

**UPDATE ON COMMISSION WORK ON  
PACKAGED RETAIL INVESTMENT PRODUCTS**

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**This working paper represents the views of the Commission Services and does not represent or pre-judge the contents of any further work of the Commission in this field.**

# Packaged Retail Investment Products

## 1. Purpose of this paper

*This paper provides an update on the Commission's ongoing work on Packaged Retail Investment Products (PRIPs) and further detail on how the Commission will take forward the commitments it made in the 30<sup>th</sup> April 2009 Communication on PRIPs [COM(2009) 204 final].*

## 2. The Communication of 30<sup>th</sup> April 2009

The Communication outlined important investor protection and level playing field issues in the retail investment markets which broadly cover investment funds (both UCITS and non-UCITS), retail structured products, and insurance-based investment products. The regulatory framework that has developed to address these problems is inconsistent and patchy and incurs a risk of regulatory arbitrage and investor detriment. The significance of these issues has been underlined by the financial crisis.

In response, the Commission committed to ensure investor protection standards are always at the appropriate level by taking a new 'horizontal' regulatory approach to the standards. This would also ensure a level playing field between different types of retail investment products. Given the 'regulatory patchwork' at the European level this will require legislative change.

Work to achieve these objectives will focus on two key regulatory areas: rules on pre-contractual disclosures, and rules on selling practices. In both these areas clear benchmarks were identified: for pre-contractual disclosures, the improved key investor information document (the KID) being developed for UCITS; for selling rules, the conduct of business and conflicts of interest requirements in the Markets in Financial Instruments Directive (Directive 2004/39/EC, MiFID), addressing conflicts of interest and inducements, appropriateness, suitability, and relevant disclosures about these.

The Communication of 30<sup>th</sup> April 2009 made clear that the Commission recognised that this was a challenging project, cutting across existing sectors and legislation. Issues to address included identifying how to:

- deliver a consistent and coherent cross-sectoral approach taking into account differences in sectoral regulation in areas which are not touched on in the PRIPs initiative (e.g. differences in supervisory oversight or authorisation regimes);
- define the scope so as to cover relevant PRIPs markets across Member States, ensure necessary flexibility to accommodate financial innovation, reduce and mitigate risks of regulatory arbitrage and ensure sufficient legal certainty;

- strike the right balance between the highest degree of standardisation possible in order to facilitate comparability and the need for tailoring requirements with respect to product specificities, taking into account that the major part of PRIPs are non-harmonised products.

### 3. Process adopted by the Commission

The Commission Services have subsequently been working on identifying options for the detailed legislative steps necessary for fulfilling the commitments made in the Communication of 30<sup>th</sup> April 2009.

The issues to be considered can be broken down into three separate but linked areas: the *scope* of the initiative (which products should be included); *pre-contractual disclosures* (how to adapt or apply the key features of the UCITS KID to other PRIPs), and *selling practices* (how to adapt or apply MiFID requirements to non-MiFID PRIPs, and also on whether MiFID requirements on sales might need to be refined so as to better achieve investor protection outcomes).

Commission services have and continue to engage extensively with stakeholders, including investor representatives, trade bodies, both at the European and national levels, individual firms, and supervisors, both at the national level and through the form of the supervisory committees. The supervisory committees (CESR, CEBS and CEIOPS) have each themselves also considered the Communication and provided the Commission with input on how to take the commitments in the Communication forward.

In order to complement its own thinking and initial input from stakeholders, the Commission Services hosted a **Technical Workshop** on 22 October 2009 to discuss with high-level industry experts and consumer representatives emerging issues. As the PRIPs initiative cuts across existing sectors and legislation the workshop aimed at providing the opportunity to test with a wide range of stakeholders the main ideas contemplated in the course of the work on PRIPs. The workshop provided a forum for all interested stakeholders to clarify their positions and focus on practical aspects of the exercise.

### 4. Workshop Issues Paper

In order to consult with workshop participants and provide a focus for the discussions at the workshop, the Commission Services prepared an 'Issues Paper' (subsequently published online at [http://ec.europa.eu/internal\\_market/finservices-retail/investment\\_products\\_en.htm](http://ec.europa.eu/internal_market/finservices-retail/investment_products_en.htm)). The issues paper drew out key emergent issues in relation to each of the three strands of work noted above.

