

**Investor Disclosure and Informed Decisions:
Use of Simplified Prospectuses by
Collective Investment Schemes**



OICU-IOSCO

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1. In March 2001, the Technical Committee of IOSCO confirmed that investor education assists in effectively regulating collective investment schemes (CIS or mutual funds) and CIS operators and helps CIS regulators achieve the goal of investor protection.¹ The Technical Committee also noted that CIS regulators seek to protect investors through a number of regulatory techniques, including requiring disclosure necessary for an investor to evaluate the suitability of a CIS and the value of the investor's interest in the CIS. Among other initiatives, investor education can be undertaken in the context of promoting investor understanding of prospectus disclosure, so that investors can make informed investment decisions.
2. Pursuant to a mandate given by the Technical Committee, the Technical Committee Standing Committee on Investment Management (TCSC-5) examined how CIS regulators can facilitate informed investor decision-making through prospectus simplification initiatives. Requirements for simpler prospectuses encourage CIS industry participants to pay increased attention to clearly informing CIS investors about their investments.
3. This paper explores key themes arising out of this work in relation to simplified prospectuses and outlines the common responses to various regulatory issues. TCSC-5 members described their prospectus requirements in responses to a questionnaire circulated in February 2001. A copy of the questionnaire and the key themes developed from responses to it are outlined in an appendix to this paper.

Background

4. In this paper, the Technical Committee wishes to build on the investor education paper and also on the guidelines for disclosure documents contained in its July 1995 publication entitled "*Principles for the Regulation of Collective Investment Schemes and Explanatory Memorandum*" and in the 1998 IOSCO publication entitled "*IOSCO Objectives and Principles of Securities Regulation*."² Principle 10 of the 1995 *Principles* reads, in part, as follows:

The regulatory regime must impose a disclosure requirement to ensure that there is full, accurate and timely disclosure to prospective investors providing all the information necessary to an investor to make an informed decision in relation to a CIS.... A CIS prospectus

¹ "*Discussion Paper on the Role of Investor Education in the Effective Regulation of CIS and CIS Operators*" Report of the Technical Committee of the International Organization of Securities Commissions, March 2001 (the investor education paper).

² The 1995 *Principles* were incorporated into the 1998 "*IOSCO Objectives and Principles of Securities Regulation*." Principle 10.4 of the 1998 *Principles* contemplates the distribution of short form, profile or introductory documents. The 1998 *Principles* state that regardless of the type of disclosure document provided to investors, it is essential that investors should be provided with the information necessary to make informed investment decisions on an ongoing basis. The principle of full, timely and accurate disclosure of current and reliable information material to investment decisions is directly related to the objectives of investor protection and fair, efficient and transparent markets.

must include all material information which investors would reasonably require and reasonably expect to find to make an informed investment decision. A prospectus must not contain information that is false or misleading.

Principle 10 and the Explanatory Memorandum outline certain minimum content requirements, but do not focus on how this information could be provided to investors in an easily understandable format.

5. Since 1995, many members of the Technical Committee have worked with their CIS industry to achieve prospectus simplification. Some regulators have done this through regulations requiring CIS to prepare prospectus documents that are easy to read and understand and some have allowed CIS to prepare simpler “short form” versions of prospectuses, in addition to the more complete prospectus documents. These “short form” offer documents are known variously as fund profiles, key features documents or simplified prospectuses.³

For the purposes of this paper, the term “simplified prospectus” is used to generically refer to any kind of CIS prospectus document that is either required or permitted to be written in an easy to read format and includes a simpler “short form” offer document.

Generally, CIS regulators working towards prospectus simplification have sought to have CIS prospectus documents outline the schemes’ key information in an accessible format and in plain language—often in sharp contrast to the technical information provided by the schemes’ rules or in full prospectuses.

