

Consumer Panel response to DG Markt Services Discussion Documents: Possible Adjustments to UCITS Directive

The Financial Services Consumer Panel was established under the Financial Services and Markets Act 2000 by the Financial Services Authority to represent the interests of consumers. The Panel is independent of the FSA. The main function of the Panel is to provide advice to the FSA, but it also looks at the impact on consumers of activities outside the FSA's remit. The Panel represents the interests of all groups of consumers.

This is the Panel's response to the discussion papers produced by DG Markt Services concerning possible adjustments to the UCITS Directive. We welcome the opportunity to engage in this important debate.

We have responded to the issues raised in the six exposure drafts that appear to us to have a significant impact on consumers, rather than addressing every proposal.

We agree that a review of the UCITS directive is both timely and appropriate and we have already taken the opportunity to respond to the recent CESR questionnaire on the Simplified Prospectus – a key issue for consumers. A copy of our response is attached. The Panel was also invited to participate in a joint meeting of two of the IOSCO Standing Committees where point of sale disclosure documents for collective investment schemes were discussed in some detail. It is vitally important that the outcomes of these various initiatives are brought together in a coherent way to achieve the best result for consumers.

The Panel recognises the potential advantages of the Single Market and the need to minimise national variations where this can be achieved without significant detriment to retail consumers. We continue to support many of the policy initiatives emerging from the EU, but nevertheless the success of the proposals contained in the DG Markt Services papers is dependent upon the quality of regulation in Member States, as well as co-operation between regulators across the EU. For example, under the proposed notification procedure the advantages to investors of swifter access to a wider choice of funds could be far outweighed by the increased risk of investing in a fund which might not have met the perhaps more rigorous regulatory approach of the Host State Regulator. It would be unrealistic to proceed on the basis that these matters can be taken as read and we would like to see the Commission taking additional steps in future to ensure appropriate, high quality regulatory standards are being applied across Member States.

The Panel would like to see a post-implementation review of changes to the UCITS Directive to assess how well the new procedures meet their objectives, including the

effectiveness of discussions between regulators and their impact on costs and competition.

Notification Procedure

We agree that it is important that retail consumers enjoy a wide choice of investment opportunities and that steps should be taken to ensure smooth 'passporting' for UCITS funds. However we remain concerned that there are significant risks to consumers arising from DG Markt's preferred option of relying on ex-post checks by host regulators – albeit with emergency powers for escalating discussions with Home State authorities – in that this could open the floodgates for cross-border investment without Host State authorities having the opportunity to ensure the suitability of a fund's marketing material etc in advance. In other words, in the event of non-compliance the Host authorities would be left to deal with actual detriment to consumers, rather than being able to identify potential problems before they arise and more consumers would be facing the prospect of how to pursue a complaint in another jurisdiction. The Paper argues that MiFID and other measures will mitigate the risks arising from the new procedure, but in our view regulatory authorities in different Member States do not enforce compliance to the same, or at least an acceptable minimum, standard. We believe the Commission needs to do more to ensure that retail consumers can rely with justifiable confidence on the standards imposed by Home State regulators.

We believe that the appetite for cross border investment will continue to be tempered by confusion about where complaints should be made if something goes wrong (it is unclear to us whether the proposed deletion of Article 45 will have an impact in this area) and the availability of a dispute resolution service in the Home State.

Management Company Passport

We do not have detailed comments on the options proposed. However we are a little concerned that DG Markt Services' preferred option 2 – the 'partial' passport – could lead to confusion about supervisory responsibility and the possibility of important issues falling through the regulatory cracks. As the Paper recognises there is a need for reasonably close and detailed co-operation between regulators and we question how well this would work in practice.

Mergers

We have considered the implications of DG Markt Services' preferred option 1 (the regulator responsible for the disappearing fund (A) decides on the merger.) We are not in a position to comment on whether 15 days from the submission of a complete application is sufficient time for a regulator to assess a merger proposal and reach a decision, although we appreciate the need for efficient and streamlined merger procedures. It is vital however that full consideration is given to the interests of investors in both fund A and fund B. The process will of course require practical and effective arrangements for discussions between regulators – even though the decision rests only with the fund A regulator, a decision should not be taken in isolation without due reference to the Fund B regulator, and not without taking account of the interests of all the investors affected by the proposed merger.

From the consumer perspective there is a need for focused, accurate and understandable information to be circulated to investors in both funds, in good time, to enable them to make a reasoned decision about their investments and the merger. We are conscious that merging funds might have differing investment objectives and strategies, so care will have to be taken to ensure that these points are made clear to investors. There might need to be an element of prescription in this area, particularly about the redemption rights of dissenting unit-holders.

In our view there is little real evidence that any cost savings by funds would be passed on to investors. If at all possible we would like to see some kind of obligation to do this built into the new requirements.