#### **Scope**

The paper outlined an approach to the definition of PRIPs based on criteria as to the economic functioning of the product. PRIPs are thereby identified as capital accumulation products (though debatably this should also cover certain products where returns are distributed as income) where returns on the product are generated

through indirect exposure to underlying assets, such that the investor carries all of the investment risk, or at least some of that risk (where protection or guarantees are offered). Such an economic approach (supported by a white list of product types that are 'in' or 'out' of scope) should help avoid regulatory arbitrage

### ***Pre-contractual disclosure***

The paper outlined the key features of the UCITS 'Key Information Document' (KID) regime that might be readily transferrable to all PRIPs.

Under this approach, PRIPs pre-contractual disclosures would be governed by a single common framework which applies a consistent set of core principles. These principles would draw from the lessons learned through the process of developing the KID (which was subject to extensive consumer testing). The purpose of the disclosures would be to enable investors to make informed investment decisions by focussing on key information presented in a format which allows for comparison. They should be fair, clear, and not misleading and they should be presented so investors can use them to guide their investment decisions and to empower them to shop around for the most suitable product for their needs (short, using plain language, with a defined format including a structured sequence of sections).

The common principles would need to be supplemented by detailed implementing measures, e.g. on the content and the format of the document and on information useful for comparisons between PRIPs, such as on cost, risk and performance. These measures would allow the tailoring of certain elements of the information for different product classes. These would also allow for a distinction between requirements that would apply to all PRIPs and requirements which might have a more limited application e.g. solely to UCITS or insurance based PRIPs. All detailed requirements should be developed on the basis of consumer testing so as to fully reflect investors' needs.

### ***Selling practices***

For selling practices, the paper reiterated the goal of using MiFID provisions (on conflicts of interest, inducements, appropriateness, suitability and disclosures to clients about these) as the basis for a common PRIPs sales regime. It was noted that the high-level requirements of MiFID seem readily and widely applicable to all PRIPs. However, there might also be some challenges given the provisions are written to establish a regulatory framework for securities markets. Some technical adjustments to the legal texts might therefore be necessary to ensure appropriate application particularly to those PRIPs whose sales are currently not subject to MiFID.

The paper also addressed the issue of potential refinements to MiFID requirements for the purposes of the PRIPs initiative, for instance relating to disclosures to retail investors about conflicts of interest, inducements and intermediary remuneration, or the disclosure of whether advice is being provided on a broader or more limited range of products. Questions were also raised as to the tailoring of sales rules for different types of distribution (particularly as regards direct distribution by product manufacturers and whether a test for the adequacy of the product for the investor should always be carried out by the service provider.)

## **5. Responses to the workshop**

The discussion at the workshop and feedback from participants confirmed a strong degree of support for this initiative. The gravity of the investor protection and level playing field issues being addressed and the need for a horizontal approach was widely accepted. Most stakeholders supported the Commission Services view that legislative change was necessary to address these problems – that the current 'regulatory patchwork' was not 'fit for purpose'.

There was broad support for the Commission's proposal for an approach to the definition of PRIPs relying on economic criteria, and indeed for the elements of the definition proposed. In practice, some stakeholders felt that the scope should be wider – to focus on whatever products are sold to retail investors when they wish to make an investment, irrespective of the form of the product e.g. including some 'vanilla' assets, such as straight equities or bonds. From the perspective of consumers it might be difficult to determine which retail products are packaged and which not, so a more relevant criterion might therefore be whether products were substitutable at the point of sale. Others felt that the scope should be narrower – excluding, for instance, structured deposit-based products where the deposit is fully guaranteed. There was no consensus on the precise line to be drawn between insurance-based investment products and other insurance products (which would fall out of scope). With pensions and annuities, there was support for these being out of scope by definition, though with some dissenting voices, at least as regards certain pillar III pensions.

On pre-contractual disclosures, stakeholders broadly supported the identified approach, including both the core principles and detailed requirements that would be standardised across all PRIPs. There was a broadly voiced view however that there should be a certain amount of 'tailoring' of detailed requirements to reflect the specificities of particular product types, and in addition some greater flexibility and reduced degrees of standardisation for non-harmonised products. Views were split as regards the respective responsibilities of distributors and product originators, with some favouring responsibilities for production of pre-contractual information falling solely on product originators, while others argued that responsibilities should fall on distributors or that it be left for distributors and product originators to allocate responsibilities between themselves as appropriate.

On selling practices, while there was widespread support for the use of MiFID as the benchmark for the PRIPs regime, some argued that some requirements inspired by the Insurance Mediation Directive (Directive 2002/92/EC, IMD), notably on the disclosure of whether advice is being provided on a broader or more limited range of products should also be considered. Improvements on conflicts of interest and remuneration requirements might be necessary to achieve the desired investor protection outcomes for all PRIPs across all sectors. It was also argued by some that the specificities of the distribution channels in the different sectors should also be taken into account.