The Purpose of Simplified Prospectuses

6. Much of the domestic regulation relating to simplified prospectuses is designed to ensure that these documents are clear, concise, understandable and well-organized and contain the most important information that an investor would consider in making an investment decision. Investors should be encouraged to read and consider the contents of a simplified prospectus through the application of plain language principles and concise and standardized formats.
7. Efficient and concise prospectus disclosure of pertinent information by a CIS to investors is linked directly with investor protection and is indirectly associated with investor education. CIS regulators, in requiring CIS to provide disclosure in a standardized and simplified format, aim to ensure investors can achieve an appropriate understanding of their proposed investment, including their rights and the relationship between risk and return for that CIS investment. Through simplified disclosure, investors can also better compare their investment options, particularly

³ For example, the United Kingdom allows a CIS to prepare a key features document, the United States permits fund profiles, which are prepared along with a simplified prospectus and other disclosure documents and Canada requires preparation of a simplified prospectus along with other disclosure documents. Australia, Hong Kong and Japan allow simplified offer documents to be delivered to investors. Directive 2001/107/EU of the European Parliament and of the Council of 21 January 2002 (the 2002 UCITS Directive) specifically allows a simplified prospectus for undertakings for collective investments in transferable securities (UCITS). The 2002 UCITS Directive asserts that such a simplified prospectus should be designed to be investor-friendly, but that investors should be told that a full prospectus is available, free of charge.

when information about CIS in the same family of CIS is provided in a standardized format together in one document. Investors need tools to evaluate whether a particular CIS is an appropriate investment for them and the level of risk to which they may be exposed. Disclosure documents that clearly and concisely state information that investors should consider when they make investment decisions can lead to more informed decision-making by those investors.

8. CIS regulators generally see a continued need for prospectuses for sales of CIS interests—simplified prospectuses may not be a substitute for the preparation and availability of a full prospectus or additional information about the CIS. However, efforts to simplify CIS prospectuses have resulted in simpler, more effective and more concise prospectus disclosure requirements.

Common Regulatory Responses

9. CIS regulators consider the following issues in their work to achieve prospectus simplification:
 - the format of simplified prospectuses versus full prospectuses (or additional information);
 - the content of simplified prospectuses versus the content of full prospectuses (or additional information);
 - the extent to which investors can make decisions based on receiving a simplified prospectus;
 - delivery to investors of a simplified prospectus and the availability of more detailed information;
 - responsibility for delivery of offer documents; and
 - compliance with regulatory requirements and accountability for content of offer documents.
10. CIS regulators may have different techniques of addressing these issues, however certain principles are universally considered important. Where a CIS regulator permits the use of simplified prospectuses, they are generally guided by the principles outlined below.

Prospectus format

11. A simplified prospectus of a CIS should:
 - be in plain language and easy for investors to understand;
 - not be false or misleading; and
 - contain a summary of the key features of the CIS,

so that investors can more easily inform themselves about the CIS and compare their investment options and thereby make an informed judgment about their proposed investment.

Prospectus content

12. A simplified prospectus for a CIS should contain information as is regarded necessary for an investor to make an informed decision about that CIS. For example, information such as:
 - the nature of the CIS, including a brief description of the legal status of the CIS, the date it was established and how long it will continue;
 - CIS objectives, investment strategy or management style or policy, including, if considered relevant, a brief description of the typical investor to which the CIS is targeted;
 - the significant benefits to which an investor in the CIS will or may become entitled, including details about the circumstances and times at which these benefits will or may be provided, and the way these benefits will or may be provided, for example, distributions of capital and income;
 - the significant risks associated with investing in the CIS;
 - the costs, fees and other charges or expenses associated with an investment in or redemption of the CIS, including a brief description of how they are determined and whether they are payable directly by investors or by the CIS;
 - key details about the pricing of CIS interests and how current pricing information may be obtained;
 - the date of issue and expiry (if applicable) of the simplified prospectus;
 - how an investor can ask for a full prospectus or other detailed information about the CIS with an explanation that such information can be obtained free of charge;
 - key details about the CIS operator (including contact information), custodian, auditor and investment manager, including their domicile, their key obligations to investors and their relationship to the CIS operator;
 - in summary form, selected financial information of the CIS—including past;
 - performance of the CIS over various time periods, compared to established and consistent benchmarks;
 - in summary form, the key operating rules of the CIS, including the key investor rights, such as ability to purchase units, redemption rights or cooling off rights;

- significant taxation implications of investing in the CIS key details of dispute resolution arrangements if investors have complaints about the CIS or its operation, including any compensation plans; and
- the name of the relevant regulatory supervisory authority.

