

OPEN HEARING

ON

RETAIL INVESTMENT PRODUCTS

- RECORD -

15th JULY 2008

Charlemagne Building 170, rue de la Loi - 1049 Brussels

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Executive summary

The European Commission held an Open Hearing on Retail Investment Products in Brussels on 15th July 2008.

Opening the hearing, European Commissioner for the Internal Market and Services, **Charlie McCREEVY**, explained ¹ that different types of investment product, including structured securities, investment funds, unit-linked life insurance policies and structured term deposits, are currently subject to different disclosure and distribution rules under European law. He considered it essential to strive for coherence between these sectoral frameworks, in particular by ensuring that a set of fundamental principles are respected in each case. These included a high level of transparency on performance, costs and risks; responsible selling practices; effective management and disclosure of conflicts of interest; and fair marketing materials. He remained unconvinced that these principles were currently respected across the board and emphasised the risks to investors and to the market of these deficiencies. Based on the results of the extensive dialogue with stakeholders conducted by DG MARKET services, he will publish a statement in the coming months.

The first panel, chaired by **Peter de PROFT** (EFAMA) discussed the development of retail investment markets and where risks to investors lie. **Brian REID** (ICI) described the US market, highlighting the dominance of mutual funds and exchange-traded funds but noting that the market for structured securities is growing rapidly. **Simon FRASER** (FEAM) emphasised the power of intermediaries in the sale of investment products in the EU and the competition between producers to gain access to these channels. **Marcin KAWINSKI** (FIN-USE) pointed to the popularity of structured bank deposits in Poland; investors are attracted by the apparent security of the associated capital guarantees. **Giuseppe D'AGOSTINO** described

how structured securities with capital protection are gaining ground rapidly on investment funds and insurance products in Italy. **Mick McATEER** argued that retail investors in the EU want simple, transparent products that they can understand and which deliver on their promises. A key risk is the possible failure of retail investors to make adequate financial provision for their futures. This might occur to the impact of mis-selling scandals on investor confidence. He advocated a more coherent approach to product disclosure and improved management of conflicts of interest. **Simon FRASER** agreed that simplicity and transparency is vital. **Giuseppe D'AGOSTINO** noted the complexity of some structured products and questioned whether retail investors understood the investment proposition. He described how the Italian regulator had responded to concerns that investors may not be fully informed of the risks and costs associated with these investments by upgrading disclosure requirements. **Marcin KAWINSKI** saw product mis-selling and regulatory arbitrage as a serious threat to retail investors. **Brian REID** pointed to examples of the challenge of product innovation to the maintenance of a high level of investor protection.

The second panel, chaired by **Carlo COMPORTI** (CESR) invited industry views on the adequacy of existing rules and of self-regulatory initiatives. **Charles CRONIN** (CFA) focused on the need for clear disclosures. He saw a risk that disclosures for structured products and unit-linked life policies were at present too opaque. He welcomed the work on identifying Key Investor Information (KII) for UCITS and suggested that this could, in time, form the basis for improved disclosures for other products, with appropriate adjustments. **Jean-Baptiste De FRANSSU** (EFAMA) strongly supported the creation of a level playing field through a cross-sectoral approach to the regulation of retail investment products, focusing in particular on disclosures and point of sale disciplines. He felt that the UCITS

¹ The [full text](#) of the speech is available on the European Commission's website.

framework embodied a high level of investor protection. **Gerard de la MARTINIÈRE** felt that 'keep it simple' should be the guiding principle for the production of disclosures for retail investors. EU regulatory requirements in the insurance sector require extensive disclosure. He stressed the importance of ensuring that distributors understand the products they sell. He felt that the provisions of the Insurance Mediation Directive were well tailored to the characteristics of the insurance industry and emphasised the importance of regulatory stability. **Tim HAILES** (JAC) pointed out that MiFID already provides a comprehensive, principles-based framework for the sale of structured securities and the focus now should be on making it work. He agreed that the risks and features of an investment must be transparent to the investor but insisted that the fundamental differences between products should be taken into account. He saw an effective relationship between issuers and distributors as the key to good investor outcomes and noted that the JAC had produced two sets of self-regulatory principles in this area. **Nikolaus NEUNDOERFER** (EuDerAs) agreed that MiFID provided the right answers and argued that the regulatory focus should be on equivalence of outcomes, not harmonisation of rules. He described the codes of conduct that have been developed in Germany and will in time be exported to the structured security industry in other countries. **Guido RAVOET** (EBF) stressed that it is in the core interest of banks to ensure that confidence in banking products is maintained and as such bank staff must ensure that they understand the products and communicate their key features to investors. He felt that MiFID provided the appropriate regulatory support and should now be implemented fully. He was sceptical that KII would be necessary or appropriate for other products. He suggested that the apparent 'unlevel' playing field may result from an excess of prescription in the fund sector.

Opening the afternoon session. **Theodor KOCKELKOREN** (AFM) presented an account of the challenges faced by the Dutch financial regulator in this area and the steps taken in the Netherlands to enhance investor protection. He cited in particular failings in disclosures

associated with certain types of structured products and unit-linked life insurance policies, with regard in particular to the range of possible returns and associated costs and charges. The Dutch authorities have introduced a Key Information Document for some of these products. He concluded that there is a need for continual vigilance in this area: in some cases, coherence can be improved through measures at national level; in other areas, EU level engagement may be required.

