

## COMMENT LETTER

October 3, 2008

# Institute Letter on IOSCO Point of Sale Issues Paper (pdf)

October 3, 2008 Via Regular Mail and Electronic Mail Mr. David Grim, Esq. Assistant Chief Counsel Division of Investment Management U.S. Securities and Exchange Commission 100 F Street, N.E. Washington, D.C. 20549 Dear Mr. Grim: The Investment Company Institute<sup>1</sup> (“Institute”) welcomes the opportunity to comment on the IOSCO Point of Sale Disclosure: Issues Paper (“Issues Paper”) produced jointly by the IOSCO Standing Committees on Regulation of Market Intermediaries (“SC3”) and Investment Management (“SC5”) (together, the “Joint Group”).<sup>2</sup> In the Issues Paper, the Joint Group focuses on disclosure to retail investors relating to collective investment schemes (“CIS”), or mutual funds, and similar products as well as the delivery of disclosure at or prior to the point of sale. Disclosure topics considered by the Joint Group include financial intermediary disclosure, CIS product disclosure and research on investor behavior and preferences for information. In addition, the Joint Group also identifies concerns associated with the imposition of differing regulatory regimes for retail investment products, including whether detailed CIS disclosure requirements may put CIS at a competitive disadvantage vis-à-vis other retail financial products for which no such disclosure requirement exists. Our key comments and concerns regarding the matters addressed in the Issues Paper are the following:

- **Financial Intermediary Disclosure:** The Institute cannot support intermediary disclosure requirements that would apply to the sale of CIS only. The Institute, <sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.11 trillion and serve almost 90 million shareholders.
- **Annex A (list of literature on investor preferences for information) and Annex B (summary of point of sale questionnaires) were referenced in the Issues Paper but were not provided, limiting the Institute’s review of the Issues Paper.** <sup>2</sup> regulators and consumer advocates have all cautioned that requiring similar disclosure regarding financial intermediaries for all retail investment products is critical. In addition, delivery and disclosure requirements should not impede an investor’s ability to effect transactions nor impose unwarranted burdens on the sales process.
- **Simplified CIS Disclosure:** The Institute is a strong advocate for simplified CIS disclosure. We are, however, unable to support a different delivery requirement for CIS product disclosure that would not be applicable to other retail investment products. The imposition of a different delivery requirement for only certain retail investment products would create inappropriate incentives for financial intermediaries to sell products not subject to those requirements even when those products may not be the best fit for an investor.
- **Information Needs of CIS Investors:** The Institute

