

**WORKSHOP ON KEY INVESTOR INFORMATION (KII)
BRUSSELS, 20 OCTOBER 2008**

SUMMARY CONCLUSIONS

Key summary

Constructive and animated debate during the workshop showed that stakeholders' interest in the KII remained strong (across industry, investors and regulators).

There was a general agreement on working to make KII an effective and investor-friendly tool whilst also keeping the costs for the industry as low as possible.

The discussion clarified further the general approach to the testing, including details on the methodology that had been used for first phase and the representativeness of the sample. The purpose and approach of phase II testing was outlined (it will focus on the consumers' understanding of tested variants while the preferences of industry will be looked upon at the later stage).

Several issues were raised by stakeholders for further consideration when looking at the detailed contents of the KII, such as ensuring the variants tested were realistic and if possible simpler (for instance with wording that fund managers might in practice use), and finding a risk/reward presentation which reconciled investors preferences with ensuring adequate information was provided to support investment decisions (the evidence suggested some confusion over guarantees and circumstances in which risk disclosures might mislead investors or be misunderstood; the possibility of combining different approaches was discussed). Other topics covered included options for the presentation of performance information and charges.

It was noted that the findings from Phase I would contribute to the preparatory process for phase II, and would also be taken into account when considering the overall results.

PURPOSE AND STRUCTURE OF THE WORKSHOP

The purpose of the workshop was to bring together all stakeholders (representatives of investment community, credit associations, financial institutions, regulators working in the frame of CESR working groups) and provide them with updated information on the progress made in the preparation of KII with special focus on investors testing. It created an opportunity for industry and investors to get first-hand information from the Commission and CESR representatives and on the other hand enabled the Contractor and the Commission to obtain first reactions from the stakeholders to the findings of the phase I testing.

The workshop was organised as follows.

- The initial section included presentations from the Commission and CESR outlining the wider background to the project and the context for the consumer testing, including the present state of play in regards the legislative changes to the UCITS directive relating to KII.
- The main part of the workshop was devoted to the presentation of consumer testing made by the Contractor (consortium of YouGov Plc and IFF Research Ltd). The whole presentation was divided into 5 sessions, covering the overall methodological approach, and then the key elements of the KII in the order in which the CESR advice proposed they be placed within the document. Each section started with a detailed presentation by the Contractor, followed by section in which participants were able to make remarks and ask questions of the Contractor, CESR and the Commission. This summary does not aim to reproduce the Contractor presentation, but focuses on the discussions that followed.

1. BACKGROUND AND GENERAL METHODOLOGY

1.1 Sample size, selection and representativeness

An initial cluster of questions related to the **sample selection, size and representativeness**. These questions came from the full range of stakeholders present.

The questions generally sought greater detail, such as to the number of consumers tested in each selected country and the process for their selection (for instance, whether the number was proportionate to the population of the relevant country; what the total number of useable interviews was; who selected the panels that were used to source the respondents; and whether the terms used to select those who had or planned to have relevant investments were suited to the local market, since it was remarked that 'UCITS' as a term might be meaningless to most investors). The reasons behind excluding or selecting particular countries for the testing process were also addressed.

Questions were raised **potential bias exhibited by on-line samples**. On-line panels might under-represent those who do not use the internet, while investors who have access to the internet may generally be more sophisticated in financial matters than

those who do not. Many investors may also prefer to purchase investments through a face-to-face rather than online channel, so testing by means of an on-line questionnaire may not effectively mimic the experience of prospective investors. Where face-to-face sales are undertaken investors will depend on information which they get from the sales people and they may make their choice because the sales persons pushes them to certain product – products may be 'sold' rather than 'bought'. It was suggested by one of the investors representatives that the duties of people selling products should be looked at alongside the work on product disclosures.

It was also questioned how pre-existing consumer testing evidence might be taken into account, given that the disclosure materials tested within this research would be different to those within the KII research. (The Contractor excluded Netherlands, UK and France from the country sample as they felt these territories had already been well researched).

