

# **Principles on Point of Sale Disclosure**

## **Consultation Report**



**OICU-IOSCO**

**TECHNICAL COMMITTEE  
OF THE  
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

**November 2009**

This report is for public consultation purposes only and it has not been approved by the IOSCO Technical Committee or any of its member securities commissions. Any final report will be submitted to the IOSCO Technical Committee for approval at the conclusion of the consultation process.

## Preamble

The International Organization of Securities Commissions Technical Committee's (TC) Standing Committee on the Regulation of Market Intermediaries (TCSC3) and its Standing Committee on Investment Management (TCSC5) (collectively: the Joint Group) have published for public consultation this Consultation Report on *Principles on Point of Sale Disclosure*. The Consultation Report sets out a set of principles that are designed to assist markets and market authorities when considering point of sale disclosure requirements. The Consultation Report will be revised and finalised after consideration of all comments received from the public. After the consultation process, the Joint Group will submit a final report on *Principles on Point of Sale Disclosure* to the TC for approval.

## How to Submit Comments

Comments may be submitted by one of the three following methods **on or before 15 February 2010**. To help us process and review your comments more efficiently, please use only one method.

**Important:** All comments will be made available publicly, unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

### I. Email

- Send comments to [posdisclosure@iosco.org](mailto:posdisclosure@iosco.org)
- The subject line of your message must indicate '*Public Comment on Principles on Point of Sale Disclosure.*'
- If you attach a document, indicate the software used (e.g., WordPerfect, Microsoft WORD, ASCII text, etc) to create the attachment.
- Do not submit attachments as HTML, PDF, GIFG, TIFF, PIF, ZIP or EXE files.

### 2. Facsimile Transmission

Send by facsimile transmission using the following fax number: + 34 (91) 555 93 68.

### 3. Paper

Send 3 copies of your paper comment letter to:

Mohamed Ben Saleem  
Senior Policy Advisor  
International Organization of Securities Commissions (IOSCO)  
Calle Oquendo 12  
28006 Madrid  
Spain

Your comment letter should indicate prominently that it is a '*Public Comment on Principles on Point of Sale Disclosure.*'

## Table of Contents

Chapter	Page
<b>I. Introduction</b>	<b>1</b>
<b>II. Research: The Main Findings</b>	<b>4</b>
A. The Need for Effective Disclosure for Retail Investors	4
B. Views on Effective Disclosure	6
C. Research on Retail Investor Preferences	6
D. Research on Investor Behaviour	8
<b>III. Existing Disclosure Requirements and Modes of Delivery in IOSCO Member Countries</b>	<b>9</b>
<b>IV. Components of Effective Disclosure</b>	<b>12</b>
A. Introduction	12
B. Content	12
C. Language	13
D. Timing	14
E. Types and Purposes of Consumer Testing Available	15
<b>V. Special Challenges for Regulator</b>	<b>17</b>
A. The Tensions between Product Disclosure and Intermediary Disclosure	17
B. Consistency of CIS and other Product Disclosure Requirements	18
C. Cost/Benefit Analysis of New Point of Sale Disclosure Requirements	19
<b>VI. Disclosure Requirements Being Proposed in IOSCO Member Countries</b>	<b>22</b>
<b>VII. Proposed Principles for Disclosure of “Key” Information in regard to CIS prior to the Point of Sale</b>	<b>24</b>
<b>Principle 1</b> <i>Key information should include disclosures that inform the investor of the fundamental benefits, risks, terms and costs of the product and the remuneration and conflicts associated with the intermediary through which the product is sold.</i>	24
<b>Principle 2</b> <i>Key information should be delivered, or made available, for free, to an investor before the point of sale, so that the investor has the opportunity to consider the information and make an informed decision about whether to invest.</i>	25
<b>Principle 3</b> <i>Key information should be delivered or made available in a manner that is appropriate for the target investor.</i>	26
<b>Principle 4</b> <i>Disclosure of key information should be in plain language and in a simple, accessible and comparable format to facilitate a meaningful comparison of information disclosed for competing products.</i>	26
<b>Principle 5</b> <i>Key information disclosures should be clear, accurate and not misleading to the target investor. Disclosures should be updated on a regular basis.</i>	27
<b>Principle 6</b> <i>In deciding what key information disclosure to impose on intermediaries and product producers, regulators should consider who has control over the information that is to be disclosed.</i>	27
<b>Appendix A: Research Summary</b>	<b>29</b>

## Chapter I. Introduction

This Consultation Report was produced by the Joint Group under the *Joint Project Specification on Point of Sale Disclosure to Retail Investors*,<sup>1</sup> approved by the TC in February 2007. Although the Joint Group mandate relates to both collective investment schemes (CIS) and similar products, the report is, for the time being, focused on CIS. The question of similar products may be considered at a later stage as proposed below.

The report analyzes issues relating to requiring *key information* disclosures to retail investors relating to CIS<sup>2</sup> and their distribution prior to the *point of sale* (POS).<sup>3</sup> It also sets out principles in Chapter VII to guide possible regulatory responses. The report does not examine issues relating to the suitability of CIS or similar products<sup>4</sup> and does not purport to describe or address *all* disclosure obligations of the intermediary (e.g., relating to general information on the intermediary's range of services, the safeguarding of client assets, client categorization or information that needs to be disclosed in the client agreement).

Transparency in the market place, particularly disclosure of information to investors, has always been a high priority and goal of regulators in seeking to ensure that markets run efficiently and with integrity. Enhancing POS disclosure, i.e., helping to ensure that investors are able to consider key information about CIS products before they invest, clearly can contribute to this goal. The recent crisis in the financial markets has highlighted the critical role that accurate, understandable and meaningful disclosure can play. This, and other IOSCO projects, can assist regulators in developing a path towards renewed investor trust in both the producers of financial products and the intermediaries that sell them.

In developing this Consultation Report, the Joint Group first wrote an *Issues Paper* that examined the issues raised by POS disclosure, including:

- whether regulatory disclosures are in fact effective in addressing information asymmetries that exist between investors, producers and sellers;
- what constitutes key information;

---

<sup>1</sup> The term *retail investor* is not defined in most jurisdictions for regulatory purposes. However, in most jurisdictions, persons who do not fall within the definition of an *institutional* or *professional* investor (e.g., individuals or entities that meet certain net worth or asset levels) are generally treated as a retail investor. As used in this paper, therefore, the term retail investor should be generally understood to have a meaning consistent with this broadly accepted approach.

<sup>2</sup> Section 11.2 of the IOSCO principles defines a CIS as including “authorized open ended funds that will redeem their units or shares, whether on a continuous basis or periodically... [including] closed end funds whose shares or units are traded in the securities market... [and] unit investment trusts, contractual models and the European UCITS (Undertakings for Collective Investment in Transferable Securities) model.” While a CIS is generally defined as including closed end funds, for purposes of this paper closed end funds will be excluded from the definition.

<sup>3</sup> For purposes of this report, *point of sale* refers to the moment at which a customer requests that a product be purchased.

<sup>4</sup> We note that the Joint Forum published in April 2008 its report on *Customer Suitability in the Retail Sale of Financial Products and Services*, Joint Forum (IOSCO, BCBS and IAIS) April 2008 available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD268.pdf>.

- how information should be delivered and whether a *layered approach*<sup>5</sup> should be used;
- what exactly should be understood as delivery;
- at what point in time the information should be delivered;
- use of plain language rather than technical jargon; and
- the format of disclosures.

The Issues Paper was provided to various industry and investor associations on an informal basis in July 2008. It solicited comment on whether the appropriate issues had been identified. Those who commented generally agreed that the Joint Group had identified the key issues. A number of more specific comments have been taken into account in drafting this Consultation Report.

The report analyzes in significant detail the key issues raised in the Issues Paper. In addition, our examination of possible disclosure of key information has highlighted the following important points:

- No matter what disclosures are mandated, they will not have the intended effect (i.e., having retail investors engage in a deliberate and informed investment process) if the investor either does not read and/or understand the information provided. Regulators should therefore consider measures to help improve retail investor education in order to enhance their financial literacy and ability to read investment documentation and make informed investment decisions;
- In general, new POS disclosure requirements should not be imposed without the benefit of consumer testing or assessment to help determine the likely effectiveness of new disclosure requirements. For example, as explained in greater detail below, research indicates that retail investors exhibit a range of behaviours and biases in the decision-making process, including acting on emotion, rather than on facts. These behaviours should be understood and considered to the greatest degree possible when developing a regulatory approach; and
- The principles set forth in Chapter VII of this report may also be applicable to non-retail investors.

Finally, the Joint Group is aware that some members of the CIS industry are of the view that if CIS products are subjected to enhanced POS disclosure requirements, this might place them at a competitive disadvantage versus other financial products, which may not be subject to the same requirements. The merits of this argument are not analyzed in great detail in this report (although it is discussed in Chapter V Section B.), partly because of the challenge in identifying truly comparable products that are as popular with the retail investor.

In addition, IOSCO would encourage further work by appropriate bodies on POS disclosure regarding products similar to CIS. Although the principles set out in Chapter VII are developed with specific reference to CIS, pending future work by IOSCO, regulators in the respective jurisdictions are encouraged to review their local conditions and, to the extent

---

<sup>5</sup> See definition in section IV.A.

possible, consider adopting the principles set out herein to investment products similar to CIS.

## Chapter II. Research: The Main Findings

### A. The Need for Effective Disclosure for Retail Investors

#### Summary

Retail financial services may be characterized by *information asymmetries* – where the supplier of the product has more information about the product (and the terms under which it is sold) than the buyer. Such an information asymmetry can put retail investors at a disadvantage. Markets are generally more efficient when accurate information is available to both consumers and suppliers.

Retail investors should be able to base their investment decisions on solid information. Whether an investor is guided by an advisor's or market intermediary's recommendations, or is largely self-directed, the investor should have the necessary information to understand what he or she is buying, its cost and its risk/reward profile. The investor should also understand a market intermediary's associated conflicts of interest, i.e. an intermediary may promote the sale of a product because it is in its, rather than the investor's, financial interest to do so.

As indicated by the research described below, some retail investors who buy CIS and similar products may not clearly understand, for example, the layers of costs associated with purchasing those products, any guarantees being offered by the product, or the risks of investing in the product. In some jurisdictions many retail investors may not clearly understand their dealer's (or adviser's) financial stake (and thus conflict of interest) in selling those products, including so-called *revenue sharing* arrangements.

Traditionally, the CIS prospectus has been the investor's primary source of information about a fund. As described in Chapter III, regulators have explored ways to make prospectus disclosure more meaningful for retail investors. One example is the creation of simplified prospectuses that seek to communicate key information in a meaningful way, but issues remain.

#### Disclosures relating to distribution and intermediaries

Two areas of particular significance in relation to distribution and intermediaries are the disclosure of costs, and the handling of the potential for *conflicts of interest*.

