FEEDBACK STATEMENT
ON CONTRIBUTIONS TO THE
CALL FOR EVIDENCE ON
"SUBSTITUTE" RETAIL INVESTMENT PRODUCTS

~ MARCH 2008 ~

FEEDBACK STATEMENT ON CONTRIBUTIONS TO THE CALL FOR EVIDENCE ON "SUBSTITUTE" RETAIL INVESTMENT PRODUCTS

Table of contents

EXECUTIVE SUMMARY 3
FEEDBACK STATEMENT ON CONTRIBUTIONS TO THE CALL FOR EVIDENCE 7
1. Consultation process on "substitute" retail investment products 7
1.1. Background to the call for evidence 7
1.2. Next steps 8
1.3. Acknowledgements 8
2. Responses to the call for evidence 9
3. Analysis of the contributions 11
3.1. General comments 11
3.2. Replies to the specific questions 12
Section 1 of the call for evidence - Scope of the review 13
Question 1 13
Question 2 15
Question 3 16
Question 4 19
Section 2 of the call for evidence - Is there a risk of investor detriment? 20
Question 5 20
Question 6 23
Question 7 25
Question 8 27
Section 3 of the call for evidence - Is there a need for action? 29
Question 9 29
Question 10 31
i) Market forces and self- (co-) regulatory initiatives 31
ii) Action by national authorities 33
iii) The case for EU involvement 35

EXECUTIVE SUMMARY

The Commission (DG MARKT) received a total of 80 contributions to its call for evidence on “substitute” retail investment products. The purpose of this feedback statement is to provide a high-level synthesis of these contributions.

Responses revealed a broad consensus that retail investment markets are characterised by rapid innovation and that the onus on retail investors to make private financial provision for retirement is increasing. It was felt to be imperative, in this context, that investor confidence in retail investment products is maintained.

Most responses recognised the need to keep the regulatory framework under review to ensure that it delivers an appropriate and consistent level of investor protection. However, many cautioned against assessing the impact of existing rules before they have been fully implemented in all jurisdictions. The lack of practical experience with the Markets in Financial Instruments Directive (MiFID) and Insurance Mediation Directive (IMD) are particular cases in point.

Impact of differences in regulatory treatment

A slight majority of contributions considered that variations in the regulatory treatment of retail investment products had not given rise to investor detriment. Respondents from the banking, securities and insurance sectors argued that differences in rules are justified by differences between products, and that existing regulations provide a level of protection that is broadly equivalent across product types.

However, all consumer responses identified threats arising from variations in rules and highlighted sectors in which regulatory protections were perceived as relatively weak. They also underlined the need for more consistency between products in pre-contractual information. A majority of public authorities shared this view. Others, notably a majority of insurance supervisors, saw that existing regimes were adequate.

A large majority of industry contributions argued that differences in sectoral regulation were not a significant hindrance to the development of pan-European markets. They saw retail markets as predominantly local for a range of reasons. Instead, it was the uneven national implementation of existing rules including, in some instances, 'gold-plating', that was seen as a threat to the development of the market.

However, the asset management sector, consumers and some public authorities argued that differing regulatory treatment, not only in product disclosure and distribution but also in rules on product constitution and pre-approval of products and advertising campaigns, could give rise to competitive distortions and threaten the balanced development of markets.

Divergence of opinion on the notion of 'substitutability'

Many industry contributions, arguing from the structural and functional differences between the products or variations in tax treatment, considered it inappropriate to describe broad product categories as 'substitutable'. However, the majority of contributors, including all consumers, the asset management sector and public authorities, considered that most of the products listed in the call for evidence - and some that were not - should be considered within the scope of the review. They argued that, although the products in question were not identical, they served similar consumer needs.

Factors driving the promotion and sale of particular investment products

"Taxation" was most frequently cited, notably with regard to unit-linked life insurance. "Distribution models" and "cultural preferences" were also deemed to be significant. "Financial innovation" was seen as a driver of the success of structured securities in some countries.

The banking, securities and insurance industries argued that consumer choices were not influenced by regulatory treatment. Instead, sales were driven by the ability of the products to meet investor needs. However, responses from other industry sectors argued that lighter rules on investment strategies and product authorisation may favour the promotion of particular products. Consumers, some regulators and the fund industry saw differences in product transparency as a factor influencing sales. They argued that certain products may be perceived as more attractive by retail investors as a result of a lack of transparency on associated risks and costs.

Is there a risk of investor detriment?

Most responses from the insurance, banking and structured securities sectors judged the disclosure, conduct of business, and conflict of interest requirements embodied in existing EU rules for their own products to be adequate. Many reported that these had been supplemented with national rules in many Member States and/or by market standards.

Several responses stated that MiFID provided a benchmark against which other regimes should be judged. Consumers, some public authorities and the fund industry perceived rules on insurance distribution to be less stringent. However, the insurance industry argued that the conduct of business regime for insurance distribution, although less detailed than MiFID, provided an equivalent level of retail investor protection. Several contributions, recalling that structured term deposits were not subject to MiFID, expressed concerns which were echoed by the fund industry. Others expressed concern regarding the adequacy of the rules applying to the proprietary distribution of in-house products.

Many consumers and public authorities identified possible weaknesses in - and a lack of comparability between - existing disclosure regimes. For instance, many insurance supervisors and consumers identified possible 'gaps' in existing pre-contractual disclosures for unit-linked life insurance, particularly with regard to conflicts of interest. Others pointed to possible weaknesses in disclosures on the embedded costs of structured securities and argued that disclosures under the Prospectus Directive are not always well-adapted to retail investors.

Funds were broadly considered to provide sufficient and clear information, although several consumers and regulators felt that there were problems with the presentation of information in the current Simplified Prospectus. Many hoped that 'key investor information' (KII) for UCITS now under development would lead to substantial improvements. The fund industry, however, expressed concern that KII was to be introduced for funds but not for other products.

Consumer associations were concerned about the adequacy of suitability testing in the increasingly important internet distribution channels. Trade unions underlined the need to focus on adequate training of intermediaries and to avoid conflicts in distribution systems linked to commission-based remuneration. Many contributions pointed also to the dangers of over-provision of information to retail

investors. Several contributors – from all stakeholder categories - argued that further improvements in financial literacy were essential.

Some authorities - mostly those that had applied common rules to the sale of retail investment products - were content with national frameworks and expressed confidence with regard to investor protection.

Many responses identified certain product types as being particularly susceptible to the risk of mis-selling. Some authorities highlighted complex products and those sold with capital guarantees as being of particular concern. Some contributions argued that the absence of a pre-approval process could result in the risk of misleading marketing communications being higher for unit-linked policies and structured securities than for funds. Most replies from industry representatives considered that the regulatory framework applying to their own sectors was robust.

Is there a need for action?

All consumer responses stated that a horizontal approach to disclosure and distribution would be appropriate and proportionate. Some regulators also saw clear benefits from treating investment products in a more consistent manner and suggested that this could be achieved through wider application of KII principles and MiFID suitability rules. Many recalled, however, that MiFID had already provided a consistent level of protection across multiple products and that several Member States had taken additional steps to improve the consistency of rules across a broad range of products.

Many industry responses supported the principle of a more consistent approach, provided that possible deficiencies in existing rules were clearly identified. It was widely felt that a cross-product approach would only work if it were proportionate and flexible. Whereas the asset management sector advocated more uniform rules for a broader range of products, allowing for fair competition and enhancing investor protection, many other industry responses considered that it would not be feasible to go further than the adoption of flexible 'high level' principles to achieve greater coherence.

A large number of contributions warned that full harmonisation of disclosure and distribution rules would be a huge and costly undertaking. There was a real risk that such harmonisation would fail to take account of product specificities. This would result in investor detriment through the stifling of innovation and a reduction in product diversity. Many industry responses argued that the focus should be on the more consistent implementation of existing rules between Member States rather than on cross-sectoral harmonisation.

A large majority of industry contributions stated that market-based solutions provided a proportionate and effective approach and could be adapted to the particular needs of national markets. Examples of such initiatives, often developed in partnership with regulators, were supplied. Several regulators commented on how self-regulatory initiatives operated in their jurisdictions. Industry responses stressed that it will be some time before the effectiveness of these approaches, notably the ongoing development of MiFID-compliant principles, can be evaluated.

However, consumer associations and many public authorities expressed scepticism as to the ability of market-led initiatives to mitigate the risks identified.

A majority of responses from the life insurance and financial services sectors (and some asset managers) considered that due to the significant differences between national retail financial markets, the respective national authorities were best placed to identify market failures and to act accordingly. However, some regulators explained that the provisions of certain Directives had limited their discretion to act at domestic level.

Two thirds of industry responses concluded that further action by national authorities was not appropriate. In many cases, this reflected support for domestic regimes in which authorities had already acted to improve the consistency of rules across a broad range of products. However, others identified that such initiatives may have resulted in some cases in uneven implementation of directives and in the application of rules to businesses for which they were inappropriate.

The majority of contributions from consumers expressed scepticism as to the willingness of Member States to tackle the problems identified. All foresaw a role for the EU, with some suggesting that MiFID-style disciplines be extended to all retail investment products and that KII-type disclosures could be applied to other products. Other consumers suggested work towards harmonisation in the implementation of rules through the work of the three Level 3 Committees. However, all insisted that this should be based on extensive consumer testing.

