

Executive Summary:

Research on KII Disclosures for UCITS Products

Prepared for

European Commission

By

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Introduction

The European Commission appointed a consortium comprised of YouGov Plc and IFF Research Ltd to undertake a detail review of the effectiveness of new forms of disclosure for UCITS funds to replace the simplified prospectus. There are two stages to the work; this document provides an executive summary of phase one of work.

In summary, the research design covers two inter-related phases of work. Phase one, based around both qualitative and quantitative research methods aims to:

- test the individual variants that constitute the core elements of a KII - strategy and objectives; risk and reward, performance; and charges.
- and to make recommendations for how to improve these variants in the second stage of the work.

The second phase of the work seeks to test two fully mocked-up documents, the design and content of which is informed by evidence gathered in phase one. The methods for phase two are again both qualitative and quantitative and capture both consumer and retail intermediary views.

We sought to ensure that we covered a good-cross section of investment markets in the EU area including two new member states¹. Our final selection of member states was as follows:

- Germany
- Hungary
- Ireland
- Italy
- Poland
- Spain
- Sweden

This captures a good cross-section of member states, covering markets where there is a reasonable level of UCITS activity and where it is feasible to capture an adequate sample of investors whose profile broadly matches our target group. We also sought to exclude member states where there is already an established body of evidence on consumer preferences for disclosure material as we felt it was more effective for the outcome of this research to add to the existing body of knowledge. Hence we chose not to cover France, The Netherlands and the United Kingdom.

The purpose of phase one of the project is to focus on testing the effectiveness and usefulness of the proposed options for individual disclosure variants rather than testing a complete document. Therefore this phase one is to determine the overall format and content of options for a final set of complete disclosure documents to be tested in phase two. The detail of the variants we have tested is described more fully in the appendix to this document. In summary, we have tested a total of 19 variants (see separate document for details of each variant):

- 1 presentation of the strategy and objectives of the investment fund (variant A);
- 4 presentations of past performance (variants B, C, D, E);
- 7 presentations of charges (variants F, G, H, I, J, K, L);
- 4 presentations of risk-reward description and indicators (variants M, N, O, P);

¹ This includes the countries that entered the EU in 2004 and 2007.

- 3 presentations of performance scenarios (variants Q, R, S).

Research Methods

Our methodology was based around undertaking 500 on-line interviews in each Member State. We then undertook 15 in-depth interviews by phone, where selected respondents from phase one were followed up to probe their initial responses in more detail. We felt it would not be practical to test respondents in relation to all 19 variants and hence we split the sample in each Member State into two groups of 250. The following table shows how we divided the variants across the two groups.

Topic	Variant	Group 1	Group 2
Strategy & Objectives	A	√	√
Past Performance	B, C, D, E	√	
Charges	F, G, H, I, J, K, L	√	
Risk	M, N, O, P		√
Performance Scenarios	Q, R, S		√

We recommended that the quantitative research for phase one be undertaken on-line for the following reasons:

- Ability to identify the target group in advance and reach low incidence groups in markets with lower levels of investors;
- Ability to use stimulus material;
- Cost effective coverage of geographic spread;
- Project scope and timing and ability to complete fieldwork within tight deadlines;
- Ability to achieve numbers of interviews needed and provide robust data.

We undertook a pilot stage in Germany and Ireland during May 2008 to test the overall length of the survey, assess the drop-out rate and to highlight some improvements to the wording and format of questions and variants. The quantitative fieldwork for the main stage was carried out between 1st and 16th July 2008.

In total we achieved 3,668 interviews across the seven Member States covered. The profile of the sample achieved showed that we had captured investors across a range of social and demographic groups with differing levels of engagement and financial sophistication. The 107 investors and potential investors included in the qualitative stage were selected by Member State, whether they had already invested and how well they had interpreted the variants they were shown during the online survey. A reasonably even spread was achieved.

Strategy & objectives

This section looks at views of a text-based variant to describe the strategy and objectives of a simple UCITS fund (Variant A). A single approach to displaying this information was tested as it was considered that this type of background information would have to be text-based. Respondents were asked to consider the objectives part of the variant first and to answer questions about this before going on to look at the strategy part separately.

The purpose in testing the Strategy and Objectives section was to:

- assess how clear respondents perceived each of Strategy and Objectives elements to be;
- establish what (if anything) they found difficult to understand about each element;
- measure actual understanding of the variant by analysing responses to a series of true/false statements regarding the fund being described by the variant.

