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Simplified Prospectus Workshop

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Issues Paper
Ways to move forward – various options

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Introduction

Section 1 of this Issues Paper aims at summarizing the basic principles of standardised disclosure based upon the discussions held in the first workshop of 15th May 2006.

Section 2 then identifies elements which could be changed to the current provisions on standardised disclosure, and in particular to the simplified prospectus as it currently stands, to meet such basic principles.

Finally, Section 3 discusses the methodology to be used to achieve such changes. It sets out the various options which the European Commission considers as possible ways of moving forward to improve standardised disclosure for UCITS:

- Abandon the simplified prospectus.
- Rely on self-regulation.
- Soft law harmonisation: Adopt level 3 measures (i.e. CCSR guidelines) / modify the existing Commission Recommendation on simplified prospectus.
- Agree on more harmonised level 2 measures (i.e. clarification of definitions by means of secondary legislation pursuant to Article 53a of the UCITS Directive).
- Change the UCITS Directive (level 1 measure).
- A combination of some of the above.

It gives participants a sense of the pros and cons of each option and of the timetables involved. The list of pros and cons does not attempt to be complete: it is a first assessment made by the Commission which could serve as the basis for further discussion and input from participants at the workshop.

In order to structure discussions at the workshop, the Commission will also provide participants with a separate overview - in tabular format - of its assessment of the possible changes which could be made and the ways to do so. This table, which is purportedly left blank, constitutes a working tool for participants. It enables them to structure their ideas and to reflect their views by filling out and/or completing the table.

1 Guiding principles of standardised disclosure

This Section discusses what we want to achieve with standardised disclosure and what should be the guiding principles thereof.

In our first Simplified Prospectus Workshops Issues Paper dated 3rd May 2005, we recalled the main objectives of the current simplified prospectus regime. They were summarized as follows:

- (1) **Inform consumers:** communicate key information to consumers so that they are empowered to make informed choices.

- (2) **Allow for comparisons among investment funds:** consumers need to be able to compare funds if they are to make an informed purchasing decision. Using a standardised format is important because it allows for easy comparison among funds.
- (3) **Create a single market for investment funds:** facilitate cross-border marketing and enhance competition between the fund promoters.

At the first workshop held on 15th May 2006, these objectives were extensively discussed. This gave a slightly different focus with less emphasis being put on the "comparability" aspect. At the first workshop, some common ground in terms of basic principles of standardised disclosure for UCITS was achieved. The main conclusion was that standardised disclosure has a future. However, in order for it to be effective and to reach the goals it is aimed at, the simplified prospectus should be based on the following guiding principles:

<p>I. It should be an instrument providing key information to the average retail end-investor in order to help him to make an informed investment choice</p>

Average retail end-investor. The simplified prospectus should be drafted / conceived to convey key information to the average retail end-investor. It is not a document for regulators or compliance officers. Its main purpose is not to provide regulatory information, to be a vehicle for legal disclaimers, to serve as a marketing tool or to provide financial education to investors.

Key information. It should contain the information which is **necessary** and **sufficient** to enable the average retail end-investor to make the right decision, i.e. to buy the product or to search for further advice. Key information for an investor mainly means understanding the fund's investment policy, risks, charges and performance of the specific product. It should not be a mini-prospectus duplicating information from the full prospectus.

To make an informed investment choice. A distinction is to be made between product information and advice. Product information should be delivered in the simplified prospectus; it is however the role of the intermediary to determine the suitability/appropriateness of a specific product for a specific investor and at what point in time the simplified prospectus has to be made available to the retail investor. However, it should be kept in mind that the simplified prospectus also needs to work in the context of self-directed investments by retail investors. UCITS – being qualified as non-complex products under MiFID, can indeed be acquired on an "execution only" basis (i.e. without interference of any intermediary). This has an influence on the type of information to be included in the simplified prospectus.

<p>II. It should not necessarily be driven by the goal of providing immediate comparability between funds</p>
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It should in the first place be an information tool for the average retail investor. Comparability should not be the primary concern: search for absolute uniformity of content/format would be a fool's errand.

