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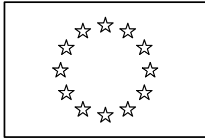

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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

PACKAGED RETAIL INVESTMENT PRODUCTS

IMPACT ASSESSMENT

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1. INTRODUCTION

The financial crisis has provided a stark reminder of the importance of transparency in financial products and of responsible selling in institutional and retail sectors. Investors naturally carry some market risk when making investments, so that exposure to weak or negative returns in adverse market conditions, while clearly detrimental to the investor, is a natural corollary of the investors' acceptance of market risk. This risk is, effectively, the price that needs to be paid to gain the potential for greater performance. The financial crisis, however, has underlined the extent to which the scale and nature of the risk taken on by investors may not be as evident to them as it should be. There has been a collapse in investor confidence in financial products and the markets more generally, and this can in part be linked to misplaced investor expectations, for instance where products have unexpectedly underperformed or where guaranteed products have, for various reasons, failed to protect capital. As a result, transparent products that are clearly explained and fairly sold to investors have a vital role to play in restoring investor confidence and promoting effective retail engagement with the financial markets.

Throughout the European Union, a range of 'packaged' investment products are actively marketed to retail investors. These products offer the prospect of financial returns over the medium to long term, based on a combination of exposures to financial markets. Up to €10 trillion were invested by the end of 2007 through different types of retail investment product, such as investment funds, structured securities, unit-linked life insurance policies and structured term deposits. These products take distinct legal forms but perform comparable economic functions for retail investors. In a well-functioning market, competition between families of retail investment product offers the prospect of an efficient allocation of resources, by creating incentives for producers to capture market share by developing and selling products that provide a good match for the profiles of prospective investors.

The markets for these products are however characterised by certain failings, notably steep asymmetries in information between product originators and distributors on the one hand and end clients on the other, and principle-agent issues resulting in conflicts of interest for distributors. Unchecked, these market failures may give rise to investor detriment, for example, as a result of product mis-selling or simply through poor decision-making due to insufficient information about the key features of the products on offer.

Public authorities have sought to mitigate these failings: by promoting financial education; through the regulation of products and the institutions that originate and distribute them; through requirements on the provision of product information; and by regulating the process by which products are sold or advised upon. Rules have been developed which seek to ensure that prospective clients receive product information pre-contractually so as to enable effective decision-making; and that the distributors and originators of investment products conduct their business fairly and objectively and do not put their interests before those of the client.

However, the rules on product disclosure and selling practices that have evolved at the European level have done so on a largely sectoral basis. Consequently, the applicable rules vary according to the legal form of the product and the legal status of the intermediary selling the product. In some sectors and for some products, there are no applicable rules at European level.

These variations and gaps have provoked widespread concern that approaches in Community law are not coherent and that, despite remedial action taken at national level in some Member States, they may result in significant differences in the level of investor protection between industry sectors, as well as an 'unlevel playing field' for originators and distributors. The question therefore arises over whether European action is justifiable, and over the form that it should adopt.

Drawing on the results of an extensive process of consultation, this Impact Assessment is an important step in determining whether there is substance to these concerns and, if so, in setting out the broad lines of a policy response to the problems identified. It is envisaged that this policy orientation would be communicated in the form of a Communication. If it is concluded that a European-level response is

justified, further impact assessment work would then be required to identify specific measures embodying an optimal trade-off between the costs and benefits of intervention.

2. PROCEDURAL ISSUES

The genesis of this Impact Assessment lies in a request from the ECOFIN Council in May 2007 for the European Commission to examine the coherence of disclosure and distribution regimes in EU law applying to different types of retail investment product.

In response to this request, the European Commission has consulted extensively with stakeholders. A written call for evidence was launched in October 2007, which attracted 80 responses from national regulators, consumer associations and the originators and distributors of all of the products concerned. The results of this consultation were published in a Feedback Statement in March 2008. A technical workshop was held with industry representatives in May 2008. This provided a forum for an exchange of views between industry experts on the risks to investor protection and the adequacy of existing European regulatory provisions. There followed a high-level Open Hearing in July 2008, which brought together over 300 senior representatives from industry, consumer associations, national regulators and the European institutions to discuss the development of the market and potential risks to retail investors. Records of this consultation, which respected the Commission's minimum standards on public consultation, are available on the European Commission website.[1,2,3]

Table 1: Preparatory Steps

Major steps / inputs	Timing
ECOFIN request	May 2007
Launch of Call for Evidence	October 2007
Publication of Feedback Statement on Call for Evidence	March 2008
Industry Workshop	May 2008
Open Hearing	July 2008
Presentation of IA report to the IAB	December 2008

These formal events have been supplemented by a series of discussions with consumer representatives (FIN-USE, Financial Services Consumer Group), regulators (Financial Services Committee, European Securities Committee, European Insurance and Occupational Pensions Committee) and industry representatives. The consultation process revealed a variety of stakeholder views on the issues discussed in this impact assessment. The opinions and evidence received have informed the analysis that follows.

An Inter-service Impact Assessment Steering Group, chaired by DG Internal Market and Services, was established in October 2008, involving representatives from DG Competition, DG Economic and Financial Affairs, the Secretariat General, the Legal Service and DG Health and Consumer Protection. The Group met on 10 October, 27 October and 11 November 2008.

On 20 November 2008, a draft Impact Assessment was submitted to the Impact Assessment Board, which issued its opinion on 19 December 2008. The recommendations of the Board led to changes in the draft Impact Assessment. In particular, the statement of objectives and the link between this initiative and the response to the financial crisis has been clarified; the case for European-level action further elaborated; the discussion of the link between the evidence cited and weaknesses in EU law was expanded (although quantification of aggregate investor detriment was not possible on the basis of the available data); and the statement of policy options and the assessment of their relative effectiveness and efficiency was clarified, including to confirm that the options are not mutually exclusive.

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[1] See: http://ec.europa.eu/internal_market/finances/docs/cross-sector/feedback_statement_srips.pdf.
[2] See: http://ec.europa.eu/internal_market/finances/docs/cross-sector/minutes_workshop_en.pdf.
[3] See: http://ec.europa.eu/internal_market/finances/docs/cross-sector/hearing-record_en.pdf.

3. Problem definition

The following sections should be read in conjunction with the 'problem tree' in Annex 1.

3.1. Market context and problem drivers

Comparable packaged retail investment products are originated in different industry sectors…

There are a wide variety of packaged investment products available to retail investors, originated in different financial sectors. The term 'retail investor' is here taken to mean a non-sophisticated, non-institutional investor. The primary focus is the individual or household - the population of the EU can therefore be considered as potential investors in this type of product – although the policy issues discussed may also be relevant to SMEs and municipalities.

The principal families of packaged retail investment product are described in the box below.[4]

These definitions should not be taken to be exhaustive. Further work will be necessary to better refine the definition of the products covered.

Investment (or mutual) funds. Investment funds are a form of collective investment vehicle that invest the pooled funds of a large number of investors for a fee. Funds raise money by selling 'units' of the fund to investors. In the EU, investment funds can be either UCITS ('Undertakings for Collective Investment in Transferable Securities', as harmonised by the UCITS Directive), or nationally regulated funds (non-harmonised funds or non-UCITS).

Investments packaged as life insurance policies. In unit-linked life insurance policies a portion of the premium is used to purchase life cover (the sum assured) with the balance invested in a fund such as a UCITS. The return on the policy is linked to the performance of the funds. As opposed to traditional life insurance products, unit-linked policies usually do not guarantee the payment of a determined financial amount in particular in the case of death / survival, but instead an amount which is a multiple of the market value of one or several units. Therefore, by definition, the policy holder bears the investment risk.

Retail structured securities. Structured securities are derived from or based on a single security, a basket of securities, an index, a commodity, a debt issue and/or a foreign currency. Normally in a structured security an investment bank promises to make, at a pre-determined time, a payout based on a pre-determined formula. The majority of structured securities offer full protection of the principal invested at the end of their term, whereas others offer leveraged returns but limited or no protection of the principal. They may be sold to investors as, inter alia, certificates, structured notes (bonds) or warrants.

Structured term deposits. Structured term deposits offer a combination of a term deposit with an embedded option or an interest rate structure. They are designed to achieve a specific payoff profile, which they achieve through transactions in derivatives such as interest rate and currency options.

The precise nature of the investment proposition, the legal structure and the tax treatment of the products differ, both between product families and across Member States. However, they share the same core functionality – namely providing retail investors with the prospect of capital accumulation over the medium to long term – and compete for the same retail savings.

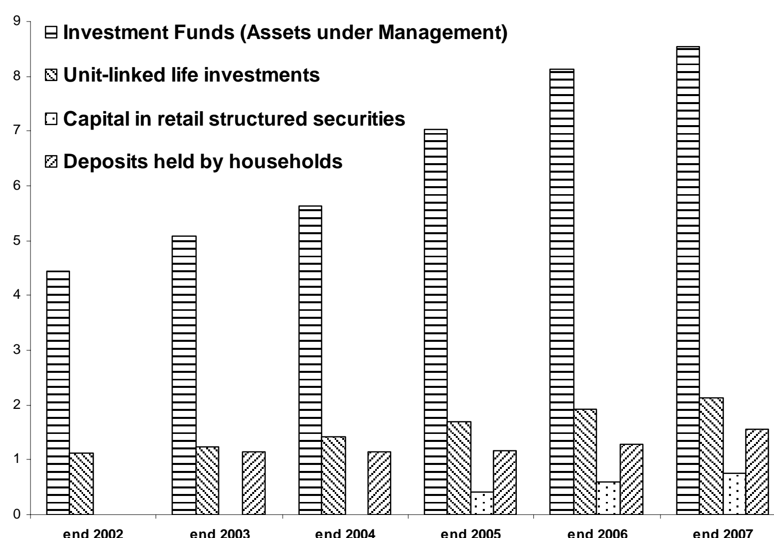
We distinguish 'packaged' products from investments in single equities or (unstructured) bonds. Some of the policy issues described in this paper also apply to these latter categories; however, the process of packaging investments adds an additional layer of complexity and cost that may make the key characteristics of the investment less transparent to the end investor.

As Chart 1 indicates, around €10 trillion were estimated to be invested through these product families by year end 2007, which is equivalent to around 80% of EU GDP. Precise data are not available for all

[4] See Annex 1 for further description of the product scope of this work. In the absence of a widely-accepted legal definition of 'retail investment products', the product scope is defined in terms of the common characteristics of these product types. Defining the precise boundaries of these product families could form part of the follow-up to the Communication. The list of product families that exhibit these characteristics is not exhaustive; ultimately, any measures would need to take account of the possibility that new retail investment products will emerge over time.

the products and such this chart is intended to be indicative only; note that 2008 has seen significant net outflows in relation to most packaged retail investment products, in some cases these have been substantial.[5]

Chart 1: Estimate of capital invested through packaged retail investment products (€ trillion)



Source EFAMA, CEA, retailstructuredproducts.com and ECB

… and are sold through similar distribution channels…

Packaged retail investment products are distributed both by their originators, be they fund managers, banks or insurance companies, and by a variety of intermediaries. The predominant model of retail distribution varies significantly between Member States.[6] However, a feature of many of these models, including the 'bancassurance' model of financial distribution prevalent in many Member States, and the independent financial adviser model in the UK, is that different product types are available from the same distributors. This convergence of product availability across a variety of different sales channels allows prospective investors or indeed intermediaries to consider and compare products belonging to different product families when contemplating an investment. This opportunity to 'look across' multiple product families is likely to lead retail investors to actively compare product offerings. In addition, it is likely to foster the expectation that the level of investor protection embodied by each product type is equivalent.

… yet are subject to different disclosure and distribution rules at European level.

Retail investment markets are characterised by a steep asymmetry of information and expertise between the originators and distributors of investment products, on the one hand, and the retail investor, on the other. The latter typically exhibit a low level of financial sophistication and hence are ill-equipped to assess the relative merits of the investment propositions on offer. Pre-contractual product disclosures and in particular financial advice from intermediaries thus play an influential role in the decision-making process. The distribution of packaged retail investment products is also however subject to potential conflicts of interest between originators, distributors and investors. For

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[5] Due to data limitations, figures for unit-linked life insurance and deposits are likely to overestimate capital invested in the specific products under consideration. There are also instances of double-counting. While these product types are designed and marketed primarily to retail investors, the figures include capital invested by institutional investors, which can be a significant proportion. See Annex 1 for further discussion of the data.

[6] See Annex 1 for more information on the channels employed for the sale of retail investment products.

example, payments by product originators to distributors, for instance in the form of commission payments, create a potential for a divergence of interest between sellers and buyers of packaged retail investment products.

Regulation has sought to mitigate these market failures and hence to limit investor detriment. One regulatory approach is to target the product itself, by limiting the access of retail investors to certain product types or directly regulating the characteristics of the products (known as 'product regulation'). While this is one of the approaches adopted in the UCITS Directive, it is not a widely employed regulatory technique. The practical challenges associated with harmonising product features for all product types would be immense and the net market outcomes deleterious, particularly through the impact of such restrictions on product competition, diversity and innovation. This approach is not considered to be within the scope of this investigation.

Regulation in this sector more commonly focuses on the sales process, that is, the interface between the investor and the originator and/or intermediary. To mitigate risks to investors, regulation focuses on ensuring that investors are adequately informed about the characteristics of the product and are treated fairly by product distributors. Two types of regulation are particularly relevant in this context:

- Rules on the form and content of pre-contractual product disclosures and marketing materials; and
- Rules governing the conduct of business of product distributors and the avoidance, management and disclosure of conflicts of interest in the sales or advice process. Collectively, these provisions can be referred to as selling rules.[7]

The focus in this impact assessment is on regulation in these two key areas.

For most product types, a substantial body of law already exists at European and national level to ensure that investors are informed of the characteristics of their investments and are treated fairly and professionally by distributors.

However, Community law in this area has been developed on a largely sectoral basis. As a result, the rules governing disclosure and selling practices vary according to the sector in which the product is originated and in which the intermediary operates. There are overlaps - for example, the application of MiFID to the sale of both funds and structured securities - but by and large the products and their sales are subject to distinct regulatory provisions. There is no single, coherent approach at European level to disclosure and selling rules for packaged retail investment products. The following table illustrates this 'regulatory patchwork'.

Table 2: Disclosure rules and intermediary regulation in Community law for packaged retail investment products

	UCITS	Non-harmonised investment funds	Unit-linked life insurance policies	Structured securities and closed-end funds	Structured term deposits

[7] In the event that these controls fail and investor detriment results, national authorities may have acted to mitigate the impact on retail investors through guarantee or redress schemes of various types. For example, financial ombudsmen provide a means of redress for investors mistreated by financial intermediaries. Guarantee schemes exist in the insurance, banking and investment sectors to provide cover in the event of the insolvency of a product provider. In the insurance sector the situation is diverse, and the Commission is currently conducting a consultation on this subject: see http://ec.europa.eu/internal_market/insurance/guarantee_en.htm. The focus of this work, however, is on the *ex ante* controls in place rather than *ex post* guarantee and redress mechanisms.

<table>
<tr><td rowspan="3">Rules on product information applying to manufacturers, issuers or intermediaries</td><td>Simplified Prospectus of UCITS Directive</td><td rowspan="2">MiFID
(high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td><td>CLD</td><td>Prospectus Directive[8]</td><td rowspan="2">No rules at EU level</td></tr>
<tr><td>MiFID[9]
(high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td><td>Insurance Mediation Directive[10] for some product disclosure requirements</td><td>MiFID
(high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td></tr>
<tr><td colspan="5">E-commerce Directive or Distance Marketing of Financial Services Directive</td></tr>
<tr><td rowspan="3">Selling rules</td><td>MiFID</td><td rowspan="2">MiFID</td><td rowspan="2">Insurance Mediation Directive</td><td rowspan="2">MiFID</td><td rowspan="2">No rules at EU level</td></tr>
<tr><td>UCITS Directive</td></tr>
<tr><td colspan="5">E-commerce Directive or Distance Marketing of Financial Services Directive</td></tr>
</table>

A brief description of the relevant provisions of these instruments is provided in Annex 1.

3.2. Problem description

The preceding discussion has identified three key features of the market for packaged retail investment products:

- Retail investment products are originated in different industry sectors but often targeted to satisfy similar retail investment needs;
- A wide range of different products are made available to retail investors through similar distribution channels; and
- European rules on disclosure and selling differ according to the legal status of the product and the channel through which it is distributed; for some products and sectors, there are no applicable rules.

The regulatory patchwork results in considerable regulatory complexity. Different types of product are subject to different disclosure obligations at European level. Similarly, different types of intermediary are subject to different obligations with respect to the conduct of their business and the management of conflicts of interest. When the same intermediary offers products from different industry sectors, different rules will apply. For certain products and intermediaries, there are no applicable rules at European level.

Variation in the form and content of rules is not a problem *per se*. Differences in sectoral approaches may be justified by the distinct characteristics of the products and intermediaries in those sectors, with regard for example to risks taken by the originating and distributing institutions; the risks faced by consumers purchasing the products; or the manner in which products are sold. However, the emergence of comparable products governed by significantly different regimes and the growing

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8 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 and amending Directive 2001/34/EC.

9 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

10 Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation.

convergence of product availability within distribution channels serve to weaken these distinctions and hence the logic of a differentiated approach.

In particular, the 'regulatory patchwork' at European level poses two key regulatory concerns:

- The first is that it creates or amplifies **risks of investor detriment** in the sectors concerned. For example, deficient or absent rules on pre-contractual product disclosure may result in a lack of transparency on the costs, risks or expected performance of a particular product. As a consequence, investors would be unable to compare competing products or understand the products they are considering buying. Similarly, missing or ineffective rules on selling disciplines or conflict of interest management would amplify risks of mis-selling.
- The second, related, concern is that differences in the level of investor protection between sectors create an **unlevel playing field** with respect to disclosure and selling rules for product originators and distributors. This may distort the market in favour of products subject to weaker regulation, thereby exacerbating the risks of investor detriment described above.

These concerns are significant enough to have provoked responses from national regulators in several Member States. However, uncoordinated action of this type presents a third barrier to the efficient operation of the retail investment market.

- **Divergent national regulatory approaches**, triggered by deficiencies in European rules, may increase the cost of selling investment products in multiple national markets, or on a cross-border basis. While differences in disclosure and selling rules are unlikely to be the most important barrier to cross-border trade, they may nevertheless act as a brake on the development of a single market in these products.

