

SIMPLIFIED PROSPECTUS WORKSHOP SUMMARY OF THE SECOND MEETING OF 11th JULY 2006

Key messages

Some areas of agreement on the required basic changes to the current standardised disclosure regime, but some divergent views on topical issues

- (1) Target public: the simplified prospectus should be addressed to retail investors (mixed views as to whether to abolish the simplified prospectus requirement for funds offered only to professional investors).
- (2) Structure/ format: the simplified prospectus should be a short document in the form of "fact sheet"; a maximum length should be imposed. The use of graphics should be further considered.
- (3) Content: the simplified prospectus should provide key information to the retail investor, enabling it to make an informed investment decision. This means:
 - Include a brief presentation of investment policy and management style.
 - Delete the concept of 'typical investor profile' (mixed views – considered by some regulators as a useful concept).
 - Specify the minimum holding period : mixed views - considered by some as a useful concept.
 - Risk profile disclosure:
 - risk disclosure in narrative way not always meaningful
 - mixed views on the use of a synthetic risk indicator and underlying risk measures (volatility or "value at risk")
 - to be accompanied by some language on the risk-reward trade-off (i.e. what is the appropriate investment period)
 - to be seen in the context of the sales process : intermediary to provide advice on suitability/appropriateness of the product for the investor.
 - Cost disclosure:
 - Total Expense Ratio (TER) or similar composite measure to be maintained, but calculation method should be harmonised
 - entry and exit fees to be presented separately (some reservations)
 - costs to be presented in % form, but to be accompanied by illustrative cash figures examples (mixed views)
 - transaction costs not to be included in the TER – should be communicated to the investor in another way
 - no disclosure of portfolio turnover rate (some reservations made)
 - distribution costs to be disclosed at the intermediary level.
 - (Historical) performance presentation:
 - in a manner which can be understood by the investor
 - standardisation required, but less complicated than cost and risk disclosure
 - performance to be calculated on a comparable basis, preferable annual

- general preference for the use of bar charts (as opposed to line charts)
 - updating of information: frequency to be specified
 - backfilling data for new funds (with no performance history) to be further addressed.
- Local information: to be a detachable part of the simplified prospectus.
- (4) Translation requirements: simplified prospectus should be available in the national language(s). Careful consideration should be undertaken before introducing similar rules as the ones contained in the Prospectus Directive should be carefully considered since the Prospectus Directive is considered to address a different target public (mainly professional investors as opposed to retail investors targeted by the UCITS Directive).
- (5) Role of home/ host state regulator: once filed with the home state regulator, the host state regulator cannot require any additional elements to be added to the simplified prospectus. Introduce self-certification by the fund promoter.
- (6) Liability issues / Respective roles of fund promoter and distributor: fund promoter to be responsible for all product related disclosures; distributor to be responsible for other disclosures.

Some common grounds, but also divergent views, on how to move forward

- (1) Several participants favoured a long term change of the UCITS Directive, i.e. a change at the Level 1 making the UCITS Directive a (full) Lamfalussy Directive on the basis of which future implementing legislation (Level 2 measures) in respect of standardised disclosure can be taken by the Commission.
- (2) Participants (mainly industry/distributors and some investors) were reluctant to rely solely on CCSR guidelines (Level 3 measures) which were considered. They considered that any such guidelines should be combined with other more stringent measures.
- (3) Given the Commission's limited scope of action for taking Level 2 measures under the current Article 53a of the UCITS Directive and awaiting changes at the Level 1, various participants (from both industry, regulators', distributors' and consumers' side) showed support for a change of the Recommendation.
- (4) Some participants however urged the Commission to exhaust its powers – although limited - under the current Article 53a of the UCITS Directive.
- (5) All participants stressed the need of consumer testing.

Introductory remarks

The Commission recalled – as already specified at the first workshop of 15th May 2006 – that the purpose of the workshops was not to reach a consensus, and that no written report was expected after the workshops. The workshops should be considered as an informal stock taking exercise which aimed at helping the Commission to understand the scale and origins of the problem and to take a view on the best way forward. The latter will then be reflected in the Commission White Paper which is to be published in November.

The Commission recalled the main conclusions of the first workshop and indicated that the second workshop would further develop some specific disclosure issues (costs, risks, performance) and would touch upon cross-product disclosures. However, its main focus would be to discuss the ways to move forward: i.e. **what** should be changed and **how** it should be changed. Reference was made to the Issues Paper sent to participants prior to the second workshop which developed the various options and indicated the pros and contras of each option.

Morning Session

The morning session focused on some specific aspects of standardized disclosure, in particular (i) cost disclosure, (ii) risk disclosure, and (iii) performance presentation. It also took up the issue of cross-product disclosure, i.e. should (and if so, to what extent) disclosure requirements be aligned between UCITS and other "competing" products? As some of the discussions held in the first part of the afternoon session also touched upon cost disclosure issues, they will be reflected under point I. below so as to ensure a coherent reading and understanding.

I. Cost disclosure

The session on cost disclosure commenced with two presentations. Mr. E. Moisson (Lipper Fitzrovia) touched upon Total Expense Ratio (TER) issues, cross-border and cost/ volatility issues. Mr. G. Prache (FAIDER) focused on cost disclosure from the investor point of view. The main points discussed in open debate included:

- Keep or abandon TER – Alternative methods of cost disclosure (e.g. combined charges figure);
- Various components of TER: what should be included (e.g. entry/exit commissions, brokerage fees/transactions costs);
- Methods to calculate and present TER;
- Additional information on other charges to be included in the simplified prospectus (e.g. transaction costs, distribution costs).