III. It should be a pre-contractual document containing short, well-structured, individual product information

The simplified prospectus is a document which should be understood as key **pre-contractual information** to be used in the context of the pre-contractual phase, i.e. it is part of the sales dialogue / the negotiation between fund promoters/ distributors and the (potential) client. Although it can be used for (general) marketing purposes, it does not seem useful to see it as a purely marketing document. It should however be capable of constituting stand-alone disclosure to help more self-directed investors select UCITS in an execution-only context.

This means that the information should be **structured** in a way that helps the end investor to decide. It should contain information on individual products (**not generic information**). It should not be overloaded: "**KISS**" approach – **keep it short and simple**: the information passed on to the investor should be clear and concise (2 to 4 pages max.) and the text as simple as possible.

IV. Liability of various parties involved should be clear

The simplified prospectus should not be seen as a contractual document: it should not become overloaded with legal disclaimers which get in the way of its objective of providing key information to the end-investor. It is however important that the simplified prospectus is **not misleading or incorrect**. It should refer to more complete documents (e.g. by **signposting** to other sources of information; the use of internet techniques to be further considered). The Prospectus Directive (which contains specific provision on "responsibility" for the full prospectus and the summary) can be a useful source of inspiration when it comes to the question as to how to deal with civil liability issues.

V. It should be looked at in the global context of the mechanics of the sales/distribution process

Simplified disclosure should be looked at in the context of mechanics of the sales process/dialogue (general marketing versus pre-contractual contacts between a financial intermediary and a client/potential client). The following questions should be examined in this perspective:

- When is the investor going to get the information?
- What should it consist of?
- What use can it play in helping the investor to reach a decision as to what product to choose or whether the product offered is the right one?

2 What can be improved to current standardised disclosure?

This Section focuses on what can/should be changed or improved to what is currently provided for in the UCITS Directive and/or the Recommendation taking into account the guiding principles indicated in Section 1.

The Commission would like to get a sense of the improvements to be made to the simplified prospectus in respect format, design, content etc. Based upon the discussions held at the first workshop, the Commission has therefore identified a (non-exhaustive) package of elements which could be changed. The proposed changes relate to more general issues (e.g. liability regime, delivery methods, role of home state regulator) as well as to more detailed elements of content of the simplified prospectus (following the current structure of Schedule C of Annex I of the UCITS Directive).

The Commission invites participants to express their views at the workshop on this first assessment of possible changes to be made to the current standardised disclosure regime:

- (i) **What elements should be changed to achieve the guiding principles listed in Section 1? Do participants agree/disagree with (some of) the proposed changes listed below? What are the views of the different constituencies?**
- (ii) **Are there any additional points participants would want to cover?**

2.1 Title

- Change current title of "simplified prospectus" to clearly differentiate from the full prospectus.

2.2 Target public

- Compulsory disclosure/offering of SP to investors prior to the sale to be limited to "retail investors" - provide exemption for "professional investors", i.e. SP must only be sent on request.¹
- Impose use of simple/plain language (no legal jargon) since targeted to retail investor.

¹ See Section 6.2 of Issues Paper 1st workshop(Q2): Should a distinction be made between "retail investors" and "professional investors" (waiver from publication of simplified prospectus for UCITS sold (only) to professional investors)?

2.3 Structure (format / design / length)

- Introduce standardised headings.
- Introduce use of (standardised) graphics.
- Introduce a fully standardised format.
- Make it a detachable part of the full prospectus, which might however be used independently.
- Impose maximum length of document (cf. Prospectus Directive).

2.4 Content²

2.4.1 Brief presentation of the UCITS

- Clarify exact scope/interpretation of the items listed in Schedule C, first part (e.g. "auditors", "depository": disclosure of name only, no detailed information).

2.4.2 Typical investor profile

- Deletion of typical investor profile (linked with 2.2. : SP only to be provided to retail investors).
- No minimum holding period to be specified.

2.4.3 Risk profile

- Clarify interpretation of "brief assessment of risk profile" (as contained in Schedule C of Annex I to UCITS Directive).
- Introduce risk categorisation/standardisation.

