

Development of a new obligatory 'financial leaflet'

Dutch Authority for the Financial Markets
Harald S. Miedema
Brussels, May 2006



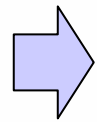
**Autoriteit
Financiële Markten**

Agenda

1. Introduction to the Dutch 'Financiële Bijsluiter'
2. Evaluation of the 'Financiële Bijsluiter'
3. Renewed 'Financiële Bijsluiter'
4. Lessons learned for Simplified Prospectus



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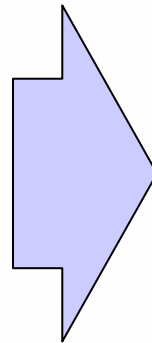
4. Lessons learned for Simplified Prospectus



What is the 'Financiële Bijsluiter' ?

Objectives

- Enable retail customers to understand product key features
- Enable retail customers to compare products



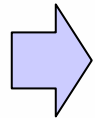
Execution

- Obligatory information document 'Financiële Bijsluiter' since 2002
- Scope is combined products with investment component plus investment funds, e.g.,
 - mortgage loans with investment scheme
 - life insurance with investment
 - leveraged investment products
- Fixed set of topics to cover
- Obligatory distribution prior to sales¹⁾
- AFM as supervisor



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Evaluation of the 'Financiële Bijsluiter'

Objectives

- Understand areas of improvement of 'Financiële Bijsluiter'
- Develop alternatives
- Propose new 'Financiële Bijsluiter' to Ministry of Finance to incorporate in new legislation

Execution

Extended primary research:

- Primary research on experiences among:
 - retail customers
 - intermediaries
 - products suppliers
- Various testing among retail customers about new versions and formats

Cooperation with market:

- Installation of a Project Advisory Board including:
 - industry representatives
 - customers representatives



Main findings of primary research

Summer 2004

Broad support for objectives

- Strong support for FB objectives:
 - Enable customers to understand: 94% customers, 99% intermediaries, 93% suppliers
 - Enable customers to compare: 78% customers, 90% intermediaries, 88% suppliers
- Objective 'enable to compare' especially for same product comparison rather than cross-product comparison

Low support for execution

- Average customer rating of 6,5 (scale 1-10)
- Customers issues: too long and too difficult to understand
- Intermediary issues: too long and too difficult to understand plus low customer usage
- Supplier issues: too much information and too costly to produce

Impact is significant

- 23% of customers claims that FB has helped in the decision process
- Customers know of the FB
 - 83% of buyers
 - 54% of broad public
- Customers have positive attitude towards FB
 - Only 9% regards FB not necessary
 - >70% of customers claims FB has helped understanding products
 - 69% of customers claims that FB has facilitated comparing products



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'Financiële Bijsluiter' adapted to better meet customer needs and preferences

	Main changes	Comments
Contents	<ul style="list-style-type: none"> • Fewer topics • Standardized vs. personalized • Graphical risk meter 	<ul style="list-style-type: none"> • Based on customer preferences • Based on standard person • Simple lay-out, complex computation
Format	<ul style="list-style-type: none"> • Format and definitions fixed • Short: only 2 pages • Graphical where possible 	<ul style="list-style-type: none"> • Hardly any room for interpretation • AFM will provide a software tool for the graphical representation
Other	<ul style="list-style-type: none"> • Extended scope • Passive distribution • Two models 	<ul style="list-style-type: none"> • Also inclusion of other mortgages and life insurances • <i>All investment funds comply to simplified prospectus</i> • No active distribution anymore • Debt product model and investment product model



Financial Information Leaflet



The product



The risks



The costs



The yields



Premature termination

Please note:

Calculations are based on an annual deposit of € 1,200 and investments in shares and bonds, each of which account for 50% of the investment.

[Name of product]
[Name of financial institution]

Consult the Financial Information Leaflet before you decide to take out [a/an] [the product name] [type of product]. You should also compare this Financial Information Leaflet with the leaflet available for other [types of product]. Be sure to also read the offer and the general terms and conditions.

