THE INVESTMENT ASSOCIATION

FUND COMMUNICATION GUIDANCE

Clarity of language in fund documentation: fund objectives and investment policy

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The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL

www.theinvestmentassociation.org

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CONTENTS

PURPOSE OF THE GUIDANCE

In June 2017, the FCA published the Asset Management Market Study Final Report (MS15/2.3) ('Final Report'). This Report highlighted, among other points, the difficulty for customers of knowing what to expect from their fund and how to assess whether or not it was performing against its stated objectives. In particular, the Final Report (paragraph 12.13) made the following points:

- **Customers could benefit from greater clarity as well as being better able to compare objectives between similar funds.**
- **Firms should continue work to ensure that all fund documentation and client communications are fair, clear and not misleading.**
- **Firms should consider fund naming conventions and the language they use to avoid misleading customers.**
- **It would be helpful if all funds set out a suggested investment timeframe (as required by the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation).**
- **Explicit and implied benchmarks must be disclosed but not all funds have to have a benchmark.**

As flagged in the Final Report, the FCA set up the Fund Objectives Working Group (FOWG), which was tasked with proposing measures on:

- How to improve the usefulness of fund objectives for customers; and
- How to facilitate the comparability of funds on the basis of their stated objectives.

This work stream resulted in the FCA consultation paper CP18/9 addressing both guidance around fund objectives and rules for the use and reporting of benchmarks. Following this consultation, the FCA issued non-Handbook Guidance in Policy Statement PS19/4 on the description of fund objectives and investment policies.

In parallel, it was agreed that the IA would work with consumer representatives and, informed by consumer testing (more information in Annex 2), it would promote the use of consistent terminology in communications from fund managers about their funds to help customers make comparisons across different funds.

HOW TO READ THIS DOCUMENT

The purpose of this document is to help members implement clearer and more consistent customer communications, focusing on the objectives and investment policy of a fund. The material is intended to assist members in two ways:

- Provide practical guidance in implementing clearer communications. This has been informed by consumer research, designed and undertaken by The Wisdom Council, and by extensive discussion within an Investor Communications Working Group set up by the IA, comprised of IA members and consumer representatives. Overall, the document provides a guide for IA members on how to explain certain concepts while avoiding or explaining language that research has shown retail customers find difficult and focusing instead on the things customers want to know about. The aim is to promote the use of more consistent terminology in communications from fund managers about their funds.
- Provide a reference point with respect to evolving regulatory expectations in this area (Annex 1).

As with similar documents issued by the IA, the Guidance is not mandatory but sets out ways in which members can address industry-wide issues on the basis of a common framework. The IA views this Guidance as a starting point in helping firms deliver consistent language in fund documentation. This Guidance will be kept under review and may evolve further following future consumer testing exercises.

CONTEXT

While this Guidance aims to promote the use of clear and consistent language when writing fund objectives and the investment policy of a fund, there are a number of overarching key points that need to be considered as overall context:

1. ***A focus on mindset, rather than compliance.*** Firms should not view the development of fund documentation content as solely an exercise in compliance, but also actively seek to always speak to customers in language they will understand and address the most important issues for them. This principle should inform the creation, design and approval stages of documentation.

2. ***An IA framework for support not prescription.*** There are no right answers in how communication should be developed, and it is not our intention to place any constraints on how firms communicate. The underlying goal for the IA is to provide a framework to help firms start thinking differently and more consistently about their use of language.

3. ***All fund communication in scope.*** As the FCA wants to see improvements both in regulated material and in marketing communications, this Guidance is to be used when developing both regulatory and non-regulatory literature, e.g. both Key Investor Information Documents (KIIDs)/ Key Information Documents (KIDs) and fund factsheets. Furthermore, our consumer research has shown that the 'how' as opposed to the 'what' can be as important as the information itself. While this Guidance does not extend to the use of different communication channels and technologies, firms are encouraged to consider this.

4. ***Balance between concision and simplicity.*** There is clearly a challenge in striking the right balance between being succinct in fund disclosure documentation and avoiding jargon or technical terms that are designed to describe a concept in a concise manner. In this Guidance, we try to find a balance between the two.

5. ***Responsibility throughout the distribution chain.*** Clear disclosure and good customer information is a responsibility throughout the retail distribution chain. This is particularly relevant given the significant involvement of other players, both platforms and advisers, in the retail sales process. Many firms are producing literature for the same products across multiple jurisdictions which raises issues of how to ensure consistency while recognising that different jurisdictions may also have different norms and expectations. This Guidance can apply to all customers, advised as well as non-advised, although it may be more important in the context of retail customers making their own investment decisions. The consumer testing showed that both advised and non-advised customers experienced difficulties with terminology, although the issue was generally more pronounced in the non-advised market, with the notable exception of experienced execution-only customers.