The third panel, chaired by **David WRIGHT** (DG MARKT) brought together regulators to discuss whether existing EU level arrangements are fit for purpose or in need of improvement. **Dan WATERS** (FSA) stressed that retail markets are local in nature and it is essential that national regulators are allowed to address the challenges they encounter in their own jurisdictions. He, however, acknowledged that European law may restrict this freedom in some areas. He argued that MiFID made a helpful contribution but noted that the sale of structured term deposits is not subject to these rules. He saw that a shortfall in financial capability and the incentives created by commission-based intermediary remuneration and sales targets as the key sources of investor detriment in this field. An ongoing review in the UK is looking at alternative intermediary remuneration models. **Kerstin AF JOCHNICK** (CEBS) noted that the recent turmoil had illustrated the possible consequences of a lack of transparency in financial products. She emphasised that financial education has a crucial role to play and saw room for improvement in existing EU regimes. She suggested that a lack of clarity over definitions led to the uncertainty over the regulatory treatment of structured term deposits. She encouraged the industry to develop a cross-sectoral perspective when developing self-regulatory approaches in this area. **Giovanni CUCINOTTA** (CEIOPS) reported that few insurance regulators perceived a problem in relation to an unlevel playing field and felt that insurance sector rules were broadly equivalent to those applied elsewhere. Nevertheless, he identified the disclosure of 'chain costs' and the management and disclosure of conflicts of interest as areas for improvement in the

insurance sector, although the differences in distribution structures needed to be taken into account. **Eddy WYMEERSCH** (CESR) perceived a clear need for regulatory consistency to avoid arbitrage. He felt that conduct of business and conflict of interest rules were an essential adjunct to product disclosures and that, at present, only MiFID offered adequate solutions in this regard. He saw merit in a cross-cutting set of principles for all sectors, similar to those enunciated by the Commissioner, and enforced at national level.

Jiri KROL (Czech finance ministry) identified a series of problems resulting from the lack of a level playing field, relating to the competitive distortions, risks to investor protection and the development of the single market. The Czech authorities are considering how to deliver a high and consistent level of investor protection through effective and comparable product disclosures and comparable outcomes in conduct of business regulation. He called on regulators to adopt a more horizontal approach to these issues.

In concluding remarks, **Thierry FRANCO** (French Treasury), representing the French Presidency, stressed that the issues at stake are important and risks to retail investors cannot be underestimated. He saw a need for EU level engagement with these issues for three reasons: i) the lack of coherence between various European directives for financial services; ii) convergence in national markets towards a single market for retail investment products; and iii) the many national public initiatives that we witnessed. He argued, therefore, that we should build on the five principles outlined by the Commissioner to ensure that they are respected across the full range of product frameworks. However, he saw that the most recent pieces of legislation needed time to bed in before considering any modifications. Any amendments to existing rules would have to be prepared and scheduled in a clear and transparent way.

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Record of the Open Hearing on Retail Investment Products

The European Commission held the Open Hearing on Retail Investment Products in Brussels on 15th July 2008. The Hearing, which attracted over 250 participants, brought together senior representatives from Member State authorities, European institutions, consumer associations and industry sectors producing and distributing retail investment products. Against the backdrop of a market that is expanding rapidly and becoming more diverse, a series of speeches and panel discussions focused on whether the European pre-contractual disclosure and selling rules applying to a wide range of investment products marketed to retail investors provides a consistently high level of investor protection and a level playing field among products.

Opening Remarks by Charlie McCREEVY, Commissioner for the Internal Market and Services

Commissioner McCREEVY opened the Hearing by describing the retail investment landscape and underlining his commitment to a level playing field and a high level of investor protection.

He explained that there is now an impressive range of products competing for retail savings, including investment funds, structured securities, unit-linked life products and structured term deposits. While all are broadly interchangeable from the perspective of the medium-term retail investor, they nonetheless exhibit distinct features which call for some degree of regulatory differentiation. However, there is a clear need to ensure that the existing patchwork of EU rules is consistent with efficient market outcomes and a high level of investor protection.

He described three ways in which public policy can contribute to these objectives: by promoting financial education in order to empower investors; by ensuring that prospective investors receive clear and relevant pre-contractual product disclosures; and by clearly defining the responsibilities of product distributors vis-à-vis their clients. He emphasised the need for clarity in responsibilities and desired outcomes and outlined five broad principles to guide regulatory and industry thinking. These principles included:

- clear, accurate product disclosures covering the features, expected returns, risks and costs of an investment proposition;
- a high level of professionalism by product distributors in ensuring that products sold match the needs and circumstances of prospective clients;
- effective management of conflicts of interest in distribution channels;
- clear, fair and not misleading marketing materials; and
- clarity in the division of responsibilities between originators and distributors.

He stressed that these principles should be respected in all sectors to ensure that investors

are adequately protected and that sales of products that respect these principles are not crowded out by sales of products that do not. This is a prerequisite for efficient market outcomes.

He reported that the initial analysis of the Commission services had revealed several areas in which there appeared to be deficiencies in respect of certain of these principles. These included a failure to provide clear and comparable disclosures for all types of investment product; weaknesses in the management and disclosure of conflicts of interest, particularly in the insurance sector; and with regard to certain products, such as structured term deposits, the absence of applicable disclosure and distribution rules at EU level.

He recognised that outcomes for investors and market participants depend critically on the implementation and enforcement of European rules in Member States. Many national regulators have added to the baseline provided by European law and the industry has been active in developing best practices. Nevertheless, there is a need for concerted effort by regulators and the industry in order to ensure the continued successful development of the retail investment industry.

He acknowledged that existing rules - e.g. Markets in Financial Instruments Directive (MiFID) and the Insurance Mediation Directive (IMD) - need time to bed in and stressed that he was not seeking to turn the European financial rule-book on its head. However, he saw potential for a number of pragmatic steps to make progress in this area and expressed the intention to set out his views in a statement before the end of the year.

The [full text](#) of the speech is available on this website.

Perspectives from the European Parliament: Othmar Karas, Member of European Parliament, Vice President, EPP-ED Group

Mr KARAS began by noting that an integrated wholesale market was now almost reality. He recalled that significant progress had been made in recent years through the implementation of the Financial Services Action Plan and other initiatives, such as SEPA. However, the situation in retail markets remains highly fragmented along national lines, with very limited cross-border trade.

He stressed that the European Parliament's reaction to the Commission's Green Paper on retail financial services illustrated the broad consensus in this area. However, he emphasised the deeply entrenched differences in culture and tax systems between Member State markets and therefore advised to concentrate on reducing barriers on the legal dimension of cross-border activities. He underlined the importance of the input of market participants in informing the further work of the European institutions in this area.