The fund industry was particularly insistent on the need for EU-level action, arguing that the existence of competitive distortions provided a clear basis for legislative action under the European Community Treaty.

A number of responses from public authorities were also supportive of EU involvement on the grounds that many of the issues identified flowed from EU rules and could not all be remedied satisfactorily at national level. However, other regulators felt that the case for further EU level action had yet to be made.

Very few contributions expressed support for new cross-cutting legislation. Those in favour of EU action generally supported a targeted, proportionate approach, limited to building on existing frameworks when relevant directives are reviewed. Any support for EU involvement was strongly qualified by the need to ensure that intervention is only considered if a clear market failure is identified and must be accompanied by strict and rigorous cost-benefit analysis.

Next steps

A public hearing will be held in Brussels in July 2008 to bring together key stakeholders to discuss the issues raised in the call for evidence.

The outcome of this consultation will contribute to a Commission Communication in the autumn, which will consider whether there is significant evidence of investor detriment and whether there is a need for further work in this area.

*

* *

FEEDBACK STATEMENT ON CONTRIBUTIONS TO THE CALL FOR EVIDENCE ON "SUBSTITUTE" RETAIL INVESTMENT PRODUCTS

1. Consultation process on "substitute" retail investment products

1.1. Background to the call for evidence

Investment products offering comparable risk/return performance can be sold in a variety of forms. Households and private investors already rely heavily on these products to meet their financial needs. At the end of 2007, assets under management by UCITS funds; non-harmonised investment funds; unit-linked life insurance policies and the total outstanding capital invested in retail tranches of structured products amounted to more than €10 trillion. Despite the recent market turmoil, which has triggered some withdrawals from retail sectors, net sales of "substitute" retail investment products were estimated at more than €900 billion for 2007. These figures are set to grow as individuals turn to private pension products to help them to provision for retirement. Effective product disclosures and a high level of professionalism in financial distribution will be vital in ensuring a successful transition.

EU legislation applying to the institutions originating and distributing these products imposes different rules on product disclosure and on the way that financial intermediaries conduct their business with retail clients, and manage any conflicts of interest that might arise. The blurring borderline between investment products and the opening architecture in EU financial distribution pose new challenges for this regulatory system.

On 26 October 2007, the Internal Market and Services Directorate General of the European Commission (DG MARKT) published a call for evidence[1] on possible risks to retail investors arising from variations in the regulations governing product disclosure for, and the distribution of, different types of retail investment product. The primary purpose of the call for evidence was to gather information and views from stakeholders to test claims that the fragmented regulatory landscape results in a real and significant risk of investor detriment. Views were sought first on the appropriate scope of the inquiry and on the factors influencing the sale of particular product types. The call invited respondents to provide detailed evidence on the existence and materiality of possible risks to investors resulting from:

- Product disclosure: are investors provided with the necessary information to understand properly the characteristics of each product type?
- Conduct of business: do differences in conduct of business regulation result in tangible differences in the level of care afforded by different types of intermediary?
- Conflicts of interest: are there effective rules in place to ensure effective management of conflicts of interest by the originators/distributors of each product type?

[1] The call for evidence is available at http://ec.europa.eu/internal_market/finances/docs/cross-sector/call_en.pdf

- Marketing and advertising: are risks of mis-selling stemming from misleading advertising and promotion more pronounced for certain product types?

Respondents were asked to specify whether they perceived a need for action, at EU or national level, to correct any identified problems, in particular with regard to product disclosure and point of sale regulation. In this context, respondents were asked to describe steps that had been taken by national authorities and market participants to ensure that investors were adequately protected.

The purpose of this feedback statement is to provide a high-level synthesis of the contributions received by DG MARKT. The report provides statistical data together with a qualitative overview of the contributions. It is not intended to provide an exhaustive account of all responses received. However, all contributions will be taken into account in our ongoing analysis in this area.

1.2. Next steps

A public hearing will be held in Brussels in July 2008 to bring together key stakeholders to discuss the issues raised in the call for evidence.

Views expressed at this event, together with the evidence gathered during the consultation process, will contribute to a Commission Communication in the autumn, which will consider whether there is significant evidence of investor detriment and whether there is a need for further work in this area.

1.3. Acknowledgements

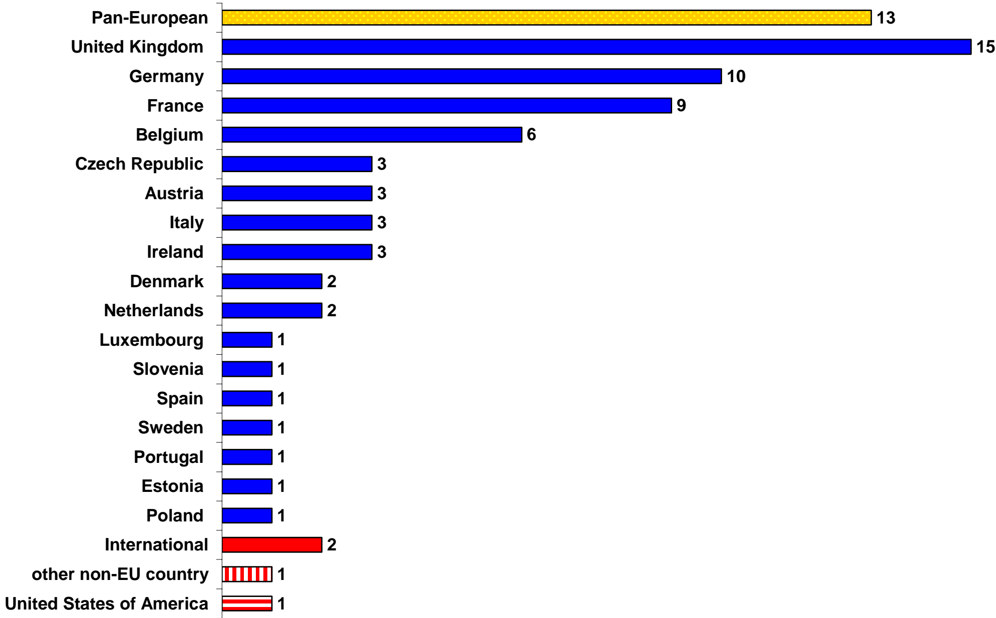
The depth and quality of the 80 contributions that the European Commission received is impressive and represents a solid base of evidence and opinion for further analysis of the questions raised in the call for evidence.

DG MARKT would like to thank the interested parties who responded to this consultation.

2. Responses to the call for evidence

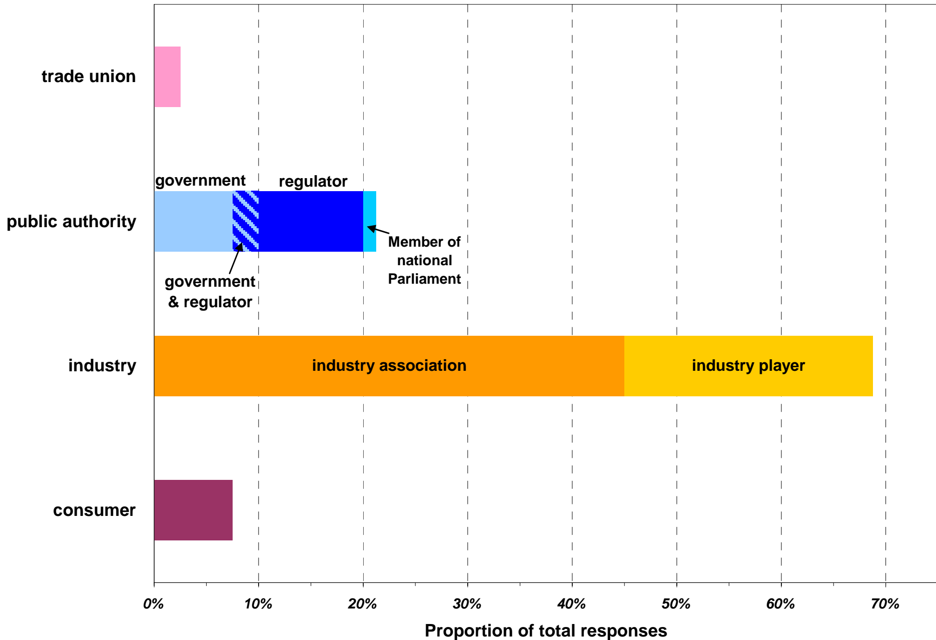
The Commission received a total of 80 written submissions containing substantive comment and replies to the ten specific questions. Out of the 80 contributions, 77 responses (all except for those for which confidentiality was explicitly requested) are available on the Commission website and are accessible at: http://ec.europa.eu/internal_market/finances/cross-sector/index_en.htm#product

Fig. 1 Breakdown by nationality



Contributions were received from 21 countries including 17 European Union Member States, with a sizeable input from the United Kingdom, Germany, France and Belgium. A significant number of contributions were also submitted by European and – to a lesser extent – international associations.

Fig. 2 Breakdown by stakeholder category



Responses from industry accounted for 69% of the contributions received, of which around two thirds were submitted by industry associations (representing 45% of total contributions) and the remainder from individual firms (24%), some of which were members of one or more of the aforementioned associations. Moreover, input was received from a broad range of industry sectors, including from associations representing industries as diverse as banking, life insurance, asset management, structured products and/or derivatives, pension fund and financial services[2]. Contributions were also received from associations representing distributors of financial and/or insurance products. Responses from individual firms were also evenly distributed across a variety of sectors including, for instance, investment funds, banking, life insurance and cross-sectoral firms (notably bancassurance).

