BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Better Finance response to the European Commission Call for evidence on the EU regulatory framework for financial services

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The European Federation of Investors and Financial Services Users
76, rue du Lombard, 1000 Brussels - Belgium
Tel. (+32) 02 514 37 77 - Fax. (+32) 02 514 36 66
E-mail: info@betterfinance.eu - http://www.betterfinance.eu

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Better Finance is the most involved European end user and civil society organisation in the EU Authorities' financial advisory groups, with experts participating in the Securities & Markets, the Banking, the Occupational Pensions and Insurance and Reinsurance Stakeholder Groups of the European Supervisory Authorities; as well as in in the EC Financial Services User Group. Its national members also participate in national financial regulators and supervisors bodies when allowed. For further details please see our website: www.betterfinance.eu

Executive Summary

Better Finance welcomes this call for evidence on the EU financial regulatory framework and indeed agrees on the fact that it is necessary to introduce improvements in certain areas, and sometimes simplification and cohesion along with the „REFIT“ approach.

However this call for evidence should not serve as an opportunity for some to try to water down the recent and badly needed improvements in investor and financial services user protection of the recent EU financial regulations. Today everybody recognises that the focus of recent financial regulations has been much more on financial stability than on end-user protection since the 2008 financial crisis; hence the

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recent launch of the Green Paper on retail financial services. This call for evidence should by no means become the starting point for lowering the protection of financial services users, which should be on the contrary more consistent and improved across markets and products [1].

The areas which we deem most important are:

- "*Rules affecting the ability of the economy to finance itself and growth",*
- and *"Interactions of individual rules, inconsistencies and gaps"*

Among those mentioned by the Commission.

Therefore, we would like to point to the following issues:

1. Rules affecting the ability of the economy to finance itself and growth

We believe that the following Regulations and Directives contain important provisions that go against the EC's flagship initiative on financial services, the Capital Markets Union, and their stated objectives for more integrated capital markets, more market-based financing versus intermediated financing, and better servicing of the real economy's financing needs, and ultimately more growth and jobs.

[1] Furthermore, the recent EC Green Paper on retail financial services states that "Consumer trust in the financial sector and in retail financial services has diminished owing to the financial crisis and the reputational damage suffered by the financial industry" page 3 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0630&from=EN

PRIIPs

- The PRIIPS Regulation, although well intended, is poised to be very detrimental to equity and equity-based investments. Indeed, its contemplated delegated acts will design the market risk measure of the KID using a VaR with only 5 years of historical data or less[2]. Typical investments in equity and equity-based products have an intended holding period that is much longer than five years. In fact, most equity UCITS recommend five years as a minimum holding period. Even capital guaranteed life insurance contracts in France have an average holding period of 12 years at least. For a diversified portfolio of equities or equity-like products the volatility is lower for longer-term investments of 10, 20, 30 years or more. Using a 5 year–based VaR is not only inadequate but will unduly disadvantage equity products which are badly needed in line with the analysis and goals of the EU CMU initiative.
  The MRM (Market Risk Measure) is not adequate for – and detrimental to - long term and pension PRIIPs such as life cycle funds for example. This is not consistent with the CMU initiative.
  The same applies to the credit risk measure which is also based on a one to five year time horizon: credit risk – other things being equal – increases with a longer time horizon, but this is not taken into account and will unduly favour fixed income investments over equity ones. Moreover, it is also misleading for investors.
  Lastly, the "future performance scenarios" will be highly misleading for retail investors – as clearly pointed out by many

[2] ESAs Joint Consultation Paper on the draft regulatory standards for the PRIIPs KID, 11 November 2015

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stakeholders[3] - and will therefore further undermine investors' trust, thus going against one of the key objectives of the CMU initiative.

Shareholder Rights Directive

- The SRD does not really address the internal market barriers to shareholder engagement, as regards voting rights especially. Lower engagement of individual shareholders hinders direct investment in the real economy, especially cross-border inside the EU. There is indeed little consistency between the SRD II and the CMU, as SRD II – in its current state – does not really address cross-border barriers to shareholder engagement within the EU[4].

Capital Requirements Directive IV and Solvency II

- CRD IV and Solvency II have led to higher capital requirements for institutional investors and in consequence lower institutional investment in the real economy, in particular as far as equity investments are concerned.
  It is quite concerning to witness that European insurers' own-risk investments in equity have already collapsed in the last 15 years from 20% in 2001 to now (2016) probably around 5% of their total own-risk investments. Insurers have become extremely risk averse, much more than individual investors.