2.4.4 Performance presentation

- Clarify interpretation of "historical performance of the unit trust/common fund/investment company (where applicable)".
- Introduce certain minimum standards of performance presentation.

2.4.5 Cost disclosure

- Introduce/revise standardised calculation method of TER.
- Introduce/revise standardised calculation of portfolio turnover rate.
- Introduce new concepts of cost calculation, i.e. replace TER by alternative method of cost disclosure.
- Remove certain elements of current cost disclosure, i.e. presentation of portfolio turnover rate.

² Following – where relevant - structure of Schedule C of Annex I of the UCITS Directive

2.4.6 Local information

- Update and/or addition of local information (i.e., information relevant to a specific host Member State in the context of cross-border distribution) should be made possible (for example by way of an addendum) without the need for re-authorisation by the home Member State regulator or formal notification to the host Member State regulator.

2.4.7 Updating of "essential elements"

- Clarify the interpretation of the term "essential elements" contained in Article 30 of the UCITS Directive.
- Specify frequency of updates required under Article 30 of the UCITS Directive.

2.5 Civil liability regime

- Introduce specific provisions on liability/responsibility issues similar to the ones contained in the Prospectus Directive.
- Use signposting in the simplified prospectus to refer to other documents (full prospectus, fund rules, articles of association, annual and half-yearly reports) with possible use of hyperlinks (cf. Prospectus Directive regime).

2.6 Translation requirements³

- Full prospectus and simplified prospectus to be drawn up in a language accepted by the competent authority of the home Member State. For cross-border marketing, full prospectus to be drawn up in a language accepted by the competent authorities of the host Member States or in a language customary in the sphere of international finance at the choice of the fund manager. The competent authority of each host Member State may only require that the simplified prospectus be translated into the (or one of) its official languages (cf. Prospectus Directive regime).

2.7 Role of home state/host state regulator

- Introduce concept of self-certification by the UCITS of its compliance with Article 28 of the UCITS Directive.⁴

³ See Section 6.4 of the Issues Paper 1st workshop (Q3): Should the simplified prospectus be available in local language(s)? Should it be made available/translated under the responsibility of the fund promoter or the distributor?

⁴ See Section 6.5 of the Issues Paper 1st workshop (Q1): Should there be an approval of the simplified prospectus by the Home Member State or a mere filing (as foreseen by the UCITS Directive)? What is the exact role of the regulator? Should self-certification be considered? The underlying idea is that the fund promoter should provide the competent authorities of the home Member State with – amongst others – the simplified

- Clarify the current provisions/regime so as to ensure that the simplified prospectus becomes a fully and automatically recognised document to be communicated to the competent authorities of the host Member State (together with any translations thereof) as part of the cross-border notification and not to be subject to any further examination by the host Member State authority.

2.8 Use of internet

- Introduce "access equals delivery" approach⁵.

2.9 Other issues

- Any other changes participants would like to consider: to be completed based upon discussions at the second workshop.

3 How to achieve the proposed changes: methodology

Section 2 set out the various changes to be made to the current simplified prospectus regime in order for it to adequately reflect the basic principles indicated in Section 1. This Section 3 examines the various options which the European Commission considers as possible ways of moving forward to ameliorate standardised disclosure for UCITS. **The choice of one or more options mainly depends on the level of harmonization one wants to achieve.**

In their feedback to the Green Paper, most respondents did not specifically address this issue. Some (both consumers and industry) merely expressed an "urgent need for a revision" of the simplified prospectus and the UCITS directive. Certain industry representatives and public authorities pointed out that a fundamental overhaul of the UCITS legislation (i.e. a new Directive) is not appropriate in the short term. They preferred to exhaust the possibilities of the existing UCITS framework before considering any further steps and indicated that the Commission should "*continue to mandate CESR to extract the maximum potential from the existing UCITS III framework (sic)*". Some industry representatives considered that recommendations should be replaced by legally binding provisions. Others suggested bringing the prescription of content requirements of the simplified prospectus within the Lamfalussy regime (e.g. modifying the UCITS directive). This view was shared by some public authorities who considered that substantial recasting of the UCITS directive should be conducted in conformity with the Lamfalussy approach.

prospectus together with a statement confirming compliance with the Directive prepared by such fund operator. This is mainly relevant in the context of the notification procedure.

