COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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CONSULTATION PAPER

A guide to clear language and layout for the Key Investor Information document (KII)

Deadline for contributions: CESR invites responses to this consultation paper by **10 September 2010**. All contributions should be submitted online via CESR's website under the heading 'Consultations' at www.cesr.eu. All contributions received will be published following the close of the consultation, unless the respondent requests their submission to be confidential.

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Part 1: Introduction

Background and purpose

The Simplified Prospectus (SP) failed as a consumer communication because the rules led to long documents. In addition, many are written in technical or legalistic language and are poorly structured and designed. The Key Investor Information document (KII) is a radical attempt to address these shortcomings.

The KII has a prescribed structure and headings. You can include only the information applicable to those headings and not add other information. The limit of two A4 pages (three for structured UCITS) places added emphasis on the requirements that:

- only information necessary for investors to make an informed decision is included; and
- the information selected is lucid and succinct.

You must not seek to bypass the page limit by using dense or small print or by relying on cross-references to cover information material to understanding of the investment. The KII must be well designed to attract rather than repel the reader. If it is not read it will fail, regardless of the quality of the text.

The rules set a framework for facilitating an effective document, but it is up to management companies to write and design KIIs in a way which makes them understandable. We suggest that you do not copy any text from a prospectus or an SP unless you have critically reviewed it in the light of this guide. This also applies to Commission Regulations and CESR text because they are addressed to the industry and not the consumer.

We do not believe there is a single right way to write and design a KII; you can meet the objective in many ways. This guide is intended to help you to craft a KII by giving pointers to widely-accepted good practice.

The contents and nature of this guide

General good practice guidance about clear language and layout is already available[1] as well as guidance more relevant to investment literature[2]. There are also plain language agencies that can help management companies write and design their KIIs. SPs failed partly because they did not follow this widely accepted good practice.

We endorse this good practice and do not seek to repeat its detailed characteristics. Instead, drawing on experience of the SP, this guide concentrates on those elements of the KII for which we believe management companies will find guidance most helpful.

All references to a management company in this guide also apply to an investment company that has designated a management company"

[1] For example the Oxford Guide to Plain English by Martin Cutts, Oxford University Press.
[2] A Plain English Handbook, How to create clear SEC disclosure documents http://www.sec.gov/pdf/handbook.pdf

Who should use this guide?

Everyone involved in the drafting and design of a KII needs to share an understanding both of its aims and of their company's approach to plain language and clear layout. An effective KII will have a consistent style and not appear to be written by a committee. This may best be achieved if the KII has an 'owner' who is responsible for final decisions on its content, language and design. But it will be rare for a single author to have all the knowledge and skills needed to produce an effective KII. It will almost always benefit from input from others, provided they share the same objectives.

It is good practice to be guided by research and testing. Do not assume that because you and your colleagues understand what the text means, an investor will understand it in the same way.

As you hone a KII into a precise document, be ready for it to take longer to prepare than a much lengthier SP. *'I didn't have time to write a short letter, so I wrote a long one instead.' (Blaise Pascal)*

Part 2: Using plain language

Understanding your audience

Most UCITS are marketed to a wide range of consumers with varying levels of financial literacy and experience. Few consumers will be lawyers or industry specialists, and even those who are financially experienced will still welcome clearly-designed, well-written documents. It is best to assume that your reader is reading about an investment fund for the first time.

A document that is hard to understand will fail. This may mean that the aims, risks and charges of an investment are misunderstood or not understood at all. That is not in the interests of either the management company or the investor.

Your company may already have a 'style guide' for the way it seeks to portray itself in its publications, such as your marketing documents. This is very likely to follow clear language principles. Therefore such a style guide is just as appropriate for KII documents, because they are aimed at the same audience.

What is meant by plain language?

'Plain language is not just about avoiding jargon. It is about the writing and setting out of essential information in a way that gives a co-operative, motivated person a good chance of understanding it at first reading, and in the same sense that the writer meant it to be understood.' *Oxford Guide to Plain English* by Martin Cutts.

Using plain language is not about dumbing-down or avoiding complex concepts. Instead it means:

- writing so that your audience are not alienated by unfamiliar and pompous vocabulary and convoluted construction;
- giving complex information in a clear way.

You should aim to enable your target market to understand each statement at their first reading. A consumer will become easily frustrated if they have to re-read the information.

Writing in plain language may require the 'unlearning' of habits inherited from the traditional formal or legalistic ways of writing business documents. Nothing is gained by the presumed certainty of legalistic or complex language, if the reader does not understand it or, worse, is misled by it.

