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## **Clarifications concerning the information to be provided to investors in collective investment undertakings referring to a benchmark index**

**On 29 March 2019 ESMA published an update of its questions and answers (Q&A) relating to the application of the UCITS Directive. This update concerns, in particular, the information to be indicated in the Key Investor Information Documents (KIIDs) of UCITS regarding how closely the UCITS track their benchmark index. The AMF takes stock of this update.**

### **Objectives of the ESMA Q&A update**

The update of the ESMA questions and answers, published on 29 March last, aims not only to clarify the information to be indicated to investors in the KIID in order to limit the risk of reclassification of certain funds as pseudo-active funds, but also to increase the transparency concerning funds which have management constraints compared with their benchmark index and which could have similar performances to those indices.

For example, ESMA clarified the obligation for Undertakings for the Collective Investment in Transferable Securities (UCITS) fund managers to declare themselves as "active" or "passive" in accordance with precise definitions (Q&A 8a) and the obligation to describe the UCITS' degree of freedom relative to its benchmark indicator, giving priority to a descriptive approach to the portfolio composition method and the measurement of risk or performance (Q&A 8c). The European authority also clarified the definition of the concept of management "in reference to a benchmark index" (Q&A 8b).

In light of observed practices and the modifications made by ESMA to its questions and answers, the AMF considers that the KIID should contain specific information notably in the cases discussed below.

## **Specific information to be included for constrained funds**

A distinction should be made between constrained funds and index funds. Certain active management funds have management limits which significantly limit the extent to which they may deviate from their benchmark. These UCITS may therefore be close to their index by construction, without necessarily replicating this benchmark index. This is the case, for example, for certain ex-ante maximum internal limits to the tracking error or sector overweighting ranges closer to their index.

These constraints have the effect of limiting the UCITS' deviations relative to their benchmark. Pursuant to Article 7.1 d) of Delegated Regulation (EU) No. 583/2010 of the Commission of 1 July 2010 ("KIID Delegated Regulation"), as specified by the ESMA Q&A 8c), when they have a structural effect, they should be described in intelligible terms in the UCITS' KIID. Regarding this, an indication such as "active risk" to designate the tracking error may be considered as not easily intelligible and should be banned. Moreover, in order to ensure that the information circulated is clear, accurate and non-misleading, these UCITS should not indicate in their regulatory documentation that the selection and weighting of stocks in the UCITS are "unconstrained" when such limits are imposed on fund management.

## **Specific clarifications concerning systematic investment funds**

"Systematic" investment UCITS are among the funds having especially marked management constraints. The allocation of these UCITS is generally determined by a constrained optimization algorithm which may include limits relative to the index (tracking error, weighting deviations, etc.).

Although there may be discretionary leeway for the fund manager relative to the allocation proposed by these algorithms, these funds can be close to their benchmark by nature.

For this reason, the AMF already recommends that the information appearing in the KIIDs for these funds should indicate to investors the existence of a systematic investment strategy. Moreover, pursuant to Article 7 1. d) of the KIID Regulation as specified by the ESMA Q&A 8c), the main management constraints taken into account for constrained allocation should be indicated to investors (e.g. ex-ante target tracking error, weighting deviations).

## Information to be provided by multi-management funds

When UCITS invest in a diversified manner in active management UCITS all referring to the same benchmark, the bets specific to each underlying UCITS may be "capped" by the diversification of strategies. As a result of this, some UCITS may be closer to their benchmark than the UCITS in which they invest.

A similar situation may occur when several fund managers share among themselves various pockets of a given UCITS by making their own specific bets. Due to the diversification implemented at the fund level, the specific bets may here again be "capped", resulting in a relatively small tracking error compared with the index.

This closeness is not the consequence of a management constraint but of investment processes aimed at risk diversification. For this reason, pursuant to Article 7 1. d) of the KIID Regulation as specified by ESMA Q&A 8c), the KIIDs of these UCITS should indicate clearly and precisely to what extent the fund manager may invest differently from the index.

Furthermore, and in all cases, the AMF reiterates its recommendation to include in reports to clients information (charts in particular) enabling them to assess how closely the funds track their benchmark.

## Information that the AMF recommends including in investor reports

The AMF also reiterates that it recommends to asset management companies that manage funds whose investment objective is based on a benchmark index that they should produce reports for investors, allowing them to assess how closely the fund tracks its benchmark. These reports must at least include the following indicators:

- the comparative performances (compared in a chart and a table),
- the portfolio's volatility compared with the volatility of the index, and
- the annualised standard deviation of the fund's performances relative to its benchmark index (or tracking error).

**Read more**

ESMA press release dated 29 March 2019: ESMA Q&As clarify benchmark

📄 disclosure obligations for UCITS

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Head of publications: The Executive Director of AMF Communication Directorate. Contact: Communication Directorate – Autorité des marchés financiers 17 place de la Bourse – 75082 Paris cedex 02