

# Packaged Retail Investment Products: Issues for discussion

PRIPs Workshop, Brussels, 22<sup>nd</sup> October 2009.

## *I Background*

The collapse in retail investor confidence during the financial crisis has given new prominence to the Commission work on level-playing field and investor protection issues in the retail investment market. Retail investors often poorly understand the risks, costs and features of investment products, and those selling these products can be subject to significant conflicts of interest. Also, existing rules on information for prospective investors and the conduct of those selling to them form a patchwork that exposes significant gaps and inconsistencies in approach depending on the legal form of a product (rather than its economic nature).

The Commission concluded in its 30th April 2009 Communication on Packaged Retail Investment Products (PRIPs) that it was vital, therefore, to take steps to improve regulatory protections for retail investors, so that the appropriate requirements apply irrespective of the legal form a product takes or how the product is sold. The Communication identified rules on pre-contractual product disclosures and rules on sales as the two key regulatory pillars of the PRIPs work. The Commission committed itself to developing a new, horizontal legislative approach in these two areas, drawing on the best of existing requirements but applying these to all relevant products and sales channels so as to achieve a consistent and coherent overall approach. The Communication received strong support from finance ministers in the Council conclusions on PRIPs of 9th June 2009.

The Commission recognises that the work on PRIPs is a challenging project that cuts across existing sectors and legislation. Since the Communication did not contain concrete legislative proposals, the Commission has subsequently been working on preparing the ground for more detailed proposals. The Commission has also been consulting with a wide range of stakeholders; and closely liaising with CESR, CEIOPS and CEBS to get supervisory input on the issues raised by the Commission's Communication on PRIPs.

This workshop forms a valuable part of this ongoing work, offering an informal chance to discuss and consider some of the key issues that will need to be faced, focused on:

- the scope of the work (which products should be covered);
- requirements on pre-contractual product disclosures (the development of consumer friendly 'key information documents' (KIDs) for all PRIPs); and
- requirements on sales (ensuring the same high consumer protection standards apply to all sales).

This issues paper follows the structure of the agenda for the workshop, and highlights some of the key issues that arise in delivering on the commitments in the Communication, providing an outline of some of our initial thinking. We wish to use the workshop as an opportunity to take views on this thinking – including where attendees consider different approaches would work better – and also to take stock of any other issues that have not been addressed but attendees consider important. Written contributions would also be welcome before or after the workshop

The Commission next aims to publish an orientation document on its work for wider consultation.

**Please note that this working paper is simply intended to serve as a basis for discussion with industry experts and consumer representatives at the Industry Workshop on 22<sup>nd</sup> October. It is part of an on-going process and DG MARKT services have yet to draw conclusions on the different specific issues raised in this paper. Thus, the working paper does not represent or pre-judge the contents of any further work of the Commission in this field.**

## ***II Scope***

### **2.1 How should we define PRIPs?**

As highlighted by the Communication, retail investment in the financial market is currently largely channelled through packaged retail investment products. They are products which can take a variety of legal forms but which provide broadly comparable functions for retail investors as defined by the Communication in the following way:

#### **PRIPs:**

- offer exposure to underlying financial assets, but in packaged forms which modify that exposure compared with direct holdings;
- have a primary function of capital accumulation, although some may provide capital protection;
- are generally designed with the mid- to long-term retail market in mind; and
- are marketed directly to retail investors, although may also be sold to sophisticated investors.

As examples of PRIPs the Communication refers to investment funds (both UCITS and non-UCITS), investments packaged as life insurance policies, retail structured securities and structured term deposits.

Based on these elements further work needs to be done in order to identify those products which in view of their comparable functions for retail investors should fall within the scope of the PRIPs work and which thus should benefit from a coherent and consistent approach towards disclosures and selling practices.

To achieve this objective we are seeking to define the scope of PRIPs in a way which:

- covers the relevant PRIPs market across jurisdictions;
- is flexible enough to accommodate financial innovation;
- avoids regulatory arbitrage; and
- provides sufficient legal certainty.