Apart from improving clarity, clear language techniques have great potential for reducing the word count – an important quality in the context of the page limitation of the KII.

Dealing with jargon

The investment industry is notorious for its use of jargon, specialist language and unusual expressions (such as *negative growth).* This results in a style that is likely to be alien to many consumers; as in the following example:

> Where, in the Manager's judgement, there is significant uncertainty that a bond holding will be redeemed at par; the amortised capital component for that holding is retained in the fund's capital and not distributed. This has the effect of reducing the estimated redemption, distribution and underlying yields and the actual distribution rate.

You can overcome reliance on jargon by:

- firstly; avoiding jargon altogether e.g. by explaining an unfamiliar feature without naming it.
- secondly; explaining jargon in brackets after its first use;
- thirdly; explaining jargon in a footnote to the section or the page; and
- finally; by cross-referring to a glossary in a supporting document. However, if this would result in a string of cross-references you should question the need for the jargon and your approach to explaining it. For cross-references it is good practice to use a graphic or other indicator to show that the term is so explained.

Words which have different meanings in normal usage

In addition to jargon, the investment industry uses many terms which may mean different things to the layman. A dictionary may give a different meaning to the one intended by the management company.

Allocation date (as in income date) *appreciation, denominated, equity, erosion, establishment, expire, exposure, liquid, redemption, repurchase, volatile.*

Such words may therefore confuse or mislead the lay reader.

Other barriers to clear language

Removing jargon or potentially confusing words will not necessarily make a document clear and engaging. There are other barriers to clear language, such as legalistic words and phrases or the use of foreign words when there is an adequate alternative in the native language of the KII. A formal, passive and impersonal style can lead to redundant words and phrases as well as being unengaging to the reader.

Short sentences

Clear language techniques will naturally lead to shorter sentences, but aim to break up any that are over 25 words.

Clear layout

Plain language needs to be supported by a clear layout. Once you have decided what you want to say and how to say it, Part 3 gives guidance on how to present it.

Questions for the consultation

1. Do you agree with the concepts in Part 2 and that they should form the basis for writing a KII?

2. Do you have any alternative or additional suggestions?

Part 3: Designing a KII

The KII must be significantly better presented than most SPs. It must grab readers' attention and encourage them to read it. This means it must be distinguishable from other documents and appear important and easily readable. When compared to marketing literature, it should not appear to be a legal document like the terms and conditions.

Although the structure and length of a KII are mandated, you are still free to use the design elements described below. It is important that you choose the right combination. A good design makes a document easier to read and understand. A poor design may mean well-written messages are undermined or not even read.

Typeface (font)

Use a typeface that is easy to read, such as Arial (or similar sans serif) or Times New Roman (or similar serif).

Type size

Use a legible type size which is balanced with the line width and the line spacing.

- Wide lines of small type are a problem for the eye to follow. It is best to keep to 50-75 characters (including spaces) in a line of 10-point type. You can use 'newspaper' columns or wide margins to achieve this.
- Typefaces vary, but when using the full width of A4 paper, aim for at least 11pt for serif fonts and 10pt for sans serif fonts; a slightly smaller type size is legible when narrow columns are used.

Headings

Use a clear hierarchy for the headings and sub-headings. This can be supported by emboldening, colour, different type sizes or by indenting the text.

Page layout

Maximise 'white space' by using:

- small paragraphs
- bulleted lists, rather than continuous text whenever appropriate
- clear gaps between sections.

Colour

Colour adds visual appeal, and more design options. But remember that the KII may be photocopied or downloaded in black and white. If you use colour, do so sparingly and ensure there is enough contrast between the text and its background – the effect is better if the text is dark and the background pale. It may therefore be better to use shading.

Questions for the consultation

3. Do you agree with the concepts in Part 3 and that they should form the basis for designing a KII?
4. Do you have any alternative or additional suggestions?

Part 4: Guidance for each section of the KII

a) Title and introductory statements

See Article 4. of Commission Regulation (EU) 583/2010 for the required content.

Make the title *Key Investor Information* sufficiently prominent so that it catches the eye of the potential investor.

The explanatory wording is mandatory, as well as the name and identification of the UCITS (and investment compartment if the UCITS is an umbrella) by code number and the name of the management company (if applicable).

b) Heading – Objectives and Investment Policy

See Article 7.of Commission Regulation (EU) 583/2010 for the required content.

This section of the KII is to tell a consumer:

– what the fund aims to do; provide growth, an income or a combination; and
– the main ways it intends to achieve the aim(s). This should enable investors to get a sufficient understanding of how the fund seeks to achieve the objective so that they can make an informed decision. Avoid long, legalistic and technical text, which is unlikely to be read, let alone understood.

