

## **Consultation by the European Commission on legislative steps for the Packaged Retail Investment Products initiative**

### **EuroInvestors reply**

**31 January, 2011**

#### **EuroInvestors**

EuroInvestors (the European Federation of Investors or EFI) was created in the summer of 2009, following the financial crisis which demonstrated the limits of the almost exclusive dialogue between regulators and the financial industry, largely ignoring the user side. EFI aims at representing and defending at the European level the interests of financial services users in order to promote training, research and information on investments, savings, borrowings and Personal Finances of individuals in Europe, by grouping the organizations pursuing the same objectives at a national or international level. Already about 45 national organizations of investors and other financial services users have joined us, and EFI already represents about two million European citizens.

#### **Summary**

**EuroInvestors (EFI) strongly supports the “horizontal” approach taken by the European Commission for its PRIPs (“Packaged retail Investment Products”) initiative, which is the right way to harmonize the selling practices of retail investment products, as most of them are “substitutable” for each other, and most of them are or can be sold by the same intermediaries. We do recognize it is innovative and challenging for the EC to cut through existing “silo” organigrams and directives.**

**We also support the proposals aimed at using the UCITS KIID as much as possible as a benchmark for harmonizing the pre-contractual information for the other retail investment products.**

**We nevertheless regret that the retail investor’s perspective is not fully taken into account. The current definition and scope of PRIPs does not reflect the reality at the point of sale. A lot of retail investment products would not qualify as PRIPs under the EC’s proposed definition. Bank saving accounts, traditional life insurance contracts, equities, bonds and all long term savings and pension products that can be subscribed on a voluntary basis nevertheless constitute a big portion of retail investments offered to the public by financial intermediaries in Europe.**

We regret that the initial name of the EU Commission project – “substitute” investment products – has been discarded for the narrower and unsatisfactorily defined “packaged” investment products one. Investors do not care whether an investment product is “packaged” or not and most often do not know what the word “packaged” means anyway. The Commission has consequently excluded a large part of substitutable retail investment products for no explicit reason. “SRIPs” do matter for the retail investor, more than “PRIPs” only.

All substitute retail investment products at the point of sale must be included. We believe that otherwise the Commission would be unfortunately wasting its time and efforts to adopt a horizontal approach. This would result in a rather limited and artificially defined section of the retail investment products market. The level of investor protection would still vary from one retail product to the other, regulatory arbitrage would likely be very widespread and the retail market playing field very uneven, which is what the EC wanted to avoid in the first place.

## Definition

**Q 1. Should the PRIPs initiative focus on packaged investments? Please justify or explain your answer.**

No, **the PRIPs initiative should** not focus only on “packaged” investments, as this would leave large portion of “substitute” retail investment products out of the PRIPs scope and out of the MiFID scope. Therefore the objectives of achieving a level playing field between retail investment products and eliminating loopholes in retail investors’ protection would be missed. Examples: EMTNs, bank savings accounts. Additionally, the EC definition of “packaged” is not entirely satisfactory and too narrow as it seems to also include some life insurance products while excluding others, as well as individual pension products, although these are clearly “packaged”.

We refer to our common letter (with FECIF and AILO) to the European Internal Market Commissioner on the scope of PRIPs (of 6 September 2010), and to our replies to the CESR consultations, which - unfortunately – have not been taken into account in the “3L3” (CESR + CEBS + CEIOPS) report to the Commission on PRIPs.

**Q 2. Should a definition of PRIPs focus on fluctuations in investment values? Please justify or explain your answer.**

No, a definition of PRIPs should not focus only on “*fluctuations in investment values*”, but also on fluctuations in investment real values and in income values. Because at the end of the day, these can be as hurting as a drop in investment values, especially for long term and retirement investments. Moreover, income fluctuations are also often based on underlying financial markets moves (e.g. income from “fonds en euros”). Also, there could be no or little “fluctuations” in nominal investment values, but a sharp drop in real investment values over time: this seems to have been largely overlooked as a key factor of long term and pension retail investments adequacy.