Responses:

- *500 useable interviews were carried out per country and the selection of those investors or potential investors in UCITS was made by YouGov and IFF using their own internet panels, persons responding to the questionnaires were not selected by authorities.*
- *The Contractor confirmed that it had been decided to carry out around 500 interviews per country regardless of population size. As to the selection of countries it had been recognized from the outset that it would be impossible to cover every single Member State given budget and time constraints and the complexity of the proposed testing.*
- *The original requirements obliged the Contractor to conduct testing in two new Member States, and Poland and Hungary were chosen. In general, markets with quite active UCITS were a criterion for country selection. Netherlands, France and the UK were rejected due to the fact that consumer behavior and preferences had already been well researched in these territories.*
- *The Commission confirmed that it had agreed that the usage of a sample of Member States was the only feasible solution; this applied to Phase II as well. Once the project had been completed, an assessment would need to be made as to the extent to which the results might be taken to be indicative for other Member States; the results themselves might provide points on this, as they would show whether there were significant variations between the Member States that were covered.*
- *The Contractor explained that investors were not asked about UCITS as such, but rather "investment funds" or the corresponding terminology common in their particular local market.*
- *On the points relating to the use of online questionnaires, the Contractor noted that its research suggested a good correlation between the investor's community being targeted and internet users. The use of online questionnaires also facilitated the use of panels which facilitated precise adjustments to the profile of the sample. For this reason they considered the samples used showed good demographic*

coverage, for instance against age, education, and financial sophistication criteria.

- *The Contractor stressed that although the panels consisted of internet users, these were not necessarily users who bought financial products online, and in fact two thirds of the sample indicated they would buy investment products through some form of intermediary involving face-to-face contact, and one third online. The process aimed to clarify what people not knowledgeable in financial services can understand and what is their opinion on KII.*
- *For the phase II however the Contractor noted that there was an intention to add an additional face-to-face component and that the eligibility criteria would be extended to those likely to be future investors, so as to include a potentially wider range of respondents.*

1.2 Interactions and practical matters

A second cluster of questions related to the **interactions** between CESR, the Commission, the Contractor and other stakeholders and **practical matters** regarding further clarity as to the likely sequencing and timing of the different streams of work (the testing work, the work on the underlying Directives, and the work on developing recommendations within CESR).

Industry representatives were concerned as to how the work being undertaken at CESR might influence the testing, including in particular the design of the mock-ups for the second phase of work, and requested further detail.

A number also raised questions as to the possibility of public consultations before final testing commenced. One remarked that it was important to avoid a situation where Phase II of the testing included variants which might be known to be misleading or impractical, simply because these variants were otherwise preferred by investors. Another noted that while new working methods at CESR involving ongoing industry involvement through EFAMA were very positive, they could not replace public consultations with the industry, where views may naturally be more varied than those presented by industry representatives.

Responses:

- *The Commission assured that there will be ample time for final consultations. The whole process has its own structure necessary for its overall integrity. The first phase concentrated on examining a wide range of variations for the individual elements of the document, while the next phase will take the best performing of these, with adjustments following the results of the Phase I work and also following CESR's technical work, and put them together into entire mock-ups to see how well the document works as a whole. The final Contractor's report will be then delivered to the Commission and CESR. Allowing for public consultations at this stage whilst the Contractor's work is only half-completed would overly complicate a process that is already very complicated. CESR will of course have its own consultations in due course, both on its technical work and its overall*

recommendations, but to ensure progress in a timely fashion it is necessary for the testing and CESR work to be two parallel and different workstreams. The Commission underlined the importance of not overloading the process and assured that once it is concluded it will be validated via broad consultations at CESR.

- The Contractor assured that liaisons between the 2 processes – CESR technical work and the consumer testing – are in place. The Commission recalled that it is the role of CESR to prepare mock-ups (CESR has confirmed the plan for these to be for both simple and complex funds) and that there is ongoing work still to be done by CESR, notably on structured/formula funds and guaranteed funds. In doing this, the CESR subgroup has worked on the basis of the Contractor's findings and their recommendations are to be taken into account by CESR. It would nonetheless be impossible to take on board and test all possibilities.*
- The Commission explained that the testing in Phase II will conclude in April-May 2009 and its results will be communicated to the Commission. CESR work including wide consultations will end in September/October 2009 and its complete advice will be sent to the Commission. At that stage the UCITS IV should be enacted which will enable the Commission equipped with the CESR advice to start preparing implementing measures (so-called Level II measures). Level I measures and Level II measures should take effect at the end of 2010 or the latest – early 2011. Meanwhile work on an impact assessment would take place Q2 to Q3 next year.*

1.3 Contributions from third parties

Finally, the Association of British Insurers outlined some consumer testing that it was carrying out itself for funds in the UK – looking for the best techniques for presenting risk/reward to consumers. They noted that they had already shared with the Commission an early phase of work, and were considering commissioning additional research if this might be fed into the Commission's work.