We think that this might be best realised by a definition which relies more on the common economic key features of the products concerned rather than on the legal form of the product.

Thus, the following conditions to be met by a product to be a PRIP might serve as a starting point:

- Rather than holding assets or any other economic reference values directly, PRIPs expose consumers to the performance of assets or reference values through other mechanisms (thus packaging); this criterion would exclude e.g. shares or vanilla bonds.
- PRIPs are products which serve the purpose of capital accumulation; therefore, seeking a return on capital through the exposure to the performance of assets or any other economic reference value would be one key feature of PRIPs; this criterion would exclude e.g. pure protection/risk coverage policies (insurance against unexpected events, death, casualty etc.)
- PRIPs have the investor bearing the investment risk fully or partially, which would cover both situations where the investor's (accumulated) capital is at risk, and situations where there is some form of capital protection, but the return the investor expects to exceed the invested capital/paid premiums is at risk, e.g. at the expiry date of the product. This approach to investment risk might need further refinement with respect to different products; it would exclude pure saving products where the outcome is known beforehand.

These broad principles will probably need to be supplemented by a more concrete list of products to clarify their application to current markets. An indicative list with examples of products which might be included or excluded is attached to this document (Annex 1).

However, defining the scope of PRIPs is not an abstract, self-contained exercise. It should be approached in very close connection with the more concrete work on disclosure and selling practices. Even if a product falls within the scope of the PRIPs work, this does not necessarily mean that the exact same requirements on disclosure and selling practices must apply. Aiming at the highest level of standardisation possible in order to foster comparability between products, does not mean that all disclosure and selling requirements will necessarily apply to all PRIPs in the same way and to the same extent. This might be worth considering when discussing retail investment products which might sit at the boundaries between PRIPs and non-PRIPs.

<b>Q1</b>	<b>Are the above mentioned criteria and the related approach able to capture the relevant market of PRIPs across jurisdictions? Are they able to achieve the identified objectives? Are there other elements to be considered?</b>
<b>Q2</b>	<b>Are there other products which should be included in the PRIPs work, and how might these impact on the approach to scope outlined above?</b>
<b>Q3</b>	<b>How should we handle non unit-linked/index-linked "traditional life insurance" / life insurance 'with profits' contracts, which in some jurisdictions are sold as investment / accumulation products?</b>
<b>Q4</b>	<b>How should we handle products which sit on the boundary of the PRIPs market but are also sold in some jurisdictions as retail investments e.g. "pure derivatives"?</b>

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## **2.2 The specific issue of annuities and pensions**

In the context of the discussion on scope the issue of including "pensions" into the scope has emerged. The pension landscape in the 27 Member States is very heterogeneous and how first (state-run pension schemes), second (occupational schemes) and third (individual, voluntary private pensions) pillar pensions interact is different from one Member State to the other. In addition, pensions are tightly interlinked with the social security systems of each EU Member State. This could make an inclusion very difficult. On the other hand, particularly third pillar pension products might have some or all the characteristics of PRIPs as defined economically, and these products might in some Member States compete directly with PRIPs so that any exclusion of these products from the PRIPs work would seem artificial.

Tightly interlinked with this debate is the treatment of annuities. Annuities are characterized by a period of capital decumulation which normally follows after a phase of capital accumulation (although this is not necessarily always the case – i.e. the accumulation can be achieved by means of a different product). This element of decumulation can create significant challenges e.g. with respect to product disclosures, but some annuities (e.g. variable annuities) decumulate in a manner which exposes the annuitant to investment risk.

<p><b>Q5 What is your view on how "pensions" and annuities should be treated? Should they be included? Can they effectively be excluded? Are there certain types/categories of pension products which should be included?</b></p>
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## ***III Pre-contractual product disclosures***

Consumer testing shows that retail investors find information about investment products difficult to understand and use, e.g. for comparing products. Information is often overly complicated and filled with jargon, unbalanced in presentation, or presented in a way that fails to engage the investor. Investors receive very different information about products which are in economic terms more or less the same. In the Communication, we committed to improving this state of affairs for the benefit of retail investors.