Mr KARAS' own report² stressed that there was a need to adopt a wide definition of retail investor, to include in particular SMEs as well as individuals and households. It underlined also that the focus of policy-making should not only be on the consumer but also on the supply side of the market. Financial services providers should be able to approach retail investors across borders, without having to establish a permanent presence in each market. He felt that the Parliament's proposals had the potential to redress the balance between supply and demand, highlighting two areas in particular. First, barriers to the growth of e-Commerce must be dismantled. Second, an appropriate legal framework for intermediaries at EU level would help to ensure legal certainty for investors and intermediaries.

He noted that the European Parliament is also active in the area of alternative investment products. They saw great potential for a harmonised market for non-harmonised

investment funds, including funds of hedge funds, managed futures and open-ended real estate funds.

In conclusion, he said that he was happy that the Commissioner had promised to take account of the European Parliament's reports and that both institutions were pursuing the same objective: a common European market for financial services for retail investors and SMEs.

² Report on Green Paper on Retail Financial Services in the Single Market - ([2007/2287\(INI\)](#))

Panel 1: Understanding developments and drivers in markets for retail investment products

Moderator:

- Peter de PROFT, Director General, EFAMA

Panellists:

- Giuseppe D'AGOSTINO, Director of Intermediaries Division, CONSOB
- Simon FRASER, Chairman, Forum of European Asset Managers and President, Investment Solutions Group, Fidelity investments
- Marcin KAWIŃSKI, Warsaw School of Economics, Insurance Ombudsman Office (Poland) and FIN-USE (Forum of user experts in the area of financial services)
- Mick McATEER, Director, The Financial Inclusion Centre
- Brian REID, Chief Economist, Investment Company Institute, USA

Introduction

The moderator, Peter de PROFT (EFAMA), introduced the panellists and explained that the panel discussion would address three core questions:

- What types of investment products are marketed to retail investors? What are the trends in the markets for these products?
- How well do these products respond to retail investors' needs?
- What are the risks to investors?

What types of investment products are marketed to retail investors? What are the trends in the markets for these products?

Brian REID (ICI) explained that the retail market in the US is dominated by products issued by companies registered with the SEC, such as mutual funds and exchange-traded funds, in which around \$13 trillion are invested. Other products are sold through insurance wrappers: these are regulated by 50 different State insurance supervisors. Structured securities are less well developed than in the EU but the sector, which is supervised by banking regulators, is growing rapidly. In addition, assets held in managed accounts (pools of securities) amount to \$700 billion and some \$2.4

trillion are held in annuities. He added that the US pension market is divided between defined benefit (DB) products - which are usually pools of a wide range of products including but not only mutual funds managed by professional asset managers -; and defined contribution (DC) products organised through individual accounts. This market amounts to \$18 trillion with a relatively even split between DB and DC products.

Simon FRASER (FEAM) observed that household savings in investment funds are smaller in the EU than in the US, despite the increasing need for households to save, for instance, to provide for retirement. The sale of retail investment products in the EU is driven by intermediaries, independent financial advisors (IFAs) in the UK or bancassurance chains in continental Europe. The vast majority of retail investment products are sold through these channels. Product promoters compete to gain access to these channels and pay the distributor remuneration in the form of a commission embedded in the product. He expressed some concern about possible regulatory arbitrage and questioned the relatively high rate of churning. He noted a paradox that the more expensive a product is, the more it is sold.

Marcin KAWIŃSKI (Warsaw School of Economics and FIN-USE) explained that in Poland the most popular retail 'investment' products are bank deposits. This is a reflection of the fact that Polish consumers do not have a long history of investment and are consequently attracted by the perceived security of deposits, for which there is a guarantee granted by the originating bank. This perception is strong even though investors do not know exactly what kind of guarantee is foreseen. He noted that asset allocations by retail investors are volatile due to macro-economic shocks and warned of a risk that investors buy/sell at inappropriate moments. Increasingly, retail investors have access to unit-linked life insurance policies which combine investment and insurance functionality. Their growing popularity is due to easy access to these products and to the preferential tax treatment in Poland. Such investments are bound by contractual obligations; they are more stable than those in

most other investment assets. In addition, Poles invest in unit-linked life insurance, funds or bank deposits through both occupational and individual pension schemes. While occupational schemes are considered to be well regulated in Poland, there are concerns as regards individual pension schemes.

Giuseppe D'AGOSTINO (CONSOB) described the Italian market where banks are the main channel for the sale of retail investment products. Structured securities with capital protection are particularly successful as they appeal to risk averse investors (ca €42 billion in 2007) and are gaining ground on collective investment schemes and unit-linked life insurance products. He suggested that there may be an incentive to sell increasingly complex products in which the distributor's remuneration is embedded in their price. Financial innovation might also be used to create products with similar payoffs but different legal forms, subject to different disciplines (financial insurance products, certificates, formula funds, structured bonds). Regulatory arbitrage is a possible driver. Finally, he noted that since the beginning of the credit turmoil, Italian banks had started to promote retail subordinated notes or certificates, which represent a convenient source of funding for capital constrained banks.

How well do these products respond to retail investor needs?

Mick McATEER (Financial Inclusion Centre and FIN-USE) argued that investor demands are relatively simple: high returns; low risks; and low costs. They want simple products that they can understand. He felt that there were currently too many 'innovative' products which perform similar functions but create an "illusion of choice". He expressed concern that there might be an inverse relationship between product price and quality; the most expensive products might eventually offer the lowest net returns. Finally, he explained that retail investors want transparency and information which is reliable, clear, fair and not misleading. For instance, when promoters or distributors make claims regarding the likely performance of a product, investors want these expectations to be met. He said that investors wanted value

for money but that products were generally too expensive in the EU due to unexploited economies of scale

Simon FRASER said that the retail investment product industry has to deliver on its promises. Retail investors will trust the industry only if it delivers simplicity and transparency. However, too many products fail to deliver on their promises. Innovative products have shifted the fiduciary relationship that characterised investment funds towards the counterparty risk which is a feature of structured securities. The industry should propose simple and easy to use products with appropriate guidance to new savers to help them to engage with savings, notably in view of personal retirement provisions.