Fig. 2.1 Breakdown of industry associations

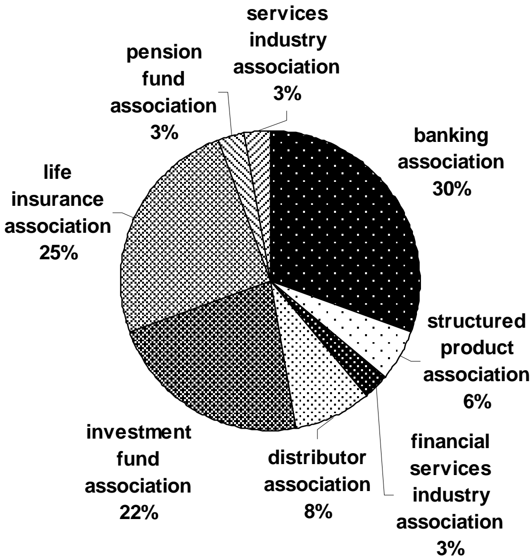
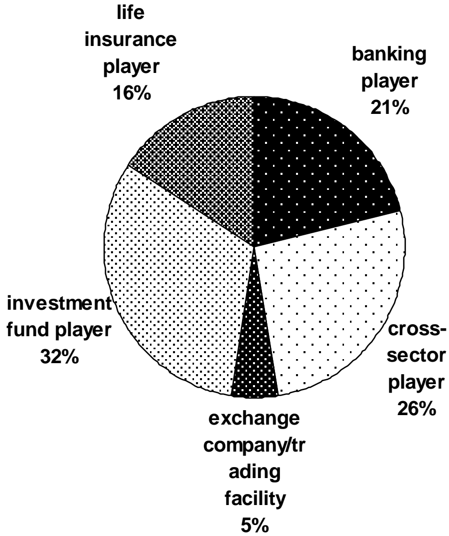


Fig. 2.2 Breakdown of industry participants



In addition, as Figure 2 indicates, there was strong input from public authorities (governments and supervisors), including the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). Given the investor focus of this call for evidence, DG MARKT was heartened to see a strong response from consumers and trade unions, accounting for just over 10% of responses.

---

[2] In Figure 2.1, "services industry" stands for an association of industrial companies and "financial services industry" association represents a contribution by joint industry associations covering a number of financial services sectors (e.g. banking, structured products etc.).

3. Analysis of the contributions

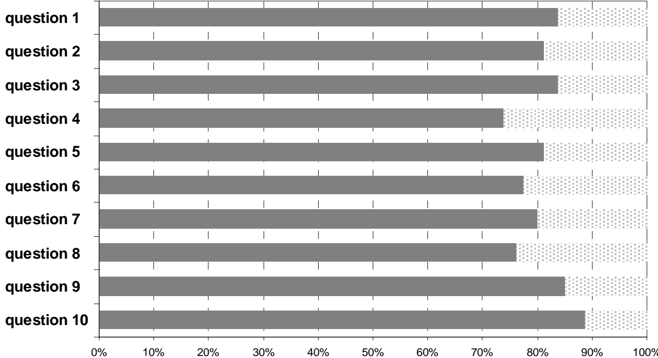
This feedback statement is structured on the same lines as the call for evidence, in which we asked stakeholders for their views and evidence on ten specific questions, divided into three sections as follows:

- Section 1 focused on the scope of the review and asked whether different types of retail investment product could be considered to be substitutable. It sought input on the factors driving the promotion and sale of particular products and asked for views on whether varying information disclosures or distribution regulations led to investor detriment
- Section 2 addressed potential sources of investor detriment, asking whether there is evidence of the sale of investment products to investors for whom they are not suitable, as a result of inadequate investor disclosures, insufficiently robust point-of-sale disciplines, failure to manage or disclose conflicts of interest in distribution channels, or through mis-selling or misleading advertising for certain products.
- Section 3 raised the question of the possible need for action to address risks arising from uneven product disclosures or sales and distribution regulations that contributors might identify. If such a need exists, would action by market participants be sufficient? Or is there a case for public authority involvement, at national or EU level?

3.1. General comments

While some contributors answered every question, others concentrated on those areas that impacted most directly on their area of interest or concern. On average, 82% of contributors responded to each question.

Fig. 3 Distribution of responses to specific questions



Some respondents opted to supply general comments rather than responding to specific questions posed. In these cases, where it was clear from the text that the contributor was addressing one or more of the specific questions raised, we have included that response in our analysis of the feedback on that particular question.

The responses revealed a broad consensus on some of the premises of the call for evidence. Respondents agreed that retail investment markets are characterised by rapid innovation, which is seen by most as a boon for investors and by some as a challenge from an investor protection perspective. It was also widely accepted that the impetus on retail investors to make financial provision for retirement is increasing in many countries as the pressure on state-funded pension systems increases. In this context, it was considered imperative that investor confidence in retail investment products is maintained.

Several respondents highlighted the links with other Commission initiatives in the area of retail financial services. In particular, stakeholders from all categories emphasised that improving the financial capability of retail investors has a vital role

to play in empowering investors to take informed investment decisions. The recent Commission Communication on financial education was frequently cited.[3]

Responses were also broadly supportive of the approach taken by the Commission to analysing whether there are deficiencies in existing regulatory regimes for retail investment products; that is, to gather evidence from a wide range of stakeholders before forming a view on the existence of risks or the need for action of any kind.

However, while the majority of responses recognised the need to keep the regulatory framework under review, a large number of responses cautioned against conducting a detailed assessment of the level of investor protection embodied in existing rules before they have been fully implemented in all jurisdictions and before market participants have completed the systems development necessary to achieve compliance. The lack of practical experience with the Markets in Financial Instruments Directive[4] (MiFID) and Insurance Mediation Directive[5] (IMD) are particular cases in point.

3.2. Replies to the specific questions

Due to the heterogeneous nature of contributions from different stakeholder categories and industry sectors (see section 2), we have not presented the aggregate responses to the individual questions in quantitative terms. Where there was a divergence of opinion between stakeholder or sectoral groups we have indicated this in the text. In so doing, DG MARKT services clearly sought to focus on the arguments and evidence presented by the diverse contributions rather than on the numerical breakdown of opinions.

Therefore, in the sections below, all statistical measures should be read in conjunction with the accompanying text.

[3] http://ec.europa.eu/internal_market/finservices-retail/capability/index_en.htm

[4] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending

[5] Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation

Section 1 of the call for evidence - Scope of the review

Question 1: Do you see that different regulatory treatment of substitute products gives rise to significant problems? Please explain why you consider this to be the case.

67 respondents (85% of total contributions) addressed this question. Of these, some took a pan-European perspective, whereas others restricted their analysis to their respective domestic contexts. Responses focused on two types of 'problem' arising from regulatory variations: risks of investor detriment; and competitive distortions. These perspectives were frequently linked: those that cited possible competitive distortions argued that these could favour the growth of products for which regulatory protections are considered to be relatively weak.

A slight majority of contributions found no evidence that variations in the regulatory treatment of retail investment products gave rise to significant problems. Some 70% of industry respondents to the question saw no significant risks, driven primarily by responses from the banking, securities and insurance sectors. Most of these responses confirmed that differences in regulatory treatment do exist, but argued that these differences are justified by differences in the characteristics of different types of product and by the varying needs of consumers in each case. The assertion of the call for evidence that borderlines between products are being increasingly blurred was thus challenged by some. Many industry responses stressed that product diversity and innovation are highly beneficial for retail investors and that any move to standardise products would be a retrograde step.

Most responses from the banking and insurance industries saw no evidence of investor detriment, finding that the safeguards built into existing sectoral regulations provided a level of protection that was broadly equivalent across product types. For example, most responses from the insurance industry stated that the level of care required by insurance legislation is broadly equivalent to that required by MiFID. Several industry responses pointed to a different problem, namely that the uneven implementation of existing rules across Member States and in some cases "gold-plating" of these rules by national authorities may act as a barrier to the development of the market. Several responses from the insurance sector asked the Commission to consider the impact of differing prudential standards for insurance and investment firms, particularly when products are sold with a capital guarantee which is provided by a legal commitment of the originator.

Other industry sectors took a different view. The large majority of contributions from the asset management sector highlighted that inequality of treatment can give rise to market distortions through the structuring of products in an attempt to avoid stricter rules. They saw a clear risk that regulatory divergence may threaten investors, since, in their view, the high level of investor protection embodied in the UCITS regime[6] is not replicated elsewhere. They argued that investors may be induced to invest in inappropriate products – citing in particular structured securities - as a result of a lack of transparency on the costs and risks of certain products. Several examples were

[6] Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) - 85/611/EEC

cited of where this risk is argued to have crystallised in practice (see also Question 8). The asset management sector added that the competitive distortions and investor risks identified are not confined to disclosure and distribution rules but concern also differences in rules on product constitution, in particular investment restrictions and requirements for pre-approval of products and advertising campaigns (or the lack thereof). Such rules are perceived to be more stringent for UCITS and nationally-regulated funds. For instance, a few contributions highlighted that products governed by the Prospectus Directive[7] (PD), e.g. listed closed-end funds and structured notes, are not subject to investment restrictions and can be brought to market much faster than UCITS, or that there is no prior review of assets (funds) underlying unit-linked life policies.