We recognise that improving the quality of disclosures cannot in itself overcome low levels of financial capability or ensure investors are always able to make informed investment decisions, particularly given that investors often do not use disclosure documents, but consider such improvements a necessary building block in rebuilding confidence in the retail investment markets. Without good quality information, informed decision making is after all largely impossible; improving the quality of information should contribute to consumer engagement with the information.

The focus in the work is on addressing issues relating to the investors' pre-contractual decision-making, rather than the ongoing relationship between an investor and the provider of the investment products they buy; for this reason, we do not consider post-contractual disclosures or ongoing disclosures.

### ***KID for PRIPs***

[Note that references to a KID for PRIPs do not imply the application of UCITS KID requirements in a 'one-size-fits-all' manner to other types of PRIP. The term is intended only as a **generic label** for these proposed disclosures, where the content and form could vary in some respects for different types of PRIP.]

#### ***Objective***

- A uniformly high level of consumer protection should apply to product disclosure requirements for all PRIPs, focused on effective communication of the underlying investment proposition and its risks, rather than its legal form. **All retail customers buying PRIPs should be provided with a short, consumer-friendly 'key information document' (KID), irrespective of how the PRIP is packaged or bought.**

#### ***Scope***

- All manufacturers of PRIPs to prepare a KID; KID to be provided to retail customers by all those selling PRIPs.

#### ***Principles***

- KID should be fair, clear and not misleading, presenting information in a balanced manner.
- KID should contain the information necessary to take an informed investment decision (e.g. covering performance and risks, charges, guarantees and how the product functions, for instance the existence of fixed maturity dates).
- Certain elements of information should be standardised across all PRIPs, where this is possible to promote transparency and comparability. Other elements to be tailored to each class or type of PRIP, as necessary. Different detailed rules possible for different types of PRIP.
- KID to be designed and presented so as to be comprehensible to retail clients, who often may have little or no investment experience: a short and simple document, with requirements on form and contents developed in the light of consumer testing findings.
- KID to be provided to retail clients in good time before any commitment is made. All who sell PRIPs to provide the relevant KID to the investor, whether they are intermediaries or manufacturers selling their own products.
- Associated marketing communications should be fair, clear and not misleading, and clearly distinguished from the KID and consistent with it.

#### ***Commitment***

- To develop proposals for the necessary legislative steps for achieving these outcomes. Most likely this will be through a new horizontal legislative instrument, setting a framework for consistent rules on pre-contractual disclosures for all PRIPs.
- The work nearing completion on UCITS fund disclosures – for a KID that provides key investor information on each fund – has been identified as a benchmark for the KID for other PRIPs, but a 'one size fits all' for all PRIPs unlikely.

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### 3.1 Principles governing disclosures for all PRIPs

What are the common principles and elements that should inform the horizontal framework for PRIPs product disclosures? The answer to this question has been well rehearsed in work on product disclosures, e.g. in work by IOSCO and during earlier phases of the PRIPs project. There is considerable agreement in regulatory thinking globally on the key building blocks of an investor disclosure regime, and this has most recently been reflected, in the European context, in the work on the KID for UCITS.

The developing UCITS KID proposals reflect the general principles identified above – that disclosures should be fair, clear and not misleading, and that their purpose is to enable investors to make informed decisions by focusing on key information, presented in a manner investors can use (using plain language and a short format). In addition, the basic structure of the KID for UCITS might have wider application so as to aid comparisons between PRIPs. A defined and common sequence of sections, with standardised section headings might be applied to the KIDs for all PRIPs, covering, in sequence, the product's:

- name (and manufacturer details);
- aims and mechanism for achieving these;
- risks;
- benefits;
- costs; and
- 'practical information'.

See Annex 2 for some further suggestions on the content of such a framework.

<b>Q6</b> <b>Would you agree that we have identified the right principles which should govern a common framework for all PRIPs? Are there other elements to be considered?</b>
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### 3.2 Indicators or information to aid comparisons

There are key points of comparison for retail investors when looking at buying different PRIPs. Common approaches to these points of comparison for different PRIPs seem therefore desirable, so long as these approaches sustain a level playing field.