What should be disclosed? TER or one global figure?

The regulator introducing the debate stated - on the basis of its national experience and consumer testing in the field of disclosure - that consumers do not have a good understanding of charges. They find it difficult to aggregate different charges to get an overall impression of costs. The main purpose should therefore be to give them an indication of the overall charge to provide a sense of the importance of the charges they are paying if they invest in a certain product rather than to provide them with detailed information about the different components of the charge.

The debate then focused on whether the use of TER for cost disclosure was actually the right method or whether alternative methods of cost disclosure should be envisaged (i.e. disclosure of one global figure).

Industry

One of the industry representatives expressed certain doubts as to whether TER was really useful to investors and stressed that the focus should be on what investors really need to understand about what they are paying. Another industry representative referred to the example of Switzerland where TER had been introduced a few years ago and turned out to be rather successful. He believed that the disclosure of one comparable figure was essential and that such figure should not include entry / exit fees. In his view, the best way to provide investors with the information they needed was to clearly disclose TER and (separately) maximum entry and exit fees.

Another industry representative confirmed that including (maximum) entry / exit fees in the TER would constitute a massive change for the industry. Such fees are indeed used as an incentive by different levels of distributors' groups, e.g. sometimes no front-end fees are paid by the investor because they are waived by the advisor. Including them in the TER would therefore not give the right picture. This idea was supported by other industry participants who seemed reluctant to combine all charges into one global figure. One industry representative highlighted that the disclosure of charges should be looked at in the context of the distribution structure. Every level in the distribution chain should be responsible for disclosing the relevant charges. A conceptual difference between costs borne by the fund and costs borne by the investor should be made.

Consumers

Consumer representatives all considered it important to respect the KISS principle ("Keep it Short and Simple"). They stressed that the investors' level of understanding should not be overestimated and that cost disclosure therefore needed to be as comprehensible as possible. In their view, this could be achieved by disclosing TER and entry / exit fees separately and not by using one global figure. One of the consumer representatives noted that the TER had some constraints and drawbacks and that an extended and comprehensible EU-wide definition was therefore required. He furthermore believed that the TER should be presented as a percentage, but should also be accompanied by illustrative cash figures (which enable to

combine the TER and entry/exit fees impacts together in a single easily understandable figure), as already done in the USA and in the Netherlands¹.

Distributors

One of the distributors' representatives noted that the argument for including entry / exit fees in the TER should be that investors do not necessarily know where the initial charges lie. Investors will pay such charges, whatever the purchase method may be. Reference was made to the situation in the UK where no (cost) difference is made between an advised and non-advised market (as opposed to the US where an advised investor would pay higher charges than a direct investor). She expressed the view that there should be a TER which includes all charges however and whenever charged so that clients know the true cost of their funds.

Regulators

Most regulators agreed that the TER and entry/ exit fees should be presented separately. One of the regulators expressed concern regarding the use of fixed / absolute figures. He stressed that it should be made clear that they are only illustrative. He therefore favoured expressing entry / exit fees in % terms. He also stressed the need to introduce one EU-wide method of TER calculation.

What should the TER include (brokerage fees/ transaction costs)? Is disclosure of the portfolio turnover rate relevant to investors?

This point was touched upon during the morning session and was then further discussed in the afternoon. For reasons of consistency, we reflect the outcome of the discussion under the section dealing with cost disclosure.

The discussion mainly focused on whether brokerage fees / transaction costs should be included in the TER and whether it was relevant to disclose the portfolio turnover rate (PTR) to investors.

Industry

One industry representative considered PTR to be a useful measure. In his view, investors had the right to be informed about the managers' activity of which PTR could give a good picture. He considered however that brokerage fees should not be included in the TER. Most of the other participants believed that PTR is not understood by investors, does not contribute to transparency (it can even be a negative figure), is too complicated to calculate and therefore should be dropped. Another industry representative questioned whether industry actually knew what was an 'expectable' turnover rate? What is the portfolio turnover rate exactly meant to signal? Some participants furthermore made the point that transaction costs were already calculated in the performance data and that there could thus be a risk of double-counting if they were to be included in the TER.

¹ Financial Information Leaflet regime in the Netherlands (as discussed in Section 5.3 of the Issues Paper prepared for the first workshop of 15th May 2006 and in the presentations made by the Dutch AFM at the first and second workshop).

Regulators

One of the regulators' representatives stressed that the whole debate departed from the point whether the TER is comprehensive or not and that the discussion whether or not to include brokerage fees/ transaction fees in the TER should be linked to this. She expressed some doubts as to whether the average investor is actually able to understand PTR and also considered that calculating brokerage fees did not seem to be feasible. Another regulator stressed that the rules should be changed on two main issues. In respect of TER, he considered that the calculation method should be made clear (i.e. what is included / excluded). In respect of PTR he indicated that one of the main problems is that subscriptions and redemptions are not properly taken into account and that there should be a netting of subscriptions and redemptions. Another regulator stressed that there are higher priority issues to remain in the simplified prospectus and that: -disclosure of cash figures (illustrative) seemed of much higher importance than disclosure of PTR.