#### Cost

CIS investors may, directly or indirectly, incur distribution-related costs that can reduce their investment returns. The type and amount of those costs often vary among funds and among share classes issued by the same fund.

For instance, some CIS' issue shares classes that impose sales fees, or loads, on investors when they purchase the fund shares.<sup>6</sup> CIS' may also sell share classes with sales fees or loads

---

<sup>6</sup> For example, 'front-end' sales loads, 'subscription fees' or 'entry charges'.

that investors must pay when they redeem fund shares,<sup>7</sup> which may vary depending on how long the investor has held the shares. Some CIS' also use their assets to pay distribution-related expenses, including compensation of intermediaries in connection with distributing fund shares. These charges, loads or fees reduce the returns that investors earn, raising important disclosure issues relating to costs. This may also be the case with financial products that are similar to CIS.

### **Conflicts of interest**

Intermediaries that sell CIS shares to retail investors may face various forms of conflicts of interest. These conflicts can give intermediaries and their personnel a greater financial incentive to sell particular funds or share classes in conflict with their duty to act in the interest of their client and to ensure compliance with applicable suitability or *appropriateness* standards when financial advice is given.<sup>8</sup>

For example, a fund or its affiliates may pay an intermediary to provide the fund with more visibility and access to the intermediary's sales force, or otherwise influence the way that the intermediary and its associated persons market the fund (or a particular share class) to investors. Payment arrangements can take a wide range of forms, for instance as direct fees, whether upfront or throughout the life of an investment,<sup>9</sup> revenue sharing, or payments which are ostensibly compensatory for costs incurred by the intermediary which may not be directly related to a particular fund sale.

Persons associated with intermediaries may also receive so-called *differential compensation* that could motivate personnel to promote the sale of some funds over others. These arrangements pose special disclosure and other regulatory issues. We note that other products might also raise the same issues related to differential compensation as CIS and nonetheless be subject to very different disclosure requirements even though also offered to retail investors (such as in the EU, a structured note or a life insurance contract).

### **Other material information**

There is other pre-sale information that investors may find useful for making informed investment decisions. Examples include any affiliation of the intermediary with product producers, whether the ranges of products available are limited to affiliated groups' products, the policies and procedures governing the giving of discounts/rebates/waivers to clients for making investments through the intermediary, and any ability to rescind a purchase order (*cooling off period*) allowable for the products and dispute resolution procedures.

---

<sup>7</sup> Which may variously be called 'deferred' or 'back-end' sales loads, 'redemption fees' or 'exit charges'.

<sup>8</sup> The issue of market intermediary management of conflicts of interest has been extensively analysed in a Report issued by the TC on November 2007. The Report makes reference only to those conflicts arising in the context of a securities offering in which the intermediary is directly involved.

<sup>9</sup> Please see also the TC Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds of November 2004, where reference to distribution costs and arrangements is made.



## Disclosures relating to products

In relation to disclosures about products themselves, the asymmetry of information between the product producers and retail investor also raises significant challenges. As a result, most jurisdictions have placed specific disclosure requirements on product producers. In particular, these requirements include disclosures regarding the objectives of a product, its risks, potential for investment returns and charges, and the nature of any guarantees being offered.

However, there is evidence from a number of jurisdictions that these disclosure requirements have not effectively mitigated the effects of the underlying asymmetry of information. For instance, the European Commission (EC) has asked the Committee of European Securities Regulators (CESR) to initiate work to overhaul the existing *simplified prospectus* for UCITS<sup>10</sup> after discovering that it has failed to be of widespread use to investors. The focus in this work has been on a shorter, more consumer-friendly document designed to be easier for investors to understand, with the aim of increasing the likelihood that the information will be of use. Several other jurisdictions also have work underway to improve on product disclosure regimes, following similar evidence that the existing requirements are not effective. See discussion in Chapter VI.

### B. Views on Effective Disclosure

As is discussed in Chapter III, some regulators have explored ways to encourage retail investors to read and use the information contained in prospectus disclosure (and, in some cases, separate intermediary-focused disclosures)<sup>11</sup>, by making it more useful for investors. Ultimately, the regulatory aim is to improve the effectiveness of the disclosure as a way to empower retail investors.

It is generally accepted that to be effective, particularly for retail investors, disclosure must:

- relate to key characteristics;
- give investors the information at a time when it is relevant; and
- be in language investors can easily understand.

Timing and language are critical to ensuring that the disclosure is effective. The issue of timing is discussed in Chapter IV Section D. The issue of language is discussed in Chapter IV Section C.

However, other factors have been identified which can be important in determining the overall effectiveness of disclosures. These include the financial literacy of investors, or the extent to which they focus on disclosures required by regulations rather than on other sources of information.

---

<sup>10</sup> UCITS stands for *Undertakings for Collective Investment in Transferable Securities*. Briefly, these are CIS which can be sold cross-border across most of Europe by virtue of meeting certain defined standards and requirements.

<sup>11</sup> For example, menu of commission and status disclosure in the UK. More generally, in relation to intermediary focused disclosures, retail investors in Europe must be provided with information on conflicts of interests, costs and fees of services and inducements.

## **C. Research on Retail Investor Preferences**

Much research has been done on what information retail investors want to have in order to make an investment decision. Annex A draws together findings and issues from the research or surveys submitted by TCSC3 and TCSC5 members.

### **What information do retail investors want?**

The research indicates that a key starting point for retail investors when looking at investment products is information about potential returns, risks and cost.

Retail investors seem to be asking the following questions:

- how much can I make (returns);
- how much can I lose (risk); and
- how much does it cost (fees).

The research suggests that retail investors focus on information about investment returns or past performance in an attempt to answer the question “how much can I make?”. They do not, however, focus only on returns. They also want to know about risks and guarantees in an effort to understand how much they might lose. Finally, they want to know about the costs. They are interested in the fees and expenses, although evidence is more mixed on the extent to which investors take costs into account.

Research is less clear on consumer preferences for information about intermediaries. Investors often do not recognise any particular information needs they might have in this area other than costs. Research indicates that retail investors may be confused about payments to the intermediary and those to a product producer.

### **In what format do retail investors want to receive the information?**

The research contains a number of key messages regarding retail investors’ preferences for the design and format of the information they wish to receive. They say that they prefer documents that are:

- short and concise;
- well presented and laid out;
- plainly and clearly worded;
- focused on the information they believe they need; and
- easy to understand with simple examples, tables and graphics to help illustrate concepts.

Design techniques may be used to improve the extent to which a disclosure document engages retail investors. Techniques such as the use of colour, bolding and white space can help make a document easier for a consumer to navigate and, therefore, understand.

The overall tone of a document also matters to retail investors. Statements about where investors could find more information have been viewed as enhancing the overall credibility of the information disclosed. Additionally, retail investors have said that they want information at a time that it is “useful” to their investment decision. This is discussed further in Chapter IV Section D.

Research summarised in the literature survey also touches on sources of information. Investors rely on a wide range of types of information when making investment decisions. In particular, they rely on the advice of others, who may be peers, professional advisors<sup>12</sup> or salespeople.

#### **D. Research on Investor Behaviour**

Research has also been done on how retail investors tend to behave when making an investment decision. See Annex A for specific references.

Consumer behaviour research attempts to answer how consumers make their decisions.

Regardless of where they obtain the information, the research indicates that retail investors exhibit a range of behaviours and biases in the decision-making process. For instance, these might include the impact of:

- **Emotion.** Investors make decisions based on how they feel as opposed to what they know or think they know;
- **Overconfidence and overestimation of investment knowledge and abilities.** Retail investors may interpret past successes as due to their own expertise rather than market conditions;
- **Representativeness biases.** Investors are overly influenced by strong or poor recent past performance or false reference points; and
- **Inertia, procrastination and status quo biases.** Investors stick with a familiar, pre-existing or established position, for instance relating to the appropriateness of following a particular investment strategy.

Some research has suggested that one way to combat these biases might be to provide retail investors with product information in a form that is easy for them to digest, for instance in a summary form, as part of the sales process. This could make them aware of the potential benefits, risks and costs before they make their purchase decision. Other approaches might include improving the readability of existing disclosures.

In relation to disclosure about intermediaries, such as their status and remuneration, the function of *trust* can be particularly significant. Evidence suggests investors can be more inclined to discount these disclosures because they place their trust in their advisor.

---

<sup>12</sup> Advice provided by a professional advisor is, in most jurisdictions, legally defined and regulated.

### **Chapter III. Existing Disclosure Requirements and Modes of Delivery in IOSCO Member Jurisdictions**

As part of its development and review of the POS issues, the Joint Group requested that regulators complete a POS Questionnaire (Questionnaire). The responses to the Questionnaire revealed that most, but not all, jurisdictions have in place some type of POS disclosure requirements for CIS and other similar products. Some require simplified information that is particularly designed for the needs of retail investors. The degree of prescription in disclosure requirements varied.

Requirements relating to disclosures about the services offered by intermediaries and their remuneration were more varied among countries – both in terms of the types of information required and the detail required.

#### **Products and services covered**

Disclosure requirements may apply to products and/or to the intermediary in relation to the service they offer. Requirements that apply to CIS products were the focus of most responses to the POS questionnaire. Jurisdictions generally applied similar requirements across all types of CIS products. Several jurisdictions have comparable requirements that apply to other investment products.

Some jurisdictions noted requirements for intermediary services, including investment advice, and intermediary remuneration relating to particular transactions in CIS and other financial instruments.<sup>13</sup>

A number of jurisdictions are examining options for new disclosure requirements. See discussion in Chapter VI.

#### **Content and format of disclosure**

Almost all jurisdictions require that information about financial products be disclosed to investors. Many jurisdictions require that simplified information particularly suited to the needs of the retail investor be provided.

For instance, European jurisdictions require that a simplified prospectus be offered in relation to UCITS. The Canadian authorities also require the offering of a simplified prospectus, while the United States SEC permits the offering of a simplified prospectus as long as certain requirements are met. Examples of other short documents required for CIS or similar products include the *Key Features Document* (required in the UK for many retail investment products, including non-UCITS CIS and life contracts), the *Financial Information Leaflet*

---

<sup>13</sup> IOSCO's *Objectives and Principles of Securities Regulation*, p. 37, provides a general recommendation that the intermediary: "should make adequate disclosure to its customers, in a comprehensible and timely way, of information needed to make a balanced and informed investment decision. It may be necessary for regulation to ensure disclosure in a particular form where products carry a risk that may not be readily apparent to the ordinary investor. Recruitment and training should ensure that staff who provide investment advice understand the characteristics of the products they advise upon." *Objectives and Principles of Securities Regulation*, IOSCO, May 2003 available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>.

(required for a range of investment products in the Netherlands), and the *Product Disclosure Statement* (Australia).