All consumer representatives identified significant threats arising from variations in rules on product disclosures, conduct of business rules and conflicts of interest, which were considered to be particularly acute due to retail investment products being "sold, not bought". All consumer respondents considered that the difficulty of comparing retail investment products underlined the need for more consistency in pre-contractual information, to allow consumers to compare product features, risks, costs and benefits. They therefore advocated a more coherent approach to disclosure, advertising and advice. They identified particular risks with the regimes applying to structured securities and unit-linked life insurance. Some consumer associations saw that risks to consumers were exacerbated by the ability to wrap what they classed as "*protected products*", such as UCITS, into forms that were perceived to be less regulated. One response referred to the 'illusion of choice', whereby the same product may be proposed in a variety of forms and marketed through costly campaigns – for which consumers ultimately pay.

Reactions from public authorities were mixed. A majority of authorities expressed concern with elements of the existing framework, finding that the application of different regimes to products with similar characteristics may result in uneven levels of investor protection. Many said that such discrepancies were prejudicial to retail investors, with particular challenges posed by products to which MiFID distribution rules do not apply (e.g., unit-linked insurance policies) and for which the disclosure rules were considered to be ill-adapted to retail investors (e.g. structured securities). Some authorities saw evidence of 'regulatory arbitrage' towards 'less regulated' products, although others did not. CEIOPS reported that a clear majority of their members felt that protection was adequate and that there was no evidence of regulatory arbitrage. One authority said that it was too early to assess whether significant risks existed.

It is important to note that several Member States had already introduced provisions at national level to supplement the protections in the relevant directives and to apply similar rules to a broad range of investment products, which in turn may have affected responses to this question. For example, one Member State found no evidence of a significant problem at national level, where action has been taken to ensure equivalence of rules for a wide spectrum of retail investment products, with similar regulatory treatment for products serving similar consumer needs.

[7] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading.

Question 2: Do you regard the perceived concerns relating to different levels of product transparency and intermediary regulation as a significant threat to the further development of EU markets for retail investment products (strongly agree; somewhat agree; no opinion; somewhat disagree; strongly disagree)?

65 contributors (82% of the total) responded directly to this question. Many respondents did not expand on their answer and treated this as a 'tick box' question, similar in substance to Question 1. Those that replied negatively to Question 1 did not see different levels of product transparency and intermediary regulation as a threat.

A large majority of contributions from all industry sectors bar asset management – and, to a lesser extent, distribution - argued that differences in sectoral regulation were not a significant hindrance to the 'development' of the market for retail investment products, or a factor in the fragmentation of EU retail markets. These contributions contended that the further development of retail markets will be driven primarily by competition and product innovation. Moreover, they saw such markets as being predominantly local in nature for a variety of reasons (culture, proximity, language, distribution, social security, fiscal, etc) and as likely to remain so. Several responses pointed to the findings presented in the Commission Staff Working Document: "*Initiatives in the area of Retail Financial Services*" and the European Financial Integration Report. To these contributors, differences in transparency and distribution rules were therefore seen as largely irrelevant to the development of 'EU markets'. However, one contribution posited that regulatory arbitrage can drive innovation; ultimately delivering benefits for end investors (e.g. through cheaper products).

Several industry responses identified what they considered to be a more serious threat arising from the uneven implementation of existing EU rules – for example, the '*gold-plating*' of the IMD and MiFID. Such practices were considered to create additional costs and to limit consumer choice. One regulator felt that greater harmonisation was unlikely to increase the cross-border provision of retail investment products but that greater consistency might decrease costs for multinationals.

However, consumers, most public authorities and the asset management sector saw the situation differently.

All consumer associations and many public authorities expressed some support for the hypothesis that the perceived concerns relating to different levels of regulation may be a significant threat to the further development of EU markets for retail investment products. Some regulators warned that the structuring of products in particular legal forms in order to avoid stringent regulation might ultimately undermine investor confidence and market development.

The asset management industry (88%) and some contributors from the distribution sector (33%) also saw a threat to the balanced development of investment markets and to fair competition. Many of their contributions argued that, while the overall market will continue to expand in line with growth in long term savings needs and the switch from defined benefits to defined contributions, regulatory distortions might mean that investors do not invest in the most suitable products, which presents a risk to the efficient allocation of assets.

Question 3: Is it appropriate to regard different retail investment products as substitutable - regardless of the legal form in which they are placed on the market? Which of the products listed below should be considered as substitute investment products (UCITS funds; nationally regulated retail funds; exchange traded or listed funds; unit-linked life insurance (especially which mortality risk level is small or nil); retail tranches of structured notes; some annuities; some bank term deposits (e.g. with embedded optionality or structured deposits); others …please list and describe)? What are the features/functionalities (holding period, exposure to financial/other risk, capital protection, diversification) that lead you to regard them as interchangeable? Have you encountered any legal or other definition which would encompass the range of 'substitute investment products'?

67 contributors (85% of the total) responded to this question, revealing a strong divergence of opinion on the notion of "substitutability". Almost 30% of these contributions, either by not replying specifically for each of the products listed in the call for evidence, or by not stating a clear answer, did not express a formal opinion for all products. Responses from the life insurance, banking and structured securities industries referred primarily to their own products.

For many industry contributors, the 'substitutability' of retail investment products is fundamentally a subjective concept that depends critically on the characteristics (e.g. age and family situation) and needs (e.g. attitude to risk, time horizon, motives for saving, capital guarantee etc) of the individual investor. Consequently, the set of products that may be substitutable for a particular investor will differ from investor to investor and from Member State to Member State. It was considered inappropriate by some, therefore, to describe broad product categories as 'substitutable' or 'interchangeable' even if - as many industry responses acknowledged - the products listed do compete for retail savings. Other responses questioned whether there is empirical evidence to support the claim of substitutability. One contribution estimated that the indicative list of products in the call for evidence was a '*great overstatement of the potential actual dimension of the issue*'. Another argued that due to the huge diversity in investment propositions, even products belonging to the same 'category' are not interchangeable.

The majority of those that opposed the inclusion of unit-linked products and structured securities in the scope of this review came from the respective industries. Many responses from the banking, securities and insurance industries focused on the structural and functional differences between investment funds, structured securities and unit-linked life insurance contracts and argued from this that the products should not be treated as substitutable. Several responses detailed the differences in the legal relationships between investors and fund management companies, issuers and insurance companies respectively. Others focused on functional characteristics. For example, many responses from the life insurance industry highlighted the distinguishing features of unit-linked life policies that:

- entail a protection component, i.e. the coverage of biometric risks;
- tend be held for a longer period than UCITS;
- entail a contract between the holder and the company (the investor is a creditor of the company, not the beneficial owner of an interest in the fund);

- cannot be unilaterally terminated and cannot be sold at any time;
- provide the ability to designate a beneficiary;
- perform a social function (complementary to social security systems);
- involve additional rights and obligations in insurance law; and
- are sold by firms subject to different solvency requirements.

Securities associations emphasised the existence of a pre-determined pay-off as a key distinction between a structured security and an investment fund.

In addition to these differences in the product features, some responses argued that products could not be considered as economic substitutes in the strict sense because of variations in the tax treatment of the products. They therefore saw the tax treatment as an integral part of the investment product, rather than as an exogenous factor with the potential to influence investor choice between products. Some contributions characterised unit-linked life insurance contracts as a distribution channel (mainly for investment funds), rather than a distinct product.

Overall, however, the majority of contributors did consider that the products listed in the call for evidence – with the exception of 'some annuities' - were broadly substitutable and as such should be considered within the scope of the review. All consumer responses shared this view, as did most responses from the asset management and regulatory communities. All CEIOPS members bar one felt that unit-linked life policies competed with funds (especially when they encompass a low level of mortality risk cover) and 19 members felt the same applied to retail structured products.

Those that described the reasoning behind this conclusion argued that the products in question performed similar economic functions; served similar consumer needs; offered a return over a similar time horizon (medium to long term); were retail-focused; and offered similar risk/return characteristics. However, many contributions recognised that the products in question were not identical and that the appropriate choice of product depends on the needs of the individual investor.

Very few respondents had encountered a definition of 'substitute' retail investment products. Indeed, several cautioned against adopting a rigid, static definition, since it would be unable to keep pace with financial innovation and might not be capable of capturing national differences. Some regulators had approached this question by simply listing the set of products subject to certain rules, whereas others had adopted a definition.

With regard to annuities, a slight majority expressed the opinion that they should not be considered within the scope of the investigation, since they are *decumulation* products and hence fundamentally different from the other products listed, which offer capital *accumulation*. However, several responses noted that 'annuities' can take different forms and might include 'deferred annuities' - which include an accumulation phase - for example in a personal pension scheme.

Some contributions (26%) cited additional products that could be considered within the scope of this review. The most frequently cited products in this respect were:

- retail closed-ended funds, such as real estate funds or private equity;

- in some countries, life insurance products beyond unit-linked products, such as with-profits insurance;
- investment trusts;
- products that wrap savings in a "*tax or regulatory efficient*" way such as employee saving schemes, corporate savings, personal pension schemes, and building savings schemes;
- some plain vanilla products like deposits and unstructured bonds / equities;
- hedge funds; and
- other types of property funds (e.g. trees).

