

**Performance Presentation Standards
For Collective Investment Schemes:
Best Practice Standards**



OICU-IOSCO

**Report of the Technical Committee of the
International Organization of Securities Commissions**

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INTRODUCTION

The Technical Committee recently completed its examination of the standards, among the jurisdictions of its Standing Committee on Investment Management (SC5) members, for the presentation of the performance of collective investment schemes (“CIS”) in advertisements.¹ In May 2002, IOSCO’s Technical Committee published a report, entitled “Performance Presentation Standards for Collective Investment Schemes” (the “PPS Report”), which set forth some of the results of SC5’s work. Among other things, the PPS Report compared the performance presentation standards (“PPS”)² in the jurisdictions of SC5 members and set forth general principles for the regulation of CIS performance presentations in advertisements. The PPS Report, however, did not make any recommendations as to best practice standards for the presentation of CIS performance in advertisements.

This report presents suggested best practice standards for the presentation of CIS performance in advertisements based upon SC5’s study of PPS, the formulation of general principles for the regulation of CIS performance presentations in advertisements and further discussion among Technical Committee members.

The Technical Committee also requests industry comment on the issues discussed in the Report. Interested parties are requested to comment by May 30, 2003, in the manner described at the end of this Report.

THE FORMULATION OF BEST PRACTICE STANDARDS FOR THE PRESENTATION OF CIS PERFORMANCE INFORMATION IN ADVERTISEMENTS

In the PPS Report, the Technical Committee observed that advertisements containing CIS performance information are important marketing tools for many CIS, and that many CIS investors may make investment decisions based upon such advertisements. The Technical Committee further observed, however, that advertisements containing CIS performance information may mislead investors when CIS performance is calculated inaccurately or is presented in a manner that omits or under-emphasizes material information. CIS performance information also may mislead investors if they cannot meaningfully compare the performance claims of various CIS.

¹ As used in this paper, “advertisements” refers to CIS advertisements and other marketing materials that contain CIS performance information, unless otherwise noted. In addition, “performance” refers to the actual performance of a CIS and, thus, does not refer to projections of the future performance of a CIS, or to the performance of other CIS and/or accounts managed by a CIS operator (also known as “related performance”).

² As used in this paper, PPS are rules or guidelines for the calculation and presentation of CIS performance information.

In the PPS Report, the Technical Committee generally discussed how CIS should calculate performance, including whether CIS should deduct fees and expenses in calculating performance. The Technical Committee also discussed how CIS performance should be presented in advertisements, including whether CIS should use (1) standardized time periods for presenting performance information, (2) performance benchmarks to compare CIS performance, and (3) disclaimers. The PPS Report did not, however, identify specific PPS that regulators should require or that CIS should implement to avoid misleading investors and to facilitate investors' comparisons of the performance of different CIS. The Technical Committee determined to formulate such specific PPS and present them in a separate report as best practice standards.

In considering the formulation of best practice standards, the Technical Committee agreed upon three basic principles. First, CIS advertisements, regardless of whether they contain performance information, should not contain any untrue statements of fact or omit to state any fact that is necessary in order to prevent the statements made, in the light of the circumstances in which they were made, from being misleading. Second, CIS performance information in advertisements should be calculated and presented from the viewpoint of the typical investor in the CIS. Third, CIS should calculate and present their performance information in advertisements in a substantially similar manner so that CIS investors may (1) make meaningful comparisons among various CIS and (2) not be misled by differences in the method of calculation and presentation.

The following best practice standards were developed by the Technical Committee in light of the three basic principles enumerated above. While some of the best practice standards are commonly implemented in the jurisdictions of SC5 members, other practices are ones that all CIS can aspire toward. The Technical Committee's best practice standards are not intended to serve as comprehensive requirements for the presentation of CIS performance information, and are not intended to impose any obligation on any member. Rather, they provide a model that CIS may follow to better ensure that advertisements that contain CIS performance information do not mislead investors and allow investors to meaningfully compare the performance of various CIS.

The Best Practice Standards

- CIS advertisements should not contain any untrue statement of fact or omit to state any fact that is necessary in order to prevent the statements made, in the light of the circumstances in which they were made, from being misleading.
 - CIS advertisements, including those that contain performance information, should be accompanied by all explanations, qualifications, limitations and other statements that are necessary to prevent such information from misleading investors.

