

Retail Investment Products

EBF Comments on the Communication from the Commission to the European Parliament and Council on Packaged Retail Investment Products

For FMC approval by Friday 26 June

Key Points:

- The EBF supports the Commission's objectives of further enhancing investor protection and of ensuring a level playing across markets and sectors.
- The Federation welcomes the Commission's recognition of MiFID as the regulatory benchmark for selling practices.
- The process of product distribution has to be seen as its entirety, as is being done by MiFID.
- In parallel, the EBF stands however ready to work with the Commission towards the construction of short disclosure documents for different types of retail investment products.
- In doing so, care must be taken to fully recognise the differences between different products.

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Related documents: European Commission Communication on Packaged Retail Investment Products,
http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/29042009_communication_en.pdf

Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions. The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

General remarks

1. The European Banking Federation takes great interest in the European Commission's thinking on "packaged retail investment products" and would like to comment on the Commission's Communication to the European Parliament and Council. Banks are among the main distributors of retail investment products and therefore have first-hand experience of dealing with clients and building the link between the production side and the demand side.
2. The introduction of the Markets in Financial Instruments Directive (MiFID) has been ground-breaking, *inter alia*, to set the framework for the distribution of products to retail clients. Banks, as well as other distributors, have made great efforts to fully transpose the Directive, including its important rules in the areas of client categorisation; suitability and appropriateness tests; information provision; and avoidance or management of conflicts of interest.
3. The EBF continues to believe that this framework is the right one and well-designed to approach the client-distributor/ adviser relationship in its entirety. The Federation also **welcomes the European Commission's recognition of MiFID as the benchmark for the regulation of selling practices**. The EBF concurs that less effective investor protection standards for investment products which are out of the scope of MiFID should be brought up to the same level as the MiFID standards, also with the objective of levelling the playing field across sectors.
4. This should **not however include traditional banking products which are straightforward in design and well known in functioning to retail customers**. It would not be economic, nor necessary from an investor protection perspective, to apply to such products e.g. the MiFID's suitability and appropriateness tests. It is the EBF's understanding that this is also not the Commission's intention. However, some uncertainty remains in the White Paper around which products specifically are targeted by the European Commission. At the same time as clarifying the scope of its envisaged activities, the EBF would welcome that the Commission clearly confirms that this scope does not include banking products.
5. Besides regulating selling practices, **MiFID includes clear, horizontally applicable rules about the information to be provided to retail investors at the point of sale**. These include that "appropriate information shall be provided in a comprehensible format" about proposed investment strategies as well as about types of financial instruments, including about the risks associated with certain investments and about costs and charges. Furthermore, all information provided to banks' clients shall be "fair, clear and not misleading".
6. These rules are particularly well designed, in particular, in that they recognise the **surrounding context of investment advice**. In practice, information is provided to clients in different formats, at different points in time. This builds on – or ideally, should build on – a general understanding of financial matters, which is necessary for retail investors to correctly interpret the information provided. However, MiFID also recognises that this might not always be the case to the desired extent, by including

additional investor protection safeguards such as the conflict of interest rules and the suitability and appropriateness tests.

7. In other words, information provision and interpretation can be pictured as a pyramid or vertical process, with a sound level of financial literacy at the bottom, and general information on different types of products pursuant to Article 19.3 of MiFID building on that as a second layer. Product-specific information, possibly in combination with personal advice, would come on top of these two layers to be most effective. The standardised short product disclosures envisaged by the Commission should also be seen in this context. As one of a range of information tools they would be complementary to such fundamentals.
8. In this context, the EBF **supports the Commission's intention of making disclosure documents easier to understand and more attractive to read for retail investors**, as well as ensuring that information provided on retail products is similar in type and allows for as much comparability as possible. This is an important complement to oral advice or, where no advice is given, can be an easy entrance point for investors who take themselves the initiative to gather information about investment products of interest to them.
9. However, the EBF is **sceptical about the implications from the Commission's assessment that the Key Investor Information (KII) document that is required for UCITS-type funds should be considered as the benchmark for product disclosures for all types of packaged retail investment products**.
10. This scepticism is in view of the **important differences between products, with both legal and economic implications**. Thus, even if two products look similar on first sight the differences can be of great significance. On the one hand, the key investor information document must not mislead investors by hiding such differences but on the contrary, should aim to help investors understand the most important characteristics of different products available to them. On the other hand, many elements of the UCITS KII would not be of the same relevance for other types of products.
11. The Commission's proposals going forward should therefore be in the form of a framework that is sufficiently clear and comprehensive to ensure universal application of the key investor disclosures; but also leaves **sufficient flexibility for disclosures to be adapted to different products**. The objective would be to ensure that such a document serves as a standard tool in day-to-day contacts with clients. The designing should therefore be done with the close involvement of the producing and distributing industry, which have the combined experience about the substance and functioning of products and about the needs and perceptions of retail investors.