⁵ See Section 6.4 – Q4 of the Issues Paper 1st workshop (as further developed in the annotated agenda of the first workshop): Making use of new technology for access to / delivery of standardised disclosure information: Physical delivery versus electronic delivery / use of "access equals delivery" approach / inspiration to be sought in the Prospectus Directive?

A clearer statement was made in the EP Report on Asset Management presenting the European Parliament's response to the Commission's Green Paper⁶. It expressed the hope "(...) **to draft a modification of Directive 85/611/EC on the content of the simplified prospectus to change it into a binding European legislative text on a fully harmonised simplified prospectus; the simplified prospectus should be designed after consulting all relevant parties, including industry and consumer associations, as well as after direct consumer testing, and with the help of marketing experts, otherwise it will remain unlikely to be read and understood by consumers**" (item 7 of the EP Resolution).

The various options presented below rank from the most radical measure, i.e. abolishment of the simplified prospectus, to the measure that would provide the highest degree of harmonisation, i.e. amendment of the existing UCITS Directive. This Section gives a short description of each option, indicating the pros and cons thereof. It should be stressed that whatever option (or combination of various options) be ultimately chosen, consumer testing of the achieved results remains crucial.

This Section gives participants a sense of the pros and cons of the various manners to move forward. At the second workshop, the Commission will present its initial assessment of the way(s) to move forward on the basis of the discussions held in the first workshop.

The Commission would welcome participants' reactions and input on the various options to move forward. It would like participants in particular to focus on how to balance the pros / cons of each option having regard to the basic principles to be achieved through standardised disclosure (as set out in Section 1).

3.1 Option 1: Abolish the simplified prospectus regime

This option would mean that a stronger emphasis is put on the role of the intermediary in the sales process. The "duty of care" of such intermediary would determine the level of information to be given to each individual investor. The MiFID conduct of business rules would play an important role in this process. In addition, the intermediary would also have to determine the right moment in the sales process to deliver such information.

For self-directed investors, this would mean that no standardised pre-contractual disclosure document would be available to help them to make their investment decision. However, they could access the full prospectus and any other documents made available by the fund promoter to support the direct sales process.

It should be noted that this option does not necessarily mean that the full prospectus would become the up-front disclosure document (changing the current regime providing that the full prospectus should be provided to the investor "on request"); this was also not the case prior to the introduction of the simplified prospectus.

⁶ See Issues Paper of 3rd May 2006, Section 3.2.

Pros	Cons
<ul style="list-style-type: none"> • Greater flexibility for promoters/distributors on choice of supporting documentation for sales process • Cost savings: eliminate cost of compliance, documentation and translation • Might set aside some of the concerns in respect of liability issues 	<ul style="list-style-type: none"> • Some costs/investments have already been made by industry to comply with simplified prospectus rules / this infrastructure would now have to disappear. • Does not cover the need of clear, concise and simple disclosure to the investors. • The main concerns will remain and will come back in another (legal) context. How to ensure adequate investor protection? Disclosure of the full prospectus is not investor-friendly (and hence does not comply with the guiding principles) and does not facilitate the investor to make an informed investment choice. • Not all liability issues will necessarily be solved. • Current carve out for SP under forthcoming MiFID level 2 directive will fall. Hence, risk of having 25 different disclosure regimes.

3.2 Option 2: Self-regulation

Self-regulation can take different forms. The relevant actors can agree on certain standard format (e.g. the EFAMA initiative on simplified prospectus format), on conduct of business rules (code of conduct) etc. However, none of these measures constitute legally binding measures. Compliance mainly depends on the willingness of the relevant actors to adhere to such rules.