Marcin KAWIŃSKI expressed the view that many investors decide to invest in a particular product because this product was heavily promoted to them. In Poland, many investors do not make a distinction between investment funds and unit-linked life insurance products. This might be a source of disappointment if they redeem their unit-linked life insurance contract too early (before two years) and receive nothing back.

Giuseppe D'AGOSTINO observed that structured products are increasingly complex and not easily understandable to sophisticated investors as well. Financial innovation has created capital protected products that are based on highly complex structures. This raises the question of whether investors are equipped to understand these and whether they can trust them. Typically, investors tend to favour capital protected products, although they might not be fully informed about the product risk profile and (implicit) costs. To tackle this issue, the Italian regulator requires that scenarios for possible returns of formula funds, index-linked life insurance contracts and structured securities are disclosed to retail investors. This represents an effort to make these products more transparent. He recalled that a study in Italy had shown that even complex structured products could be explained effectively through some key data on expected pay-off.

What are the risks to investors?

Mick McATEER felt that the biggest risk would be a situation in which citizens failed to save enough in a context where they have to make provision for their own retirement. He illustrated this by referring to the fact that in the UK half of the population do not provide for retirement. One reason for this might be mis-selling scandals and the resultant lack of confidence in the financial industry. A better approach towards investor protection rules (disclosure, conflict of interest) would be the first step in restoring this confidence. Obviously, there is a risk that different regimes for disclosure on costs, conflicts of interest, risks, etc. are not effective enough for certain products. The lack of competition in distribution would allow distributors to recommend products that were the most profitable for them but not necessarily for investors. There might well be a need for a more coherent approach regarding product disclosure. There is also a need to address conflicts of interest along the whole value chain and to ensure that distributors have a sufficient level of professionalism and competence.

Giuseppe D'AGOSTINO cited the consultation launched by the CONSOB two months ago. Although it is still underway, certain observations are emerging. While sales of structured securities are growing in Italy, there remain questions on their transparency, on the valuation of these products and on the suitability procedures/tests performed by distributors. One objective of this consultation would be to make clear to retail investors that structured securities are much more complex than plain vanilla Treasury bonds. He referred also to the work of the Joint Forum on the suitability of "illiquid" products for retail investors. In his view, distributors should make clear to retail investors that early exit from such products would most likely result in capital losses. Financial intermediaries do not apply more robust suitability and disclosure procedures when they offer complex or illiquid products. There is one standard for all retail customers no matter what they buy. Specific cautions are suggested with regard to procedure for the suitability evaluation. The consultation paper highlights the need to stress the

assessment of liquidity risk, with regard both to complexity of the product (fair price problem) and consistency with customer's holding period.

Marcin KAWIŃSKI outlined two concrete examples of conflicts of interest and mis-selling, mainly owing to commission-biased distribution. Thus, in France, sales of unit-linked life insurance have increased following the implementation of MiFID. This suggests that funds may have been increasingly wrapped into unit-linked life insurance policies in order to avoid the application of more stringent MiFID requirements. He noted also that in Poland there are incentive programmes for commercial bank staff that strongly encourage the sale of term deposits ahead of other products. He described this as "systematic" mis-selling, as term deposits might not be suitable for all retail investors in the long term.

Brian REID described the US situation where investment advisers are registered with the regulator and subject to strict professional and suitability standards. In particular, the regulator seeks to ensure that these advisers understand the products that they sell. In the US, financial innovation led to the creation of "qualified" funds which are sold in packaged products and are subject to fewer investment restrictions than mutual funds. However, these are subject to specific transparency requirements with regard to their portfolio. A second example of innovation lies in the emergence of auction rate securities. These do not have any secondary market which exposes retail investors to a serious liquidity risk.

Questions

Dieter PSCHIEDL (Austrian Insurance Association) asked whether panellists agreed that there was a need for more clarity on the kind of guarantee and the way it is backed for guaranteed products, including investment funds that claim to offer guarantees. Marcin KAWIŃSKI and Mick MCATEER agreed with the view that there is a need for more clarity on types of guarantee, on how the guarantee works, what its limits are and how much it costs. It was felt that more light should also be shed on the distinction between a capital guarantee and capital protection.

Oliver WAGNER (German Bank Association), asked whether panellists agreed that MiFID provided many of the regulatory answers to the issues under discussion. Mick MCATEER averred that MiFID would only partially solve the problems and only under certain circumstances. In his view, for example, MiFID does not adequately address the issue of conflicts of interest, as it is limited to requirements of disclosure of such conflicts. He observed that the retail financial system is built on commission-based distributor remuneration. In such a context, there is a need to distinguish the functions, and separate the costs of selling and advice.

Panel 2: Do existing disclosure and point of sale rules deliver adequate levels of retail investor protection?

Moderator:

- Carlo COMPORTI, Secretary General, Committee of European Securities Regulators

Panellists:

- Charles CRONIN, Head, CFA Institute Centre EMEA
- Jean-Baptiste de FRANSSU, Vice President, European Fund and Asset Management Association
- Timothy HAILES, Chairman, Joint Association Committee on Retail Structured Products
- Gérard de la MARTINIÈRE, Vice-President, Comité Européen des Assurances
- Nikolaus NEUNDOERFER, European Derivatives Association
- Guido RAVOET, Secretary General, European Banking Federation

Introduction

Carlo COMPORTI (CESR) began the session by recalling the three pillars of investor protection outlined in the Commissioner's speech: first, the duty of care of product distributors towards their clients; second, the provision of adequate pre-contractual information; and third, the capacity of investors to process this information and to conduct appropriate 'due diligence'. He highlighted challenges in all three areas:

- In product distribution, the scope of execution-only sales must be appropriately defined to avoid undermining duties of care. Inducement rules are not applied in non-MiFID sectors and their application to spread-driven products is as yet unclear. The debate on the optimal architecture of financial distribution remains open.
- Product information requires simplification and there is a need for a level playing field across products. The summary of the securities prospectus and the work on KII in the UCITS context are steps in the right direction. But it is not yet clear whether KII could usefully serve as a benchmark for disclosures in other areas.
- There is a risk of over-reliance on the knowledge and capacity of retail investors to process the information provided to them.