Generally, information material to the retail investor's investment decision must be provided but jurisdictions differ as to the degree of prescription they use in clarifying what must be provided. Typically, required information includes:

- investment objectives or goals;
- main investment strategies (sometimes specifically whether the fund invests in derivatives);
- the key risks of investing in the CIS;
- fees and expenses;
- the investment adviser, sub-adviser(s) and portfolio manager(s);
- information regarding the policy of purchase and redemption of the CIS's shares; CIS distributions;
- tax information;
- other services that are available from the CIS (e.g., exchange privileges or automated information services);
- conflicts of interests; and
- contact information.

Many jurisdictions have no or limited requirements governing the format or presentation of the documents, although most jurisdictions require that the prospectus be written in *plain language*. The majority of jurisdictions permit the incorporation of one prescribed document into another for delivery purposes.

Although many jurisdictions do not appear to have specific requirements regarding intermediaries, some require specific disclosures relating to the service and status of the intermediary or distributor, including detailed disclosures relating to costs and intermediary remuneration.

### **Recipients of the disclosure**

In most jurisdictions retail clients are the intended recipients, although professional or institutional clients are given or offered the same disclosures as retail clients. However, some jurisdictions apply reduced requirements for non-retail clients.

### **Timing and mode of delivery**

Most jurisdictions require the disclosure of information before a transaction is executed, although some allow delivery upon completion. While electronic media are generally permissible, the client's consent is often necessary before mandatory disclosures may be provided solely in this form. The mode of the sale (e.g., internet or telephone) will generally determine the timing and mode of any required delivery.

### **Responsibility and liability for preparation and delivery**

While requirements to prepare and make available or publish information are similar across jurisdictions, requirements to give the information to the consumer are more varied. In

general, product producers are responsible for preparing and publishing the disclosure, and intermediaries (advisers) are responsible for delivering it (see also footnote 19).

In most jurisdictions product producers are not able to delegate their liability, although in some jurisdictions they may share it. While a product producer is generally responsible for the content of a prospectus, the intermediary is in most jurisdictions, responsible for explaining the features of the product to a client. In the European Union, the Markets in Financial Instruments Directive (MiFID)<sup>14</sup> requires that an intermediary falling within the scope of the directive be held responsible for any information it provides.

---

<sup>14</sup> *Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments and implementing directive and regulation available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:145:0001:0044:EN:PDF>.*

## **Chapter IV. Components of Effective Disclosure**

### **A. Introduction**

As discussed in Chapter II, regulatory disclosures are intended to protect investors by addressing the information asymmetries that exist between retail investors and those manufacturing or selling investment products. An important issue for regulators to consider is whether investors may not be properly using the information provided to them under current disclosure regimes because they have trouble finding and/or understanding the information they need. This information may, for example, be buried in long and complex documents, and investors may have difficulty comparing information about different products. Investors also may find it difficult to locate information about the intermediary and its remuneration and, if they find it, to understand its significance or how to use it.

By making disclosure more effective regulators may be able to address these potential weaknesses. Some regulators have evidence to suggest that effective disclosure depends on factors such as providing:

- retail investors with key information about a CIS product;
- where relevant, the intermediary services being offered in relation to the distribution of that product;
- the information in an accessible and comparable format;
- the information at the right time – when retail investors are making their purchase decision; and/or
- the information in a *layered approach*. A *layered approach* refers to supplementing key summary information with additional and more detailed information either upon request or through additional supplementary material attached or linked to the summary information.

The issues may be different in different jurisdictions. As mentioned above, other significant factors may determine the effectiveness of disclosure requirements, such as the extent to which retail investors rely on the disclosures, the level of consumer financial capabilities, or the complexity of the investment product in identifying key information to be disclosed and in designing effective disclosure requirements. In addition, regulators should take into account whether the fund documents are primarily aimed at retail investors rather than professional investors.

### **B. Content**

Based on the investor research summarised in Chapter II and the existing requirements among jurisdictions summarised in Chapter III, the key content of the disclosures should include:

- objectives and investment strategies;
- risks e.g., relating to the potential negative performance of the investment, or even broader risks and their variability, such as liquidity risks (e.g. redemption restrictions,

lock-up periods, *gates* etc), counterparty risks when there is some capital protection or guarantee; operational risks; etc;

- past performance (which may be presented in a graphical or tabular manner, and may be standardised between CIS') or, where past performance is not available, potential return scenarios;
- costs (e.g. subscription or redemption fees, annual management charges (AMC), miscellaneous expenses or indeed composite measures such as the Reduction in Yield (RIY) or Total Expenses Ratio (TER)<sup>15</sup>); and
- conflicts of interest which could include both conflicts arising within the fund manager, and those affecting the distributor or intermediary (this could include disclosure of the conflict itself and the mitigation strategy).

Retail investors have said that they want a short document that contains the information they want in a form they can understand. The use of simple examples, tables and graphics might help to achieve this objective. Information about costs, for example, can be difficult for investors to understand, and some jurisdictions have initiatives to improve disclosures in this area. However, this can give rise to issues such as the appropriate form that information about charges should take. For example, should it be generic or should it illustrate, for instance in cash terms, the actual proposed contract?

Information about the service being offered by the intermediary, the handling of conflicts of interest and remuneration, are all likely to be important. Information about costs, for example, can be difficult for investors to understand, and some jurisdictions have initiatives to improve disclosures in this area.

### **C. Language**

Effective disclosure also means providing retail investors with information in language they can easily understand. All jurisdictions generally require that prospectuses be written in *plain language*. *Plain language* can be described as communicating in a way that facilitates audience understanding - as being clear, succinct and comprehensible while avoiding unnecessary jargon and technical terms.

Writing using *plain language* requires an understanding of the intended audience. In order to gain a better understanding of the characteristics of the intended audience, the following characteristics can be helpful to analyse potential barriers to communication:

- literacy;
- investment knowledge; and
- role of intermediaries in the sale of the product.

Low literacy levels can constitute a significant barrier to communication. Recent research indicates that, while literacy levels vary between countries, a significant proportion of adults

---

<sup>15</sup> Fund management charges and costs are often disclosed as an AMC. In some jurisdictions additional measures of charges are also disclosed. TER is a proxy measure for the charges and expenses deducted from the fund each year. RIY is another proxy measure which shows the overall impact of charges on an illustrative growth rate.



have serious problems absorbing the information contained in printed materials, e.g., are only able to tackle simple reading tasks. In addition, financial disclosure documents will include a mixture of numerical and non-numerical information that may exacerbate barriers to communication.<sup>16</sup>

Research indicates that levels of investment knowledge and financial capability are generally very low. This reinforces not only the need for clear and simple disclosures, but also the importance of efforts to enhance investors' ability to understand financial information.

Finally, in many jurisdictions, retail investors rely heavily on the intermediary in making an investment decision, which might have an impact on how investors review or consider the information contained in disclosure documents. This may be addressed, in some jurisdictions, by having the document include unbiased, i.e., neutral prompts to "ask your adviser" for more information on particular points, particularly with regard to fees.

The investor research discussed in Chapter II makes it clear that investors are primarily interested in information on potential benefits (performance), risks and costs. Disclosure documents under the current regimes in many jurisdictions already provide this information, but not always in a form or using language that makes it easy for retail investors to understand. This suggests that in some jurisdictions regulators may wish to consider whether the information needs to be revised, for example, by simplifying existing disclosures or redesigning them, and putting them into a format that investors can more easily read and understand.

#### **D. Timing**

For the purposes of this report, we have considered the term *point of sale* as referring to the moment at which a customer requests that a product be purchased (see footnote 3). A survey of existing regimes reveals, however, that there is no uniform or clear definition of the phrase "point of sale" across jurisdictions, although we observe that, in its proposed POS disclosure regime, Canada has defined *point of sale* as the point in time when the investor gives instructions to the intermediary to purchase the investment product.

Many jurisdictions require that information be disclosed before a transaction is completed. In Japan, disclosure must be made before *trade execution*. The U.S. CFTC requires commodity pool operators to obtain a signed acknowledgement from a prospective fund participant that he or she has received a disclosure document before accepting any funds from the prospective participant for investment in the fund. Under MiFID in Europe, the focus is on ensuring investors receive information "in good time before" carrying on the relevant business, so as that the information can inform their investment decision.<sup>17</sup>

Canada and the U.S. SEC do not currently require that information be provided until a transaction is completed, although there is no prohibition against providing it earlier.

---

<sup>16</sup> See International Adult Literacy Survey, [http://www.oecd.org/document/2/0,3343,en\\_2649\\_201185\\_2670850\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/2/0,3343,en_2649_201185_2670850_1_1_1_1,00.html); also see National Institute for Literacy, <http://www.nifl.gov/nifl/facts/IALS.html>.

<sup>17</sup> The UCITS and Prospectus Directives contain the same type of requirement ("in due time before").

Some other jurisdictions require that certain disclosures must be made available, but only on request. In some cases, flexibility is allowed. For instance, the Irish Consumer Protection Code requires that “information must be supplied according to the urgency of the situation and to allow the investor the time to absorb and react to the information” and that “the terms and conditions related to a service must be provided before entering a contract or before the cooling off period finishes where applicable”.

Some jurisdictions are considering a *layered* disclosure approach. As described in Chapter IV Section A, this is where key summary information is supplemented with additional and more detailed information either upon request or through additional supplementary material attached or linked to the summary information. In general, regulators should consider what information should be given prior to or at the *point of sale*, what can be signposted as available elsewhere or available upon request, and what information can be delayed until after the conclusion or execution of the investment transaction.

For example, recent amendments to the law in Australia enable layered disclosure where more detailed information can be “incorporated by reference” into the initial disclosure document that is provided to a retail investor before a product is purchased. The additional layered disclosure is available on request, and is to be provided prior to the purchase of the product. The Canadian proposal on point of sale disclosure adopts a similar approach by requiring that investors receive a 2-page document prior to or at the point of sale, with other disclosure documents available on request.

#### **E. Types and Purposes of Consumer Testing Available**

Regulators may wish to consider what, if any, testing, or other assessments, might be done to help establish how well investors understand the current disclosure and compare that to how well they understand and will react to any new/improved disclosure requirements.

There are two types of data that may be obtained through consumer testing. Quantitative data provides numbers and statistics about a particular subject and is obtained through online, telephone or in person surveys of large numbers of consumers (control studies). Qualitative data provides attitudinal information and is obtained through focus groups and protocol testing.

- Control Studies involve the collection of quantitative data from a statistically significant number of respondents.
- Focus groups are conducted with a small group of people (usually 8-12). They are valuable for gathering information about how people feel about a product, issue or document. Participants will advise if they like or dislike the item or matter being tested. However, focus groups alone may not be the most effective way to test the usability of a document, or to learn how well an individual really understands what is written.
- Protocol testing involves a one-on-one interview with a reader and is generally used to test the readability of a document.

The SEC, Canada and the European securities regulators within CESR have tested their proposed forms for point of sale disclosure.

