

Consumer Panel response to CESR consultation paper on content and form of Key Investor Information disclosures for UCITS

The Financial Services Consumer Panel was established under the Financial Services and Markets Act 2000 by the Financial Services Authority to represent the interests of consumers. The Panel is independent of the FSA. The main function of the Panel is to provide advice to the FSA, but it also looks at the impact on consumers of activities outside the FSA's remit. The Panel represents the interests of all groups of consumers.

This is the Panel's response to CESR's consultation paper on the content and form of Key Investor Information disclosures for UCITS.

Overview

The Panel believes that CESR's work on disclosure and the proposals set out in this paper represent a significant step forward for investors. We support this initiative and many of the suggestions and recommendations in this Paper.

The Panel is particularly pleased that there is already a commitment to conduct research into key aspects of the proposals. We believe, however, that there is a strong need for further qualitative research amongst both consumers and advisers to test a number of assumptions about the best way to meet consumers' needs in the KII before quantitative work is undertaken. We have highlighted these areas in our answers to the specific questions posed in the Paper, including aspects of risk and past performance. The KII will be one of the key tools used by advisers and it is important that its effectiveness is assessed in this context, as well as in the way it is used by individual investors.

This is a unique opportunity to avoid the pitfalls of the Simplified Prospectus and to make sure that we get the KII right. We look forward to contributing to the debate as it moves forward and to seeing positive outcomes for investors in this vitally important European market.

Chapter 2 Summary analysis of SP regulatory failure

Q1: Are respondents aware of other research which is relevant to the market and regulatory failures associated with the SP?

Although the Simplified Prospectus itself was not the subject of the Panel's recent research into 'risk ratings', the research report¹ does provide useful information

¹ Risk Ratings Research conducted on behalf of the Panel by IFF, May 2007 published on www.fs-cp.org

about consumer understanding of risk which is relevant to the debate about the treatment of risk in the KII. For example, the research concluded that consumers generally do not fully understand how they need to factor risk into their buying decisions. Few understand more complex aspects such as the risk to capital, the risk/reward ratio or the time impact on risk. However, there is a clear benefit to consumers in using consistent terms to explain levels of risk as a guide to inexperienced investors. The FSA's work into a possible simplification of the Key Features Document² is also relevant to the broader issues.

Q2: Do respondents consider CESR's proposals would address the regulatory failures associated with the SP?

We are strongly supportive of many of these proposals, but are unable to comment in any detail on the regulatory failures associated with the SP. Nor is it possible to isolate the failures related to the SP from wider regulatory failures such as the quality of advice investors receive.

Chapter 3 The wider context in which KII would be used

Q3: Do respondents think that CESR has accurately described the context in which KII is likely to be used, and has correctly identified outstanding issues?

Yes, we believe that the Paper sets out the key issues accurately. We would like to comment on the following points in particular:

- Operator and distributor responsibilities. The most important point is that it is clear to consumers where they should direct any questions or complaints about their investment. The responsibilities set out in paragraph 3.6 seem appropriate.
- Outsourcing. Responsibility for the quality of the service and delivery of compliant KII should ultimately rest with the outsourcing firm. It should be the UCITS provider's responsibility to make **up to date** copies of the KII available to all distributors selling their products and to publish them more widely.
- KII for UCITS packaged in a wrapper. The definition of a 'wrapper' may well vary between Member States, but whatever the additional documentation that would be provided in relation to a wrapper, a KII for a particular fund should always be produced. The style and format of the KII should distinguish it from other material.
- Interaction with other directives. Conflict/inconsistency with MiFID in particular appears important if the outcome could be that some retail investors would not receive the KII in the format proposed. This is an issue that needs to be addressed in the short term.

² Consumer Research 55 "Investment Disclosure Research" conducted by IFF, November 2006, published on www.fsa.gov.uk.

- Medium of delivery and timing. These are important areas. The stated purpose of the KII is to set out key pre-contractual information to enable potential investors to make an informed decision. It must therefore be disclosed at an early stage and before any commitment is made by the investor. The Paper acknowledges that investors prefer to receive disclosure information in paper form and this should be accommodated within the requirements.

Chapter 4 General options for format and content of KII

Q4: Do respondents agree with the proposed purpose and scope of KII?

