

**DISCUSSION PAPER ON THE ROLE OF
INVESTOR EDUCATION
IN THE
EFFECTIVE REGULATION OF CIS AND CIS
OPERATORS**



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Introduction.

In October 1999, IOSCO's Technical Committee approved a mandate for its Standard Committee on Investment Management (TCSC-5) to study the role of investor education in the effective regulation of Collective Investment Schemes ("CIS") and CIS operators. A *Discussion Paper on the Role of investor Education in the Effective Regulation of CIS and CIS Operators* was presented for consideration to the Technical Committee by TCSC-5 during its 19 and 20 March 2001 meeting. Its contents were approved by the Technical Committee and a decision was made to authorize its public release.

Investor education is particularly relevant for CIS because most CIS investors are retail investors, many of whom are not financially sophisticated and could benefit from investor education. At several meetings, TCSC-5 discussed the varied approaches of its member regulators to investor education. Several members prepared written materials generally describing the investor education that they have undertaken in their jurisdictions.

Based on those discussions and written materials, the Technical Committee agrees that investor education assists in the effective regulation of CIS and CIS operators. It further agrees that investor education should complement, rather than substitute for, direct supervision and regulation of the operations of CIS and CIS operators. Technical Committee members' individual approaches to investor education vary widely, however, depending on the degree to which a member's jurisdiction embraces investor education as part of the member's investor protection mandate, and the availability of resources.

This discussion paper seeks to provide a greater understanding of how investor education may assist in the effective regulation of CIS and CIS operators. This paper also details the elements of successful investor education programs that have been employed by some Technical Committee members, and details general principles regarding the establishment and implementation of these programs. This paper, however, does not attempt to set out an investor education program to be implemented by all jurisdictions. The Technical Committee does not believe that regulators must necessarily implement formal investor education programs to achieve their investor protection mandates.

Investor education assists in the effective regulation of CIS and CIS operators, and helps the regulator achieve the goal of investor protection.

As stated in the general principles of securities regulation adopted by IOSCO, one of the key objectives of securities regulation is to protect investors. Technical Committee members seek to protect CIS investors through a number of regulatory techniques, including: (i) by requiring disclosure which is necessary for an investor to evaluate the suitability of a CIS and the value of the investor's interest in the CIS; (ii) by substantively regulating certain of the activities of CIS and their operators; and (iii) by prosecuting CIS and CIS operators who commit fraud or other abuses in the offering and operation of CIS.

The Technical Committee agrees that investor education cannot replace the substantive regulation of the activities of CIS and their operators. Nevertheless, the Technical Committee agrees that investor education assists regulators in protecting investors in a number of ways. As described in more detail below, investor education may enhance investors' understanding of the role of the regulator, provide investors with the tools to protect themselves against fraud (and other abuses) and to assess the risks associated with particular investments, assist the regulator in the enforcement of the securities laws concerning offerings and sales of securities, and maximize the regulator's limited resources. Educated investors also can better choose investments that are the most appropriate for them in light of their individual circumstances, such as age, wealth, income, debt and years to retirement. Investor education has become even more important with the rise in popularity of the internet, which may bring more first-time investors into the securities markets.

The regulator's role. Through investor education, a regulator can explain to the public the regulator's role with respect to CIS and CIS operators. Investor education also can help the public to understand what the regulator can and cannot do for them. For example, some regulators provide information about which CIS or CIS operators have been authorized by the regulator. By making this information available to the public, a regulator allows investors to avoid any problems associated with doing business with an unauthorized CIS or CIS operator. At the same time, a regulator can explain to investors what authorization of a CIS or CIS operator in that jurisdiction says about the CIS and CIS operator, and that authorization does not constitute an endorsement by the regulator of their services.

In addition, a regulator may provide investors with information describing certain of the regulatory requirements applicable to CIS and CIS operators, such as the need for a CIS public offering to be made by way of a prospectus. Regulators also may stress to investors the importance of reading and understanding the prospectus before making an investment in any CIS. Investor education also may enable investors to inform the

regulator about the types of disclosure that assist them in making investment decisions, thereby helping the regulator to assess the adequacy of current disclosure standards and raise the standard of prospectus disclosure.