- CIS advertisements, including those that contain performance information, should be consistent with the CIS's prospectus.
- CIS advertisements that contain performance information should provide a balanced presentation (*e.g.*, a CIS advertisement should not focus on periods during which the CIS produced its best returns and exclude equally relevant periods in which the CIS did not perform as well). In addition, the performance information should be balanced with other relevant information, such as risk.
- CIS performance information should be calculated and presented from the viewpoint of the typical CIS investor.
 - CIS performance information should reflect the deduction of all fees and expenses that are indirectly paid by each CIS investor, such as management and/or performance fees and taxes paid by the CIS.
 - CIS performance information should reflect the deduction of all fees and expenses relating to the CIS that are directly paid by the typical CIS investor, such as sales loads, redemption fees and account fees.
 - If CIS performance information does not reflect the deduction of all fees and expenses that are indirectly and directly paid by the typical investor, it should be accompanied by prominent disclosure that the performance information does not reflect the deduction of such fees and expenses and that, as a result, the actual returns to certain (or all) investors were lower.
- CIS should calculate their advertised performance according to standardized formulas.
 - Standardized formulas for calculating CIS performance information should:
 - Require the deduction of all fees and expenses that are indirectly paid by each CIS investor.
 - Require the deduction of all fees and expenses that are directly paid by the typical CIS investor.
 - Assume a complete redemption of the CIS investment at the end of the performance period (which will show the effect on performance of sales loads, redemption fees or other similar expenses that are directly paid by the typical investor upon redemption).
 - If standardized formulas for calculating CIS performance information do not require the deduction of all fees and expenses that are indirectly and directly paid by the typical investor, or do not assume complete

redemption of the CIS investment at the end of the performance period, the CIS performance information should be accompanied by prominent disclosure that the performance information does not reflect the deduction of such fees and expenses and that, as a result, the actual returns to certain (or all) investors were lower.

- If a CIS does not calculate its advertised performance according to a standardized formula, the CIS should consistently use the same formula or method for calculating its advertised performance.
 - A CIS should disclose information regarding the formula or method that it uses so that investors can understand the effect of the formula or method on the calculation and presentation of the CIS's performance.
 - If a CIS changes the formula or method for calculating and presenting its advertised performance, the CIS should (1) disclose that fact prominently, (2) disclose how the new formula or method differs, and (3) disclose the effect of the new formula or method on the calculation and presentation of the performance of the CIS.
- CIS performance information should be presented for standardized time periods:
 - Time periods should include a short-term interval, such as one year, to show the CIS's recent performance, but should not be so short that the CIS's performance might mislead investors.
 - Time periods should include longer-term intervals, such as five and ten years (or since the CIS's inception, if shorter), to show volatility over time.³
 - Time periods should be measured as of a recent date, *e.g.*, as of the end of the most recently completed calendar quarter, to permit investors to compare CIS performance information for the same time periods.
- CIS performance information, even if it is measured as of a recent date, *e.g.*, as of the end of the most recently completed calendar quarter, may nonetheless become stale and misleading. CIS performance information that is not current should be accompanied by prominent disclosure that the CIS's current performance may be lower than the advertised performance, and that directs investors to where they may obtain current performance information.

³ A CIS should consider including other data in CIS performance advertisements to demonstrate the volatility of its performance over time, such as a bar chart showing changes in its performance from year to year, or standard deviation data, which measures the degree to which the CIS's performance fluctuates from its average or mean.

- CIS performance information should be accompanied by a relevant performance benchmark or benchmarks to enable investors to compare CIS performance to that of the benchmark(s).
 - A relevant performance benchmark could include an appropriate broad-based securities market index.⁴
 - A relevant performance benchmark also could include a more narrowly based index that reflects the specific market sector in which the CIS invests.
 - A CIS should not use a performance benchmark in an advertisement that contains CIS performance information if the benchmark is administered by an organization that is affiliated with the CIS, its operator or principal underwriter, unless the benchmark is widely recognized and used.
- CIS performance information should be accompanied by a prominent disclaimer that a CIS's performance changes over time and that past performance is not indicative of future results.
- A CIS should provide additional relevant information relating to its performance upon the request of any investor.