Q5: Should non-retail investors be permitted to opt out of receiving KII?

The analysis in paragraphs 4.6 and 4.7 seems logical. We agree that the KII should be focused on retail investors' needs before they make a decision, but it should also be updated at least annually to ensure that on-going information needs are addressed. We believe too that there should be a responsibility to deliver the KII, rather than to offer it, although professional clients and eligible counterparties should have the option to decline.

Q6: Do you think that CESR's proposals on general presentation are appropriate?

As a general premise we believe the KII should be a 'stand alone' document containing the key information on the particular investment. It should be easily distinguishable from any marketing or other information. Clearly the KII cannot be a substitute for the full prospectus and other information, which should be available to investors through website links/signposting. In particular it is important that there is nothing in the full prospectus that modifies what is contained in the KII – in other words, investors should not have to look at the full prospectus to see "the small print".

We agree that the maximum length of the KII document should be one sheet (two sides of A4) in a reasonably sized type, with the sole justification for anything longer being investor information needs about specific, complex funds. The two page structure set out in paragraph 4.16 seems appropriate.

The Paper acknowledges that previous attempts to encourage the use of plain language in documents such as the KII have been largely unsuccessful so far. The Panel agrees that a good practice guide might help firms to produce useful documents, but endorsement/verification with a national plain language body – wherever available – would be desirable. The overall aim should be consistency and an appropriate degree of standardisation.

Q7: Should CESR propose adopting a more prescriptive approach, for instance using detailed templates, or should it support a less prescriptive, principles-based approach?

In our view the best option will be a combination of prescription and the use of principles. So far as the format of the KII is concerned, it is important that the same

headings are used on all KII and in the same order and we would like these requirements to be prescribed. However we do not think it would be realistic to prescribe the content of the text under each heading due to the diversity of UCITS funds. Overarching principles should be applied here. We acknowledge that this is a difficult area and consideration could be given to reviewing the KII after, say, three years and the approach reconsidered if necessary in the light of the findings of that review.

Q8: In relation to the proposals on content, should Option A (with fewer items) be favoured compared to Option B?

Q9: How should both options best be tested with consumers?

We believe that qualitative research should be undertaken to test consumer understanding of the information contained in the KII and whether it meets their needs before particular formats are subjected to further research. The disparate nature of distribution channels across Member States, combined with the diversity of consumer understanding and capability, means that exploratory qualitative research is essential. Individual elements of the KII should be tested with investors and advisers to assess their effectiveness before mock-up documentation is produced and researched. The best chance we have now to avoid a repetition of the failure of the SP is to take the time to make sure that the detail of the document - as well as its presentation - is rigorously tested.

Q10: Has CESR correctly struck the balance between reducing the information provided and ensuring investors receive the key messages they need?

This is a difficult balance to strike. It is important to ensure that the document is kept to one page, but we believe that more needs to be included on the objectives of the particular fund, including the identification of risks unique to that fund or type of fund.

Q11: Should the competent authority of the fund and the tax regime of the fund in its Home Member State be included?

It is important that the competent authority of the fund is clearly identified in view of the passporting arrangements. Although we acknowledge that the tax regime of the fund in its Home Member State could be useful to investors, we do not consider it essential information for inclusion in the KII.

Q12: Do you think other items of information are necessary? If so, which ones in particular?

We think investors would find link to a directory of terms and important points to consider when reviewing a prospectus on a website extremely helpful.

Q13: Do you agree that the distribution costs should not be systematically 'unbundled' within KII? Should there be flexibility to allow this where appropriate?

We believe that the KII should cover only the costs of the fund, not the distribution channel. It is essential therefore that these are unbundled.

Q14: Does the proposed approach of local information (a harmonised section for local information within KII that would be precisely delineated) achieve a correct balance between the need for local information and the smooth functioning of the passport?

We think that signposting is a more appropriate method of dealing with local information. This would also free up space within the KII for more information on significant areas such as risk.

Q15: Should a 'building block' approach be permitted, whereby providers can produce different parts of the KII separately?

No, we are opposed to a building block approach. We think investors would find this confusing and it would be contrary to the principle that the KII should be standardised and prescribed in terms of the nature of the information that should be provided.

Q16: Do respondents agree with the proposed treatment of funds of funds?

