

EuroFinuse's Position on the Proposal for a Regulation on Key Information Documents for Investment Products (PRIIPs Regulation)

EuroFinuse advocates for an enlarged scope of the PRIIPs Regulation to guarantee effective long-term and pension savers protection

17 November 2012

The European Federation of Financial Services Users (“EuroFinuse”) (formerly European Federation of Investors, in short EuroInvestors) counts more than fifty national and international member and sub-member organizations. In turn those count about four million individual members. EuroFinuse acts as an independent financial expertise center to the direct benefit of the European financial services users (shareholders, other investors, savers, pension fund participants, life insurance policy holders, borrowers, etc.) and other stakeholders of the European financial services who are independent from the financial industry.

EuroFinuse has experts participating in the Securities & Markets, the Banking and the Pensions Stakeholder Groups of the European Supervisory Authorities, and the EC Financial Services User Group. Its national members also participate in the national financial regulators and supervisors bodies when allowed. For further details please see our website: www.eurofinuse.org.

ID number Transparency Register: 24633926420-79

Executive Summary

- The long awaited **Regulation on Key Information Documents** for investment products will unfortunately, and contrary to the original aim, **only address the harmonization and improvement of pre-contractual product information**, and not sales practices.
- The Regulation must **apply to ALL “substitutable” investment products** at the retail point of sale. The artificial requirement of “*indirectness of holding of assets*” only serves to favor more complex, inducement-laden “*packaged*” products.
- The PRIPs Regulation must **end the discrimination** of simple, “*inducement-light*” and long-term products such as **shares and bonds versus “packaged” products** in the EU retail distribution markets, and ensure that shares and bonds also benefit from a harmonised, simpler and more comparable “KID”
- The PRIPs Regulation must **cover all pension savings products** as they require “*particular care*” as acknowledged by the EC five years ago.
- The regulation must also **cover all interest-bearing deposits** as they are one of the most popular savings products in the EU and largely substituted by “in-scope” products such as life insurances.

And for the Key Information Document (KID) for PRIPs:

- **Risks** should be **reflected through a synthetic index** rather than through multifactor indicators.
- Key **quantified information** should also be **provided in monetary terms** (and not only in percentages) to ensure completeness and intelligibility by the majority of people.
- Information on **after tax “performance” and “inducements”** should be **disclosed** in an addendum at the point of sale, **prior to the conclusion of the contract**. Investors should also be informed about any inducements received **after the conclusion of the contract**.

The PRIPs proposal from the European Commission is the last step in a long process. The EC Green paper on retail financial services of April 2007¹ already stressed that *“due to the nature of long-term savings and pension plans, particular care is needed to ensure that consumers are being offered products that are really adapted to their needs and marketed appropriately”*. The ECOFIN Council made an appeal in May 2007 for the facilitation of access of households to financial products as a way to insure an adequate income for retirement. In 2009, the European Commission announced the project of a transversal regulation aimed at establishing a coherent basis on conduct of business rules when commercializing all retail investment products to investors. These common rules should contribute to strengthen the confidence of investors in financial markets and products.

It was necessary to wait until 3 July 2012 to see the realization of a specific proposal for an EU regulation addressing only pre-contractual information of certain retail investment products. However, there is a big difference with the initial announcement of the European Commission. Instead of having a single rulebook, the project has been cut into three legislative pieces:

- a transversal initiative that addresses only pre-contractual information on certain products;
- MIFID (Markets in Financial Instruments Directive); and
- IMD (Insurance Mediation Directive) for commercialization practices.

However, **no legislation covers commercial practices for occupational pension products.**

The approach taken by the Commission is contrary to the spirit of the request of the European Council in 2007. Instead of having facilitated the access of households to financial markets, it has further contributed to the “intermediarization” of financial markets and diffusion of structured and complex financial products where distributors charge abusive fees to consumers.

A single legislative text for both pre-contractual information disclosure and sales practices, as defended by EuroFinuse in its Position Paper to the European Commission’s PRIPs Workshop², would have contributed much better to the ultimate aims of the Regulation of increasing transparency and confidence of retail investors in the financial system.