The key findings are as follows:

- Overall, around three-quarters (73%) of respondents found the objectives section very (14%) or fairly (59%) clear. 74% thought the description of strategy was very (10%) or fairly clear (64%).
- In terms of things respondents found difficult to understand the most common request was for a general simplification of the language used and an avoidance of or a definition of the financial terms used. This makes a case for reviewing the language used in the variant to make it as simple as possible.
- Testing actual understanding of the key messages from the strategy and objectives variant showed a number which were understood by only a minority:
 - The fund may invest in all types of bonds (False: 41% correct).
 - Because the fund invests in bonds 40% of my capital is protected whatever happens (False: 30% correct).

Past Performance

This section examines investor reaction to presenting the past performance of funds in 5-year and 10-year time periods as a method to help investors in their decision to invest in a particular fund. As a further test of investor understanding, a comparison of a fund's past performance relative to a market index, in this case the MSCI EM (Morgan Stanley Capital Investment Emerging Markets Index), was also shown to gauge investor reaction. Investors were presented with four variants displaying past performance: Variant B (5-year past performance with comparison to the MSCI EM); Variant C (10-year past performance with comparison to the MSCI EM, including references to negative growth); Variant D (5-year past performance with no MSCI EM comparison); and Variant E (10-year past performance with no MSCI EM comparison). An initial description of the fund was presented in Variant A which outlined the strategy and objective of the fund as reported in the previous section.

The objectives in testing the past performance variants was to establish which of a shorter (5-year) or longer (10-year) time period for past performance achieved the best results in terms of:

- perceptions of clarity;
- understanding of the key messages being shown
- respondent preference;
- whether the purpose of showing the performance of an index alongside the fund performance was understood and whether this added to the usefulness of the variant;

- the ease of comparison between different funds

The key findings are as follows:

- Overall levels of clarity are similar between the 5-year and 10-year past performance examples with 83% in each group stating that the display of the fund's past performance was clear to them.
- However, levels of understanding were low and broadly similar for both the 5-year and 10-year examples with very few investors able to correctly answer all five true/false statements pertaining to the graph while over half provided incorrect answers to three or more statements.
- There was some difficulty in selecting the year(s) when the fund outperformed the MSCI EM although the majority could do so. In particular, the year when both the fund and the MSCI EM performed negatively was difficult for respondents to assess.
- Generally, investors prefer to see past performance information displayed on a period longer than 5-years with many indicating that the 10-year period worked well.
- In terms of the ability to correctly compare funds there was little difference between the 5-year and 10-year variants although this ability was slightly higher for the 10-year variants.
- In the case of both variants some difficulties were evident in the ability to compare performance between funds which may be due to the different scales on the axes. In some cases respondents appeared to be simply picking the longer bar.
- The majority of respondents understood the purpose of including the MSCI EM viewing it either as a comparison or as a benchmark.

Charges

Fund charges and fees are often used by investors to determine whether they will invest in a certain fund. However, this information can often be misinterpreted by investors. This section details investor thoughts on the presentation of fees and charges for various investment funds. Three different types of approach were shown to investors;

- A 'short' text based variant (Variants F, G and H).
- A version with an added illustration of charges section in text format (Variants I and K).
- A version with an added illustration of charges section in table format (Variants J and L).

Our objectives for testing the charges variants were to:

- Assess whether the additional information in the illustration of charges section in the text and table variants led to improved levels of understanding compared to the "short" variant;
- Establish which of the two approaches of showing the illustration of charges led to higher levels of understanding regarding the charges associated with the fund and which was actually more effective in enabling respondents to calculate the likely amount of charges;
- Ascertain which of the two illustration of charges approaches was considered the clearest and which was preferred by respondents;

The key findings are as follows:

- In terms of clarity the text variants get slightly lower ratings compared to the other approaches tested

- All the approaches tested included some core information shown in a table and associated text. Understanding of this core information was reasonably high. However, understanding of whether entry charges are fixed and whether ongoing charges represented all charges paid during the year drew nearly equal numbers of respondents saying they were true or false. Investors showed better understanding in terms of the variation of ongoing fund charges and the impact of charges upon investment growth.
- In reviewing the purpose of including an illustration of charges section, the majority of investors understood that both the text and table variants show illustrations rather than fixed charges; however, there was a sizeable majority that believe the illustrations display maximum charges.
- Investors were asked to estimate the total amount of charges one would pay over a 5-year period if €10,000 were invested in the fund shown in the variants. The proportion of these calculating this incorrectly was similar across all three approaches.
- Confidence levels among investors reviewing the text or table comparisons were fairly similar. Over half in each group felt confident in their ability to distinguish between the variants.
- Investors offered their thoughts on which format was easier to understand: percentage figures or cash figures. By a wide margin, cash figures were selected as easier to understand than percentage figures. This preference was seen across Member States, attitudes to risk and financial sophistication.
- In the qualitative research respondents demonstrated a slightly better understanding of and expressed a clear preference for the illustration of charges in table format.