CIS regulation generally prescribes how and when the information provided in simplified prospectus should be updated, whether when a material change occurs or on an annual or bi-annual basis.

Investor decision-making

13. Where a simplified prospectus of a CIS is required to be prepared, CIS regulators generally allow investors to apply for interests in the CIS by completion and delivery of an application attached to or accompanying the simplified prospectus.

Delivery requirements

14. At least, a simplified prospectus should be made available to a potential investor in a CIS before the purchase decision is completed. As a matter of best practice, CIS regulators generally consider that simplified prospectuses should be actually delivered to potential investors.⁴ Where an investor has received a simplified prospectus, generally CIS regulators require a CIS to offer to deliver, without charge, more detailed disclosure documents to those investors who ask for them before the conclusion of a purchase decision and afterwards. These more detailed disclosure documents may be a full prospectus, documents containing additional information and annual and semi annual financial reports. Some CIS regulators may also require that certain additional detailed disclosure documents (such as a full prospectus) be delivered in a short time period soon after purchase of a CIS. Simplified prospectuses (and other more detailed disclosure documents) may be provided electronically to investors, with the consent or at request of a prospective investor.

Delivery responsibilities

15. CIS regulators specify the entities that are responsible for ensuring that an investor has received an offer document. That responsibility may lie with the CIS operator, the CIS, the dealer acting on the sale of an interest in the CIS or the underwriter of the CIS.

Compliance and accountability

16. Where the simplified prospectus and additional more detailed disclosure documents (such as a full prospectus) are provided to investors, whether on request or otherwise, all documents must comply with the requirements of the law, including content, format and delivery requirements. CIS regulators hold specified entities to be accountable for the content of the offer documents—including, scheme promoters, the

⁴ The 2002 UCITS Directive requires that a simplified prospectus be always offered free of charge before a purchase is concluded. A full prospectus, along with annual and semi-annual financial statements must also be available free of charge.

person or company making the offer, the directors or trustees of the CIS and the CIS operator. Where a simplified prospectus and a full prospectus (including for these purposes documents containing additional information) exist for one CIS, CIS regulators may clarify the liability of those accountable for the contents of those documents. One technique clarifies that the liability for each type of document is based purely on the content requirements for that particular document. In the United States, however, liability for each type of document may arise even if the document complies with the content requirements, if the document nonetheless is materially misleading. Some other CIS regulators provide that those accountable for the simplified prospectus are accountable to investors to the same extent as if the contents of the full prospectus were included in the simplified prospectus.

Conclusion

17. Technical Committee members seek to achieve two important regulatory objectives through prospectus simplification:
 - better educated investors who make more informed decisions on CIS investments; and
 - CIS industry participants who focus on the importance of plainly informing investors about their CIS investment options.

With prospectus simplification initiatives, CIS regulators can ensure prospectuses continue to be effective tools to achieve protection for investors who are deciding to invest in CIS. The principles outlined in this paper are intended to further these initiatives.

Appendix
Summary of Responses to Questionnaire on Prospectus Simplification
Key Features of Simplified Prospectuses

TCSC-5 members answered a questionnaire on their regulation of CIS disclosure documents in February 2001. A copy of the questionnaire is reproduced at the end of this Appendix. The following is a summary of the responses to that questionnaire.

General offer document requirements — Most TCSC-5 members (apart from Germany, Switzerland, Italy, Mexico and the Netherlands) have provisions for short form offer documents. Generally, these simplified prospectuses are not a substitute for preparation and availability of a full prospectus. The full prospectus must be available if requested. Italy's laws require a full prospectus be provided to investors, although this document is required to be written in a user friendly style. Italy's regulation requires the prospectus to be clear enough for an investor to be able to make an informed assessment of the securities offered, but at the same time, requires CIS operators to prepare the prospectus in accordance with specific model forms, and in plain language. Some countries, such as Italy and Sweden, encourage CIS to include information about all CIS in a fund family in one prospectus document to facilitate comparisons of investment options. The Netherlands expects to implement a simplified prospectus regime in 2002 for CIS, as well as for other financial products. Mexico does not provide for simplified prospectuses and allows investors to negotiate with dealers for delivery of a full prospectus about a CIS.