Consumers

One of the consumer representatives noted that it was not fair to investors to provide them with a **Total Expense Ratio** which in fact does not include a big portion of the costs (i.e. transaction costs). This led to further discussion on how such costs should then be disclosed. Another consumer representative suggested adding a statement to the TER to specify that it did not include transaction costs which can be very significant and referring to the full prospectus for further information. He also noted that PTR is likely not to be understood by the average investor and suggested that its computation should be changed to match the one used in the USA.

Disclosure of distribution costs

During the morning session, the discussion also addressed the disclosure of distribution costs, the use of soft commissions and potential conflict of interest issues. The main view seemed to be that – although such issues were important – the simplified prospectus was not the best tool to handle them.

This discussion was taken up again in the afternoon session. The Commission asked participants to express their views on whether a distinction should be made between: (a) *fund promoter disclosure*: product related disclosure in the simplified prospectus and (b) *distributor/intermediary disclosure*: disclosure of other issues related to distribution (i.e. fee sharing arrangements, distributions costs, soft commissions), mainly relying on MiFID.

Regulators

One of the regulators expressed its concerns on the exact interaction/reading of the relevant provisions of MiFID and indicated that asking the distributors to complement disclosure made by the fund promoter might give rise to confusion and/or a perception of contradiction. Another regulator argued that the distribution cost is a relevant part of the total cost of the asset manager and that they can be different for each class, hence the need to specify them for each class separately. One of the regulators furthermore stressed that if there is a retrocession of part of the management fee to the distributor, the investor should be informed. Another

regulator indicated that he supported the views of the industry (see below) and that the simplified prospectus should focus on product disclosure only.

Industry

One of the industry representatives indicated that in his country it was the practice to disclose the fact that there can be a fee sharing, but that no specific figures were given (e.g. indication only that the fund manager can share [x] to [y]% of its management fee). He considered it to be the obligation of the intermediary/distributor to inform the client of any possible conflict of interest that could arise from such fee sharing arrangements. Another industry representative stressed that one should be more pro-active and transparent on the disclosure of fee sharing arrangements, but stressed however that the simplified prospectus should give information on the product and that MiFID should deal with the distribution side. If one wants to put everything in the simplified prospectus, it would no longer remain "simplified".

Distributors

One of the distributors' representatives argued that the investor should be informed that some components of the management fee may be used for payment of distribution fees, without entering into too much detail.

Investors

One of the investors' representatives stressed that the conflict of interest issue raised by the retrocessions or trailer fees schemes must be addressed in one way or another, either at the product level or at the intermediary level.

SUMMARY – COST DISCLOSURE

- **TER or similar composite measure should be kept, although its calculation method should be harmonised.**
- **Entry and exit fees (one-off fees) should be presented separately (some reservations).**
- **Costs to be presented in %, accompanied by additional cash figures examples (mixed views on the latter).**
- **No disclosure of portfolio turnover rate (some reservations made).**
- **Transaction costs not to be included in the TER (not calculable), but no clear agreement on how they should/could be communicated to the investor (i.e. whether it is sufficient to simply disclose that they exist and have an impact without quantifying them).**
- **If fees differ because of the way a product is sold, it is the distributor's responsibility to inform the consumer about the (differences in) charges.**
- **Disclosure of distribution costs is important, but should be rather done at the distribution level. Proper communication to the end investor is the main point. However, one of the concerns expressed is that further disclosure at the distribution level could lead to complication / confusion in the vertical structure.**
- **Conflict of interest issues should be addressed, but the simplified prospectus is not necessary the best tool for this.**

II. Risk disclosure

The session started off with four presentations reflecting both the regulators' and the industry's point of view on risk disclosure:

- (1) Mr. F.M. De Rossi (CONSOB) "UCITS Simplified Prospectus: why using a synthetic risk indicator"
- (2) Mr. M. Denkers (AFM) "A risk measure for retail financial products"
- (3) Mr. J. Vander Stuyft (KBC Asset Management NV) "Disclosure of risks in a UCITS III Prospectus"
- (4) Mrs. T. Wilkinson (BNP Paribas Luxembourg): "The Challenges of Risk Measurement"

The main points discussed in the open debate included:

- Risk categorisation
- Use of a synthetic risk indicator (SRE)
- Use of volatility²/ value at risk (VAR) measure³

The Commission commented that all the presentations were informed by the need to arrive at a certain risk classification/grid and participants were asked to comment.

Regulators

One of the regulators stated that there was a common desire to find a simple way to communicate risks to investor. It was noted that the list of risks as currently established should be simplified: the link between risks and reward should be made clear to the investors. The use of volatility⁴ as a risk measure was questioned: was this really what the investors needed to know? This regulator queried the use of (a kind of) risk categorisation. Using categories does not necessarily mean that investors understand the underlying risk (e.g. "high" could mean that they lose all their money invested, but they also might need to pay something on top of that). In addition, risk categorisation might change over time and the risk of the same investment could depend on the investor's circumstances, how long they intended to hold the investment and what it was intended to be used for. A further question to be answered was which risks should be disclosed? Only those linked to the fund or also those linked to the product which could be just as important? In respect of defining the target investor, the same regulator expressed the view that this did not form part of risk disclosure, but that nevertheless some degree of information could be given (e.g. stating that the product is suitable for investors willing to take a certain degree of risk).

