Concurrent Session - 3B

Disclosure – the PDS, the register entries, and other disclosure docs
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Introducing

James Hartley
Ministry of Business, Innovation and Employment

and

Madhu Gayner
BNP Paribas Securities Services
Disclosure – the PDS, the register entries, and other disclosure documents

Madhu Gayer
Head of Investment Reporting & Performance, Asia Pacific
BNP Paribas Securities Services

James Hartley
Manager, Investment Law
Ministry of Business, Innovation and Employment
What is the FMC Act?

Clear information for investors

Competent market services providers

Fair conduct & dealing standards

Participants held accountable

New ways to raise capital
Next Steps

Cabinet decisions

Finalise drafting

Make regulations

1 December 2014
Disclosure

PDS

Register

Disclosure
Managed fund updates

Q1
Q2
Q3
Q4
Risk indicator
What are its main objectives?

- To provide European asset managers with a true single market,
- Making it possible for global fund managers to enter into Europe efficiently by being able to distribute from a single location and
- To enabling pan-European players to rationalise their set-up

The directive comprises 5 measures:

1. Fund mergers
2. Management company passport
3. Master-feeder structure
4. Regulator to regulator notification Procedure
5. Key Investor Document

- Compliance monitoring
- VaR, Backtest, Stress Test and Liquidity monitoring (from CESR/10 788 guidelines)
- Provision and distribution of the KIID
- SRRI Risk Calculation (from CESR/10 673 guidelines)
Primary articles of compliance in UCITs IV

2. Management company passport

Two possible approaches for global exposure calculation
- **Commitment** approach
- **VaR** approach
(from CESR/10 788 guidelines)

5. Key Investor Information Document

A comprehensive document containing:
- **Main information** on the fund
- **Ongoing charges**
- **SRRI** Risk Calculation
(from CESR/10 673 guidelines)

Commitment approach:
- Daily global exposure calculation

VaR approach:
- Daily VaR (absolute or relative)
- Back test
- Stress test
- Liquidity risk

One document for **each share class**
One document per country of distribution
Yearly publication
Re-edition in case of change of the SRRI
Schedule 3: Managed investment products in managed fund – Risk Indicator

**Risk indicator**

- **Clause 4** presentation of the risk indicator diagram
- **Clause 5** how the risk indicator is calculated according to the table
- **Clause 6** cases where the risk indicator would deceive / mislead because of change in SIPO
- **Clause 7** cases where the risk indicator would deceive / mislead because of nature of the fund

<table>
<thead>
<tr>
<th>Risk Class</th>
<th>Ann. stand. deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0%-0.5%</td>
</tr>
<tr>
<td>2</td>
<td>0.5%-2%</td>
</tr>
<tr>
<td>3</td>
<td>2%-5%</td>
</tr>
<tr>
<td>4</td>
<td>5%-10%</td>
</tr>
<tr>
<td>5</td>
<td>10%-15%</td>
</tr>
<tr>
<td>6</td>
<td>15%-25%</td>
</tr>
<tr>
<td>7</td>
<td>25%+</td>
</tr>
</tbody>
</table>

**Methodology**

- Historical volatility as the basis
- At least weekly returns used (monthly ok)
- Last 5 yrs of the fund’s total returns

**SRRI revisions**

- Material changes to risk-return profile
- Changes in realised volatility also triggers revision
- Preceding 4 months time horizon

**Insufficient history**

- Applicable to market funds
- Use of representative portfolio
- Combining ‘simulated’ and actual performance data allowed

**MBIE Comments**

“advantage of this measure is that it provides a standard and relatively objective indicator of where a fund sits on the risk-return spectrum that can be compared across funds from different providers”

“draft regulations have adopted the core principle of [UCITS] guidance. It is envisaged that this guidance will then be supplemented with FMA frameworks and methodologies”

“Our intention is that a change in the risk indicator for a fund by 1 risk class would not generally require an update to the PDS”
Analysis of the risk indicator

- **Is volatility the ‘right’ measure** and is it aligned with the investment strategy focus
- Volatility does not distinguish between “good” / “bad” volatility
- Volatility can mis-represent actual risk – case of infrequent valuations in PERE
- No reference to liquidity in the SRRI document

**Counterpoint:**
- SRM indicator focus on propensity for drawdown
- Risk-reward trade-off important not just volatility

- **Historical returns based not forward looking**, compared to the SRM
- Range of historical volatility used heavily subject to market cycles
- **Embedded historical scenarios may not reflect future events**
- Difficult to account for complex risks – credit / liquidity in historical analyses
- Migration of indicator bands based on retrospective changes

**Counterpoint:**
- Forward looking risk management a key focus
- Combining historical and forecast risk as a best practice