Notes to the Best Practice Standards

The following notes explain in greater detail how the best practice standards may be used: 1) to prevent CIS investors from being misled generally by CIS advertisements and specifically by CIS advertisements that contain performance information; and 2) to promote comparability among various CIS.

- General. When referring to CIS advertisements, we are concerned primarily with CIS advertisements and other marketing materials (such as newsletters and Internet web sites) that are directed at, or available to, retail investors.
- Misleading Statements and Omissions. CIS advertisements are one of the most basic and important communications made to investors by CIS. Investors should not be misled by information contained in CIS advertisements. While this report focuses on CIS advertisements that contain performance information, SC5 believes that all CIS advertisements should be balanced and should include any explanation, qualification, limitation or statement that is necessary to ensure that the advertisements are not misleading, regardless of whether the advertisements contain performance information.

⁴ For example, a broadly based index of common stocks ordinarily would be an appropriate benchmark for a CIS that invests in a broad range of common stocks, but an index based upon a relatively few large "blue chip" stocks would not be an appropriate benchmark.

If a CIS advertisement contains performance information, the CIS should disclose any unusual circumstances that have contributed to the performance, including those that are not likely to be repeated due to changes in the CIS or its investment policies and practices.

- Standardized Formulas. The use of standardized formulas for calculating CIS performance information can help to prevent CIS investors from being misled and can promote CIS investors' ability to compare CIS performance presentations. Standardized formulas require all CIS to make the same assumptions when calculating their performance, rather than permitting CIS to make assumptions that may inflate their performance.⁵

CIS that calculate and advertise their performance according to standardized formulas can also include non-standardized performance information, so long as the non-standardized performance information is not itself misleading. For instance, any non-standardized performance information shown should reflect all elements of return and should reflect the deduction of fees and expenses in accordance with the best practice standards. Thus, if a CIS advertises its standardized performance information, *e.g.*, its 1-, 5- and 10-year performance reflecting the deduction of all fees and expenses, including sales loads, the CIS also could include in the same advertisement its 1-, 5- and 10-year performance information excluding the deduction of sales loads, provided that the advertisement prominently disclosed that this non-standardized performance did not reflect the deduction of sales loads and that, as a result, the actual returns to investors were lower. Similarly a CIS could include other non-standardized performance information, such as its 2-, 3- and 4-year performance, with its standardized performance. Non-standardized performance should not be presented more prominently than standardized performance.

A CIS that does not calculate its performance according to a standardized formula should provide disclosure, in advertisements or otherwise, regarding the formula that it uses to calculate its performance. Information about the formula that is material to understanding the performance (*e.g.*, if the formula does not call for the deduction of the CIS's fees and expenses) should be disclosed in the advertisement. General information about the formula may be useful to investors

⁵ If CIS performance information is not based on the currency of the jurisdiction in which the CIS is advertising its performance, the currency used should be clearly disclosed. Additionally, in some jurisdictions, shares of CIS are traded on stock exchanges and, as a result, it is possible for CIS performance information to be calculated as percentage changes in (a) the net asset value of the CIS shares, and (b) the stock exchange value of the CIS shares. For such CIS, CIS performance advertisements should disclose which calculation method is used and should consistently use the same calculation method.

to better understand the CIS's performance information. A CIS may provide such information in, for example, its offering documents or on its website.

- Fees and Expenses. CIS performance information should reflect the fees and expenses that are indirectly and directly paid by a typical CIS investor. For instance, if a CIS pays a management fee to its CIS operator, the CIS performance information should reflect the deduction of the fee that is paid by the CIS. Similarly, if the typical CIS investor would pay a sales load, the CIS performance information should reflect the deduction of the sales load.⁶ If CIS performance information does not reflect the deduction of all fees and expenses that are indirectly and directly paid by the typical investor, it should be accompanied by prominent disclosure that the performance information does not reflect the deduction of such fees and expenses and that, as a result, the actual returns to certain (or all) investors were lower than the advertised performance. CIS investors should not be misled about the impact of fees and expenses on the performance of a CIS.
- Standardized Time Periods. CIS performance presentations should include performance over standardized time periods. Standardized time periods promote a number of important regulatory goals. First, they promote comparability among CIS. Second, they demonstrate to investors the volatility of a CIS's performance over time, as well as the relative volatility of different CIS' performance over time. Third, they reduce the likelihood that the performance information will only focus on periods during which the CIS produced its best returns and exclude periods during which the CIS did not perform as well.