The UCITS KID proposals highlight risks, performance and costs as key points of comparison. The UCITS KID is likely to contain a simple risk indicator (a scale of 'risk buckets' based largely on historic fund volatility). This indicator is intended also to show likely rewards as an indicator of a basic risk/reward trade-off. Performance is also addressed through the inclusion of a past performance graph, while for structured funds, so-called 'performance scenarios' are envisaged. On costs, the UCITS KID will contain a structured and standardised table showing the main elements of the cost structure in a simple and consistent way.

We think that it might be possible to extend these approaches more widely, though some adjustments might be needed. For instance, exposures to market risk for all PRIPs might be made comparable if the same basic scale and calculation methodology is used; a common approach to performance scenarios for all structured products might be possible, simplifying

and improving the information for investors in this complex area; and comparisons of costs for all PRIPs might be enabled through a common approach to showing product costs. In addition, the general area of guarantees or capital protection raises common consumer comprehension issues across all PRIPs that have these features, so that care will be needed to ensure comparisons on a level playing field can be made. Furthermore, the question of liquidity must be carefully examined and communicated to investors.

Developing common approaches for all PRIPs is nonetheless challenging and will require painstaking work; for instance, cost structures can be very different for different types of PRIP. Indeed, a significant risk for retail investors would be the disclosure of cost, risk or performance metrics which do not effectively achieve a level playing field, potentially leading to misleading comparisons.

**Q7 Would you agree that these are the key areas in which comparisons are important for investors? How can these be best disclosed so as to aid comparisons? Are there other areas which might be equally important?**

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### **3.3 Tailoring of disclosures for specific features of products**

While the KID for UCITS is a good starting point for identifying broad principles, there are of course differences between UCITS, which are harmonised products at the European level, and the other PRIPs, which are not harmonised. For non-harmonised PRIPs there is likely to be significant variation across different jurisdictions in terms of the form and nature of the underlying products. In addition, there can be important differences between types of PRIP in terms of their functioning or what they offer the potential investor, and effective disclosures would need to be able to take account of these differences. This implies that a strongly standardised approach, as is possible for UCITS, may not be so easily achieved for all PRIPs, and that differences may be needed between types of PRIPs.

There are therefore likely to be elements of the KIDs for different PRIPs that need to be tailored to the features or nature of particular types or classes of PRIP. For instance, for insurance-based PRIPs, information about benefits will need to address not only possible investment returns, but also biometric risk benefits. This might even require a certain personalisation of KID information to the life insured. Also, information about the nature and functioning of the product is likely to require different approaches for different types of PRIP – for instance, in regards mechanisms for subscription or redemption and any limitations on these, which might be relevant for certain non-UCITS PRIPs. Work on tailoring KID to different PRIPs also implies the development of a classification of PRIPs from the retail investors' perspective – what are the different needs that different PRIPs are satisfying? This links to the issue above relating to points of comparison: what elements of PRIPs do retail investors need to compare?

**Q8 What elements of the KID might need to be different for different classes of PRIP? E.g. for retail structured products, insurance-based PRIPs or non-harmonised funds?**

**Q9 What are the classes or types of PRIP for which differences might be necessary?**

**Q10 How far might the KID for PRIPs be harmonised for products that are not harmonised at the European level?**

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### **3.4 Responsibilities for pre-contractual product disclosures**

Our starting point is that requirements on preparing pre-contractual disclosures for PRIPs should be directed at product originators, on the basis that these entities are best placed to understand the PRIP and its features, but that there also must be responsibilities that apply to the distributors of these PRIPs, so as to ensure that the documents are actually provided to retail investors. In some defined cases other responsibilities might be envisaged, for instance for distributors where they materially alter a product, e.g. by adding their own margin, unknown to the product originator (this may even be considered an instance of 'remanufacturing' the product, with the distributor now the product originator on their own behalf).

There may be some particular cases where a product falls within the scope of the PRIPs regime – in so far as that scope does not define PRIPs by reference to their being marketed to retail investors – yet which is not intended for the retail market by the product's originator or so being marketed by them. In these cases moves to sell a particular product into the retail market may be due to the actions of distributors rather than the product originator themselves.