While evidence may indicate that consumers may prefer to receive information in a particular format about particular key elements of a product, it can be argued that consumers will benefit from improved disclosure only if consumer behaviour changes. Several regulators have used *behavioural mock sales testing* as a key element in assessing the benefits of introducing changes to disclosure requirements. This type of testing has generally included assessing changes in understanding when consumers are presented with the new documents along with simple tests of behaviour in response to the additional information.

## Chapter V. Special Challenges for Regulator

### A. The Tensions between Product Disclosure and Intermediary Disclosure

The responses to the POS Questionnaire indicate that while most jurisdictions require disclosures relating to products, specific disclosures that relate to the services being offered by intermediaries are less common. Where such disclosures exist, the requirements are often less detailed.

In some cases it can be difficult to determine who is responsible for disclosure – the product producer or intermediary. For example, the total amount of charges paid by an investor may depend on the channel through which he or she purchases a product and the particular arrangements between the product producer and the intermediary. For instance, an intermediary may offer discounts or rebates on some of the fees. Generic disclosures by the product producer may need to be supplemented or personalised so the client can see the actual charges he or she is to pay. Personalised illustrations may also be useful.

Some jurisdictions require specific disclosures about intermediary services including disclosures of conflicts of interest or inducements, or policies for managing these conflicts, a variety of requirements relating to the disclosure of the remuneration of the intermediary, and how this relates to the payment of commission to them by product producer.

Some jurisdictions, such as European Union members states under MiFID<sup>18</sup>, have developed disclosure requirements that focus specifically on the intermediary and the services it offers. As noted in the summary of consumer research, the two underlying *market failures* that disclosure should address are:

- the potential for the intermediary to suffer from a conflict of interests (that is, a principal/agent issue, where the interest of the intermediary in its own affairs might conflict with that which it has as agent for its client); and
- the poor understanding of retail investors of the nature of the services being offered and the remuneration structures which support them (asymmetry of information).

Of particular concern are compensation arrangements between intermediaries and product producers that may influence the advice provided by the intermediary to a retail client. These arrangements may create a direct financial incentive to sell particular products because they offer higher compensation for the intermediary.

One further complication is that the structure of compensation payments may be difficult for an investor to understand, making it in turn difficult for the investor to grasp the value of the service being offered by the intermediary. Specifically, some research (see Annex A) suggests that investors frequently do not understand that the return on their investment in CIS may be diminished by the compensation arrangement between the intermediary and the product producer. That is, investors do not understand that they indirectly pay the compensation. Some investors may even think that the distributor service is free.

---

<sup>18</sup> Some requirements predated MiFID. For instance, the UK had a pre-existing regime for such disclosures, and continues to maintain requirements for services not covered by MiFID.

Key issues therefore include:

- how to disclose the nature (including its scope, quality and duration) and costs (including how these are taken) of the service offered by the intermediary;
- how to manage conflicts of interest faced by the intermediary, the role of disclosure and the role of other regulatory tools;
- a possible split in responsibility between the product producer and the intermediary for disclosure requirements relating to transactions – e.g. when buying shares in a CIS. For instance, if disclosure is required *in good time before* a particular transaction, where the intermediary may have responsibility for ensuring appropriate delivery, yet the product producer typically will be the only party capable of disclosing the details of their product;<sup>19</sup> it should, however, be noted that while a product producer would generally be responsible (liable) for the contents of a prospectus, the intermediary in some jurisdictions may need to obtain additional product information independently rather than solely rely on the contents of prospectus.
- accuracy of the information if the entity required to deliver the information does not have access to the most up-to-date information, for example, if CIS are required to deliver information about broker-dealer arrangements, or broker-dealers are required to deliver information about CIS costs; and
- whether disclosure is an effective tool for managing these issues.

## **B. Consistency of CIS and other Product Disclosure Requirements**

As discussed above, many jurisdictions require the delivery of disclosures about CIS products to investors at or prior to the point of sale. Some commentators have argued that such requirements may put CIS products at a competitive disadvantage vis-à-vis other financial products (for which no such POS disclosure requirements exist).

For example, in response to the U.S. SEC proposed point of sale rules, some commentators expressed concern that the proposed rules could discourage intermediaries from selling CIS shares in favour of other investment products not subject to the same rules. This point has also been raised by respondents to the TC consultation on its work programme. In contrast, others supported enhanced point of sale disclosure, particularly concerning revenue sharing and other compensation practices.

Regulators need to consider at least three questions:

1. To what degree do CIS POS disclosure requirements differ from POS disclosure requirements for other financial products sold to the retail public (e.g., primary offering registration statements)?
2. Do similar disclosure requirements exist for substantially similar products?

---

<sup>19</sup> While a product producer would generally be responsible (liable) for the content of a prospectus, the intermediary would in most jurisdictions play an important role in explaining the features of the product to a client. By doing this, the intermediary may in some jurisdictions become liable for the content.

3. To what degree do CIS and similar products raise issues and concerns unique to those products compared to other financial products?

Clearly, regulators will want to try to avoid to the greatest degree possible the imposition of more onerous disclosure requirements on specific products compared to competing products that raise the *same* disclosure issues (e.g., distribution costs and conflicts of interests due to revenue sharing arrangements). The issue of the *level playing field* is arguably one that may lead some jurisdictions to consider legislative reform and/or rulemaking whenever disclosure requirements for CIS and similar non-CIS products differ.

Some regulators, such as the UK FSA, have put in place regulatory regimes that cut across many products with similar characteristics to CIS in an attempt to harmonise the core requirements. But the emergence of new forms of product and investment arbitrage has made this more difficult to achieve.

Since 1998, a single regulator in Australia has regulated disclosure for all financial products. In 2001, a single disclosure regime for all such products was adopted. This means that issuers that create CIS-like products are subject in Australia to the same disclosure rules as CIS. Thus, the issue of the level playing field is less likely to arise.

In Italy, CONSOB adopted a similar approach. In 2005, it introduced new rules extending the scope of application of rules of conduct and transparency, including prospectus requirements, to the subscription and placement of financial products issued by banks and insurance companies.

In addition, different issues may exist where different regulators regulate the product producer and the intermediary.

Responses to the questionnaire suggested particular issues for products or services sold within the EU, where different EC directives can govern different elements of the sales process, and different products. This can make developing a consistent approach difficult to achieve. The EC's current work program includes steps to address this issue at the directive level.<sup>20</sup>

In assessing the costs and benefits of disclosure requirements, the potential for 'regulatory arbitrage' needs to be considered.

### **C. Cost/Benefit Analysis of New Point of Sale Disclosure Requirements**

Measuring the costs and benefits of changes in regulatory requirements is a complex exercise. In considering the potential costs and benefits of new rules, regulators need to consider the existing disclosure practices of intermediaries and product producers and establish the extent to which the new requirements might generate additional costs.

#### **Benefits**

Measuring the benefits of disclosure is particularly challenging because they may be intangible or very difficult to measure with any precision (e.g., measuring the *value* of people

---

<sup>20</sup> See [http://ec.europa.eu/internal\\_market/finservices-retail/investment\\_products\\_en.htm](http://ec.europa.eu/internal_market/finservices-retail/investment_products_en.htm)

making more informed investment decisions). A starting point is to track the channels through which the benefits may be expected to arise. Some possible benefits of enhanced point of sale disclosure rules include:

- less risk of retail investors buying inappropriate products or not fully benefitting from the services they pay for, or reduced risk of mis-selling;
- retail investors being in a better position to understand conflicts of interest of intermediaries and compare the costs of investing;
- the potential for downward pressure on prices due to greater transparency in areas such as charges or commissions. This may enhance the overall efficiency of the market and create benefits that spread beyond the direct recipients of the disclosure material; and
- comparability and ease of CIS point of sale disclosure may encourage investors to save.

Several jurisdictions have conducted research, such as the “behavioural mock sales testing” referred to in Chapter IV Section E above, to assess the effectiveness of new documents on consumer understanding, behaviour and outcomes. Work is underway in the UK to attempt to quantify the effects of standardized charges disclosure on overall charges levels in the CIS industry.

## **Costs**

The direct costs of new disclosure requirements usually fall into two main categories: costs of change in moving to a new approach; and on-going costs of maintaining that new system, which would have to be compared with the cost of existing systems.

Possible sources of costs include:

- legal and other compliance costs for preparing a document;
- information technology costs for re-programming and updating information delivery systems;
- compliance and other staff costs for overseeing and maintaining the information delivery systems; and
- external costs for printing and typesetting of the new disclosures.

Additional costs for intermediaries in particular could include generating and sending information to investors, calculating revenue sharing and maintaining and further updating information delivery systems.

Costs could be minimized to the extent that new POS information can be incorporated into current delivery systems. Or costs may not be impacted at all to the extent that firms already disclose this type of information at POS even though regulators do not yet require this.

Producers in jurisdictions that use a simplified risk disclosure statement may also face potential litigation risk if an investor believes that the simplified form failed to alert him/her of material risks, or was misleading because of its brevity, even if cross-reference is made to

the more detailed prospectus. This is a particular concern in jurisdictions where private civil litigation is frequently and easily pursued.

Indirect costs (and benefits) resulting from new rules in this area include the possibility:

- that investors may choose other types of financial products that do not have, or do not appear to have, the costs and conflicts associated with CIS products;
- that funds restructure how they compensate sellers of their securities; and
- of duplicative disclosure by the CIS firm and by the intermediary.



## Chapter VI. Disclosure Requirements Being Proposed in IOSCO Member Jurisdictions

A number of jurisdictions have described proposals for new disclosure requirements. Canada has proposed two new two-page documents for segregated and mutual funds: “Fund Facts” (FF) would provide key information that is in the simplified prospectus, but in a user-friendly and simplified manner, and prior to or at the POS; “Key Facts” (KF) would summarize key features of the insurance component of a segregated fund and would be offered in addition to the FF. As to format, the proposed new forms would need to be consistent with the following principles:

- avoid legal or financial jargon;
- use simple examples, tables and graphics to illustrate concepts;
- use bold headings and white space to make the document easier to read and navigate;
- writing should be at a reasonably modest educational level; and
- recognize the role of the adviser in the sales process.

In these jurisdictions, other disclosure documents such as a simplified prospectus would be available on demand.