Responses:

- The Contractor and Commission urged those with findings that can be fed into the process to provide these within a few weeks due to the time constraints.*

2. INVESTMENT OBJECTIVES AND STRATEGY

2.1 Questions concerning the methodology

Both investor and industry representatives wondered how the Contractor would address difficulties encountered by investors and address them in phase II? It was also questioned whether the results reflected differences between the options being tested or

other factors that weren't the focus of the testing as such, for example difficulties faced by the investors that might be attributed to the wording used, translation, design of text, unfamiliar language, and so forth.

Responses:

- *The presumption is that any variants will be refined for phase II as the purpose of phase I was to identify and correct problems so to better prepare for phase II. In Contractor's experience all the variants performed well in terms of comprehension and clarity and no significant issues as to language and design were highlighted, and they would not recommend significant redrafting although minor modifications might be necessary. The Contractor stressed that the first section of KII is of vital importance for better understanding of other sections and it was important to ascertain the attention investors paid to it where they are provided with the whole document. This would be testing in phase II.*
- *The Contractors also considered that translation could not be regarded as a source of problems because special efforts were made to ensure questions were effectively translated for local markets – translation was verified and aided by experts in the Commission and relevant authorities as contacted through CESR.*

2.2 Questions concerning the content of KII

Investor representatives proposed the introduction in this section of a statement on guarantees written as clearly as possible to make it understandable for average investors.

Industry representatives suggested the idea of introducing a glossary to aid investors in comprehending the document. They also questioned the language in the variants, as being too unrealistic (for instance with regard to the use of derivatives, where liability concerns could lead firms to say less as to outcomes and impact whether positive or negative) and so warned that the mock-ups would need to reflect the sort of material a firm in practice might include in such a document. It was noted that writing a text is a challenge and a balance between the preferences of marketing departments and lawyers can be difficult to obtain. They also raised doubts as to the feasibility of full harmonization of KII as currently every bank produces thousands of their own documents.

Responses:

- *The Contractor explained that the purpose of the language used was to see how consumers understand variants and to ensure the variants tested had strong contrast. The focus was on finding the language preferred by consumers rather than that which fund managers might be comfortable with. Effort would be put into ensuring the mock-ups for Phase II were as realistic as possible, though again it would be important to ensure that they effectively contrasted with one another. As a general observation the Commission underlined that KII was being designed to facilitate investor's engagement in a specific fund, rather than as an educational tool.*

2.3 Questions concerning differences between Member States

Responses:

- *The Contractor noted that there were some differences but these were not generally significant. Generally, investors in Sweden found the variants less clear, those in Spain gave poorer answers and for consumers in Ireland and Hungary variants were clearer than for others.*
- *It was interesting that there was not always a correlation between investor self-perception and actual understanding – in some cases those investors that were more confident in their ability performed less well on understanding tasks than those that were less confident.*

3. RISK / REWARD

3.1 Questions concerning synthetic indicator versus narrative presentation

Some participants questioned that the narrative presentation of risk contained in the variants would reflect what would happen in reality, as the clarity of such disclosures would depend on producer's choice of words. In their opinion synthetic indicator offered a good opportunity to raise the standard for these disclosures across the board, as it had the potential to guarantee a harmonized approach, with the same methodology and presentation being applied by all producers. The view was put that the approaches of different producers to narrative disclosures would vary, so that a narrative presentation would in practice be harder to use for comparisons between funds produced by different fund providers.

There were some doubts raised as to the need for a narrative explanation of the indicator in the situation when the whole part will count only ½ of a page.

A significant number of participants representing both the industry and investors advocated a mixed or hybrid approach – a synthetic indicator accompanied by a text explaining the risk in narrative terms. These participants suggested preparing for phase II a more balanced combination between synthetic indicator and text. Separately a number of participants stressed the need for clear textual disclaimers or explanations (for instance, on the absence or presence of guarantees).

There were specific appeals for the introduction of particular explanations in those areas where consumers tend to make mistakes, for instance in the case of Class I funds which they may mistake with a guarantee. Explanations would be helpful when scales are used.