One approach to this latter point might to apply the requirement to prepare the KID only where a PRIP is or is to be sold into the retail market. Effectively, PRIPs cannot be sold to retail clients without a KID being prepared and made available by the product originator. The requirement to prepare the KID should, it would seem, still sit on the product originator. Such an approach could give the originator a tool to better influence whether a PRIP is sold to a retail investor at all. It would give him a stronger role in making sure that only products which are actually suitable will be sold to retail investors.

**Q11 Do you agree that requirements on pre-contractual disclosures should be directed at the product originator? Are there any practical issues to be considered with this approach, e.g. where individual products are not intended for retail clients, or where a distributor is able to add margins to a product, changing its cost structure? How can it be best ensured that retail clients buying PRIPs are always given a KID?**

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### **3.5 Specific issue: Wrappers**

The entity offering a PRIP may be different from the entity offering the underlying investments that the PRIP creates exposure to. For instance a PRIP might include a 'wrapper' that provides a tax-efficient vehicle for holding a wide range of underlying investments, such as an ISA (Individual Savings Account) in the UK, which can hold stocks and shares, cash or funds (or a combination). This raises challenges, both in regards relative responsibilities for disclosures to the end investor, but also in regards the contents of these disclosures. In some Member States wrappers exist which can offer access to a very wide range of underlying investments, including hundreds of funds.

A particularly significant challenge arises because of the difficulties retail investors face in combining different layers of information, particularly where additional layers of information alter the impact and significance of underlying layers. A 'wrapper' may not be entirely transparent, introducing additional costs or tax treatments which alter the performance profile of the overall investment proposition (this can be the case, for instance, for UK ISAs as just mentioned; indeed, the packaging element of certain PRIPs (e.g. unit-linked life insurance products) can be considered analogous in function to this kind of wrapper). We think that where a wrapper alters the overall investment proposition, disclosures should be sensitive to retail investors' needs; one way of doing this would be to ensure the impact of the wrapper is always reflected in cost, risk and performance information being shown to investors in relation to the underlying, and that the wrapper itself and its impact are clearly disclosed alongside or as part of the information about the underlying.

**Q12 How should wrappers be handled so as to ensure investors receive information that is comprehensible to them and which they can use to compare PRIPs?**

**Q13 Are there special cases that need particular treatments? E.g. in some Member States a single wrapper may provide access to a very wide of underlying assets or products, including hundreds of funds.**

### **A horizontal approach to the regulation of selling practices**

#### ***Scope***

- The same (broad) selling requirements should apply to all those selling PRIPs, irrespective of whether the entity is an intermediary or the product manufacturer itself.

#### ***Principles***

- Selling practices must be focused on the fair treatment of the investor.
- When an investor receives investment advice, the advisor should always be required to undertake the necessary steps to ensure products sold correspond to the profile and 'demands and needs' of the investor, and that the investor understands the nature of the service being provided by the advisor. Those assessing the suitability of products must fully understand those products and their features.
- If non-advised sales, the limits to the service provided and risks for the investor must be clearly communicated. An assessment of the adequacy of the product for the investors' needs may be required in some circumstances.
- For both advised and non-advised sales, conflicts of interest must not adversely affect investors. They should be avoided where possible, or be identified, managed and disclosed in a way that investors can understand.
- For both advised and non-advised sales, investors must receive clear and effective disclosures of remuneration arrangements and all charges, commissions or fees paid, in a form they can use.

#### ***Commitment***

- To prepare proposals for a horizontal approach across all sales of PRIPs, with MiFID as the clear benchmark. One possible approach might be to extend the application of relevant MiFID provisions to non-MiFID PRIPs, though the specificities of respective sectors would need to be recognised at the level of technical provisions.

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### **4.1 Application of MiFID-inspired selling rules across sales of all PRIPs**

As set out in the Communication it is our aim to ensure consistent and effective rules on all sales of PRIPs, irrespective of the form of the PRIP or the channel chosen for the sale, and we have identified that the conflicts of interest, inducements, suitability and appropriateness requirements in MiFID offer a good framework for this which could be applied more widely.

