INVESTMENT COMPANY INSTITUTE

MEMO# 14887

July 17, 2002

IOSCO REQUESTS COMMENT ON PERFORMANCE PRESENTATION STANDARDS FOR FUNDS

ACTION REQUESTED [14887] July 17, 2002 TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 13-02 INTERNATIONAL COMMITTEE No. 55-02 RE: IOSCO REQUESTS COMMENT ON PERFORMANCE PRESENTATION STANDARDS FOR FUNDS The International Organization of Securities Commissions (IOSCO) has requested comment on the attached report on Performance Presentation Standards for Collective Investment Schemes prepared by the Standing Committee on Investment Management (SC5). The Report reviews the standards currently used by member jurisdictions with respect to performance presentations in CIS, including fund advertisements and marketing materials and articulates some general regulatory principles based on this review. The first part of the Report summarizes the findings of two IOSCO surveys covering: whether performance presentation standards (PPS) exist in each responding jurisdiction, who sets them, whether they are mandatory, what time periods are prescribed, and whether fees and expenses are disclosed or reflected in the performance presentations. According to the Report, PPS exist in most jurisdictions, are established by the regulator, an SRO, or both, and mandate a standardized period for presentations. While almost all jurisdictions require performance presentations to disclose fees and include mandatory disclaimers, most jurisdictions do not require the presentation of volatility information or comparisons to benchmarks. The Report notes that six jurisdictions (Australia, Canada, Italy, Portugal, Sweden and the US) prescribe standardized methods to calculate performance but noted that the formulas used do not all make the same assumptions about the treatment of front-end sales loads, deferred sales loads and redemption fees, ongoing fees and expenses, and reinvestment of dividends and distributions. The second part of the Report formulates general principles for the regulation of performance presentations. Noting that some funds use past performance as a primary marketing tool and that some investors appear to consider this information as very important, the Report states the regulation of fund performance presentations is important to ensure presentations do not mislead investors and allow investors to make meaningful comparisons of fund performance information. The Report details how specific regulatory requirements can help achieve these goals. The Report states that the use of standardized formulas can promote investors’ ability to 2 compare funds and prevent misleading performance claims by funds and notes that these formulas can prescribe the method of performance calculation most appropriate for specified types of funds. The requirement to reflect fees and expenses in performance information, even if the jurisdiction does not require standardized formulas, can serve to promote comparability and prevent a fund from inflating its performance. The use of standardized time periods can prevent misleading claims, promote comparability, and help demonstrate to investors the volatility of a fund over time. Requirements to compare performance to a relevant benchmark enable investors more readily to compare fund performance to the overall market and determine whether performance is more attributable to manager investment acumen or the rise or fall of the market. The Report also notes that mandatory disclaimers, particularly if they are prominent, can prevent investors from being misled. The Report also discusses the enforcement of PPS and observes that mandatory PPS generally are more effective, but that voluntary standards can be effective if competition or other pressures in the market effectively force funds to comply with the voluntary standards. The Report states that regulators use different means to promote compliance with PPS, including reviewing the contents of specific advertisements, inspecting funds to determine if they have calculated performance correctly, relying on investor complaints, or reviewing advertisements in the media for compliance. The last section of the Report articulates a set of general principles for the regulation of performance presentations in collective investment schemes (CIS.) These principles, on which comment is requested, are as follows: CIS performance presentations raise investor protection concerns when performance is calculated inaccurately or presented in a misleading manner. Regulators can take different approaches to ensuring that investors are not misled, such as enforcing a general prohibition on false and misleading statements about CIS performance or adopting or endorsing PPS for the calculation and presentation of CIS performance information. The use by regulators of PPS can protect investors from being misled by performance information and facilitate the ability of investors to compare CIS performance. PPS can be established by the regulator, an SRO, a professional organization or other group. PPS can be mandatory or voluntary; mandatory, enforceable PPS may be more effective, although voluntary PPS can be effective if competitive or other pressures effectively force a CIS to comply with them. PPS may vary depending on the type of CIS. The need for comprehensive PPS may vary from jurisdiction to jurisdiction, depending on the maturity of the CIS industry, current CIS advertising practices and the history of abuses, if any. 3 The Report suggests that regulators in jurisdictions that do not require compliance with PPS may wish to evaluate the effectiveness of voluntary PPS and that all jurisdictions may wish to consider whether existing PPS, either mandatory or voluntary, are sufficiently comprehensive to address the investor protection concerns presented by current CIS performance presentation practices. The Report also states that the SC5 intends to engage in further work on developing best practice standards for the presentation of CIS performance information in advertisements. The Institute is considering whether to comment on the issues presented in the Report. If you have any views on whether the Institute should submit comments, or on particular matters that the Institute should consider addressing in its comments, please provide them to me at 202 326-5826 or podesta@ici.org or Dorothy Donohue at 202 218 3563 or ddonohue@ici.org by August 20, 2002. In 1997, when Japan was implementing a trade agreement commitment to improve investment trust performance data disclosure, the Institute submitted a memorandum to the US Treasury Department, a copy of which is attached, on principles for developing an effective mutual fund performance reporting system. We would be interested in your views on whether the points made in the memorandum remain pertinent and should be mentioned in any comment letter the Institute may submit to IOSCO. Comments are due by September 30, 2002. Mary S. Podesta Senior Counsel Attachment no. 1 (in .pdf format)