has conducted extensive research on U.S. investor information preferences which may inform the Joint Group's work. • "Substitute" Investment Products: We urge the Joint Group to remain sensitive to the impacts of differing regulatory requirements among "substitute" retail investment products. Different regulatory regimes can inappropriately impact the sales and distribution of retail investment products and raise risks to investor protection. Below, we describe our views in more detail. Financial Intermediary Disclosure Consistent with the Joint Group's findings, we believe that financial intermediary disclosure and CIS product disclosure serve different purposes. In particular, intermediary disclosure is intended to provide customers with certain information in connection with their securities transactions. The focus of such disclosure relates to the relationship between the intermediary and its customer. As acknowledged by the Joint Group, the key disclosure issues for financial intermediaries involve the disclosure of the financial intermediary's compensation and the resulting potential conflicts of interest. The purpose of the intermediary's disclosure is to put the customer on notice regarding compensation received by the intermediary that might be relevant in assessing the intermediary's recommendation, and not to provide information about the CIS product itself.<sup>3</sup> The different purposes of intermediary and CIS product disclosure raise associated legal and practical considerations (e.g., who should be responsible for making the disclosure, who has ready access to the information needed for the disclosure). For these and other reasons, we have urged that intermediary disclosure in the U.S. be considered as a separate initiative from CIS product disclosure. As importantly, we have further urged U.S. regulators to examine intermediary disclosure in the context of all retail investment products to ensure that investors receive appropriate investment recommendations.<sup>4</sup> In the U.S., the Securities and Exchange Commission (the "SEC") has considered requiring brokers selling mutual funds to disclose certain information at the point of sale. The Institute, however, does not support the manner in which the SEC has proposed to effectuate this disclosure because it is inconsistent with the manner in which brokers sell mutual fund shares (i.e., typically by telephone or over the Internet, rather than face-to-face meetings) and other financial products would not be subject to the same requirements. Any requirements for point of sale disclosure or delivery regarding intermediaries should be designed to minimize disruptions to the sales process. Delivery requirements should neither impede an investor's ability to effect transactions nor impose unwarranted burdens on the sales process. We have urged the SEC to consider requirements that are consistent with the nature of the sales process and that do not create competitive disadvantages for mutual funds. <sup>5</sup> If the Joint Group pursues an evaluation of financial intermediary disclosure, the Joint Group must not support the imposition of financial intermediary disclosure that would be applicable to CIS only. Imposing financial intermediary disclosure requirements prior to the sale of CIS only would not fairly serve investor interests and would create incentives for intermediaries to sell products not subject to the requirements. Former NASD Chairman Robert Glauber, for example, has stressed the need to consider this consequence, explaining that "[a]n investor should be sold a security because it's right for him or her, not because it's easier to sell than something else." <sup>6</sup> Similarly, Barbara Roper of the Consumer Federation of America stated that by considering fee disclosures as "a mutual fund issue, instead of a broker compensation issue, sort of more holistically, you run the risk that you make mutual funds less attractive to sell. And I think that would be a very bad thing."<sup>7</sup> <sup>4</sup> See Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Mr. Jonathan Katz, Secretary, U.S. Securities and Exchange Commission (the "SEC"), dated Apr. 4, 2005, [http://www.ici.org/statements/cmltr/2005/05\\_sec\\_pos\\_com.html#TopOfPage](http://www.ici.org/statements/cmltr/2005/05_sec_pos_com.html#TopOfPage),

commenting on the SEC's proposed confirmation and point of sale disclosure rules. 5 See, e.g., Investment Company Institute, Submission to the U.S. Chamber of Commerce, Commission on the Regulation of Capital Markets in the 21st Century (Jan. 26, 2007), available at [http://www.ici.org/statements/cmltr/07\\_reg\\_cap\\_mark\\_stmt.html](http://www.ici.org/statements/cmltr/07_reg_cap_mark_stmt.html) ; Letter from Paul Schott Stevens, President, Investment Company Institute, to Hal S. Scott, Director, Committee on Capital Markets Regulation, dated Nov. 20, 2006, available at [http://www.ici.org/statements/cmltr/06\\_ccmr\\_fund\\_issues\\_ltr.html](http://www.ici.org/statements/cmltr/06_ccmr_fund_issues_ltr.html); Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, dated April 4, 2005, available at [http://www.ici.org/statements/cmltr/2005/05\\_sec\\_pos\\_com.html#TopOfPage](http://www.ici.org/statements/cmltr/2005/05_sec_pos_com.html#TopOfPage). 6 Remarks by Robert Glauber, Chairman, NASD, at the Investment Company Institute's 2006 General Membership Meeting (May 18, 2006), available at <http://www.finra.org/PressRoom/SpeechesTestimony/RobertR.Glauber/p016642>. 7 Remarks by Barbara Roper, Director of Investor Protection, Consumer Federation of America, at the Securities and Exchange Commission 12b-1 Roundtable, Unofficial Transcript, p. 196, available at <http://www.sec.gov/news/openmeetings/2007/12b1transcript-061907.pdf>. 4