However, applying MiFID requirements more widely raises potential challenges, as MiFID selling rules have been developed for the distribution of a specific set of financial products, rather than the full range of PRIPs (more precisely, financial instruments as defined under Annex I Section C of MiFID, such as shares, bonds and derivatives). These challenges might

be overcome by adjusting the legal text so that the application and meaning of provisions is effective for all PRIPs. There might also be specific practical issues when applying those requirements to other products and related distribution channels, e.g. insurance products, where, for instance, inducement requirements might need specific and tailored elaboration. In principle, however, we consider that the high-level requirements in MiFID on conflicts of interest, inducements, suitability and appropriateness can be applied more widely.

**Q14 What are the issues with applying MiFID selling rules to the distribution of insurance-based PRIPs and banking-based PRIPs (e.g. structured term deposits)?**

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## **4.2 Conflicts of interest**

Conflicts of interest can often arise between a person selling and their client, the retail customer, e.g. product or provider biases can arise due to the impact of commission structures or the impact of sales bonuses or other incentives. MiFID addresses these issues through requirements relating to the avoidance, management and disclosure of conflicts of interests and through requirements on inducements. Notably, these requirements are not largely disclosure related, though disclosure may be an element: effectively, conflicts of interest must be managed, and inducements (normally) avoided. (The case of inducements disclosure is covered below).

Such standards should apply to all sales of PRIPs. However, it is possible that some refinements or developments may be appropriate, particularly taking into account their application to non-MiFID PRIPs. In addition, given the issues retail investors face in understanding and using information about financial services, how might disclosures relating to conflicts of interest (and linked to this, inducements) be best developed and delivered, so that investors can understand them and make effective use of them (see section 4.4)?

**Q15 Are there any refinements to the MiFID handling of conflicts of interest that should be considered for PRIPs?**

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## **4.3 Advice**

The MiFID establishes an overarching principle governing the provision of investment services notably the obligation for investment firms to act honestly, fairly and professionally in accordance with the best interest of their clients. More specific requirements concern the provision of investment advice (see below) and non-advised services (see section 4.6).

When a retail investor receives investment advice, his or her advisor takes responsibility for collecting his or her relevant information and ensuring products sold correspond, in so far as is reasonable, to the profile as well as the 'demands and needs' of the investor. It appears clear that the same broad standards on advice should apply to all PRIPs.

However, the challenges in ensuring investors are able to make informed decisions in relation to investment services are just as significant as those relating to product choice. The nature of a service being offered can often be unclear to retail clients – for instance, in regards details on what the service actually entails (e.g. how far the advisor will make recommendations

across the market or instead from a more limited set of products, or the reasons underpinning the advice). Indeed, research in some Member States shows that investors can be significantly confused as to the nature and cost of services being offered, and it can be surmised this might lead to more inefficient markets and consumer detriment.

- Q16** Should the general duty to act in the best interest of the client constitute a common overarching principle for all PRIPs?
- Q17** How can the nature of the services being offered by the seller be best communicated? Should the client be informed if the recommendations are based on a broader or more limited range of products?
- Q18** Should those making recommendations comply with specific comparable reporting obligations to clients, e.g. on the underlying reasons underpinning the advice, as is currently the case in the IMD?

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#### **4.4 Remuneration of the seller**

As identified by the Communication, one of our major aims is making sure that information given to investors is useful to investors and helps them make informed investment decisions, including clear and effective disclosures of remuneration agreements and all charges, commissions or fees paid. Research suggests that retail investors have considerable difficulties understanding costs, whether those relate to the products themselves, the distribution of those products, or the provision of services (e.g. advice). Yet retail investors have an interest in comparing service providers as well as products, and an informed comparison would require cost transparency for both the service and the product.