² Volatility is a measure of the variability of returns over a chosen time period. It reveals the extent to which the daily/weekly/monthly price changes from the average. A low percentage volatility shows that the price has stayed quite close to the average whereas a high percentage volatility shows that the price has moved up and down a lot over the time period. Volatility is thus a market measure of investor uncertainty (about a company, a sector or the stock market as whole) and is therefore considered to be an indicator of investment risk.

³ VAR is based upon the expected pay-off in bad scenarios – see AFM presentation

⁴ For more details on the use of volatility as a risk measure - see CONSOB presentation

Another regulator disagreed with the idea of using a synthetic risk indicator. In his view, this was unrealistic (as it would need to be calculated in the same manner in 25 Member States). He also disapproved the idea of volatility being the only risk measure. Exact information on risks contained in both the simplified and full prospectus was in his opinion a more useful solution for investors. He furthermore agreed that there were many drawbacks of risk categorisation.

One of the regulators was of the opinion that volatility was a good solution and was commonly used by risk management companies. He noted however that it did not need to be disclosed to investors, as use of a single word (high/ medium/low) was enough to give investors a sense of risks involved. His views were shared by another regulator.

Consumers

One of the consumers' representatives insisted that the KISS principle should also be respected in relation to risk information. He considered that investors are not sophisticated enough to understand the different categories of risk. The only thing they are interested in is the potential loss. For this reason, he preferred the risk disclosure approach of the Dutch AFM since it was based on the expected pay-off in bad-case scenarios (i.e. 'value at risk'), i.e. rather than on volatility, which an average consumer might find difficult to understand. In respect of the question whether or not a minimum holding period should be indicated, he indicated that one should be prudent and that it could be useful to explain financial market risk.

Distributors

According to a distributors' representative hardly any investor or advisor understands how volatility measures work and therefore using VAR would be a better solution.

Industry

An industry representative suggested that the simplified prospectus could not be everything to everyone and therefore "signposting", also for risk information, was necessary. She also indicated that one should not forget liability issues. Another industry participant commented that although a synthetic risk indicator could not do everything it was a far better solution than any other description of risk and should be seen together with other measures (i.e. disclosure of investment policy, performance). With regard to disclosure of a (minimum) holding period, he stressed that it should be the role of the distributor/advisor to advice on whether an investor needs a product at a particular moment of time. Moreover, a recommended holding period could give consumers the false impression that, if they respect the holding period, a positive return could be taken for granted.

SUMMARY – RISK DISCLOSURE

- **Some type of risk disclosure is necessary, but :**
 - **the list of narrative risk disclosures as set out in the Recommendation is not necessarily meaningful to the investors**
 - **investors do not necessarily understand a breakdown of risks.**

- risk categorisation has a lot of weaknesses.

- **Divergent views exist on the use of a synthetic risk indicator:**
 - support from some regulators
 - some doubts about its feasibility (calculation in the same way in 25 MS)
 - two different risk measures: volatility and VAR whereby VAR better picks up risks associated with UCITS III.
- **Use of synthetic risk indicator alone is not sufficient. This should be accompanied by some language on the risk-reward trade-off (i.e. what is the appropriate investment period) and should be seen in the context of the sales process where in advised sales the intermediary is to provide advice on suitability of the product.**

III. Performance

As an introduction to the discussion on performance, T. Wilkinson (BNP Paribas Luxembourg) presented an overview of performance presentation issues in the simplified prospectus.

Following the presentation, the Commission asked participants to give their views on the following issues:

- (1) To what extent should performance disclosure be driven by the need for comparability?
- (2) Should performance, as currently presented in the simplified prospectus (based upon the Recommendation), be changed?

Industry

One of the industry participants noted that the presentation focused mainly on the use of GIPS⁵ standards to show past performance. He commented that performance calculation based on net asset value (NAV) had been internationally accepted and that therefore there was no need to challenge this approach. The only question was **how to present** past performance. The best way, according to the same participant, was the use of a bar chart. The advantages cited were that it gives a good picture, provides for comparability, and gives some indication on volatility and the risks involved. He furthermore indicated that one of the main problems associated with performance presentation were funds with a short life and no track record and questioned whether a provider should in such cases be allowed to use a synthetic performance indicator and if so, which information sources should be used (e.g. those of the best performing fund?). He considered that this constituted a challenge to be answered by the industry.

In response to the above views, another industry participant noted that although GIPS standards did not apply to funds – GIPS was a good example of a standards organisation. She went on saying that the industry had to be obliged to standardize and that the Recommendation was not enough since it is not legally binding. She also came back to the

⁵ Global Investment Performance Standards (GIPS) established by the Association for Investment Management and Research (AIMR) to support a global standard (1995)

use of either the fiscal year or the calendar year to calculate performance. If the investor was happy with both, this should be fine with the industry.

Regulators

One of the regulators indicated that past performance presentation did not seem to be the most important piece of information a consumer needs to know and that it could even be misleading. She indicated that they had not identified massive problems in their jurisdiction with the current approach to presenting the information if it is required. In order to secure comparability, she expressed however a preference to use "year to date" as calculation basis in order to clearly reflect what has been happening with the fund.