Beyond the U.S., similar concern has been expressed for the consequences of disparate regulation of retail investments. Commissioner Charlie McCreevy of the European Commission has explicitly voiced this concern commenting that European regulations that impose different selling rules and different levels of product and fee disclosure on different types of investment products may be distorting competition among those products and resulting in a disservice to retail investors. He also identified a further troubling consequence of disparate rules -- investment products may be structured or sold under certain wrappers to avoid inconvenient regulatory requirements on product disclosure or distributor compensation.<sup>8</sup> The policy goals underlying intermediary point of sale disclosure with respect to the sale of CIS are no less valid in the context of other investments that are sold by financial intermediaries; any intermediary point of sale requirement should, therefore, apply to all retail investment products sold by intermediaries, and not solely to CIS. The Institute firmly believes that if a regulator considers it beneficial to require that investors receive certain information earlier in the sales process, it should do so for all retail investment products. Simplified CIS Disclosure CIS disclosure focuses on the product. The Joint Group has identified common investor problems and issues with CIS disclosure, including the concern that investors may not be properly using current CIS information due to trouble finding and understanding the information that they need. In the U.S., extensive empirical research conducted by the SEC, the Institute and others, has resulted in a strikingly broad consensus that investors would be best served by simplified, streamlined disclosure of essential fund information.<sup>9</sup> The Institute, therefore, strongly supports simplified CIS disclosure. 8 Remarks by Charlie McCreevy, European Commissioner for Internal Market and Services, at the Public Commission Hearing on Retail Financial Services (Sept. 19, 2007), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/548&format=HTML&aged=0&language=EN>. 9 See, e.g., Investment Company Institute, The Profile Prospectus: An Assessment by Mutual Fund Shareholders (Summary of Research Findings) (May 1996), available at [http://www.ici.org/stats/res/arc-rpt/rpt\\_profprspctus3.pdf](http://www.ici.org/stats/res/arc-rpt/rpt_profprspctus3.pdf); Investment Company Institute, The Profile Prospectus: An Assessment by Mutual Fund Shareholders (Volume 1) (May 1996), available at [http://www.ici.org/stats/res/arc-dis/rpt\\_profprspctus.pdf](http://www.ici.org/stats/res/arc-dis/rpt_profprspctus.pdf); Investment Company Institute, The Profile Prospectus: An Assessment by Mutual Fund Shareholders (Volume 2) (May 1996), available at [http://www.ici.org/stats/res/arcdis/rpt\\_profprspctus2.pdf](http://www.ici.org/stats/res/arcdis/rpt_profprspctus2.pdf); Investment Company Institute, Understanding Shareholders' Use of Information and Advisers (April 1997), available at [http://www.ici.org/stats/res/arc-dis/rpt\\_undstnd\\_share.pdf](http://www.ici.org/stats/res/arc-dis/rpt_undstnd_share.pdf); Investment Company Institute, Understanding Investor Preferences for Mutual Fund Information (2006) ("ICI Investor

Preferences 2006”), available at [http://www.ici.org/stats/res/1rpt\\_06\\_inv\\_prefs\\_full.pdf](http://www.ici.org/stats/res/1rpt_06_inv_prefs_full.pdf); Investment Company Institute, *Ownership of Mutual Funds and Use of the Internet*, 2006, Research Fundamentals, Vol. 15, No. 6, October 2006, available at <http://www.ici.org/pdf/fm-v15n6.pdf>; Barbara Roper and Stephen Brobeck, Consumer Federation of America, *Mutual Fund Purchase Practices* (June 2006), available at [http://www.consumerfed.org/pdfs/mutual\\_fund\\_survey\\_report.pdf](http://www.consumerfed.org/pdfs/mutual_fund_survey_report.pdf). 5 Simplified CIS disclosure such as that contemplated in the U.S. with the proposed summary prospectus,<sup>10</sup> and in other jurisdictions such as Canada and Europe, could create significant benefits for CIS investors. Research by the Institute suggests that U.S. investors would be far more likely to read a streamlined disclosure document than the U.S. mutual fund prospectuses that are typical today. Consequently, the Institute has supported the SEC’s concept of a summary prospectus as a new prospectus delivery option for U.S. mutual funds and believes that the summary prospectus has the potential to make disclosure documents more usable than the existing required CIS documents.<sup>11</sup> Indeed, when asked a series of questions about the SEC’s proposed approach, the response of U.S. investors surveyed by the Institute was overwhelmingly positive.<sup>12</sup> For all of these reasons, we fully support the Joint Group’s efforts to consider simplified CIS disclosure; such consideration, however, should not include a different delivery requirement for CIS. We are greatly concerned that requiring delivery of CIS product disclosure prior to selling CIS only would create incentives for dealers and other intermediaries to sell products not subject to the same requirement, even when those products do not offer the same level of regulatory protection and other benefits for investors.<sup>13</sup>

