understand the extent or degree of tracking pursued.

### 1.2. Interpretation of 'the unit trust's/common fund's or the investment company's investment policy'

In the second indent Member States are recommended to interpret 'the unit trust's/common fund's or the investment company's investment policy' as meaning the following information, provided it is material and relevant:

- (a) the main categories of eligible financial instruments which are the object of investment;
- (b) whether the UCITS has a particular strategy in relation to any industrial, geographic or other market sectors or specific classes of assets, e.g. investments in emerging countries' financial instruments;
- (c) where relevant, a warning that, whilst the actual portfolio composition is required to comply with the broad legal and statutory rules and limits, risk-concentration may occur in regard of certain tighter asset classes, economic and geographic sectors;
- (d) if the UCITS invests in bonds, an indication of whether they are corporate or government, their duration and the rating requirements;
- (e) if the UCITS uses financial derivative instruments, an indication of whether this is done in pursuit of the UCITS' objectives, or for hedging purposes only;
- (f) whether the UCITS' management style contemplates some reference to a benchmark; and in particular whether the UCITS has an 'index tracking' objective, with an indication of the strategy to be pursued to achieve this;
- (g) whether the UCITS' management style is based on a tactical asset allocation with high frequency portfolio adjustments.

### 1.3. Joint presentation of the UCITS' objectives and investment policy

Home Member States are recommended to allow the information required under points 1.1 and 1.2 to be set out as a single item in the simplified prospectus (e.g. for the information on index tracking), provided that the information so combined does not lead to confusion of the objectives and policies of the UCITS. The order of the information items may be adapted to reflect the UCITS' specific investment objectives and policy.

### 1.4. Interpretation of 'a brief assessment of the fund's risk profile'

In the second indent, Member States are recommended to interpret 'a brief assessment of the fund's risk profile' as meaning the following information:

#### 1.4.1. Overall structure of the information provided:

- (a) a statement to the effect that the value of investments may fall as well as rise and that investors may get back less than they put in;
- (b) a statement that details of all the risks actually mentioned in the simplified prospectus may be found in the full prospectus;
- (c) a textual description of any risk investors have to face in relation to their investment, but only where such risk is relevant and material, based on risk impact and probability.

#### 1.4.2. Precisions regarding the textual description of risks

##### 1.4.2.1. *Specific risks*

The description referred to in point 1.4.1(c) should include a brief and understandable explanation of any specific risk arising from particular investment policies or strategies or associated with specific markets or assets relevant to the UCITS such as:

- (a) the risk that the entire market of an asset class will decline thus affecting the prices and values of the assets (market risk);
- (b) the risk that an issuer or a counterparty will default (credit risk);
- (c) only where strictly relevant, the risk that a settlement in a transfer system does not take place as expected because a counterparty does not pay or deliver on time or as expected (settlement risk);
- (d) the risk that a position can not be liquidated in a timely manner at a reasonable price (liquidity risk);
- (e) the risk that the investment's value will be affected by changes in exchange rates (exchange or currency risk);
- (f) only where strictly relevant, the risk of loss of assets held in custody that could result from the insolvency, negligence or fraudulent action of the custodian or of a subcustodian (custody risk);
- (g) risks related to a concentration of assets or markets.

##### 1.4.2.2. *Horizontal risk factors*

The description referred to in point 1.4.1(c) should also mention, where relevant and material, the following factors that may affect the product:

- (a) performance risk, including the variability of risk levels depending on individual fund selections, and the existence, absence of, or restrictions on any guarantees given by third parties;
- (b) risks to capital, including potential risk of erosion resulting from withdrawals/cancellations of units and distributions in excess of investment returns;

- (c) exposure to the performance of the provider/third-party guarantor, where investment in the product involves direct investment in the provider, rather than assets held by the provider;
- (d) inflexibility, both within the product (including early surrender risk) and constraints on switching to other providers;
- (e) inflation risk;
- (f) lack of certainty that environmental factors, such as a tax regime, will persist.

#### *1.4.2.3. Possible prioritisation of information disclosure*

In order to avoid conveying a misleading image of the relevant risks, Member States are also recommended to consider requiring the presentation of the information items to prioritize, based on scale and materiality, the risks so as to better highlight the individual risk profile of the UCITS.