He commented on the role of public authorities, which in some cases exercise *ex ante* control of product design and marketing materials. He flagged the risk that regulatory action in this area could hinder financial innovation.

Panellists were then invited to comment on how the originators and distributors of retail investment products seek to protect retail investors and whether the existing framework of EU rules provides a robust basis for this.

Panel discussion

Charles CRONIN (CFA) emphasised the need for clear disclosures. At a minimum investors should be directly and prominently informed of an investment vehicle's expected returns after charges, the expected risks and the associated charges. He felt that such disclosures for structured securities and unit-linked insurance products were either absent or opaque. He argued that the standard of care afforded to retail clients should be consistent across the board, whether a product is sold directly or through a wrapper. He doubted whether a sufficient standard was currently provided by the minimum harmonisation provisions of the IMD, although he noted that many Member States had added additional safeguards at

national level. His view was that the regulatory environment was ready to raise levels of disclosure and harmonise standards of care to MiFID thresholds across Europe. He expressed scepticism that reputational forces would be sufficient to guarantee the interests of the clients. He felt that the putative KII could provide a useful starting point for greater standardisation of disclosures elsewhere. However, he remained concerned that the value of the KII would be at risk if it catered to the lowest common denominator of investor ability. For the risk is that useful content would be displaced by extensive explanatory narrative.

Jean-Baptiste DE FRANSSU (EFAMA) noted that a wide range of investment propositions compete for retail savings and are packaged in different forms. He advocated a cross-sectoral approach to ensuring a high level of investor protection, with a particular focus on clear and comparable product disclosures and effective point of sale rules. He argued that UCITS offered a high level of investor protection through, *inter alia*, a high level of transparency of risks, costs and investment objectives. This had helped UCITS to become an internationally recognised brand. He added that MiFID had brought about greater transparency at the intermediary level and that the work on KII in the context of the forthcoming UCITS IV proposal would raise standards further.

He argued that the traditional sectoral approach to regulation had resulted in an uneven playing field and significant variations in the level of information provided. He noted that MiFID applied to the sale of funds and structured products but not to other sectors. He saw a clear need for the industry to deliver greater transparency and for greater regulatory consistency. He suggested that improving the provisions on cost disclosure in the Prospectus Directive would be one possible measure. Finally, he called for the development of self-regulatory initiatives across the full range of product types.

G rard DE LA MARTINI RE (CEA) stressed that investors need to know what they buy by receiving tailored information on the product; they need to understand the product through appropriate advice from the distributor; and

then need to decide who to entrust their money to. There is a need to 'keep it simple'. At present in the life insurance sector, 49 pieces of information need to be supplied to comply with EU regulatory requirements. Account must be taken of the level of sophistication of the investor. With regard to distribution disciplines, the key is to ensure that salespeople are appropriately trained and monitored. He also highlighted the importance of stability in the regulatory framework, notwithstanding the ongoing evolution in distribution channels, e.g. the emergence of independent advisors and internet sales. It is not the role of regulators to decide how to structure the industry but rather to adapt regulation as necessary as the industry evolves. He concluded that the market and national regulators were better placed to adapt to such changes.

Tim HAILES (JAC) recalled that MiFID was now in force and was the conclusion of a substantive debate on the distribution of financial instruments. The c now is to make MiFID work. He argued that there is no direct connection between risk and product complexity, since more complex products can deliver lower investment risks through financial engineering. He concurred with the other participants that investors must understand the risks inherent in the products they are sold and must understand the nature of and conditions attached to capital guarantees and capital protection mechanisms. He stressed that there are clear differences between investment funds and structured products and that comparing the two categories is akin to comparing apples and oranges. Structured products typically offer a defined return: investors are informed at the outset how the return will be calculated and when it will be paid out. Investment funds by contrast offer a variable return. There are overlaps between the investment propositions offered by structured products and investment funds but the core distinctions remain. He suggested that growth in the popularity of structured products may be explained by the ease with which investment outcomes and risks are understood. Finally, he concurred with the broad principles set out by the Commissioner, adding that time is needed for MiFID to bed down. An effective partnership between

industry and regulators is needed to make MiFID work.

Nikolaus NEUNDOERFER (EuDerAs) welcomed the Commission's work in this area and agreed that investor confidence must be preserved. In recognition of this, investor protection codes of conduct have been developed in Germany and will shortly be rolled out in other countries. He rejected the notion of 'substitute products', arguing that the features of different products vary and that this should be reflected in tailored regulation. The objective should be equivalence of outcomes for investors, not uniformity of rules. Investment funds are characterised by an ongoing fiduciary relationship between the investor and fund manager, whereas the formula for determining the return on a security is agreed at the point of purchase. Thereafter, the funding of the promise made is the concern of the issuer. He likened this difference to the distinction between a ready-made car purchased from a garage forecourt (retail structured securities) and instructions given to a mechanic to build a car subject to pre-determined specifications (investment funds). He recalled that the sale of structured securities is subject to MiFID, which provides a good basis for investor protection through product disclosure and provisions on conduct of business and inducements.

The moderator then invited panellists to respond to a set of targeted questions on disclosure and distribution practices in their respective sectors.

Guido RAVOET (EBF) emphasised that it is in the core interest of banks to ensure that client confidence in banking products is maintained. Bank staff must understand the products they sell and must be close enough to prospective clients to understand their needs, preferences and risk appetite. Nevertheless, there are black sheep in any industry and so it is necessary to buttress banks' own efforts with a robust set of rules. A potential weak spot might in the current time lie in the relationship between advisors and clients, also due to the internal constraints on the bank in serving multiple clients and the need for improved financial literacy on the part of the client. He considered that MiFID provided a comprehensive,

principles-based framework, which should be considered as the benchmark in this area. The challenge now is to ensure that it is implemented comprehensively. Finally, he noted that any changes in this area must take account of the fragmentation of national markets, in particular differences in national and tax rules.