For example, deferred annuities (a quite popular retail investment product in France for example) are “packaging” a portfolio of securities (mainly bonds and equities), therefore in line with the EC proposed definition of PRIPs. , But the providers guarantee that the annuity amounts will never go down. So, then according to the EC definition, these long term investment products could be deemed “non PRIPs” arguing their “investment value” does not “fluctuate”. The problem is that we have evidence of big deferred annuities products (one million subscribers) which have increased the annuities values much less than inflation for the last 8 years at least. As a result, retail investors in these products are suffering anyway from heavy real values losses on their investments. They should definitely be included in the PRIPs scope.

**Q 3. Does a reference to indirectness of exposure capture the ‘packaging’ of investments? Please justify or explain your answer.**

No, it is too restrictive: again this could leave out a significant portion of retail investment products out of scope and could quite easily generate regulatory arbitrage. See reply to Q1.

**Q 4. Do you think it is necessary to explicitly clarify that the definition applies to fluctuations in ‘reference values’ more generally, given some financial products provide payouts that do not appear to be linked to specific or tangible assets themselves, e.g. payouts linked to certain financial indices, the rate of inflation, or the overall value of a fund or business?**

Yes, according to the EC proposed definition, this is a matter to ensure full transparency. But reference values are often implicit (see the example of deferred annuities above), and the definition itself is ineffective (see our other replies in this section).

**Q 5. Do you have any other comments on the proposed definition? If you consider it ineffective in some regard, please provide alternatives and explain your rationale in relation to the criteria for a successful definition outlined above.**

Yes, it is ineffective in our view: we refer to our previous replies and to our joint letter on the scope of PRIPs with Fecif and Ailo and with the support of BEUC.

The much better alternative is to go back to the initial one set by the EC: all “substitute” retail investment products at the point of sale. It is the only way to ensure:

- the consistency of investor protection rules,
- a much better comparability of retail investments products ,
- a level playing field for the providers and
- to avoid big loopholes and consequent regulatory arbitrage.

## Possible Exceptions

### a) Deposits

**Q 6. Should simple (non-structured) deposits be excluded from the scope of the initiative? Please justify or explain your answer.**

No, this does not reflect the reality at the point of sale. Bank savings accounts for example are very often offered as an alternative to insurance products ‘e.g. “fonds en euros”) at the point of sale. This may sound an inappropriate advice (advising to switch between a short term product and a long term one), but this is routinely occurring. Also, returns on the bank savings accounts do obviously fluctuate on the basis of the underlying capital markets assets or financial markets references as well, even if they are implicit.

**Q 7. Do you consider option 1 or option 2 preferable for achieving this? Please explain your preference, and set out an alternative if necessary, with supporting evidence.**

As mentioned, “simple” deposits such as savings accounts should not be excluded.

But, if the EC still wants to exclude them, then it should certainly not consider option 2: a lot of other retail investment products are repayable at par and are already MiFID eligible (bonds) or PRIIPS eligible (EMTNs). See also our reply to Q2.

Option1 could be OK if it is amended as follows:

*“A deposit shall be a PRIIP where [it is fully repayable, on terms under which] any interest or premium will be paid (or is at risk) according to an explicit or implicit formula which involves the performance of:*

- ~~indices or combinations of indices; excluding variable rate deposits whose return is directly linked to e.g. EURIBOR, LIBOR or another interest rate index;~~*
  - MiFID financial instruments or combinations of such financial instruments;*
  - commodities or combinations of commodities;*
  - foreign exchange rates or combinations of foreign exchange rates, or*
- . derivatives or combinations of derivatives of the instruments mentioned in the first four bullets above.”*

Why:

- Having the definition referring only to explicit formulas creates an immediate and very large loophole and a big opportunity for a regulatory arbitrage.
- We don’t see any valid reason to exclude deposits directly linked to interest rates. In that case why not also excluding variable rate bonds and all other retail investment products which have returns directly linked to interest rates? Plus the term “*directly*” is not clear (for example, the return formula of the most popular short term retail investment vehicle in France – the “Livret A” – is only partially linked to short term interest rates: is that considered “direct” or not ?).