Consumers

According to one of the consumers' representatives, bar charts are far better than tabular presentation. Consumer testing is however required in order to confirm this. Performance presentation is a major issue in which consumers are interested. It therefore needs to be addressed in a "fit for purpose" manner. He preferred to use the calendar year as calculation basis and insisted to also address the frequency of updating the information. In addition, the UCITS historical performance must be compared to the performance of indicators of reference, such as market indices.

Distributors

From the distributors' perspective, performance data is very crucial information in the decision making process. One of the distributors expressed his preference for a line chart rather than a bar chart to depict performance data (especially if the performance fee has a high hurdle rate or high watermark⁶). Whether or not the performance information is to be included in the simplified prospectus or in other documents (such as a fact sheet or other marketing material) is another question. However, if it were to be included in the simplified prospectus, a more harmonised approach should be adopted. Another distributor however considered the use of benchmarks in the simplified prospectus meaningless and opted for a use of a simple bar chart.

⁶ Investment managers usually charge an annual management fee. Some incentive-fee structures go one step further, imposing thresholds before the performance fee kicks in. The most common of these structures are the high watermark and the hurdle rate. The hurdle rate is a performance target. It refers to the minimum return an investment fund manager must achieve before a performance-related fee is paid. A performance fee with a high watermark usually means that the fee is only paid when the value of the fund's shares exceeds the maximum share value in previous months when the manager was compensated. Typically, if the manager makes any losses, the accumulated losses must be recouped before the performance fee is paid.

SUMMARY – PERFORMANCE PRESENTATION

- **Performance issues are less complicated and challenging than cost & risk disclosure.**
- **Regulators' sense is that the presentation of performance information should be carefully defined because this is data consumers want to look at.**
- **To be calculated on a comparable basis, preferable annual (discussion whether this would be a fiscal or calendar year).**
- **Include a comparison with the performance of indicator(s) of reference (investor's view).**
- **General preference for bar charts.**
- **Frequency of updating – needs to be further addressed.**
- **Issue of backfilling data for new funds – needs to be further addressed.**

IV. Cross-product disclosure

This session was introduced by a **representative of the life insurance sector, Mr. C. Kenny (ABI)** who delivered a presentation entitled: "Unit-linked life: disclosure rules and customer needs".

Mr. Kenny stressed in his presentation that the main objective of disclosure was to help consumers to understand the product rather than to "feed" regulators. This meant that information disclosed to investors should be comparable, complete and comprehensive. Mr. Kenny furthermore indicated that one should first inquire whether it was useful for consumers to receive certain types of information and if so, whether it necessarily made sense to do this by way of prescription (at the EU or national level) or rather by industry self regulation.

Following the presentation, participants were invited to express their views on the issues raised by Mr. Kenny and, more generally, on the need for cross-product disclosure rules.

Regulators

One of the regulators observed that the cost/benefit analysis of any change to be introduced is very important. She indicated that there are certain elements where a degree of comparability and/or consistency is required and that this might not always be sufficiently covered by industry regulation alone. As to the question whether the simplified prospectus approach needed to be extended to the insurance industry she put forward the following reflections:

- (i) What should the simplified prospectus look like?
- (ii) Could this be useful for insurance products (this might have an impact on the decision of what it should look like).

Another regulator stressed that UCITS and unit-linked life insurance products / structured products are competing products and that fees paid to distributors were much higher for unit-

linked life insurance products than for UCITS. He indicated that structured products can be sold cross-border under the Prospectus Directive regime under which the host Member State cannot require additional information, but that in fact the prospectus of such products (even the summary) is not comprehensible for the retail investor. This was confirmed by some other regulators. One of the regulators indicated that in his view, the simplified prospectus should be offered when the fund product is embedded in a tax (insurance) wrapper in the same manner as when the fund product is sold directly. He indicated that his national regulation dealt with this by requiring that in such cases a simplified prospectus or equivalent information be provided. This offers some more flexibility to the provider.

Industry

One of the industry organisations outlined the importance of this issue for the fund industry. They stressed that they are in favour of "soft regulation" but that they did not understand why this should be limited to one sector only (i.e. the life insurance industry). Another industry representative suggested that one should look at the example of the KeyFacts Quick Guide as developed by the FSA in the UK.

Distributors

A distributor confirmed that she also considered unit-linked life insurance products as competing products with UCITS. She indicated that the question rather was as to how to recommend investment in a fund: direct investment or as an insurance wrapper? She considered that there was a tendency to advise the option which gives the adviser the highest fee. She insisted that one should make the investor understand the difference between such options. Another distributor stressed that disclosure should be done rather at the point of sale and not necessarily by means of a simplified prospectus.

Life insurance representative

Mr. Kenny responded to the issues raised indicating that one does not need to look at disclosure on a stand-alone basis, but at the full regulatory framework for the sector. He insisted that this is an area where there is a big scope for "soft law", referring to – amongst others – the ABI Code of Conduct. He agreed that the question of commission exposure is a delicate one and that the level of fees/incentives should be transparent. However, he was not sure that having a special unit-linked life insurance version of the simplified prospectus would do the trick. If a common disclosure document was needed, then it should be rather up to the industry to develop it and not necessarily the regulators.

The Commission inquired as to how risk disclosure was dealt with in respect of unit-linked life insurance products. Mr. Kenny replied that in respect of this specific aspect, there was less difference between both sectors. He underlined that the most difficult challenge was to try to relate back to the individual investor expectations. He expressed some doubts as to whether it would be possible to find a common risk language. He also stressed that any proposals/initiatives should be subject to consumer testing.