Some of the products cited were only available in a small number of Member States.

Question 4: Which factors in your opinion drive the promotion and sales of particular investment products? Please use the table below to rank these factors in terms of importance (very significant; significant; no opinion; insignificant) for each of the different products. In addition to completing the table, we would welcome further explanation of your view as to which factors are particularly important for each product.

This question attracted the smallest number of responses (59 contributions representing 75% of the total). Many respondents commented that it was difficult to capture the complex interactions between factors in the table provided.

Analysis of the responses reveals that "taxation" was the factor most frequently cited. This was considered particularly influential for unit-linked life insurance products but also for non-UCITS funds and, to a lesser extent, for UCITS. Taxation regimes were also argued to be a factor in explaining why retail markets have developed on a 'multi-domestic' basis (and therefore why the level of cross-border trade is limited). "Distribution models" were also considered to be influential, principally here also for unit-linked life insurance. Cultural preferences were repeatedly cited as a powerful influence on the relative popularity of particular products in different national contexts (e.g. for life insurance in France, deposits and equities in Spain, structured notes in Germany, etc). "Financial innovation" was frequently cited to explain the success of structured securities in some countries.

Although often cited in respect of unit-linked life insurance, the least influential factor, according to contributors, was "regulatory treatment". The majority of responses from the banking and insurance industries argued that promotion and sales were driven in large part by the willingness to cater for consumer needs. They added that consumer choice was not influenced by differing levels of product transparency/disclosure but rather by the features of the products available. The presence of a capital guarantee, an insurance element or pre-specified returns were all cited as being attractive features to retail investors. However, several industry contributions added that lighter rules on investment strategies and product authorisation may favour certain products, in particular structured securities. The ability to deliver a product to market more rapidly was considered as a key factor in explaining the growth, for instance, of certificates in the Netherlands, Germany and elsewhere.

However, consumers, regulators and the fund industry did perceive a regulatory influence on consumer choice, relating in particular to the level of product transparency. Several contributions, including, but not limited to, consumer associations, explained that investment products are typically not "bought by" but "sold to" retail investors. The producer and distributor are therefore seen to play a powerful role in influencing consumer choice.

In this context, differences in regulatory treatment were felt to be significant, since consumers may be attracted to products for which the costs and risks are less transparent. For example, one consumer association considered that the requirements of the IMD did not result in a clear obligation to disclose the 'double layer of commission' in unit-linked life insurance products. However, this factor was deemed to be less important in Member States that had acted to adopt a harmonised regulatory approach across the spectrum of products.

Section 2 of the call for evidence - Is there a risk of investor detriment?

Question 5: Product disclosures: Do pre-contractual product disclosures provide enough information to help investors understand the cost and possible outcomes of the proposed investment?

65 contributors (82% of contributions received) supplied an answer to this question. This question was qualitative in nature and did not lend itself to statistical analysis. Many contributions linked their replies to this question to the discussion of conflicts of interest in Question 7.

A generic and cross-cutting problem, highlighted by all stakeholders, was that of the danger of overloading consumers with information that is irrelevant, overly technical or presented inappropriately with some responses advocating simplification of disclosures to retail investors. The issue is not felt to be (as the question might have implied) whether there is 'enough' information but whether the information will be read and understood by the consumer. Several contributors argued that improving disclosures is only one element in building consumer understanding, and that further improvements in financial literacy are an essential complement. The importance of the advisory role of the intermediary was also emphasised, particularly for products for which regulation is intermediary-focused.

Most responses from the banking and structured securities industries judged the disclosure requirements embodied in MiFID and the PD, in conjunction with additional requirements at national level, as adequate and equivalent to standards found elsewhere. Several contributions highlighted that MiFID would engender a significant increase in the transparency of structured securities but that it was as yet too early to evaluate the disclosure standards currently being developed by market participants. However, a few responses from the structured securities sector said that disclosures required by the PD are more issuer- than product-focused and arguably already resulted in too much information being provided to retail investors. The fund industry generally supported the view that MiFID and UCITS provide for adequate fund disclosures.

Responses from the insurance industry stated that there is already a high level of disclosure associated with unit-linked products and that the Consolidated Life Directive (CLD) and IMD provided a coherent sector-specific approach. Many reported that European rules had been supplemented with additional requirements in many Member States: CEIOPS confirmed that disclosure is extensive and supplemented by detailed requirements at national level, with 16 Member States having upgraded information requirements for life insurance.

Many industry responses stressed that the content of disclosures should be driven by the structure of the products. They felt that the products discussed in the call for evidence are intrinsically different and that this should be reflected in the product disclosures. For example, several responses from the banking and/or structured securities industries argued that imposing similar cost disclosure to structured securities and funds would be inappropriate, since their cost structures are very different. One response reported that management fees are not typically charged for certificates (and if they are, they are disclosed under MiFID) and that

margins and costs depend on the efficiency of hedging and market developments and so cannot be disclosed at the outset. They felt it to be sufficient that disclosures specify the pay-offs at maturity. Some contributions from the insurance sector also claimed that the extension of fund disclosures to insurance might be inappropriate and that unit-linked life policies should not be required to duplicate UCITS disclosures.

In addition to identifying specific perceived weaknesses in sectoral disclosures, many consumer responses also alluded to the problem of comparability. Even when existing disclosures were seen to be substantially similar, several responses complained that it is currently difficult for consumers to make informed comparisons of and choices between investment products.

The responses also identified a series of concerns regarding the content of existing disclosures for specific product types:

- As regards UCITS funds and retail nationally regulated funds, a very large majority of respondents to this question considered that the pre-contractual information provided to investors was sufficient and clear, notably as regards costs, performance and risks. However, several consumer contributions noted that there are problems with the presentation of information in the current Simplified Prospectus (e.g. on past performance) and hoped that KII[8] would lead to substantial improvements. However, while welcoming the ongoing work on KII, the fund industry expressed concern that the introduction of KII for funds - but not other products - would impose a disproportionate burden on the fund industry. Most consumer contributions remarked that the quality of information may depend on the way in which MiFID is implemented in Member States. One industry player expressed similar concern as regards non-UCITS, for which the quality of product disclosure may depend on whether the distributor is subject to MiFID rules.
- Responses in respect of unit-linked life insurance products were fairly evenly split. A slight majority, including not only the insurance industry saw that pre-contractual product disclosure was satisfactory. Others noted that investors in unit-linked products benefit from the underlying fund disclosures. Other responses identified possible 'gaps' in existing disclosures. For example, responses from the fund industry highlighted differences between disclosures on UCITS and unit-linked products, arguing that the latter lack information on risks, past performance, costs (ongoing) and fees/commissions (particularly fees relating to the underlying units, rather than the contract). Several consumer associations stated that disclosure regarding the product itself and the direct costs are clear but that this is not the case for the disclosure of indirect costs or potential conflicts of interest within distribution channels (see also Question 7). Several regulators – including many CEIOPS members – also identified possible deficiencies with regard to the disclosure of risk information on the underlying investments and on cost disclosure.

[8] KII stands for 'key investor information'. It refers to the proposed replacement of the current simplified prospectus for UCITS funds by a new concept, format and content of pre-contractual product disclosure to retail investors. This work was launched by the European Commission, as part of its wider work to revise the UCITS Directive.

However, other public authorities were content with existing disclosures: indeed the majority of these had acted, notably to apply additional disclosures to unit-linked products in their jurisdictions, though in varying ways in different Member States.

- Views on disclosures accompanying <u>retail structured securities</u> varied. A small majority of contributions saw information about these products as clear and sufficient. However, concerns were expressed by almost half of the respondents, including most consumers. Several of these, and all responses from the fund industry, were critical of the perceived lack of cost transparency in structured securities. One consumer response described the 'hidden cost structures' built into certificates (e.g. transaction costs), which made it difficult to compare the costs of alternative investments. Responses from consumers, the fund industry and some regulators also noted concerns regarding the transparency of costs and capital guarantees. Several responses (including from regulators) suggested that PD disclosures were too extensive and did not serve as an effective pre-contractual disclosure document for retail investors.

- Fewer respondents expressed views on product disclosure relating to <u>structured term deposits</u>. Although a small majority expressed a positive view on information on these products, many contributions, including consumers, voiced concerns in this respect. Many contributions recalled that the distribution of such products is not subject to MiFID. In particular, one regulator expressed concern that investors are not provided with the necessary information to understand the characteristics of such products. However, some contributions cited self-regulatory initiatives in the banking sector, reputational risk and competition as a strong incentive to increase product transparency.

Question 6: Conduct of business rules: Do differences in conduct of business regulation result in tangible differences in the level of care that different types of intermediary (bank, insurance broker, investment advisor/firm) offer to their clients? For which conduct of business rules (know-your-customer, suitability, information/risk warnings) are differences the most pronounced and most likely to result in investor detriment?

A majority of contributions to this question – to which 62 responses (79% of the contributions) were received – did not see significant differences in the level of care offered to retail investors as a result of differences in conduct of business rules. Responses from the banking and structured securities industries explained that MiFID, despite some divergence in implementation at national level, provided a coherent and appropriate set of distribution rules for investment products that fall within its scope. They reported that additional national and industry rules are applied in some jurisdictions. Several responses stated that MiFID provided a standard against which other regimes should be judged.