Risk

Exploring the optimal approach for the description of risk factors and the presentation of the relationship between risk and reward is one of the key issues for the design of the KII. The research tested two high level approaches across two example funds with a different level risk/reward:

- One approach was based on a purely narrative description of risks (Variants M and O); and
- The alternative approach used a synthetic indicator to communicate the level of risk that an investment in the fund would represent (Variants N and P).

The overall objectives of the risk variant testing were to:

- Ascertain which of the two high level approaches was most effective in communicating the key messages relating to the potential risk/reward associated with the fund;
- Assess which of the approaches was considered the clearest and most usable in terms of comparing between different funds;
- Identify the approach preferred by respondents in terms of instilling confidence in understanding and usefulness;
- Examine what messages the synthetic indicator approach communicated for funds with the lowest level of potential risk/reward, i.e. “class 1” funds. In particular whether these funds were perceived to have a guaranteed element.

The key findings are as follows:

- There was no difference in the perceived clarity of the text approach and synthetic indicator approach.
- The indicator tended to lead to a more “bullish” view of the potential rewards available.
- Understanding of the risk/reward potential of the fund was very similar across both approaches.

- A significant proportion of investors interpret “Class 1” funds using the indicator as providing a guarantee of some kind.
- The synthetic indicator was consistently preferred to text approach across a range of factors, in particular in being easier to use to compare between different funds. However, there was little difference between the approaches in actually being able to compare between two different funds.
- Respondents were more confident in their ability to compare funds using the synthetic indicator approach.
- The qualitative research shows that investors were divided between those who want information to be as simple as possible and those who wanted more info. Whilst most felt the synthetic indicator was a simplified way of showing risk/reward some felt that it over simplified the issue.

Performance scenarios

Structured funds present a particular challenge in the display of information relating to potential risks and rewards. These are funds that offer a pre-determined pay-off at a certain time horizon depending on particular parameters which often introduce discontinuities into the risk/reward profile. This can occur, for example, when guarantee mechanisms are triggered by certain events. As such it can be particularly difficult to convey to consumers how these complex funds are likely to perform. The Commission wished to investigate ways in which additional information about performance of funds under different scenarios could be included in the KII for these particular types of funds.

The research tested three types of approach to displaying information on performance scenarios as follows:

- A table showing the probability of achieving different rates of return (VARIANT Q).
- Graphs to show the possible return of the fund under favourable and less favourable conditions (VARIANT R).
- A graph displaying backtesting data showing how the fund would have performed under historic market conditions (VARIANT S).

The purpose of testing the performance scenario variants was to:

- Establish which of the three approaches led to higher levels of understanding of the workings of the fund and the potential impact of different scenarios;
- Identify any particular issues or areas of mis-understanding associated with any of the three approaches
- Assess how clear each approach was considered to be and how confident respondents are in their ability to actually use this type of information.

The key findings are as follows:

- Variant Q (the tabular presentation) obtained significantly higher ratings for clarity than either of the other two graph-based variants.
- Responses given to “the product will always get the full benefits of any gains made by the DJ Eurostoxx index’ (Variant R) are very similar to those given for Variant Q indicating that the addition of the graphs does not greatly improve understanding over the tabular format.
- Respondents were slightly more confident in their ability to interpret the probabilities table in Variant Q than their ability to interpret the graphs in Variant R correctly.

- Generally, there were higher levels of mis-understanding for Variant S (backtesting), in particular a substantial proportion thought that the graph was displaying past performance information.
- The qualitative research confirms the preference for variant Q (table) over variant R (graph).
- Some qualitative respondents suggested developing variant Q by presenting the existing information in the table as a pie chart. This improvement would show probabilities in the form of a percentage and have accompanying text yet also provide a visual for those who find this more engaging.