SUMMARY – CROSS-PRODUCT DISCLOSURE

Three issues seem to arise:

- **WHY are we interested in this issue?**
Stakeholders consider that certain products (mainly unit-linked life insurance products and structured products) are competing with UCITS; some of the product structure and performance is quite similar to UCITS.
- **WHAT is important?**
Cost and risk disclosures seem to be the main issues. One risk of investor detriment seems to flow from the difficulty for investors to know how much the product will cost him. The question remains whether there is further work to be done here.
- **HOW to achieve it?**
From the life insurance industry perspective, it is stressed that one should be careful when trying to roll-out problematic funds disclosure to other products. There is a plea for self-regulation / industry approach. Participants to the workshop support the view that adequate disclosure is required to create a level playing field. It seems difficult to generalise funds disclosure to life insurance industry at this stage. However, the issue exists and needs to be further reflected upon in the future.

Afternoon Session

The afternoon session focused on ways to move forward. In the first part, participants were invited to express their views on what they considered should be changed to make standardised disclosure work (better). In the second part, the various options to achieve such changes were discussed.

I. Moving forward: What can be improved to current standardised disclosure?

The Commission indicated that a list of possible changes/improvements reflecting the outcome of the discussions of the first workshop and anticipating some of the issues discussed in the second workshop had been sent to all participants prior to the workshop. This list was included in the Issues Paper for the 2nd workshop and was also provided to participants as a working document in table format. The Commission stressed that the list was not exhaustive and that participants might wish to add items to such list and/or delete items from the list.

A first part of the discussion focused on cost disclosure issues (i.e. relevance of disclosure of portfolio turnover rate / transaction costs to be included in the TER / disclosure of distribution costs. As indicated, for consistency reasons they have been reflected above under Section I – Cost disclosure.

Participants were then invited to express their views on what improvements should be made to standardised disclosure for UCITS. For clarity, we follow below the list of possible changes as indicated in the working document and summarize for each item the feedback (if any) received from participants in respect of the necessity / priority to make such change.

Title

Some of the stakeholders (*industry/ distributors*) noted that the title of the document should be modified so as to avoid confusion with the (full) "prospectus" concept.

Limit target public

Different stakeholders (*regulators/ industry/ distributors*) indicated that standardised disclosure should be targeted at retail investors only and that this should be clearly reflected when deciding upon format and content of the simplified prospectus. One of the *regulators* stressed that the simplified prospectus should not be offered only to retail investors and that it has also a value for institutional investors. Some industry representatives stressed the fact that the simplified prospectus should not be required where the fund was being offered only to professional investors.

Structure (format/design/length)

Most of the participants considered that (i) a common format of the simplified prospectus should be devised and tested; (ii) the maximum length should be limited (some participants expressly stated that the document should not be more than 2 pages); and (iii) the language used should be simple. Some participants expressed their preference to use graphics. One *regulator* expressed however doubts on the feasibility of the use of pictograms. This approach would, in her view, require a lot of academic and scientific work. One of the regulators also expressed the view that one should envisage to include a legend of technical words in the simplified prospectus. An independent financial advisor favoured a prioritisation of information (including for risk disclosure).

Content

Views were more varied in respect of the content of the simplified prospectus.

- ***Presentation of UCITS***
Only limited specific comments were made on this item. One of the regulators indicated that certain typical "full prospectus" items should be dropped, e.g. the details of the auditors.
- ***Typical investor profile***
With regard to the typical investor profile, one of the *regulators* noted that the concept of the minimum holding period should be deleted. Another regulator opposed the deletion of the 'typical investor profile' concept and insisted that at least a distinction between mass retail, affluent retail and institutional investors should be maintained. In its view, this remains significant and constitutes a first safety belt to avoid misselling. Some of the *distributors* opted for keeping the indication of the minimum holding period. One of them, however, expressed the view that while keeping an indication of

the minimum holding period, the concept of "typical investor profile" should be taken out. Some of the *industry* representatives also stressed that the typical investor profile should be deleted from the simplified prospectus since the fund manager cannot know who is the typical investor and necessarily needs to make assumptions. One of the *investor* representatives confirmed that the indication of a minimum holding period was useful.

- ***Risk profile***

Some *regulators* noted that the description of different types of risk should be simplified and that only the main ones should be reflected. The views on whether or not to use a synthetic risk indicator (SRI) was less clear amongst the participants. Although there seemed to be some sympathy for the introduction of a SRI amongst some of the regulators present at the workshop, others were unconvinced. One of the regulators opted for inclusion of a SRI based on volatility. Another regulator expressed some sympathy for a SRI but did not specify which risk measure should be used. Another regulator indicated that the use of a SRI should be carefully considered. Two others expressed strong concerns about the use of any such indicator.

Only one *industry* representative explicitly opted for the introduction of a SRI if it could be disclosed in the form of a short sentence (e.g. low risk, medium risk, high risk) or in other simple forms (charts, graphs, etc.). Another participant representing industry sector expressed sympathy for volatility as a risk measure. Keeping it short and simple ("KISS") was also considered a main element in respect of risk disclosure. Another participant stressed however that one should be careful not to "oversimplify" risk categorisation when amending the current disclosure regime.