Yes, we agree with this approach.

Q17: Should separate KII be produced for each sub-fund of an umbrella? Should providers be permitted to produce a compendium for all the sub-funds of an umbrella if they wish?

Production of a KII for each sub-fund of an umbrella fund will be essential if investors are to have all the information they need in order to take investment decisions.

Chapter 5 Describing the fund's objective and strategy

Q19: Do you think that CESR's proposals on the presentation and objectives of a fund are appropriate?

Generally we believe CESR's proposals on presentation of objectives and strategy are appropriate, but we think it would be helpful to potential "execution only" investors in particular to include, as well as the categories of investment, the actual top ten investments. If the information is not appropriate for a particular fund, that should be stated in the KII. The entire KII should be updated at least annually including the top ten list.

Q21: Is the streamlining of the current applicable Recommendation relevant for the purpose of focusing the description on key elements? Do you agree with the addition of new key items to mention within that section: guarantee, period of holding inappropriate if any, design also for retail non-sophisticated investors?

Q22: More specifically, do you agree that it should be required that in case the capital is not legally guaranteed, the term 'guaranty' should not be used in the KII, and it should be shortly mentioned to investors how the protection is achieved? In case the capital is legally guaranteed do you agree the guarantor should be mentioned? Do you agree that it is not necessary to mention explicitly that a fund is not capital guaranteed?

Issues such as inappropriate holding periods and target investor groups should be covered in the descriptive text relating to risk. If a fund is legally guaranteed it should be so stated and the guarantor identified. If it is only capital protected, the term "guaranteed" must not be used. It should be briefly and simply explained how the protection is achieved. This is a clear example of the need to use consistent and standardised terms within the KII. Investors will then be able to make more informed decisions about their investment.

Q23: Do you agree that mentioning whether it would not be appropriate for the investor to invest into the UCITS, if he anticipates the need to redeem within a defined time period to be stated, is the appropriate way to deal with time horizon issues without leading to misunderstandings?

This should be covered in the KII. A clear statement on these lines will assist investors to exercise their judgement when considering the fund in question and their financial circumstances as a whole.

Q24: Do you agree that giving management companies the opportunity to flag funds that have not been designed for non-sophisticated investors, with no legal consequences, would help in preventing missellings, especially in the case of 'execution only' subscriptions?

We would like to see further work being undertaken into an alternative to the term "sophisticated" investors, which is open to misinterpretation. We do agree however that it is important to 'red flag' high risk funds. This would include appropriate comment in the section of the KII dealing with the objectives and strategy of the fund, as well as any classification in the risk section.

Chapter 6 Risk disclosure

Q25: Do you agree that the presentation of a synthetic indicator should be favourably tested with stakeholders and consumers?

Q26: What specific presentation (icon, wording, numeric scale) should be favoured, and if so on what basis?

We are opposed to the use of a synthetic risk indicator based on a mathematical model or formula/algorithm. We favour instead a basic risk indicator – we have referred in this response to the use of a 'red flag' type arrangement, but we are open minded as to the graphics to be used – supplemented with informative text in plain, standardised language. One of the key objectives should be to warn inexperienced investors who may be attracted by high potential rates of return. We believe that it should be possible to identify classes of products which most advisers would regard as more risky or very risky. This is an important area for qualitative research with consumers and advisers and the type of indicator and key terminology should be decided in the light of this research. This should cover levels of understanding of the underlying message and expected consumer/adviser action on the basis of that message, rather than presentation alone.

Q27: How prescriptive should regulators be for the choice of methodology that should be proposed?

Q28: Are you aware of any specific existing calculation methodology that should be proposed?

As we have said, we do not support the use of a synthetic risk indicator. The language used in the descriptive text should be standardised rather than strictly prescribed.

Q31: Do you agree that the possible limitations to a risk reward might be effectively communicated to consumers through textual warnings? Is the proposed wording appropriate?

Any wording should be subjected to research and testing with consumers and advisers.

Q33: Could the display of scenarios or tables illustrating the behaviour of formula funds enhance the information disclosed for those funds? Do you think that such presentations should be limited to formula funds? Do you think that such presentations might have some misleading effects, might be manipulated, or mistaken for a guarantee? How could these be addressed and reduced? Do you think that such disclosure should be made in a harmonised way? What could be possible ways of showing prospective scenarios?