## **6. Commission Services preliminary conclusions**

The Commission Services are still considering input from stakeholders, including detailed reports from CESR, CEBS and CEIOPS.

Stakeholder input has already indicated however that the Commission’s commitment in the Communication to make the legislative changes necessary to achieve a **horizontal** regulatory regime for PRIPs sales and pre-contractual disclosures was appropriate. Such an approach is the most effective and efficient way of ensuring that investors receive the right measure of protection irrespective of the legal form of the investment products they are seeking to buy or the channels through which they are seeking to buy them; and that a level playing field exists between different providers and distributors of PRIPs.

Stakeholder input has also confirmed the choice of the two benchmarks identified in the Communication (MiFID for sales rules, and the UCITS KID for pre-contractual disclosures); no major issues seem to impede the wider application of these benchmarks.

The outlines of the emerging approach are also becoming clearer, allowing for some preliminary conclusions to be drawn:

Area	Preliminary Conclusions
<b>Scope</b>	An approach relying on economic criteria is almost certainly necessary. It is important that the scope captures the core market for retail investment products where risks of consumer detriment are most prominent.
	The criteria outlined in the issues paper are largely sound – building the definition on three legs, each of which must be satisfied for a product to be a PRIP: <ul style="list-style-type: none"> <li>• an element of packaging;</li> <li>• a product capable of meeting an investor need for capital accumulation; and</li> <li>• a product that creates exposure to investment risk for the investor</li> </ul>
	Further technical work is necessary to define the precise details of the scope. Considering that measures to enable comparability between products are being sought, which would be difficult to achieve if the scope is widened too broadly, it still appears sound to rule out direct investments in simple "plain" assets ('pure' shares, 'pure' bonds, commodities, property), especially with respect to requirements on pre-contractual disclosure. Unit-linked or index-linked insurance-based investment products are clearly in scope; in addition, a strong case has yet to be made for ruling out other insurance-based investments.
	Inclusion or exclusion of pensions and annuities requires further work and analysis taking into account the dependency of

	arrangements and features of these on national social systems.
<b>Pre-contractual disclosures</b>	Disclosure framework to be applied cross-sectorally, with detailed requirements containing both common elements and tailored elements.
	Framework to include requirements on use of plain language, document length.
	Detailed contents of disclosures need to be subject to consumer testing so that document requirements fully reflect investor needs.
	Common elements to allow for comparisons to include the structure of documents, order of sections, use of plain language, and focus on key information about nature of product, its risks, potential performance and costs.
	Detailed requirements will be necessary for standardisation of certain elements, including common risk, cost and performance metrics.
	Some tailoring of disclosure requirements necessary for investor protection reasons.
	Two options conceivable as regards the responsibilities for the preparation of the document: <ul style="list-style-type: none"> <li>• Detailed rules setting out responsibilities for preparation of document, to generally sit with product originator, but, given the role of distributors in relation to bringing certain PRIPs into the retail market, responsibilities also placed on distributors.</li> <li>• A more flexible approach relying on the cooperation between product originator and distributor.</li> </ul>
	Responsibilities for delivery of document sit on whoever is selling.
<b>Selling practices</b>	Same principles and overall framework (high-level rules) should apply to all sales of PRIPs, irrespective of the sector of the PRIP or the channel by which it is being sold.
	The same detailed requirements (on conflicts of interest, inducements, appropriateness, suitability and disclosures about these) should in general apply to all sales, but some tailoring of the detailed requirements to reflect different distribution arrangements may be necessary.
	Certain aspects of these detailed requirements are likely to need further refinement so as to ensure the desired investor protection outcomes.

## **7. Next steps**

The Commission Services are now working on preparing legislative proposals consistent with these conclusions and the commitments made in the Communication. To support this work the Commission Services are preparing studies, including on the costs of potential options for change for the industry, and to better understand consumer behaviour.

Proper coordination between this initiative and the reviews of MiFID and the IMD as regards selling practices will be ensured.

Commission services also recognises strong interaction with this initiative and other on-going work, notably amendments on the Prospectus Directive, on finalising the Solvency II framework, on finalising the UCITS IV framework, on a directive on Alternative Investment Fund Management, on remuneration in financial services, and on Investor Compensation and Deposit and Insurance guarantee schemes. The Commission services involved in these different initiatives are working together to ensure consistent time lines and approaches where necessary or appropriate

The Commission Services plan to consult in the forthcoming months on a draft of these proposals before seeking their adoption, in accordance with the principles of better regulation.