6. ***Importance of testing.*** Our work has been informed by consumer testing, in collaboration with The Wisdom Council, which gives an insight into what customers understand and how they would like things explained to them (more detail in Annex 2). The testing explored how customers interact with the fund industry and aimed to explore how best to engage them in the key documentation. In particular, the testing explored clarity of language in objectives, policy and strategy as well as customer expectations regarding performance reporting, risk and time horizons.

Clearly there are many other types of information (for example on Socially Responsible Investment) that can be found in fund documentation, which has not been explored in this phase of consumer testing. Also, some of the areas explored in the testing, for example describing the use of derivatives, would benefit from more detailed research, in order to explore how best to describe them.

For these reasons, the IA views this Guidance as a starting point in helping firms deliver consistent language in fund documentation and it will be kept under review and amended following future IA-led consumer testing exercises.

IA GUIDANCE

The Guidance is split into two parts:

- **Part 1** examines a number of key regulatory disclosure components. The aim is to reflect IA interpretation of the relevant legislative provisions.
- **Part 2** aims to reflect the findings from the consumer research, in particular, what it tells us about customer understanding. It also considers the thought process firms should go through when writing for retail customers. Part 2 also lists some examples of words and phrases some customers struggle with and suggests how to make these clearer.

Breakout boxes show details of results from the consumer testing carried out by The Wisdom Council. An overall summary of key messages is set out below.

KEY MESSAGES FROM CONSUMER TESTING

Accessibility and setting tone

- Pay close attention to what may constitute 'jargon' and try to minimize this as far as possible.
- Customers want information to be more accessible on provider websites and as up-to-date as possible, particularly execution-only customers who may also look for more accessible data than what is included in PDF attachments to manage their own spreadsheets.

Concision and precision

- Short simple explanations can aid understanding. Regardless of knowledge base, many customers can be confused by too much detail, particularly if new technical terms are introduced.
- Customers prefer precise rather than vague terms, for example, 'acceptably low' or 'predominantly' are not very helpful without qualification.
- Percentages are helpful but ideally would add up to 100%, for example where allocations are broken down. It is recognised that this will not always be possible, for example where investment limits are being set out.

Importance of narrative

- Coherent and well-articulated narrative goes a long way to helping customers understand what they are buying.

Role of layout

- Although there are constraints on the layout of the KIID and the KID, there are still improvements that can be made to layout, for example using bullets and section headers in bold to signpost details and aid comprehension.

PART 1
KEY DISCLOSURE COMPONENTS

CURRENT DISCLOSURE REQUIREMENTS

The current regulatory landscape is explored in detail in Annex 1 of this Guidance and aims to help firms navigate the relevant legislative provisions. We have distilled key messages from regulation in the table below.

KEY MESSAGES FROM REGULATION
Managers should set clear objectives so customers know what to expect from their fund.
The language used to describe fund objectives should be clear, succinct and comprehensible to retail customers.
Although the KIID/KID must be consistent with the prospectus, the language used in KIIDs/KIDs and other material does not need to mirror that in the prospectus.
In most cases, KIIDs should include a description of the investment strategy (in addition to the objectives and policy).
Key information disclosure should aid comparison between different funds.
Managers need to consider whether they should provide information in these documents which goes beyond what is stated in the prospectus.
Firms must disclose in the prospectus and the KIID whether the fund is managed in a way that includes or implies reference to a benchmark.

WHAT ARE FUND OBJECTIVES?

The description of a fund's objectives should set out what the fund is trying to achieve, for example, whether it is aiming to provide growth of the fund, income from the fund, or a combination of the two. Any additional detail, for example how much income the fund is aiming to achieve, should also be mentioned. There are other specific requirements, e.g. funds that aim to track an index must state in their objective that this is what they are doing.

In a broad sense, KIIDs should explain to a customer the aims of a fund and how the manager intends to achieve those aims. There is a requirement for the KIID to be consistent with the prospectus. However, as per Article 7(1) of the Key Investor Information (KII) Regulation and FCA views in CP18/9 (para. 3.17), consistency does not have to mean identical language between the prospectus and other key information documents. KIIDs (and KIDs) are required to be written in customer-friendly language in order to help inform customers and help them compare investment products.

WHAT IS THE INVESTMENT POLICY OF A FUND?

The investment policy sets out how the manager intends to achieve the objectives.

While the objective sets out what the manager is trying to achieve, the investment policy should describe the broad parameters of the approach towards delivering the objective. Typically, this will describe the type of investments the manager will invest in and any geographical or industry sectors that the fund will focus on.

WHERE DOES INVESTMENT STRATEGY FIT IN?

The investment strategy describes how the fund manager will approach the task of managing the fund within the confines set out in the policy.