3.2.1. Risks of investor detriment

Packaged retail investment products normally expose the investor to a degree of investment risk. Depending on market movements, an investment may deliver a positive or negative return, with the range of possible outcomes determined partly by the features of the product (for example, downside risk may be eliminated by the existence of a robust capital guarantee, at the expense of reduced potential for gains). By contrast, the risk of investor detriment refers to the risk of product mis-selling and/or ill-informed investment decisions resulting from investors being either inadequately informed of the key characteristics of the product they are offered, or being otherwise mistreated by originators or distributors in the sales process.

If risks of investor detriment crystallise, the impact could take the form of financial losses for investors, or where there is no absolute loss, the opportunity cost of selecting an investment with a different risk-reward profile to that which was intended or expected. Opportunity cost can be difficult to pin down; often it can only become clear over the longer duration that a product has failed to perform in the manner expected. Detriment can also be crystallised indirectly – for instance, a poor understanding of the performance structure of an investment may lead to an investor significantly mis-timing their entry and exit into the market , for example because they did not expect the investment to exhibit short term volatility.

A systematic pattern of product mis-selling or inadequate disclosure of product features may result in retail investors losing confidence in the products and in the institutions originating and distributing them. Impaired reputations can result in a loss of business and a reduction in revenues and profits. This impact may be felt unevenly across the market, i.e. the originators and distributors of certain products may gain while those selling products in which investor confidence has been lost will suffer.

However, there is also a risk of contagion. It is plausible that a loss of faith in particular products could have knock-on effects on the whole investment market. In the current environment, adverse market conditions have triggered a flow of retail savings away from investment products and towards basic savings accounts or cash balances. Such effects could be accentuated if investor confidence were impaired not only by market developments but by losses that might not have been reliably foreseen on

the basis of information disclosed or advice given. Investor detriment in one sector may not simply lead to a redistribution of savings between sectors, but rather a reduction in the propensity to make use of any type of packaged retail investment product. To the extent this implies that productive investment opportunities are foregone, such a development may impact negatively on the efficiency of resource allocation and may compromise the ability of individuals to make financial provision for later life. This is a potentially significant issue at time when public pension systems are under strain.

The Call for Evidence and subsequent discussions with stakeholders, including national regulators, has produced a significant body of evidence and expert opinion to use as an initial basis for assessing these issues. Despite this, the risks of investor detriment – and their associated impacts – remain intrinsically difficult to quantity, particularly when ineffective disclosures or inadequate selling practices result in poor investment decisions of which the opportunity cost is high, but measurable financial losses are not incurred. Such incidents are best observed by those closest to the respective markets. In assessing these risks, we must therefore rely to a large extent on the expert opinion of consumers, national regulators and market practitioners.

The evidence that follows is sub-divided into two sections: examples and perceptions of risks crystallising as a result of ineffective pre-contractual product disclosures and misleading marketing material; and risks associated with inadequate regulation of selling processes. The examples included have been selected solely to illustrate the risks most frequently identified; they are by no means exhaustive or intended to provide a comprehensive overview of the evidence.

3.2.1.1. Inadequate pre-contractual product disclosures and marketing rules

The evidence points to four types of problem with existing pre-contractual disclosures.

- The first is that the content of disclosures may provide a misleading or partial account of a products features, such as its costs; the range of possible returns; associated risks; limits to capital guarantees provided; or any restrictions that apply (notably on when an investor may be able to take their money out). The investor would not then be in a position to take an informed decision. A lack of balanced or transparent information may result in investors giving undue weight to the elements that are disclosed more prominently, such as tax benefits, capital protection or estimates of the maximum possible return.
- Secondly, inconsistent disclosure practices may also prevent the effective *comparison* of alternative investment propositions by retail investors, particularly relevant as charging models can be very different.
- Thirdly, even if the relevant 'key' information is provided, it may not be presented in such a way that it can actually be used by non-sophisticated, retail investors to understand the product or compare it with others.
- Fourthly, and relatedly, there is an abundance of research to suggest that retail consumers suffer from 'information overload'. If disclosures are excessively long and drafted using technical jargon instead of using simple, understandable language, retail investors may be deterred from using them.[11]

An additional, related, problem is that of misleading marketing materials. Unfair, unbalanced or otherwise misleading marketing material may induce an investor to select a product that is a poor match for his/her investment profile. Misleading advertising may also result in the investor paying insufficient attention to the content of more detailed product disclosures.

These problems are common to disclosures in all markets and have important implications for rule-making at national and European level (there have been some steps at both national and European level to tackle them). The focus here is on the extent to which current disclosure obligations in

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[11] For example, see National Consumer Council, *Warning: Too Much Information Can Harm*.

Community law might be failing to adequately mitigate these problems or contribute to them. Here we present some illustrative examples of the evidence of such failures, on a product-by-product basis.[12]

Unit-linked life insurance policies

Many responses to the Call for Evidence on unit-linked life insurance policies highlighted deficiencies with regard to the disclosure of likely performance and of the costs associated with this type of investment.

The response from the insurance supervisors in CEIOPS highlighted the disclosure of 'chain costs' as a particular problem (the use of insurance 'wrappers' entails the addition of costs both at the level of the insurance company and the originator of the underlying investment).

More broadly, the Dutch AFM and other regulators have reported that differences in regulation between life insurance products and mutual funds have caused significant problems. They argue that transparency of costs and inducements is not achieved in the insurance sector solely on the basis of EU requirements, so to the extent that the EU requirements set the standard of disclosures, prospective investors are unable to weigh these factors up against other features that might be highlighted, such as the tax advantages of the product. This is considered to have resulted in the sale of insurance products even where mutual fund investments offering similar asset exposures with lower charges might have offered better risk-adjusted performance.

A recent example of such a potential distortion in sales is the alleged misselling of equity-linked insurance products in the Netherlands, which resulted in a class action lawsuit. The complaint was that there was insufficient disclosure of the costs associated with those policies, leading to investment returns that were significantly lower than investors had been led to expect and penalties on early withdrawal that were not expected. Following intervention by the Dutch Insurance Ombudsman and its replacement, the Financial Services Ombudsman, out of court settlements were reached with certain distributors of such products.[13]

There are other examples. For instance, a Belgian consumer association has warned that rules for advertising on unit-linked life insurance in Belgium do not specify how information on past returns should be presented so as to avoid misleading prospective investors.[14] The association encountered an insurance company advertising a unit-linked life contract by referring to the return achieved in 2006, without mentioning the return earned in 2007, which was considerably weaker. The same association is currently suing an insurance company for misleading advertising. In particular, the company is considered to have given undue prominence in its marketing material to the return on only one of the funds underlying the insurance policy (the best performing fund), rather than the basket of funds in which client's assets were invested.

The management and / or disclosure of potential conflicts of interest is addressed in Section 3.2.1.2.

Investment funds

Consultation on possible amendments to the UCITS Directive revealed that most respondents felt that the Simplified Prospectus (a shorter summary document required for all UCITS since 2005) had failed to provide key information in a form that was easily understood by the average retail investor. This finding triggered the ongoing work on developing Key Investor Information. Respondents to the Call for Evidence reported similar problems for non-harmonised funds and closed-ended funds.

In France, the Final Court of Appeal recently sanctioned a commercial bank over failure of compliance with the combination of rules on product disclosure and marketing communications. The Court found that the firm did

12 Evidence drawn from responses to the Call for Evidence and the records of the Industry Workshop and Open Hearing is not individually referenced.

13 See http://www.kifid.nl/uploads/2008-03-04-Recommendation_of_the_Financial_Services_Ombudsman.pdf

14 See http://www.test-achats.be/map/src/522123.htm.

not mention in its advertisement the downside risk that a formula (structured) fund presented.[15] Problems with formula funds were also noted elsewhere in the French market.

In Belgium, a consumer association recently criticised an advertising campaign for a structured fund distributed by a Belgian commercial bank.[16] It is claimed that adverts placed undue emphasis on a guaranteed rate of return, without a clear indication that this return would only be achieved on half of the capital invested.

The Dutch AFM have reported that the mandatory information provided in the prospectus for closed-ended real estate funds is not well-tailored to this type of investment, which is growing in popularity in the Netherlands. The result is that investors cannot understand the expected return, the costs and most importantly the level and nature of the risks involved in these investments.

In Germany, a number of legal proceedings have highlighted problems of mis-selling, unfair marketing, and misleading or inaccurate product information with respect to closed-ended funds.

In the United Kingdom, the FSA have recently published an assessment of the standards of disclosure documents across the whole range of retail investment products, which found many to be inadequate and unlikely to be understandable for their target audience.[17]

Retail structured securities

Many stakeholders have argued that structured product disclosures do not adequately describe the costs associated with the product or the likely range of performance outcomes. Prospectuses produced in accordance with the Prospectus Directive – including the summary prospectus - were not considered to be effective disclosures for structured securities, since they focus on the issuer rather than the product and are both lengthy and technical.

The European Securities Markets Expert Group, in their review of the functioning of the Prospectus Directive, found that "'[...] from the point of *view of the investors, the Prospectus Directive has failed to produce an effective means of communication. For example, the average length of prospectuses has increased dramatically due to the requirement for additional information. The length and complexity of prospectuses make them more a sort of 'liability shield' for the persons involved in the preparation (issuers, intermediaries, auditors, law firms and competent authorities), effective ex post in minimizing the risk of potential litigation, rather than a document to be used ex ante by an investor when making investment decisions.*" They added that "*many investors have difficulties in understanding the technical language and the complex structure of information as well as analyzing the importance of various types of information. As a consequence, most retail investors rely only on the marketing material prepared in connection with a public offering. The summary is often a simple "cut and paste" exercise of various parts of the prospectus without any attempt to simplify the language of such parts (often very technical) as required by the Prospectus Directive.*"[18]

Obligations in the Prospectus Directive are supplemented by additional disclosure requirements on intermediaries in MiFID, which relate primarily to the services provided by the intermediary but also to the financial instruments they may be selling. However, many stakeholders argued that these provisions are subject to inconsistent implementation in Member States and do not go far enough in ensuring that the relevant items are clearly disclosed.

In a cross-country survey, Deloitte found that *'material differences exist between investment funds and structured notes in the nature and level of detail of information disclosed to the investors ... this is clearly the case for characteristics, risks and costs. These differences make it difficult or even impossible for investors to compare in detail all characteristics of the products. The differences also result in a different quality of information given to investors*.'

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[15] See *Arrêt n° 740 du 24 juin 2008 06-21.798 Cour de cassation - Chambre commerciale.*

[16] See http://www.test-achats.be/map/src/522123.htm.

[17] See http://www.fsa.gov.uk/pubs/other/key_features.pdf.

[18] See http://ec.europa.eu/internal_market/securities/docs/esme/05092007_report_en.pdf.

The Dutch AFM published an analysis of developments on the market for structured products in May 2007, arguing that *many* are difficult for retail investors to understand. These developments constituted grounds for an 'exploratory analysis of structured products',[19] which concluded that …' *the information provided to investors is not as it should be. Prospectuses do not focus sufficiently on the information that consumers need to make well-considered investment decisions. In addition, the legal entity chosen for the products means that financial information leaflets are not obligatory ... The AFM feels investors may select an unsuitable product, which will jeopardise the proper operation of the market and, if investors are disappointed in their choices, the confidence in the market'.*

In another example of the issues being raised, the Czech National Bank has expressed concerns in relation to an index-linked bond, the yield of which is based on a specific underlying asset (for example the performance of an index or an exchange rate). The product was sold as a 'guaranteed bond', while it in fact presented a significantly higher risk than standard guaranteed bonds.

In the United Kingdom, the FSA has fined or some cases banned a number of product manufacturers and intermediaries in relation to sales and marketing of certain kinds of complex 'high income products', typically known as precipice bonds.[20] The FSA had previously issued a series of warnings in relation to the products, such as an alert in December 1999 which urged consumers to consider carefully the level of risk they were willing to accept before investing in so-called high income products; the FSA reiterated in later communications that consumers should be cautious when investing in bonds that promise income but carry a high risk that investors may not receive back all, or any, of their original investment, and required regulated firms to improve the information they provided to consumers..[21]

Structured term deposits

Many responses to the Call for Evidence noted that there were no European rules that applied to structured term deposits as a class of product. (In this area, no specific targeted examples of investor detriment were provided.) The Joint Forum reiterated the point, and noted that there are retail investment products (such as structured term deposits) that are not subject to disclosure regulation at EU level. Noting that similar lacunae existed in other jurisdictions, they suggested that '*this is [an issue] that governments should consider*'.[22]

There is evidence that some of same issues as are raised for other classes of PRIP apply. For instance, in Poland in the first half of 2008, the Polish Financial Supervision Authority (PFSA) ordered some banks to withdraw advertisements of structured term deposits due to the violation of professional standards and ethical codes in operation. The PFSA was concerned that these placed excessive emphasis on a product’s benefits for the customer and deliberately omitted other important product characteristics, e.g. penalties for early withdrawal of funds.

Summary

The examples presented in this section do not in themselves constitute systematic evidence of market or regulatory failure with respect to product disclosure. Particular instances of investor detriment do not necessarily indicate a failure in the European regulatory framework; they may instead relate to

19 http://www.afm.nl/corporate/default.ashx?DocumentId=9246.

20 These so-called "precipice bonds" were linked to derivatives such as the performance of an index or indices or baskets of stocks. They were often structured as offshore investment companies or offshore insurance companies and so are not regulated by the FSA. They were structured to deliver a high income without protection against loss of the initial capital invested; return of the original capital was linked to the performance of an index/indices or a basket of stocks. The risk of capital loss (particularly high given the income being taken) was often not clearly explained.

21 See for example FSA/PN/122/2002 of 15/12/2002 'Precipice bond' investors may not get their money back, FSA warns". See also http://www.fsa.gov.uk/pubs/guidance/guidance7.pdf.

22 Joint Forum, *Customer Suitability in the retail sale of financial products and services*, April 2008.

failures in the transposition or enforcement of those rules in the Member States. However, it is apparent that the examples cited cluster around areas where expert opinion, including from the regulatory and investor communities, indicates that the disclosure provisions of Community law are comparatively weak, or indeed absent, exposing less sophisticated investors in particular to potential detriment. This suggests that there is scope for considerable improvement in this area, across the full spectrum of packaged retail investment products.

The recent experience of the financial crisis has further corroborated these conclusions. Investors have suffered from adverse conditions and have found, in some cases that products have not performed as might reasonably have been expected. A particular issue affecting a number of sectors has been the performance of products sold with capital guarantees. The default of counterparties providing such guarantees has exposed retail investors to the crystallisation of counterparty risks of which they were not fully aware. As the lessons are drawn from the crisis, the descriptions of the nature and conditions attached to guarantees are coming under increased scrutiny.

3.2.1.2. Inadequate care or professionalism in the selling process

Risks of investor detriment may also arise from inadequacies in the regulation of the selling practices of product distributors. These inadequacies relate to two areas:

- Insufficient objectivity and professionalism in sales or advice results in the mis-selling of products that are a poor match for the risk profile (or other characteristics or needs) of the prospective investor.
- The financial incentives provided to distributors by the originators of particular products or other distributors or 'packagers' of products for the sale of their products may result in a conflict of interest between the distributor and the prospective investor. In particular, differences in payment levels may lead a distributor to sell those products that generate the highest payments, rather than those best suited to the needs of the end investor.

Feedback received in relation to gaps or inconsistencies in the regulation of intermediaries at European level consisted primarily of anecdotal evidence and comparison of legal provisions. It was frequently highlighted that given the short period of time that MiFID and IMD rules have been in force, it would be premature at this stage to draw firm conclusions about their impact and the residual risks to retail investors.

However, it was widely accepted that there are marked differences in conduct of business rules between sectors.[23] For example, MiFID contains a set of differentiated selling rules, where the requirements depend on the type of service being offered and the type of client being served. For retail investors, when providing investment advice or portfolio management services, MiFID intermediaries must perform a test of the suitability of any proposed investment. When providing other services, an 'appropriateness' test may be required. By contrast, in the insurance sector, the IMD requires that insurance intermediaries provide advice on the basis of a fair analysis of a suitable range of contracts available on the market and to advise products that are 'adequate' for the needs of the consumer. There are no rules in place at European level for the distribution of structured deposit products.

> The Joint Forum also noted once again that there are retail investment products (such as structured term deposits) that are not subject to conduct of business regulation at EU level. Noting that similar lacunae existed in other jurisdictions, they suggested that '*this is [an issue] that governments should consider*'.

It was also noted that there are gaps in the application of distribution rules when products are sold directly by originators – for example, fund managers or insurance companies - rather than by an intermediary. No evidence was provided to link these gaps with instances of investor detriment but it is unclear why rigorous selling disciplines should not apply to the direct - as well as intermediated -

[23] See Annex 1 for an outline of the relevant provisions of Community law.

distribution of packaged retail investment products (though of course the service provided may differ in other respects).

With regard to conflicts of interest, MiFID has introduced a sophisticated regime for the avoidance, management and disclosure of conflicts of interest and detailed provisions concerning the payment of inducements to intermediaries; both regimes apply to the sale of funds and structured securities. The IMD, by contrast, does not contain comparable conflict of interest or remuneration disclosure rules, although it does require intermediaries to tell the customer whether they are giving advice based upon a fair analysis (for instance, by comparing the features of a sufficiently large range of insurance contracts) or whether they have contractual obligations with one or more insurers.

The regulation of conflicts of interest in the insurance sector drew criticism in the Call for Evidence.

CEIOPS' Members, through their combined response to the Call for Evidence, concluded that '*there is a gap in terms of the coverage of conflict of interest rules that should be addressed in the course of the revision of the IMD*'.

The Dutch AFM argued that the duty of care obligations in force in the insurance sector were not as robust as those found in other sectors.

The Joint Forum found that disclosures of conflicts of interest (for example, ownership structures of the sales agent, or remuneration to be received) are generally less rigorous for sales of insurance than for other products. [24]

Consultation revealed a divergence of view on whether these differences were of concern from an investor protection or competitive standpoint. We do not as yet have strong evidence of the extent to which such inconsistencies and gaps might have resulted in specific investor detriment or competitive distortions. As mentioned above, practical experience with this legislation remains limited and as such it would be premature to draw firm conclusions at this stage on whether these provisions have successfully mitigated the risks associated with lax selling practices or conflicts of interest.