We are not in a position to provide a detailed response to this question, but we believe that this is an area where research would be useful.

Q34: On the narrative side, do you agree with the suggested high-level principles?

Yes, we believe that the seven principles identified in the Paper cover the key points to be considered.

Chapter 7 Past performance

Q35: Is CESR correct to recommend that information about past performance be included in the KII?

Yes. Past performance information generally finds its way to consumers through the marketing process or the media. We think it would be preferable for it to be presented in a standardised way in the KII, albeit with appropriate warnings on over-reliance on past performance as a guide to the future.

Q36: Has CESR identified the right areas and ways in which this information should be standardised?

We agree with the areas that should be tested with consumers and advisers and look forward to seeing the results. Subject to the findings of the research, currently the Panel favours a ten-year time period using a benchmark in all cases, not just where the particular fund is linked to a benchmark. This will help consumers to identify where a fund has performed against market trends.

Q37: Which charges should performance figures take into account? For instance, should figures include allowance for subscription and redemption fees?

All charges should be removed from the performance figures, which should reflect performance alone.

Chapter 8 Charges

Q38: Has CESR identified the best overall options for including information about charges in the KII?

Q39: Should a 'consolidated' charges disclosure be included, and how should it be described?

The information about charges in the KII should relate only to the charges levied by the fund. There is a diversity of distribution channels throughout Member States and the fees/costs imposed by intermediaries are a matter for individual investors. We believe that any attempt to combine these two aspects of the total investment cost could be misleading and would be contrary to the general principle that the KII should relate only to a particular fund. Guidance about likely distribution charges could be provided by a signpost to local information.

Q40: Should options for the disclosure of charges in cash terms be explored further?

The Panel is satisfied that overall the use of percentages is appropriate. We would like to see the possibility of additional disclosure of charges in cash terms given further consideration.

Q41: Do you have any comments on how charges should be organised (eg between charges relating to subscribing and redeeming units, ongoing fund charges, and contingent charges), labelled (eg 'initial charges', 'exit charges', 'ongoing charges') and the accompanying narrative messages regarding what they include or exclude? How much detail is necessary in a document like the KII?

We are not in a position to respond to the detail of this question. Clearly this is an area where consumer/adviser research is important. However the overriding principle should be that all charges are brought to the attention of the consumer before purchase and none should later come as a surprise.

Q45: Has CESR identified the best option for handling performance fees in the KII?

We agree with the approach outlined in paragraph 8.33 of the Paper. There should be a statement of the existence and basis of the charges with a signpost to the full prospectus for further information.

Q46: Do you agree that CESR should recommend that charges are disclosed on a maximum basis?

Yes, CESR should recommend that charges are disclosed on a maximum basis. We believe that this is the only feasible option.

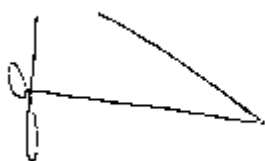
Q47: Are there any options for providing more accurate information, in a way which consumers might understand, about charges under different distribution arrangements?

No, we do not think this would be appropriate or feasible. The KII should be used for fund charges only.

Chapter 9 Testing the benefits and assessing the cost of KII

Q49: Do respondents have any comments on the proposals for consumer testing?

As we have said elsewhere in this response, the Panel believes strongly that there is a need for qualitative research looking at a range of issues where consumers and advisers need to engage and understand. The FSA's work into a possible simplification of the Key Features Document, which I referred to earlier in this response, shows how difficult the area of disclosure can be. The diversity of consumer capability and differing distribution channels within the EU add a further layer of complexity. To move straight to quantitative research at this point would be a wasted opportunity for us to make sure the KII is the right document for investors and advisers. The cost to both industry and investors of the misguided simplified prospectus was significant. The respected UCITS 'brand' could be damaged by the introduction of another document that fails to achieve its objectives. It is vitally important to get this right. We applaud CESR for making such rapid progress with its work on the KII, but would not wish to see this momentum becoming the driving force for change, rather than carefully researched evidence from consumers and advisers.

A handwritten signature in black ink, appearing to be 'John Howard', written over a horizontal line.

John Howard
Chairman
Financial Services Consumer Panel

17 December 2007