For example, if it is not the manager's strategy to invest in a particular area where the investment policy permits investment, this should be made clear. Or, if it is the manager's strategy to make specific use of one of the investment powers, e.g. around the use of derivatives, this should be made clear. It is not necessary to set out investment policy and strategy under separate headings. But the FCA has stated in PS19/4 that it would generally expect a KIID to include information about the investment strategy, so information about the strategy should be included where necessary, even if it is not specifically labelled as such. Including such information in the KIID will require the KIID to be updated as and when the strategy changes.

DESCRIBING RISK IN FUND DOCUMENTATION

KEY MESSAGES
Explain why a risk is being taken so customers get a balanced understanding.
Explain the nature and implications of each risk for the customer.

The KII and PRIIPs Regulations each set out in a prescriptive manner how risk should be explained to customers and there is limited leeway for managers to supplement what is required with additional detail.

Fund managers have the ability in marketing material to help explain the link between risk and reward and how volatility impacts a fund, although this must not detract from any risk warning.

Consumer testing findings

- *Risk means different things to different people, regardless of the knowledge base of the customer. When asked about the key decision drivers when selecting a fund, 54% of fund investors in our research ranked the level of risk associated with a fund as the most important factor in helping them make a decision when selecting a fund. At the same time, research also shows that the link between risk and reward is not well understood and customers tend to think of risk largely in negative terms.*

- *Customers prefer a written explanation of how risk affects their fund rather than simplistic rankings alone.*

Hence, it is likely to be useful to include in fund factsheets and other marketing material:

- A clear description of the risks the fund manager is taking

- If and how these risks are mitigated and the possible impact over time, set in the context of what the manager is trying to achieve.

Where there is sufficient space to do so (not always the case for KIIDs/KIDs), different risks can be split out and described separately, e.g. market risk, currency risk, counterparty risk etc.

The relationship between risk and reward can be explained in documents such as fund factsheets and this might be particularly helpful to customers trying to understand why the fund may have experienced periods of poor performance. It is important that reasons for poor performance, and the manager's plans for correcting it, are given to customers.

Explanations added to graphs can help explain the impact of volatility and the importance of considering how long a fund is going to be held.

DESCRIBING TIME HORIZONS

KEY MESSAGES
Avoid vague descriptions of time horizons; be specific and reference the number of years.
Make clear that a minimum recommended term for holding shares in a fund is just a minimum.

Consumer testing findings

- *There are wide discrepancies between what customers typically regard as short, medium and long-term time horizons for holding an investment product. From the wide discrepancies, on average, 3 years is considered short-term, 7 years is considered medium-term and 13 years is considered long-term. There may also be a difference in views depending on whether the customer is advised or not, and the perception of long-term decreases with age.*

Due to the wide variation in views on time horizons, fund documentation should aim to set out any time horizons in numbers rather than stating short, medium or long-term. Firms should also make clear to customers that the recommended time horizon is a minimum and not a recommendation to sell at the end of that minimum period.

Information on time horizon can be included in the objective and policy section within the KIID and is a required element of the KID.

DISCLOSING THE USE OF BENCHMARKS AND SHOWING PERFORMANCE AGAINST THOSE BENCHMARKS

KEY MESSAGES

State the degree of freedom available in relation to any stated benchmark (explicit or implied).

Track and disclose performance against objectives so customers are able to assess how the fund is performing.

The KII Regulation requires KIIDs to disclose whether the manager uses an approach that includes or implies reference to a benchmark and the degree of freedom available in relation to that benchmark.

FCA PS19/4 sets out that where the fund is, in effect, restricted in how far it can deviate from a benchmark, this implies a reference to a benchmark for the purposes of the KII Regulation. The FCA Guidance also suggests that fund managers should consider quantifying the degree of freedom they have in relation to the benchmark. This might involve stating that the fund will be managed in such a way that it should stay within x% from the relevant benchmark.

Consumer testing findings

- *When assessing fund performance, 87% of participants in the quantitative sample considered the fund's return target as key in helping to assess that performance. Furthermore, while customers (particularly experienced self-directed customers) may choose their own comparators against which to measure performance (e.g. peer groups, interest rates, inflation), there is a general expectation that, for most funds, the manager will show performance against a suitable benchmark.*

- *In terms of wider benchmarks, peer group is paramount and customers want to ensure that managers are comparing 'apples with apples'. There is also a strong emphasis on beating cash.*

- *Two to three years was considered a sensible time to get a feel for a fund's performance relative to its objectives.*

- *A combination bar chart and annual performance comparison to the relevant benchmark is seen as the most effective way to show performance track record and to highlight periods of under and over performance.*

- *Customers want commentaries on performance (this is particularly relevant to fund factsheets), especially when performance has been poor, in which case they want an explanation of why performance has been poor and what the manager plans to do to address the situation. The more directly the commentary is seen to come from the portfolio manager, the better, in customers' eyes.*