There is nonetheless *prima facie* cause for concern over the regulatory patchwork in this area. Retail investment business is typically intermediated rather than direct, and many investors rely on third parties when making investment decisions. Consequently, a failure to conduct business professionally or to effectively manage conflicts of interest could be a particularly significant cause of investor detriment. Inconsistencies in intermediary requirements between types of products might also distort competition, leading to further detriment by means of regulatory arbitrage effects.

3.2.2. Competitive distortions resulting from an 'unlevel playing field' between product types and distribution channels

A second consequence of variations in disclosure and distribution rules at European level between sectors is that certain originators/distributors may be placed at a competitive disadvantage with respect to market participants originating or distributing other product types.

This 'unlevel playing field' may manifest itself in two ways.

- First, as a consequence of regulatory differences alone, originators/distributors in a particular sector may face higher compliance costs (for example due to the need to produce additional disclosure documents or to develop internal systems for the management and reporting of conflicts of interest) or otherwise more burdensome requirements than those in other sectors. This may affect both the cost of the product offered to the consumer and the ease with which the sector can innovate and bring new products to market.
- Second, as described in the previous section, differences in regulation may distort consumer decision-making. For example, weak disclosure standards may result in inadequate disclosure of

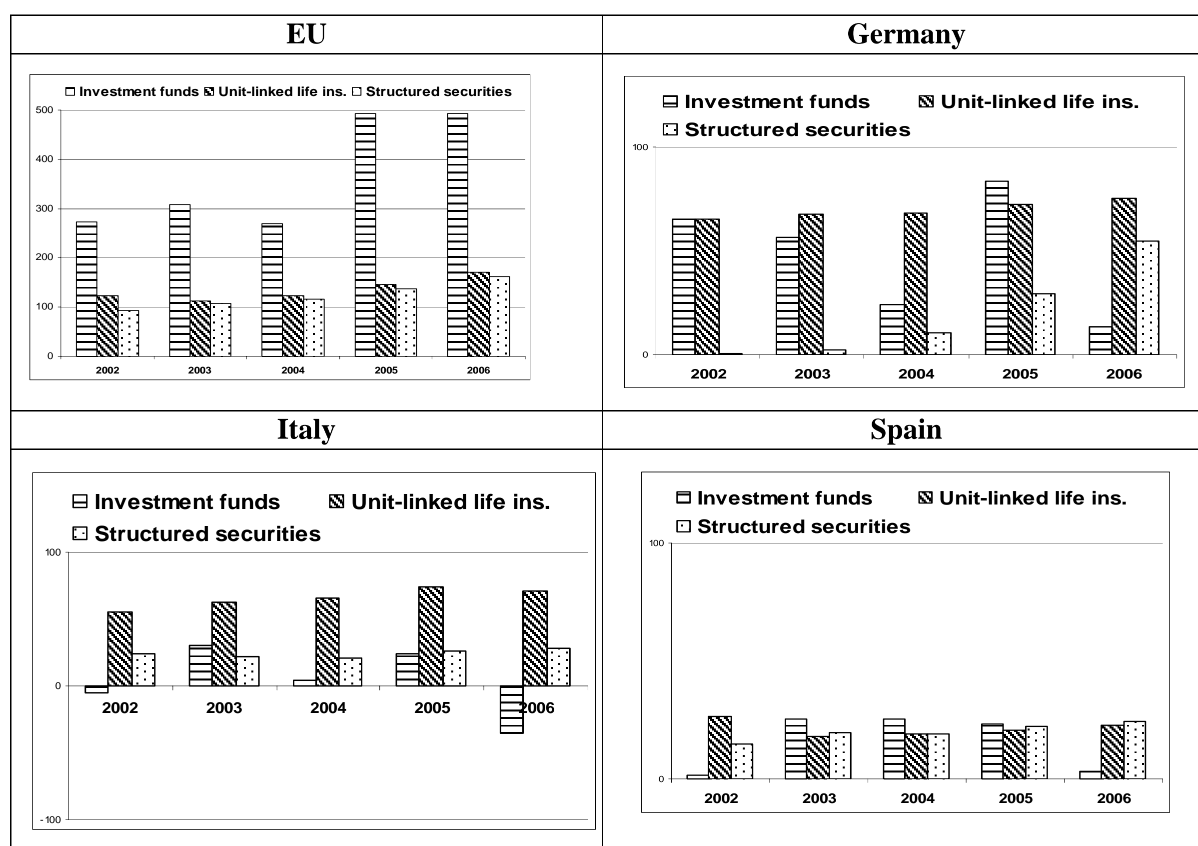
[24] Joint Forum (2008), p.2

costs or risks, with the result that a product appears more attractive than a competing product for which these factors are more transparent.

These factors may in turn create incentives for originators/distributors to package products in particular ways so as to avoid more burdensome regulation. A process of 'regulatory arbitrage' would thus be set in motion, working in favour of those products subject to less stringent regulation. If this were the case, the risks of investor detriment outlined in the previous section would be amplified.

To what extent can we demonstrate that the purported unlevel playing field with respect to disclosure and distribution rules at European level has given rise to competitive distortions? At the aggregate level, there is limited evidence of shifts of savings between product families on a pan-European scale. Data on net sales indicate that the proportion of net sales accounted for by investment funds has remained roughly constant since 2002. However, there are tentative signs that that the structure of the market is changing. Fund sales remained roughly constant between 2005 and 2006, whereas growth was strong for both retail structured securities and unit-linked life insurance policies. This trend was most apparent in the German, Italian and Spanish markets.

Chart 2: Net sales of packaged retail investment products (€ billion)



Sources: EFAMA - EVCA – AIMA, Eurohedge, CEA and www.structuredretailproducts.com.

Sales data are volatile and do not span a sufficiently long time period for us to be confident that wholesale changes in market structure are taking place. Moreover, even if we could demonstrate that such changes were occurring, we could not confidently attribute these trends to differences in disclosure regimes and the regulation of intermediaries. Sales patterns are affected by a variety of factors on the demand and supply side. Commercial decisions by product providers and evolution in consumer preferences are likely to be influential. For example, capital protected products – such as structured securities – are seen to gain in popularity during uncertain economic times.

Producers cannot move seamlessly from one sector to another. The process is not frictionless. Relevant regulatory authorisations are required, for example, to issue securities or to sell insurance contracts. The infrastructure, skills and expertise for supporting active fund management may also

vary greatly from that required to originate structured securities. Therefore, even if differing selling rules created an incentive for arbitrage, the response from the supply side may be limited.

It is also important to recognise that disclosure and distribution rules are only one component of the 'playing field' on which originators and distributors compete. Tax is another highly relevant factor. For reasons of public policy, it has been common for Member States to apply favourable tax treatment to particular product types. There is evidence that this exerts a powerful influence on savings flows. For example, the popularity of insurance-based products in France, even for the distribution of UCITS, can largely be attributed to the favourable tax treatment that these products enjoy. Similar arguments can be made in most Member States. Responsibility for taxation policy resides with Member States and hence options for levelling this element of the 'playing field' are not discussed further here.

While it is difficult to draw firm conclusions about the importance of regulatory arbitrage, it remains clear that all of the product types described are used extensively by retail investors, which is in itself a case for ensuring that risks of investor detriment are effectively mitigated. Regulatory arbitrage, or the active migration of savings from one product to another, would amplify these risks, but the existence of widespread arbitrage is not a precondition for these risks to emerge.

3.2.3. Divergent national responses: impact on single market

The problems flowing from the European regulatory patchwork for packaged retail investment products described in the previous section have been widely acknowledged by Member States. Perhaps the clearest indication that national regulators consider differences in rules between sectors to be of real, rather than purely theoretical, significance is that many have supplemented European rules with additional requirements at national level. This has been done both to enhance the level of investor protection and to 'level the playing field' between alternative investment propositions.

This is reflected in the conclusions of a comprehensive survey of national regulatory views on the issue conducted by the three 'Level 3 Committees' (3L3) in May 2007.[25] The conclusions of this work confirmed that '*differences between distribution [and disclosure] rules applicable to the different substitute products are widely acknowledged. The most frequently mentioned differences are related to authorisation and market access, approval of marketing and advertising material, and scope and form of the information to be supplied ...The reasons for these differences can be found in the Directives themselves, which did not follow the trend toward increasing similarity between the financial characteristics of substitute products'.* In response to this, the 3L3 found that '*... the competent authorities representing almost half of the Member States did not consider these differences as a regulatory concern, because a large number of them supplemented the Directives with national rules aiming at bringing distribution rules closer*.'

The approaches taken at national level differ significantly between Member States. In some Member States, the provisions of MiFID have been applied to business that does not fall within scope at European level. Several Member States have also mandated additional disclosure documents, often in the form of a simplified information sheet; and some have applied a harmonised conduct of business regime to all distributors of packaged retail investment products. Detailed examples of national approaches can be found in Annex 1.[26]

While national approaches may to some extent constitute an effective response to gaps and weaknesses in Community law at national level, their effect has been to increase the divergence in

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25 The '3 Level 3 Committees' are the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Supervisors (CESR) and the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS).

26 In other cases, the concerns of national regulators have been translated into explicit demands for the industries concerned to deliver the necessary improvements through self-regulatory measures. This is the case in Germany, where self-regulation is already in place for retail structured securities in the form of a code of conduct. Issuers have voluntarily committed themselves to transparency and disclosure in various respects, notably with regard to product information. Codes have also been instituted in other sectors and Member States; and in some cases on a pan-European basis.

national rules even in areas in which European legislation applies. This is not necessarily problematic, in that the applicable European directives explicitly provide the flexibility for national authorities to fill gaps and to tailor European rules to the reality of domestic markets. However, divergent national approaches to disclosure rules and the regulation of intermediaries would increase costs for market operators distributing products in multiple Member States and are a potential source of legal uncertainty for originators/distributors and investors operating in multiple markets.

To what extent are these barriers likely to be material? At present, the aggregate level of cross-border business in packaged retail investment products varies considerably between product types. At one end of the spectrum, around 20% of UCITS funds are sold on a cross-border basis using the product passport provided by the UCITS Directive. Indeed, growth in cross-border net sales has outpaced domestic sales in recent years.[27] Cross-border trade in life insurance products and structured securities is much less developed. Data for unit-linked life insurance policies specifically are not available but for life insurance more broadly, only Luxembourg, Irish and British insurers receive a significant proportion of life premia from abroad (91%, 36% and 10% of total premia respectively in 2005). Data are not available on the cross-border sales of retail structured securities; anecdotal evidence suggests that cross-border sales are negligible in the EU.

These patterns are consistent with trends observed in markets for retail financial services more broadly. Commission surveys suggest that only 1% of EU consumers currently buy financial services cross-border at a distance.[28] Despite the growth of distribution channels that facilitate the cross-border sale of retail financial service provision (notably, the internet), consumers still prefer to buy products distributed through local branches, subsidiaries and intermediaries. To the extent that it occurs, access to non-domestic markets is typically achieved through establishment or the merger of service providers, rather than cross-border purchases from a foreign provider.

Why has cross-border trade not grown more rapidly for packaged retail investment products? In the case of unit-linked life insurance products, different approaches to contract law and claims settlement, as well as differences in taxation systems represent a significant barrier. It is less clear why retail structured securities, which benefit from a passport under the Prospectus Directive, are not sold more extensively on a cross-border basis. The answers appear to lie both in differences in tax treatment and in cultural preferences, in particular preferences for familiar, nationally-branded products and originators/distributors. These factors help to explain not only the existence of barriers to cross-border trade but also why there are marked differences in the structure of national markets, in terms of the relative popularity of particular products and in the way in which they are sold.

It is difficult to be precise about the role that regulatory differences play in the continued fragmentation of markets for packaged retail investment products. However, differences in national rules on disclosures and distribution are likely to result in additional costs for market operators distributing products in multiple Member States. For example, they may be obliged to produce different disclosure documents for identical products, even when the products are harmonised at European level and sold under a European passport. Divergent national approaches may also be a source of legal uncertainty for both distributors and investors. There is some evidence that producers do perceive divergent regulatory provisions as a barrier to cross-border activity,[29] although there is no

[27] Note however that this figure is not adjusted for so-called 'roundtripping' – where for tax reasons a firm in one Member State may domicile funds in another, creating matching cross-border flows between the two Member States without any authentic cross-border retail business being conducted from the investor's perspective.

[28] http://ec.europa.eu/consumers/cons_int/fina_serv/cons_experiences/report_eurobarometer63-2_en.pdf, p.39.

[29] For example, from the review of the Distance Marketing of Financial Services Directive and feedback on the implementation of the UCITS Simplified Prospectus.

indication that cross-national differences in regulation affect consumer decision making between nationally- and internationally-sourced products.[30]

It is important to note, however, that consistency in disclosure and distribution rules would not in itself create the conditions for products to be offered on a cross-border basis in the same way as those products currently subject to a European passport. Differences in the regulation of products and their managers may also act as a significant barrier in this regard. Notwithstanding this important caveat, it is not unreasonable to assert that divergence in rules resulting from variegated national responses to the regulatory patchwork at European level is not conducive to the further development of cross-border trade in these sectors.

However, it is important to recall that, even in predominantly local markets, disclosure rules and regulation of intermediaries in many sectors flow directly from the implementation of Community law. Member State actions are constrained to a greater or lesser extent by Community law, whether that law is minimum or maximum harmonising, and the differences in approach within Community law (e.g. between MiFID, the Prospectus Directive, UCITS, the IMD and the CLD) inevitably lead to complicated regulatory patchworks at the Member State level reflecting the complexity at the European level. As a result, variations and gaps in effective standards at the local level are in part a consequence of the European patchwork itself, and cannot be seen as solely reactions to local market problems. This argues in favour of a European response to the problems identified as a core part of addressing local market problems, irrespective of other responses at local level. The form that this European response might take is analysed in the options section below.

3.3. How would the problem evolve without further action?

Taking no action at the European level to address the above problems means that they would be likely to persist. It does not, however, imply that the regulatory environment would remain unchanged or that the problems themselves would remain static. Indeed, the financial crisis has exposed the weaknesses in the current framework and is likely to increase the impetus for action at national and European levels in order to rebuild investor confidence.

It is reasonable to assume that some Member States may take further action. This may have a beneficial impact with respect to investor protection and the level playing field within the Member States in question. However, it would also lead to further divergence of regulatory approaches across Member States, thereby potentially impeding market cross-border business and further complicating the legislative landscape, while, as noted above, certain inconsistencies cannot be addressed effectively at Member State level as they relate to inconsistencies in Community law. Also, it is unlikely that *all* Member States would take unilateral action, leaving some markets without adequate regulation.

Some self-regulatory initiatives can also be expected to emerge without further stimulus from the EU. There is some evidence that the industry is acting to address some of the weaknesses identified above. For example, in the insurance sector, BIPAR and FECIF/AILO have recently adopted codes of conduct that are relevant to some of the problems identified; and a taskforce dedicated to enhancing product disclosures has been created within the European Banking Federation.

At EU level, in the absence of new initiatives, existing workstreams may contribute to mitigating the problems in certain sectors and for certain products. These include:

- Development of Key Investor Information for UCITS;
- Review of the Prospectus Directive, and possibly other sectoral directives;
- Work on improving financial education, in conjunction with Member States;

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30 This would only be a factor when services are distributed cross-border. When services are provided by a foreign originator or distributor established in the same Member State as the consumer, this would not be an issue, since the 'host' rules would apply.

- Reviews of DMD and IMD; and
- Ongoing work on Non-Harmonised Funds.

More generally, the financial crisis has been the catalyst for a wider package of regulatory measures to enhance the stability of the financial system and to rebuild confidence in financial institutions and products, and there are likely to be continued developments in this area. While announced measures have focused largely on prudential and supervisory issues, these will impact on investor protection, since investors share an interest in the stability of the institutions from which they purchase financial products.

The initiatives described above would not, however, alone be able to address the weaknesses in a coherent and systematic manner. A comprehensive process of upgrading disclosures is currently envisaged only for UCITS; this may yield insights of broader application but will focus only on harmonised funds. With regard to distribution, scheduled reviews of existing sectoral directives could be used to examine some of these issues; however, without a coherent organising framework it could not be guaranteed that a level playing field and consistently high level of investor protection would result.

Without further action, therefore, it is both highly likely that the problems would remain and moreover that additional uncoordinated national action would increase the complexity of the regulatory framework, with attendant implications for the single market.

4. SUBSIDIARITY AND LEGAL BASIS

The preceding discussion has identified a strong European dimension to the problems identified. Differences in Community law can distort market and regulatory outcomes in all Member States, irrespective of whether products are distributed on a cross-border basis. Differences in Community law thus represent a significant barrier to the implementation of a consistent approach to disclosure and distribution between sectors at national level. For those products sold on a cross-border basis, investor protection concerns cannot be tackled effectively at Member State level. Uncoordinated national responses would also risk encumbering the development of the single market in these products.

The legal basis for action in this field is found in the following Treaty provisions. According to Article 3 of the EC Treaty, an internal market is characterised by the abolition of obstacles to the free movement of goods, persons, services, and capital. Article 14 further states that the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty. Any further action as a follow-up to the Communication is likely to be based on Art. 211 of the EC Treaty (if in the form of a Recommendation) or Article 95 of the EC Treaty (if in the form of legislation).

5. OBJECTIVES

The overarching objective of this work is to promote the efficient allocation of resources through:

- A high and consistent level of investor protection embodied in Community law;
- A level playing field for the originators and distributors of retail investment products; and
- Increased efficiency in cross-border business.

The first and second of these should be seen in tandem at the heart of this work: the level playing field with respect to disclosure and distribution rules is to be achieved at a high level of investor protection. Given the predominantly local nature of certain parts of the retail markets, the third objective is

subsidiary to the first two. It is, however, an important consideration for those products that are sold on a cross-border basis; and for those for which this could potentially be the case.

5.1. A high and consistent level of investor protection

General objective

A consistently high level of investor protection across all packaged retail investment products is the key objective, thereby creating an environment in which retail investors are provided with the information they need to take effective decisions and are treated fairly in the sales and advice process by product originators and distributors.