Asset Pooling

We have no objection to DG Markt Services' preferred option 2 (UCITS compliant master-feeder structures) and we can see advantages for consumers in the proposed approach – although again we believe it might be optimistic to suggest that cost savings would be passed on to investors unless there was some form of requirement to do so built in to the procedures. It is vital however that investors are informed about the investment strategy and other key features of the master fund. There is also a need for absolute clarity about charges.

Simplified Prospectus – Investor Disclosure Regime

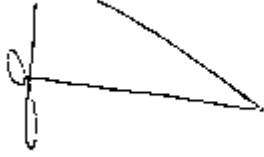
Attached to this document is the Panel's response to the recent CESR questionnaire on the Simplified Prospectus for retail investors which sets out in some detail the Panel's views on what is needed from a retail consumer perspective. We favour a single document – no more than two sides of A4 in length – that captures in plain and concise terms what consumers need to know in order to compare products and make an informed decision.

We have no objection to an opt-out for professional investors provided that this is *only* available to professional investors.

Supervisory Co-operation

DG Markt Services has rightly identified supervisory co-operation as being important to the success of the procedures set out in the consultation papers. The Panel's concerns go further than that however. Of course it is correct to say that UCITS products were always designed to be appropriate for passporting/cross-border selling and that in many respects there are uniform requirements in all Member States. But it remains a fact that the quality of enforcement and regulation varies across the EU and we believe that while such inconsistencies remain they will be a barrier to both effective investor protection and increased levels of retail investor participation in the single market. While we would not support a call for a "regulator of regulators" we would like to see the Commission put in place a rigorous assessment of regulators' effectiveness once the new arrangements have been put in place, or preferably before any significant changes are made. Regulators need to exchange information in a timely and effective way and consumers need to be

confident that regulators are enforcing a sufficiently high set of standards across the EU.



Financial Services Consumer Panel

14 June 2007

Consumer Panel response to CESR questionnaire on the simplified prospectus for retail investors

The Financial Services Consumer Panel was established under the Financial Services and Markets Act 2000 by the Financial Services Authority to represent the interests of consumers. The Panel is independent of the FSA. The main function of the Panel is to provide advice to the FSA, but it also looks at the impact on consumers of activities outside the FSA's remit. The Panel represents the interests of all groups of consumers.

This is the Panel's response to CESR's questionnaire on the Simplified Prospectus for retail consumers. We welcome the opportunity to engage in this important debate.

We thought that the questions asked by CESR tackled many of the key issues relating to the Simplified Prospectus. We have set out our answers below. We would like to emphasise at this stage the importance of the SP or its successor document being concise, consistent, relevant, written in plain language and timely. The resources allocated to the review of the SP by numerous bodies across the EU could potentially be wasted if the final document is too long and complex - potential investors will simply not read it. The Panel believes strongly that the information needed to draw up options for a revised SP must be based on authoritative research into consumer needs and experience. We also fully support consumer testing as a means of validating the final recommendations.

Q1: What information should be included?

The Panel's view is that the primary purpose of the Simplified Prospectus (SP) is to provide consumers with sufficient information on which to base an investment decision, having used it to compare products if necessary. Consequently the SP should focus on a limited amount of important information and be driven by consumer needs rather than strictly contractual considerations. The information that should be included can best be identified by way of consumer research – in some markets there is a great deal of research already available, although further work might be required. Subject to consumer testing, we would like to see information relating to issues such as complaints bodies limited to links or contact details, rather than more extensive information being included in an appendix or supplementary pages. If consumers are to be encouraged to read and understand the SP the information it contains must be important and worded in a consistent and readily understandable way. Consequently the finished document will be focused and concise.

Q2: What substantive UCITS features do consumers need to know about?

The range of consumer diversity is such that we believe there is no such thing as the "average consumer". Consumers buying UCITS products will enjoy different levels of knowledge and capability – the UCITS 'brand' is becoming more well known and inspires some comfort and confidence - so we believe the approach should be to identify key information and present it in plain language, rather than attempting to establish the profile and average financial ability of the target market. The range of information that investors would need can probably be best identified through consumer research. However, we would expect this to include basic information about the objectives of the fund; its strategy; risk profile; past performance; costs; tax regime and a link or reference to where further information can be found. We provide further views on these aspects in the following answers.

Q3: What information should be provided about risks and rewards?