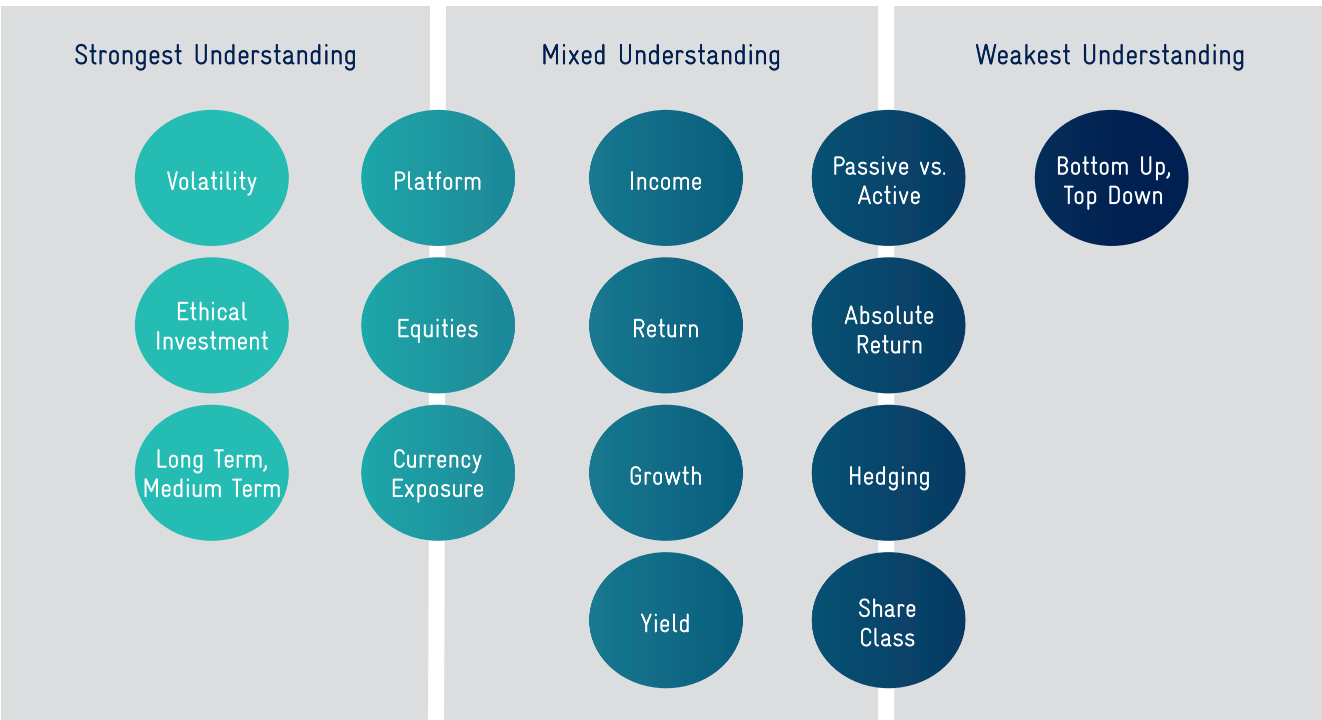
PART 2
CLARITY AND CONSISTENCY OF LANGUAGE

The language used in communicating investment concepts to customers is clearly very important. However it is not sufficient to take material written for a professional customer and adapt it for retail customer consumption. Rather, communications aimed at retail customers need to be designed for their use from the outset and written with that end-reader in mind.

Testing retail communications or sample language with focus groups can yield useful information about how to communicate effectively with customers. Where testing in advance is not possible, fund documentation should be drafted with the target market in mind and an understanding of what that audience would like to know about and how it would like it explained.

As part of the qualitative focus groups consumer testing, participants were presented with regularly used investment terms and showed varying degrees of understanding. Figure 1 highlights some of those terms by degree of how well understood these were:

FIGURE 1: Fifteen regularly used investment terms presented to focus group participants