#### 1.4.3. Additional disclosure of a synthetic risk indicator

Where the UCITS has been set up at least one year before, home Member States are also invited to consider as a possible option requiring that the description referred to in point 1.4.1.c) be supplemented by a synthetic indicator of risk in just one figure or word, based on the volatility of the UCITS' portfolio, in which case:

- (a) the volatility of the UCITS' portfolio should be intended as measuring the dispersion of the UCITS' return;
- (b) the UCITS' return should be calculated taking into account all the UCITS' net asset values (NAVs) of the period, e.g. daily NAVs where this is the normal frequency of NAV calculation as approved by the UCITS competent authorities, computed by assessing the UCITS assets on that same frequency.

#### 1.5. Interpretation of 'historical performance of the unit trust/common fund/investment company (where applicable)'

In the third indent, Member States are recommended to interpret the 'historical performance of the unit trust/common fund/investment company (where applicable)' with 'a warning that this is not an indicator of future performance' as meaning the following information:

##### 1.5.1 Disclosure of past performance:

- (a) the UCITS' past performance, as presented using a bar chart showing annual returns for the last 10 full consecutive years. If the UCITS has been in existence for fewer than 10 years but at least for a period of one year, it is recommended that the annual returns, calculated net of tax and charges, be given for as many years as are available;
- (b) if a UCITS is managed according to a benchmark or if its cost structure includes a performance fee depending on a benchmark, the information on the past performance of the UCITS should include a comparison with the past

performance of the benchmark according to which the UCITS is managed or the performance fee is calculated. Member States are recommended to require that comparison to be achieved by representing the past performance of the benchmark and that of the UCITS on the same bar-chart and/or separately.

#### 1.5.2. Disclosure of cumulative (average) performance

Additionally, Member States are recommended to consider requiring disclosure, either of the cumulative performance, or the cumulative average performance of the fund over specific periods of time (such as on three, five and 10 years). In case they use either of these options, Member States are recommended to require also a comparison with the cumulative performance, or cumulative average performance (where relevant) of a benchmark, when comparison to a benchmark is required in accordance with point 1.5.1(b).

#### 1.5.3. Exclusion of subscription and redemption fees, subject to appropriate disclosure

Taking into account existing regulatory standards, Member States are recommended to consider, whether or not to require subscription and redemption fees to be included in the calculation of the fund performance. However, Member States should require the exclusion of that information (where relevant) to be subject to an appropriate statement drawing attention to this fact. Member States are also recommended to encourage their competent authorities to ensure progressive convergence to standards aligned on best practice in performance calculation.

#### 1.5.4. Disclosure of a benchmark

Member States are also invited 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' investment objective does not explicitly refer to a benchmark.

### **2. As regards the economic information referred to in the third heading of Schedule C in Annex I to Directive 85/611/EEC it is recommended that Member States apply the following interpretations:**

#### 2.1. Interpretation of 'tax regime'

In the first indent, Member States are recommended to interpret 'tax regime' as meaning the following information:

- (a) the tax regime applicable to the UCITS in its home Member State;
- (b) a statement which recalls that the regime of taxation of the income or capital gains received by individual investors depends on the tax law applicable to the personal situation of each individual investor and/or to the place where the capital is invested and that if investors are unclear as to their fiscal position, they should seek professional advice or information from local organisations, where available.

#### 2.2 Interpretation of 'entry and exit commissions' and 'other possible expenses or fees'

##### 2.2.1. Overall contents of the information provided

In the second and third indents, Member States are recommended to interpret the ‘*entry and exit commissions*’ of the fund and ‘*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*’ as meaning the following information:

- (a) disclosure of a total expense ratio (TER), calculated as indicated in Annex I, except for newly created UCITS where a TER cannot yet be calculated;
- (b) on an ex ante basis, disclosure of the expected cost structure, i.e. an indication of all costs available according to the list set forth in Annex I so as to provide investors, insofar as possible, with a reasonable estimate of expected costs;
- (c) all entry and exit commissions and other expenses directly paid by the investor;
- (d) an indication of 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;
- (e) as an additional indicator of the importance of transaction costs, the portfolio turnover rate, calculated as shown in Annex II;
- f) an indication of the existence of fee-sharing agreements and soft commissions.

The requirement set out in point (f) of the first paragraph should not be interpreted as a general validation of the compliance of any individual agreement or commission with Directive 85/611/EEC, and especially with Article 5f(1)(b) thereof, or with national regulations. Taking into account current market practice, Member States are therefore invited to require UCITS to consider how far existing fee-sharing agreements and comparable fee-arrangements are for the exclusive benefit of the UCITS.