Responses from the insurance industry acknowledged that the rules embodied in the CLD and IMD are not identical to those found in MiFID but argued that the regime is well-tailored to insurance distribution and provides an equivalent level of retail investor protection. Indeed, one contribution argued that the rules applying to insurance entities are stricter than MiFID, since "execution only" sales are not permitted and there are no appropriateness (as opposed to suitability) tests. CEIOPS reported that many of its members viewed IMD rules as less detailed than MiFID but felt that they could be considered to be roughly equivalent in effect; with the exception of provisions on risk warnings and information (see Question 5).

As mentioned above, most industry replies stressed that there was a need to allow MiFID and IMD rules to 'bed in' before attempting to assess their effectiveness.

By contrast, most consumers and many public authorities argued that the conduct of business provisions applying to life insurance distributors are less comprehensive than those found in MiFID and asserted that the risk of investor detriment is greater for these products.

Such concerns were echoed by most responses from the fund industry. The requirements of the insurance directives were judged to be '*rather general rules regarding distribution and advice*' and have not been implemented consistently across Member States. For instance, the IMD provisions are perceived to be less stringent or detailed than MiFID requirements regarding the duty for insurance intermediaries to give advice or to perform suitability testing.

Several public authorities pointed to weaknesses in conduct of business rules in areas in which MiFID does not apply. MiFID was generally viewed as a benchmark, although one regulator commented that the MiFID protections may not themselves serve to protect consumers from the mis-selling of complex products that are not well understood by the distributors. A number of public authorities reported that they had taken steps to apply MiFID-style distribution rules to other products so as to provide harmonised suitability rules to the sale of a broader range of products, including unit-linked life insurance.

One response from the fund management sector raised a concern regarding the secondary trading of structured securities,

citing instances of issuers apparently failing to provide quotes or to make markets for certificates.

The concerns expressed seemed more pronounced as regards structured term deposits. They related to such products not being subject to MiFID and not being considered as "investment" products in many Member States. According to one contribution, banking regulation does not cover product characteristics or distribution and as such the standard of investor protection may be weaker for the sale of these products. However, some contributions cited codes of conduct in the banking sector and reputational risks as safeguards for the offering of these products to retail consumers.

Responses also identified as a source of concern for both consumers and regulators a number of other 'channels' in which the MiFID conduct of business rules are not felt to be properly applied. In particular, the distribution of funds by management companies and the sale of in-house insurance products by insurance companies and/or their employees were cited in many responses. One consumer association also felt that the possibility of 'execution only' sales of complex products might result in the sale of unsuitable products to retail investors.

Another concern of consumer associations related to the increasing prevalence of internet distribution channels. One contribution warned that the lack of direct and traceable advice might lead investors to choose unsuitable products as a result of the ease of purchase and/or heavy marketing of 'high margin' products. Another response agreed that the suitability test in MiFID is not as stringently applied for internet sales. Both responses cited the example of online distribution of certificates, particularly in the German and Italian markets. One insurance industry response also warned of the possibility of detriment resulting from the use of less protected channels, including the internet.

More generally, consumer responses were highly sceptical about the level of care afforded to consumers in the distribution of investment products. Even if appropriate regulatory regimes are applied, they felt that investor detriment may still result from the sale of highly complex products that neither customer nor adviser understand; from inherent conflicts of interest in distribution; and from poor levels of training and compliance in distribution firms.

Question 7: Conflicts of interest: Are there effective rules in place to ensure effective management/disclosure of conflicts of interest (and/or compensation arrangements) by the different categories of product originators and/or intermediaries for the different types of investment product? For which type of product do you see a regulatory gap in terms of the coverage of conflict of interest rules? Please explain.

This question attracted 64 replies (81% of total contributions). Contributions interpreted this question in two ways. Some focused on the possibility of producers and distributors structuring products so as to avoid relatively burdensome regulatory requirements. This topic was covered under Questions 1 and 4. Most contributions, however, focused on possible conflicts in distribution channels; that is, a divergence between the interests of the investors and distributors as a result of financial arrangements between producers and distributors (product or commission bias).

Overall, a slight majority of respondents concluded that there are effective rules in place. However, some of these responses referred only to a limited set of retail investment products. All responses from consumers and 75% of contributions from public authorities voiced concerns that there may be gaps in terms of the coverage and effectiveness of conflict of interest rules.

For instance, consumers, many regulators and some industry responses judged the rules on disclosure of potential conflicts of interest linked to remuneration in the insurance sector to be inadequate, in particular the remuneration of insurance intermediaries by fund managers. A majority of CEIOPS members agreed that there is a gap here, since the insurance directives only require the disclosure of contractual or significant links between the insurance company and producer of units and not commission payments. One regulator reported that the IMD did not require insurance intermediaries to adopt and disclose rules on the management of conflicts of interest and several others felt that only MiFID provided a comprehensive approach to the disclosure of possible conflicts. One insurance association concurred that '*insurance regulation may well fail to require disclosure of, for example, the relationship between and the remuneration of, an insurance intermediary and a fund manager whose fund is a link in a unit-linked product'*.

However, some responses from regulatory authorities expressed confidence with regard to the management of conflicts of interest. In many cases, this confidence appeared to derive from the application of common conflict of interest rules to MiFID and non-MiFID firms[9] in several Member States. Moreover, a large majority of contributions from the banking, securities and insurance industries - but also to some extent the fund industry - expressed the view that the rules in place are effective. MiFID was deemed to provide effective rules for funds and structured products, whereas the rules in insurance regulations were deemed to provide an adequate level of protection against investor detriment as a result of unmanaged / undisclosed conflicts of interest. Some contributions also cited reputational risk as a further safeguard in this respect.

As for Question 6 above, several responses expressed concern regarding the adequacy of the rules applying to the proprietary distribution of in-house products, be they

[9] "MiFID firms" means firms which are subject to MiFID whereas "non-MiFID firms" relates to entities that do not have to apply MiFID rules due to their nature or the types of product that they distribute.

funds, structured securities or insurance products.

Several contributions from a variety of stakeholder categories questioned whether disclosure is an effective tool to mitigate the impact of conflicts of interest that may arise from commission-based remuneration of intermediaries. One consumer association asked whether commission and retrocession disclosure is useful for the retail investor, i.e. will the average retail investor be able to process such disclosures and factor them into their decision-making in a meaningful way. One industry response suggested that disclosures to regulators would suffice.

Finally, trade unions underlined the need to focus on adequate training of intermediaries/advisers and to avoid conflicting financial sector workers with commission-based remuneration. One industry contribution noted that IMD imposes some training requirements but that MiFID focuses only on disclosure. It added that some products may simply be too complex for distributors to understand, which may result in mis-selling.

Question 8: unfair marketing / misleading advertising: Is the risk of unfair marketing / misleading advertising more pronounced for some product types than for others? If so, why? Can you point to concrete examples of the mis-selling of the different types of investment product resulting from unfair marketing / misleading advertising?"

61 contributions (77% of the total) responded to this question, with the majority revealing concerns regarding the mis-selling or unfair marketing of some product types. Many responses – cutting across all stakeholder groups – linked the risk of mis-selling to the complexity of the product, irrespective of its legal form. More specifically, certain product types were identified as being particularly susceptible to the risk of mis-selling. These included complex structured products and products with a capital guarantee.

Two thirds of replies from industry representatives considered that the regulatory framework applying to their own sector is robust. Those sectors regulated by MiFID felt that the requirement that communication was '*fair, clear and not misleading*', coupled with additional requirements in the UCITS, Prospectus and Unfair Commercial Practices Directives and in national and industry rules, is effective. However, they noted some concerns with regard to failings in implementation and enforcement. Many responses from consumer associations and public authorities also felt that the regime provided by MiFID and UCITS is effective, notwithstanding broader concerns about complex structured and some guaranteed products. Responses from the insurance industry also judged the rules applicable to the marketing and sale of insurance products to be proportionate and effective.

However, all consumers and trade unions, 86% of public authorities and a third of industry contributions identified a risk of unfair marketing or misleading advertising for some products and many pointed to incidences of mis-selling in a number of Member States.

The fund industry considered that the regulation of the marketing of certain products, in particular for structured securities and unit-linked insurance products, was weaker than that of the fund sector through UCITS and MiFID. For example, several responses described how marketing campaigns for UCITS and nationally-regulated funds are submitted for regulatory pre-approval, whereas advertising for other products is not. They argued that the risk here is compounded by concerns about a perceived lack of cost transparency for certain products.

Many contributions from the insurance sector identified a possible risk stemming from the sale of funds with legal guarantees[10] amounting to a legally enforceable promise to return the initial investment. Such promises may be backed by capital, which raises the question of solvency requirements for management companies that are not considered to be as stringent as for insurance companies.

