ICSA
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Kim Allen
International Organization of Securities Commissions
Calle Oquendo 12
Madrid 28006 Spain

RE: IOSCO's Issues Paper on POS Disclosure to Retail Investors

Dear Ms. Allen,

The members of ICSA's Working Group on Retail Investors are pleased to respond to the Technical Committee's issues paper on point of sale disclosures to retail investors related to collective investment schemes and similar products.[1] ICSA members are extremely appreciative and supportive of the work done by IOSCO's Technical Committee and Secretariat to develop a structured dialogue with industry participants. We see the invitation to comment on the issues paper regarding point of sale disclosures to retail investors (hereafter referred to as the Issues Paper) as an important part of that dialogue as it allows market participants the opportunity to comment on an aspect of IOSCO's work at a very early and preliminary stage.

We would like to compliment the members of Standing Committees 3 and 5 for the important contribution that they have made in summarizing the current research related to disclosure for retail investors and outlining some of the issues involved in developing global standards for disclosure requirements. We would note that the Standing Committees have also identified some of the basic elements that would need to be included in global standards for disclosure requirements. Specifically, the Issues Paper suggests that in order to be effective, regulators would need to ensure that disclosure documents:

a. Provide key information about CIS products, including information about the fund's objectives and investment strategies, potential returns or past performance, risks, costs, and conflicts of interest (including conflicts arising within the fund management and those affecting the distributor or intermediary);

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[1] ICSA is composed of the self-regulatory organizations and trade associations that represent and/or regulate the securities industry in the world's major financial markets. For a list of ICSA members and activities, see www.icsa.bz

b. Where relevant, provide information about the intermediary services being offered in relation to the distribution of CIS products;

c. Are written in a way that investors can easily read and understand;

d. Are in an easily accessible and comparable format; and,

e. Are provided either when retail investors are making their investment decision and/or in a layered manner (i.e., a simplified disclosure is provided first followed by a more detailed disclosure).[2]

The members of ICSA's Working Group on Retail Investors agree that all of the elements listed above would be critical for any set of international principles regarding disclosure requirements for retail investors. However, as is abundantly clear from the Issues Paper itself, regulators in a number of jurisdictions are still experimenting in order to discover the best processes for ensuring that disclosure requirements actually help to reduce the information asymmetry that is inherent in the relationship between retail investors and the financial services industry. In light of the very different approaches that have been taken by regulators in various jurisdictions, we strongly agree with the statement in the Issues Paper to the effect that any set of global principles for disclosure requirements, "…would need to be 'high level' in order to reflect fairly these differences and to achieve consensus".[3]

In addition, we would suggest that any international standards for disclosure requirements should be set within a framework based on principles of better regulation. Such a framework would require, for example, that regulators first determined that a significant market failure existed and that they consider the full range of possible policy responses to that market failure, including but not limited to new or revised disclosure requirements.[4]

These are both important issues since, as the Issues Paper notes, disclosure requirements are usually seen as necessary because of two types of market failure: (1) information asymmetries between retail investors and financial intermediaries; and (2) possible conflicts of interest between the interests of the investor and the financial intermediary that works with the investor. In both cases disclosure obligations would help to ensure that investors received the information they would reasonably require in order to make informed investment decisions. However, disclosure requirements are only effective if investors are able to adequately understand the information that is disclosed. For that reason, we believe that individual regulators need first to determine the extent to which there is a significant market failure regarding information asymmetries and conflicts of interest at financial intermediaries in their jurisdiction. If a market failure does exist, regulators then need to determine the most appropriate way to address the problem.

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[2] See IOSCO *Point of Sale Disclosure: Issues Paper* (May 2008), page 9.
[3] Ibid., page 20.
[4] For a more comprehensive discussion, see ICSA *Principles for Better Regulation* (2006), at: http://www.icsa.bz/html/statements_and_letters.html

Consequently, we strongly support the suggestion in the Issues Paper to the effect that regulators should understand the needs and abilities of retail investors in their jurisdictions and adjust disclosure documents as necessary in order to ensure that those documents are as appropriate as possible for the intended audience.[5] This would mean, as the Issues Paper also notes, that regulators should, "…consider what, if any, testing…might be done to help establish how well investors understand current disclosure and compare that to how well they understand and will react to any new/improved disclosure requirements".[6] ICSA members agree strongly with both of these suggestions and think that they should be incorporated into any global standards for disclosure requirements.

We would also suggest that any global standards for disclosure requirements would require that regulators employ rigorous analysis, using cost-benefit techniques to the extent possible, in order to determine whether the expected benefits of new or revised disclosure requirements exceeded the costs of those requirements. We were gratified to see that the Issues Paper included a discussion of how regulators might measure the costs and benefits of any revised or new point of sale disclosure requirements.[7] Since any new or revised regulation imposes a cost, we would suggest that the use of cost-benefit analysis would need to be incorporated into any global standards for disclosure requirements in order to ensure that the new or revised disclosure requirements do not unnecessarily distort incentives to financial intermediaries and to retail investors.