Jean-Baptiste DE FRANSSU warned that the absence of adequate disclosures for certain products would work against the most transparent products in the market, in particular if investors are unable to appreciate fully the likely performance, costs and risks of the products. He emphasised that he was not opposed to the increasing sophistication of products but was anxious to ensure that the products were properly understood.

Charles CRONIN described the work on KII as a tremendous achievement, which will cover many of the key elements of investor disclosures (investment objectives & strategy, charges, past performance, risk indicators etc.) He is very keen that the risk metric used is historical annualised standard deviation of return. He recognised that some would see this metric as being too technical and drew a parallel with his own purchase of a laptop computer. He did not understand the workings of a computer or the deep meaning of the technical specifications, but knew enough to draw comparative value between computer products. He thought with financial products the same consideration should apply for investors. He was not sure that all facets of 'substitutable' products could be captured on one model of KII but felt that it was worth investigating the possibility.

Guido RAVOET asserted that the sale of structured securities - as well as that of investment funds - was subject to MiFID. He argued that the arguable level playing field problem did not arise from inadequate product disclosures but rather from an excess of prescription in certain sectors. If the objective is to 'level the playing field', this needs not to be achieved through harmonisation at the most prescriptive level. He was sceptical that KII would provide an appropriate benchmark for

disclosures in other sectors due to the differences between products.

Gérard DE LA MARTINIÈRE urged regulators to consider whether regulatory provisions were useful and not to aim for perfect regulation for its own sake. Investor protection requirements should be calibrated to the sophistication of the investor to whom the product is being sold. He questioned whether MiFID was in fact a principles-based regime, given that the provisions were very detailed in certain areas. He argued that the provisions of the IMD fit well the distribution systems typically employed in the insurance sector (tied agents, brokers and bank branches) and recalled that the DG Competition inquiry on professional insurance found no significant examples of conflicts of interest in the sector.

Tim HAILES identified the relationship between the originator and distributor as key to delivering the right investor outcomes. The respective responsibilities of the two parties needed to be well-defined, with the originator ensuring that the distributors receive sufficient product information to be able to understand what they are selling; and the distributor responsible for suitability-testing subsequent sales. He recalled that the JAC had produced two sets of principles in this area (on the originator-distributor and the distributor-investor relationships respectively). He noted that for structured products there is little by way of ongoing disclosure requirements between the issuer and investor but acknowledged that there is more that could be done to clarify information on liquidity in secondary markets should investors wish to sell their investment prior to maturity. With regard to KII-type disclosures, he questioned whether a prescriptive document was required to achieve the regulatory goal. He urged regulators to consider substance over form and pointed out that the market already provided a range of term sheets and key fact documents.

Nikolaus NEUNDOERFER argued that self-regulatory initiatives are of critical importance in this area. In Germany, codes of conduct have been developed by the industry to ensure that the level of disclosure and transparency is consistently high. Compliance with these codes

is monitored by the German Derivative Association and is enforced essentially by peer pressure. A bank that failed to comply with the code would be forced out of the association. He said that the industry were aware of the need for further progress in this area and that work was underway to export German industry codes to other countries represented in the EuDerAs.

Questions

Dieter PSCHIEDL (Austrian Insurance Association) asked whether disclosures regarding the nature and provider of capital guarantees would be improved under KII. Charles CRONIN agreed that this information should be disclosed but did not yet know what the final KII document would contain.

John BARRAS (APCIMS) asked whether the clear separation of advice from sales would help to eliminate potential conflicts of interest in product distribution. Gérard DE LA MARTINIÈRE felt that separation of this sort might be a solution but that it would be extremely hard to implement for all products and distribution channels. He suggested that an increase in the use of written advice would help to ensure that the quality is high. Guido RAVOET pointed out that fewer independent agents operate in the banking than in the insurance sector. He considered that they could have a positive contribution also in the banking sector, but that possible conflicts of interest should be carefully considered. In particular, he doubted whether the 'multi-tied agent' model which is becoming increasingly popular, really provided for independent views since such agents typically end up working very closely with a few providers.

Conclusion

Carlo COMPORTI concluded by recalling that a high level of investor protection is the key to maintaining client relationships. Product disclosure and point of sale disciplines have an essential role to play. Some consider KII to provide an appropriate benchmark for disclosures elsewhere, whereas others stressed that product disclosures do not need to be identical – the substance is more important. The emergence of independent advisors is an important development. Views differ on the

need to level the playing field, with some arguing that sectoral rules are adequate and well attuned to the needs of the particular industries whereas others perceive a strong case for a more cross-sectoral approach. All industry representatives saw a central role for self-regulatory initiatives in delivering the necessary improvements.

Theodor Kockelkoren, Member of the Executive Board, Netherlands Authority for the Financial Markets: how important is a coherent approach to regulation of investment product disclosure and point of sale regulation? A Dutch perspective

Theodor Kockelkoren (Dutch AFM) opened the afternoon session with an account of the situation in the Netherlands. He expressed the AFM's strong belief in the value for companies and consumers of a consistent regulatory approach to the long term savings market. He explained how the Dutch regulatory approach had shifted from a sectoral to a functional approach in 2002, under which the AFM is responsible for conduct of business supervision and the Dutch central bank for prudential supervision.

He then described the effects of uneven regulation in the Netherlands, with regulation in some sectors failing to provide an adequate level of investor protection. He gave three concrete examples of potential investor detriment and the actions that had been taken by the Dutch authorities to mitigate the risks.

- First, 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. As a result of the maximum harmonisation nature of the Prospectus Directive, the Netherlands authorities cannot augment the disclosure requirements through national legislation. The authorities have encouraged the industry to implement effective self-

regulation in this sector and welcome the progress that has been made. However, progress has been slow.