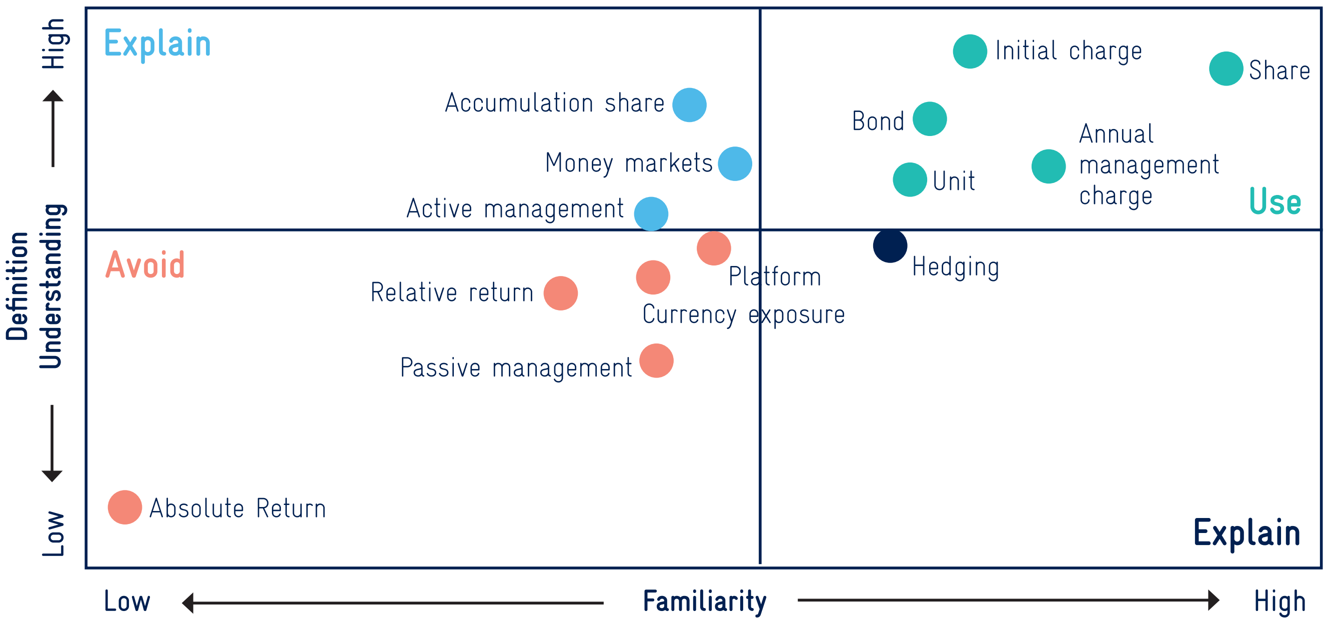


Some terms were better understood than others. Short descriptions generally worked better than long ones, partly because the latter tended to then bring in other terms that were not fully understood.

The quantitative phase of consumer testing further explored how terms and explanations map for levels of understanding. Figure 2 maps terminology along two axes: familiarity with a term (i.e. whether you have seen it before), and understanding of that term. It is not a prescriptive tool, rather a framework for diagnosis where changes to communication may be helpful:

- Where terms score high for both familiarity and understanding, then firms can be more confident in using them.
- Where familiarity is high, but understanding low (or conversely, understanding is high but familiarity low), then research indicates that greater explanation accompanying the term is needed.
- Where both familiarity and understanding are low, it may be more appropriate to avoid the term and seek alternative explanations.

FIGURE 2: How terms and explanations mapped for levels of understanding in quantitative testing



In response to these consumer testing findings, the Guidance includes two lists:

I. Terms that retail customers find confusing but can be understood shown alongside simple explanations; and

II. Terms that retail customers struggle with and an alternative form of words should be used instead of the term itself.

The two lists are not intended to be a comprehensive list of industry terms that customers do not understand, but rather provide concrete examples that have come to light from consumer research. Some firms may feel that some terms belong in the first list rather than the second and vice versa. Once again, we emphasise that our Guidance is intended to help provoke a review process and not to prescribe a specific approach to the use of a term.

A key point is that it is best to avoid jargon. Industry jargon can be a useful shorthand for communicating with professional customers, but it frustrates many retail customers, who just want a clear explanation of what managers are aiming to achieve and how they plan to do it. While difficult to distinguish and define, industry jargon acts as a barrier to understanding and there is a level of technical language that even the most experienced customers struggle to understand, as the research shows.

Furthermore, it is important to note that non-technical terms can also cause confusion or, at best, lack precision. Terms like 'mainly' or 'predominantly' are too open to interpretation and specific limits are more informative, e.g. 'more than four fifths'.

LIST I
TERMS TO USE WITH SIMPLE EXPLANATIONS

The consumer research shows that many retail customers find the following terms confusing and that short, simple explanations, shown alongside the term, can aid understanding when expressed in plain language. The consumer research also shows that longer, detailed explanations risk bringing in more unfamiliar words and can add to the confusion.

Members should consider whether a short description of what the term means should be included in the fund documentation; suggested explanations are listed below.

Accumulation share/unit – 'Funds are divided into portions called shares or units. In accumulation shares/units, the income earned by the fund is paid into the fund and reflected by an increase in the value of each share/unit.'

Advanced/developed markets – 'Countries with relatively high levels of personal income and established economies.'

Annual management charge – 'An ongoing fee paid to the management company for managing the fund, usually charged as a percentage of the investment.'

Bond – 'A loan, usually to a company or government, that pays interest.'

Where relevant, consider using 'bond' instead of 'fixed income', which is a less well understood term. In some contexts, it might be helpful to point out that an 'investment bond' (insurance product) is something completely different.

Bottom-up – 'An investment approach that focuses on analysing individual shares rather than stock markets.'

Capital markets – 'Markets that raise money from those who want to invest and make those funds available to businesses or governments.'