¹ European Commission Green Paper on retail financial services in the single market, May 2005, page 11

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0226:FIN:EN:PDF>

² <http://eurofinuse.org/upload/positions/EFI%20PRIPs%20position%20paper%202010%2002031283865065.pdf>

EuroFinuse's propositions to improve the proposal from the European Commission

A) We advocate for the inclusion of certain excluded investment products categories (Article 2, Scope of the Regulation)

Unfortunately, it is no longer possible to return to the single legislative text for the commercialization of financial products to retail clients. However, **the enlargement of the scope of the PRIPs Regulation would eventually ensure a harmonized, clearer, briefer and more comparable pre-contractual information regime for all retail investment products**; not only for products most favored by the financial intermediaries because of their very high level of embedded commissions and fees. We do not agree with the consideration from the European Commission of the definition of "*indirectness of holding of assets*"³ to set up the scope of the PRIPs Regulation and exclude those products that would imply a more direct ownership of assets by the investor, and therefore minimize intermediaries' commissions.

We believe that the criteria to define the scope of the Regulation should **include all investment products aimed at achieving capital accumulation over time and mainly target retail investors**.

We therefore, would like to propose the following inclusions and modifications regarding the Scope of the Regulation:

1. Pure, simple and long-term products: straight shares and bonds

(Article 2 (d): other securities which do not embed a derivative)

We believe that **the adopted approach only adds discrimination to simple and direct investment products (like shares and bonds)** in the EU retail financial markets in comparison to packaged products. Packaged products will therefore benefit of a clearer and harmonized pre-contractual disclosure regime to retail investors. It is in the interest of financial intermediaries to sell structured products as they receive much bigger inducements (commissions). In fact there are no annual commissions for the intermediary on the sale of shares or bonds. **Therefore, if the information on simple investment products is not clearly disclosed, retail investors** when receiving investment advice **will be biased towards structured or packaged investment products**, which are not always the most profitable and suitable investments for them.

³ Proposal for Regulation on key information documents for investment products, page 7

The “RIPs” terminology, similarly as the “UCITS” brand, could become a retail marketing label. This label could direct people’s savings to packaged and complex products instead of simple products like shares. This issue will be accentuated by the fact that these packaged products will benefit from a harmonized pre-contractual information regime; adapted to individual clients regarding both its format and its content (this would not be the case for shares and bonds). **This is a time when the savings of individuals should be oriented towards the direct financing of the European economies.** The aforementioned situation also appears to be in contradiction with other initiatives of the Commission looking to promote investments in SMEs.

Besides this, regarding the format of information provided to retail investors, the review of the Prospectus Directive has given birth to a new format of the Summary Prospectus for securities (shares and bonds). This new prospectus summary is even longer, as it will have up to 15 pages or 7% of the total number of pages of the Prospectus. Therefore, **the changes of the Prospectus Directive do not improve the quality and readability of the information communicated to retail investors.**

There is one striking example: Euro Medium Term Notes (EMTNs) are bonds providing returns through coupons depending on a variable or fixed interest rate. They are commonly referred as EMTNs instead of bonds, as they are usually issued in series by financial institutions. Attached are an EMTN Base Prospectus (attachment 1) and its Final Terms Document (attachment 2) for a six year period, 6% fixed interest bond sold to European retail customers. **The summary of the Base Prospectus is 9 pages long, full of legal terms but not even mentioning the interest rate to be paid to the EMTN holder.** This information is only available when looking at the 14-pages Final Terms Document. In our opinion, this clearly exposes the discrimination of pure and simple products like bonds and shares compared to “packaged” products.

Another interesting example can be found for the commercialization of shares. The attached example of a shares prospectus (attachment 3) contains the information on the nominal value of the shares on its first page but only on the 5th page of the 6-page document it is mentioned that the price to pay is equal to the nominal value of the share.

In our opinion, the examples above proof that the prospectus for the simplest investment products can be challenging even for literate investors: **it is a necessary requirement that the key features even of the simplest investment products are clearly displayed to the retail investor.**

2. Non mandatory occupational pension schemes

(Article 2 (e): occupational pension schemes falling under the scope of Directive 2003/41/EC or Directive 2009/138/EC)

EuroFinuse would like to first point out that the issue of long-term and pension savings was rightly identified by the European Commission more than five years ago in its Green Paper on retail financial services:

*“Ageing populations and increasing pressure on public finances present clear challenges for consumers and investors, and are a new market for the financial industry. The EU framework needs to lay strong foundations for enabling a competitive, open and effective market for **long-term savings, retirement and pension** solutions that meet consumers' needs. The Commission has commissioned external research that will report at the end of 2007 on the current state and development of the market for retail long-term savings vehicles to help identify the range of products currently available, the main distribution channels and the influences on consumer choices. Building on this, the Commission will examine developments affecting the marketing of savings and retirement products together with arrangements governing their sale and recommendation.*

Due to the nature of long-term savings and pension plans, particular care is needed to ensure that consumers are being offered products that are really adapted to their needs and marketed appropriately. These are major, once in a lifetime, financial decisions for consumers. Therefore, consumers must be in a position to make their choices in full knowledge of the product, correctly assessing their circumstances and needs.”⁴

This is the very reason why **all occupational private pension products should be included in the scope of the Regulation on Key Information Documents for investment products**. We agree with the position expressed by the EC in this Green Paper: if only one type of retail investment products were to be included in the scope, it should be all long-term and pension savings products.

Due to the current and expected further reductions of Pillar I pension benefits citizens will have to rely both on mandatory, occupational (Pillar II) and private, voluntary (Pillar III) pension products to guarantee an adequate level of income when retiring. Therefore, we believe it to be a really bad public choice to exclude non mandatory occupational pension schemes provided by

⁴ European Commission Green Paper on retail financial services in the single market, May 2005, page 11
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0226:FIN:EN:PDF>

the employer, especially because the information currently available to consumers on private pension funds is highly deficient⁵.

For example, the current proposal would exclude the only French Defined Contribution corporate pension plans (known as PERCOs), as well as the insurance-based “article 83” corporate plans. Again, individuals are arbitrating their long-term savings between all “substitutable” products and contributions to non-mandatory occupational pension products are clearly part of these.

3. Interest-bearing deposits

(Article 2 (b) - deposits with a rate of return that is determined in relation to an interest rate)

The European Commission, according to some insights from officers at DG Internal Market, is considering to propose a specific long-term investment product in their Green Paper on Long Term Investing (planned to be released beginning of December 2012). This long-term investment product would be largely inspired by the most popular short-term savings product in France, the *Livret A*⁶ (that is to say, a regulated savings deposit account offering capital guarantee and an interest rate established by the Government).

The French finance ministry commissioned the Duquesne Report⁷ which recommends the French government to raise the *Livret A* ceiling by 25% in 2015 and an additional 25% in 2016, on top of the already planned increases by the government.

In view of this scenario of institutional support for such kind of financial instruments, we are foreseeing for most retail investors a “back to basics” to financial instruments they can clearly understand.

Those retail investment products should be subject to the same commercialization rules as other substitutive investments in order to assure comparability and avoid regulatory arbitrage: retail investors could be misled to invest in products that fit into the generic definition of “*deposits with a rate of return defined by an interest rate*” but that do not offer capital guarantee or whose return rate is not guaranteed.

Besides, considering capital requirements for banks, it could be surprising that term deposits will not benefit from this future retail label of “RIPs”.

⁵ According to upcoming research from EuroFinuse (the Real Value of Pensions Study)

⁶ The *Livret A* is a basic, tax-free savings account regulated by the French government where investors can save up to 19,125 €. Currently, there are over 60 million *Livret A* savings accounts and over 94% of French citizens own one.

⁷ <http://www.economie.gouv.fr/files/rapport-duquesne-reforme-epargne-reglementee-2012.pdf>

B) We advocate for a clearer and more complete KID to help retail investors taking the right decision

We would like to praise the European Commission for having implemented very appropriate proposals. The Commission took the right decision by establishing a summary indicator of the risk profile. **We expect the ESMA to establish a Synthetic Risk and Reward Indicator (SRRI), e.g. a number between 1 and 7 to indicate the risk level of the investment product.**

According to Article 8.6 a) of the PRIIPs Regulation proposal from the European Commission, the ESAs should develop appropriate draft regulatory standards in the same way as it was done for the UCITS' KIID.