The U.S. SEC has proposed prescribed forms and model Internet disclosure that would provide investors with a wide range of product cost information, as well as information about intermediary compensation and conflicts of interest.<sup>21</sup> For example, at the POS, investors would receive disclosure of ownership costs (including management fees and operating expenses), distribution-related costs, and volume purchase discounts (examples of specific investment amounts and their costs would be attached), and insurance security investors would receive information on insurance/administrative costs, expenses on underlying funds, and the ability to terminate the contract. As proposed, the SEC rules would apply to transactions in *covered securities*, which would include any security issued by an *open-end company* (typically a CIS).<sup>22</sup>

---

<sup>21</sup> See *Point of Sale Disclosure Requirements and Confirmation Requirements for Transactions in Mutual Funds, College Savings Plans, and Certain Other Securities, and Amendments to the Registration Form for Mutual Funds Reopening of Comment Period and Supplemental Request for Comment*, Securities Act Rel. No. 8544 (Feb. 28, 2005), available at <http://www.sec.gov/rules/proposed/33-8544.htm> and *Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds*, Securities Act Rel. No. 8358 (Jan. 29, 2004), available at <http://www.sec.gov/rules/proposed/33-8358.htm>.

<sup>22</sup> It would also include any security issued by a ‘unit investment trust’ (typically a variable insurance product), and any ‘municipal fund security’ (a security that typically receives special tax treatment and that is used to fund educational expenses).

More recently, the U.S. SEC adopted rules allowing CIS the *option* of sending or giving investors a summary prospectus and providing the full prospectus online. The summary prospectus incorporates by reference the full prospectus (a *layered* disclosure approach).<sup>23</sup>

Japan has proposed to require a new “document before concluding a contract” that would contain a statement that the company is a financial instruments firm; and the registration number; an outline of the contract and any fees; a warning concerning potential losses; and information concerning applicable taxes, cancellation rights (*cooling off* period), fund contact information, and the name of the self regulatory organization (SRO) of which the firm is a member.

In addition, CESR has provided preliminary advice to the EC on the form and contents of a *Key Information Document* (KID) for UCITS funds.<sup>24</sup> This work was launched at the request of the European Commission as part of a wider work to revise the UCITS Directive.<sup>25</sup> This would ultimately replace the simplified prospectus, which has not achieved its objective of providing retail investors with information they can easily use to make well-informed investment decisions.

CESR has considered the factors that are likely to make disclosure of product information useful to such consumers, in particular the need for this to be short, focused, expressed in clear language, and presented in a way that enables comparisons between funds. Following a significant public consultation with market participants and EU retail consumer associations, it delivered its preliminary advice to the EC in February 2008, proposing in some areas alternative options. In addition, CESR identified a number of technical issues arising from its work that merited further consideration. In March 2009, CESR launched a technical consultation on a set of recommendations regarding these issues.<sup>26</sup> In parallel, the EC is carrying out consumer and industry testing of the various options for KID. Taking into account, inter alia, the final results of the EC’s testing exercise and the outcome of the technical consultation, CESR consulted on the full package of its final advice on the KID in summer 2009. The final advice was to be submitted to the EC by the end of October 2009.

---

<sup>23</sup> See *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Investment Companies*, Inv. Co. Act Rel. No. 28584 (Jan. 13, 2009), available at: <http://www.sec.gov/rules/final/2009/33-8998.pdf>.

<sup>24</sup> See the CESR’s Advice to the European Commission on the *Content and form of Key Investor Information disclosures for UCITS* (Ref.: CESR/08-088), available at: <http://www.cesr.eu>.

<sup>25</sup> See [http://ec.europa.eu/internal\\_market/investment/ucits\\_directive\\_en.htm](http://ec.europa.eu/internal_market/investment/ucits_directive_en.htm).

<sup>26</sup> See CESR’s consultation paper (Ref. : CESR/ 09-047) available at: <http://www.cesr.eu>.

## Chapter VII. Proposed Principles For Disclosure of Key Information in regard to CIS Prior to the Point Of Sale

**Principle 1** *Key information should include disclosures that inform the investor of the fundamental benefits, risks, terms and costs of the product and the remuneration and conflicts associated with the intermediary through which the product is sold.*

**Key information in product disclosure could include:**<sup>27</sup>

- The name of investment and type of product;
- The investment objectives and strategy of product;
- Its risk and reward profile. Risk disclosures should include the material risks for the product. This may include performance risk/volatility, credit risk, liquidity risks and operational risks. In some jurisdictions, a scale may be considered appropriate to identify the overall risk measurement or classification of the product, rather than a list of specific product risks. This may assist with risk comparisons, although regulators and investors need to be aware of the inherent limitations in such measures. Regulators might wish to include supporting information indicating minimum length of holding relative to short term volatility, what types of *targeted investors* the product is being marketed to and what commitment those investors need to make;
- Fees and costs, including information on any breakpoint discounts and/or expense reimbursements or fee waivers;
- The nature of any guarantees being offered, including any restrictions or conditions that the guarantees are based on;
- Potential conflicts of interest inherent in the terms of the product. For example, these may include when:
  - Payments to the investor are dependent on certain criteria (e.g., product performance as measured against a benchmark); and/or
  - There are penalties for policyholders who cash in their investments early; and
- Past performance. The information should be presented in a way that enables easy comparison between products. Past performance disclosures should include a warning that historical performance is not an indicator of future performance. Where no past performance is available, potential return scenarios should be provided, if the CIS concerned has a payout structure based on a pre-determined formula;
- Additional information:
  - Information on portfolio managers and key service providers (e.g. trustee or custodian). This could include the identity of the portfolio managers and key service providers and their regulator, where applicable;

---

<sup>27</sup> Key information will necessarily vary depending on the type of financial product being offered. For some complex financial products with a multitude of risks, the amount of key information that a regulator might mandate for immediate disclosure to the investor under a “layered approach” may be greater than for less complicated products.

- The arrangements for handling complaints about the product;
- Information on any compensation that might be available if the firm cannot meet its liabilities in respect of the product;
- Any rights to cancel or withdraw; and
- A summary of tax implications on premiums and benefits.

**Key information in intermediary disclosure could include:**

- The name of intermediary, its services and its contact information.
- Fees, intermediary compensation and costs, including any charges and fees that reduce the returns that investors earn.
- Potential conflicts of interest. For example, any conflict of interest that can give intermediaries and their personnel a financial incentive to sell particular funds or share classes in breach of their duty to act in the best interest of their client, as well as any non-monetary benefits provided to intermediaries.

**Means for Implementation:**

- Disclosure requirements should be flexible to accommodate different kinds of CIS and to allow producers and intermediaries to provide their own disclosure. Some jurisdictions may mandate separate intermediary focussed disclosure and product disclosure; and
- If a jurisdiction chooses a *layered approach* to disclosure, the disclosures made prior to the point of sale should specify where and how the investor can obtain additional information on the proposed investment.

**Principle 2** *Key information should be delivered, or made available, for free, to an investor before the point of sale, so that the investor has the opportunity to consider the information and make an informed decision about whether to invest.*

**Means for implementation:**

- Regulators could require that appropriate proof exists to demonstrate that requirements for delivery or availability of key information have been met;
- Intermediaries and product producers could retain appropriate and sufficient documentation to prove that the requirements have been met. The product producer or the intermediary may wish to obtain a signed acknowledgement from the investor that he or she received, or had access to, the appropriate disclosure information; and
- Regulators may want to consider whether an investor is in a position to make an informed decision about whether to invest before the point of sale.

**Principle 3** *Key information should be delivered or made available in a manner that is appropriate for the target investor.*

**Means for Implementation:**

- In determining the required mode of delivery or availability of key information, intermediaries or product producers should take into account:
  - Individual investor characteristics and preference, e.g., access to the internet and email, or access to a fax machine. Intermediaries or product producers should consider requiring delivery by mail for those investors who do not have access to electronic and fax delivery; and
  - Whether the investment is recommended by the intermediary.
- Regulators should require intermediaries or product producers to deliver to investors, upon request, key information in writing free of charge, irrespective of the means of delivery of the key information.

**Principle 4** *Disclosure of key information should be in plain language and in a simple, accessible and comparable format to facilitate a meaningful comparison of information disclosed for competing products.*

**Means for Implementation:**

- *Plain language* disclosure should be used to convey information in a way that is likely to be understood by the target investor. The needs and abilities of the target investor should be considered to ensure that the content of the information is relevant, the organization of the information is logical and the language appropriate;
- The following plain language techniques may be considered to improve disclosure:
  - common everyday words;
  - when technical, legal and business terms are unavoidable, clear and concise explanations of them; and
  - examples and illustrations to explain abstract concepts.
- The use of characters of readable size for every item;
- The format should allow for comparison. In order to promote simplicity and comparability, regulators should consider prescribing certain aspects of the disclosure such as the length of the document when written material is used, minimum items to be addressed as described above in Principle 3, their order and certain content related to certain sensitive items such as performance, risk and costs;
- Regulators should consider prescribing the order in which the items are presented. Establishing a logical and consistent structure will ensure the essential elements are given appropriate prominence and will help to facilitate comparisons between key information related to different CIS; and

- Regulators should consider the tension between allowing producers to include additional product specific information on the one hand, and the desire to promote simplicity and comparability on the other.

**Principle 5** *Key information disclosures should be clear, accurate and not misleading to the target investor. Disclosures should be updated on a regular basis.*

**Means for Implementation:**

- Information should not emphasize potential benefits of a CIS without also giving a fair and prominent description of any relevant risks. It should not obfuscate important items, including warnings, or seek to diminish their importance;
- Where the information provides comparisons with other CIS or similar products, regulators should consider requiring that (1) the comparison be unbiased and objective; (2) the sources of the information used for the comparison are specified; and (3) the facts and assumptions used to make the comparison are included;
- If key information contains disclosures on past performance, regulators should consider imposing requirements designed to reduce the potentially misleading focus on past performance. If key information contains predictions for future performance, regulators should consider requirements to help ensure that this information is based on objective facts and is not misleading;
- Regulators should require the product producer or intermediary, as appropriate, to revise and update key information as often as reasonably necessary to reflect any material change in the information that could affect its accuracy. This could include, for example, updating changes to the investment strategy, an alteration in its risk profile, the adoption of a new charging structure, or a description of past performance. However, this principle should not be interpreted as suggesting that the product producer or intermediary should be required to deliver on a continuous basis (i.e., on a post-investment basis) updated POS disclosures to the investor. That determination will need to be made by each regulator taking into consideration the nature of any POS disclosure requirements that it may impose; and
- Regulators should consider requiring the producer or intermediary, as appropriate, to make available on its website an up-to-date version of the key information.

**Principle 6** *In deciding what key information disclosure to impose on intermediaries and product producers, regulators should consider who has control over the information that is to be disclosed.*

**Means for Implementation**

Who controls the information is an important factor to consider in determining who should make the disclosure. Thus, in general, responsibility for providing key product information will tend to rest primarily with the product producers; and disclosure of information relating to intermediary services will rest primarily with the intermediary. Nevertheless, regulators

will need to consider several complicating factors in implementing this principle, particularly when seeking to avoid duplication of disclosure obligations:

- If the intermediary provides or alters product information, it may need, in some jurisdictions, to take additional responsibility for that information.<sup>28</sup> Sometimes this is prescribed in over-arching legislation (e.g., MFID in the EU);
- While a product producer may be generally responsible for the content of the disclosure the intermediary is responsible in many jurisdictions for explaining the features of the product to a client; and
- The product producer may not be able to specify clearly certain information at the point at which the product is produced. For instance, while the product producer should disclose the charges imposed directly by the product, the full range of charges associated with purchasing and owning the product will often vary according to the method of distribution. This means that the intermediary will often have to provide the actual product charges as well as the intermediary charge in order to give the client full disclosure of charges.

