



CODE OF GOOD CONDUCT ON THE PRESENTATION OF PERFORMANCE RECORDS AND THE CLASSIFICATION OF INVESTMENT FUNDS

Introduction

- A) **Performance comparisons and investment funds classifications promote a better knowledge of the collective fund industry by the general public. Therefore FEFSI strongly encourages professionals to participate in a fair way for all their products.**
- B) The calculation of the prices of UCITS investment funds is well regulated in Europe through the existence of precise rules for the calculation of investment funds Net Asset Values, usually on a daily basis, and valuing their underlying securities, together with the requirement to adhere to strict accounting standards. However, these calculations should be complemented by fair and effective presentation rules of investment funds performance results to the public. This is especially important in regard to the competitive ranking of investment funds in the press and in an environment of proliferating awards and prizes to investment funds managers.
- C) The comparison of performances, in an increasingly more open and competitive market, is an essential element to sound investment decisions. FEFSI is therefore developing a set of principles of good conduct to improve the quality of information disclosure to the public to enable investors to better understand the performance record of each investment fund.
- D) It is hoped that, as soon as possible, these ethical principles of recommended good conduct will be accepted by all investment fund managers in Europe. In addition, specific recommendations are formulated for the providers of performance measurement services, the media and other commentators.
- E) At present the unsophisticated investor's appreciation of the quality of investment management and performance results is often confused by the many awards and prizes offered to managers. Also the way certain awards are advertised or presented is often ambiguous, or even at times incorrect. FEFSI's aim is to achieve a progressive improvement in both the quality and the clarity of performance information offered to the investor. FEFSI has therefore initially limited these principles to help promote their general acceptance and will not at this stage specify, nor provide a stamp of quality, to any one method of performance calculation, as no one calculation methodology is irrefutably the best.

PROVISIONS

I. Requirements applicable to fund managers

1. Each presentation should be supplemented by a disclosure note which states that “past performance is not necessarily a guide to the future performance results of the investment funds or of the manager. The value of an investment and the income from it can go down as well as up and you may not get back the amount invested”.
2. Once a sufficient historical performance record is available on a given investment fund, the performance presented must be calculated on a period which is either equal to or longer than the relevant term of the investment fund investment policy and the investors’ time horizon, i.e. 2, 3 or 5 years except for money market funds.
3. The period of the performance presented must be calculated using relevant and current data. The date of the last Net Asset Value taken into account in the calculation must be disclosed.
4. Performance for periods of less than one year must not be annualised. Similarly, performance must not be extrapolated.
5. The performance of a sole or selected investment funds may not be used, intentionally, to represent other products or the whole investment funds range of the promoting group without full disclosure of other funds under management.
6. The manager should allow providers of performance measurement services access to information on investment funds for performance comparisons. Such information would include details of the investment objectives to be met by the manager, the investment policy of the investment funds, the data on net asset values and the associated issues and redemptions, the amount of management and subscription/redemption fees, and details of any extraordinary event eg a merger, take-over, etc.
7. The manager should verify that each investment fund is correctly classified to reflect its investment policy and that it is included in the appropriate investment fund category or peer group to provide investors with fair comparative information.
8. If a fund manager gets the approval from a provider of performance measurement services that a fund be withdrawn from the relevant classification, the withdrawal is definitive and the fund manager specifically renounces to apply for a reintroduction later on.
9. The origin, the performance period covered and the publication date, of any category ranking or award associated with a particular investment fund must be fully disclosed, together with a note stating that “these past results are not necessarily a guide to the future performance of the investment fund. The value of an investment and the income from it can go down as well as up and you may not get back the amount invested”.

II. Recommendations applicable to fund managers

10. Apart from money market investment funds, the manager should disclose sufficient information to indicate the degree of risk associated with the investment of the investment funds. Therefore, the manager should present a history of annual performances for each of the last five years. The manager should show, or make available on request, the asset allocation breakdown and the underlying markets exposure for each business year-end of the annual returns presented.
11. An appropriate benchmark should be selected on an ex-ante basis for each investment fund.

III. Requirements applicable to performance measurement services

Note: These are “Requirements” to which performance measurement services should commit, even though FEFSI does not have specific authority over them.

12. It is the responsibility of the performance measurement services to check periodically with the fund manager or any other person officially in charge the quality of its database and the reliability of the Net Asset Value and other information.