[3] The ESMA SMSG, the European Commission's FSUG, Better Finance, the Savers consultative Commission of the French Regulator AMF, etc. (see their replies to the ESAs' latest discussion paper on PRIIPs)

[4] For more details our report "Barriers to Shareholders Engagement" http://www.betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/FINAL_Barriers_to_Shareholder_Engagement.pdf

According to European insurers this is mainly due to Solvency II rules. Therefore Solvency II should better take into account the duration of certain insurers' liabilities (like life insurance and pension ones) and of the evidence showing that diversified equity investments become less volatile than fixed income ones over the long term.

Therefore, it is much more challenging, in terms of capital requirements, for institutional investors to put aside more capital for lending to the real economy than to invest in sovereign debt, thus creating a distortive discrimination that does not contribute to the proper functioning of capital markets and economic development[5].

2. Interactions of individual rules, inconsistencies and gaps

UCITS IV and PRIIPS Regulation

- In this regard, the most urgent issue for citizens as financial services end users that European institutions should solve is the upcoming foreseeable and dramatic regression of investor protection, in particular fund investor protection between the UCITS IV Directive (which created the KIID for investment funds) and the PRIIPs Regulation as it is currently interpreted by the EC and by the ESAs as far as its delegated acts are concerned. One of the main issues is the elimination of performance disclosure for

[5] For instance, OECD has stated that *"European Solvency II Directive will discourage insurance companies and pension funds from investing in infrastructure assets, not allowing them to properly match long-term liabilities on their balance sheets with long-term assets"*
Fostering Long-Term Investment and Economic Growth. Summary of a High-Level Financial Roundtable, 2011, page 6 http://www.oecd.org/finance/financial-markets/48608840.pdf

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individual investors. We believe 10-year past performance disclosure, when available, would be a minimum (like in the UCITS IV Directive establishing a KIID for UCITS funds); since shorter term disclosure may be misleading indeed.

IORP II

- The same (and even worse) applies to the upcoming IORP II Directive where the Council and the EP Rapporteur have eliminated the mandatory and standardised (i.e. comparable) disclosure of past performance – and also of total fees - of occupational pension products in the "PBS" (Pension Benefits Statement). Already in 2007, the first Green Paper on retail financial services from the EC had however correctly identified pension savings as a critical financial service warranting a priority treatment in terms of savers' protection. Today in 2016 pension savers are nonetheless the least protected, be it through pre-contractual disclosures (excluded from PRIIPs and now from IORP II), or conduct of business rules (no alignment of IORP rules to the more protective ones of MIFID). That pensions consistently remain the worst ranked EU consumer market (re: the EC consumer scoreboard) should therefore come as no surprise to EU regulators.

PRIIPS, UCITS, Prospectus, IORP - Pre-contractual disclosure requirements

- For the PRIIPs KIDs, the Prospectus Directive, the UCITS' KIIDs and especially for the IORPs' Pension Benefit Statements and personal pensions, key information remain unaligned and have inconsistent levels of pre-contractual disclosure that deter individual investors from investing directly in the real economy and returns. The current review of the Prospectus Regulation (article 7 of the EC proposal) and the PEPP (Pan European Personal Pension) project currently plan to reduce these inconsistencies respectively for securities (shares and bonds) and for personal pensions. But the former has yet to be approved by the European Parliament, and the PEPP project has to this day not even been endorsed by the EC.

Insurance Distribution Directive

- The recent IDD is a review of the Insurance Rights Directive from 2002, and is unfortunately not in line with MiFID II as far as conduct of business rules for the selling of insurance-based retail investment products are concerned: life insurance brokers may therefore continue to collect commissions without having to disclose the amounts of commissions they collect, under the recently approved IDD. Article 24(9) of MiFID II requires intermediaries to disclose the ‘existence, nature and amount’ of any commission received prior to sale. The IDD refers to ‘any third-party payments’ to be included in the costs and charges to be disclosed, but the costs will be presented as an aggregate figure, so the consumer will have to request a breakdown to get at the commissions figure. There should be a clear requirement in the IDD to disclose commissions, in line with the provisions in MiFID II. In conclusion, Selling requirements should be the same for all „packaged“ and „plain-vanilla“ products.