Member States are recommended to provide for the simplified prospectus to make a reference to the full prospectus for detailed information on that kind of arrangements, which should allow any investor to understand to whom expenses are to be paid and how possible conflicts of interest will be resolved in his/her best interest. Member States are therefore recommended to ensure that the information provided in the simplified prospectus remains concise.

### 2.2.2 Precisions on the notions of ‘*fee-sharing agreements*’ and ‘*soft commissions*’

#### 2.2.2.1 Identification of ‘*fee-sharing agreements*’

Member States are recommended to identify and classify as fee-sharing agreements those agreements whereby a party remunerated, either directly or indirectly, out of the assets of a UCITS agrees to split its remuneration with another party and which result in that other party meeting expenses through this fee-sharing agreement that should normally be met, either directly or indirectly, out of the assets of the UCITS.

Furthermore, Member States are recommended to consider the following as fee-sharing agreements within the meaning of the above paragraph:

- (a) fee-sharing agreements on transaction costs between a UCITS’ management company and a broker whereby the broker agrees to split with the management

company the transactions fees paid by the UCITS to the broker for processing transactions for the UCITS;

- (b) fee-sharing agreements in funds of funds between a UCITS management company and another fund (or its management company) whereby, if that UCITS invests in the fund, part of the fees charged to that UCITS (either directly – subscription/redemption fees – or indirectly – TER) because of this investment will be paid by the target fund (or its management company) to the UCITS management company.

#### *2.2.2.2. Identification of 'soft commissions'*

Member States are recommended to identify as soft commissions any economic benefit, other than clearing and execution services, that an asset manager receives in connection with the fund's payment of commissions on transactions that involve the fund's portfolio securities. Soft commissions are typically obtained from, or through, the executing broker.

#### *2.2.3. Presentation of TER and portfolio turnover rate*

Member States are invited to allow both the TER and the portfolio turnover rate to be either included in or attached to the simplified prospectus in the same paper as information on past performance.

**3.** The Member States are requested to inform the Commission, in so far as possible, by 30 September 2004 of any measures they have taken further to this recommendation and to inform it of the first results of its implementation, in as far as they are able, no later than 28 February 2005.

**4.** This recommendation is addressed to the Member States.

Done at Brussels, 27 April 2004.

*For the Commission*  
Frederik BOLKESTEIN  
*Member of the Commission*

*ANNEX I***Total expense ratio (TER)****1. Definition of the TER:**

The total expense ratio (TER) of a UCITS is equal to the ratio of the UCITS' total operating costs to its average net assets calculated as according to paragraph 3.

**2. Included/Excluded costs**

**2.1** The total operating costs are all the expenses which come in deduction of a UCITS' assets. These costs are usually shown in a UCITS' statement of operations for the relevant fiscal period. They are assessed on an 'all taxes included' basis, which means that the gross value of expenses should be used.

**2.2** They include any legitimate expenses of the UCITS, whatever their basis of calculation (e.g. flat-fee, asset-based, transaction-based<sup>3</sup>), such as:

- management costs including performance fees;
- administration costs;
- fees linked to depository duties;
- audit fees;
- payments to shareholder services providers including payments to the UCITS' transfer agent and payments to broker-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;
- any additional remuneration of the management company (or any other party) corresponding to certain fee-sharing agreements in accordance to point 4 below.

**2.3** The total operating costs do not include:

- transaction costs which are costs incurred by a UCITS in connection with transactions on its portfolio. They include brokerage fees, taxes and linked charges and the market impact of the

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<sup>3</sup> This non-exhaustive typology of calculation bases reflects the diversity of recent commercial practice across Member States (i.e. at the end of 2003) and should not be interpreted as a general validation of the compliance of any individual agreement or commission with Directive 85/611/EEC, as last amended by Directives 2001/107/EC and 2001/108/EC, and especially with Article 5f(1)(b) thereof, regarding conflicts of interest, or with national regulations.

transaction taking into account the remuneration of the broker and the liquidity of the concerned assets;

- interest on borrowing;
- payments incurred because of financial derivative instruments;
- entry /exit commissions or any other fees paid directly by the investor;
- soft commissions in accordance with point 4.

### **3. Calculation method and disclosure:**

3.1 The TER is calculated at least once a year on an ex post basis, generally with reference to the fiscal year of the UCITS. For specific purposes it may also be calculated for other time periods. The simplified prospectus should in any case include a clear reference to an information source (e.g. the fund's website) where the investor may obtain previous years'/periods' TER figures.