13. The performance measurement services should periodically confirm with the manager the appropriateness of the allocation of each investment fund to any given investment fund category.

If the manager decides that the investment policy for an investment fund has been changed, then the performance measurement services should consider how the past performance record of the fund should be treated and whether this treatment is in accordance with the guidelines defined by appropriate bodies (trade association, regulator) where such bodies exist.

In the case of fund mergers, the performance measurement services should pay attention to the size of the funds as well as to the investment objective of the continuing fund and to the investment manager.

14. The definition of the categories chosen by the performance measurement services should be set out clearly in writing, should not conflict with the FEFSI classification scheme definitions and take full account of the various investment market sectors and embrace a sufficient number of representative investment funds.

15. The performance measurement service should disclose a full description of the methodology used to rank the investment funds in a category and provide appropriate guidance on how to interpret it correctly.

16. All investment funds satisfying the stated criteria should be taken into account.

IV. Recommendations concerning the Media and other commentators

17. The rules of an award on the performance of investment funds should be communicated in advance to managers.
18. An award should represent one homogeneous classification of investment funds and include a sufficient number of similar investment funds to justify the significance of the award.
19. Any publication of the results of an award should be accompanied by a disclosure giving details of the award's characteristics, its calculation methodology and any other significant elements, in order to help investors interpret the results presented correctly. It should also be clearly stated that the past is not necessarily a guide to future performance results.
20. The vocabulary used in describing an award should be appropriate to its nature and to ensure that the targeted investors will readily understand it and interpret its significance correctly.
21. The objective behind the promotion of any award should be to ensure that investors generally are fully and fairly informed. The basic purpose of this code of good conduct is to protect the interests of underlying investors and any comments, advertisements and awards should be promoted with this purpose in mind on all occasions.

FEFSI Mutual Fund Classification Scheme - Post Euro Launch

1. A pan-European Classification Scheme

1.1. Two main criteria

To be appropriate from a pan-European perspective, any classification methodology is likely to be built on two main criteria, which are the following:

- Market exposure (type of asset risk exposure), which splits into
 - Equity
 - Fixed income
 - Money market
 - Balanced

- Geographical exposure (type of currency risk exposure), which splits into
 - Domestic
 - Euroland
 - Europe
 - Global

1.2. Definition of criteria¹

- Market exposure

Equity funds : The fund is permanently exposed to the equity market at a minimum ratio of 66%. (*minimum equity exposure ratio requirement may be higher than 66 % at the country-classification level*). See Appendix 1 : the formula for calculating the equity exposure ratio.

Fixed income fund : The fund is permanently exposed to the bond market. An ancillary exposure to the equity market could be accepted but this should not exceed 10% of the fund assets.

Money market fund : The fund is permanently exposed to the bond and/or the money market. The fund global modified duration should not exceed 1,0. (*when exceeding this limit, the fund should be classified as a «fixed income fund »*). Credit risk is not expected to be significant (*credit rating disclosure may be required at the country-classification level*).

Balanced fund : The fund is invested in different classes of assets and markets. (no limits in % for equity and bond asset classes).

¹ Criteria defined above are the result of an agreement in accordance with the current regulations in each country. They may be reviewed at a later date.

- Geographical area of investment

For equity funds : Geographical criteria must be defined according to nationality of the equity issuer. Exposure to equities issued by issuers from other nationalities should remain de minimis.

For fixed income fund : Geographical criteria must be defined according to currency exposure. Exposure to other currencies should be de minimis.

For money market fund : Geographical criteria must be defined according to currency exposure. There should be no exposure to other currencies.

For balanced fund : Geographical criteria must be defined according to the nationality of the issuer for equities and to the global currency exposure for bonds. Exposure to other currencies should be de minimis.

Note : From the euro conversion date, the domestic money market and fixed income funds categories no longer exist for the « in » currencies ; but information on these prior categories must be kept for the purpose of performance comparisons on periods including prior to conversion date history.

1.3. Type of funds not covered by the present classification scheme

Funds for which a classification in the four asset type categories is impossible should be listed separately. At this stage, the FEFSI Mutual Fund Classification Scheme does not especially cover:

- Venture capital funds, Private Equities funds
- Future funds
- Real estate funds
- Closed ended funds
- Guaranteed funds (if not correctly classified in the present classification scheme)
- Other dedicated funds (if not correctly classified in the present classification scheme)...