However, we believe that certain changes to the proposal of the Commission could improve the investment decision-making process of investors and consequently have a positive impact in terms of market efficiency and resource allocation:

1. Disclosure of expenses in monetary units

It is necessary to disclose expenses paid in monetary units (e.g., absolute terms) in addition to percentage terms (as currently required in the EU). If such information is disclosed only in percentage terms, investors may not be aware on which value the percentage is applied (invested amount or amount at the end of the investment period, for example). Additionally, retail investors may not be fully conscious of the real value of commissions and other costs: a small annual percentage charged to the investor may erase all or most of the returns delivered by the investment product. In the US it is mandatory to disclose total expenses in monetary terms in addition to the percentages for all mutual funds in the summary information (as shown in attachment 4, pages 2 and 3).

2. Disclosure of inducements to promote transparency and improve financial advice quality

There is a general consensus on the fact that inducements (e.g. any fees, commissions or any non-monetary benefits that financial advisors may receive from investment product manufacturers) have a dramatic impact on the quality of advice retail investors receive on before the conclusion of the transaction.

Despite the fact that it will be necessary to wait until the end of the Trialogue negotiations to see the final wording of Article 24 of the MiFIR, everything points at that, at least, “hard disclosure” of inducements will be required for investment products under the MiFID scope.

We understand that it would be discriminatory to deprive retail investors in PRIPs from receiving such information which has a determinant impact on the investment advice investors receive. Consequently, this information should be an additional factor to consider when taking a decision on which product to invest.

That is why, in our view, a significant contribution to individual investors in PRIPs could be made if the information on all inducements (those received before as well as after the conclusion of the contract) was disclosed.

A brief report informing about any inducements that might have been received by the intermediary from the product manufacturer should be delivered to retail investors in addition to the KID (but in a separated sheet) prior to the conclusion of the contract.

Information on inducements received by the intermediary in the previous six months’ time from the product manufacturer should also be provided to retail investors twice a year after the conclusion of the contract.

3. Information on after tax performance

Tax treatment of investment products is a determinant factor of the investment’s performance and therefore the choice of the retail investor.

In the US, the disclosure of past performance after tax is mandatory for all mutual funds in the summary information (as shown in attachment 4, page 5).

We believe that investors should have this information available before the conclusion of the transaction, in addition to the rest of the information provided in the key information document.

However, for reasons of cost-effectiveness, tax information should not be included in the KID as there are as many different tax regimes as Member States in the EU. Therefore, **information on after tax performance for retail investors on PRIPS should be provided in the additional report on inducements to be delivered prior to the conclusion of the contract.**

ANNEX

EuroFinuse's Proposed Amendments to the European Commission's Proposal

Amendment n. 1
Proposal for PRIPs Regulation
Article 2

Text proposed by the Commission

Article 2

This Regulation shall apply to the manufacturing and selling of investment products.

However, it shall not apply to the following products:

- (a) insurance products which do not offer a surrender value or where that surrender value is not wholly or partially exposed, directly or indirectly, to market fluctuations;
- (b) deposits with a rate of return that is determined in relation to an interest rate;
- (c) securities referred to in points (b) to (g), (i) and (j) of Article 1(2) of Directive 2003/71/EC;
- (d) other securities which do not embed a derivative;
- (e) occupational pension schemes falling under the scope of Directive 2003/41/EC or Directive 2009/138/EC; and
- (f) pension products for which a financial contribution from the employer is required by national law and where the employee has no choice as to the pension product provider.

Amendment

Article 2

This Regulation shall apply to the manufacturing and selling of investment products.

However, it shall not apply to the following products:

- (a) insurance products which do not offer a surrender value or where that surrender value is not wholly or partially exposed, directly or indirectly, to market fluctuations;
- ~~(b) deposits with a rate of return that is determined in relation to an interest rate;~~
- (c) securities referred to in points (b) to (g), (i) and (j) of Article 1(2) of Directive 2003/71/EC;
- ~~(d) other securities which do not embed a derivative;~~
- ~~(e) occupational pension schemes falling under the scope of Directive 2003/41/EC or Directive 2009/138/EC; and~~
- (f) pension products for which a financial contribution from the employer is required by national law and where the employee has no choice as to the pension product provider.