**Information Needs of CIS Investors** In an effort to understand the information needs of investors, the Joint Group reviewed research on retail investor preferences.<sup>14</sup> The Institute also has performed extensive research to better understand the information needs of mutual fund investors as well as the sources from which they obtain that information.<sup>15</sup> Although our research involved U.S. investors and U.S. 10 In an effort to better serve fund investors’ information needs, the SEC in late 2007 issued a proposal to permit funds to fulfill their legal responsibilities to deliver a full statutory prospectus by delivering a summary of key information (a “summary prospectus”), and making additional information, including the full prospectus, available on the Internet and in paper or by email upon request. See *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, SEC Release Nos. 33-8861 and IC-28064 (Nov. 21, 2007), 72 Fed. Reg. 67790 (Nov. 30, 2007). 11 See Investment Company Institute, *Investor Views on the U.S. Securities and Exchange Commission’s Proposed Summary Prospectus* (Mar. 14, 2008) (“ICI Investor Views 2008”), available at [http://www.ici.org/statements/res/ppr\\_08\\_summary\\_prospectus.pdf](http://www.ici.org/statements/res/ppr_08_summary_prospectus.pdf). 12 The Institute conducted a survey of more than 500 mutual fund investors with respect to the summary prospectus. Ninety-four percent of the survey respondents agreed that they would be more likely to read a document like the proposed summary prospectus than the longer and more detailed prospectus, and that a summary document would make it easier for them to compare different funds. See ICI Investor Views 2008 *supra* note 11. 13 We also would have concerns about potential disruptions to the sales process for mutual funds. See *supra* note 5 and accompanying text. 14 As noted above, the Institute was not provided with Annex A, an extensive literature survey that references the research reviewed by the Joint Group. 15 For example, the Institute engaged an independent research firm to conduct in-home interviews with 737 randomly selected fund owners who had purchased mutual funds outside workplace retirement plans in the 6 mutual funds, many of the lessons may help inform the Joint Group’s examination of effective CIS disclosure. Our key findings are generally set out below:

- U.S. investors consider a wide range of information before purchasing mutual fund shares outside workplace retirement plans. Investors most often want to know about a fund’s fees and expenses and historical performance before