Currency exposure – 'The potential for a fund that invests overseas to lose or gain money purely because of changes in the currency exchange rate.'

Dilution levy/adjustment – 'An amount you pay to cover the dealing costs incurred by the fund when it buys or sells investments as a result of you buying or selling shares/units in the fund. It is normally only charged when those costs are significant.'

Diversification – 'Holding a variety of investments that typically perform differently from one another.'

Emerging markets – 'Countries that are progressing toward becoming advanced, usually shown by some development in financial markets, the existence of some form of stock exchange and a regulatory body.'

Entry/Initial charge – 'An up-front fee paid to the management company when you buy shares/units.'

Frontier markets – 'Countries that are more established than the least developed countries but still less established than emerging markets.'

Growth – 'The increase in value of investments.'

Income – 'Money paid out by an investment, such as interest from a bond or a dividend from a share.'

Income share/unit – 'Funds are divided into portions called 'shares' or 'units.' In income shares/units, the income earned by the fund is paid out to investors.'

Liquidity – 'The degree to which an investment can be quickly bought or sold on a market without affecting its price.'

Money market instruments – 'Investments usually issued by banks or governments that are a short term loan to the issuer by the buyer. The buyer receives interest and the return of the original amount at the end of a certain period.'

Ongoing Charges Figure (OCF) – 'A measure of what it costs to invest in a fund. It includes the fee paid to the management company and other operating costs.'

Platform – 'An online service that allows you to buy and sell shares and funds and see your investments in one place.'

Return – 'The money made or lost on an investment.'

Rolling three year period – 'Any period of three years, no matter which day you start on.'

Consumer testing findings

- *While 86% of participants said they knew what the term meant, when presented with four definitions of what is meant by 'rolling 3-year', only 34% chose the correct definition. However, a further 40% chose a definition that was largely correct, indicating that a majority of customers have some understanding of what the term means.*

Share – 'An equal portion representing part ownership of a company. Can also apply to a fund.'

Consumer testing findings

- *There was a degree of consensus in the consumer testing results that equities was another word for shares, but 'shares' was better understood than 'equities'. Therefore this Guidance proposes firms consider using 'share' instead of 'equity' where this is feasible.*

Share class – 'One of the types of share representing part ownership of the fund that is different to other share classes for some reason, such as it pays out income rather than paying it back into the fund.'

Stock lending – 'Process whereby those holding investments (such as a fund) lend them to other parties who pay a fee for borrowing.'

Top-down – 'An investment approach that looks at the big picture first, e.g. the economy, then at the detail, like how individual shares are performing.'

Unit – 'An equal portion representing part ownership of a unit trust fund (note: 'Share' has a similar meaning but for funds structured as corporate entities such as an open-ended investment company.'

Volatility – 'A measure of the size of short term changes in the value of an investment.'

Yield – 'The income from an investment, usually stated as a percentage of the value of the investment.'

Consumer testing findings

- *Consumer research shows that retail customers struggle to differentiate between terms which are common to the industry. For example, less than half of participants who took part in one of our consumer testing exercises could correctly match the following terms to their definitions:* ***growth****;* ***yield****;* ***income****;* ***return****. Yield, in particular, causes confusion as it is often interpreted to mean 'total return'.*

- *The consumer testing results emphasise the need to be clearer about using words in context and the importance of writing for the audience rather than expecting people to understand terminology or go and look it up. When using growth, yield, income and/or return, firms should be consistent in using the same term throughout their documentation.*

LIST II
TERMS WHERE A DESCRIPTION MIGHT WORK BETTER THAN THE TERM ITSELF

As stated above, consumer research shows that certain terms which are common in our industry are not well understood by many retail customers. This section lists terms that retail customers struggle with and suggests alternative ways to describe these concepts. These descriptions (or versions of them) can be used in place of the term or, if that is impractical, as a concise explanation of what the term means.

Absolute return – 'The profit or loss on an investment without comparing it to how other investments have performed. Absolute return investing aims to produce a profit over time regardless of what the stock market does. Even when markets are falling, an absolute return fund can still make money, although this is never guaranteed.'

Consumer testing findings

- *This was a very confusing term for participants and many felt it was linked to the return an individual receives on their investment in any type of fund, not just absolute return funds.*

- *Some participants also felt this might refer to a guaranteed minimum return.*

Active – 'Where the fund manager uses their expertise to pick investments to achieve the fund's objectives.'

Asset allocation – 'Dividing the money invested in the fund across different investments ('assets'), e.g. in different geographic areas or by industry sectors such as oil and gas or financial companies.'

Derivatives – 'Investments whose value is linked to another investment, or to the performance of a stock exchange or to some other variable factor, such as interest rates.'

Consumer testing findings

In one of the consumer testing exercises, half of participants received a detailed explanation of derivatives and half of participants received a shorter, simpler definition.