This objective does not necessarily imply total uniformity in the information that should be provided or in the way in which products are sold. Differences in the relationship between the investor and the originator and the varying nature of the investment propositions imply a need for flexibility.

However, to the greatest extent possible, an investor surveying the available options should be able to *compare* the key characteristics of the products offered - which is a matter both of the type of information that is provided and the way in which it is presented. This implies seeking, where relevant, common formats that allow for comparison of key characteristics and which are developed so as to take into account typical consumer behaviour. Investors should be able to be confident that the quality of service is comparable in each case.

This objective must be qualified by the observation that while improvements in disclosure and the regulation of intermediaries can help to create the conditions for effective decision-making by retail investors, they cannot eliminate the possibility of poor decision-making and hence investor detriment. In particular, the quality of investor decision making will depend greatly on the willingness and ability of consumers to understand and process the information and advice received. Improvements in financial education will thus be an essential complement to this work.

Specific objectives

To lay the foundation in European rules on pre-contractual disclosure and the regulation of intermediaries for retail investors to make informed and appropriate investment decisions.

To achieve this, a retail investor should be able to expect a consistently high level of product disclosure and fair treatment by distributors irrespective of the product type they select, or the distribution channel through which they obtain the product.

The benchmark for this assessment can be expressed in the form of a set of core 'principles' that define outcomes to be delivered by Community law and applied to the full spectrum of packaged retail investment products and distribution channels. The ideas embedded in these principles are not novel; they are drawn from widely accepted benchmarks found in international standards and in European and national law. Further work will be required to fine-tune these principles as appropriate.

Product disclosures should be fair, clear and not misleading, even for less experienced retail investors.

They should contain all information necessary to take an informed investment decision (such as information about performance and risks, charges, guarantees and how the product functions, for instance fixed maturity dates). They should be presented in a format appropriate for a retail investor and how that investor is likely to use the information, and to the greatest extent possible they should be designed consistently across different products to allow for comparisons between the products.

The format should be as short and simple as is possible, and tested with investors to ensure it works as intended.

The disclosures should be provided to the investor in a timely fashion so as to be capable of influencing the decision as to whether to buy an investment.

Any associated marketing communications should be fair, clear and not misleading, and should be clearly distinguished from the mandatory disclosures and should indicate where such disclosures can be obtained (where relevant). They should not undermine mandatory disclosures.

Selling practices should be focused on the fair treatment of the investor.

When an investor receives investment advice, the advisor should undertake best efforts to ensure any products sold correspond to the profile and the needs of the investor, and should ensure that the investor is aware of the nature of the service being provided by the advisor, included remuneration arrangements in relation to the service.

If a product is sold without advice, the responsibility of the intermediary and risks for the investor should be made clear before proceeding with the provision of services. Also in this case, some assessment concerning the adequacy of the product to investors' needs may be required.

All necessary steps should be taken to prevent conflicts of interest from adversely affecting clients. Such conflicts should be avoided if possible and, if not possible, they should be identified, managed and, where appropriate, disclosed in a way investors can understand. Links between manufacturers and distributors in the form of ownership stakes should be disclosed to the end investor. Links in the form of remuneration for product sales should be disclosed and should be assessed in the perspective of client interests.

Manufacturers should provide distributors with the necessary product information related to the product and distributors should clearly understand the product and ensure investors receive relevant product information. Manufacturers also would bear some responsibility in relation to the generic suitability of products which they distribute into the retail market.

5.2. A level playing field for the originators and distributors of packaged retail investment products

General objective

The second objective is to achieve a level playing field for all types of packaged retail investment product with respect to disclosure and distribution rules. Consistency in these requirements would already help to ensure that competition between products takes place on a transparent and fair basis. This will help to ensure that markets develop on the basis of the quality of the products and their compatibility with consumer needs, not by a lack of transparency or of selling disciplines with respect to certain products. Product diversity is potentially beneficial for the retail investors and as such this objective does not imply a regulatory preference for one product type over another.

As discussed earlier, it is important to recognise in this context that there are other elements of the regulatory 'playing field' that impact on competition between products but which are not addressed in this analysis. For example, UCITS managers are subject to prescriptive product regulation that limits the range of financial assets in which they can invest, their use of borrowed funds, redeemability etc. These restrictions are not generally found in other sectors. Other non-regulatory factors, most notably features of domestic tax systems, will also impact on competition between product types.

Specific objective

More specifically, the objective is to achieve a coherent overall approach to disclosure and distribution provisions in Community law, thereby achieving a level playing field with respect to these rules.

This objective must be seen in the context of the first objective: the level playing field should be set at a consistently high level of investor protection for all packaged retail investor protection.

5.3. Increased efficiency in cross-border business

General objective

Markets for retail investment products are largely segmented along national lines. Further integration of these markets through an increase in cross-border trade could deliver efficiency benefits for both producers and consumers. In principle, a divergence in disclosure rules and distribution rules between Member States may constitute a barrier to the cross-border provision of services. The objective is therefore to remove obstacles to cross-border trade resulting from divergence in national approaches to disclosure and distribution regulation.

Specific objective

To promote more consistent national approaches to disclosure and distribution rules by ensuring that Community law provides a coherent approach to disclosure and distribution regulation.

An important caveat to this objective is that, as discussed above and in the Green Paper on Retail Financial Services, there is reason to believe that certain legal and fiscal barriers, as well as behavioural preference for products provided locally (and face-to-face), represent a more significant barrier to cross-border trade than differences in disclosure and distribution regulation. Moreover, greater harmonisation of disclosure and distribution regulation at European level will not in itself provide cross-border marketing opportunities equivalent to a product passport. Other differences in approach, for example with respect to product regulation, would potentially remain.

6. OPTIONS

This section considers the efficiency and effectiveness of alternative policy options in the area of pre-contractual disclosures and selling practices, as means to achieving the three objectives outlined above:

- a high and consistent level of investor protection across all products and distribution channels, including those not currently subject to EU disclosure and distribution rules;
- a level playing field for all types of retail investment product, including their distribution; and
- a strengthened single market in packaged retail investment products.

The multitude of factors involved means that the policy options analysed here cannot alone guarantee the three objectives above, although they can contribute to their achievement. In particular, while the analysis below treats options separately so as to clarify their incremental impact, in general terms the options should not be considered to be mutually exclusive – for instance, coordinated regulatory and supervisory action at the European and national levels could provide the framework for a consistent overall approach, to be accompanied and supported by self-regulatory activity (e.g. developing best practices for the use of plain language).

In the following analysis we address pre-contractual disclosures and selling practices separately. However, we think it likely that there would be synergies between these two areas – a package of options relating to pre-contractual disclosures as well as selling practices might have greater benefits than either on its own.

6.1. Pre-contractual product disclosures

6.1.1. Identification of options

Our analysis is that the options for addressing pre-contractual product disclosures broadly sit on a scale from a base-line of no change to the highest level of harmonisation at the European level. To give shape to the analysis, we have focused on the following: no policy change; Commission-promoted self-regulation; a mandate to the Level 3 committees to promote supervisory convergence; a Commission recommendation to implement principles through national regulation; or EU-level legislative action to harmonise requirements where appropriate across products and channels. As

stated these options are not mutually exclusive, the first notwithstanding, and may be effectively combined. An assessment of the exact nature of any future measures does not form part of this Impact Assessment; any specific follow up actions would be accompanied by a separate impact assessment which might address the optimal combination of initiatives necessary for achieving the objectives.

Table 3: Identification of options for pre-contractual product disclosures

Option	Description of option
1. No policy change	As described already in section 3.3., without policy action at EU level neither foreseeable policy change at Member State level, nor parallel pre-existing or foreseeable EU work flows would address the problems effectively. Any potential action at national level could further aggravate cross-border inconsistencies, while existing inconsistencies at EU level would persist, undermining the effectiveness of action at national level. **This no policy change scenario is used as the baseline for the assessment of other policy options.**
2. Commission sponsored self-regulation	Under this option market sectors involved – both originators and distributors – would be invited to develop pre-contractual disclosures in compliance with a common set of principles. Market participants would be free to develop their own solutions, though with a steer from the Commission. No legislative changes would be made at European level, so differences that can be traced to Community law would remain, while this option would not directly tackle differences in laws between Member States themselves, where they have already acted to address the issues raised in this assessment. This could be on the basis that the Commission would review the approach should outcomes turn out to be ineffective, so as to encourage market participant engagement.
3. Mandate to Level 3 committees to promote supervisory convergence	The committees of regulators could be invited to work together to identify 'best practices' in pre-contractual disclosure and to disseminate these to all Member States. Peer pressure could be used to promote agreement on and respect for either high-level principles or more concrete disclosure solutions. As with option 2, no legislative changes would be made at European level.
4. Commission Recommendation to implement principles through national regulation	A Recommendation could build upon relevant provisions (e.g. in MiFID, CLD and IMD) to guide Member State implementations of these, for instance to clarify what would constitute compliance with existing disclosure obligations. Member States could also be encouraged to introduce requirements in national law for product originators to develop compliant disclosure documents. As with option 2, no legislative changes would be made at European level; a Recommendation would offer the Commission's opinion in relation to existing Community legislation.
5. EU-level legislative action	EU-level legislative action could take a variety of forms, running from a more limited removal of EU-level impediments to best practice and provision of a high-level framework of common principles, to detailed requirements setting out the content and form of harmonised pre-contractual disclosures across all relevant products. While we cannot assess the most appropriate form of possible legislative action at this stage, any action would need to take account of existing provisions in EU law, both in sectoral and cross-cutting directives. In principle, the legislative objectives could be achieved either by a new stand-alone legislative instrument or by adjustments to existing EU legislation. In either case, the legislation could be embedded in the Lamfalussy framework, with general principles established at Level 1 and detail added at Level 2.[31]

6.1.2. *Analysis of costs and benefits*

Our detailed analysis of the options can be found in Annex 2, but we would like to make here a few general remarks on cost and benefit drivers.

Costs

[31] See: http://ec.europa.eu/internal_market/finances/committees/index_en.htm#committee for further information on the Lamfalussy framework.

The incremental compliance and administrative costs of designing and producing new disclosure documents are likely to be similar irrespective of the underlying mechanism by which change has been promoted, so likely costs could be very similar across different options, at least in so far as those options effectively change industry behaviour.

- Our analysis focuses on incremental costs, i.e. those costs that firms or others would incur that can be solely (or proportionally) attributed to the impact of the policy options under analysis. These can be divided into both one-off costs of changing existing documents or developing new ones, and ongoing costs of maintaining the documents.
- Cost drivers include the design of new documents and the establishment of systems and controls for ensuring compliance, including, where relevant, the preparation of figures, whether audited or not, one-off and ongoing production and distribution costs, incremental costs in changing other documentation and websites which might cross-refer to the documents, and training costs (which may largely be related to distribution channels).
- In general terms, costs can be analysed in terms of costs for the parties directly affected by changes, costs for regulators or supervisors and other similar bodies, and less direct costs – such as changes to the quantity, quality and variety of transactions, or to market efficiency.

The balance between these cost drivers is likely to vary for the different options being analysed, depending on the amount and nature of the change required for particular market segments. The costs will also vary significantly depending on whether requirements already exist within a particular Member State and whether the new requirements entail incremental changes to pre-existing disclosures by firms or the creation of entirely new disclosures, e.g. for instruments hitherto outside the scope of requirements.

- The incremental benefit of changes for consumers in Member States that have already developed mandatory disclosure requirements aimed at addressing the issues in this paper is likely to be low, in so far as these consumers continue to shop within their home markets and in so far as the existing mandatory disclosure requirements are effective in protecting consumers.
- For these jurisdictions with pre-existing disclosure requirements, a high-level principles-based approach may offer relatively lower costs (compared to more detailed and strongly standardised requirements), particularly where the pre-existing requirements are already consistent with the high-level principles. There could well nonetheless be some compliance costs. For jurisdictions which do not have pre-existing disclosure requirements there would likely be one-off costs for national regulators or other self-regulatory bodies interpreting these principles for firms, on top of the direct costs firms would face.
- More detailed and strongly standardised requirements might reduce some costs by providing participants with ready-made solutions which do not require significant adaptation and compliance testing, though under this option all participants impacted would necessarily face costs of change.
- There are also likely to be varied impacts on supervisory costs, for instance should supervisors need to pre-authorise or otherwise develop an enhanced capability for monitoring or supervising the quality of pre-contractual disclosures or marketing material.

Assessing the relative materiality of these different factors is difficult at this stage, given the range of variables that can impact costs and the necessarily high level of the current analysis. However, experience from past directives offers some very useful ex-post data on the likely maximum scale of costs where change is required for all participants. In particular, the Prospectus Directive is a good starting point, as this directive primarily related to investor disclosures, introducing requirements on securities issuers to issue an investor prospectus.

Recent work on the costs related to the Financial Services Action Plan (FSAP) identified the following one-off and ongoing costs for the Prospectus Directive:

Table 4: Costs identified for Prospectus Directive, average absolute values and as % of operating expenses

	Banks and financial conglomerates	Asset Managers	Investment Banks
One-off costs	€200,000 0.01%	€71,000 0.02%	€46,000 0.00%
Ongoing Costs	€88,000 0.01%	€250,000 0.06%	€38,000 0.00%

Source: Europe Economics[32]

While absolute costs for the markets and products discussed in this paper could be greater – for instance, given the relative size of the unit-linked insurance market and its retail exposure (no insurance products were directly impacted by the Prospectus Directive) – it would seem plausible that costs per product requiring disclosure would be consistent with these figures. Indeed they could be lower – the costs per listing under the Prospectus Directive could well be higher than those per product under this assessment, since the Prospectus Directive costs include additional costs related to listing a security, such as auditing and professional fees.

The Simplified Prospectus for UCITS is perhaps a useful guide to how far the Prospectus Directive costs can be taken as a proxy, since this document did not incur the additional costs associated with the Prospectus Directive. If figures available from the UK are an indication, the costs for the Simplified Prospectus were indeed lower; a survey of UCITS firms reported figures ranging from £1800 to £55000 per firm. (Smaller firms showed higher relative costs).[33]

It is likely that some proportion of any additional costs for the industry will be passed onto consumers through product pricing.

Benefits

In analysing different policy options, we have had regard to likely benefit drivers. These can be split between micro and macro effects, though the two are linked.

At the micro level, improvements to investor decision making could lead to an increase in the proportion of 'suitable' transactions, leading directly to reduced levels of investor detriment. This in turn might lead to more macro effects, where reduced levels of complaints and improved trust in the industry might trigger an expansion in the market. At the micro level greater transparency might lead to greater prevalence of 'shopping around' behaviour where investors actively compare the features of competing offerings, which might lead to competitive pressure on product pricing at the macro level. Also, improvements to the consistency of pre-contractual information requirements may lead to an increase in cross-border business, potentially leading in turn to greater competition and economies of scale.

The scale of the benefit generated by these drivers can be expected to vary according to the effectiveness of different options. In general, those options that are most effective at improving the quality of disclosures have the greatest change of effectively delivering benefits, while in general terms, greater standardisation in approach is more likely to drive benefits linked to improvements in relation to the investors' ability to compare between different offerings, for instance in relation to their overall 'value for money'.

Naturally, the incremental benefit for consumers in Member States that have already effectively developed disclosure regimes aimed at addressing the issues in this paper is likely to be in direct

32 Study undertaken by Europe Economics for the Commission Services; expected to be finalized and published in the end of 2008. Insert link to study once published.

33 FSA: CP 04/18, http://www.fsa.gov.uk/pubs/cp/cp04_18.pdf, Annex 1 p.2.

proportion to the effectiveness of any new regime compared to the existing regime, in so far as these consumers continue to shop within their home markets.

As we have noted, disclosures themselves are only one link in a longer causal chain, with final benefits depending on the practical use and comprehension of such disclosures by investors and the practical achievement of an adequate standard for such disclosures across different jurisdictions and markets.

As we have stated, we do not consider it possible to provide concrete quantitative estimates of benefits at this stage of the policy development process.

6.2. Selling practices

6.2.1. Identification of options

In the area of selling practices, our focus is on ensuring investors are treated fairly by those selling to them – this relates not only to the management of conflict of interests, but also the conduct of sales business more generally, including requirements governing the provision of advice services. Policy options here follow the broad outlines of those for pre-contractual information.

Table 5: Options for addressing deficiencies in selling practices

Option	Description of option
No policy change	As described already in section 3.3., without policy action at EU level neither foreseeable policy change at Member State level, nor parallel pre-existing or foreseeable EU work flows would address the problems effectively. Any potential action at national level further aggravating cross-border inconsistencies, while existing inconsistencies at EU level would persist, undermining the effectiveness of action at national level. **This no policy change scenario is used as the baseline for the assessment of the other policy options.**
Commission sponsored self-regulation	Under this option, the Commission would promote self-regulatory measures within the industry, to seek greater consistency in firms' practices across sectors and across different Member States (though divergent national and EU rules would, without further change, still create inconsistencies that firms would not be able to overcome).
Mandate to Level 3 committees to promote supervisory convergence	The committees of regulators could be invited to work together to identify and coordinate Member State approaches to improving conduct of business and conflict of interest management across the sales processes for different investment products. Peer pressure could be used to promote agreement on and use of either common high-level principles or more concrete disclosure solutions.
Commission Recommendation to implement principles through national regulation	A Recommendation would coordinate the implementation and interpretation of existing European rules, to promote greater convergence across Member States and less disparity across products and distribution channels. A Recommendation would offer the Commission's opinion in relation to existing Community legislation, and could also recommend the extension of some rules to yet unregulated areas or promote the development of rules or standards in those fields along the same line.
EU-level legislative action	Under this option, legislative action at the European level would be taken. The exact form of European level direct action can only emerge during follow up work to the Communication. This option could take a variety of forms with varying degrees of impact on regulatory landscape (for instance, varying in the degree of harmonisation and the vehicle used for that harmonisation: e.g. adjusting existing sectoral legislation to achieve consistent outcomes, or introducing a wholly new regime for sales of packaged retail investment

	products).

6.2.2. *Analysis of costs and benefits*

As before, our detailed analysis of the options can be found in Annex 2, but we would like to make a few general remarks relevant across all of the options, but focused on the costs of legislative change.