purchasing shares, but, for example, rarely review or ask questions about a fund's portfolio manager. Other information usually considered by investors includes fund risks, fund price per share, and the types of securities held by the fund. • U.S. investors look for concise investment information and, where possible, graphic presentations. • U.S. investors consult a variety of sources for fund information before and after purchasing shares and one of these sources is usually a professional financial adviser.<sup>16</sup> • Regardless of their age, a majority of recent U.S. fund investors regularly go online and use the Internet for a variety of financial purposes. Consequently, the Internet has strong and deep potential for effectively communicating fund information to investors.<sup>17</sup> As noted in the Issues Paper, many retail investors who purchase CIS may not fully understand the product they have purchased and, by making disclosure more effective, regulators may be able to address this issue. We encourage the Joint Group to consider our research as it evaluates effective disclosure. preceding five years. See ICI Investor Preferences 2006 *supra* note 9. The Institute also conducted a survey regarding investor views on the SEC's summary prospectus proposal. See ICI Investor Views 2008 *supra* note 11. 16 For example, the Institute found that before purchasing: 73 percent of recent fund investors consulted professional financial advisers; 46 percent consulted fund company or other websites; 40 percent consulted friends, family or business associates; 34 percent consulted mutual fund prospectuses; 33 percent consulted print or television media; 30 percent consulted mutual fund shareholder reports; 25 percent consulted fund company literature; 20 percent consulted mutual fund rating services; and 14 percent consulted fund company telephone representatives. See ICI Investor Preferences 2006 *supra* note 9. 17 See ICI Investor Views 2008 *supra* note 11; Investment Company Institute, Ownership of Mutual Funds and Use of the Internet, 2006, Research Fundamentals, Vol. 15, No. 6, October 2006, available at <http://www.ici.org/pdf/fm-v15n6.pdf>. See also A Typology of Information and Technology Users, Pew Internet & American Life Project, at 2 (May 2007), available at [http://www.pewinternet.org/pdfs/PIP\\_ICT\\_Typology.pdf](http://www.pewinternet.org/pdfs/PIP_ICT_Typology.pdf); Internet Penetration and Impact, Pew Internet & American Life Project, at 3 (Apr. 2006), available at [http://www.pewinternet.org/pdfs/PIP\\_Internet\\_Impact.pdf](http://www.pewinternet.org/pdfs/PIP_Internet_Impact.pdf). 7 Substitute Investment Products and Investor Protection The Joint Group raises concerns about the "leveling playing field" among substitute retail investment products and the potential detrimental impact of differing regulations. For example, the Joint Group identifies the concern that detailed disclosure requirements for CIS, but not for other retail financial products, may put CIS at a competitive disadvantage compared to other products that are not subject to such requirements. Further, the Joint Group also recognizes that other problems arise from the interaction of regulations governing the investment product and regulations governing the intermediary selling the investment product. The Institute agrees with these concerns. In fact, the consideration of issues arising from differing regulatory regimes for substitute or competing retail investment products is commanding increasing attention from regulators, industry participants, investor advocates and others.<sup>18</sup> Today, retail investors are confronted with an expanding array of investment options, some of which are quite complex. Many share key characteristics but others have significant differences. As a general matter, the Institute believes that product innovation, and the resulting competition it engenders among substitute investment products, ultimately provides benefits for retail investors. We believe, however, that it is of paramount importance for innovation also to occur in how these various products are regulated, so that regulation does not inadvertently make some products more attractive or easier to sell than others. The Institute has considered, from a U.S. standpoint, issues relating to the regulation of "substitute" investment products, and has identified certain principles that we strongly believe should guide public policy, and which we recommend be considered by the Joint Group.<sup>19</sup> First, disclosure requirements should be comparable for "substitute" retail

investment products that offer risk/return performance similar to investment funds. Whether they make these decisions individually or with the help of a financial adviser, investors need meaningful, comprehensible information about the range of investment products from which they may choose, so that they can make informed investment decisions based upon their individual needs.<sup>20</sup> We believe that, while some elements of disclosure may need to be tailored to

18 See, e.g., Call for Evidence, Need for a Coherent Approach to Product Transparency and Distribution Requirements for “Substitute” Retail Investment Products (Oct. 2007), available at [http://ec.europa.eu/internal\\_market/finances/docs/cross-sector/call\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/cross-sector/call_en.pdf). 19 See Letter from Susan M. Olson, Senior Counsel, Investment Company Institute, to European Commission, dated January 17, 2008, [http://www.ici.org/statements/cmltr/08\\_ec\\_retail\\_com.html#TopOfPage](http://www.ici.org/statements/cmltr/08_ec_retail_com.html#TopOfPage). 20 The U.S. Department of Labor appears to have recognized the importance of creating or maintaining a level playing field among products in a recent defined contribution participant fee disclosure proposal. This proposal will for the first time require that participants and beneficiaries in all self-directed defined contribution plans receive basic and comparable information on all the investment options available to them, regardless of type, at the time of enrollment and annually thereafter. See Department of Labor, Proposed Rules, Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, 73 FR 143 (July 23, 2008) available at <http://www.dol.gov/federalregister/PdfDisplay.aspx?DocId=20973>.