- *The shorter, simpler definition was seen as significantly clearer and easier to understand when the two were scored independently: 39% of participants found the longer description easy to understand compared to 48% who preferred the shorter definition.*
- *The terms that introduced more confusion in the longer definition included 'swaps', 'exposure', 'options' and 'futures'.*

Efficient portfolio management – 'Managing the fund in a way that is designed to reduce risk or cost and/or generate extra income or growth.'

The term 'efficient portfolio management' (EPM) presents particular challenges in that it has a specific meaning as defined by the FCA in the Handbook Glossary and firms need to be careful to distinguish in their KIIDs between use of derivatives purely for EPM and use for broader investment purposes. In that context, and in order to mitigate against any regulatory misunderstanding, it is suggested that where firms use derivatives for EPM only, they might use the wording suggested in this Guidance, but include the following in brackets: '(often referred to as 'efficient portfolio management')'.

Hedging – 'Using some investments as a way to reduce risk.'

Passive – 'The fund manager aims to track the performance of a stock exchange index or another investment.'

Consumer testing findings

- *Passive versus active: most customers were unable to explain what these terms meant in relation to the way individual funds are structured or managed.*
- *The term 'passive' had negative, literal connotations of 'unmanaged'.*
- *Regarding the proposed description, consumer testing shows that 'tracking' is a better understood term.*

Relative return – 'The profit or loss on an investment compared to how other investments have performed.'

ANNEX 1: NAVIGATING THE REGULATORY LANDSCAPE

CURRENT DISCLOSURE REQUIREMENTS

Disclosure to customers takes a number of forms, some of which are subject to detailed regulation. Fund prospectuses must comply with prescriptive rules set out in the FCA Collective Investment Schemes sourcebook (COLL), while Key Investor Information Documents (KIIDs) for UCITS and available to NURS must comply with the Key Investor Information (KII) Regulation. Key Information Documents (KIDs) required by the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation are also subject to detailed regulatory requirements and apply to some NURS.

Regulation surrounding marketing material, such as fund factsheets, is less prescriptive, leaving more flexibility for firms in terms of what to include. Marketing material is subject to rules in certain areas, such as past performance, the principle of information being 'fair, clear and not misleading' and a requirement not to contradict or diminish the significance of information contained in the regulated disclosure.

The KIID was developed to provide information to retail customers who were unlikely to engage with the full prospectus, although, as the FCA pointed out in the Final Report (para. 12.13), there is mixed evidence of customer engagement even with the KIID. Where they are available, customers find fund factsheets useful in terms of providing an ongoing commentary on how a fund is performing and how it is being managed.

The IA Guidance is supplementary to the relevant legislative provisions outlined above and to guidance issued by the FCA and EU supervisory authorities, details of which are given below. As with all EU legislation, the terms of Brexit and decisions taken after the UK leaves the EU will have an impact on how EU provisions apply in the future. However, regardless of the regulatory context, it is hoped the IA Guidance will be useful to firms when drafting and reviewing fund documentation, focusing particularly on KIIDs, KIDs (if and when they become applicable to investment funds) and marketing material (including fund factsheets).

FCA NON-HANDBOOK GUIDANCE

FCA non-Handbook Guidance in Appendix 2 of PS19/4 sets out how the FCA considers that greater clarity on fund information, enabling comparisons of objectives between similar funds, can be achieved. It covers disclosure in key information documents, including KIIDs and KIDs, and in marketing communications such as fund factsheets and other customer literature.

As well as describing the existing obligations in respect of prospectuses, KIIDs and KIDs, the key provisions are as follows:

OVERALL APPROACH

- KIIDs and KIDs should be written in language that is clear, succinct and comprehensible, avoiding the use of jargon and technical terms.

- Key information should set out overall aims and how they are to be achieved. It should also aid comparison with other funds/products.

RELATIONSHIP WITH PROSPECTUS

- Information in the KIID and the KID must be consistent with the prospectus, but this does not mean that the text must be identical.

- Firms need to consider whether they should provide information in KIIDs and KIDs that goes beyond what is in the prospectus.

INVESTMENT OBJECTIVES AND POLICY

- The KIID section on objectives and investment policy must include information on the broad categories of investments to be used and the approach to these investments. It may contain other information where this is necessary to adequately describe the objectives and policy.

- The FCA considers that it would generally be necessary to include relevant elements of the investment strategy in order to adequately describe the objectives and investment policy. Two examples are given: i) if it is not the manager's current strategy to invest in a particular area where the investment policy permits investment, this should be made clear; ii) if it is the manager's strategy to make specific use of one of the investment powers, for example around the use of derivatives, this should also be made clear.