Regulators from around the world may engage in cooperative investor education efforts to focus public attention on the role of the regulator with respect to specific investor protection issues. For example, 21 members of IOSCO recently coordinated their efforts to detect and deter securities violations occurring on the internet, particularly those involving cross-border activity.¹ Many of the regulators agreed to announce to the public the results of their participation in what was titled International Internet Surf Day. Thus, investor education may be enhanced when regulators publicize their enforcement activities.

Tools to assess risk. Investor education provides CIS investors with tools to assess the risks associated with their CIS investments (e.g., investments in foreign CIS). For instance, some Technical Committee members provide information about how to invest wisely, including examples of the types of questions to ask about investment opportunities. Other materials are designed to generally increase financial literacy and may describe particular types of investments, such as CIS. One Technical Committee member (from the United Kingdom) has undertaken regulatory initiatives to provide financial literacy curriculums to be used in workplaces, community groups and schools. Another (from the United States) has worked with industry participants to develop similar curriculums.

In crafting tools to help investors assess risk, regulators must take care to avoid providing investors with specific investment advice. Securities regulators should not recommend the purchase or sale of particular securities by individual investors, nor particular strategies to guide their investment decisions.

In most member jurisdictions, investor education is undertaken in the context of promoting better investor understanding of prospectus disclosure, so that investors can make well-informed investment decisions. An educated investor can better relate the disclosed risks of a CIS to his or her individual financial needs. By helping investors make appropriate investments for themselves, the regulator may avoid a loss of public confidence in the markets.

Watchdog role. Investor education also allows investors to protect themselves against fraud and other abuses. Educated investors can better monitor certain activities of the CIS in which they invest (or in which they are considering an investment) and assist the regulator in spotting abuses. For example, investors who understand the requirements of a CIS offering (such as the requirement for a prospectus) will be able to alert the

¹ As another example, in 1998, the Council of Securities Regulators of the Americas initiated the Facts on Saving and Investing Campaign involving twenty-one countries throughout the Western Hemisphere.

regulator to illegal offerings. Some regulators provide information about how to contact the regulator about complaints with respect to CIS and CIS operators (and other market participants), and how to formulate and file complaints with the regulator. This information helps investors to understand their rights and options in the event of a dispute with a CIS or CIS operator and may assist the regulator in correcting any wrongdoing by the CIS or CIS operator.

Maximize a regulator's limited resources. Investor education may maximize the limited resources of a regulator because investor education usually is proactive rather than reactive (i.e., it seeks to address regulatory problems before they develop).

Many regulators do not have the resources to develop proactive investor education programs. To maximize limited resources, investor education efforts generally should target investors who lack experience or financial sophistication (generally, retail investors). A 'one size fits all' approach, however, may be less effective because CIS investors, even among a class of retail investors, have different levels of experience and financial sophistication. For greater effectiveness, regulators should target different categories of investors, taking into account their needs, experience and accessibility. In addition, regulators may work in partnerships with self-regulatory organizations and industry associations, and encourage other market participants to engage in investor education activities. Such entities have a vested interest in establishing and maintaining investor confidence in the financial markets, and recognize that educating investors can help to achieve that goal. A regulator, however, must give special consideration, when engaging in investor education activities with self-regulatory organizations and industry associations, to avoid even the appearance of endorsing the products or services of any industry participants.

Regulators may consider using the internet to maximize their limited resources when pursuing investor education efforts. The internet provides a cost-effective way of providing investor education information to a large number of investors, as well as to the financial press and other third parties that directly or indirectly are engaged in investor education efforts and activities. For instance, by posting information on its website, a regulator may save the costs of printing and mailing the information.

Specific Investor Education Techniques

Technical Committee members take varied approaches to investor education depending on the degree to which the member embraces investor education as part of its investor protection mandate, and the availability of resources. In some jurisdictions, the regulator has express statutory authority to address investor education. In one jurisdiction (the United Kingdom), the regulator has an express statutory obligation to undertake investor education efforts. In another jurisdiction (Mexico), a separate governmental institution is responsible for providing investor education.