- To avoid loopholes, the definition should use the plural instead of the singular (for example “*indices or combinations of indices*” instead of “*an index or combination of indices*”): and include the performance of financial derivatives.

**Q 8. Should such an exclusion be extended to financial instruments which might raise similar issues as deposits (e.g. bonds), and if so, how might these be defined? Please justify or explain your answer.**

No, see reply to Q7 above. Moreover, this would further enlarge the loopholes. For example EMTNs are technically bonds. Additionally, there are bank certificates for which returns are linked to e interest rates. Does the EC also want to exclude bank EMTNs and interest rates linked bank certificates?

#### **b) Pensions**

**Q 9. Should pensions be explicitly excluded from the PRIPs initiative at this stage? Please justify or explain your answer.**

A distinction must be made between pension products where individual contributions are mandatory, and pension products where it is up to the individual to decide to contribute or not.

In the first case, they can be excluded as the individual investor does not really have a choice, and therefore cannot decide to substitute this pension product for another PRIP.

But the non –mandatory pension products are clearly packaged retail investment products. For example, most “pillar III” products fall in this category and therefore EFI is firmly opposed to such pension products being excluded from the PRIPs initiative. Such an exemption would provide a ‘loophole’ for banks and insurance companies enabling them to label their products as ‘Pensions’, and then to sell those under exemption from any regulation. Such an exemption would endanger the entire objective of the PRIPs initiative.

**Q 10. Should annuities be treated in the same fashion? Again, please justify or explain your answer.**

Yes, see previous replies. We absolutely see no reason why an investment product should be excluded due to its redemption being not provided in capital but in annuities. The exposure to underlying financial and real assets remains and can also impact the net present value as well as the real value (net of inflation) of the annuities.

**Q 11. Do you have any comments on the proposed manner of achieving this exclusion?**

No comments.

**Q 12. Do you agree that variable annuities might need to be treated as a special case? If so, how should these be defined, and how do you think they should be addressed?**

No, they do not need to be treated as a special case, and should be clearly included in the scope of PRIPs. We see no reason for doing it differently: variable annuities are one of the most “packaged” retail investment products one can imagine, and full of various embedded fees. In

addition many variable annuities include or are linked to “units”, which are most often investment funds.

### Indicative Lists of Products

**Q 13. Do you see benefits from such an indicative list being developed? If not, please provide alternative proposals and evidence for why these might be effective.**

The optimal solution lies in having a clear and simple definition (see our reply to Q5).

An indicative list may help as long as it is clearly not meant to be and not presented as comprehensive. A list seen as comprehensive would allow for extended opportunities to find loopholes. Such a list should also be regularly updated.

The Commission should also consider an alternative: a list of excluded products, as this one should hopefully be shorter and not having to be revised too frequently.

**Q 14. Do you have any suggestions on the possible contents for such a list, including on how to define items placed on the list?**

We refer to our common letter of September 2010 on the scope of PRIPs to the EC Internal Market Commissioner.

### Sales Rules

**Q 15. Should direct sales of UCITS be covered by means of including the relevant rules within the UCITS framework?**

Yes, they should be included in MiFID.

**Q 16. Do you have any comments on the identified pros and cons of this approach, and any evidence on the scale and nature of impacts (costs as well as benefits)?**

An obvious con for fragmenting sales and investor protection rules between two directives is the existing lack of consistency, which was what the PRIPs initiative wanted to cure in the first place.

If the question regards direct sales of UCITS only, we do not see any con for applying the same investor protection rules. Actually this should not be limited to direct sales of UCITS, but to all retail investment products.

## Pre-Contractual Product Disclosure Instrument

### a) Principles underlying the design of the regime

**Q 17. Should the design of the KIID be focused on delivering on the objective of aiding retail investment decision-making? If you disagree, please justify or explain your answer.**

EFI of course agrees with this objective of the KIID. It must however be simple and clear, taking UCITS as a benchmark.