Calculations in this leaflet are based on an annual deposit of € 1,200 and investments consisting of a combination of shares and bonds, each of which account for 50% of the investment. For further information, go to: [www.definancieleb\[sluiter.nl\]](http://www.definancieleb[sluiter.nl])

If you have any questions, please contact:
[name, address and telephone number of financial institution]
or contact an advisor.

This Financial Information Leaflet was compiled on [date] according to the conditions set out by the Netherlands Authority for the Financial Markets (AFM) (www.afm.nl), which is the supervisory authority for the savings, loans, investment and insurance markets.

What is [Name of product]?



When you	You must	You can
invest	pay in a fixed monthly amount inquire about the amount and what you are investing in	accumulate an amount of money
and take out insurance	pay a monthly premium inquire about the amount	bequeath a fixed amount to next of kin upon your death

What are the risks?



Risk that you will lose your deposit

If the product is terminated prematurely (1 year)



After the full term (10 years)



What can happen in the worst-case scenario?

If the product is terminated prematurely, you could lose your entire deposit

at the end of the full term (10 years), you could lose your entire deposit

What are the costs?



The resulting costs based on a forecast of a 4% increase in the value of the investment

	Value	Costs involved	What you retain
After 1 year	€ 1,200	€ 60 insurance premium € 100 other costs € 40 if terminated prematurely	= € 1,000
After 6 years	€ 8,800	€ 300 insurance premium € 600 other costs € 170 if terminated prematurely	= € 6,600
After 10 years	€ 14,280	€ 600 insurance premium € 1,680 other costs € 0 if terminated prematurely	= € 12,000

What could the [Name of product] yield?



The resulting yield based on historical data

The yield is greater than the deposit

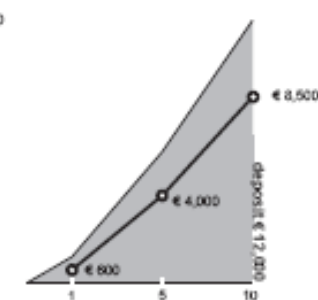
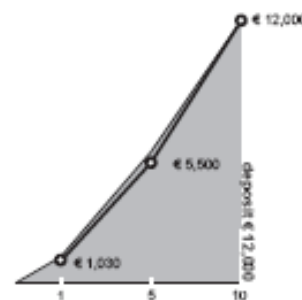
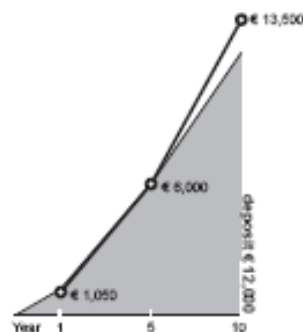
The resulting yield based on a forecast of a 4% increase in the value of the investment

The yield is about the same as the deposit



The resulting yield based on a pessimistic forecast

The yield is lower than the deposit



What happens in the event of premature termination?



Premature termination

upon your death

If terminated due to other circumstances, such as divorce, loss of job or occupational disability

Consequences

your next of kin receives a fixed amount
inquire about the conditions

penalty costs apply
inquire about the amounts

Financial Information Leaflet



The product



The risks



The costs



The yields



Premature termination

Please note:

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[Name of product]
[Name of financial institution]

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Calculations in this leaflet are based on an annual deposit of € 1,200 and investments consisting of a combination of shares and bonds, each of which account for 50% of the investment. For further information, go to: www.definancier.nl

If you have any questions, please contact us by phone, email, or contact an advisor.

This Financial Information Leaflet is approved by the Netherlands Authority for the Financial Markets (AFM).

Currently, we are developing a voluntary format for simplified prospectus in cooperation with market representatives. The format will resemble the new FB standard as much as possible.

What is [Name of product]?



When you	You must
invest	pay in a fixed monthly amount inquire about the amount and what you are investing in
and take out insurance	pay a monthly premium inquire about the amount
	accumulate an amount of money bequeath a fixed amount to next of kin upon your death

What are the risks?