You can, if appropriate, describe the objective and the policy in a single paragraph. But if this results in a large block of text, you can split the objectives and investment policy into separate paragraphs or describe them under sub-headings.

Do not copy from the prospectus unless that is in clear language. Some elements of the prospectus wording:

– may be immaterial for a summary document like the KII and
– may belong in other sections of the KII. For example information about the riskiness of any of the assets belongs in the *Risk and reward profile*.

But remember that you may need to go beyond the prospectus wording to ensure you give a balanced description of the objectives and investment policy.

Your approach will depend on the length and complexity of the prospectus wording. Clear language techniques may make a shorter wording possible without removing elements. For example by:

– removing redundant text such as *In order to achieve the investment objective, the Company on behalf of the Fund will enter into…*
– personalising the style; by using *you* instead of *the investor* or *the unit holder* and *we* instead of *ABC International Asset Managers Limited (*provided this creates no uncertainty about who *we* is)
– removing self-evident text; such as *to the extent permitted by the regulations*
– avoiding vague or aspirational statements such as *The Fund aims to deliver attractive positive long term returns.*

If, after following the practices suggested above, the result is still too long, critically assess the need for all of the information. For example, if there is the potential to invest in a wide variety of investment instruments, analyse their materiality based on past usage.

Special considerations for structured UCITS

See Articles 7 and 36 of Commission Regulation (EU) No 583/2010 for the required content. Select at least three example performance scenarios as described in CESR's level 3 guidelines on the selection and presentation of performance scenarios in the Key Investor Information document (KII) for structured UCITS (Ref. CESR/10-530).

Structured funds have many and varied formulae for calculating the possible pay-out at the end of the term. Ensure that the formula (or formulae) is presented in a balanced manner without over-emphasis on the up-side potential.

When explaining the formula, consider the following, where applicable.

- Make it clear that a fund's structure will alter its risk and reward profile when compared to a direct investment in the same underlying assets.
- Make it clear that a reduced risk is compensated by a reduced potential return. Consequently, avoid using words such as *performance* or *return* side by side with words such as *security*.
- If there is no legally enforceable guarantee the term *guarantee* may mislead consumers about the security of their investment.
- If there is a risk of capital loss at one of the trigger dates in the formula, clearly describe this risk within the *Objectives and investment policy* and state that investors' capital is not guaranteed.
- Where less than 100% of an investor's capital is guaranteed or protected, avoid phrases which could cause the nature or extent of the guarantee / protection to be misunderstood. Clearly state that the capital is not fully guaranteed or, where there is no legally enforceable guarantee, that the capital is not fully protected.
- Where a fund's formula is pegged to the average performance of an index up to 100% or where it is pegged to the index's capped performance, balance the level of indexing with the explanation of the effect of the averaging or the capping.
- Use positive wordings like *if the index falls by more than 30%* rather than *if the index performance is less than-30%.*
- Where structured funds are offered in consecutive dated issues, avoid over use of templated text. For example, instead of using *start date* and *end date* state the actual dates.

c) Heading – Risk and reward profile

See Article 8 of Commission Regulation (EU) No 583/2010 for the required content.

The risk and reward section must give a fair and balanced description of the inherent chance for growth or loss.

Consider what impression the title of the fund may give to an investor. For example, *cautious, balanced* and *total return* may mislead the layman about the riskiness of a fund. Therefore explain the nature of the investments these funds make (or cross-refer to the *Objectives and investment policy*) and put them into context with the information in the *Risk and reward indicator*.

Synthetic risk and reward indicator

CESR's guidelines on the methodology for the calculation of the synthetic risk and reward indicator in the Key Investor Information Document (Ref. CESR/10-673) explain the calculation of the indicator for UCITS funds, including structured UCITS.

See Article 8 of Commission Regulation (EU) No 583/2010 for the statements which must support the indicator. These statements include a clear and succinct explanation of the *material* risks that are not, or not fully, reflected by the indicator. This section gives guidance on these statements within the context of the space limit of the KII.

The aim is for the investor to understand the uncertainties – both for loss and for growth – that may affect their investment. There are two main elements:

- the mandated synthetic risk and reward indicator and its explanation; and
- the narrative explanation of risks not captured by the synthetic indicator.

Where applicable, explain that the indicator is not a measure of the risk of capital loss but is a measure of the fund's previous ups and downs in value. For new funds, explain how the indicator has been worked out. For structured funds, explain that the indicator seeks to show the risk of capital loss at the end date.