- Second, differences in regulation between life insurance products and mutual funds have caused significant problems. Until recently, transparency of costs and inducements had not been achieved in the insurance sector. Moreover, duty of care obligations were in place in the fund industry, but not in the insurance industry. And 'insurance investment products' benefited from tax advantages that mutual fund investments did not. As a result of these differences, many people were sold insurance products even when the outcome of a mutual fund investment would have been equivalent or better. The lack of cost transparency led in some cases investors to favour insurance-based products due to the tax incentives, even when such benefits were outweighed by other associated costs. The situation has since improved with industry initiatives to increase transparency and the introduction of a more consistent consumer protection regime in 2006. In addition, the tax benefits accruing to insurance investment products have now been extended to mutual fund and simple savings products, under certain conditions. A recent survey indicated that the quality of advice has improved since the introduction of new duty of care and transparency obligations and should improve further once an inducement regime is introduced for insurance products.
- Third, structured products have become popular in the Dutch market due to the existence of capital guarantees and to the significantly lighter regulatory regime compared to mutual funds. According to the industry, it makes lower costs possible and provides for a faster time-to-market. He provided an example of a product for which surveys demonstrated that investors systematically over-estimated the expected returns. The issue here is that based on the information in the product brochure, investors cannot make a realistic assessment of the expected return of the product. The information necessary to make an accurate

assessment of the expected return may have been buried in a lengthy prospectus but in any case an investor could not have been reasonably expected to calculate this accurately.

An AFM report on this topic resulted in the industry establishing a self regulatory code on how to ensure quality and compliance in the product development phase and a number of principles to guide product transparency. The self regulatory code has led to improvements in information providing via advertisements and product brochures but it remains difficult to ensure consistent and comparable information that consumers can understand readily. The Prospectus Directive precludes national legislation to fill this gap.

He argued that, ideally, a Key Information Document that is mandatory across all different sectors should be used. In the Netherlands, a Financial Leaflet must be provided for complex financial products but not securities regulated under the Prospectus Directive. Such leaflets inform customers about what the product is, the level of risk in the product, costs (in nominal and relative terms) and expected returns under three scenarios. The customer is also informed of what happens if he or she terminates the product before the contract ends. The indicators in these leaflets were developed through extensive consumer testing. This allows consumers to understand the key features of the product and to compare products performing similar functions.

He concluded by reiterating that uneven and inadequate regulation had led to negative consequences in the Dutch markets. In some cases, it was possible to remedy these problems and to introduce greater consistency through national measures. This was not possible in all cases, however. Looking forward, he called for continuous attention to be given to the creation of consistent rules across sectors. Where this was not practicable at EU level or where markets were still predominantly national, he called on the Commission to allow national law makers room to deliver consistent cross-sector rules at national level.

Panel 3: Taking stock of existing EU level arrangements: fit for purpose or in need of improvement?

Moderator:

- David WRIGHT, Deputy Director General, DG Internal Market and Services, European Commission

Panellists:

- Giovanni CUCINOTTA, Head of Research Department, ISVAP and Member of Management Board, CEIOPS
- Kerstin af JOCHNICK, Chair, CEBS
- Jiri KROL, Director, Financial Markets Analysis and Development Department, Czech Ministry of Finance
- Dan WATERS, Head of Asset Management Sector, UK FSA
- Eddy WYMEERSCH, Chairman, CESR

Introduction

David WRIGHT moderated the third panel, which considered whether existing EU level rules provided a coherent basis for investor protection across the full suite of retail investment products, or whether further work was needed to bring greater coherence to the regulatory framework. The discussion focused in particular on product disclosures and the management and disclosure of conflicts of interest in distribution chains.

Debate

Dan WATERS (FSA) stressed that regulatory frameworks for retail investment products are a combination of EU and national rules. With the notable exception of UCITS, there is currently no cross-border retail investment market. Retail markets are characterised by local consumer preferences and differences in tax systems. Distribution mechanisms are complex and very different from one country to another. In view of this, national regulators are best placed to remove discrepancies at national level; in the UK, the FSA has acted to level the playing field between products in certain respects, for example with regard to key product information. That said, there are areas where EU rules constrain Member State discretion, for example, the maximum harmonisation provisions of the Prospectus Directive. He saw a

case for tidying up existing EU directives as and when they come up for review.

He saw investor detriment as arising primarily from a lack of consumer confidence and capability in dealing with investment products; and from the misalignment of incentives of the distributors of financial products. The incentives arising from commission bias and sales-driven targets create a distortion that works against the interests of the client. As part of a review of retail distribution under way in the UK, the FSA has advocated higher professional standards for advisers and a move from provider-driven sales decisions to a model in which the intermediary agrees the remuneration level with the client. The review also aims to clarify the distinction between sales and advice.

Giovanni CUCINOTTA (CEIOPS) noted that there may be some confusion in classifying insurance products as investment products, since they often include an insurance component. CEIOPS had undertaken a review earlier this year and found that few members saw problems stemming from an 'unlevel playing field'. Many insurance supervisors felt that the disclosure and conduct of business rules in the Consolidated Life Directive and Insurance Mediation Directive were well-aligned with rules elsewhere. Where there were gaps, he noted that many Member States had already taken action to improve consistency with other sectors.

Kerstin af JOCHNICK (CEBS) suggested that the recent crisis had served to emphasise how important effective disclosures are, since a lack of information has resulted in a crisis of confidence in financial products and a lack of trust in financial institutions. She noted that CEBS had focused predominantly on prudential issues to date but that papers had been produced recently on transparency and the valuation of illiquid assets. The CEBS consultative panel has drawn lessons from the credit turmoil and found that even sophisticated investors were not always as competent as expected. She saw therefore a case for further work on financial education. The three 'Level 3' committees surveyed their members in 2006 on this topic and found that several had acted to enhance cross-sectoral consistency. However,

she felt that national level rules could be needed to compensate for gaps in directives.