- **Use of simulated performance** track records fraught with issues
- **Reverse engineering of volatility** from VaR for absolute return & structured funds subject to a HS / parametric computation of VaR
- **Added complexity for total return funds** – maximum of actual volatility / volatility of reference allocation / risk limits

**Counterpoint:**
- GIPS prohibits linking of simulated / model portfolios with actual performance
- Impact of transaction costs need to be accounted for
## Calculation of the risk indicator

<table>
<thead>
<tr>
<th>Type of fund</th>
<th>If the fund has 5 years of NAV data</th>
<th>If the fund has partial NAV data for 5 years</th>
<th>If the fund has no NAV data</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market funds</strong></td>
<td></td>
<td>- Calculate the fund's volatility from existing NAVs&lt;br&gt;- Choice of using data from the benchmark or another share to replace the missing returns data</td>
<td>Choice of using data from the benchmark, another share, or a Model Portfolio to replace the missing returns data</td>
</tr>
<tr>
<td><strong>Absolute return funds</strong></td>
<td>The maximum of:&lt;br&gt;- historical annualised volatility and&lt;br&gt;- annualised volatility corresponding to the fund's Risk Limit</td>
<td>Annualised volatility corresponding to the fund's Risk Limit</td>
<td>Annualised Volatility corresponding to the fund's Risk Limit</td>
</tr>
<tr>
<td><strong>Total return funds</strong></td>
<td>The maximum of:&lt;br&gt;- historical annualised volatility and&lt;br&gt;- annualised volatility corresponding to the fund's Risk Limit and&lt;br&gt;- annualised volatility of the fund's Target Asset Mix</td>
<td>The maximum of:&lt;br&gt;- annualised volatility corresponding to the fund's Risk Limit and&lt;br&gt;- annualised volatility of the fund's Target Asset Mix</td>
<td>The maximum of:&lt;br&gt;- annualised volatility corresponding to the fund's Risk Limit and&lt;br&gt;- annualised volatility of the fund's Target Asset Mix</td>
</tr>
<tr>
<td><strong>Structured</strong></td>
<td>The fund's volatility in relation to the 99% VaR at maturity</td>
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</tr>
<tr>
<td><strong>Life cycle funds</strong></td>
<td>Annualised historical volatility, so long as the fund has not changed its Target Asset Mix in the past 5 years</td>
<td>- Calculate the fund's volatility for existing NAVs&lt;br&gt;- Choice of using data from the benchmark, Target Asset Mix, or a model portfolio to replace the missing data</td>
<td>Choice of using data from the benchmark, Target Asset Mix, or a model portfolio to replace the missing data</td>
</tr>
</tbody>
</table>
Schedule 3: Managed investment products in managed fund – Part 3

**Description of the Fund**

- **Clause 57.** Description of the fund, including its investment objective and a summary of its investment strategy.
- **Clause 58.** Risks of investing, including the inclusion of a risk indicator.

**Fund Performance**

- **Clause 59.** How has the fund performed, including the inclusion of a benchmark.
- **Clause 60.** Meaning of returns, including the basis of calculation of the returns.
- **Clause 61.** Benchmark returns to be included.
- **Clause 62.** Inclusion of a bar graph of returns.

**Key points**

- Brief description of the strategy of the fund
- Description of the risk indicator, and what it represents
- Returns are net of all fund fees and accrued tax
- Returns must be calculated as a time-weighted return
- If the period is more than 1 year, returns must be compounded
- Benchmark returns to be reinvested of all income
Schedule 3: Managed investment products in managed fund – Part 3

Key points

- Use of appropriate information and manager judgement to produce an accurate representation of the fund’s assets
- Prescribed categories for asset classes (Australian equities can be both AU / NZ)
- Specific notation of composition of “other”
- Composition reflects aggregation of common holdings between fund and any underlying fund
- Look through considerations

What does the Fund invest in

- Clause 68. actual investment mix (pie)
- Clause 69. target investment mix (pie / table)
- Clause 70. top 10 investments by value
- Clause 71. nature of “other”, and the appropriateness / nature of the information used for the pie chart and table
- Clause 2(3). Categories of individual assets for target / actual investment mix

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## Implications

### Improved transparency and clarity
- Clear sections in the PDS and Fund update focusing on Key Investor Information
- Performance, risk-reward, top tens, asset mix

### Enhanced and explicit risk oversight
- Synthetic risk-reward indicator used in Europe and Asia
- Customisable calculation subject to fund type to accommodate a variety of strategies

### Consistency and comparability
- Single format for the update, with consistent labelling of key information
- Aligned with the KIID experience in Europe (customer-tested)

### New regime
- Opportunities for the asset management industry
- A clear focus on the investor
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