Content requirements — About half of the TCSC-5 members stated that their law requires prescribed prospectus content. The other half applies some sort of general disclosure test. Of those jurisdictions that require prescribed information, some (for example, Hong Kong) also provide for a general disclosure test that the prospectus must be clear enough so that an investor can make an informed decision.

Requirements on language; order of information and formatting — While some TCSC-5 members (for example, Australia) do not prescribe requirements for prospectus content, their laws have a general test that prospectuses must contain enough information so that they are not misleading. Other jurisdictions vary on the amount of detail prescribed - but most state that the offer document must be in plain language.

Paramount disclosure items — Disclosure about benefits, risks and costs are generally accepted as paramount by members of TCSC-5. Some members, such as France and Germany go further to consider that the legal status of the CIS, its structure, its financial characteristics and operating rules are also important. Italy considers as important benchmarks consistent with CIS risks. Disclosure requirements on benchmarks are designed both to enhance a full, accurate and timely disclosure to prospective investors and to permit them (and regulators) to properly evaluate CIS performance.

Availability of other information — Where simplified disclosure documents are used, most jurisdictions require that a more detailed disclosure document be either delivered or made available for investors. This detailed disclosure document can be in the form of additional information (for example, in Canada) or a full disclosure document (for example, in the United States, Hong Kong, Australia and some European jurisdictions). All TCSC-5 members consider that financial information, that is, semi annual or annual financial reports, must be made available to investors by the CIS. Quarterly reports are often available as well.

In the United Kingdom and the United States, half year and full year accounts must be sent to all investors. In Mexico, in addition to financial reports, CIS are required to publish financial statements in nationwide newspapers on a quarterly and yearly basis, and make available weekly reports on their portfolio composites at the CIS operator's office.

Accountability for contents of offer documents — In general, promoters of CIS, the persons or companies offering the CIS, the directors or trustees of the CIS or the CIS operators are accountable for the contents of the offer document. Most TCSC-5 members do not differentiate between the simplified offer document and a full prospectus when determining accountability.

Relationship between the offer documents — Those TCSC-5 members that permit a simplified and a full prospectus require that both versions comply with the law. Persons accountable for prospectus content are liable when the two documents are inconsistent.

Delivery to investors — TCSC-5 members differ in their delivery requirements. Some members require delivery of the offer document to investors before purchase (Hong Kong), while others require that the offer document, the latest annual report and any subsequent published half-yearly report must be offered to investors before purchase (Luxembourg). Japan and Italy require the full prospectus to be delivered before a purchase can be completed. Canada requires that a simplified prospectus be provided to investors not before purchase, but within two business days of a trade (with time limited rights given to investors to withdraw from the purchase after receiving the prospectus).

Cooling off — In a number of jurisdictions, investors do not have a cooling off period following a purchase of a CIS interest. Canada allows investors to withdraw from their mutual fund purchase if they do so within two days of receiving the prospectus. Investors will receive a refund, plus any sales charges paid. Germany and Italy have similar provisions (but for 14 and 7 days, respectively) where the units were sold to investors door-to-door (or, in the case of Italy, also through the Internet). In the United Kingdom, investors have a right to cancel a purchase if exercised within 14 days from the confirmation of purchase. In Australia, legislative changes made in March 2002 introduced provisions giving retail investors a 14 day cooling off period.