---

<sup>28</sup> This is important as some fund supermarkets do this to a degree.

## Annex A: Research Summary

1. This note draws together findings and issues from the research or surveys submitted by members of TCSC3 and TCSC5.
2. In particular, this note draws on:
  - The report submitted by AMF, *Investigation of investment information and management processes and analysis of disclosure documents for retail investors* (TNS Sofres, Nov. 2006) (*AMF Study*).<sup>1</sup>
  - Initial Feedback to Trial: *Health Warnings on Prospectuses*, prepared by Taylor Nelson Sofres for the Australian Securities and Investments Commission (ASIC) (Oct. 2001) (referred to herein as the “ASIC Study”).
  - The consumer research series submitted by the UK FSA.<sup>2</sup>
  - Consumer testing done on behalf of the US Securities and Exchange Commission.<sup>3</sup>
  - A research study commissioned by the Task Force to Modernize Securities Legislation in Canada, entitled *How are Investment Decisions Made (Canadian Study)*.<sup>4</sup>
  - Hong Kong SFC *Survey on Engagement of Investment Advisers* (Sept. 2006) (*SFC Study*).<sup>5</sup>

---

<sup>1</sup> *Investigation of investment information and management processes and analysis of disclosure documents for retail investors* TNS Sofres for AMF, November 2006, available at [http://www.amf-france.org/documents/general/7504\\_1.pdf](http://www.amf-france.org/documents/general/7504_1.pdf).

<sup>2</sup> *Consumer Research* series; studies consulted are cited individually below.

<sup>3</sup> The Commission retained Siegel & Gale, LLC and Gelb Consulting Group, Inc. (S&G) to help develop and test model disclosure forms that would effectively convey information to investors. See Siegel & Gale, LLC/Gelb Consulting Group, Inc., “*Results of In-Depth Investor Interviews Regarding Proposed Mutual Fund Sales Fee and Conflict of Interest Disclosure Forms: Report to the Securities and Exchange Commission*,” November 4, 2004 and “*Supplemental Report to the Securities and Exchange Commission*” November 29, 2004 (together, *SG1*). The report is available at <http://www.sec.gov/rules/proposed/s70604/rep110404.pdf> and the supplemental report is available at <http://www.sec.gov/rules/proposed/s70604/suprep010705.pdf>. We also received additional information through continued testing of potential disclosure forms, as well as consumer testing of oral disclosures. See Siegel & Gale, LLC/Gelb Consulting Group, Inc., “*Results of Investor Interviews to Test and Refine Point of Sale Disclosure Forms*” (May 31, 2005) (*SG2*)(available at <http://www.sec.gov/rules/proposed/s70604/siegel053105.pdf> and “*Results of Investor Interviews to Test Oral Point of Sale Disclosure*” June 1, 2005 available at <http://www.sec.gov/rules/proposed/s70604/supprpt060105.pdf> [SG3]. See also Low & Associates, Inc., *Results of Focus Groups with Individual Investors to Test Proposed Rules 15c2-2 and 15c2-3*, April 2004(*Low*).

<sup>4</sup> Richard Deaves, Catherine Dine, William Horton, May 24, 2006 available at [http://www.tfmsl.ca/docs/V2\(3\)%20Deaves.pdf](http://www.tfmsl.ca/docs/V2(3)%20Deaves.pdf).

<sup>5</sup> *Survey on Engagement of Investment Advisers*, SFC, September 2006 available at [http://www.sfc.hk/sfc/doc/EN/speeches/public/surveys/06/survey\\_ia\\_060920.pdf](http://www.sfc.hk/sfc/doc/EN/speeches/public/surveys/06/survey_ia_060920.pdf) (*SFC Report*).



- An Investment Company Institute (ICI) research report on *Understanding Investor Preferences for Mutual Fund Information* (2006) (ICI Study).<sup>6</sup>
- Report prepared for the Investment Funds Institute of Canada (IFIC) by Pollara, Inc., entitled *Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry* (2006) (IFIC Report).<sup>7</sup>

## I. Key Findings and Common Themes

- The key findings in the research group together around common themes, which we have used to organise the findings in this summary. Some key points (which are outlined in more detail below) include:
- *What do consumers want?* Investment returns are a key focus for many consumers, along with information about risks, costs (including fund fees and expenses), and intermediary conflicts of interest.
- *What ways of presenting information do consumers prefer?* Generally, consumers prefer short, well-laid out and plainly worded documents, without *legalese* or marketing material. Although open to electronic disclosure, most investors appear to continue to prefer to obtain fund information in paper form (particularly mutual fund investors) or from a professional financial adviser, rather than online, prior to purchasing. Oral disclosure can also be an important means of providing investors with information that is integrated into the sales process.
- *How do consumers make decisions?* Consumers can rely on a range of information sources other than official disclosure documents when making investment decisions, including a significant reliance on the advice of others, including salespersons. However, other factors play an important role including emotion (e.g., intuition), personality (e.g., overconfidence),<sup>8</sup> and *representativeness* (i.e., a tendency to be inappropriately influenced by past performance).
- *What are the limitations or biases with consumer decision-making?* Consumers can exhibit a range of biases when making decisions, such as wrongly discounting information, or overly relying on poorly understood or misunderstood disclosures.
- *What are the implications for consumer behaviour?* Consumers do not necessarily alter their behaviour or understanding, even where exposed to better disclosure documents.

---

<sup>6</sup> *Understanding Investor Preferences for Mutual Fund Information*, Investment Company Institute, 2006 (ICI Study), available at [http://www.ici.org/pdf/rpt\\_06\\_inv\\_prefs\\_full.pdf](http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf).

<sup>7</sup> *Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry* IFIC Report, 2006, (IFIC Report) available at <https://www.ific.ca/Content/Document.aspx?id=2832>.

<sup>8</sup> For example, the IFIC Report (p. 17) found that almost all of the surveyed Canadian investors in mutual funds say that they felt comfortable that they had the right information to make an informed decision about investing in mutual funds.

3. Research needs to be placed in a context that the baseline for financial capability can be rather low. For example, according to a research project conducted recently by the UK FSA,<sup>9</sup> many consumers have a poor understanding of financial services and products, including an understanding of remuneration arrangements, or the nature of different asset classes and fund types and their associated risks.<sup>10</sup> The low levels of consumer understanding stand as a key driver of much of the research, including the AMF, ASIC, Canadian and UK FSA research submitted.
4. A further general point is that some of the research submitted focuses on *unpacking* the preferences of investors using qualitative techniques followed, in some cases, by additional quantitative research to provide some statistically relevant support. In general terms, qualitative research techniques are particularly suited to exploring preferences. The conclusions can contribute to the fine-tuning of disclosure documents. However, the methodological limitations of such research can make it difficult to generalise findings, or to make assumptions as to the likely impact of particular documents on consumer behaviour. We return to this issue under Section V below.

## II. What do consumers want to know when purchasing investment products

5. Given this limitation, evidence nonetheless suggests that a key starting point for consumers when looking at investment products is information about benefits, risks, costs (including fund expenses and fees as well as sales-related costs), historical performance, and conflicts of interest. Investors seem to be asking the following: What might he/she get back from an investment? What could impact on the investment? What conflicts may be influencing an intermediary's recommendation? And, how much of the investment could be lost to charges and commissions?
6. The AMF noted that consumers most want to receive a description of the features of the product providing information about risk, expected return/loss and fees and that they are less interested in many other details, such as the description of typical profile or even the rack record of the fund. Research by the UK FSA has also shown that consumers focus on information about investment returns or performance more generally.<sup>11</sup>
7. Consumers do not, however, only focus on benefits. They also want to know about risks and guarantees, and any limits on guarantees.<sup>12</sup> Investors typically, regardless of

---

<sup>9</sup> See *Levels of Financial Capability in the UK: Results of a baseline survey* Prepared for the Financial Services Authority by Personal Finance Research Centre University of Bristol, March 2006, available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr47.pdf>

<sup>10</sup> Studies suggest that when terms or concepts may be unfamiliar to investors, it may be necessary to include additional explanatory text in disclosure documents. [SG1 p. 6.

<sup>11</sup> AMF Study, p. 41; *Informed decisions? How consumers use Key Features: a synthesis of research on the use of product information at the point of sale* CR5, FSA, November 2000 (FSA Informed Decisions?) at p16, available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr05.pdf>.

<sup>12</sup> Even though UK FSA evidence regarding financial capabilities suggests a low level of understanding of the nature of different asset classes and their performance characteristics. See *FSA Informed decisions?; The development of more effective product disclosure* CR18, FSA, March 2003, available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr18.pdf>; *Investment Disclosure Research*, CR55, FSA, November 2006 available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr55.pdf> (FSA *Investment Disclosure Research*);. See also <http://www.fsa.gov.uk/pubs/consumer-research/crpr47.pdf>.

their level of sophistication, wish to understand the extent to which they can rely on an investment.<sup>13</sup> For example, the investors surveyed in the SFC Study indicated that the three most important things they *should know* before investing are (1) capital risk; (2) expected return and calculation method; and (3) historical performance.<sup>14</sup>

8. In addition, investors also have expressed an interest in product costs.<sup>15</sup> For example, the *ICI Study* found that investors are most interested in a fund's fees and expenses and its historical performance.<sup>16</sup> The significance of product costs is particularly illustrated by the fact that salespersons pay special attention to costs. ASIC notes that "when presented with a series of prospectuses for examination in the group discussion, most advisers opened straight to the fees and charges."<sup>17</sup>
9. Personalized information (e.g., a fee estimate specific to their purchase amount), may be a particularly helpful way to communicate cost information.<sup>18</sup>
10. ASIC, AMF, Canadian and UK FSA research all suggested questions of trust can be a key factor in consumer behaviour, in relation to which (as we will see later) consumers often focus on intuition. UK FSA research suggests that by comparison, cost and remuneration information can seem of secondary importance to the investor.<sup>19</sup> While some evidence suggests that the investor may be primarily seeking reassurance in regards to the trust they are already potentially extending to the advisor, and so may discount disclosure evidence which is contrary to this,<sup>20</sup> other studies indicate that investors are likely largely unaware of the incentives their market intermediary may receive for recommending one fund over another and find such information useful.<sup>21</sup>
11. The timing of the disclosure can determine its effect. Investors want information at a time that is useful to their investment decision.<sup>22</sup>

---

<sup>13</sup> Low capabilities of course can have the effect of reducing consumers' ability to grasp the limits of guarantees; evidence from the UK FSA suggests many investors take products contained in a particular life policy tax wrapper in the UK to be guaranteed even when they are clearly stated to not be so. See *FSA Investment Disclosure Research*, p.3.