**Q 18. Should the KIID be a separate or ‘stand alone’ document compared with other information that might be necessary, e.g. background information, other disclosures, or contractual information? Please justify or explain your answer.**

For the sake of simplicity and comparability, and given it is the most important document, EFI advocates for a stand-alone document, providing only the information necessary for the consumer to make an investment decision. It should highlight the relevant key points an investor must be aware of in relation to the product, while further information and specifics can be provided in detail at the investor’s request.

**Q 19. What measures do you think will be necessary to ensure KIID remain streamlined and focused solely on key information?**

One way to limit the content of the KIID, so that it only contains key information, is to standardize the format of the document, requiring the content to be in a standard font and size.

Additionally, a maximum length shall be imposed, like for UCITS.

### b) Level of Standardisation

**Q 20. While the same broad principles should be applied to all PRIPs, should detailed implementations of some of these principles be tailored for different types of PRIP? Please justify or explain your answer, and provide examples, where relevant, of the kinds of tailoring you might envisage.**

The same rules must apply to all products, in order to ensure the efficiency of the initiative. Clear and simple rules are the best way to achieve an efficient directive. Even though EFI is aware of the difficulty of establishing such broad principles, there is evidence suggesting that greater standardization enhances consumer protection and can be effective in raising standards across the EU.

**Q 21. Do you foresee any difficulties in requiring the KIID to always follow the same broad structure (sequence of items, labeling of items)? Please justify or explain your answer.**

The PRIPs directive must provide a clear definition of what information is to be included in the KIID. We do foresee major issues regarding the adoption of the same broad structure.

**Q 22. Do you foresee any difficulties in requiring certain parts of the key information and its presentation (e.g. on costs, performance, risks, and guarantees) to be standardized and**

**consistent as possible, irrespective of tailoring otherwise allowed? Please justify or explain your answer.**

EFI recognizes that the key information document cannot be completely standardized. Nonetheless, it is unlikely that any difficulties would arise in presenting certain aspects of the document in as standardized and concise manner as possible, such as costs, performance, risks, and guarantees for instance.

**Q 23. Can you provide examples and evidence of the costs and benefits from your experience that might be expected from greater standardisation of the presentation and content in the KIID?**

Yes, for example retail investors will be provided at last with the full (total) cost of insurance products, in particular unit-linked ones, as the UCITS KIID requires that the disclosed expense ratio includes those of underlying investment products as well.

**Q 24. Should the content of the KIID be controlled so that there is no possibility for firms to add additional information unless expressly allowed for?**

Taking the UCITS KIID as a benchmark, and considering the limited space available, an average KIID would not allow for much additional information to be included. In that case, it must be ensured that the content of the KIID does not provide any misleading information.

c) **Content of PRIPs KIIDs**

**Q 25. Do you foresee any difficulties in applying these broad principles to the KIID for all PRIPs, as the building blocks on content and format for a 'level 1' instrument? Please justify or explain your answer.**

No, but the comparability principle should be added to these level 1 general requirements: the key information must be as comparable as possible between different retail products allowing an average investor to make an informed decision on the PRIP in question.

The same applies for the past performance of the product: it is misleading if not accompanied by that of a comparable indicator of reference.

**Q 26. Are there any other broad principles that should be considered on content and format?**

Comparability as a primary principle should be added.

d) **Allocation of Responsibilities for Production of KII**

**Q 27. Should product manufacturers be made generally responsible for preparing a KIID? Please justify or explain your answer.**

EFI absolutely supports idea of product manufacturers generally holding responsibility for preparing a KIID. It is the only way to maintain the uniformity necessary for the KIID to achieve



the intended consumer protection. As stated in the consultation paper, this option carries the benefits of clarity and simplicity.

**Q 28. Are you aware of any problems that might arise in the distribution of particular products should responsibilities for producing the KIID be solely placed on the product manufacturer?**

Usually no, except when brokers (like some insurance brokers) add features to the manufacturer's product.