Amendment n. 2
Proposal for PRIIPs Regulation
Recital 7

Text proposed by the Commission

(7) In order to ensure this Regulation applies solely to such packaged investment products, insurance products that do not offer investment opportunities and products solely exposed to interest rates should thereby be excluded from the scope of the Regulation. Assets that would be held directly, such as corporate shares or sovereign bonds, are not packaged investment products, and should therefore be excluded. Since the focus of this Regulation is on improving the comparability and comprehensibility of information about investment products being marketed to retail investors, occupational pension schemes which fall under the scope of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision¹¹ or Directive 2009/138/EC of the European Parliament and the Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II), should not be subject to this Regulation. Similarly, certain occupational pension products which fall outside the scope of Directive 2003/41/EC should be excluded from the scope of this Regulation, provided that a financial contribution from the employer is required by national law and provided that the employee has no choice as

Amendment

(7) In order to ensure this Regulation applies solely to such **retail packaged** investment products, insurance products that do not offer investment opportunities ~~and products solely exposed to interest rates~~ should thereby be excluded from the scope of the Regulation. ~~Assets that would be held directly, such as corporate shares or sovereign bonds, are not packaged investment products, and should therefore be excluded.~~ Since the focus of this Regulation is on improving the comparability and comprehensibility of information about investment products being marketed to retail investors, occupational pension schemes which fall under the scope of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision¹¹ or Directive 2009/138/EC of the European Parliament and the Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II), should **not** be subject to this Regulation. **Similarly Nonetheless**, certain occupational pension products which fall outside the scope of Directive 2003/41/EC should be excluded from the scope of this Regulation, provided that a financial contribution from the employer is required by national law and provided that the employee

to the pension product provider. Investment funds dedicated to institutional investors are not within the scope of this Regulation either since they are not for sale to retail investors. However, investment products with the purpose of accumulating savings for individual pensions should remain in scope because they often compete with the other products under this Regulation and are distributed in a similar way to the retail investor.

has no choice as to the pension product provider. Investment funds dedicated to institutional investors are not within the scope of this Regulation either since they are not for sale to retail investors. However, investment products with the purpose of accumulating savings for individual pensions should remain in scope because they often compete with the other products under this Regulation and are distributed in a similar way to the retail investor.

Amendment n. 3
Proposal for PRIIPs Regulation
Article 8.2

Text proposed by the Commission

Article 8

2. The key information document shall contain the following information:

(...)

f) under a section titled "What are the costs?", the costs associated with an investment in the investment product, comprising both direct and indirect costs to be borne by the investor, including summary indicators of these costs;

Amendment

Article 8

2. The key information document shall contain the following information:

(...)

f) under a section titled "What are the costs?", the costs associated with an investment in the investment product, comprising both direct and indirect costs to be borne by the investor, **in monetary units, and** including summary indicators of these costs;

Amendment n. 4
Proposal for PRIPs Regulation
Article 12

Text proposed by the Commission

Article 12

1. A person selling an investment product to retail investors shall provide them with the key information document in good time before the conclusion of a transaction relating to the investment product.

(...)

4. The Commission shall be empowered to adopt delegated acts in accordance with Article 23 specifying:

(a) the conditions for fulfilling the requirement to provide the key information document in good time as laid down in paragraph 1;

(b) the method and the time limit for the provision of the key information document in accordance with paragraph 2.

Amendment

Article 12

1. A person selling an investment product to retail investors shall provide them with the key information document in good time before the conclusion of a transaction relating to the investment product.

The person selling an investment product to retail investors shall provide to them, prior to the conclusion of the contract, a second information document disclosing any fees, commissions, monetary or non-monetary benefits or other inducements from third parties in relation to the provision of the investment advice in good time before the conclusion of a transaction. Information on after tax performance will be included in the additional information document.

This second information document will have to be produced by any person selling investment products to retail investors.

The person selling an investment product to retail investors will have to provide twice a year after the conclusion of the contract a report to the retail investors on any fees, commissions, monetary or non-monetary benefits or other inducements they may have received in the last six months from third parties in relation to the provision of the investment advice.

(...)

4. The Commission shall be empowered to adopt delegated acts in accordance with Article 23 specifying:

(a) the conditions for fulfilling the requirement to provide the key information document in good time as laid down in paragraph 1;

(b) the method and the time limit for the provision of the key information document in accordance with paragraph 2.

(c) the conditions for fulfilling the requirement to provide the information document on any fees, commissions, monetary or non-monetary benefits or other inducements from third parties in relation to the provision of the investment advice in good time before the conclusion of a transaction;

5. The European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) shall develop draft regulatory standards to determine the format of the document disclosing inducements received by the intermediary to be received by retail investors