<sup>14</sup> *SFC Report* Page 3.

<sup>15</sup> See *AMF Study*, p. 40; *FSA Informed Decisions*,? at p.16; *Low* p. 3; *SGI* p. 6. Of note, many investors prefer *complete* disclosure of fees paid rather than disclosure only of some fees (e.g., sales or other fees paid to their intermediary). *SGI*, p. 7. This suggests that if only some fees are set forth, disclosure should emphasize that other fees will be charged, and if possible state the potential amount (e.g. "up to \$100 per year"). *SGI*, p. 7; *SG2*, p. 5.

<sup>16</sup> See *ICI Study* Page 1-2.

<sup>17</sup> *The ASIC Study*.

<sup>18</sup> See *SGI*, p. 4.

<sup>19</sup> FSA: unpublished research, *Depolarisation Disclosure, Qualitative Research*, BMRB, 2006. (*FSA: Depolarisation Disclosure*). *FSA: Polarisation: Consumer Research*, (January, 2002), p. 31 (*FSA: Polarisation*)

<sup>20</sup> *FSA Polarisation*. Other factors that have been emphasised by investors in UK FSA research (*FSA Depolarisation Disclosure*) include: information on the range of products, information about the advisor and their status (e.g. their 'independence').

<sup>21</sup> *Low*.

<sup>22</sup> *Low*, p. 3

### III. What designs and formats are effective in achieving consumer engagement

12. Qualitative research techniques are also particularly suited to teasing out the elements of the design of disclosure information that are particularly effective from the perspective of the consumer.
13. Key messages repeated throughout the literature are that consumers prefer documents that are:
  - short;
  - well presented and laid out;
  - plainly and clearly worded; and
  - focused on the information they believe they need.<sup>23</sup>

Moreover, the ICI Study noted that mutual fund shareholders look for concise investment information and, where possible, graphic presentations.<sup>24</sup>

14. Design techniques may be used to improve the extent to which a document engages consumers. However, making a document engaging is only part of the larger picture: other points to consider include the relative prioritisation of different messages within a document,<sup>25</sup> and the extent to which a document is able to create a particular impression (e.g., that it is neutral or trustworthy, or that it ranks or prioritises key messages in the appropriate way).
15. Detailed design factors include:
  - the use of colour and visual cues to enliven documents and call investors' attention to particular pieces of information;
  - the effective use of space to make documents easier to follow and less overwhelming; and
  - the deployment of well-paced and logically sequences of information.<sup>26</sup>
16. Readability can be seen as a function of all of these elements of layout. The prioritisation of information and use of focus within a document can also help impart key messages unambiguously.<sup>27</sup>

---

<sup>23</sup> For instance, ASIC noted that "in judging the merit of a prospectus, investors look for clarity – the prospectus had to be simple to read." One way to accomplish this may be to provide disclosure in a "layered" manner, where brief disclosure is provided initially with more detailed information available either upon request or accessible on the Internet.

<sup>24</sup> *ICI Study* Page 2.

<sup>25</sup> See, e.g., [SG3 Summary]; [SG2], p. 2 (the order of information presented can aid or hinder comprehension; for example, investors were better able to recall certain information when it was made at the beginning of a conversation).

<sup>26</sup> *SG1*, pp. 2-4.

17. The overall *tone* of a document also matters. For instance, AMF and S&G note a consumer preference for documents that are honest and accessible.<sup>28</sup> (This preference is tempered however by a desire that the documents are not off-putting and that their accessibility does not lead them to become untrustworthy.) Statements regarding where investors could find more information have been viewed as enhancing the overall credibility of the information disclosed, even when the investor indicated little likelihood of accessing the additional information.<sup>29</sup> The research notes that consumers find neutral documents reassuring, and feel that they offer a degree or element of *explanation*. The researchers concluded that “the main challenge is to strike a balance between the need to be accessible and non-technical and the need to be trustworthy”.<sup>30</sup> Readers were hostile to anything which came across as advertising, and preferred documents which felt official.<sup>31</sup>
18. UK FSA and US SEC research also amplifies and supports these points, including the preference for clear and straightforward presentation, the use of plain language, and a preference for short documents.<sup>32</sup> This is supported by the Canadian Study as well.<sup>33</sup>
19. The UK FSA research has also drawn out the extent to which consumers often are more comfortable with presentational techniques with which they are familiar, such as the use of tabular question and answer sections. For instance, when examining different ways of presenting information about projected returns on long term investments in funds, the UK FSA found that many respondents tended to be more confused by, or take the wrong message from, unfamiliar presentational techniques (showing richer and more sophisticated information using putatively easier to understand grasp graphical techniques) when compared with the use of familiar tabular presentational styles.<sup>34</sup> This is confirmed by the Canadian Study.<sup>35</sup>
20. A further point worth drawing out is that research suggests that different ways of showing similar information can create different degrees of reliance or focus on the

---

<sup>27</sup> *AMF Study*, p.41. Of note, some studies suggest that investors find “yes/no” questions easy to comprehend, and the information useful, even when “no” was the appropriate answer.

<sup>28</sup> *AMF Study*, p. 35-36.

<sup>29</sup> *SG1*, p. 8

<sup>30</sup> *AMF Study*, p. 46,

<sup>31</sup> Many investors in one study interpreted their signature on a form negatively, and believed their signature established a contractual agreement to the fees stated on the form. *SG2*, p. 3.

<sup>32</sup> These points recur across UK FSA research; see, in particular, *FSA: Informed Decisions?*, *FSA: More Effective Disclosure* and *KeyFacts Quick Guide - research findings* CR41, FSA, July 2005 (*FSA: KeyFacts Quick Guide*) available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr41.pdf> .

<sup>33</sup> The *Canadian Study* noted that “[w]hen information overload occurs, there is a tendency for retail investors to simply tune out and not try to process the information at all”. Page 263.

<sup>34</sup> UK FSA unpublished research by Synovate, *Projections research: Reviewing projections Key Facts documents 2005 (FSA Synovate)*. Importantly, the effectiveness of different presentational techniques can be significantly segmented in demographic terms, with respondents having divergent needs. For instance, respondents can split into those who respond well to text and figures, and those who prefer graphical presentations.

<sup>35</sup> The *Canadian Study* refers to this as *familiarity bias* (which in turn is related to the *status quo bias*). This is the degree of comfort that people have in the familiar. This leads to placing a greater value on what is known. Page 254.

information amongst consumers. For instance, UK FSA research into the presentation of past performance information suggests presentation can impact on a users' emotional response to and reliance on information (for instance, through the use of figures showing cumulative cash gains or losses).<sup>36</sup>

21. Putting these points another way, it is clear consumers respond to devices which place information in a context with which they are familiar or which imparts impressions of trustworthiness or reliability. For instance, a common theme explored in the ASIC, AMF and UK FSA research, is the perceptions respondents have of the regulator along with the regulator's role in relation to disclosure information.
22. Key tensions concern the extent to which information provided is seen as *legalese* (consumers often express frustration in the face of *small print*), or as something that can be relied on and which has some form of *independence*.<sup>37</sup> These points relate to wider points in regards *branding*, which we return to below.
23. One study indicated that information disclosed orally can be useful and easy to understand.<sup>38</sup> Investors commented that such disclosure could facilitate discussions with their salesperson. Nonetheless, investors who received oral disclosure still expressed a preference for access to additional information in digital or printed form. This particular study also indicates that the order of the information presented can aid or hinder comprehension (for example, investors were better able to recall information about conflicts of interest when the disclosure was made at the beginning of the conversation).
24. More generally with regard to format, the *Canadian Study* observed that investors still generally access disclosure information in paper form, and that mutual fund investors had lower levels of electronic information usage and comfort levels.<sup>39</sup> Notwithstanding the tremendous growth in the use of the Internet, the *ICI Study* found that only 30% of recent fund investors prefer to obtain mutual fund information online rather than by mail or in-person from professional advisors.<sup>40</sup>

#### IV. What factors do consumers use in decision making

25. While messages about consumer preferences and the information they believe they should be receiving appear relatively consistent and clear, understanding the actual information consumers use when decision-making can be more complicated.
26. In thinking about this, we need to also take into account the wider context impacting on particular investment decisions, such as the consumer's reliance on the advice of others,

---

<sup>36</sup> *Standardisation of past performance*, CR21, FSA, May 2003, available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr21.pdf> (FSA: *Standardisation of Past Performance*)

<sup>37</sup> See *ASIC Study*, p. 21; *AMF Study*, pp. 35-46; more generally, *FSA: Informed Decisions?*; *FSA: More Effective Disclosure*; *FSA: KeyFacts Quick Guide*; see also *SGJ*, p. 5 (direct and colloquial language was found to be effective while jargon, and legal terms were not).

<sup>38</sup> *SG3 Summary*, *SG2* p. 2.

<sup>39</sup> *Canadian Study* Page 286.

<sup>40</sup> *ICI Study* Page 33.

whether or not they are buying directly, or their use of other sources of information (such as promotional material, press coverage, information available through their employer, or ‘word-of-mouth’).<sup>41</sup> As ASIC research suggested, these other factors can have a significant effect on investor’ actual reliance on documents: “Investors’ use of prospectuses appeared casual at best, with no real consensus on the worth of a prospectus document as a stand-alone source”.<sup>42</sup> Indeed, the *Canadian Study* found that for investors, including mutual fund investors, the prospectus is one of the least used sources of information.<sup>43</sup> The *ICI Study* went further and stated that “most shareholders do not consult fund prospectuses or annual reports.”<sup>44</sup> It is true that 63% of the investors surveyed as part of the *SFC Study* “looked at the product’s offering documents or fact sheets.”<sup>45</sup>

27. The *Canadian Study* also found that, with regard to mutual fund transactions, the key driver in decision making is the financial advisor recommendation, followed by past performance.<sup>46</sup> This is consistent with the *SFC Study*, which found that 72% of the surveyed investors relied on their investment adviser’s verbal recommendations or financial plans in making their investment decisions,<sup>47</sup> and with the *ICI Study* (“shareholders usually turn to professional financial advisers for information before purchasing shares”).<sup>48</sup>
28. The key information investors seek that we noted above – information about historical performance, risk, and cost (particularly in the mutual fund context) – remains important, but investors may find apparent answers to their questions by a variety of means. The ASIC research noted that “typically, after investigating a prospectus, the investor would take their decision back to the adviser to attempt to gauge the adviser’s recommendation”.<sup>49</sup> This reliance on others is particularly the case where the investor rates themselves as poorly equipped to make investment decisions.

---

<sup>41</sup> See for a wide ranging discussion of the information that investors use, FSA: *Better informed consumers*, CR1, April 2000, and [FSA: Informed Decisions].