This can be complicated by the fact that costs are intertwined – where a fee-based approach is not in place, distribution and service costs are often bundled into product costs as commissions, raising important conflict of interest and inducement issues. MiFID provides a central tool for addressing this – requirements on inducements, which include disclosure to the client about the existence, nature and amount of the payments. However, the question may remain as to the practical application of this requirement, such as what exactly to disclose, and how best to disclose it. For example, a more standardised approach might be developed (e.g. a common layout or template that has been tested on consumers), so that retail clients are in practice able to effectively compare services and their costs.

- Q19** What information do retail investors need about remuneration and costs, so as to combat so-called 'commission bias' and enable informed decision making?
- Q20** Would a more standardised approach to cost and remuneration disclosure tested on consumers help?

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#### **4.5 Direct sales**

The Communication outlined the principle that the same broad requirements should apply to all retail sales of PRIPs, irrespective of whether these are handled by an intermediary or by

the product originator themselves. Currently certain direct sales (e.g. by insurance undertakings) are not covered by rules applying to intermediaries, e.g. the assessment of suitability for the client. Yet similar risks can exist for retail investors irrespective of whether a sale is direct or intermediated. For instance, conflicts of interest can exist between a product originator and a retail client, such as might occur where bonuses are paid linked to sales volumes, while retail investors can face the same challenges in understanding the nature or limits of the service being offered when buying directly from a product originator as they would when buying from an intermediary. While we consider therefore that the same broad requirements therefore should apply irrespective of the distribution channel, it is nonetheless likely that detailed rules need to reflect differences between direct and intermediated channels.

**Q21 Do you agree that direct sales should be covered by PRIPs sales rules? Should rules be only tailored in so far as this allows differences in the risks to consumer protection found in different channels to be reflected?**

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#### **4.6 Non-advised sales**

MiFID calibrates the assessment of the adequacy of products for the client on the basis of the service provided. In the case of advice, a full suitability test applies; an intermediary must assess suitability on the basis of knowledge and experience, financial situation and investment objectives of the client. In the case of non-advised sales, MiFID requires intermediaries to conduct an "appropriateness test", that is an assessment of whether the client has sufficient knowledge and experience to understand the product they are seeking to purchase. Only for non-complex products (and provided that other conditions are fulfilled) is this test not necessary (the so called 'execution-only' regime).

It might be argued that PRIPs are intrinsically complex investments (compared to non-PRIP financial instruments, say), and the appropriateness test should always apply. On the other hand, it might be argued that PRIPs straddle the boundary between complex and non-complex instruments. UCITS, for instance, are currently 'non-complex' by definition.

This issue further relates to whether the calibration of investor protection measures might need adjustment for different classes of PRIPs. In particular, one might argue that some categories of PRIPs (such as insurance products) can be highly personalized and the retail client may therefore reasonably expect that all the elements of the suitability test should be considered.

**Q22 Should a suitability, or at the least an appropriateness test, always be required when selling PRIPs, or only for some PRIPs?**

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#### **4.7 Concept of Retail Investor**

Any horizontal approach tailored to the protection of retail investors needs clarity as to how to understand the concept of retail investor. The fact that a product is sold to the retail investor will be the relevant trigger for the application of the relevant requirements on selling practices. It seems that the approach of MiFID could serve as a starting point for identifying retail investor for the purposes of the PRIPs work. MiFID contains a distinction between

professional and retail client, but however also contains some mechanisms which ensure flexibility as regards this categorisation to ensure that investors are treated in accordance with their profile. There is the possibility to downgrade certain professional investors to retail investors and to upgrade certain retail investors to professional investors.

**Q23 Are there any issues to be addressed when applying the MiFID approach towards the concept of retail client across the whole PRIPs market?**