Pros	Cons
<ul style="list-style-type: none"> • Flexibility – adapting easily to fast-changing market 	<ul style="list-style-type: none"> • No legally binding measures, unless endorsed at national level/ EU level. There is no precedent at EU level of endorsement of code of conduct. • Different actors are involved (fund promoter / distributor)

3.3 Option 3: Soft law harmonisation

3.3.1 Option 3.1: Level 3 measures - CESR guidelines

In order to facilitate coherent implementation and uniform application of EU legislation by the Member States, CESR may adopt **non-binding guidelines** (level 3). These are administrative measures only; they have no legally binding force. They can however contribute to a more consistent understanding of the provisions on simplified prospectus through co-operation and coordination between (national) regulators/supervisors and thus facilitate cross-border distribution of UCITS. CESR can also adopt common standards regarding matters not covered by EU legislation (but these standards have to be compatible with level 1 and level 2 legislation).

Pros	Cons
<ul style="list-style-type: none"> • More consistent and equivalent implementation of the relevant provisions on simplified prospectus which should facilitate cross-border marketing of UCITS. • Would go faster than legislative change (e.g. guidelines on transitional period: 6 months; on notification: 2 years). • Role of review panel from CESR (good results achieved on the guidelines on transitional period). 	<ul style="list-style-type: none"> • No legally binding measures → enforceability issue (even though you have the CESR review panel mechanism, i.e. peer pressure). • While delivering technical advice or working on interpretation guidelines, the members of CESR share their respective expertise in order to develop European "best practices" rules. The process is subject to extensive public consultation, but authorities-driven. The risk therefore exists that the results of Level 3 measures may be more "consensus" than "best practice" driven. • Rapidity should not be overestimated considering the need for consumer testing. • CESR guidelines can only be developed within the limits of the existing Directive and/ or national law (if any) (cf. limitations on the work of the CESR group on notification). They cannot impose a modification of the law, which can be necessary if new obligations are to be proposed (e.g. TER).

3.3.2 Option 3.2: Modification of Recommendation 2004/384/EC

A recommendation aims at clarifying certain elements of the UCITS Directive to ensure a common reading thereof. It can be used to clarify most of the issues raised in Section 2. It has however no binding legal force and hence, no enforcement action can be taken on the

basis of non-compliance with a recommendation issued by the Commission. The lack of a legally binding instrument was considered to be one of the main shortcomings of the current simplified prospectus regime.

Pros	Cons
<ul style="list-style-type: none"> • Timetable: similar to option 3.1 (likely to be based on CESR advice) • Member States could tend to give better reception to a recommendation when it comes to changing their laws. 	<ul style="list-style-type: none"> • No legally binding force. Changing the laws still results from the goodwill of each Member State. • Poor record of the 2004 Recommendation on certain issues, notably on TER.

3.4 Option 4: Level 2 measures – secondary regulation clarifying definitions

In the context of the Lamfalussy approach, the Commission can adopt, adapt and update through comitology technical implementing measures to render the level 1 principles operational. They are adopted by the Commission after having been submitted to the European Securities Committee (ESC) and the European Parliament for their opinion. The ESC is a comitology committee; however, a part from its legislative capacity, the ESC is also responsible for assisting the Commission with respect to policy issues in the field of securities. Upon request in the form of mandates, the Committee of European Securities Regulators (CESR), an independent advisory group, can advise the Commission on the technical implementing details to be included in level 2 legislation.

In respect of UCITS, it should be noted that although the Lamfalussy structure is in place since April 2005, the UCITS Directive was not itself adopted as a "Lamfalussy Directive". Hence, the **comitology powers entrusted to the Commission under Article 53a of the UCITS Directive are limited** (compared to other directives following the Lamfalussy process, such as MIFID, Prospectus Directive etc.).

Article 53a of the UCITS Directive allows the Commission to make **technical amendments** to the UCITS Directive in accordance with the procedure referred to in Article 53B(2) of the UCITS Directive in the following areas only:

- (a) clarification of the definitions in order to ensure uniform application of the Directive throughout the Community;
- (b) alignment of terminology and the framing of definitions in accordance with subsequent acts on UCITS and related matters.

Any Level 2 measures which would be taken in respect of the simplified prospectus will have to fit within the abovementioned limits, i.e. clarification of definitions only. This means that under the current legal framework, no items that could be interpreted as creating new rights and/or imposing new obligations can be introduced by means of Level 2 measures, e.g. proposed changes on the choice and structure of certain ratio's

(such as TER, portfolio turnover rate etc.) can therefore not be achieved by way of Level 2 measures.