2. Detailed classifications, matching local or specific requirements

Other criteria are expected to be used by national funds associations and/or performance measurement and rankings providers for building detailed classifications.

FEFSI strongly recommends that any detailed classification at the country level be designed to allow aggregation on the pan-European classification scheme's criteria.

FEFSI Board of Directors, Brussels, 11.02.1999

Example 1: more details on the geographical criteria

(a) Equity Funds

- each individual country
- Euro-land
- Europe (and also Europe ex each specific country, such as a Europe ex UK for a UK investor, and a Europe ex Switzerland or France for a Swiss or French investor)
- North America
- Japan
- Far East ex Japan
- Emerging Markets
- Global, i.e. potentially all markets, and potentially Global ex specific markets (ex United States, or maybe ex Euro-land).

These categories could be further subdivided for funds concentrating on particular types of investment

- small cap
- specific industrial sectors
-

(b) Fixed income Funds (bonds as well as other fixed income assets)

- Fixed income in particular currencies (pre-in currency, e.g. Italian bonds and money market instruments, or out-currency, e.g. Swiss or UK fixed income instruments)
- Fixed income Euroland
- Fixed income Europe (including in and out currencies)
- Fixed income Dollar
- Fixed income Yen
- Fixed income Emerging Markets
- Fixed income Global

These categories could be further subdivided into

- fixed interest and inflation-linked categories *if a material CPI-linked bond market exists*,
- shorter or longer modified durations,
- credit risk of issuers (ratings)...

(c) Money market funds (Cash Funds)

Essentially mirroring the fixed income fund currency breakdown

Cash funds may be regarded as subdivision of fixed income funds (there is no minimum to the fixed income funds duration, but there is a maximum to the money market funds duration)

(d) **Balanced Funds**

Essentially mirroring the equity fund geographical breakdown

Balanced funds may also be split regarding to the level of risk exposure, i.e.

- balanced with equity dominant
- balanced with bond dominant
- balanced without dominant

Example 2 : breakdown on other criteria

Further subdivisions (third level criteria) may be made

(a) Income funds

UK equity funds (and mixed UK equity and fixed income funds) are subdivided into separate categories depending on the income they target/deliver (at present there are three UK equity categories - an income category, a growth category and a growth & income category, but AUTIF is thinking of merging the last two). Non-UK equities tend to have much lower dividend yields and are therefore generally categorised as “growth” type assets.

Thus the main practical consequence of including an income/growth division is that the UK classification system includes more types of UK equity funds, reflecting the greater emphasis placed on equity investment within the UK mutual industry. A similar division seems to apply in other Anglo-Saxon markets (which also tend to place more emphasis on equity investments than currently occurs in many Continental European countries).

These could in practice be treated as subdivisions of other categories shown above, e.g. by splitting the UK equity category into a UK ‘equity growth’ and a UK ‘equity income’.

(b) Geographical diversification with domestic preference

On a third level criteria, two main types of funds may be falling under the general heading:

- Equities, Fixed income or Balanced as viewed from a domestic perspective (*which would typically have a higher domestic component*)
- Equities, Fixed income or Balanced in a truly global context

Appendix 1

Calculation for the Exposure Ratio to equity market of mutual funds

A) Factors which must be taken into account :

- + valuation of the securities from the market which defines the fund's characteristic)
-)
- +/- temporary sales or purchases of the same securities)
- These operations must be taken into account if they have a significant impact on the exposure to the considered market.)
-)
- +/- physical equivalent of traded futures in the same market) **A**
- (after netting across expiration dates))
- (number of contracts x unit value x clearing price))
-)
- +/- underlying equivalent of swaps modifying the exposure to the same market)

B) Factors which must be taken into account if they have a substantial impact

on the calculation of the exposure to the market ; they will be added to or deducted from the numerator :

- underlying equivalent (delta-equivalent) of the net positions selling calls and buying puts)
- in the same market (Warrants and stock purchase warrants are considered as options).)
-) **B**
- + underlying equivalent (delta-equivalent) of net positions selling puts and buying calls)
- in the same market (Warrants and stock purchase warrants are considered as options).)

R) Calculation of the exposure ratio :

Exposure Ratio to equity market $R = (A+B) \times 100 / \text{total net asset}$