Other jurisdictions do not have express statutory authority to implement investor education programs, although some regulators have engaged in investor education activities as an integral part of their investor protection charters. For instance, in Hong Kong, there is no explicit statutory requirement for the regulator to implement an investor education program, but the regulator has dedicated staff to these efforts since 1996. In some jurisdictions, no specific efforts are undertaken with respect to investor education, although the regulator may enhance investor education through certain of its other regulatory activities. For instance, in Luxembourg, the regulator undertakes investor education efforts indirectly through its efforts to improve prospectus disclosure and through the public dissemination of information about the role of the regulator.

Various Technical Committee members use many of the following techniques when seeking to educate investors.² In general, the techniques correspond to the types of information that the regulator wishes to convey to investors, the types of investors to be educated, and the resources available to the regulator.

- **Consumer publications.** A regulator may prepare written educational materials regarding the role of the regulator, provide tools to appreciate risk, and make available many other kinds of information. These materials may be forwarded to the public on request, by regular mail or through the internet. These materials may be updated to focus on issues that are relevant during a particular period of time.
- **Hot lines and websites.** A regulator may provide the public with a telephone number, or e-mail address, through which the public may directly contact the regulator about, among other things, possible violations of the securities laws, or how to obtain consumer publications. A regulator also may publish investor education information on its website.

² Some jurisdictions offer publications that set forth principles for the use of investor education, as well as ideas on how to implement investor education programs (e.g., Australia, the United Kingdom).

- **Investor alerts.** A regulator may make public announcements regarding issues of particular importance to investors, such as alerts about internet fraud and “cold calling.”³
- **Financial literacy curriculum.** A regulator may design curriculums to enhance the financial literacy of a specific group of people (such as school-age children, or adults nearing retirement age). These curriculums may be used in workplaces, community groups and schools.
- **Town meetings.** A regulator may conduct public meetings in various cities and towns to disseminate investor education information. These meetings usually are preceded by publicity that encourages participation in the meeting by the general public. Regulators may work in conjunction with local governmental bodies and industry associations when conducting town meetings.
- **Specific investing tools.** A regulator may provide investors with specific tools to assist them in making CIS investment decisions. For instance, some regulators have established cost calculators on their websites. A cost calculator allows investors to estimate the costs of investing specified amounts of money in particular CIS by inputting fee and expense information contained in CIS prospectuses.
- **Plain language disclosure documents.** By encouraging or requiring CIS to use plain language in CIS disclosure documents, the regulator may assist the investor in making suitable investments based on an understanding of the risks associated with particular CIS investments.

³ Australia’s 1999 “April Fools’ Day” internet scam website alerted investors to their own susceptibility to internet fraud. The Australian Securities & Investments Commission (“ASIC”) established a scam website offering investors “millennium bug” insurance. More than 200 investors offered to forward money to the operators of the website. ASIC subsequently notified the investors that the website was a scam designed to expose some of the risks of internet fraud.

General principles.

Technical Committee members identified the following general principles for the establishment and implementation of investor education programs, particularly as they relate to CIS. The Technical Committee based these principles on the varied experience of its members in undertaking investor education.

- Investor education assists regulators in achieving the goal of protecting investors.
- Investor education cannot replace direct supervision of CIS and CIS operators.
- Investor education can take many forms, depending on the specific goal of the regulator, the types of CIS and the experience and sophistication of the investors, and the resources available to the regulator.
- A ‘one size fits all’ approach to investor education programs may be less effective because CIS investors, even among a class of retail investors, have different levels of experience and financial sophistication.
- Regulators should not provide investment advice to the public. When regulators engage in investor education activities, care must be given to distinguish investment advice from investor education.
- Regulators must remain independent of the market participants that they supervise. When regulators engage in investor education activities with market participants, care must be given to avoid even the appearance of endorsing the products or services of any market participants.