Responsibility for ensuring that an investor has received an offer document — Some TCSC-5 members, including Spain and Switzerland, require that the CIS operator ensure investors receive offer documents. In Canada and Hong Kong, the dealer acting on the trade is generally responsible for delivery of the offer document to the investor. In the United States and Japan, the CIS, the underwriters of the CIS, and dealers who sell CIS securities are responsible for delivering documents to investors. In Australia, a CIS operator is prohibited from acting on an application unless the application form is from the current offer document. This results in the CIS operator having in place suitable control mechanisms (eg. certifications, dating of forms etc.) to ensure it can act on an application form.

Electronic delivery of offer documents — Generally, electronic provision of offer documents is permitted. Canada, the United Kingdom and Luxembourg require that investors must give prior consent before electronic delivery of offer documents. In the United States, for effective delivery, the SEC has interpreted its prospectus delivery requirements to require (i) notice to investors that information for them is available, (ii) access (that is comparable to paper delivery) and (iii) evidence to show delivery (which can be shown, for example, by

informed consent). Japan has detailed rules in relation to evidence that the customer has consented to electronic delivery. In Italy, purchases can be effected “by other equivalent procedures” specified in the prospectus, as long as the law does not require contracts to be reduced to writing. However, the transmission of the offer document (including the prospectus) must permit the addressee to store the documents on a permanent medium.

Risk disclosure — All TCSC-5 members require that offer documents contain risk disclosure, but the form of disclosure varies. For example, in Australia, the law does not prescribe the form of risk disclosure; in France, specified risk related information must be disclosed; and in the United States and Canada, narrative information about risk is required. In certain jurisdictions such as Germany, past performance information is allowed provided there is a warning that it is no indication of future performance. Italy requires complete disclosure of past performance made by CIS operators. Performance must be calculated in a manner consistent with the benchmark valuation. Hong Kong and Luxembourg allow disclosure by way of standard risk measurement, provided it can be substantiated and is not misleading. In the United States, a standard risk measurement is not permitted to be included in the fund profile—one can be provided in the prospectus so long as it is not misleading and does not impede the understanding of the information that is required to be included. Portugal is the only Standing Committee member that presently requires disclosure of risks by way of a standard deviation, that is a numeric risk measurement, although it also and primarily asks for qualitative explanations of risk. Spain requires standard deviation in its quarterly reports. Many jurisdictions allow past performance information to be given, primarily as an indication to consumers as to the past volatility of the fund (and as the case in Hong Kong, providing advertising rules are complied with and statements about inherent difficulties in relying on past performance in making purchasing decisions).

Specific risk disclosure requirements — Most jurisdictions (apart from Australia – where there is a general disclosure requirement), require specific risk disclosure about the CIS investments. In Germany, the prospectus must contain an explanation of special risks involved. The United States requires disclosure of the principal risks of investing in a CIS, including those to which the CIS’s portfolio as a whole is subject, and the circumstances reasonably likely to adversely affect net asset value, yield or total return. For example, whether a CIS’s use of derivatives would need to be disclosed would depend on whether the strategy poses the risk of substantial gains or losses for the CIS.

Role of the regulator — The role of the regulator in relation to simplified prospectuses varies greatly, and generally depends on the legal status given to the simplified prospectus. In Hong Kong, the simplified offer document is pre-vetted and approved by the regulator. Canadian regulators selectively vet disclosure documents. In Australia, disclosure documents are not prevetted. Australian legislation that commenced in March 2002 requires disclosure documents for some CIS products to be lodged. For the other CIS products, the legislation only requires lodgement of a notice that a disclosure document is in use. In Germany, as the simplified prospectus is considered as advertising only, the regulator’s role is limited to preventing misleading advertising and checking that there is a reference to the official prospectus. In the UK, the regulator must approve all CIS prospectuses and allow the scheme to be authorized. Key features documents are not filed with the regulator, but are subject to routine, and surprise, surveillance by the regulator.

Consumer and other continuing research — Consumer research on reaction to simplified prospectus (and prospectuses, more generally) has been carried out in Australia, Canada, the

United States, the United Kingdom and the Netherlands. Regulators in the United Kingdom, Australia, the Netherlands and Hong Kong are presently reviewing their disclosure requirements. The 2002 UCITS Directive on simplified prospectuses is an example of continuing and recent regulatory work in this field.