Costs

The costs for the different options for addressing selling processes (conflicts of interest and conduct of business issues) are likely to vary significantly, depending on the extent to which firms make changes to their sales processes. Changes to selling processes can be costly for firms. Key cost drivers include the production and dissemination of any disclosures required (for instance of remuneration arrangements, commission or intermediary status), the introduction of new procedures and associated systems, controls and training, or changes to the length of the sales process, which might potentially reduce sales volumes per man hour. Some costs are likely to scale according to the extent of incremental change while others are likely to be largely fixed.

There can also be significant indirect costs through the impact of change on market efficiency, for instance through changes to the variety and type of products that are available in the retail market.

The different options we have identified will clearly generate varying degrees of disruption and change for the industry and markets. These changes are likely to impact particular sectors more than others, depending on the extent to which a sector is already subject to substantive investor protection measures which are consistent with any proposed changes. Since in this paper we do not address the detail of specific options and so cannot provide concrete quantitative estimates that are tuned to the particular changes envisaged, we are limited to indicating the likely magnitude of costs for the most costly option – legislative change to ensure selling practices are consistent for the products identified in this paper, assuming the effective introduction of a new regime with all of the compliance, systems and controls, disclosure, training and other costs this would entail.

The figures under the FSAP relating to MiFID are a good starting point to assessing the incremental costs of changes, since that directive encompassed all of the key elements that a legislative intervention might be expected to cover. This table outlines a recent estimate of these costs:

Table 6: Costs identified for MiFID within FSAP, average absolute values and as % of operating expenses

<table>
<tr><th></th><th colspan="2">Banks and financial conglomerates</th><th>Asset Managers</th><th>Investment Banks</th></tr>
<tr><td rowspan="2">One-off Costs</td><td colspan="2">€8,118,000
0.52%</td><td rowspan="2">€195,000
0.47%</td><td rowspan="2">€5,060,000
0.52%</td></tr>
<tr><td>Large
€25,000,000
0.50%</td><td>Small
€200,000
0.86%</td></tr>
<tr><td>Ongoing Costs</td><td colspan="2">€1,239,000
0.10%</td><td>€794,000
0.28%</td><td>€734,000
0.08%</td></tr>
</table>

Source: Europe Economics

These figures are likely however to overstate the impact of potential legislative changes. This is for a number of reasons:

- Figures for the introduction of a new regime may be misleading, as changes would most likely be only incremental for many firms already subject to MiFID requirements when conducting MiFID business. For these firms the introduction of consistent requirements across products could simply entail broadening the scope of practices that have already been supported. The same could be said for firms subject to the IMD, where any changes might also be incremental in nature.
- Even for firms that are currently entirely outside the scope of MiFID (or the IMD), figures for MiFID are likely to be an overstatement. This is because legislative action envisaged by this paper only relates to part of MiFID. MiFID covers a wide range of conduct of business activities, such as transaction reporting or best execution policies, so as to provide a basis for a general regime, whereas the focus of this paper is squarely on specific requirements relating to the sales of certain types of products to retail clients.

An additional factor that should be taken into account is that MiFID firms might be significantly different as a population from other populations caught by options in this paper, such as insurance intermediaries. The impact of such variations may be reduced where investors are exposed to different kinds of product through the same sales channels, as those sales channels would likely already by subject to MiFID. Also, increased consistency in regulatory requirements across different products and channels could reduce compliance costs for distributors.

We consider that greater granularity as to the extent by which these figures might overstate costs is not necessary for the purposes of this paper. A more detailed impact assessment addressing these points would be needed to support detailed legislative proposals.

Benefits

In analysing different policy options, we have however had regard to likely benefit drivers, at the both the micro and the macro level.

At the micro level, improvements to selling practices could lead to an increase in 'suitable' purchases and reduction in cases of 'mis-selling', thereby directly reducing investor detriment, leading in turn to macro level benefits with reduced levels of complaints, improved confidence in the industry and possibly overall market growth. Improved selling practices could also lead at the macro level to greater competition between offerings, which in turn might lead to competitive pressure on product pricing and indirect consumer benefits.

Also, improvements to the consistency in the regulation of selling practices could lead to an increase in firms providing services cross-border or marketing products cross-border, driving further market efficiency and competitiveness benefits.

As we have stated, we do not consider it possible to provide concrete estimates of benefits at this stage of the policy development process.

6.3. Comparison of high-level assessment of options

In this section we summarise the more detailed analyse of options in Annex 2.

6.3.1. Pre-contractual information

	EFFECTIVENESS			**EFFICIENCY**
Objectives / **Policy option**	**Consumer protection**	**Level playing field**	**Single Market**	
No policy change	n.a.	n.a.	n.a.	n.a.

Self-regulatory initiatives	(--)	(--)	(-)	(≈)
Mandate to Level 3 committees	(+)	(+)	(+)	(+)
Commission recommendation	(+)	(+)	(+)	(+)
EU legislative action	(++)	(++)	(+(+))	(++)

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ marginal; ? uncertain; n.a. not applicable

6.3.2. Selling practices

	EFFECTIVENESS			**EFFICIENCY**
Objectives / **Policy option**	**Consumer protection**	**Level playing field**	**Single Market**	
No policy change	n.a.	n.a.	n.a.	n.a.
Self-regulatory initiatives	(--)	(--)	(-)	(-)
Mandate to Level 3 committees	(+)	(+)	(+)	(+)
Commission recommendation	(+)	(+)	(+)	(+)
EU legislative action	(++)	(++)	(++)	(++)

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ marginal; ? uncertain; n.a. not applicable

6.3.3. Identifying the preferred options

To summarise, for both the areas of pre-contractual disclosures and selling practices, we conclude that non-legislative options (the encouragement of self-regulatory initiatives, action through the 3L3 committees, or a recommendation from the Commission aimed at establishing common principles) could all have some positive impact on consumer protection, level playing field and single market outcomes, (though this might be particularly marginal for self-regulatory initiatives on their own).

However, all of these non-legislative options, since they can only indirectly address issues caused by fragmentary and inconsistent legislation at the EU level, are subject to a significant limit on their likely effectiveness. This is particularly clear in relation to level-playing field and single market outcomes, but we also consider it is also the case in relation to consumer protection. This is not only due to the extent to which legislative inconsistencies can impede the development best practice, but also, and importantly, because non-binding and non-legislative approaches are in general less likely to

deliver a consistent focus on improving outcomes across all market sectors and national jurisdictions than binding ones.

Hence, we conclude that EU legislative action offers greater effectiveness against all three outcomes.

In regards efficiency, we consider the greater effectiveness of the EU legislative option to better offset costs than the other approaches. The analysis is that these other approaches could all engender significant costs for certain firms and industry segments whilst not necessarily delivering the benefits of overall consistency or coherence. Incremental changes in the future could also be more necessary.

As can be seen, this assessment is by necessity high-level and qualitative in nature. Accordingly, the results for options relating to pre-contractual disclosures and selling practices are very similar, with similar assessments of the advantages on the balance of costs and benefits for an approach incorporating EU legislative action in both areas. We expect that an analysis of concrete legislative proposals at an increased level of granularity will offer greater differentiation than is possible at this stage.

We conclude therefore in favour of an overall approach which includes EU legislative action. Inconsistencies, gaps and weaknesses in EU legislation will otherwise act as barriers to achieving consumer protection, level playing field and single market benefits, whilst non-binding activity could still generate significant costs.

The following section will look at other impacts of an overall approach that includes EU legislative action.

7. IMPACTS ON VARIOUS STAKEHOLDERS' GROUPS, EMPLOYMENT, SMES, ENVIRONMENT AND THIRD COUNTRIES

7.1. Stakeholders

The following table lays out the expected net effect of the preferred proposals on various stakeholders: consumers, industry (originators and distributors of products), and national regulators.

Table 7: Impacts on Stakeholders

Stakeholder / Issue	Consumers (retail investors)	Originators	Distributors	National regulators
Pre-contractual disclosure	+ (↑ investor protection, ↑ confidence in market)	+ (↑ investor protection , ↑ market activity, ↑ certainty and consistency offsetting ↑ costs)	+ (↑ investor protection, ↑ market activity, possibly ↓costs where originators do not deliver adequate disclosures currently, while consistency in product documentation potentially leads to ↓ costs)	+ / - (↑ market conduct and relation with investors, may be ≈ where effective pre-existing requirements already in place, may be ↑ supervisory costs)
Selling practices	+ (↑ investor protection, ↑	+ (↑ investor protection, ↑	+ (↑ investor protection, ↑	+ / - (↑ market conduct and relation with

	confidence in market)	market activity, ↑ legal certainty and consistency in handling different distributors, possibly ↓costs)	market confidence, offsetting ↑ costs, while greater consistency in requirements may lead to ↓ costs for distributors who are currently subject to different regimes for different products)	investors, may be ≈ where effective pre-existing requirements already in place, may be ↑ supervisory costs)

Legend: + overall positive effect, - overall negative effect, +/- overall mixed effect, ≈ effect not significant, ↓ decrease, ↑increase

7.2. Employment

It is not possible to draw sound conclusions in relation to the impact of the proposals on employment given the high-level nature of the options being currently analysed.

It is nonetheless likely that the net impact of any legislative options would be marginal, though longer term improvements to market confidence, competitiveness and cross-border activity could combine with other factors leading to shifts in the location and concentration of financial services. This would require further analysis.

We would not expect any significant impact on the profile of those employed in the sector, beyond such rebalancing.

7.3. SMEs

Given the role of relatively small firms in both distribution and to an extent product origination sectors, interventions will necessarily have an impact. However, we cannot at this stage determine the number of SMEs in the financial sector, as the definition of SME relies on a combination of employment and turnover/balance sheet figures,[34] and employment data is only collected for the non-financial business economy, where 99.8% of firms are SMEs.

Looking at only turnover/balance sheet totals, we already see however that there is a significantly smaller proportion of SMEs in the financial sector; more than 65% of credit institutions[35] and at least 55% of insurance companies are large enterprises. It is acknowledged though that the ratio of small and large firms is likely to vary across markets, for instance depending on the distribution channels that are most prevalent. For instance, in some local markets – notably UK – IFA distributors are common, while in others – e.g. Spain, but to a degree most other territories – bancassurance distribution is more common.

The findings of the FSAP cost survey[36] suggest that the relative impact on smaller firms will be greater than larger ones, for instance with proportionate costs in relation to MiFID on the average around 70% greater for small firms (this survey does not cover insurance firms and insurance intermediaries).

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34 A small and medium-sized enterprise is one that employs less than 250 persons and has an annual turnover of up to EUR 50 million or an annual balance-sheet total of no more than EUR 43 million. (See Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises).

35 only 35% of credit institutions have a balance sheet total below EUR 100 million, the smallest threshold foreseen in this industry, while the definition of SMEs categorises as large enterprise any firm with a balance sheet figure above EUR 43 million.

36 Europe Economics: Study on the Cost of Compliance with Selected FSAP Measures.

Likewise, the FSAP cost survey suggests that the impact of changes to intermediary regulation would be greater than pure disclosure changes.

There is also a second way in which SMEs may be impacted by changes to investor protection measures: as clients of the financial services, rather than as service or product providers. This is because many SMEs may be classified as retail clients, either electively or otherwise. In such cases steps to improve protections in the retail market could well benefit SMEs.

However, it is premature to assess the precise impact on SMEs at this stage, as the exact nature of the proposals is not yet determined. Further and more detailed analysis will be carried out at a later stage to assess detailed proposals.

7.4. Environment and third countries

There would be no considerable impact on the environment as a result of the introduction of the preferred policy options.

Likewise, no considerable negative impact of policy options on third countries is apparent, though impact of detailed proposals on branches of non-EEA firms might be material. Notably, recent work (such as the FSAP study) has found it difficult to distinguish between EEA and non-EEA business.

7.5. Administrative burden

Any follow-up measures to the Communication are likely to affect the current level of administrative burden on firms. The analysis of options examined above has also made reference to costs that include items qualifying as administrative burdens. Here a separate assessment of foreseeable administrative burden is carried out.

It should be recalled however that the current Impact Assessment only analyses high level options, and the exact contents of the options to be taken forwards will only be determined at a later stage. Thus it is not possible to calculate precisely with the use of the standard cost model what the exact change in administrative burden would be. We can only assess the direction and magnitude of such change. A separate impact assessment on follow-up measures will be carried out at a later stage, which will contain precise measurement of administrative burden. Further steps will be undertaken as necessary then to gather the necessary data for such an assessment.

At this stage however, it can be established that legislative action to harmonise pre-contractual disclosure requirements would likely create incremental administrative costs for firms where disclosure requirements change or where new requirements apply. Experience from the Prospectus Directive suggests these will be material costs, particularly for smaller firms. However, as a proportion of total operating expenses the Prospectus Directive experience was that they could be well below 0.5%. For reasons outlined in the analysis of options above, the impact of the follow-up measures to the Communication can be estimated to be lower than this in terms of administrative burden.

The administrative burden related to the regulation of intermediaries (for instance, relating to the management of conflicts of interest and general conduct of business) was greater than in the case of pre-contractual disclosures, if the experience of MiFID is taken as a proxy. But again, there are good reasons for thinking that the costs of the Communication follow-up measures would be significantly lower (largely because changes are likely to be purely incremental for many intermediaries, and many who are already exposed to different requirements may well already having put in place consistent 'highest common denominator' standards to ease their own compliance burden).

To give an order of magnitude of the number of firms potentially impacted by any follow-up measures to the Communication, in the EU 27 there are 8,348 credit institutions,[37] and 769 life insurance and

[37] Source: 2007 Eurostat data, http://www.ecb.int/pub/pdf/other/eubankingstructures2008en.pdf.

composite insurance companies.[38] There are over 50000 investment funds, but we do not have at this stage a precise figure on the number of enterprises managing those funds (which will be considerably lower than the number of individual funds).

A separate impact assessment on the follow-up measures will be carried out at a later stage, to contain a precise measurement of the administrative burden using the Standard Cost Model. Further steps would be taken as necessary to gather necessary data for such an assessment.

7.6. Monitoring and evaluation

A comprehensive monitoring and evaluation programme can only be developed once detailed proposals have been made. Different policy options carry different implications in terms of such work: for instance, it is unlikely that achieving effective disclosure practices across the various market segments will be possible solely through the relevant degree of harmonisation of requirements at the European level, without considerable additional supervisory work to encourage best practices amongst market participants.

[38] Own calculations based on Eurostat 2005 data on life and composite insurance enterprises. No data available for Germany, Ireland, France, Malta and the United Kingdom.

8. CONCLUSIONS

A key challenge in the aftermath of the financial crisis is to rebuild consumer confidence in financial markets. A high level of product transparency and of professionalism in the financial sector will be essential if this challenge is to be met. As such, it is imperative that the European regulatory framework for retail investments reflects the realities of modern financial markets and that a lack of coherence resulting from out-dated regulatory silos is not allowed to lead to investor detriment and distorted competition.

This impact assessment has reviewed the regulatory landscape for packaged retail investment products at European level and has demonstrated clear inconsistencies in rules on pre-contractual disclosures and selling practices between products and sectors. In some sectors, rules are entirely absent at European level.

The available evidence does not allow us to be precise about the scale of the problems arising from this fragmented regulatory framework. However, we have outlined the mechanisms by which problems are likely to arise, provided a range of examples of investor detriment relating to the sale of each of the product families concerned, and have summarised the qualitative evidence that we have received from a range of stakeholders on the impact of gaps and inconsistencies in Community law.

We have also reviewed the responses by Member States to these problems. In some Member States, action has been taken to buttress the provisions of Community law in order to enhance consumer protection and to provide a level playing field for competing investment propositions. However, there has not been a systematic or co-ordinated response at national level. The result has been further fragmentation of the regulatory framework for retail investment products, with potential impacts on cross-border service providers and hence the single market.

We conclude, therefore, that in the absence of action at the European level, the lack of coherence in approaches to pre-contractual disclosures and the regulation of intermediaries in Community law will continue to pose a threat to the efficiency of the market for retail investment products. Consumer detriment, distorted competition between product families on the basis of regulatory arbitrage, and barriers to the development of the single market will remain as significant problems.

Further to this, our analysis of options indicates that while a thorough assessment of costs and benefits cannot be made prior to the development of detailed provisions, legislative action appears necessary to address the problems identified. This shall of necessity be at the European level, since it is differences in Community law which underpin many of the problems.

We are unable at this stage to draw firm conclusions about the details of an optimal legislative intervention, so it is not possible to be precise about its likely costs and benefits. The level of harmonisation to be delivered and relatedly the degree of flexibility for national authorities or industry sectors to maintain existing regimes will be a key determinant of both sides of the scorecard. Considerable further work will be required to target further legislative work at the European level, so that it may effectively achieve an optimal trade-off between costs and benefits.