Specific comments on the European Commission's analysis and proposal

Definition

12. The European Commission's definition of packaged retail investment products approaches the issue from an investor point of view, which is appropriate given the

investor protection angle of its proposals. The EBF also **welcomes that the Commission recognises the developing nature of the markets and that new investment products are constantly emerging.**

13. At the same time, this approach leads to the definition being somewhat blurred from a legal point of view, as also implicitly recognised in the Commission's acknowledgement that there is "currently no widely-accepted legal definition of the product families in question". In any legislative proposals, it must be ensured that the **legal scope is clearly defined.** As mentioned in the introductory remarks, this should exclude banking products.
14. In this context, the consideration given by the Commission to the involvement of different financial institutions at different stages of the value chain is also of great importance. **Respective legal responsibilities have to be clear, especially, between the manufacturing and the selling side.**

Risks to retail investors and existing regulation

15. The EBF agrees in principle with the Commission's analysis in this section and welcomes that the Commission recognises the benefits of competition, in addition to considering potential risks.
16. The Commission points to potential asymmetries of information between different market actors. It is true that whilst retail investors have in principle the possibility of comparing different products and services between different distributors, they are often not prepared to take this additional initiative. As rightly pointed out by the Commission in the next section, this is also one consideration behind the comprehensive MiFID rules, which set out the circumstances under which the financial adviser would successfully mitigate such information asymmetry, at the same time as protecting the client from potential own interests of the financial adviser.
17. In addition, it is pragmatic to look at the form and content of short information given to investors, as there is evidence that investors do typically not read the full information documents available about products but look for comprehensive, overview information. Thus, although all relevant information is already available today some parts of it are likely overlooked, until the moment that they become relevant.
18. Therefore, the EBF **supports that more thought is being given to the short disclosure documents.** The Federation also agrees with the Commission's recognition of the need to improve, as a complementary measure, the level of financial education among retail investors.
19. Nevertheless, short disclosure documents must be built on a relatively basic level of financial education to be useful to all investors. They **should therefore in a first instance help investors to understand the basic functioning and characteristics of the product.** This will often mean to clarify the differences of different products, rather than to focus on comparability, which might often even be misleading.

Is the European legal framework fit for purpose?

20. The EBF notes the findings of the impact assessment with regard to investor detriment. In the view of the Federation, MiFID should however be the first safeguard against such detriment. MiFID was given very little time to be implemented. No changes to MiFID as such should therefore be envisaged at the current point in time. Rather, it is the right approach for regulators to now focus on due and full MiFID implementation.
21. At the same time, the EBF acknowledges that there is a regulatory patchwork which partly results in concerns around both, potential gaps in investor protection and possibilities for regulatory arbitrage. As noted above, the EBF therefore supports that the MiFID-style investor protection standards are applied to other types of investment products, and that additional disclosure standards are introduced for retail investment products.
22. Furthermore, it shall be noted that the difficulties that are encountered result to an important extent from generally low levels of financial literacy. This is a more general issue, which must be addressed in a wider framework. In the first instance, it is a public responsibility to ensure a sufficient level of understanding of financial matters. Such efforts is however widely supported by the banking industry.
23. In this context, the EBF has recently produced a report on the initiatives taken by EBF member associations and their member banks to enhance financial education.¹ This was with the objective of promoting the exchange of best practices between financial institutions and to further encourage ongoing initiatives. The EBF will further continue its efforts in this direction, as will its member associations.

Problems with EU rules on key investor disclosures

24. The EBF agrees with the European Commission's consideration that legal disclosures are often not in an accessible form for retail investors, which is to a large extent the result of liability concerns. Distributors therefore provide additional concise written information for some products expected to be suitable for a larger number of clients. Such disclosure documents are subject to the MiFID rules, where the product itself is subject to MiFID.
25. Nevertheless, European Banks recognise the intention of going beyond MiFID and introducing common standards of disclosure documents for all retail investment products. The EBF also continues to support the Key Investor Information document (KII) for UCITS funds. However, this document cannot be simply be mapped across to other documents. Differences in product construction, underlyings and legal set-up necessitate an approach that is more targeted towards specific products.

¹ EBF Report on Financial Literacy – empowering consumers to make the right choices, April 2009:
http://www.ebf.eu/DocShareNoFrame/Docs/1/CHIDCPAAGNNHGKDPEAELMINL1DAD2T9YBD735NFCYD1H/EBF/docs/DLS/D0305C-2009-EBF_report_on_Financial_Education_-_rev6-webversion-2009-00831-01-E.pdf.
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26. The EBF would therefore argue in favour of a “building block” approach to constructing the disclosure documents. I.e., the disclosure documents should be the result of the combination of similar elements, recognisable to the investor; but special product characteristics would at the same time be clearly identified.

Weaknesses in the regulation of selling practices

27. The EBF **welcomes the Commission’s recognition of the importance of MiFID** in this respect. Even though it is true that experience remains limited, the Federation expects that the MiFID rules will prove successful.