Explanations of risks not adequately reflected by the indicator

Firstly be clear about what a risk is.

- *Risk for reward*

  Remember that the section covers both risk and reward and therefore should not be merely a list of bad things that can happen. Tell the investor why a risk is being taken so they can gain a balanced understanding.

- *A risk is uncertainty*

  Describe only the *uncertainties* which may affect the value of the fund.

  It is not a risk where investors can lose money as a predictable consequence of their own actions, because it is a function of the way the investment plan or fund works. If such consequences are material, they are better explained in the other sections of the KII where they can be placed into context. For example:

  - the likelihood of capital loss in *Objectives and investment policy,* where a structured UCITS is cashed in early.
  - the deduction of an exit charge in *Charges* if an investor cashes in early.

- *Risks are judged on their impact and probability*

  Go beyond a bald statement of the risk by briefly explaining its implications to the investor. For the information to be helpful, a potential investor will need an idea of your assessment of a risk's materiality. For example: how much of the fund is being exposed to a particular risk, how likely it is that the risk will materialise, and how severe the impact would be if it did. Where relevant, explanations of ways by which a risk is mitigated may help a consumer understand the impact and probability.

- *Effect of guarantees or protections*

  Explain if the risk is modified by a legally enforceable guarantee or a protection and the implications of cashing in the investment outside of any associated set period.

In analysing the volatility data over the last five years, you will identify which risks are reflected in the synthetic indicator and which are not.

The typical risks that may not be reflected in the synthetic indicator are counterparty, default, liquidity, operational and some emerging market risks.

- Where material (bearing in mind that all UCITS should be liquid enough to enable investments to be cashed in quickly), clearly explain the risk and its potential impact. But giving the risk its technical name may not be helpful to investors. It may be sufficient simply to describe the nature and implications of each risk separated by a bullet or other design device.
- Do not include immaterial risks in the KII, even if there is space for them. The required signpost to the prospectus will allow interested investors to find out full details of all the risks.
- Rather than itemising each risk, it may be appropriate to categorise them by the asset or strategy that gives rise to them; for example, by grouping together the risks arising from bonds or from emerging markets.
- For an umbrella structure with no legal segregation between investment compartments, explain the possible impact on such a sub-fund in the Practical information section.

Note that a statement about the impact of tax in the investor's home State belongs in the 'Practical information' section, not in the risk and reward profile.

d) Heading – Charges

See Articles 10-13 and 24 of Commission Regulation (EU) No 583/2010.

Charges information is summarised in a mandatory table, with each charge then explained in turn.

One-off charges taken before or after you invest	
Entry charge	[ ]%
Exit charge	[ ]%
This is the maximum that might be taken out of your money [before it is invested] [before the proceeds of your investment are paid out].	
Charges taken from the fund over a year	
Ongoing charges	[ ]%
Charges taken from the fund under certain specific conditions	
Performance fee	[ ]% a year of any returns the fund achieves above the benchmark for these fees, the [name of benchmark].

Explain briefly each of the charges in the table. In doing so note the following:

- State where necessary that detailed charges information is in the prospectus.

– The entry and exit charges are the maximum amounts which could be taken. Refer investors to the financial advisor where it is possible that lower charges may apply to certain investors

– The entry charge should include any difference between the buying and selling prices.

– If the ongoing charges are taken from capital rather than income and you consider their effect on final returns may be material, explain this in this section rather than as a risk.

– Avoid industry terms such as *subscription*, *redemption* and *re-purchase*.

– Explain if a charge for a fund switch differs from the normal charge for buying units.

e) Heading – Past performance

See Articles 15-19 of Commission Regulation (EU) No 583/2010.

This section is not required for structured UCITS.

This section includes a bar chart that must be no larger than half of an A4 page and prominent supporting statements. Standards for the fair presentation of the bar chart are given in Annex III of Commission Regulation (EU) No 583/2010.

f) Heading – Practical information

See Article 20 of Commission Regulation (EU) No 583/2010. The extra information required for umbrella structures is given in Article 25, for share classes (where applicable) in Article 27 and in Article 34 for feeder UCITS. No other information is permitted but, where it will help an investor, it is good practice to put the information into context.

The mandated statement below emphasises the precision of wording required for the KII and should stimulate a final check on the content.

[Name of investment company or management company] may be held liable solely on the basis of any statement contained in this document that is misleading, inaccurate or inconsistent with the relevant parts of the prospectus for the fund.

Questions for the consultation

5. Do you agree with the concepts in Part 4 and that they should form the basis for assessing the content of each section of a KII?
6. Do you have any alternative or additional suggestions?