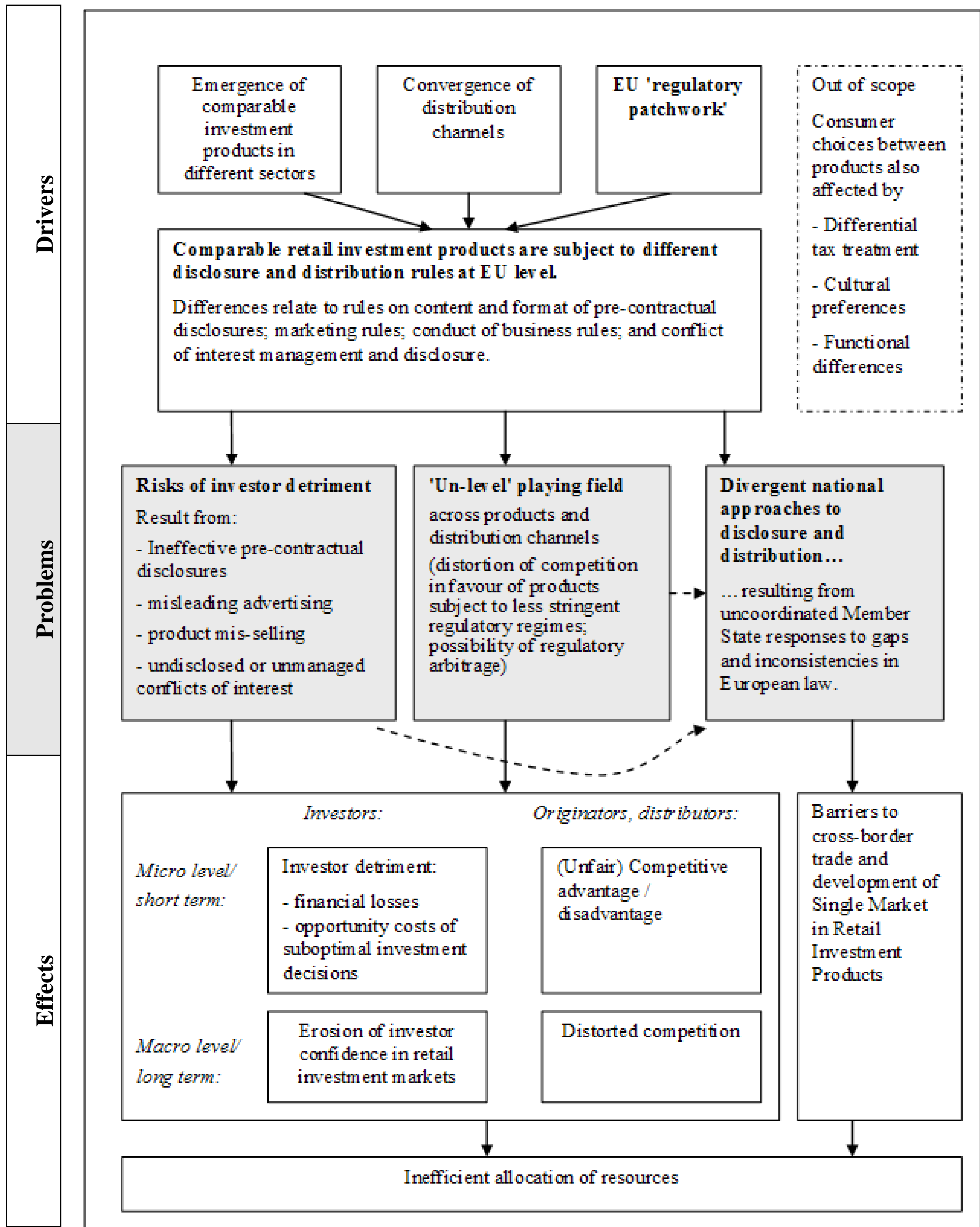
Nonetheless, updating the European regulatory framework so as to replace out-dated regulatory silos with a more coherent approach which ensures a consistently high level of investor protection and a level playing field for comparable investment propositions is likely to underpin effective engagement in packaged retail investment products by retail investors, and in turn contribute to an efficient allocation of resources, with attendant benefits for the individual and the wider economy.

ANNEX 1

1. LIST OF ACRONYMS

3L3	Lamfalussy Level 3 Committees
AFM	Dutch Financial Markets Authority
AIMA	Alternative Investment Management Association
AILO	Association of International Life Offices
BIPAR	European Federation of Insurance Intermediaries
CEA	European Insurance and Reinsurance Federation
CEIOPS	Committee of European Insurance and Occupational Pension Supervisors
CLD	Consolidated Life Directive
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EVCA	European Venture Capital Association
FECIF	European Federation of Financial Advisers and Financial Intermediaries
FIN-USE	Independent expert forum, comprising consumer protection and small business experts, academics and consumer organisation representatives
FSA	Financial Services Authority (UK)
FSAP	Financial Services Action Plan
IFA	Independent Financial Adviser
IMD	Insurance Mediation Directive
IOSCO	International Organization of Securities Commissions
MiFID	Markets in Financial Instruments Directive
PFSA	Polish Financial Supervision Authority
SME	Small- and Medium-Sized Enterprise
UCITS	Undertakings for Collective Investment in Transferable Securities

2. PROBLEM TREE



3. WHAT ARE PACKAGED 'RETAIL INVESTMENT PRODUCTS'?

There is currently no definition of a 'packaged retail investment product' in Community law, nor is there a common definition in Member State legislation. We define the concept here with reference to the characteristics of the products on offer and the set of investors to whom they are sold. The core characteristics are as follows:

- They are 'packaged' products which combine investments in (usually) multiple financial instruments;
- They are typically held for a medium to long term period;
- Their core economic function is capital accumulation; and
- They are designed for, and sold predominantly to, retail investors.

This set of products should not be confused with retail *financial* products or services in general, which may include credit products (mortgages, loans), insurance products, payment services etc.

All of the product families described in this Impact Assessment offer comparable economic functionality. However, there is considerable variation in product characteristics both within and between product families. The key differences are as follows:

- The products are structured differently. For instance, investment in a fund entails the delegation of fiduciary responsibility to a fund manager, and with actively managed funds the return is affected by the decisions taken by that manager over the lifetime of the investment. By contrast, the calculation of the return on a structured security at maturity is determined in advance by a fixed algorithm.
- The legal relationship between the investor and originator varies. The client remains the beneficial owner of the assets in a fund investment, whereas this is not the case when an investment is made through an insurance wrapper: the underlying assets are legally owned by the insurance company. The company promises to provide a return to the policy holder based on the investment performance of the assets.
- The (non-investment) risks associated with the products differ. For example, an investor in a structured security bears a counterparty risk against the issuer of the security. An investor who entrusts his/her assets to a fund manager accepts the risk that the manager will not act in his/her best interests. There can also be differences in the exposure to liquidity risks between different types of product.
- The characteristics of the products may differ, for example in terms of the types of market exposure they offer and the existence and nature of a capital guarantee. The liquidity and accessibility of the products may also vary significantly, with some having lock-ins or penalties if the investor needs quick access to their capital.
- Average holding periods may vary; anecdotal evidence suggests that insurance-based products in particular are typically held for longer than the average maturity of a structured security.
- They are subject to differential tax treatment, according to the policy preferences of national authorities.
- Some products may offer additional functionality, such as biometric risk coverage in a unit-linked life insurance policy.

It is important that these differences are taken into account in the design of any policy response to the problems identified. However, it is clear that, from the perspective of the retail investor, all of these products perform comparable economic functions.

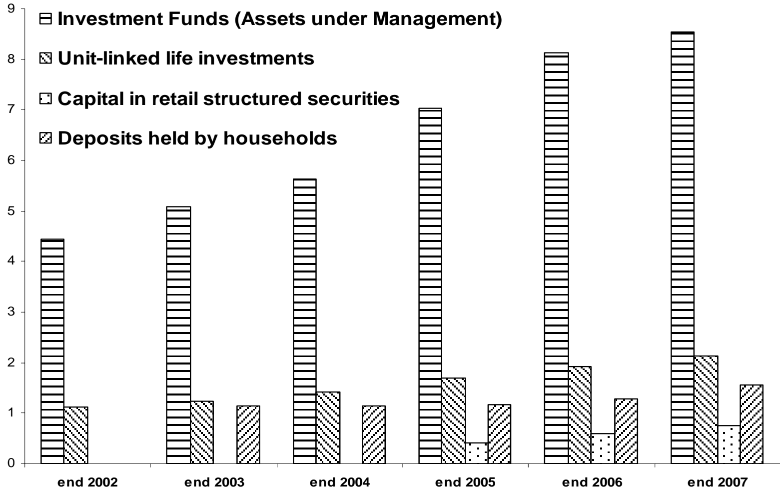
Work conducted on these issues in other public fora (e.g. Joint Forum, IOSCO, 3L3 and at national level) has variously referred to the same set of products as 'competing' or 'substitute' products. While

these descriptions may apply to a subset of the products in question, we do not consider these terms to be generally applicable. For the reasons given above, we do not consider all of the products under consideration to be perfect substitutes. Moreover, while they do compete for retail savings, it is not always accurate to treat them as being in direct competition. For example, unit-linked life policies often serve simply as a 'wrapper' for an investment in an underlying fund. In this case the 'competing product' is more accurately described as an alternative channel for the distribution of the investment fund.

4. HOW BIG IS THE MARKET FOR PACKAGED RETAIL INVESTMENT PRODUCTS?

It is not straightforward to arrive at an accurate estimate of the size of the market for retail investment products. The available data on unit-linked insurance investments do not distinguish between those products offering significant biometric risk cover and those that do not. Data on term deposits do not distinguish between those that are structured and those that are not. There is also a problem of double-counting, to the extent that investments in units of investment funds through unit-linked life wrappers are included in both product categories. Nevertheless, an estimate of total market size of €8-10 trillion is not unreasonable, even following the outflows that occurred during 2008.

Capital outstanding (EURO trillion) [39]



Source EFAMA, CEA, retailstructuredproducts.com and ECB

5. HOW ARE PACKAGED RETAIL INVESTMENT PRODUCTS DISTRIBUTED?

On the supply side, it is necessary to distinguish between the *originators* of retail investment products and their *distributors.* Originators include fund managers, securities issuers and insurance companies. These entities may distribute their products directly to retail investors – in which case the originator and distributor are the same – or through an intermediary.

Funds and structured securities are distributed predominantly by banks in many Member States, although independent financial advisers are prevalent in the UK. Financial institutions also distribute

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39 Investment funds: includes UCITS and non-UCITS but not hedge funds or private equity. Unit-linked life investments: includes life insurance policies with biometric risk component. Term deposits held by households: with Monetary and Financial Institutions: includes deposits without embedded optionality

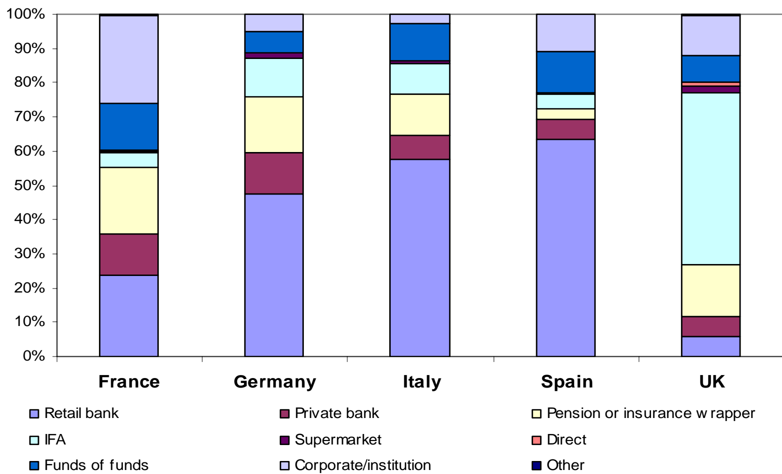
the majority of unit-linked life insurance policies, along with insurance company employees, agents and, in some countries, insurance brokers. Greater detail is given in the sections that follow.

Traditionally, financial institutions distributed products developed 'in house' by fund managers and structurers. In recent times, however, funds and securities distributors have moved towards more open models of distribution, with third-party products offered alongside own-brand products ('open architecture'). It is also common for different types of investment product to be made available from the same distribution channel. For example, a prospective investor seeking to purchase an investment from branch of a bancassurer or from an independent financial advisor may be offered products from any of the product families. There are also signs of developments whereby intermediaries offer services which blur some of the distinctions between intermediation and product origination, such as distributor managed funds and wrap platforms.

Investment funds

Industry estimates suggest that, in continental Europe, commercial banks and insurance companies remain the largest distributors of investment funds but that their market share in fund distribution fell from 97% to 75% between 1990 and 2005. In the UK, independent financial advisors (IFAs) are the main distribution channel.

Distribution channels by country, 2007

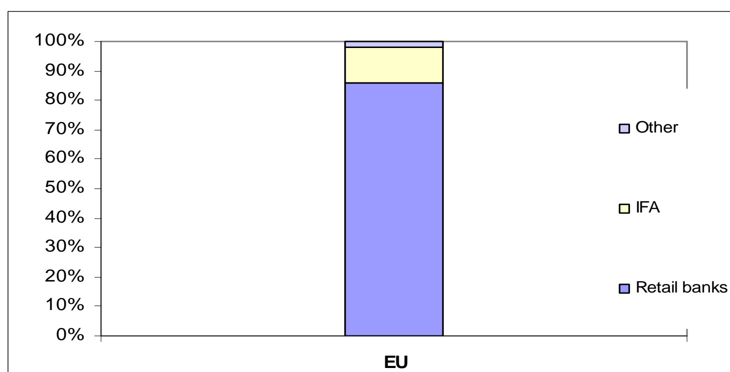


Source: Lipper FERI, *European Fund Market Data Digest 2007*

Structured securities

In 2006, banks were the primary distributors of retail structured securities, with a market share close to 86%. IFAs and brokers, which can either sell structured products from multiple issuers or from a single issuer, accounted for 12% of structured product retail sales in 2006.

Distribution channels, EU, 2006

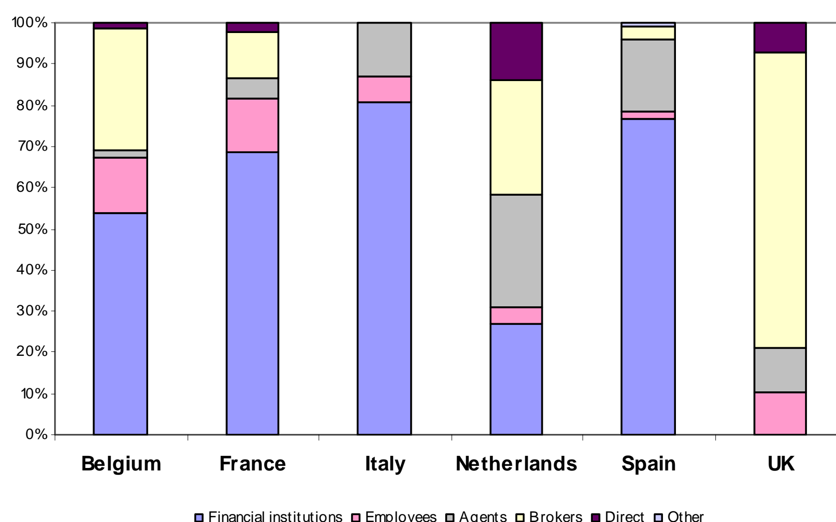


Source: www.structuredretailproducts.com

Unit-linked life insurance

The available data do not distinguish between distribution channels for unit-linked life insurance policies, and life insurance more generally. Financial institutions remain the main distribution channels, with the exception of the UK and the Netherlands, where brokers and agents predominate. Life insurance products are also distributed through networks of insurance company employees.

Life insurance (new individual contracts) distribution channels, EU, 2006



Source: CEA

Structured term deposits

No data are available on distribution channels for structured term deposits. However, it can be reasonably assumed that, by nature, structured term deposits are distributed by deposit-taking institutions, i.e. commercial banks. In some Member States, financial advisers might well propose these as part of their range of products.

6. MEMBER STATE APPROACHES TO THE REGULATION OF RETAIL INVESTMENT PRODUCTS.

Many Member States have supplemented the provisions of European directives with additional provisions within their own jurisdictions. This section provides examples from three Member States, which are included for illustrative purposes only.

United Kingdom: At the time of the implementation of MiFID, the UK introduced a new Conduct of Business sourcebook[40] under which many MiFID provisions were applied to non-scope business, e.g. life insurance products. In particular, conduct of business obligations, requirements for client categorisation, communicating with clients, including financial promotions, information about the firm, its services and remuneration, suitability (including basic advice) and appropriateness (for non-advised services) generally apply to MiFID and non-MiFID firms. Both MiFID and non-MiFID firms must also prepare a Key Features Document (KFD) and a Key Features Illustration (KFI) for some 'packaged products' (not including structured term deposits). (The UK concept of a 'packaged product' includes, in addition to retail investment products, other products such as personal pension schemes and annuities.) The requirements for financial promotions generally apply to all investment activity, without distinguishing between products. Certain additional requirements apply to all types of 'packaged product'. Many of the UK requirements significantly predate the introduction of MiFID.

In **Italy**, the amended Consolidated Law on Financial Intermediation[41] adopted a homogeneous approach for both product disclosure and rules on conduct of business. 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. For instance, 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**, the Decree-Law[42] transposing MiFID into national law transferred the powers of supervision and rulemaking on the assurances linked to investment funds and the individual subscription contract to open-end pension funds, from the Portuguese Insurance Institute (ISP) to the Portuguese Securities Commission (CMVM), with regard to the business conduct duties imposed on the distribution of said products, particularly within the context of information duties. Making use of these new regulatory competences, the CMVM approach was to supplement the existing requirements for unit-linked insurance contracts and open-ended pension funds with some relevant MiFID provisions. One example was the obligation to provide retail clients with key product information in the form of a simplified prospectus similar to that required for UCITS. It also introduced a rule of “suitability” and “know your customer” (also applicable to investment advice) but not as prescriptive as the related MiFID rules, as these products are investment products in substance, but insurance products in their legal form. In addition, the CMVM Regulation nº 8/2007[43] supplemented the existing requirements[44] 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.

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[40] New Conduct of Business Sourcebook (COBS) applying to firms with effect from 1 November 2007

[41] Legislative Decree n° 58 of 24 February 1998 - Consolidated Law on Financial Intermediation, pursuant to Articles 8 and 21 of Law 52 of 6 February 1996 (as amended by Legislative Decrees 164/2007, 195/2007 and 229/2007)

[42] Decree-Law No. 357-A/2007 of 31 October 2007

[43] CMVM Regulation n.º 8/2007 "Selling open-ended pension funds with individual adhesion and insurance contracts related to investment funds" (only available in Portuguese).

[44] For more detailed explanations on requirements introduced by this regulation, see the CMVM's contribution to the Call for Evidence (page 12)

7. EUROPEAN DISCLOSURE AND DISTRIBUTION RULES FOR RETAIL INVESTMENT PRODUCTS

7.1. Pre-contractual product disclosures

Investment funds

Funds covered by the UCITS Directive are subject to disclosure requirements in the form of the Simplified Prospectus that must be provided before the conclusion of the contract and, on request, a full prospectus, an annual report and a half-yearly report covering the first six months of the financial year. Article 33 UCITS provides that a Simplified Prospectus must be offered to subscribers free of charge before the conclusion of the contract. Article 28 UCITS indicates that the simplified prospectus must include the information necessary for investors to be able to make an informed judgment of the investment proposed to them, and in particular of the risks attached thereto. The key information to be provided in the simplified prospectus is further defined in Schedule C, Annex I to the UCITS Directive. In addition, MiFID imposes high-level disclosure requirements notably in relation to the distributor (when it is MiFID regulated). Concerning nationally regulated funds, most national laws require a full and a simplified prospectus, whereas others require additional disclosure documents. In addition, the distributing firm has to meet all MiFID information requirements. This means that the firm must check whether the requirements as regards risk disclosure and costs and associated charges (including exit and entry fees) of Article 19(3) MiFID are fulfilled, for instance by provision to the (potential) investor of a simplified prospectus or any other disclosure document required under national law.