Will changes in European legislation improve outcomes?

28. The Commission’s proposals have the potential of delivering a further enhanced level of investor protection and of fostering investor confidence, if well designed. However, the Commission’s better regulation principles must not be neglected in this process. Furthermore, sight must not be lost of the overarching objective of helping investors in the first place to better understand product characteristics. This would be as opposed to either, the straight-jacketing of products; or the straight-jacketing of disclosures which would lead to a mis-representation of the essential features of some products.

What does the European Commission propose?

29. Despite the fact that MiFID was designed to address investor protection issues in a horizontal and comprehensive way, the EBF overall supports the Commission’s proposals.
30. The EBF also agrees that **separate legislative initiatives would be appropriate to take account of the respective roles of product manufacturing and distribution**. A thorough design will be needed to clearly set out the respective responsibilities on certain activities. The EBF **endorses the assumption made by the Commission that the production of the content of the disclosures would be the responsibility of product manufacturers; and that it would subsequently be the responsibility of the distributor to provide the disclosures to investors**. However, some flexibility should be left on other activities, for example the actual printing of the disclosure documents.
31. In view of the fact that some products envisaged by the European Commission are already subject to diverse publication requirements, the EBF believes that it should be considered that the new short product disclosures would replace the summary prospectus in the Prospectus Directive (2003/71/EC). This would necessitate a distinction to be made within the Prospectus Directive between “packaged retail investment products”, which could be exempted from the current requirement to publish a summary prospectus; and other types of products such as traditional equities and bonds.
32. **The EBF is however unsure about the implications from the European Commission’s considerations of the UCITS KII being the benchmark for investor disclosures**. If KII-similar documents are to be introduced for other types of products

care must be taken to accurately recognise the differences between different types of products.

33. **Sufficient flexibility must in particular be left for disclosures to be adapted to products in a way that allows to describe the product as accurately as possible.** Some parts of the UCITS KII would not be relevant for other types of products. For example, past performance data is of interest to investors in actively managed funds, but would be much less meaningful for structured products with a pre-defined outcome that depends on the development of the product underlyings.
34. The discussions around the UCITS KII have also pointed to the difficulties of defining a synthetic risk and reward indicator. In anticipation of these difficulties, the EBF's preference was in favour of a narrative approach which would entice investors to understand themselves the relevant risks, and to make an informed judgement about the risks they are prepared to take. In order to simplify this analysis for investors, the Committee of European Securities Regulators (CESR) is nevertheless trying to design a risk and reward indicator on the basis of past data, for example past volatility.
35. Such an indicator is in itself problematic, in view of the fact that past volatility is only an accurate measure of risk for comparatively short periods of time and cannot predict shocks such as the recent financial crisis. Furthermore, such an indicator would not be relevant for many structured products, such as for example those with a guarantee built into them. In thinking about the possible set-up of key investor disclosures the Commission should be aware of both, the difficulties that have become apparent for describing the features of UCITS funds; and the specificities of other types of products. **Risks and rewards are amongst the most difficult elements to describe, and amongst the most important for investors to understand properly. To avoid misleading simplification, this could accurately only be done through a narrative description.**
36. Differences also exist between UCITS funds and other types of products in the composition and nature of costs. The European Commission envisages that disclosures for non-UCITS products are being produced by product issuers who would typically not be informed about distribution costs. Costs that are being indicated in these documents should therefore only be those that relate to the product itself, and to the extent that they are relevant for the net performance of the product.
37. In order for the above considerations to be taken into account and for disclosures to be sufficiently flexible, the EBF would have a preference for **framework legislation that leaves room for the industry to fill in the details of the disclosures.** The EBF stands ready to work with the Commission and CESR in this respect.
38. The Federation also considers important the Commission's suggestion that the form of Lamfalussy legislation should be used so that the principle requirements would be set out in a uniform way, but allowing the specifics to be tailor-made for different types of products.

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Selling of packaged retail investment products by intermediaries and other distributors

39. The EBF welcomes that the Commission recognises MiFID as the benchmark for selling practices, regardless of the distribution chain.

Challenges in delivering a horizontal approach

40. The Federation considers the Commission's considerations in this respect to be of great significance, as regards both the need to find a comprehensive and clear definition of products; to avoid overlapping legislation; and to define the detailed contents of disclosure proposals.

Concluding remarks

41. Historical evolution, but also legal considerations have led to different regulatory frameworks for different types of investment products, designed to meet different retail investment objectives. The EBF welcomes that the Commission gives consideration as to how to best ensure a high level of investor protection for all types of products and distribution chains, as well as to ensure a level playing field across countries and sectors.
42. At the same time, the discussion is complex. The Commission rightly foresees another round of consultation on more specific proposals to be made going forward. The EBF stands ready to constructively work together with the Commission to achieve the desired outcomes, and looks forward to commenting on the Commission's more detailed proposals.