Standardized time periods should include a longer-term interval to show volatility over time as well as a shorter-term interval to show recent performance. The advertisement of CIS performance information for very short-term time periods, such as for less than one year, however, may be atypical and misleading.

In general, a CIS should not exclude performance information from its calculation and presentation of performance for the standardized time periods even if the CIS has changed its investment policies and practices, merged its operations with another CIS or otherwise has changed its operations. For example, a CIS that changed its investment objective may wish to exclude the performance that it achieved prior to the change, especially if the performance was poor relative to other similar CIS or to the market in general. Rather than exclude the performance, the CIS should explain any such change in the disclosure accompanying the performance information. In addition, if a CIS merges with

⁶ In some jurisdictions, it may be difficult for a CIS to ascertain (a) whether the typical investor directly pays certain fees and expenses, and/or (b) the amount of certain fees and expenses directly paid by the typical CIS investor. For example, in some jurisdictions, sales loads are negotiable and, as a result, there may be no typical sales load paid by investors in a particular CIS.

another CIS, the surviving CIS should continue to include its prior performance in any presentations of performance for the standardized time periods.

CIS also should consider the use of other means, such as graphics and charts, to present to investors the volatility of CIS performance over time.

- Use of Performance Benchmarks. PPS that require a CIS to compare its performance to a relevant performance benchmark facilitate the ability of investors to more readily compare the CIS's performance to that of the overall market (or a relevant portion of the market). That comparison may assist investors in determining whether a CIS's performance is generally more attributable to a rise or fall in the overall market (or a relevant portion of the market), or to the investment acumen, or lack thereof, of the CIS operator.

Performance benchmarks should be independent of a CIS (*e.g.*, an index that is not administered by an organization that is an affiliated person of the CIS, its operator or principal underwriter, unless the index is widely recognized and used), particularly if CIS are permitted to choose the performance benchmarks to which their performance is compared. Performance benchmarks that are created by persons or organizations that are closely related to the CIS, its operator or principal underwriter may not provide a fair or objective measure of the performance of the overall market or relevant portion of the market.

A relevant performance benchmark may include a broad-based securities market index and/or a more narrowly based index that reflects the market sector in which a CIS invests, so long as the comparison is not misleading.

- Use of Disclaimers. Disclaimers can be effective tools for communicating information to investors and may help prevent investors from being misled by CIS performance information. PPS that require CIS performance presentations to include disclaimers readily provide CIS investors with information to assess the risks generally associated with an investment in a CIS or specific risks associated with different types of CIS. Disclaimers that are prominently displayed, rather than placed in footnotes or small type font, are more effective in informing investors of the risks associated with investing in CIS. Disclaimers can help to ensure that investors realize that CIS performance claims represent historic data, and do not constitute guarantees or projections of future performance.
- Rankings. A CIS may wish to advertise rankings that demonstrate the performance of the CIS relative to other CIS. These best practice standards do not address the use of rankings in CIS advertisements.

CONCLUSION AND DISCUSSION OF THE WAY FORWARD FOR CIS REGULATORS

The presentation of CIS performance information raises important investor protection issues for Regulators. The jurisdictions of SC-5 members regulate CIS performance presentations in several ways, and the applicable standards for the presentation of CIS performance vary among those jurisdictions. This Report suggests some best practice standards that emerge from a consideration of practices in various jurisdictions.

Jurisdictions that do not require compliance with PPS may wish to evaluate and consider the effectiveness of voluntary PPS. All jurisdictions also may wish to consider whether existing PPS, whether mandatory or voluntary, are sufficiently comprehensive to address the investor protection concerns presented by current CIS performance presentation practices.

The Technical Committee welcomes comments on the suggested best practice standards presented in this Report. Observations on whether the standards outlined above are correct and sufficient would be particularly helpful.

All interested parties are requested to comment by May 30, 2003. Comments in English are invited by post, fax or e-mail, addressed as follows:

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Members of the Technical Committee may also ask for comments from members of the CIS trade association in their country. Written comments received will be sent to the IOSCO General Secretariat.