<sup>42</sup> *ASIC study*, p. 19. ]. Even where investors appear to use disclosure documents, evidence suggests that they may particularly focus on messages regarding the risk–reward balance of the particular investment. However, the focus can be significantly segmented demographically. Some more sophisticated investors may focus more directly on price measures, for instance as a key determinant of investment outcomes once portfolio diversification has been addressed. See *FSA: Informed decisions? Synovate* examined respondents’ use of projection information according to the ‘sophistication’ of the respondent, and saw significant differences. *ASIC Study* distinguished throughout between ‘direct’ and ‘indirect’ investors. See also *UCITS: charges disclosure – presenting product charges to customers*, CR34, FSA, April 2005, available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr34.pdf>.

<sup>43</sup> *Canadian Study* Page 286-7.

<sup>44</sup> *ICI Study* Page 2.

<sup>45</sup> *SFC Study* Page 17.

<sup>46</sup> *ICI Study* Page 288. The *IFIC Report* (p. 18-19) likewise found that the following were the top three factors that surveyed mutual fund investors considered most seriously before they last invested in mutual funds: the advisors’ opinion; the risks associated with investing in the fund; and the fund’s past performance compared to other funds in its category.

<sup>47</sup> *SFC Study* Page 17.

<sup>48</sup> *ICI Study* Page 9.

<sup>49</sup> *ASIC Study*, p. 20.

29. Nonetheless, even for investors who indicated a heavy reliance on their salesperson's recommendations, and commented they would be likely to continue to depend on those recommendations, information regarding costs and conflicts of interest was considered useful as an educational tool and viewed as a prompt for them to ask their salesperson for more information.<sup>50</sup>
30. The mechanisms that sustain or undermine the investor's trust in the person who is advising them then become significant, which we will discuss in the next section.
31. Other elements also come to the fore in decision-making where the investor feels they lack understanding. For instance, consumers can turn to intuition: AMF, ASIC, the Canadian Study and UK FSA all highlight perceptions by some consumers that their 'gut-feeling' about an investment is the key factor they rely on.<sup>51</sup>
32. The evidence also suggests that one particularly important factor is brand-identity and familiarity, which can be used by consumers as proxies for the reliability and trustworthiness of an investment proposition.
33. For instance, UK FSA evidence notes that consumers use their experience of brand in non-investment areas and apply it when making investment decisions – and this brings with it well known effects such as the impact of brand-loyalty.<sup>52</sup> ASIC note that consumers often assume that general firm behaviour around brands can be assumed to apply to investment firms – for instance, that the value of a brand to firms means they will generally not take actions likely to damage the brand.<sup>53</sup>

## V. What are the limitations of consumer decision making / biases

34. In considering the limitations of consumer decision-making, the low levels of financial capability are a key theme, as discussed above. Low basic understanding lays a key part of the basis for consumers to misunderstanding key messages or disregard important information.<sup>54</sup>
35. Other kinds of bias or limitation also can be found. The framing and positioning of information can be very important in terms of the messages consumers of the information take away. For instance, we have already touched on evidence that information will strike consumers differently depending on whether it is contained within marketing documents or standalone, or how the information is introduced or positioned, e.g., through a regulatory message, other branding, or by an intermediary/ other third party.
36. Consumers can exhibit biases where they are interpreting and assessing information: for instance, UK FSA research and the Canadian Study suggest that consumers can be

---

<sup>50</sup> *SGI*, p. 2.

<sup>51</sup> *AMF Study*, p. 37; *ASIC Study*, p. 19; *FSA: Depolarisation Disclosure*; *Canadian Study*, p. 278 (24% of respondents indicated that "gut feeling or intuition" was important to them).

<sup>52</sup> See for instance *FSA: Informed Decisions,*? at p. 20.

<sup>53</sup> *ASIC Study*, p. 19.

<sup>54</sup> Some information was deemed useful only when accompanied by information that could allow the information to be put into context.



overly optimistic about future returns;<sup>55</sup> AMF and ASIC research both also note the extent to which consumers can overly find some information off-putting, as they may exhibit a (patchy) aversion to risk which concentrates on certain elements of risk (e.g. risk to capital) at the expense of others (e.g. inflation).<sup>56</sup>

37. Although work in this area is only now being fully developed, other early indications for the UK FSA include the capacity of some information to become ‘false focal points’ which is readily misinterpreted by consumers.<sup>57</sup> This can be particularly acute where low levels of financial capability are common. The false focal points typically cluster around the information about benefits, risks and costs that the investor is most seeking. The desire for answers can itself drive the misreading, as consumers seek to fit information into their existing understandings.<sup>58</sup>
38. For instance, research into the use of information about future benefits by investors has shown there to be number of common problems.<sup>59</sup> These can be characterised as errors in understanding the limitations of information being provided; thus, despite textual messages, consumers can focus on the figures they are most seeking, and disregard the caveats to these. Though figures might be presented relatively clearly as only suggestive and in no way guaranteed, respondents will overly rely on them.
39. These tendencies to misunderstand or misinterpret can therefore make it difficult to provide simple messages which include key information the investor is seeking in ways which are not going to be misleading. The UK FSA research into past performance data and work on the presentation of risk offers a case in point in regards this sort of issue.<sup>60</sup>
40. In relation to advice, the relationship between the investor and the advisor raises the interesting question of the role of trust. Trust is used by consumers where they need to rely on others. In these cases, consumers will typically rely on a full range of social tools for assessing the situation: they may summarise the conclusions of this process in terms of a ‘gut-feeling’ they have in regards the other person. Obviously, for advisors able to create the right social environment and impression, this can offer a significant opportunity to create a bond with the investor to promote increased sales. As ASIC noted ‘on the whole, in front of the client, the prospectus was used simply as a sales tool.’ For the client however,

“there was a tacit statement of trust in the adviser’s recommendations. The legitimacy of the advice given was generated through an assumption that the

---

<sup>55</sup> Indeed, the *Canadian Study* suggests that investors inappropriately rely on past fund performance. Page 279.

<sup>56</sup> For a summary, see *Informing Consumers: a review of product information at the point of sale*, Discussion Paper, FSA, Nov 2000 available at [http://www.fsa.gov.uk/Pages/Library/Policy/DP/2000/discussion\\_04.shtml](http://www.fsa.gov.uk/Pages/Library/Policy/DP/2000/discussion_04.shtml), Annex B, p. 3 (for the fuller report see *FSA: Informed Decisions?*).

<sup>57</sup> See *FSA: Standardisation of Past Performance* and *FSA: Synovate*.

<sup>58</sup> *Canadian Study*, page 254.

<sup>59</sup> *FSA: Synovate*, and *FSA: Informed Decision*, pp. 15-19.

<sup>60</sup> *FSA: Standardisation of Past Performance and Consumer understanding of financial risk* CR 33, FSA, November 2004 available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr33.pdf>.

adviser spends considerably more time investigating the strength of various investments than the individual investor would be able to do".<sup>61</sup>

41. This brings to the fore necessary limitations in the capacity of consumers to properly adjudge the credibility or reliability of expertise in regards the advisor. The consumer understands that they cannot unaided make a decision; however, they may not have a ready way to evaluate their relationship with their advisor and the appropriate degree of reliance on that advisor. Low financial capabilities can amplify the problems here, as consumers only poorly understand the conflicts of interest which may impact on their advisor. The psychology and sociology of trust is certainly more complicated than can be analysed here.<sup>62</sup>
42. On questions of trust, AMF research indicated that more than two thirds of retail investors questioned said it was important or vital to have access to an official approved document before investing. However, the AMF research also raised some concerns regarding the role of the regulator. One half of the respondents thought the regulators role entailed ensuring that the investment is financially advantageous for the investor, especially when a prospectus is approved by the Securities regulator.
43. The *SFC Study* did look into the issue of investor evaluation of their investment advisors.<sup>63</sup> 88% of the surveyed investors were, in general, satisfied with their investment advisor services. However, when evaluating particular areas of services, investors were least satisfied with their investment advisor's fees and charges.<sup>64</sup>

---

<sup>61</sup> *ASIC Study*, p. 17.

<sup>62</sup> *FSA: Depolarisation Disclosure; FSA: Polarisation*.

<sup>63</sup> *SFC Study* Page 20.

<sup>64</sup> *SFC Study* Page 21.

**VI. How does the format and content of information have an impact on actual consumer behaviour and outcomes?**

44. The research outlined in the above overview focussed on exploring consumer preferences, using techniques such as focus groups and other interview based surveys. It did not explore issues such as:
- How far changes in either the format or content of information change consumer's actual understanding of products or their purchasing behaviour; and
  - How the disclosures work in a real world environment where many other influences may be at work.
45. Research within this area has, understandably, been limited, a reflection of methodological, legal and practical difficulties. The UK FSA has, as part of its cost benefit work surrounding the development of a new disclosure regime in 2005-2006 (refs inset), explored techniques to test the effectiveness of proposed changes to the disclosure regime for investment products.<sup>65</sup> Prior to introducing the regime, it wished to test whether the new approach yielded materially different consumer (outcomes and) understanding. The results were quite stark:
- Although consumers confirmed their preference for the new material, it did not materially increase their understanding of the product or its risk;
  - Even without rule changes, firms could achieve a lot by presenting the material more clearly.
46. The work did not identify why there was this apparent mismatch of preferences and understanding, although limitations in financial capability (mentioned above) were clearly a significant contributor. It also has limitations as a measure of real behavioural change since it was not conducted in the environment of a "real sale", where many other influences are likely to impact on both consumer and advisor behaviour. The UK FSA is attempting to trial live testing for oral disclosures and investment product intermediary disclosure later this year, but the methodology is still being developed.

**Conclusions**

47. The research suggests the following key themes:
- Consumers do not understand many key messages about charges, remuneration, conflicts of interest, and fund risks and features based on current disclosure regimes, and will commonly simply follow the advice of others.
  - Investors would like the format and content of disclosures to be carefully designed to promote accessibility and readability.
  - When designing an appropriate point of sale disclosure, regulators may need to:

---

<sup>65</sup> The FSA developed a "Quick Guide" for investment products to replace its Key Features regime, on the basis of focus group research. CP05/12 *Investment product disclosure: proposals for a Quick Guide at the point of sale*, FSA, July 2005, available at [http://www.fsa.gov.uk/pages/Library/Policy/CP/2005/05\\_12.shtml](http://www.fsa.gov.uk/pages/Library/Policy/CP/2005/05_12.shtml).

- a) Consider investor frames of reference, biases and emotions in order to enhance the likelihood of accurate investor comprehension of material facts.
- b) Take into account the overall impact of information and the different contexts in which it may be used.
- c) Consider how different forms of point of sale disclosure (e.g., documents or oral disclosure) may generate a meaningful and positive behavioural change.