Structured securities

Structured securities which are to be distributed to the public on a pan-EU basis are subject to the Prospectus Directive and hence to the publication of a prospectus. Article 5 of this directive states that the prospectus "*shall contain all information which, according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities. This information shall be presented in an easily analysable and comprehensible form*". The prospectus shall also include a summary, which "*in a brief manner and in non-technical language, convey the essential characteristics and risks associated with the issuer, any guarantor and the securities*". This prospectus has to contain all the information required by the annexes of the Prospectus Regulation (Commission Regulation N° 809/2004), depending on the issuer and the securities offered. The prospectus has to be approved by the relevant competent authority. Thus, the prospectus must describe the essential features and risks associated with the issuer and the securities issued, with considerable detail on the issuer, but less about the financial details of the product. In addition, MiFID imposes high-level disclosure requirements notably in relation to the distributor (when it is MiFID regulated).

For security issues which are subject to MiFID, Article 19(2) provides that information addressed by an investment firm to clients or potential clients, including marketing communications, should "*be fair, clear and not misleading*". In addition, Article 27 of MiFID Implementing Directive[45] specifies in particular the conditions with which information must comply in order to be fair, clear and not misleading. It provides *inter alia* that if the information contains an indication of past performance of a financial instrument, financial index or an investment service, or refers to simulated past performance of such financial instrument or financial index certain conditions are to be satisfied.

[45] Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

Article 19(3) of MiFID requires[46] that appropriate information shall be provided in comprehensible form to clients or potential clients about – amongst others – risks associated with investments in financial instruments and costs and associated charges. In extensor, it reads that "[…] *Appropriate information shall be provided in a comprehensible form to clients or potential clients about: the investment firm and its services, financial instruments and proposed investment strategies; this should include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies, execution venues, and costs and associated charges so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. This information may be provided in a standardised format*". Articles 30 to 33 of MiFID Implementing Directive, Article 31 ("Information about financial instruments"), specify requirements on 'appropriate information' to be provided to clients or potential clients. In particular, Article 31 of MiFID Implementing Directive lays down detailed rules on risk disclosure, whereas Article 33 deals with information about costs and associated charges.

Unit-linked life insurance

The third Life Insurance Directive of 1992, consolidated by the 2002 Directive (the Consolidated Life Directive) concerning direct life assurance, indicates in a detailed list the information to be provided to the policyholder prior to the conclusion of the contract. The information will first relate to the insurance undertaking and to the commitment itself. Article 36 of the Consolidated Life Directive states that:

- "Before the assurance contract is concluded, at least the information listed in Annex III(A) shall be communicated to the policy holder.

- The policy-holder shall be kept informed throughout the term of the contract of any change concerning the information listed in Annex III (B).

- The Member State of the commitment may require assurance undertakings to furnish information in addition to that listed in Annex III only if it is necessary for a proper understanding by the policy holder of the essential elements of the commitment".

Annex III lists the required elements of pre- and post-contractual disclosures and states that the information "*must be provided in a clear and accurate manner, in writing, in an official language of the Member State of the commitment*". Specifically regarding unit-linked policies, definition of the units to which the benefits are linked as well as an indication of the nature of the underlying assets must be disclosed.

In addition, the Insurance Mediation Directive (IMD) includes disclosure requirements regarding the intermediary (status, service and suitability). Its article 13 provides that:

"All information to be provided to customers in accordance with Article 12 shall be communicated:(a) on paper or on any other durable medium available and accessible to the customer; (b) in a clear and accurate manner, comprehensible to the customer; (c) in an official language of the Member State of the commitment or in any other language agreed by the parties…". This however relates more the form of the disclosure and less to its content.

Structured term deposits

There are no European pre-contractual disclosure rules applicable to structured term deposits.

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7.2. Conduct of business rules

Investment funds

Direct sales by the management company of its own products are governed by the relevant provisions of the UCITS Directive. When intermediaries sell third-party investment funds, MiFID applies and provides rules on conduct of business (see below).

Structured securities

MiFID applies to distributors which offer either third-party or proprietary retail structured securities. Under Level 1 MiFID provisions, structured securities are considered as complex products which cannot be sold on an "execution only" basis.

The overarching principle in MiFID as regards conduct of business is in Article 19 which states that "[…] (1) Member States shall require that, when providing investment services and/or, where appropriate, ancillary services to clients, an investment firm act honestly, fairly and professionally in accordance with the best interests of its clients […]". A distinction is then made between the provision of investment advice or portfolio management, and other investment services.

- In the former case, *"[...] the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are **suitable** for him*". The Directive also describes situations in which investment services can be provided without these disciplines applying. In all such cases, *"(6) [...] the client or potential client has been clearly informed that in the provision of this service the investment firm is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the corresponding protection of the relevant conduct of business rules; this warning may be provided in a standardised format*".

- In the latter case, *"[...] (5) Member States shall ensure that investment firms, when providing investment services other than those referred to in paragraph 4, ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is **appropriate** for the client. In case the investment firm considers, on the basis of the information received under the previous subparagraph, that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client. This warning may be provided in a standardised format.(6) In cases where the client or potential client elects not to provide the information referred to under the first subparagraph, or where he provides insufficient information regarding his knowledge and experience, the investment firm shall warn the client or potential client that such a decision will not allow the firm to determine whether the service or product envisaged is appropriate for him. This warning may be provided in a standardised format. [...]*"

Suitability and appropriateness tests are different[47] and should not be confused. As well as applying to different types of services, they differ in the degree of information-gathering and the rigour of the assessment required.

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[47] The 'appropriateness' test is less wide-ranging than the suitability test. Firms are only required to assess whether the client has the knowledge and experience necessary to understand the risks involved in relation to the specific type of product or service in question. For the purposes of the 'suitability' test, the firm, in addition to this element, also has to be satisfied that the specific transaction a) meets the client's investment objectives, and b) is such that the client is able financially to bear any related

Unit-linked life insurance

Employees of insurance companies, who are not considered as intermediaries, are not within the scope of the Insurance Mediation Directive and hence are not subject to the same obligations as insurance intermediaries. The latter are subject to IMD, which provides that they must deliver written advice, taking into account the demands and needs of the policyholder. The scope of this obligation might be considered to be similar to that applying to financial advisors subject to MiFID. Thus, Article 12 of IMD provides that: "[…]

2. When the insurance intermediary informs the customer that he gives his advice on the basis of a fair analysis, he is obliged to give that advice on the basis of an analysis of a sufficiently large number of insurance contracts available on the market, to enable him to make a recommendation, in accordance with professional criteria, regarding which insurance contract would be adequate to meet the customer's needs.

3. Prior to the conclusion of any specific contract, the insurance intermediary shall at least specify, in particular on the basis of information provided by the customer, the demands and the needs of that customer as well as the underlying reasons for any advice given to the customer on a given insurance product. These details shall be modulated according to the complexity of the insurance contract being proposed. […]"

Structured term deposits

There are no European conduct of business rules applicable to structured term deposits.

7.3. Conflicts of interest and inducement rules

Investment funds

Direct sales by the management company of its own products are governed by the relevant provisions of the UCITS Directive. When intermediaries sell third-party investment funds, MiFID applies and provides rules on conflicts of interest (see below).

Structured securities

MiFID rules on conflicts of interest apply to distributors which offer either third-party or proprietary retail structured securities. First, Article 18 of MiFID disposes that conflicts of interest should be avoided and, if not possible, managed and disclosed by stipulating that: "[…]

> *(1) Member States shall require investment firms to take all reasonable steps to identify conflicts of interest between themselves, including their managers, employees and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof.*
>
> *(2) Where organisational or administrative arrangements made by the investment firm in accordance with Article 13(3) to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the investment firm shall clearly disclose the general nature and/or sources of conflicts of interest to the client before undertaking business on its behalf.* […]".

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investment risks. The firm is required to collect all necessary information to have a reasonable basis for reaching this opinion. Finally, the regulatory consequences of the two tests are different: while an investment firm may not provide an 'unsuitable' recommendation, it may provide a service which it considers as not 'appropriate' to the client, as long as the client is given adequate warning.

In addition, Article 19(1) of MiFID requires an investment firm to "*act honestly, fairly and professionally in accordance with the best interests of its clients*". Furthermore, the MiFID Level 2 directive contains extensive guidance on conflict of interest policy and the disclosure of 'inducements'. Article 26 of Implementing Directive complements MiFID Article 19(1) so as to regulate the giving and receipt of fees, commissions or non-monetary benefits (inducements) by investment firms. Thus, firms must be careful to ensure that any inducements they provide or are provided with do not conflict with their fiduciary duty of loyalty to their clients. In particular, the provision targets any economic flows which distort the integrity of advisory or other services provided to clients. In particular, under Article 26 of MiFID Implementing Directive, firms may not pay or provide, or be paid or provided with, any inducement, in connection with the provision of an investment or ancillary service to the client, with three limited exceptions[48]:

- The first is where inducements are paid or provided to or by the client or a person acting on behalf of the client.

- The second applies when the following three tests are met: i) the existence, nature and amount of the inducement, or, where the amount cannot be ascertained, the method of calculating that amount, must be clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant service; ii) the inducement is designed to enhance the quality of the relevant service to the client; and iii) the inducement does not impair compliance with the firm's duty to act in the best interests of the client.

- The third exception covers all "proper fees which enable or are necessary for the provision of investment services, such as custody costs, settlement and exchange fees, regulatory levies or legal fees, and which, by their nature, cannot give rise to conflicts with the firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients".

Unit-linked life insurance

Employees of insurance companies, who are not considered as intermediaries, are not within the scope of the Insurance Mediation Directive and hence are not subject to the same obligations as insurance intermediaries. The latter are subject to IMD. Although the concept of conflict of interest is not explicitly mentioned in the IMD, this directive provides some high level rules in this respect. Thus, the IMD Article 12 provides that: "[…]

> *1. Prior to the conclusion of any initial insurance contract, and, if necessary, upon amendment or renewal thereof, an insurance intermediary shall provide the customer with at least the following information:*
>
> *(c) whether he has a holding, direct or indirect, representing more than 10 % of the voting rights or of the capital in a given insurance undertaking;*
>
> *(d) whether a given insurance undertaking or parent undertaking of a given insurance undertaking has a holding, direct or indirect, representing more than 10 % of the voting rights or of the capital in the insurance intermediary;*
>
> *(i) he gives advice based on the obligation in paragraph 2 to provide a fair analysis, or*
>
> *(ii) he is under a contractual obligation to conduct insurance mediation business exclusively with one or more insurance undertakings. In that case, he shall, at the customer's request provide the names of those insurance undertakings, or*

48 See recommendations "inducements under MiFID" published by CESR in May 2007 for more detailed explanations.

(iii) he is not under a contractual obligation to conduct insurance mediation business exclusively with one or more insurance undertakings and does not give advice based on the obligation in paragraph 2 to provide a fair analysis. In that case, he shall, at the customer's request provide the names of the insurance undertakings with which he may and does conduct business. […]".

Structured term deposits

There are no European conflict of interest rules applicable to structured term deposits.

7.4. Marketing and advertising rules

Investment funds

The UCITS Directive does not harmonise rules for advertising and only stipulates that distributors of UCITS funds have to comply with national rules governing advertising in each Member State. When intermediaries sell third-party investment funds, MiFID applies and provides some rules on marketing communications.

Structured securities

Structured securities which are offered to the public are subject to article 15 of the Prospectus Directive. Inter alia, this article requires that advertisements state that a prospectus has been or will be published, with an indication of where investors can obtain it. Advertisements shall be clearly recognisable as such. The information contained in an advertisement shall not be inaccurate, or misleading. This information shall also be consistent with the information contained in the prospectus. In addition, Article 15 gives the competent authority of the home Member State the power to exercise control over the compliance of advertising activity. However, this does not predetermine whether such a control has to be ex ante or ex post and, therefore, this varies in Member States. In addition, MiFID applies to structured security offers to the public.

MiFID has not harmonised marketing/advertisement requirements. Thus, Member States can impose such measures subject to applicable Community legislation. However, MiFID has introduced information requirements that include marketing communications. In particular, Article 19(2) of MiFID provides that: "[…] *(2) All information, including marketing communications, addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading. Marketing communications shall be clearly identifiable as such.* […]". Moreover, Recital 42 and Article 24(2) of MiFID Implementing Directive provide that marketing communications should be clearly identifiable as such and carry other disclaimers in certain circumstances concerning investment research. Article 27 MiFID Implementing Directive specifies in particular the conditions with which information must comply in order to be fair, clear and not misleading. It provides – inter alia – that if the information contains an indication of past performance of a financial instrument, financial index or an investment service, or refers to simulated past performance of such financial instrument or financial index certain conditions are to be satisfied.

Unit-linked life insurance

The Consolidated Life Directive (Article 47) does not harmonise rules for advertising. It is limited to state that Member States may require compliance with their national rules on the form and content of advertising. Therefore, rules for marketing communications on unit-linked life insurance product will vary between Member States.

Structured term deposits

There are no European conflict of interest rules applicable to structured term deposits.

In addition, at the EU level, a piece of Community legislation on advertising may apply to marketing communications for the broad range of product families considered. Indeed, The Directive concerning unfair business-to-consumer commercial practices[49] provides safeguards, such as in the Section 1 (Misleading commercial practices); Article 6 - Misleading actions: "[…]

> 1. A commercial practice shall be regarded as misleading if it contains false information and is therefore untruthful or in any way, including overall presentation, deceives or is likely to deceive the average consumer, even if the information is factually correct, in relation to one or more of the following elements, and in either case causes or is likely to cause him to take a transactional decision that he would not have taken otherwise:
>
> (a) the existence or nature of the product;
>
> *(b) the main characteristics of the product, such as […];*
>
> *2. A commercial practice shall also be regarded as misleading if, in its factual context, taking account of all its features and circumstances, it causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise, and* […]".

In addition, Article 7 defines misleading omissions as: "[…]

> *1. A commercial practice shall be regarded as misleading if, in its factual context, taking account of all its features and circumstances and the limitations of the communication medium, it omits material information that the average consumer needs, according to the context, to take an informed transactional decision and thereby causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise.*
>
> *2. It shall also be regarded as a misleading omission when, taking account of the matters described in paragraph 1, a trader hides or provides in an unclear, unintelligible, ambiguous or untimely manner such material information as referred to in that paragraph or fails to identify the commercial intent of the commercial practice if not already apparent from the context, and where, in either case, this causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise.*
>
> […]
>
> *4. In the case of an invitation to purchase, the following information shall be regarded as material, if not already apparent from the context:*
>
> *(a) the main characteristics of the product, to an extent appropriate to the medium and the product;*
>
> *(b) the geographical address and the identity of the trader, […];*
>
> *(c) the price inclusive of taxes, […] or, where these charges cannot reasonably be calculated in advance, the fact that such additional charges may be payable; […]*
>
> *(e) for products and transactions involving a right of withdrawal or cancellation, the existence of such a right.* […]".

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[49] Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market

7.5. E-Commerce Directive and Distance Marketing of Financial Services Directive

In addition, other provisions of EU law may be applicable to the distribution of retail **investment products.**

According to the **E-Commerce Directive**, service providers are entitled to provide their services by the means of Internet throughout the EU, exclusively on the basis of the rules of the Home Member State without any further restriction. Indeed, in contrast to the UCITS Directive, for instance, which confers some residual competences to the Host Member State, the e-commerce Directive is based on a strict "country-of-origin" principle. This Directive imposes certain information requirements for the conclusion of contracts by electronic means. In addition to other information requirements established by EU law, the service provider must give the following information prior to the service provision:

- the technical steps to follow to conclude the contract;
- whether or not the concluded contract will be filed by the service provider and whether it will be accessible;
- the technical means for identifying and correcting input errors prior to the placing of the order;
- the languages offered for the conclusion of the contract;
- any relevant codes of conduct to which he subscribes and information on how those codes can be consulted electronically; and
- contract terms and general conditions provided to the recipient must be made available in a way that allows him to store and reproduce them.

Moreover, the service provider shall supply information on its name; address; e-mail address; company registration number; professional title; VAT number; and details of membership of professional associations easily, directly and permanently accessible. These requirements are in addition to those imposed by MiFID.

The **Distance Marketing of Financial Services Directive** (DMFSD) applies to the distribution of financial services or products sold by the means of distance communication, i.e. those means which do not require the simultaneous physical presence of the supplier and the consumers such as fax, telephone and again Internet. In contrast to the e-commerce Directive and similarly to the UCITS Directive, the Distance Marketing of Financial Services Directive recognises certain residual competences of the Host Member State. The Distance Marketing of Financial Services Directive also regulates the information which has to be provided to the investor. The "distance marketing information" must be provided before the client is bound by a contract. This information includes:

- all the contractual terms and conditions and the information on paper or on another durable medium available and accessible to the consumer in good time before the consumer is bound by any distance contract or offer;
- the identification of the supplier;
- the description of the financial services;
- the characteristic of the distance contract; and
- the existence of a redress.

Although the DMFSD requirements appear to add a separate layer of information to be disclosed, these requirements are often already satisfied through existing disclosure requirements. They are partly similar to those of the UCITS Directive.

These two Directives may be seen as making the regulatory patchwork governing the distribution of retail investment products to retail investors more complex. The question of the relationship of their provisions with those of other Directives (such as MiFID, UCITS, IMD, Prospectus, etc.) may arise. The two directives do not establish exemptions to the application of the complementary provisions of the UCITS, MiFID, Life Insurance and Insurance Mediation Directives. The obligations to offer information and advice provided for by these latter directives should consequently be applicable for distance marketing.