Pros	Cons
<ul style="list-style-type: none"> • Legally binding measure 	<p>Limited scope of action – some main issues cannot be caught (e.g. introducing a standardised TER or other compulsory cost disclosure; imposing the use of a standardised format; reducing the current level of information contained in Schedule C). Such changes can only be achieved by amending the UCITS directive. This would thus mean splitting up the package of proposed changes which might not be very transparent.</p>

3.5 Option 5: Level 1 measures: amend the existing / adopt new UCITS Directive

This option includes amendment of the existing UCITS Directive and/or adoption of a new UCITS Directive. The latter would include adoption of a new directive containing framework principles, reflecting key political choices to be co-decided by the European Parliament and the Council, with implementing powers being delegated to a second level.

Pros	Cons
<ul style="list-style-type: none"> • Could cover all proposed changes • Legally binding measure. • Allows introduction of a higher / maximum level of harmonization • Possibility to introduce full Lamfalussy structure, introducing – amongst others – specific delegation to Commission to take the relevant measures on SP at level 2 (more flexibility). 	<ul style="list-style-type: none"> • Timetable : lengthy process • Political decision process

Conclusion

Consideration of various options of ameliorating the simplified prospectus in the end comes down to the question of what we want to do, how far and how fast we want to go (assuming that there is a clear view on what a useful simplified prospectus would look like).

In essence, all proposed changes to improve the functioning of standardised disclosure for UCITS could be achieved through an amendment of the existing UCITS Directive / adoption of a new UCITS Directive.

It should be pointed out that the process of amending the UCITS Directive / adopting a new UCITS Directive would take considerably more time and efforts than the process of drawing up a new recommendation, modifying the existing recommendation, or relying on Level 3 coordination and guidelines. However, the use of recommendations has proved to be rather unsuccessful in the past, mainly due to its non-binding legal force. The Green Paper feedback indeed confirmed that Member States, when given too much freedom in respect of implementation of the Directive, tend not to follow more specific guidelines of the Recommendation. For the same reason, the use of CCSR guidelines might prove to be insufficient to achieve the desired result.

The use of Level 2 measures at this stage seems not relevant given the limited scope of action it given by Article 53a to the Commission. Level 2 measures could however be useful if the UCITS Directive itself is restructured reflecting a full Lamfalussy approach, i.e. providing a broader delegation of powers to the Commission at level 2, including in respect of the simplified prospectus.

Self- regulation, although being probably the fastest and least cost consuming route, does not appear to be an option which could guarantee the application of uniform rules and certain minimum standards in respect of the simplified prospectus. Too many varying interests of different stakeholders (fund promoters, fund distributors) seem to be involved in this process to ensure adequate results.

Making the right choice of one or more options therefore needs to be carefully balanced, taking into account the following factors:

- (i) the pros and cons of each option;
- (ii) the level of harmonisation desired;
- (iii) the urgency of (some of) such changes;
- (iv) if changes to the Directive would be decided, whether an incremental/ step by step approach is to be preferred to an all or nothing approach in the coming three years;
- (iv) the cost/benefit analysis of introducing (some of) the proposed changes.

The input from the different constituencies on this is crucial: brainstorming with participants at the first workshop has proved to be useful to help the Commission to agree some guiding principles, scoping issues and key information elements that should be reflected in the design of the simplified prospectus.

The Commission looks forward to receiving participants' feedback to the issues raised in this Paper and to further discuss them with participants at the second workshop. This will help the Commission to identify the best route to deliver the improvements discussed at the first workshop, to be reflected in its White Paper to be published in the autumn of this year.

The Commission intends to publish a summary of both workshops and related background information on its website shortly after the second workshop.

As from the White Paper, further work will have to be undertaken (e.g. relating to the development of EU wide standards of information presentation). A possible study to be carried by an external contractor might furthermore help the Commission to translate the agreed information elements into a format that can be easily understood by retail investors in

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the different EU Member States and to have it tested with retail investor communities across the different Member States of the EU so as to save-guard the "Better Regulation" principle.