



FINANTSINSPEKTSIOON

REFLECTING RISKS IN THE PROSPECTUS OF AN INVESTMENT FUND

These advisory guidelines have been enacted by the 12 August 2009 Resolution No. 1.1-7/33 of the Management Board of the Financial Supervision Authority.

1. Competence

In accordance with Section 3 of the Financial Supervision Authority Act (hereinafter 'FSAA'), the Financial Supervision Authority conducts national financial supervision in order to enhance the stability, reliability, transparency and efficiency of the financial sector, to reduce systemic risks and to promote prevention of the abuse of the financial sector for criminal purposes, with a view to protecting the interests of clients and investors by safeguarding their financial resources, and thereby supporting the stability of the Estonian monetary system.

In accordance with Subsection 57 (1) of the FSAA, the Financial Supervision Authority has the right to issue advisory guidelines to explain legislation regulating the activities of the financial sector and to provide guidance to subjects of financial supervision.

2. Scope of regulation, purpose and application

2.1. Purpose

- 2.1.1. In accordance with Subsection 220 (1) of the Investment Funds Act (hereinafter 'IFA'), the information presented in prospectuses shall be accurate, unambiguous and not misleading and comply with the requirements provided by legislation, and contain a clear and understandable explanation concerning the risk level associated with the fund. Subsection 6 of the same Section provides that specific requirements for prospectuses and a list of information contained therein shall be established by a regulation of the Minister of Finance.
- 2.1.2. Regulation No. 137 of the Minister of Finance of 13 September 2004 'Requirements for the public offer prospectus and simplified prospectus of public contractual investment fund units and for the list of data included' (hereinafter 'the Regulation') has been enacted under Subsection 220 (6) of the IFA. Information on the risk level included in the prospectus of the investment fund is provided in Section 7 of the Regulation.

- 2.1.3. Purpose of the guidelines is to specify the requirements set out in IFA and the Regulation of the Minister of Finance on the content of the information published on the risk level of the fund and to ascribe meaning to the obligation of due diligence by the management company in assessing risks and reflecting these in the fund prospectus.
- 2.1.4. The Guidelines create prerequisites for increasing the transparency of the service and help the client of the service understand risks accompanying investment better and thus comprehend the nature of the service, standard of the respective professional activity and good practices better, thus creating larger presumptions for avoiding possible disputes within legal relationships upon performing the rights and fulfilling obligations in good faith.

2.2. Scope of application

- 2.2.1. The Guidelines shall apply to the compiling of prospectuses of investment funds and pension funds, established and registered in Estonia, by a management company.
- 2.2.2. The scope of application of the Guidelines is, first and foremost, the information included in the prospectuses that shall enable investors (including potential investors) to knowingly assess the investment offered and, above all, the risks accompanying it. Such information shall be related to the investments of the concerned fund.
- 2.2.3. Application of the Guidelines shall take into account requirements arising from legislation. In the case of imperative requirements arising from legislation, provisions in legislation shall apply.
- 2.2.4. In case of problems involving implementation and interpretation in the application of the Guidelines, the principle of reasonableness shall be taken into account in light of the purpose of these Guidelines and in good faith with the diligence expected of a management company.

3. Description of a model investor

- 3.1. The prospectus shall present the description of a model investor to whom units of the fund are directed, including the presumed experience of the investor in investing of assets, expected risk tolerance of the investor and presumed reasonable duration of the investment if possible.
- 3.2. In describing the model investor, the management company shall assess beforehand the risks arising from the investment policy of the investment fund and shall submit, together with the description of the model investor, the company's qualitative assessment on the risks of the investment fund (risk level) and ascribe meaning to it in the prospectus.
- 3.3. In describing the model investor, the management company shall assess whether the investors are capable of estimating and understanding on their own or with the help of an investment consultant the risks accompanying investment and the risks related to the possible benefit gained.

4. General requirements for presenting risks in the prospectus of an investment fund

- 4.1. Information on the offered investment fund, nature of the investment and purpose of the investments made with the assets of the fund shall be submitted in a format that enables investors to make thoroughly deliberated investment decisions and to estimate the correspondence of the made decision to the interest of the investor.
- 4.2. A reference to a more detailed description of the risks related to the investments shall be made in the description of the investment purposes of the investment fund.
- 4.3. Possible benefits gained from the investment may not be emphasised if risks related to investment are not clearly referred to in the same part of the prospectus.
- 4.4. Submitted information may not give actual or apparent warranty of the profitability or payments of the investment fund, except in cases provided for in the IFA (e.g., guaranteed yield fund).
- 4.5. Information regarding risks shall be correct, accurate, unambiguous, the information may not be misleading and anything that would significantly influence the content or meaning or understanding of the data given in the information may not be omitted or missing from the information on the basis of the principle of reasonableness.
- 4.6. Information regarding the risk level of the fund given in the prospectus shall be up-to-date.
- 4.7. Upon presenting risks in the prospectus, the management company may assume that investors are moderately informed, attentive and reasonable, who know their investment objectives and ask for additional information when necessary.

5. Reflecting risks of the fund in the prospectus

- 5.1. The prospectus shall include the risk level of the fund and a description of any possible important and relevant risks related to the investment fund due to which the value of the investment of the investor may decrease. It is recommended to separately emphasise significant risks arising from the nature of a specific fund.
- 5.2. The management company shall assess the influence of the given risks on the investment and possible probability of the risks occurring upon determining the possibility, significance and relevance of the risks.
- 5.3. In assessing the risks, the management company shall take into account the type of the relevant investment fund, its investment policy and investment limits and any other significant circumstance related to the investment fund or management thereof. Such risks related to investments of an investment fund may arise, among other things:

- directly from investment activities (market risk, liquidity risk, credit risk, currency risk, inflation risk, market concentration risk, volatility risk and the like);
 - from potential changes in the legal environment (tax risk, political risk, other changes bearing on the activities of a fund and the like);
 - from asset safe-keeping (risk of insolvency, destruction/loss of the assets of a depository, underwriter or depository of other assets or the risk of the abuse of other assets and the like);
 - from asset valuation (complexity of the fair valuation of investments made off the regulated markets, absence of a presentable quotation of assets and the like);
 - from operational risks (counterparty risk, settlement system risk, risk of register maintenance and the like);
 - from conflicts of interests (transactions with persons linked to the management company or the presence of conflicts of interests with such persons, conflicting incentive schemes for managers and staff, membership of an independent treasurer in the same group as the management company and the like);
 - from the illiquidity of the fund (impossibility to perform the obligations assumed by the fund, suspending withdrawal of units and the like).
- 5.4. In case all assets of a fund may be allocated into one investment fund, in accordance with Subsection 247 (3) of the IFA, the prospectus shall describe possible and significant risks and the risk level related to the assets of the underlying fund.
- 5.5. In case derivative transactions are permitted in the rules of the fund, the prospectus shall describe the risks with regard to the types of derivative instruments.
- 5.6. In case the underlying assets of a fund are securities that are marketed off the regulated markets, the prospectus shall describe the risks related to such securities.

7. Final Provisions

The guidelines shall enter into force as of 15 November 2009.