Risk that you will lose your deposit

If the product is terminated prematurely (1 year)

After the full term (10 years)

very high
high
reasonably high
low
very low



very high
high
reasonably high
low
very low



What can happen in the worst-case scenario?

If the product is terminated prematurely, you could lose your entire deposit

at the end of the full term (10 years), you could lose your entire deposit

What are the costs?

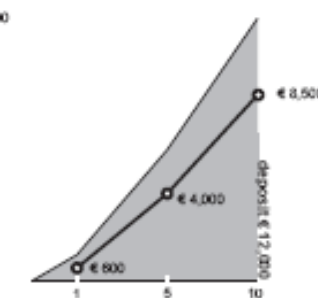
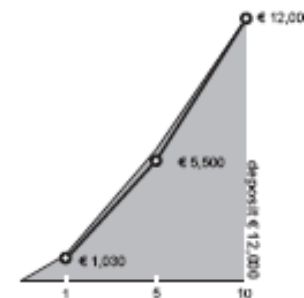
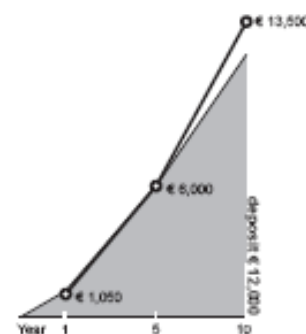


The resulting costs based on a forecast of a 4% increase in the value of the investment

	Value	Costs involved	What you retain
After 1 year	€ 1,200	€ 60 insurance premium € 100 other costs € 40 if terminated prematurely	= € 1,000
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[Name of product] yield?

The resulting yield based on historical data	The resulting yield based on a forecast of a 4% increase in the value of the investment	The resulting yield based on a pessimistic forecast
The yield is greater than the deposit	The yield is about the same as the deposit	The yield is lower than the deposit



What happens in the event of premature termination?



Premature termination upon your death

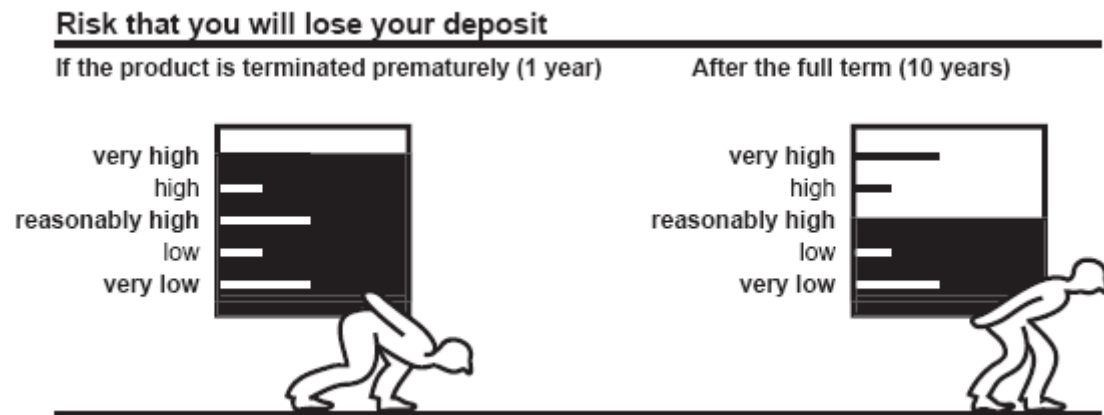
If terminated due to other circumstances, such as divorce, loss of job or occupational disability

Consequences

your next of kin receives a fixed amount
Inquire about the conditions

penalty costs apply
Inquire about the amounts

Inclusion of graphical risk meter



Primary research shows strong support for risk meter

- 63% of customers in favor
- 72% of intermediaries in favor
- 49% of suppliers in favor

Separate effort has yielded this graphical lay-out

- Strong reliance on qualitative research efforts

Another effort has resulted in a computation methodology

- Project team of market representatives, university professors and AFM
- Computation based on worst case scenarios of expected outcome