8 accommodate distinctions among product types, greater comparability in disclosure about various investment products is important. Second, if regulators determine that a particular requirement should be imposed upon CIS, that requirement should be extended to substitute investment products (“regulatory equivalency”). There is a fear, as noted in the European Commission’s Call for Evidence on “Substitute” Retail Investment Products, that “less transparent or regulated products may be easier to sell, thereby displacing more heavily-regulated products and exacerbating investor protection concerns.”<sup>21</sup> The U.S. fund industry has similar concerns that in the U.S. market, heavier regulatory burdens often are placed on mutual funds than on other investment products sold to retail investors. The Institute has long sought to make U.S. regulators sensitive to this dynamic in their rulemaking, so that regulatory requirements placed on funds – however well- intentioned – do not inadvertently create substantial disincentives for brokers and other intermediaries to sell fund shares. As discussed above, of particular concern to the Institute and its members would be point of sale requirements for CIS but not other retail investment products. Third, if there are intentional differences among investment products, the regulatory requirements to which they are subject should respect those differences and should not be allowed to blur together (“regulatory distinctions”). The Institute believes that it is important for regulators to identify the investment products that belong within the scope of the category of substitute investment products for retail investors and to clearly identify those that belong outside of this category. Generally speaking, investment products that are broadly marketed to retail investors, and the companies that sponsor those products, are subject to a much greater degree of regulatory scrutiny than products intended for sophisticated investors. These distinctions are rooted in the longstanding, and logical, recognition that fewer regulatory safeguards are needed for financially sophisticated investors who have the requisite level of knowledge and financial sophistication and are able to bear the risk of loss associated with their investment. Last, differences in tax treatment should not steer an investor toward a particular investment product. In the United States, for example, by utilizing a gap in U.S. tax laws, retail exchange-traded notes (“ETNs”)<sup>22</sup> have been able to provide their investors with tax treatment that is far superior to that provided to mutual fund shareholders. The Institute has urged the U.S. Congress to

enact legislation to eliminate this disparate tax treatment, for which there is no compelling tax policy rationale.<sup>23</sup> We believe that unless the tax treatment of retail ETNs is 21 See Call for Evidence, Need for a Coherent Approach to Product Transparency and Distribution Requirements for “Substitute” Retail Investment Products (Oct. 2007). 22 ETNs are financial products structured as debt instruments with maturities ranging from five to thirty years, the return on which is typically based on the value of a specified index. 23 See Letter to Hon. Charles B. Rangel, Chairman, and Hon. Jim McCrery, Ranking Member, Committee on Ways & Means, U.S. House of Representatives, from Paul Schott Stevens, President & CEO, Investment 9 corrected, mutual funds stand to become substantially less attractive to investors solely for tax reasons. \* \* \* \* \* In conclusion, the Institute supports efforts to improve CIS disclosure for investors. We believe, however, that imposing different delivery requirements in the context of CIS only would create inappropriate incentives for intermediaries to sell products not subject to the same requirements, distorting the retail investment product market and raising serious investor protection concerns. If a regulator considers it beneficial for investors to receive certain information at a specific point in the transaction process, it should be the case for all retail investment products. We appreciate the opportunity to express our views and invite you to contact us directly if you have any questions about our comments please contact me at 202-326-5813 or Eva Mykolenko at 202-326-5837. Sincerely, /s/ Susan M. Olson Susan M. Olson Senior Counsel – International Affairs Company Institute, dated Nov. 1, 2007, available at [http://www.ici.org/statements/cmltr/2007/07\\_house\\_etn\\_ltr.pdf](http://www.ici.org/statements/cmltr/2007/07_house_etn_ltr.pdf).

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