Contributions from a number of public authorities argued that the absence of regulatory pre-approval of the product and/or advertising campaigns could mean that the risk of misleading marketing communications was higher for unit-linked insurance products. This was consistent with the view expressed by

[10] A legal guarantee is provided by a commitment of the management company and differs from capital protection which is part of the fund's investment objective, through the use of various financial techniques. The latter protection is in fact not legally guaranteed, since there is an operational risk that the techniques may fail to achieve their aim.

some CEIOPS members. Public authority responses also referred to the risks associated with complex products and those sold with capital guarantees. However, many Member States have acted to apply uniform rules to the sale of all financial products and as such did not consider that the risk of mis-selling is more pronounced for some products than others. Incidents of mis-selling did occur but were typically a result of compliance failures rather than regulatory gaps.

One response from the distribution sector focused on the possible risks associated with the marketing of investment products through internet channels. It referred to the existence of "*thousands of websites…often little more than "shell" sites which heavily promote and market financial services and products*", which were seen as not adhering to regulatory requirements as regards retail investor protection.

Section 3 of the call for evidence - Is there a need for action?

Question 9: Is a horizontal approach to product disclosures and/or to regulation of sale and distribution appropriate and proportionate to address the problems that you have identified? Can you specify how this objective of coherence between different frameworks would address the problems? What are the potential drawbacks of such an approach?

Almost 80% of the 68 responses (86% of the total) to this question stated that, in principle, a horizontal approach to product disclosures and/or to the regulation of sales and distribution would be appropriate and proportionate to address the perceived risks of investor detriment identified in previous questions. However, many responses conditioned their support on the clear identification of deficiencies in existing rules and on the method employed to achieve greater coherence. Those who did not perceive a problem with the existing arrangements or did not see the products under review as substitutable did not see a case for a more horizontal approach.

Those in favour of greater coherence across investment products generally advocated a principles-based / risk sensitive approach - supplemented where appropriate with tailored rules for specific products - over a more prescriptive approach. Many responses argued that MiFID had already provided a consistent level of protection across multiple products and that, in several Member States, steps had been taken to improve the consistency of disclosure and selling rules across an even broader range of retail investment products. The method for achieving greater consistency in disclosures and distribution rules is covered in Question 10.

The need for flexibility was repeatedly stressed: the risk of a horizontal approach most frequently cited was that the approach would be insufficiently flexible to take account of product specificities. This could stunt innovation and limit product diversity, thereby diminishing consumer choice. Little support was expressed for harmonisation of product regulation.

All consumers and many public authorities responded positively to this question. There was notably strong support for a consistent and standardised framework for disclosure and transparency from consumer groups, who viewed it as a means of enhancing the comparability of investment products and ensuring that retail investor protection outcomes are consistent. Many consumer responses acknowledged, however, that inflexible harmonisation could constrain consumer choice and was therefore to be avoided. They also cautioned against measures that would simply result in an untargeted increase in the quantity of information being provided.

The level of support from industry respondents varied by sector. Intermediaries were in favour of a more coherent, horizontal approach to disclosure for all products, applicable at the level of either the underlying investment or the 'wrapper' and to both direct and intermediated channels. They also broadly supported the application of common suitability requirements.

91% of responses from the asset management sector favoured a harmonised approach. They argued that greater consistency would allow for fair competition between products and institutions and would enhance investor protection. Greater comparability between products would also allow consumers to

distinguish between different products more easily. However, some recognised that full harmonisation would be a huge undertaking and the costs would likely exceed the benefits. Many responses from these sectors believed that UCITS-style disclosures (once modified by KII) should provide a benchmark for disclosures elsewhere. Others advocated an extension of MiFID suitability requirements to unit-linked life insurance policies as a '*consistent development of regulatory framework in context of practical evolution towards open distribution*'.

Some responses from the life insurance sector expressed some support for high level principles for the regulation of comparable products, provided that they are proportionate and flexible. In some Member States, this had already been achieved. Flexibility was seen as vital due to the intrinsic differences between products, and between product features and product distribution in different European markets. However, other contributions from the insurance sector warned that harmonisation on common disclosure and distribution rules would pose a significant threat to innovation and product diversity and that it would be counterproductive from the perspective of investor protection to force products to look similar when they are not.

50% of responses from the banking and structured securities sectors identified a need for a more coherent approach and equivalent distribution rules for intermediaries to promote competition and full comparability. Some high-level principles may be needed on costs, risks and returns to enable consumers to compare and choose. However, other responses from this sector were strongly opposed to a 'one size fits all' approach, arguing that equivalence of outcomes is already achieved through existing regimes and that further harmonisation was inappropriate due to the structural differences between products and the absence of solid evidence of market failure.

Several responses from the structured securities, banking and insurance industries argued that the focus should be on the more consistent implementation of existing rules between Member States rather than on cross-sectoral harmonisation.

Many regulators saw clear benefits for investor protection from treating investment products in a more consistent manner, to achieve greater consistency in investor outcomes on disclosure, suitability testing and conflicts of interest. The majority of CEIOPS members supported the harmonisation of rules on disclosure, sale and distribution of substitute products, as had been achieved in some Member States. However, several authorities stressed the need to avoid hindering innovation and artificially treating heterogeneous products as equal. Some authorities suggested that this could be achieved through wider application of KII principles and suitability rules.

Some responses drew parallels with the regulatory environment in the United States, where the SEC is said to treat certain types of insurance contracts as securities and to regulate them similarly, in a way which one contribution described as 'substantially similar' to the regulations applying to mutual funds.

Question 10: Can market forces solve the problems that you identified (fully/partially)? Are there examples of successful self-regulatory initiatives in respect of investment disclosures or point of sale regulations? Are there any constraints to their effectiveness and/or enforceability? Are you aware of effective national approaches to tackle the issues identified in this call for evidence? Should it be left to national authorities to determine the best approach to tackling this problem in their jurisdiction? Is there a case for EU level involvement? Please explain.

With 71 responses (90% of total contributions), this question attracted most attention. Those unable to identify weaknesses in existing investor protection regimes perceived no need for further action of any kind. The themes summarised below are drawn mainly from the responses of those who identified weaknesses in earlier questions, although several others opined on how corrective action could be approached should evidence of a market failure come to light.

The analysis of responses is divided into three sub-questions, on: i) self- (and co-) regulatory initiatives; ii) the case for national intervention; and iii) the case for EU involvement.

Several industry replies suggested that the focus should be on the uneven or non-implementation of existing directives in some Member States. They said that only once Member States had fulfilled their obligations in this regard would it be possible to assess whether regulatory gaps existed.

i) Market forces and self- (co-) regulatory initiatives

45 contributions commented on whether the risks identified could be addressed effectively by self-regulatory initiatives. Within the industry contributions, a large majority (74%) stated that market-based solutions provide a proportionate and effective approach to (fully or partially) addressing issues of investor concern and that regulatory responses should only be considered were market-based solutions shown to be inadequate. Market-based solutions were argued to have the advantage of flexibility and responsiveness to investor needs, of avoiding excessive implementation costs and of engaging all interested parties in their development.

Some industry, regulatory and consumer contributions provided examples of self-regulatory initiatives designed to enhance disclosures and distribution practices that had been employed in different sectors and countries (see Box 1). Some of these were developed in conjunction with national regulators.

Box 1: Examples of Self-Regulatory Initiatives cited in contributions

In Belgium, the life insurance and insurance broker industries have developed a **Code of good conduct for advertising and information about individual life insurance products** which notably introduces a standardised, non-personalized info sheet ("life insurance financial information sheet") that provides consumers with information about the main characteristics of life insurance products and makes it easier for the consumer to compare the different products. The regulator recommends compliance with the Code as a good practice. In addition, the industry has elaborated **standardised documents** that help insurance intermediaries to fulfil their information duties and contain specific questions in order to determine the profile of the investor.

In the Czech Republic, the Insurance Association and the Association of Pension Funds developed a self-regulatory initiative: the **Codex**.

In Denmark, in Spring 2007, the National Bank and the Ministry of Finance strongly encouraged **self-regulation** with respect to **structured notes** at national level.

In France, the insurance industry has developed various initiatives such as a **Professional recommendation** relating to the consultancy duty of insurance intermediaries or the **FFSA's professional undertakings of a deontological nature**.

In Germany, the banking industry uses **standardised information booklets** for the purpose of communicating information to retail investors about financial instruments. Moreover, self-regulatory rules are already in force for **retail structured securities** offered in Germany, by way of **a code of conduct (the *Derivate Kodex*)** in which issuers have voluntarily committed themselves to transparency and disclosure in various respects, notably with respect to product information.

In Netherlands, the industry (including the national banking association) and the regulator AFM have developed **best practices; transparency standards and a product approval process for structured retail products**.

In the United Kingdom, industry **codes of conduct** and/or **good practice guides** have been tested. For instance, the insurance industry (ABI) has promoted a Savings and Long Term Risk Project (SALTR project) and a With-Profits Bonds – Best Practice Guide to enhance investor understanding of the terms, advantages and disadvantages of with-profits bond, including bonds offering both with-profits and unit linked funds.

At international level, five leading trade associations (the Joint Associations Committee) released a **set of non-binding principles for managing the provider-distributor relationship in the sale of retail structured products**.

In addition, many responses reported that the industry is currently actively engaged with the development of MiFID-compliant principles throughout the EU. It will be some time before the effectiveness of these approaches can be judged.

Several regulators commented on how self-regulatory initiatives operated in their jurisdictions. For example, the practice is a well-established feature of UK's principles-based regulatory regime. The Dutch regulators also highlighted initiatives in the Netherlands, while expressing some reservations as to whether they had gone far enough in delivering comparable disclosures and robust suitability testing. Others stressed that it was in the industry's own interests to develop solutions in an appropriately tailored way – i.e. flexible disclosure requirements, advertising guidelines. One bank explained that it had voluntarily applied MiFID principles to non-MiFID business.