New regime of obligatory warnings in financial promotion will enforce risk meter recognition

In print and online:



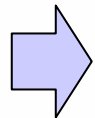
On television:



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Lessons learned for simplified prospectus

- Customer understanding requires plain and simple text (even simpler than one would think at first glance) ¹⁾
- Customer understanding requires graphical representation
- Customer recognition requires distinctive look-and-feel
- Contents should reflect customer needs, not government ideas on what customers prefer or technical explanation of products (hence, primary research is required)
- Comparison as an objective requires fixed formats and fixed definitions
- Avoid a simplified prospectus to develop into a legal disclaimer for suppliers (hence simplified prospectus as pre-contractual information)
- A simplified prospectus should be short, a few pages max (consumer should decide on trade-off between accessibility of information and comprehensiveness)



1) Bureau Taal has done research on proficiency levels of government reporting in the Netherlands. It shows that the average message is written at language level C1. Because of this, 60% of the Dutch population cannot understand an ordinary letter or brochure from the government on their own

Appendix



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What is the 'Financiële Bijsluiter' ?

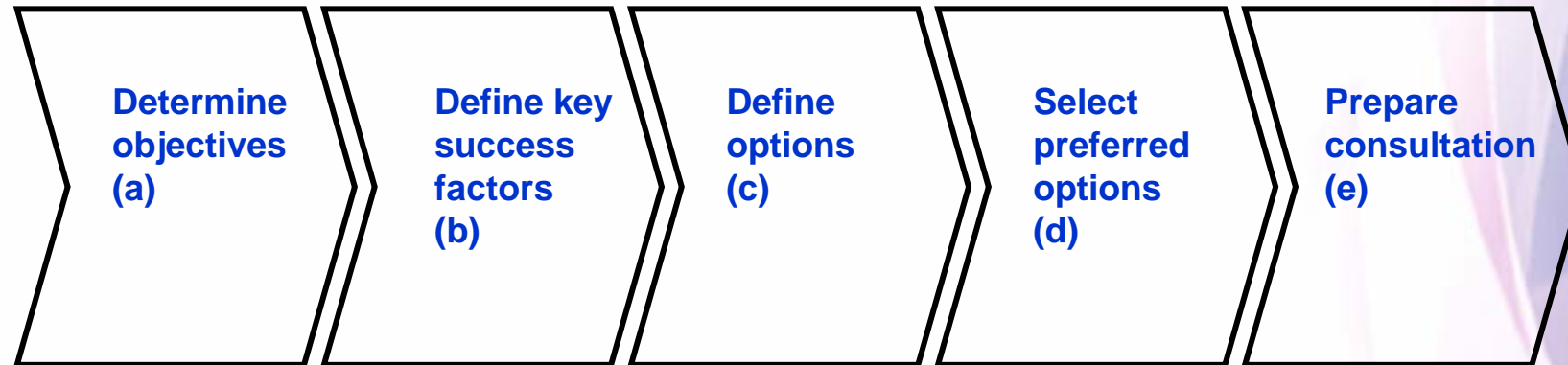
Fixed set of topics to cover

- About the 'Financiële Bijsluiter'
- What is the product
- Risks
- Obligations for customer
- Yields and costs
- What happens when ending the contract
- What happens when customer dies
- Effect on income taxes
- Guarantee schemes
- How to complain
- Supervision