ANNEX 2

1. DETAILED ANALYSIS OF HIGH-LEVEL OPTIONS FOR PRE-CONTRACTUAL DISCLOSURES

1.1. Analysis of options

1.1.1. Commission sponsored self-regulation

Effectiveness			Efficiency
Consumer protection	**Level playing field**	**Single Market**	
Pros – Reputational incentives for industry to avoid mis-selling, promote effective decision-making as a means of building confidence in the industry, linked to importance of brand identity within many retail markets. – Allows disclosures to be adapted to the specifics of particular products and sales channels; originators may be best placed to understand the features of their products. **Cons** – Inconsistencies and constraints in EU law would remain. – Sub-optimal standards possible as consensual solution, reducing potential extent of consumer protection (e.g. focus on limiting legal liability or	**Pros** – Originators may be best placed to understand features of their products and devise solutions which provide information about these consistently across product types. **Cons** – Inconsistencies and constraints in EU law would remain. – Sub-optimal standards possible as consensual solution, reducing potential impact. – Coordination challenges with segmentation of industry. – Existing national regimes may limit scope for improvements. – The problem analysis suggests market failings require more robust regulatory	**Pros** – Originators may be best placed to understand features of their products and devise solutions which provide information about these consistently cross border. **Cons** – Inconsistencies and constraints in EU law would remain. – Limited in capacity to overcome differences between Member States where national regimes are already in place. – Sub-optimal or minimal standards likely as consensual solution, reducing potential impact. – Coordination challenges with segmentation of	– Flexibility for the industry might promote disclosures which are more specific and suited to particular products. – Industry may be more sensitive to cost drivers, and so able to lower cost impacts of changes. – Self-regulatory codes already exist in the sectors in question in several Member States. One such code (the 'JAC principles') is intended for application on a pan-European basis. Other industry associations (EBF, BIPAR, FECIF / AILO) have begun to develop additional measures in response to the Commission's ongoing work on this topic. – Some Member States have already invited industry participants to develop codes. An EU-level request would not necessarily create additional costs for all industry

marketing goals for industry). – Information advantage with respect to regulators and consumers could be exploited. – Unlikely that industry would develop consistent approaches across different products, such that shopping around by investors would be no easier than currently. – Segmentation of industry may limit scope for change, as different segments reluctant to move without commitments from other segments to move. – Enforcement of standards challenging with reduced opportunities for sanctions.	intervention to achieve optimum outcomes (e.g. around balanced presentation of costs and potential benefits). – Enforcement of standards challenging with reduced opportunities for sanctions.	industry. – Enforcement of standards challenging with reduced opportunities for sanctions.	participants. – The design and production of new disclosure documents would nevertheless entail significant incremental compliance and administrative costs for those affected. See the general discussion above for indicative figures relating to MiFID and the Prospectus Directive.
Overall assessment			
--	--	-	≈

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ neutral; ? uncertain; n.a. not applicable

1.1.2. Mandate to Level 3 committees to promote supervisory convergence			
Effectiveness			**Efficiency**
Consumer protection	**Level playing field**	**Single Market**	
Pros – Provides flexibility to local supervisors for solutions that can be tailored to local markets context which may be better focused on local consumer needs. – IMD (and to lesser extent MiFID) explicitly allow Member States the latitude to tackle these issues in their local markets. – Convergence at MS level likely to raise overall consumer protection standards **Cons** – Inconsistencies and constraints in EU law would remain. – Sub-optimal standards possible as consensual solution, reducing potential extent of consumer protection. – Gold-plating and inconsistency of implementation: likely to offer less consistency across products than a mandatory solution, both within	**Pros** – Potentially responsive to changes in market and emergence of new products. – Convergence at MS level likely to lead to more consistent requirements **Cons** – Inconsistencies and constraints in EU law would remain. – Sub-optimal standards possible as consensual solution, reducing potential extent of consumer protection. – Coordination challenges between 3L3 committees. – Inconsistency of implementation: likely to offer less consistency in MS approach to level-playing fields than a mandatory solution. – Likely to be more suited to establishing only the weakest forms of harmonisations, and limiting equivalence in treatment for different products.	**Pros** – History of joint work (in 3L3) on this topic, so could be seen as natural and organic next step. – Convergence at MS level likely to lead to more consistent requirements **Cons** – Inconsistencies and constraints in EU law would remain. – Inconsistencies of implementation. Fragmentation of internal market would remain, with attendant costs for cross-border service providers. – Experience of low levels of co-ordination between national authorities.	– Offers potential for improved consistency and convergence. – Some Member States have already supplemented EU law at national level to provide for simplified disclosures. Possibly no additional action required in these cases, but firms in these Member States would also face significant additional costs if the Member States chose to make changes to bring alignment to common standards. – Progressive refinement of existing practices, where necessary, may be less costly than introducing entirely new disclosures. – Level 3 committees, Member States and to lesser extent COM would face costs in preparing for convergence, including e.g. potential for increased supervision costs especially where

particular Member States and between different Members States, reducing extent to which investors can effectively choose between products.			new supervisory responsibilities or approaches are developed – New mandatory disclosures would be costly for industry to implement, as discussed above.
Overall assessment			
+	+	+	+

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ neutral; ? uncertain; n.a. not applicable

1.1.3. Commission Recommendation to implement principles through national regulation			
Effectiveness			**Efficiency**
Consumer protection	**Level playing field**	**Single Market**	
Pros – Can combine a stronger common starting point (within the recommendation) with the flexibility for Member States to adjust requirements as necessary for local market, which may lead to disclosures which are more responsive to local consumer needs. – IMD (and to lesser extent MiFID) explicitly allow Member States the latitude to tackle these issues in their local markets. **Cons** – Inconsistencies and constraints in EU law would remain. – Gold-plating and inconsistency of implementation: likely to offer less consistency across products than a mandatory solution, both within particular Member States and between different Members States, reducing extent to which investors can	**Pros** – Can combine a stronger common starting point (within the recommendation) with the flexibility for Member States to adjust requirements as necessary for local market, which may lead to disclosures which are more responsive to local consumer needs. – IMD (and to lesser extent MiFID) explicitly allow Member States the latitude to tackle these issues in their local markets. – Potentially responsive to local distribution and product issues, as Member States would have some flexibility to adapt requirements to suit local landscape. **Cons** – Inconsistencies and constraints in EU law would remain. – Gold-plating and inconsistency of implementation: likely to offer less	**Pros** – Can combine a stronger common starting point (within the recommendation) with the flexibility for Member States to adjust requirements as necessary for local market, which may lead to disclosures which are more responsive to local consumer needs. – IMD (and to lesser extent MiFID) explicitly allow Member States the latitude to tackle these issues in their local markets. – Develops starting point for further work without imposing costs of wholesale change on industries where cross-border trade is currently limited. **Cons** – Inconsistencies and constraints in EU law would remain. – Gold-plating and inconsistency of implementation: significant fragmentation of internal market	– Offers potential for improved consistency and convergence. – Impact on Member States likely to be very varied. Some Member States have already supplemented EU law at national level to provide for simplified disclosures. Possibly no additional action required in these cases, but (should change be necessary) costs of change would likely be high and benefits more limited than the case where no existing supplementary requirements are in place. – New Member State requirements on disclosures would be costly for industry to implement, as discussed above. – Full benefits of changes may not be realised due to remaining inconsistencies – May be time consumer and

effectively choose between products. – Likely to be more suited to low degree of harmonisation, possibly reducing overall investor benefits depending on effectiveness of Member State actions.	consistency in MS approach to level-playing fields than a mandatory solution. – Likely to be more suited to establishing low degree of harmonisation, and limiting equivalence in treatment for different products.	would likely remain, with attendant costs for cross-border service providers. – Likely to be more suited to establishing low degree of harmonisation, and limiting cross-border consistency.	costly for COM and stakeholders to develop effective recommendation, particularly if detailed and so tailored for nature of individual product families
Overall assessment			
+	+	+	+

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ neutral; ? uncertain; n.a. not applicable

1.1.4. EU-level legislative action			
Effectiveness			**Efficiency**
Consumer protection	**Level playing field**	**Single Market**	
Pros – Greater consistency requirements, raising net standards across EU – Degree of standardisation possible through harmonised and enforced approach may aid investors in comparing the costs and features of otherwise very different products – Allows any inconsistencies in EU requirements to be addressed. – Likely to be more effective than non-binding tools at driving change (e.g. overcoming 'first mover' issues). **Cons** – For products with significant variations across different local markets, degree of harmonisation of approach at the EU level may be more limited. Overall effectiveness may depend on supporting work by local Member States and effective supervisory	**Pros** – The greater the harmonisation the greater the disclosure contribution to creating a level playing field (across products and distribution channels). – Allows any inconsistencies in EU requirements to be addressed. – Likely to be more effective than non-binding tools at driving change (e.g. overcoming 'first mover' issues). **Cons** – For products with significant variations across different local markets, degree of harmonisation of approach at the EU level may be more limited, reducing the overall impact.	**Pros** – More harmonised requirements would ensure better consistent approach across all Member States – reduced compliance costs and legal certainty for cross-border service providers; greater certainty/familiarity for investors moving across borders. – More harmonised requirements may serve to counterbalance local factors such as brand loyalty, increasing competitiveness of EU markets as whole. – For products with significant variations across different local markets, degree of harmonisation of approach at the EU level may be more limited, reducing the overall impact.	– Offers greatest potential for consistency and convergence, alongside stronger net impact on market behaviour across EU. – In Member States and sectors in which principles are already respected, would not necessarily require additional action, though this would depend on the legislative form of the proposals – harmonised documents with common cost and performance metrics, for instance, would likely require costly changes if benefits are to be realised. – New mandatory disclosures would be costly for industry to implement, as outlined above. – Time consuming to design and implement for COM and those COM consult. This would particularly be the case for products where disclosure

initiatives. – May be less able to respond to product innovation and change, so risk that harmonised requirements do not work so effectively for new products.			requirements at EU or national level are so far limited or patchy, or for options which seek to develop a common basis for comparing different products, including those which are not harmonised – such as common price or 'value for money' metrics.
Overall assessment			
++	++	+(+)	++

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ neutral; ? uncertain; n.a. not applicable

2. DETAILED ANALYSIS OF HIGH-LEVEL OPTIONS FOR SELLING PROCESSES

2.1. Analysis of options

2.1.1. Commission sponsored self regulation			
Effectiveness			**Efficiency**
Consumer protection	**Level playing field**	**Single Market**	

Pros – If industry agree and adopt effective common approaches, could lead to higher standards of consumer protection. **Cons** – Inconsistencies and constraints in EU law would remain. – Sub-optimal standards possible as consensual solution, reducing potential extent of consumer protection. – Information advantage with respect to regulators and consumers likely to remain. – Monitoring and compliance issues difficult to address in voluntary approach. – Voluntary approach hinders spread of best practice, as 'first movers' may be put at competitive disadvantage. – Overall effectiveness may be limited due to identified market failings and incentives on firms. – Enforcement of standards challenging with reduced opportunities for sanctions.	**Pros** – If industry agree and adopt effective common approaches, could lead to a more even playing field across products and distribution channels. **Cons** – Inconsistencies and constraints in EU law would remain. – Sub-optimal standards possible as consensual solution, reducing potential impact. – Monitoring and compliance issues difficult to address in voluntary approach. – Voluntary approach hinders spread of best practice, as 'first movers' may be put at competitive disadvantage. – The logistical challenge of co-ordinating multiple industry sectors would be significant. No guarantee that industry would be able to agree, particularly given incentives within market. – Enforcement of standards challenging with reduced opportunities for sanctions.	**Pros** – If industry agree and adopt effective common approaches across different Member States, could lead to greater cross-border consistency. **Cons** – Inconsistencies and constraints in EU law would remain. – Sub-optimal standards possible as consensual solution, reducing potential impact – Monitoring and compliance issues difficult to address in voluntary approach. – Voluntary approach hinders spread of best practice, as 'first movers' may be put at competitive disadvantage. – Divergence of regulatory requirements at the national level would not be tackled. – The logistical challenge of co-ordinating multiple industry sectors across different jurisdictions would be significant. No guarantee that industry would be able to agree, particularly given incentives within market. – Enforcement of standards challenging with reduced opportunities for sanctions.	– Offers marginal potential for improved consumer outcomes, consistency between sales practices for product types and convergence cross-border whilst allowing industry opportunity to manage costs. – May nonetheless lead to significant costs through process of negotiation without practical outcomes if consensus proves elusive. – High costs may be incurred by some industry segments where changes made – including opportunity costs for first movers.

Overall assessment			
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Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ neutral; ? uncertain; n.a. not applicable

2.1.2. Mandate to Level 3 committees to promote supervisory convergence			
Effectiveness			**Efficiency**
Consumer protection	**Level playing field**	**Single Market**	
Pros – Changes in national approaches may lead to improved standards of consumer protection in relevant jurisdictions – May be more effective than self-regulation at driving change (e.g. overcoming 'first mover' issues). **Cons** – Inconsistencies and constraints in EU law would remain. – Inconsistencies and weaknesses also likely to remain, as consistent approaches would not necessarily be effectively implemented across all jurisdictions. – Enforcement of standards challenging with reduced opportunities for sanctions. – Coordination	**Pros** – Changes in national approaches may lead to greater consistency in treatment of different products and channels. – May be more effective than self-regulation at driving change (e.g. overcoming 'first mover' issues). **Cons** – Inconsistencies and constraints in EU law would remain. – Inconsistencies and weaknesses also likely to remain in some Member States, as convergence would not necessarily be effectively implemented across all jurisdictions. – Enforcement of standards challenging with reduced opportunities for sanctions.	**Pros** – Changes in national approaches may lead to greater consistency in treatment between Member States, though differences in EU law would remain. – May be more effective than self-regulation at driving change (e.g. overcoming 'first mover' issues). **Cons** – Inconsistencies and constraints in EU law would remain. – Inconsistencies and weaknesses also likely to remain, as convergence very unlikely to be implemented in same manner across all jurisdictions, particularly those with prior art in this area. – Coordination challenges between 3L3 committees.	– Offers potential for improved global standards of consumer protection, consistency in approaches and convergence cross-border, whilst allowing Member States to tailor local impact according to pre-existing approach. – Potentially high costs for industry, depending on the degree of change locally, though continued inconsistencies between jurisdictions and channels likely to significantly limit benefits despite costs. – Costs for 3L3 committees and Member States in developing and implementing approaches.

challenges between 3L3 committees.	– Coordination challenges between 3L3 committees.		
Overall assessment			
+	+	+	+

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ neutral; ? uncertain; n.a. not applicable

2.1.3. Commission Recommendation to implement principles through national regulation			
Effectiveness			**Efficiency**
Consumer protection	**Level playing field**	**Single Market**	
Pros – Improved standards of consumer protection in some jurisdictions – Offers stronger common starting point than 3L3 convergence alone. – May be more effective than self-regulation at driving change (e.g.	**Pros** – Greater consistency in treatment of different products and channels. – Offers stronger common starting point than 3L3 convergence alone. – May be more effective than self-regulation at driving change (e.g.	**Pros** – Greater consistency in treatment between Member States, though differences in EU law would remain. – Offers stronger common starting point than 3L3 convergence alone. – May be more effective than self-	– Offers potential for improved global standards of consumer protection, consistency in approaches and convergence cross-border, given common starting point, whilst allowing Member States some flexibility to tailor local impact according to pre-

overcoming 'first mover' issues). **Cons** – Inconsistencies and constraints in EU law would remain. – Inconsistencies and weaknesses also likely to remain, as Recommendation would not necessarily be effectively implemented across all jurisdictions. – Enforcement of standards challenging with reduced opportunities for sanctions.	overcoming 'first mover' issues). **Cons** – Inconsistencies and constraints in EU law would remain. – Inconsistencies and weaknesses also likely to remain in some Member States, as Recommendation would not necessarily be effectively implemented across all jurisdictions. – The effectiveness of a recommendation would greatly depend on the extent to which it would be followed by Member States. – Enforcement of standards challenging with reduced opportunities for sanctions.	regulation at driving change (e.g. overcoming 'first mover' issues). **Cons** – Inconsistencies and constraints in EU law would remain. – Inconsistencies and weaknesses also likely to remain, as Recommendation very unlikely to be implemented in same manner across all jurisdictions, particularly those with prior art in this area.	existing approach. – Potentially high costs for industry, depending on the content of Recommendation and implementation by Member States; continued inconsistencies between jurisdictions and channels likely to significantly limit benefits despite costs. – May be time consuming to develop with no certainty of consistent impact.
Overall assessment			
+	+	+	+

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ neutral; ? uncertain; n.a. not applicable

2.1.4. EU-level legislative action			
Effectiveness			**Efficiency**
Consumer protection	**Level playing field**	**Single Market**	

Pros – Likely to achieve highest level of consistency of approach and seeks to ensure all jurisdictions brought up to same standard – Allows any inconsistencies in EU requirements to be addressed. – Likely to be more effective than non-binding tools at driving change (e.g. overcoming 'first mover' issues). **Cons** – Significant challenges in developing effective and consistent requirements that are responsive and flexible to local market conditions and national regimes. – Effectiveness likely to depend heavily on consistent and successful supervision at local level	**Pros** – Most effective in laying basis for a level playing field (across products and distribution channels). – Allows any inconsistencies in EU requirements to be addressed. – Likely to be more effective than non-binding tools at driving change (e.g. overcoming 'first mover' issues). **Cons** – Significant challenges in developing effective and consistent requirements that are responsive and flexible to local market conditions and national regimes. – Effectiveness likely to depend heavily on consistent and successful supervision at local level	**Pros** – Most effective in promoting greater cross border homogeneity. – Would ensure consistent approach across all Member States – Reduced compliance costs and legal certainty for cross-border service providers and originators in marketing cross-border; greater certainty/familiarity for investors moving across borders. – Likely to be more effective than non-binding tools at driving change (e.g. overcoming 'first mover' issues). **Cons** – Impact likely to vary according to channel (e.g. sales via distance means c.f. face-to-face advice services, where cross-border service provision less common).	– Offers greatest potential for consistency and convergence, alongside stronger net impact on market behaviour across EU. – In Member States and sectors in which principles are already respected, would not necessarily require additional action; and action that did impact on them potentially would be costly with little or no incremental benefit. – Changes in selling rules would be costly for industry to implement. Such costs may ultimately be passed through to the consumer. The net cost would depend on the starting point in a particular Member State / sector. – Time consuming to design and implement.
Overall assessment			
++	++	++	++

Magnitude of impact as compared with the baseline scenario: ++ strongly positive; + positive; – – strongly negative; – negative; ≈ neutral; ? uncertain; n.a. not applicable