The provision of information about risk is vitally important, but remains problematic. Research undertaken on behalf of the Panel this year¹ showed that consumers would like to have a consistent approach to explaining the risk to their money when buying or investing in financial products. This qualitative research also showed that generally, many consumers do not understand the potential impact of risk or how they need to factor it into their financial decisions. There are of course many types of risk –inflation, performance, prudential (regulatory) and political for example – but we think that any attempt to encapsulate all these risks could lead to confusion. Our view is that the information provided should be limited to the risk profile of the particular investment. The Panel is actively involved in discussions with industry and other bodies in the UK about possible scenarios for a common 'language' for risk at the moment and consequently we are not in a position to suggest a structure for this. We would however expect any narrative to include the lack of suitability of the equity product for anyone likely to wish to withdraw their money after, say, twelve months, or alternatively a minimum recommended holding period.

As regards the potential gains, in principle we do not think that the SP is the most appropriate document for large amounts of comparative information or narrative on the nature of the relationship between risk and reward. This could make the SP too long and unwieldy and would discourage potential investors from reading it. If the SP contains the right information about the investment in a digestible form, consumers who wish to do so will make their own comparisons. We do agree that a balanced presentation of a reasonable set of projections would be helpful. Consumers would not be able to use this information for 'shopping around' throughout the EU unless it was consistent across all Member States both in terms of assumptions used in calculations and in levels of potential gain or loss – we recommend that any set of projections should include a nil and/or negative rate of return. We see a strong argument, therefore, for prescription in this area. We will be interested to see the results of research on this.

¹ "Investment risk rating – consumer attitudes towards risk" published on www.fs-cp.org.uk

Q4: What information should be provided about strategy and objectives?

We agree that a plain language statement of the strategy and objectives of the fund is essential. This would not necessarily include detailed information about the financial instruments used by the fund.

Q5: How should past performance information be presented, and for what time period?

This is a complex area. We understand that there is a real appetite amongst consumers for information on past performance, both of the fund itself and of the fund managers, although we accept that many consumers might not understand, or might be likely to misinterpret, the information provided. It is extremely important that options in this area are thoroughly researched and that presentation is standardised. A warning that past performance is no guarantee of future performance is essential. Information about suitable investment holding periods should be included elsewhere in the SP and we do not believe it would be appropriate to adjust the past performance information to indicate any recommended holding period. At this stage we support the use of simple returns and we believe a period of five years' individual annual returns would be appropriate. New funds that were set up within the previous five years should be required to use a zero figure for pre-trading years. We would, however, be interested to see the results of research in this area across the EU.

Q6: How should information about charges and fees be presented?

Concise and meaningful information about charges should be presented in the SP.

A great deal of useful information is already provided about charges and fees, although both the information itself and the figures/ratios used are often complex. The size of the charges to be applied and their impact on return are of course of particular interest to consumers. From the consumer perspective a table of figures in cash terms showing the effect of all charges on performance would probably be the most meaningful, although we agree that the total expenses ratio in particular is also helpful. The Retail Distribution Review being undertaken in the UK by the FSA is examining, amongst other things, alternatives to commission based remuneration. These include a cost and payment split between the production of the product and its distribution. This work might help to inform the debate on how best to present information about charges and fees.

Q7: How should the packaging of funds into different end-products be handled?

Our understanding of packaging is that this might affect the charges, tax position and ultimate purpose for which the consumer selected or was advised to purchase a particular investment. Mandatory integration of the key information relating to wrapped products could result in lengthy and complex SPs which would not necessarily achieve the objective of providing investors with clear and concise information. In these cases it might be necessary for more than one SP to be provided, with some kind of umbrella document covering all the investments within

the wrapper where possible. Again, these must be concise and easily understandable.

Q8: How far should the information be harmonised between firms and between EU members?

The Panel recognises the potential advantages of reducing fragmentation in the Single Market and the importance of easily comparable product information for consumers. Without detailed knowledge of the operation of retail markets across the EU, however, we find it difficult to comment on the level of harmonisation that would be appropriate, although the standardised or at least consistent presentation of information in the SP is important.

Q9: Would it be useful to specify how this information should be presented?

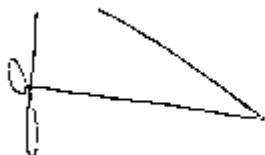
The key to successful presentation lies we believe in the use of plain language and the inclusion of key information only. As explained earlier in this response, there is a need for consistent information across Member States – suggesting a level of prescription – and the overall length of the document must not be too daunting or it will simply not be read. Although it may be difficult to stipulate the exact length, we feel the SP should be no longer than two sides of A4 and, hopefully, considerably shorter.

Q10: In what form should the information be delivered?

As indicated in the questionnaire, much depends on how the investment is purchased. Whatever the form of the information and however it is distributed, it should be readily identifiable as the SP/KII.

Q11: How should we ensure consumers get information in sufficient time for it to be useful for their investment decisions?

Again, the timing will to some extent depend on the channel through which the investment is to be purchased. It is important that the potential investor has time to consider the document and if necessary ask for clarification/further information, before committing themselves to the investment.

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Financial Services Consumer Panel

25 May 2007