Only one *distributor* noted that the use of different types of risks should be abandoned and that one common methodology of presenting risk should be introduced. Another distributor expressed sympathy for VAR as a risk measure.

- ***Performance presentation***

Most of the participants agreed that common standards should be introduced (see also below under cost disclosure).

- ***Cost disclosure***

Most of the participants indicated that TER calculation should be harmonized.

One of the *regulators* mentioned that the PTR should be taken into account when presenting costs and that there should be a clear indication of distributors' costs. Another regulator clearly stated that cost disclosure should include TER, entry/ exit fees and illustrative cash figures but not transaction costs. However, the use of cash figures was considered to be risky by another regulator.

One of the *industry* participants preferred to include a breakdown of the basic components of the TER in the simplified prospectus. The same representative did not support the inclusion of transaction costs in TER. and also preferred not to disclose the portfolio turnover rate. Although this figure theoretically offers the investor some possibility of gauging portfolio trading activity costs, in practice there is still much debate on how it should be calculated. However, if the PTR is to be disclosed, it was suggested that alternative definitions be sought (the US formula could be a good point

of departure). It was also mentioned that the problem of how to make distribution costs transparent necessarily implies clarification of the relationship between manager, distributor and investors. Another industry representative stressed that the entry/ exit fees should be presented separately from TER and that cash figures should be included in the standardised disclosure document.

An *independent financial advisor* considered that even if existing disclosure of [TER] + [performance fee] and [performance fee] as two fields is maintained, one should be aware that the resulting figure may not be helpful for investors since performance fees are normally charged as a percentage of net gains (not net assets). In his view, disclosure of charges should try to address why charges matter and how they work. A combined figure uses various assumptions to address the former⁷, while separate ongoing (TER) and one-off (initial/exit) figures are vital for the latter. He also considered that the current recommendation to exclude transaction costs from the TER calculation is correct. However, as brokerage commissions are not (compulsorily) disclosed for UCITS, he expressed concern about dropping disclosure of PTR figures. He considered that the US model might be a useful source.

- ***Local information***

Some of the *regulators* also addressed the issue of local information which should be used to provide information on local marketing rules (including distribution costs). According to one of the regulators, such local information should be a detachable part of the simplified prospectus.

Civil liability regime

The issue of whether or not specific provisions on civil liability should be introduced in the UCITS Directive (in a similar manner as has been done in the Prospectus Directive) was less touched upon. One of the *regulators* expressly stated that the Prospectus Directive regime should not be taken as an example and that following such approach would mean taking the wrong path for investor protection. An *industry* representative however considered that, when reviewing the issue of civil liability, the "responsibility" system as provided for in the Prospectus Directive (Articles 5(2) and 6 thereof)⁸ should be taken as an example. It was furthermore pointed out that the liabilities of the different segments of the industry (management company/fund promoter, distributors etc.) towards the investor should be made clear.

Translation requirements

Some of the participants suggested that the translation requirements should be deleted from the current UCITS directive. One of the *regulators* strongly insisted that the current translation requirements should not be touched upon and that no example should be taken from the Prospectus Directive. Another regulator expressed its doubt about using the Prospectus Directive approach and indicated that, if signposting were to the full prospectus were to be used in the simplified prospectus, it appeared to be difficult not to translate the full

⁷ e.g. the length of time over which the initial charge is amortised; the maximum initial charge (as quoted by a product provider and not taking into account of discounts via fund supermarket or discount broker) which is actually paid by the investor etc.

⁸ For more details, reference is made to Section 6.1, Q3 of the Issues Paper prepared for the first workshop of 15th May 2006.

prospectus into the local language. One of the regulators also suggested that the host state authorities should only check the appropriateness of the translation.

Role of home state regulator

Some participants also touched upon the role of the home state regulator in respect of standardised disclosure documentation. One of the *regulators* proposed to rely upon self-certification of compliance of (at least some of) the provisions of the UCITS Directive. Some *industry representatives* indicated that there was too much regulatory arbitrage and that only one "European" format should be used and recognised in all Member States.

Signposting / use of internet

Some participants (*regulators/ industry/ consumers*) also raised the use of signposting and the use of electronic tools as an issue to be addressed.

Other issues/suggestions

One of the additional issues raised was that the *respective roles of the fund promoter and the distributor* should be clarified. It was argued that the fund promoter should only be responsible for product related disclosure and that the distributor should be responsible for disclosure of other items, mainly relying on MiFID.

SUMMARY: REQUIRED CHANGES

- **Title**: need to change title, but not a major issue.
- **Target public**: only for retail investors (mixed views as to whether to abolish the simplified prospectus requirement for funds offered only to professional investors).
- **Structure/ format**: short document in a form of "fact sheet"; maximum length to be imposed.
- **Content**:
 - Brief presentation of investment policy and management style
 - Delete the concept of 'typical investor profile'
 - Minimum holding period: considered by some as a useful concept
 - Risk profile: mixed views on synthetic risk indicator & on the use of VAR/ volatility risk measure
 - Performance presentation: standardisation required (but considered to be less complicated than cost and risk disclosure)
 - Cost disclosure: TER (or similar composite measure) to be retained and complemented by entry/ exit fees; information to end investors that the TER does not encompass all charges; delete PTR; introduce cash examples (mixed views)
 - Local information: to be a detachable part of the simplified prospectus