3.2 The average net assets must be calculated using figures that are based on the UCITS' net assets at each calculation of the net asset value, e.g. daily NAVs where this is the normal frequency of NAV calculation as approved by the UCITS competent authorities. Further circumstances or events which could lead to misleading figures have equally to be taken into consideration.

Tax relief should not be taken into account.

The calculation method of the TER must be validated by the UCITS' auditors and/or competent authorities.

### **4. Fee-sharing agreements and soft commissions:**

It regularly results from fee-sharing agreements on expenses that are generally not included in the TER, that the management company or another party is actually meeting, in all or in part, operating costs that should normally be included in the TER. They should therefore be taken into account when calculating the TER, by adding to the total operating costs any remuneration of the management company (or another party) that derives from such fee-sharing agreements.

There is no need to take into account fee-sharing agreements on expenses that are already in the scope of the TER. Soft commissions should also be left outside the scope of the TER.

Thus:

- the remuneration of a management company through a fee-sharing agreement with a broker on transaction costs and with other fund management companies in the case of funds of funds (if this remuneration has not been already been taken into account in the synthetic TER or through other costs already charged to the fund and therefore directly included into the TER) should anyway be taken into account in the TER;

- conversely, the remuneration of a management company through a fee-sharing agreement with a fund (except when this remuneration falls under the scope of the specific fund-of-fund case covered in the previous indent) should not be taken into account.

### **5. Performance fees:**

Performance fees should be included in the TER and should also be disclosed separately as a percentage of the average net asset value.

### **6. UCITS investing in UCITS or in non-UCITS:**

When a UCITS invests at least 10 % of its net asset value in other UCITS or in non-UCITS which publish a TER in accordance with this Annex, a synthetic TER corresponding to that investment should be disclosed.

The synthetic TER is equal to the ratio of:

- the UCITS' total operating costs expressed by its TER and all the costs suffered by the UCITS through holdings in underlying funds (i.e. those expressed by the TER of the underlying funds weighted on the basis of the UCITS investment proportion), plus the subscription and redemption fees of these underlying funds, divided by
- the average net assets of the fund.

As mentioned in the previous subparagraph, subscription fees and redemption fees of the underlying funds should be included into the TER. Subscription and redemption fees may not be charged when the underlying funds belong to the same group in accordance with Article 24 (3) of Directive 85/611/EEC.

When any of the underlying non-UCITS does not publish a TER in accordance with this Annex, disclosure of costs should be adapted in the following way:

- the impossibility of calculating the synthetic TER for that fraction of the investment must be disclosed;
- the maximum proportion of management fees charged to the underlying fund(s) must be disclosed in the simplified prospectus.
- a synthetic figure of total expected costs, by calculating:
  - a truncated synthetic TER incorporating the TER of each of those underlying funds for which the TER is calculated according to this Annex, weighted on the basis of the UCITS investment proportion, and
  - by adding, for each of the other underlying funds, the subscription and redemption fees plus the best available upper-bound assessment of TER-eligible costs. This should include the maximum management fee and the last available performance fee for that fund, weighted on the basis of the UCITS investment proportion.

### **6. Umbrella funds/multiclass funds:**

In the case of umbrella funds, the TER should be calculated for each subfund. If, in the case of multiclass funds, the TER differs between different share classes, a separate TER should be calculated and disclosed for each share class. Furthermore, in keeping with the principle of equality among investors, where there are differences in fees and expenses across classes, these different fees/expenses should be disclosed separately in the simplified prospectus. An additional statement should indicate that the objective criteria (e.g. the amount of subscription), on which these differences are based, are available in the full prospectus.

*ANNEX II***Portfolio turnover rate**

A fund's or, where relevant, a compartment's portfolio turnover rate should be calculated in the following way:

Purchases of securities = X

Sales of securities = Y

Total 1 = Total of transactions in securities = X + Y

Issues/Subscriptions of units of the fund = S

Cancellations/Redemptions of units of the fund = T

Total 2 = Total transactions in units of the fund = S + T

Reference average of total net assets = M

Turnover =  $[(\text{Total 1} - \text{Total 2})/M] * 100$

The reference average of total net assets corresponds to the average of net asset values calculated with the same frequency as under Annex I, Article 1(3). The turnover rate disclosed should correspond to the period(s) for which a TER is disclosed. The simplified prospectus should in any case include a clear reference to an information source (e.g. the fund's website) where the investor may obtain previous periods' p