Conceptual project approach

Five project steps



- *Choice of KSF*
- *Define KSF*
- *Weight KSF*

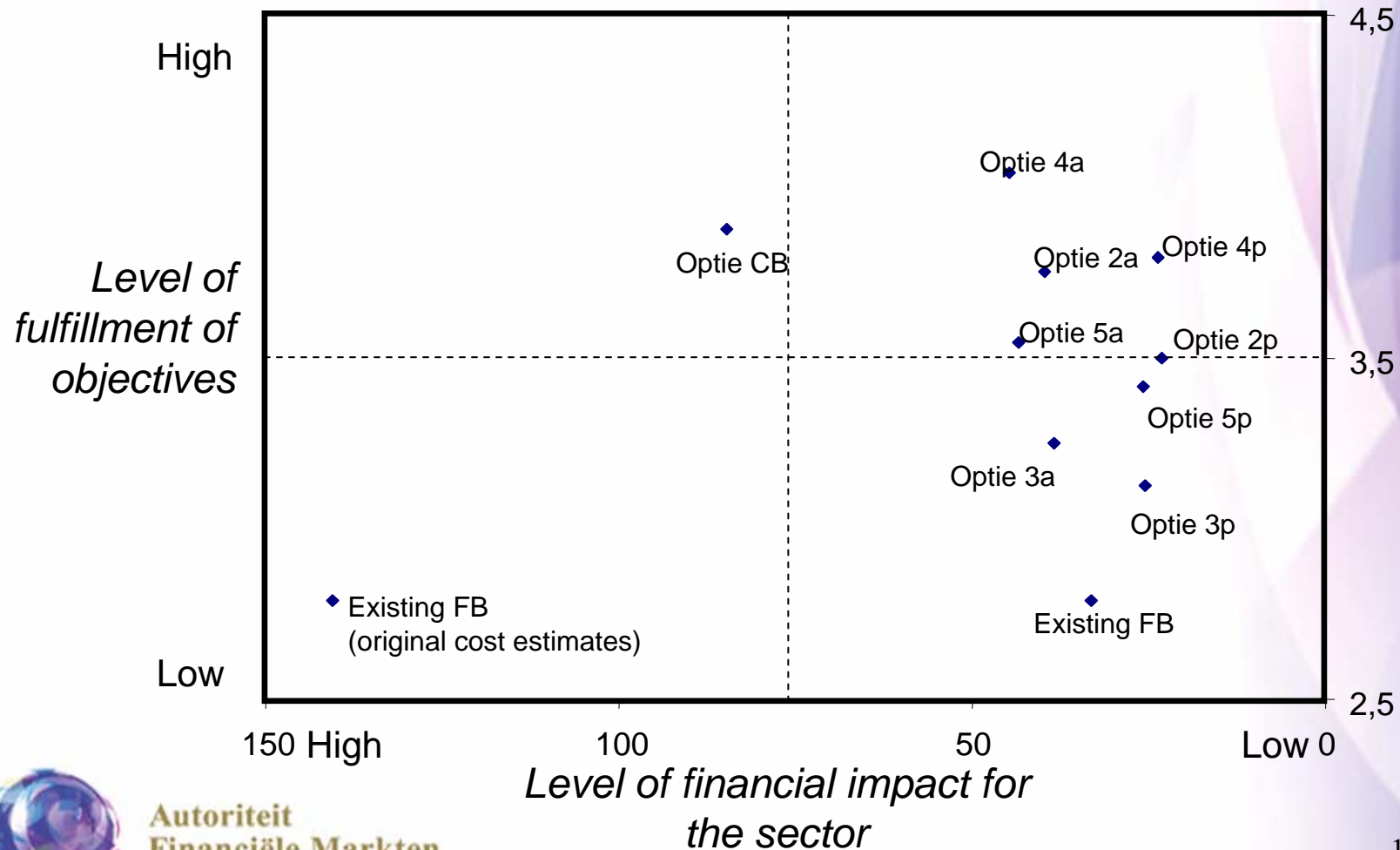
- *Score on KSF*
- *Impact on financial burden of regulation*