**Q 29. If intermediaries or distributors might be permitted to prepare the documents in some cases, how would these cases be defined?**

These cases can be seen as particular arrangements between manufacturer and distributor. What is important is that authorisation of the document, as well as ultimate responsibility for the document, lies with the manufacturer.

e) **Labelling and Enhanced Transparency of PRIPs in Relation to Socially Responsible Investments**

**Q 30. What detailed steps might be taken to improve the transparency of the social and environmental impacts of investments in the KIID for PRIPs?**

This must be left at the initiative of the manufacturer. He should then specify which standards or criteria it is using to be able to use such labelling. EFI is somewhat wary about such labelling, for which there are no agreed common definition and common criteria.

**Q 31. How might greater comparability and consistency in product labelling be addressed?**

EFI believes this information should not be contained in the KIID. It is not a part of the key information that the client should be aware of when making a decision.

Nevertheless, as long as there are no uniform definitions at EU level on product labeling, EFI supporting the Single Market Act believes that labeling should only be permitted on the grounds that the authenticity of the claimed label can be verified.

### **Existing Legislation**

**Q 32. Should the summary prospectus be replaced by the KIID for PRIPs? Please outline the benefits and disadvantages you see with respect to such an approach.**

Yes, this is an absolute necessity, so that the consumer can better understand the elements of the product and compare it to other investment choices. There should also be consistency in format, content, etc. so as to achieve uniformity. In addition, the current summary prospectus format is of a very poor quality (for example, some do not even mention the interest rate of fixed rate bank EMTNs).

**Q 33. Should *Solvency II* disclosures provided prior to the investment decision be replaced by the KIID for PRIPs? Please outline the benefits and disadvantages you see with respect to such an approach.**

Yes, as long as such disclosures are understandable by the average retail investor (comply with MiFID rules on clear investor information).

**Q 34. Do you agree with the suggested approach for UCITS KIIDs?**

Yes.

**Q 35. Are there any disclosures, e.g. required by the existing regimes, which you believe the PRIIPs KIID should not include, but which should still be disclosed, e.g. separately to the KIID? Do you have any practical examples for such elements?**

No, as long as they are understandable by the average retail investor

### Appropriate Implementing Measures: Issues

> **Risks**

**Q 36. What in your view will be the main challenges that will need to be addressed if a single risk rating approach is to work for all PRIIPs?**

Great caution must be exercised in applying a ‘one-size-fits-all’ approach.

**Q 37. Do you consider there are any other techniques that might be used to help retail investors compare risks?**

No comments.

> **Costs**

**Q 38. What in your view will be the main challenges that will need to be addressed in developing common cost metrics for PRIIPs?**

Brackets or averages will have to be used for “umbrella” products such as unit-linked insurance products offering a wide range of units with different expense ratios. But this is achievable. The alternative being indicating the full cost to the investor for each unit as this was enforced in France between 2004 and 2006.

**Q 39. How can retail investors be aided in making ‘value for money’ comparisons between different PRIIPs?**

‘Value for money’ comparisons between different PRIIPs are essential for retail investors to make a good investment decision, especially for long term and retirement investments which are critical to their future well being. Comparability is the key word and principle: expense tables have to be standardized to the maximum extent possible. We also regret that our proposal to give a cost impact example in money terms (in Euros for example) - instead of using only percentages which are difficult to understand for the average investor – has not been considered. This is has been mandatory in the US for decades for mutual funds for example.

In many cases this will not be enough though. The development of a neutral body to assess it should be investigated.

> **Performance**

**Q 40. Do you consider that performance information should always be included in a KIID?**

Only if:

- There is a clear warning that past performance is no guarantee or even predictor of the future one
- The product performance is whenever possible presented together with that of a comparable and objective performance indicator (UCITS KIID rule)

**Q 41. What in your view will be the main challenges that will need to be addressed in ensuring performance information can be compared between different PRIPs?**

Similar challenge as the one for structured UCITs, for example for variable annuities.

> **Guarantees**

**Q 42. Do you agree that a consistent approach to the description of guarantees and capital protection in the KIID should be sought, e.g. through detailed implementing measures, for different PRIPs?**

Yes.

**Q 43. What information should be provided to retail investors on the cost of guarantees?**

The cost of guarantees must be disclosed to investors, because the decision lies within the clients as to whether they want the guarantee or not.