PRIIPS and European Long Term Investment Funds

- The calendar for the PRIIPS and ELTIFS Regulations needs to be coherent: PRIIPS requires that retail investors receive KIDs for investment products from 1 January 2017 onwards and according to the ELTIFs Regulation distributors have to submit the ELTIFs’

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KIDs to national supervisors; but the ELTIFs Regulation came in force on 9 December 2015. The ESAs are developing the technical standards which will be needed to draft such KIDs at the moment. Therefore there should be coordination between both legal texts for the period from 9 December 2015 to 1 January 2017. There are further inconsistencies between PRIIPS and UCITS, namely the fact that the PRIIPS regulation establishes an exemption for funds already distributing KIIDs for 3 years. However, for instance unit-linked PRIIPs with several options (also called *multi-option products* or MOPs) are obliged by level II rules to produce KIDs as well as KIIDs as established by UCITS IV. Therefore, this double obligation should be corrected since this would be very confusing for the retail investor.

Market in Financial Instruments Directive and Regulation

- MiFID favours the execution of retail investors' orders via SIs (Systematic internalisers) and OTC (over-the-counter) venues instead of through Regulated Markets, since brokerage firms may benefit of execution within their own venues, thereby taking unfair gains at the expense of the retail investor. Retail orders should be executed in regulated markets, unless SIs and OTC venues comply with the same transparency and investor protection rules as the Regulated Markets.

  Furthermore, and as we said above, Article 24 of MiFID II requires investment intermediaries to disclose transaction costs for investment products. For UCITS funds, the intermediary must obtain the cost information from the management company. However, the management company is not subject to MiFID II, and is under no obligation to report transaction costs under the UCITs Directive. While the PRIIPs KID will apply to all PRIIPs manufacturers, UCITs are exempt from the PRIIPs Regulation until the end of 2019. This situation both weakens the disclosure requirements of MiFID II and delays any benefits of the PRIIPs KID disclosures for a long time. In respect of disclosure gaps, the first is the exclusion of most pension products from MiFID II, from the IDD and from the PRIIPs Regulation. Costs have a significant impact on the size of the accumulated pension pot, and hence on retirement income. Without transparent, comparable and comprehensive cost disclosure, investors and intermediaries have no basis for judging the "value for money" of different pension investments.

- *IDD, MiFD, Mortgage Credit Directive - inconsistent definition of financial "advice"*

  As clearly identified by the ESAs in their discussion paper on automated advice, there is no consistent definition of financial advice in EU Law and sometimes no definition for *investment advice* in MIFID, *advice* in IDD and *advice* in the MCD (actually the only piece of bank regulations where advice is defined). Therefore, the three definitions are not the same. Also, they all refer to "personal" recommendations. And, moreover, it is not clear what "generic" advice is and, more importantly, what its legal status is with regards to European legislation.

  UCITS and AIFMD – managers' remuneration rules

- There are some inconsistencies between the principle of proportionality for fund managers' remuneration, which was introduced to align managers and fund investors' interests as defined in the AIFM Directive and UCITS. The definitions for fund

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managers' remuneration in the UCITS V Directive are not consistent with those included in the Directive for alternative (non-UCITS) funds, AIFMD. It would be most appropriate, however, to achieve consistency in the level II rules for both Directives covering the whole spectrum of investment funds, which are being drafted by ESMA at the moment.

Last but not least, the withdrawal of certain legislative projects by the European Commission within the framework of their "REFIT" philosophy, namely the Investor compensation schemes project withdrawn in 2015, is unfortunate since projects of such kind contribute to building up market confidence and are therefore necessary in the current context. Besides, given the fact that Deposit Guarantee Schemes (DGS) cover banking products and sight deposits, it creates an unevenplaying field among providers of investment services to individuals in favour of banks.

In conclusion, there are a number of steps, some requiring the adaptation of legal texts but others not, that could be taken by EU institutions.

There are certain easy measures that could contribute towardsavoiding regulatory inconsistencies, including greater involvement of the ESAs in the parliamentary discussions and Trilogues between the Commission, Parliament and Council to improve coherence between level I and level II and reduce the technical discrepancies between different texts. Last but not least, the ESAs should consider making use of their legal powers as regards non-compliance with EU law, possibly against NCAs, to promote common interpretation and implementation of European rules including banning certain financial products or activities when this is justified for reasons of investor protection or market stability.