In addition, we would suggest that any global standards for disclosure requirements should require that those requirements should be reviewed from time to time in order to examine whether they and the market failure to which they were initially directed are still relevant and whether existing disclosure requirements should be amended, simplified or abolished. This is an important issue since it is quite possible that regulators would discover that the needs and abilities of retail investors in their jurisdiction had changed over time, thereby necessitating changes in disclosure requirements for those investors. It is also important for regulators to check periodically to determine if their redesigned disclosure document has expanded over time in response to additional requirements until it resembled the document it was intended to replace.

We would also suggest that any global standards for disclosure requirements should encourage regulators to design their disclosure requirements in a way that would take advantage of the most advanced technology possible. For example, regulators in a number of jurisdictions are promoting the use of a new technique known as "extensible business reporting language" (XBRL) to improve disclosure to retail investors.[8] XBRL provides a number of advantages to

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[5] See IOSCO *Point of Sale Disclosure: Issues Paper* (May 2008), page 10.
[6] Ibid., page 12.
[7] Ibid., page 14.

investors without increasing the regulatory burden for issuers and intermediaries.

Finally, we would note that there are a number of issues that we think need to be better understood before global principles for disclosure requirements could be fully developed. For example, as mentioned in the Issues Paper, it would be important to have a better understanding of how important it would be to have consistency between disclosure requirements for CIS products and disclosure requirements for other types of financial products. Obviously regulators would want to avoid a situation where, for example, imposing disclosure requirements on CIS products would disadvantage those products relative to other financial instruments that did not have similar disclosure requirements.[9]

We would also suggest that it would be important to have a better understanding of the elements needed for effective disclosures by financial market intermediaries and whether or not it is possible to develop global standards for those types of disclosures. As the Issues Paper points out, although regulators in a broad range of jurisdictions require disclosures for specific financial products, "…disclosures that relate to the services being offered by intermediaries are less common. Where such disclosures exist, the requirements are often less detailed."[10] This suggests that it may be difficult to reach consensus on global standards for disclosure by financial market intermediaries, since such disclosures are currently not required in most jurisdictions.

If, on the other hand, IOSCO does develop global standards for disclosures by financial market intermediaries, we would suggest that all of the elements noted above for product disclosure standards – such as the need to determine whether or not a market failure exists, to consider the full range of possible policy responses, to undertake rigorous cost-benefit analysis and to review existing disclosure requirements from time to time in order to examine whether they and the market failure to which they were initially directed were still relevant – should also be part of those standards

On a broader level, the members of ICSA's Working Group on Retail Investors would also encourage IOSCO to promote measures that would improve retail investors' ability to understand and utilize financial information and to encourage its members to do the same. Increased attention to financial literacy and investor education will not fully eliminate the information asymmetry that

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8 XBRL, an XML-based language for the electronic communication of business and financial information which makes it easier for companies to share information with each other, with investors and with financial analysts across all software formats and technologies, including the Internet, is gaining momentum around the world as a business reporting language that has the potential for efficient analysis and sharing of financial information.

9 For example, the Issues Paper cites the experience of Australia, where a single disclosure regime for all such products was adopted in 1981. As a consequence, there is a relatively level playing field between CIS and CIS-like products in Australia. This would not be the case in other jurisdictions, however, where the regulator might not be able to impose the same disclosure requirement on CIS-like financial products.

10 See IOSCO *Point of Sale Disclosure: Issues Paper* (May 2008), page 15.

is faced by retail investors. However, we would suggest that such programs are a necessary complement to any measures to develop or revise disclosure standards, as they will help investors to better utilize the information that is available to them. Developing or participating in financial literacy and/or investor education programs will also help the regulator to better understand the needs and abilities of retail investors in their jurisdiction.

This is an area where regulators and the industry can beneficially work together, as it is in the interest of both that consumers are able to obtain the understanding, skills and knowledge necessary for them to become informed investors. Because of the importance of this issue, ICSA issued a set of *Principles and Best Practices for Investor Education* in early 2004 which set out high level principles for investor education programs.[11] ICSA subsequently contributed resources to the development of a separate organization, the International Forum for Investor Education (IFIE), whose primary objective is to improve investor education on a worldwide basis so that consumers in all jurisdictions are able to make informed choices about financial products and investments.

We are well aware that IOSCO has already co-sponsored one conference with IFIE and will be co-sponsoring another conference with IFIE in early 2009. We strongly support that initiative. In addition, ICSA members would encourage IOSCO to publicize and promote 'best practices' among its members for financial literacy programs in general, and investor education programs in particular. These best practices could be taken from the extensive financial literacy and investor education programs that are already being promoted by IOSCO members and the industry in a number of jurisdictions.

In closing, we would once again like to thank you for the opportunity to comment on the Issues Paper. Please do not hesitate to contact Paul Bourque (pbourque@iiroc.ca) and Marilyn Skiles (mskiles@sifma.org) to discuss any of the issues contained in this letter.

Best regards,

Paul Bourque, Chairman
ICSA Working Group on Retail Investors
and Executive Vice-President, Investment
Industry Regulatory Organization of Canada

Marilyn Skiles, Secretary General
International Council of
Securities Associations (ICSA)

[11] See ICSA *Principles and Best Practices for Investor Education* (2004) at: http://www.icsa.bz/html/statements_and_letters.html