A few of the industry representatives expressed concerns with the SRRI option. One industry representative noted that if there was no clear distinction between the results from a narrative presentation compared to those from a SRRI, that they would have a

clear preference for a narrative presentation, and argued that fund providers would be particularly worried if they were required to include a SRRI if this was shown to be misleading for some investors. Another supported this concern that the SRRI presentation might lead investors to take more risky investment decisions than they otherwise would, and questioned the added value of a SRRI should it need to be accompanied by significant amounts of narrative text.

Responses:

- *The Contractor explained that investors in general expressed their preference for the synthetic indicator however results were almost identical when it came to which presentation investors understood better. The Contractor stressed that a synthetic indicator can help investors to engage with the material. The aim of the exercise of phase I was to enable refine approaches before moving to phase II. The Contractor, CESR and the Commission would consider the results of the phase I, and whether there were ways to further improve the variants; it was noted that the intention from CESR was always that the synthetic indicator would be accompanied by appropriate warnings and explanations, including clear statements around the status of guarantees where relevant.*

3.2 Understanding v comparing risk

A few participants from both the investor and industry perspectives noted that understanding risk and comparing it might require different approaches. While the presentation of a synthetic indicator may make comparisons relatively easy (comparing one number with another), if the underlying methodology was not consistent this might be misleading.

One investor representative argued that the KII should focus on ensuring clear understanding rather than facilitating the comparison of the risk of different funds, as investors who can compare are more sophisticated and the focus of the document should be rather on those who simply intend to invest some money and wish to understand the basic function of a fund.

Responses:

- *The Contractor stressed that for the purpose of starting investors testing of the comprehensibility of different presentations of a synthetic risk indicator there was no need for a methodology for that indicator to be completed, but clearly the presentation would depend on such a methodology being developed.*
- *They also stressed that the indications were that a synthetic indicator allowed better comparisons but did not necessarily lead to better understanding overall. Phase II would provide further evidence on this.*



4. PERFORMANCE ISSUES

4.1 Questions relating to the information that might be shown

One of the investors' representatives drew the workshops' attention to the US approach, where both figures and bar charts are shown, which they considered an effective way of providing information in a way that would suit investors with different preferences. They also noted that they considered a comparison with a benchmark to be key information for investors, and that the results supported the view that this comparison might be comprehended by investors.

One of the industry representatives also raised a question as to the handling of situations where a full track record is not available, and the investors' comprehension of the optical difference between 0% performance and the actual absence of performance data for a particular year, as was being discussed at CESR.

One of the industry representatives asked for the clarification regarding presentation of past performance in the KII.

Responses:

- *The Contractor confirmed that 0% performance of the fund due to its non-existence had not been included in testing variants in Phase I. It was noted by the Contractor that CESR would contribute to the preparation of mock-ups for the next phase of testing; CESR were considering whether this point might be tested during Phase II.*
- *In relation to performance scenarios for structured funds or formula funds, it was noted by CESR that proposals for these would be developed over a slightly longer time frame, and the aim was to feed proposals into later qualitative parts of the Phase II testing.*

4.2 Questions relating to the research

It was noted that it was not clear as to whether the 5 or 10 year presentation was most effective. It was also remarked that the scaling of the graphs might impact on investors reactions – that a five year presentation using the same space as a ten year would have 'larger' bars and might have greater visual impact and appear 'simpler'.

Responses:

- *The Contractor recognized that the research results were mixed on the 5 and 10 year graphs, and that the poorer performance of the 10 year graph may in fact be due to the fact it showed a year of negative performance which investors found particularly difficult to interpret. Although in terms of clarity and understanding 5 year graphs might marginally appear stronger, investors preferences were with 10 years graphs, posing additional questions as to how to*

balance these results. CESR agreed that 5-year and 10-year graphs will both be included for the two mock-ups to be tested at phase 2.

5. CHARGES

One investor representative reiterated their support for the presentation of charges in terms of an example in monetary amounts in addition to percentages, as has been the practice for US mutual funds, and noted that there was much research showing that investors responded much more strongly to this. This was leant some support by other participants. There were no other remarks at this stage.

6. OTHER ISSUES

One industry representative sought clarification regarding the involvement of distributors in phase II testing.

Responses:

- *The Contractor affirmed that in phase II in-depth interviews (10 in each selected country) with distributors would be carried out. They will include questions on distribution channels and methodology as well as their general reaction to mock-ups. Their opinions will be then compared with the views of consumers.*