## Annex 1

### **1. Indicative list of examples of products that might be included or excluded**

Included	Not included
<ul style="list-style-type: none"> <li>• structured investments issued under the form of bonds and other forms of securitised debts or structured term deposits (both capital guaranteed and not capital guaranteed)</li> <li>• asset backed securities</li> <li>• collateralised debt obligations</li> <li>• covered bonds</li> <li>• UCITS including ETFs and UCITS providing capital protection/guarantees</li> <li>• non-UCITS including closed end funds, ETFs funds providing capital protection/guarantees).</li> <li>• unit-linked life insurance policies (with or without guarantee)</li> <li>• index-linked life insurance policies (with or with guarantee)</li> <li>• hybrid life insurance products (combining, for example, unit-linked life insurance elements with investments in traditional insurance funds)</li> <li>• structured products written as insurance policies</li> <li>• warrants, covered warrants.</li> <li>• convertible shares</li> <li>• convertible bonds</li> </ul>	<ul style="list-style-type: none"> <li>• savings accounts</li> <li>• shares</li> <li>• depositary receipts for shares or bonds</li> <li>• treasury bills/government bonds</li> <li>• ordinary ('plain vanilla' or 'traditional') bonds</li> <li>• cash</li> <li>• certificates of deposits</li> <li>• commercial papers</li> <li>• subordinated bonds</li> <li>• callable and puttable bonds</li> <li>• term insurance (e.g. payment of a fixed sum on death during the life of the policy)</li> <li>• pure protection/risk coverage policies (insurance against unexpected events, death, casualty etc.),</li> <li>• mortgages and loans</li> <li>• a pure wrapper – i.e. a form of legal structure that can be placed around an asset that is, itself, owned and controlled by the investor but that does not alter the costs, risks or return of the underlying investment</li> <li>• sports spread betting</li> </ul>

### **2. Products which deserve closer examination and further discussion before they can be added to the list under point 1**

- non unit-linked/index linked life insurance such as with-profits life insurance/endowments and traditional life insurance investment products
- derivatives (options, futures, financial contracts for difference etc.)
- Pensions
- Annuities

## Annex 2

### Elements of a horizontal regime for precontractual disclosures for PRIPs

Element		Principles	Detailed requirements, tailored for individual PRIPs
<b>Principles</b>		<ul style="list-style-type: none"> <li>• Fair, clear and not misleading</li> <li>• All key information necessary for making an informed investment decision</li> </ul>	
<b>Form of disclosure</b>		<ul style="list-style-type: none"> <li>• Short / simple, plain language</li> <li>• Harmonised structure, sequence of sections</li> <li>• Similar standard to marketing material</li> <li>• Standalone</li> </ul>	<ul style="list-style-type: none"> <li>• Rules on headings, layout, order of items, signposting and cross-referencing</li> <li>• Rules on length for some products</li> <li>• Rules on font sizes, etc.</li> </ul>
<b>Common disclosure elements</b>	<b>What does the product aim to do?</b>	<ul style="list-style-type: none"> <li>• Common disclosure elements that must be included in all PRIPs disclosures, key points of comparison</li> </ul>	<ul style="list-style-type: none"> <li>• Detailed rules.</li> <li>• Possible split between common aspects that apply to ALL PRIPs, and product specific aspects that only apply to particular products.</li> </ul>
	<b>What are the key risks and rewards?</b>		
	<b>How much will it cost?</b>		
<b>Other disclosure elements</b>		<ul style="list-style-type: none"> <li>• Some elements not common to all PRIPs</li> </ul>	<ul style="list-style-type: none"> <li>• Disclosure elements for particular products, e.g. on benefits, lock-ins, etc.</li> </ul>
<b>Timing / medium of delivery</b>		<ul style="list-style-type: none"> <li>• Durable medium – consistency with MiFID</li> <li>• Sufficient time to inform investment decision – consistency with language on timing in MiFID</li> </ul>	
<b>Liability</b>		<ul style="list-style-type: none"> <li>• Clarify liability applying to document</li> </ul>	
<b>Keeping up to date</b>		<ul style="list-style-type: none"> <li>• Must be kept up to date</li> </ul>	<ul style="list-style-type: none"> <li>• Detailed requirements possible on revisions?</li> </ul>
<b>Relationship with other documents</b>		<ul style="list-style-type: none"> <li>• Clarify interactions with prospectus, other contractual documents</li> <li>• Handling of 'wrappers' / combined documents</li> </ul>	<ul style="list-style-type: none"> <li>• Handling of 'wrappers' / combined documents</li> </ul>