However, a large number of contributions – including all responses from consumer associations - expressed scepticism as to the ability of market-led initiatives to mitigate the risks identified in earlier questions. 80% of public authorities shared this scepticism as to the ability of self-regulatory initiatives to address some of the perceived sources of investor detriment; whereas 20% replied that they are effective provided that they act in coordination with regulators or supplement, with detailed codes of conduct for instance, coherent regulation.

Several reasons were adduced to justify this scepticism. Some contributions said that market participants can do little to combat problems rooted in the fragmentation of regulation, since, for example, it is not possible to extend MiFID requirements to insurance firms without regulatory involvement. Some pointed to the intrinsic complexity of some of the issues. Others questioned whether competitive dynamics would effectively block effective measures, since industries perceived to be more lightly regulated might be reluctant to relinquish competitive advantages stemming from the regulatory framework. Similarly,

consumer responses saw conflicts of interest and the inherent information asymmetry between investors and industry as an insurmountable obstacle. Questions of enforceability and sanctions in case of breach to such codes and self-regulations were also identified.

ii) Action by national authorities

39 contributors answered the second sub-question on whether there is a case for further national authority involvement. 65% of industry representatives felt that action by national authorities was not appropriate, albeit in some cases because they considered that there was either no problem or that self-regulation already in place was sufficient. Others identified that national responses to these challenges had resulted in some cases in uneven implementation of directives - which can add costs and complexity for cross-border providers - and in the application of, for example, MiFID rules, to businesses for which they are inappropriate or disproportionate.

However, two thirds of responses from the asset management and life insurance sectors, as well as some financial services providers considered that national authorities were best-placed to address any concerns that emerged. This is because national retail financial markets differ significantly. This position was corroborated by a number of national authorities, one of which added that in the absence of significant cross-border sales of many retail investment products (with the exception of UCITS funds), responsibility should remain at national level.

It should be recognised in this context that a number of national authorities have already taken action to enhance consumer protection and to remove perceived distortions in their jurisdictions. For instance, 11 CEIOPS members reported that they had implemented a horizontal approach with, for example, national rules for unit-linked life insurance inspired by UCITS and/or MiFID. Several national authorities provided extensive descriptions of their national regimes, many of which were created at the time of the implementation of MiFID and the IMD. Many industry responses from Member States employing a 'horizontal approach' were supportive of their domestic regime.

Box 2: Examples of national regulatory initiatives cited in contributions

In Ireland, the Financial Regulator applies a **unified Consumer Protection Code** to practically all financial service providers (including banks, insurance brokers and investment advisor firms). The code contains common rules including "know your customer" and "suitability" rules applicable to all regulated financial service providers. It does not apply to the provision of services covered by the MiFID. However its provisions are consistent with those contained in MiFID which means that a similar regime applies to investment type products provided by life assurers, long term deposits or certain types of bonds as applies to the investment products provided by MiFID firms. However the code does not apply to structured products which are subject to a 'lighter' regime.

In Italy, the amended **Consolidated Law on Financial Intermediation** adopts a homogeneous approach both for product disclosure and for rules on conduct of business. In particular, any public offering of securities, investment funds (both UCITS and non-UCITS) or financial products issued by banks or insurance undertakings is subject to the same rules concerning the prospectus as well as to the supervision of the CONSOB. MiFID rules on conduct of business (including the provisions concerning inducements and conflicts of interest) are applicable also to: i) subscription and placement of financial products issued by banks and insurance

undertakings; and ii) collective management service and UCITS directly marketed by management companies. Moreover, the **Law n° 252 of 5 December 2005** introduced new transparency requirements for supplementary pension schemes, providing investors with pre-contractual and contractual information similar to that required for retail investment funds.

In Portugal, MiFID transposition was accompanied by the transfer of legal, supervisory and regulatory competences from the Insurance Institute to the Securities Commission (CMVM) with regard to conduct of business rules (information duties) for insurance contracts related to investment funds and open-ended pension funds with individual adhesion. The **CMVM Regulation nº 8/2007** supplemented the existing requirements for these two types of product with some relevant MiFID provisions: e.g. key product information in the format of a simplified prospectus similar to that required for UCITS; a rule of "suitability" and "know your customer" (also applicable to investment advice) but not as prescriptive as the related MiFID rules.

United Kingdom: On 1 November 2007, at the time of the introduction of MiFID, the UK introduced a new **Conduct of Business sourcebook** in which many of the provisions are set by European Directives and then applied to non-scope firms and products. For example, many MiFID provisions apply to non-scope business to avoid the possibility of regulatory arbitrage. The requirements for financial promotions, for example, generally apply to all investment activity, without distinguishing between products. In addition, certain extra requirements apply to a specific group of products, called **packaged products** (i.e. potentially complex and long-term investment products sold widely to the mass market: personal pensions; units in collective investments schemes; life insurance products; and investment trust savings schemes). Examples of the provisions that apply to this group of products include the requirements for **Key Features Documents** (requiring similar information to that for the UCITS Simplified Prospectus or Key Investor Information).

The Czech Republic's Ministry of Finance now aspires to follow a **more functional approach** when designing its new investor-protection regulatory framework, especially in the fields of disclosure and competency requirements imposed on retail products/services distributors.

In France, a **comprehensive diagnosis and a set of proposals** were made at the end of 2005. Implementation of these has been achieved partly through national measures, partly through the implementation of MiFID, and is to some extent still pending. For instance, the amended AMF General Regulation imposes on structured/formula funds a specific disclosure in the form of three hypotheses of performance according to three different scenarios of market development.

In Germany, **the Insurance Contract Law** will impose more obligations such as disclosing acquisition, management and transfer expenses for each insurance contract in addition to the Consolidated Life Directive's provisions.

Some regulators said that provisions of certain Directives "*can unduly constrain legislative interventions*", at domestic level and cited, for instance, Article 34 of the Life Insurance Directive concerning ex ante disclosure obligations of unit-linked contracts. Others reported that while national initiatives were appropriate for some of the risks identified, others required more co-ordinated approaches due to the existence of product passports (for example, in the Prospectus Directive).

Only one third of consumers expressed comfort with national authorities dealing with these issues. The majority were sceptical as to the willingness of Member States to tackle the problems identified effectively and all saw a need for involvement at EU level.

iii) The case for EU involvement

56 contributions addressed the possible need for further action at EU level. All consumers and many public authorities foresaw a role for the EU but there was a wide divergence of views among industry responses, where just over half saw a case for EU involvement in some form. However, such support was strongly qualified by the need to ensure that intervention is only considered if a clear market failure is identified and must be accompanied by strict and rigorous cost-benefit analysis. There were also repeated calls to wait for implementation of directives such as MiFID or the review of IMD, and later MiFID, before evaluating the effectiveness of provisions on, for example, inducements and remuneration. Some contributions drew attention to the costs of the recent upheaval deriving from the implementation of important pieces of EU legislation in the area of financial services. One response called for greater clarity in the interactions between directives, e.g. UCITS and MiFID.

No support was given for new cross-cutting legislation: those in favour of EU action, with a few exceptions from the asset management sector, supported a targeted, proportionate approach, limited to building on existing frameworks when relevant directives are reviewed. Several responses saw an important role for further work by the three Level 3 Committees to better co-ordinate sectoral regulation, to improve disclosures and to promote consistent implementation in order to foster convergence within a framework of common principles.

A sectoral perspective shows wide divergence in views, ranging from the structured securities sector, which does not see any need for additional EU involvement on the one side; life insurance, banking and distribution sectors which are evenly split; and asset management and cross-sector entities which saw compelling grounds for EU involvement, on the other side. The fund industry was particularly insistent, arguing that the existence of competitive distortions provides a clear basis for legislative action under the European Community Treaty. Many of the contributions from this sector called for further work to extend beyond selling rules and to address inconsistencies in rules on eligible assets.

A number of responses from public authorities were supportive of EU involvement on the grounds that many of the issues identified flow from EU rules and cannot all be remedied satisfactorily at national level. However, in some cases it was felt that Member States should seek to correct to the extent possible the perceived discrepancies in disclosure and distribution rules between life-insurance products and other investment products at national level in the first instance. However, as mentioned above, when a European passport is in place or when national discretion is limited by EU rules, co-ordinated EU level action was felt to be necessary. Other regulators felt that the case for further EU level action had yet to be made. Another saw a role for the EU in establishing high-level principles for the outcomes to be achieved at national level, while leaving the achievement of those goals to national authorities.

A key demand relayed by consumers was that they should be able to make choices on the basis of a consistent or standardised framework for disclosure and transparency. They required as a first step for the EU that MiFID investor information and distribution requirements be extended to all retail investment products, "*not only to a small part of them*"

and perhaps for the extension of KII-type disclosures to other products

Like several industry replies, other consumers suggested work towards harmonisation between MiFID and IMD rules by the three Level 3 Committees. However, other consumer associations warned that, whatever procedures were put in place to achieve this degree of harmonisation, they should be based on extensive consumer testing. The point was also made that the development of consumer understanding ultimately requires stability in the legal framework.

*

*   *