- *Write regulations*
- *Test new FB*



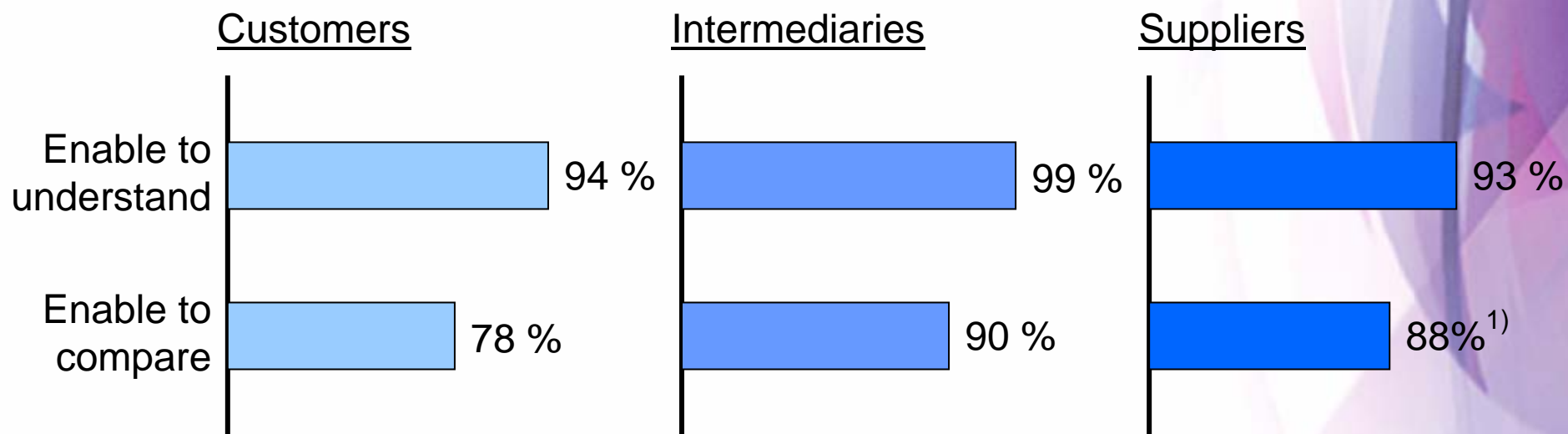
After defining various options, we select the preferred option on two criteria

Selection screen



Broad support for objectives

% respondents that support the objectives



1) Average of within sector and cross-sector comparisons



Impact is significant

% Respondents

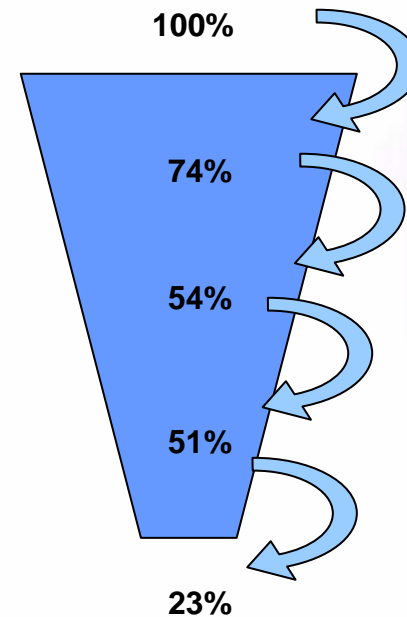
Customers who buy a product that needs to have a 'Financiële Bijsluiter' (FB)

% Customers that has received an FB

% Customers that has read the FB ¹⁾

% Customers that thinks the FB has explained the product ²⁾

% Customers that claims that FB has helped in the decision process



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1) For min 50%

2) At least somewhat clear

Source: Primary market research Millward Brown (June 2004)

Computing the risk level of the risk meter

Risk level reflects revenues in worst case scenarios

- Average of worst 10% of possible returns on investment ($\approx 0,3125 * 1\text{-scenario} + 0,4375 * 5\text{-scenario} + 0,25 * 10\text{-scenario}$)
- AFM has set volatility and an average return for six different investment categories (e.g. Bonds, Emerging Markets and Real Estate Investments)
- The actual investment determines the category, AFM parameters are to be used
- With enough history though, own historical data may be used

Other factors taken into account

- Existence of currency risk
- Existence of guarantees (e.g. deposit repayment at maturity)
- Existence of a surplus value construction build into a mortgage
- Whether the consumer may be left in debt
- 'Investment objects' such as teak investments, are always categorized in the highest risk level

AFM will provide a software tool to compute risk level