ROLE OF BENCHMARKS

- The KIID requires disclosure of whether the fund uses an approach that includes or implies reference to an internal or external benchmark. The FCA considers that where the fund is, in practice, constrained in how far its holdings can deviate from a benchmark, this implies 'reference to a benchmark'. Three non-exclusive examples of such constraints are given: the risk management process causing the fund to be monitored and controlled relative to a benchmark; the portfolio manager being remunerated based on fund performance relative to a benchmark, and; the portfolio management system restricting transactions using hard or soft limits relative to a benchmark.

- The KIID should disclose whether the fund is managed with reference to a benchmark and the manager's freedom of action in relation to that benchmark, quantifying that degree of freedom if possible. (Note FCA PS19/4 includes new definitions of 'target benchmark', 'constraining benchmark' and 'comparator benchmark' that will be in FCA COLL Handbook.)

NON-FINANCIAL OBJECTIVES

- If a fund has non-financial objectives, such as environmental or social objectives, these should be set out in the prospectus.

- Firms should be clear about how they will measure non-financial objectives and provide ongoing information to customers.

CESR GUIDE TO CLEAR LANGUAGE AND LAYOUT FOR THE KIID

The European Securities and Markets Authority's (ESMA) predecessor, the Committee of European Securities Regulators (CESR), published a good practice guide to clear language and simplicity of presentation in KIIDs, which includes a section on using plain language and guidance for the Objectives and Investment Policy statement in the KIID. There is some crossover between the CESR guide and the FCA's non-Handbook Guidance and the main points in the CESR guide relevant to the IA Guidance are as follows:

- It is best to assume that your audience is reading about an investment fund for the first time.

- Using plain language is about writing so that your audience is not alienated by unfamiliar vocabulary but is given complex information in a clear way.

- Try to avoid jargon altogether by explaining the feature without naming it, or by explaining jargon in brackets after its first use.

- Do not copy from the prospectus unless that is in clear language.

- You may go beyond the prospectus wording.

- Avoid vague statements.

- Describe risk and reward together, rather than just listing bad things that can happen. (Bear in mind that any description of possible benefits must not detract from a warning about risk.)

- Briefly explain why a risk is being taken so that customers get a more balanced understanding.

- Go beyond a bald statement of the risk by briefly explaining its implications for the customer. Explain how much of the fund is exposed to a particular risk, how likely it is that the risk will materialise, and how severe the impact would be if it did. Where relevant, explanations of risk mitigation may help a customer understand impact and probability.

- Clearly explain material risks that are not captured by the SRRI and their potential impact.

ANNEX 2: CONSUMER TESTING

BACKGROUND

In response to the FCA's Asset Management Market Study and as a natural extension of its involvement in the Fund Objectives Working Group, the IA instigated a program of customer-led insight to help shape this Guidance for the industry, specifically in the areas of investment objectives and policy, and benchmark disclosure. This annex outlines the overall objectives and methodology of the testing.

OBJECTIVES

The testing was led by The Wisdom Council and aimed to garner insight into how customers interact with the fund industry and how best to engage with customers across fund communications, in particular KIIDs, KIDs, fund factsheets and marketing and informational material written for customers. The testing focused on customer insight along two strands:

- Clarity of language in objectives, policy and strategy (building on FCA Draft Guidance published as part of CP18/9); and
- Customer expectations regarding performance reporting, risk and time horizons (understanding what comparators retail customers currently use and which they might find useful in investment decision making and when judging whether or not outcomes are meeting expectations).

METHODOLOGY

The testing included both qualitative and quantitative phases.

- The qualitative phase included four discussion groups with retail customers, in Manchester and London (30 in total covering different ages, genders and levels of financial sophistication), to explore the language used in communications. This included testing definition of terms aimed at retail customers in order to understand levels of comprehension, and the resulting impact on overall attitudes towards funds and potential outcomes. As stimulus, elements of KIIDs from a range of funds were used.
- The qualitative phase also included a round table discussion with six experienced, self-directed customers who use a broad range of funds and other investments within their portfolios. The key question posed to participants was how do customers evaluate the performance of the funds in which they invest and what benchmark information is useful to them. As stimulus, a selection of performance charts across a range of sectors and fund types was used.
- The quantitative phase of testing comprised of 1000 online surveys with a nationally representative sample of customers with a balance of gender and age ranges, all of whom held at least one type of investment, to further explore information needs and terminology. Of those surveyed, 60% made use of a financial adviser (36% always use a financial adviser and the rest use one for managing some investments but also manage some investments themselves) and 40% were self-directed and did not take advice.
- The quantitative phase explored in more detail aspects of customer understanding of investment terms that had been flagged in the earlier qualitative phase. In one exercise, participants were asked to match the definition to the appropriate term and in another to select the correct definition of 'rolling 3-year period'. Terms with explanations were mapped for familiarity and understanding to help gather data on those terms which are either not well known or not understood. The results were used to help refine the suggested explanations of investment terms included in this Guidance.

The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL

www.theinvestmentassociation.org
@InvAssoc

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