- **Civil liability regime:** introducing a specific regime was less of a priority for some participants. . Liabilities of the different segments of the industry (management company/fund promoter, distributors etc.) towards the investor should however be made clear.
- **Translation requirements:** simplified prospectus to be available in national language(s) – Introducing similar rules as the one contained in the Prospectus Directive should be carefully considered since the Prospectus Directive is considered to address a different target public (mainly professional investors as opposed to retail investors targeted by the UCITS Directive).
- **Role of home/ host state regulator:** once approved by the home state regulator, the host state regulator cannot require any additional elements to be added to the simplified prospectus – role of self-certification.
- **Delivery methods / use of internet:** adoption of "access equals delivery" approach to be further considered, but not a priority for most of the participants.
- **Respective roles of promoter and distributor:** fund promoter to be responsible for all product related disclosures; distributor to be responsible for other disclosures (impact of MiFID).

II. Moving forward: How to make the required changes?

The last section of the workshop was dedicated to the methodology to be used to achieve the desired changes. The Commission summarised the various ways of moving forward, in particular:

- Abandon the simplified prospectus.
- Rely on self-regulation.
- Soft law harmonisation: Adopt level 3 measures (i.e. CESR 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.

The Commission recalled that the pros and cons of each option were explained in more detail in the Issues paper for the 2nd workshop. It highlighted in particular the limited scope of action it currently had to take Level 2 measures due to the limited scope of powers conferred to it under Article 53a of the UCITS Directive. Article 53a of the UCITS Directive allows the Commission to make technical amendments to the UCITS Directive to clarify definitions in order to ensure uniform application of the Directive throughout the Community. Any Level 2 measures which would be taken in respect of the simplified prospectus would have to fit within the abovementioned limits, i.e. clarification of definitions only. The process of drafting the Recommendation on the simplified prospectus has revealed very strict limits as to what

changes could be considered to fall within the abovementioned limits (i.e. no items that could be interpreted as creating new rights and/or imposing new obligations can be introduced). The debate which then followed showed that different views existed between participants (even within the same group) as to how to move forward. However, there seemed to be a general understanding that changes should be implemented quickly once evidence had been gathered to show that they would deliver benefits.

Industry

One of the industry representatives considered that the Commission should first make a statement (not clear in which format) which should then be followed by CESR work and finally by the amendment of the UCITS Directive. The same participant noted that the Recommendation had given little comfort so far and suggested that another option would be to consider which elements in Schedule C could be clarified under Article 53a of the UCITS Directive (i.e. using Level 2 measures)..

Some other industry representatives agreed that a change of the UCITS Directive was the optimal solution, but that this was however too lengthy. They did not believe that Level 3 measures (CESR guidelines) could bring the right solution as they considered it might be difficult to obtain a consensus within CESR and that one might end up with a document for regulators and compliance officers, rather than for investors. They therefore considered that a modification of the Recommendation would be the best way forward and would be a valuable first step before changing the UCITS Directive.

Regulators

One of the regulators noticed that prior to suggesting and implementing any changes to the UCITS Directive, one should first consider whether any of the proposals to be made would have a better effect on the internal market. In this respect, it was stressed that consumer testing was considered to be crucial. Another regulator suggested that a combination of Level 2 and 3 measures would be the most pragmatic and effective approach. One of the regulators also favoured changing the Recommendation (e.g. on TER issues) and stressed that some other issues could only be addressed by changing the UCITS Directive (e.g. change of title). Another regulator however did not support any amendment to the UCITS Directive or the Recommendation and considered that the current legislative framework offered enough space to make things work (e.g. by using Level 3 measures (CESR guidelines)).

Consumers

A consumer expressed the opinion that changing the UCITS Directive was the best possible way forward since it was the only way to introduce a mandatory format for standardised/simplified disclosure. He furthermore claimed that changing the Directive was not necessarily the lengthiest solution. Some support was shown for a two level approach: first amend the Recommendation to cover small issues which should then be covered later on by an amendment of the Directive. Another consumers' representative noticed that any changes should be done in a "package" so that an investor is not faced with many different amendments which in the end do not deliver the expected result. The need for consumer testing was stressed once again.

Distributors

One of the distributors' representatives indicated that many distributors in the sales practice would not miss the simplified prospectus in case it would be abandoned. He explained that in practice, UCITS are usually sold using other means of customer information, e.g. fact sheets at the point of sale, and that the simplified prospectus is hardly ever used as an additional sales tool. In his view, if the investor required more complete information concerning the product, he would in any event consult the full prospectus. However, if there would be a future for the simplified prospectus, he considered that long term measures were required (i.e. a change of the Directive), but that they ought to be preceded by a change of the Recommendation. He considered that this should contribute to a joint interpretation of the Directive and a limitation of additional requirements.

SUMMARY – METHODOLOGY

- **Some support for the need for a long term change of the UCITS Directive (bringing it under a full Lamfalussy approach).**
- **At the same time, support for a change of the Recommendation (both from industry, regulators, distributors).**
- **Reluctance (mainly from industry/distributors and some investors) to rely solely on CESR guidelines.**
- **Attempts should be made to make the most use of Article 53a (some scepticism expressed on the limited powers of Article 53a of the UCITS Directive).**
- **Consumer testing is crucial.**