Eddy WYMEERSCH (CESR) recalled that mis-selling episodes in the Netherlands and United Kingdom had almost resulted in the failure of the offending banks and therefore there is a clear link between investor protection and financial stability. He explained that the lack of coherence in existing regimes is a result of the historical tendency to treat the banking, securities, insurance sectors separately (an approach to regulation in "pillars"), even in countries where supervision is integrated in a single supervisor. He felt that disclosure on its own not being a sufficient solution, since disclosures are often unreadable as they encompass too much information and the most serious risks are unlikely ever to be disclosed. He considered that conduct of business and conflict of interest rules were important and that at present only MiFID provided an acceptable regime in this regard. He concurred with Dan Waters on the need for distinguishing sales (commission influenced) and advice. He stressed that there was a need to focus on consistent outcomes rather than regulation. Failure to achieve this would result in regulatory arbitrage, as he argued has been seen on a massive scale through the growth of the certificate market.

Jiri KROL (Czech Finance Ministry) considered that the existing regulatory patchwork poses a problem, in terms of i) the competitive consequences of an un-level playing field (e.g. between UCITS and products subject to MiFID on one hand and products not subject to MiFID on the other); ii) genuine risks to investor protection (e.g. it is not acceptable that retail investors buy unsuitable products because they did not read the fine print) and; iii) threats to the development of the single market. The Czech authorities are looking at how to deliver a high and common level of professional competence; to promote similar outcomes in conduct of business regulation; to address the asymmetries of power/information between distributors and investors and to deliver improvements in financial education. He saw a role for public authorities in researching and developing effective product disclosures, notably to improve comparability, and in

ensuring that European rules are effectively transposed and enforced at national level.

David WRIGHT emphasised the importance of cross-sectoral consistency and effective enforcement, noting that there had been a certain 'balkanisation' of sectoral policy making in the Commission. He recalled the need for simplification and clarification of disclosures and for the effective management of conflicts of interest and invited panellists to expand on these issues in their sectors.

Eddy WYMEERSCH agreed that simplicity and accessibility in disclosures were key. He saw a need to ensure that the risks associated with investments were made explicit and that investors should be made aware of the content of the investment portfolio. Notably, he believes that additional work needs to be done on the valuation processes for structured securities. He was sceptical, however, that the KII could be rolled out to other sectors, since it had been developed to fit the specific features of mutual funds.

Dan WATERS argued that the MiFID had made a helpful contribution to improving product transparency, although the rigidity of the Prospectus Directive was rather less helpful. In the UK, MiFID principles had been rolled out to other sectors and product types. He questioned whether MiFID provisions applied to structured term deposits; these are an "unregulated" (banking) product in the UK although there are high level disclosure provisions provided through the banking code. He described the FSA's ongoing analysis of new products entering the market, monitoring of financial promotions and systems for handling complaints from retail investors.

Giovanni CUCINOTTA explained that there were differences in the provisions of MiFID and the IMD in this area, although both incorporate the same principle of 'know your customer'. However, he recognised that the information requirements in the MiFID are broader than those of the IMD. He identified disclosure of chain costs and provisions on conflicts of interest as weaknesses of the IMD regime. However, he argued that the traditional prevalence of tied agents that are subject to stringent professional requirements in insurance

distribution in many countries meant that conflicts of interest were less relevant here than elsewhere.

Jiri KROL concurred that there was a clear need for improvement in the regulation of the sale of unit-linked life insurance products. He explained that the inducements regime in MiFID had had a profound impact on the industry and had been beneficial to them. However, he noted that some Member States had made use of Article 3 to exempt certain intermediaries/sales agents from MiFID. This implies that the regime is applied differently across Member States. The impact of this would need to be analysed in due course.

Eddy WYMEERSCH agreed that the inducements regime had been successful but that there might be a need for CESR to provide more guidance on the implementation of these provisions. A Call for Evidence may be issued in due course on the possible lack of a level playing field resulting from different supervisory interpretations and variation in the approaches taken by firms.

Dan WATERS concurred that there were significant differences between MiFID and the IMD. Eddy WYMEERSCH identified particular problems in insurance distribution in Belgium, where some life insurance products offered portfolios managed by insurance brokers.

Eddy WYMEERSCH recalled that 'guaranteed products' had proved extremely popular following the 'dot com' bust but regretted that the returns on these products had been eaten away by the embedded costs. He stressed the importance of clear explanations of guaranteed and protected products, which make clear who is offering the guarantee and how it is backed.

Dan WATERS noted that guaranteed products had only recently emerged in the UK but agreed that clear descriptions of the nature of the guarantee and any conditions applying were vital. However, he cautioned that there are clear limits to product disclosures as a tool of investor protection, since consumers rarely pay attention to the documents and do not typically display the capability to discern which investments constitute value for money. For instance, many investors do not understand the distinction between capital guarantees and capital

protection. Suitability testing and conflict of interest management rules are thus an essential complement to product disclosures.

Kerstin af JOCHNICK suggested that the uncertainty over whether structured term deposits are currently subject to effective regulation reflects the absence of a clear product definition. She noted that their sale, although not subject to MiFID, is subject to banking codes in some Member States, while other Member States capture them under national legislation. She took note of the concerns expressed by the Czech Finance Ministry in their contribution to the Call for Evidence on retail investment products published by the European Commission.

Jiri KROL stressed that the focus of the debate should be on outcomes. The current silo approach implies that an investor buying a product from a financial conglomerate may face different outcomes in terms of investor protection depending on the legal form of the product. He queried why the MiFID disciplines should not apply to non-MiFID products that do exactly the same thing. He questioned whether appropriate conduct of business rules applied to the sale of structured term deposits.

David WRIGHT spoke of a need for a consistent set of principles applying to all products covering disclosure and conduct of business. He noted the differences in views and did not take a position on whether there were inadequacies in existing regimes. To conclude the discussion, he asked panellists to identify their priorities for further work to remove any gaps or inconsistencies they saw.

Dan WATERS saw a case for rationalising and simplifying the European rulebook but without overlooking fundamental differences between national markets. Regulators should not force local markets to become international, at the risk of sacrificing outcomes for consumers. He saw potential for further Level 3 work in this area but emphasised that national regulators should be allowed to tackle local problems. For instance, concerns about certificates should be addressed by the regulator of countries where these products are prevalent.

Giovanni CUCINOTTA suggested that existing national measures should be analysed

thoroughly to determine whether they deliver the high-level principles outlined in the Commissioner's speech. It could be checked whether a Key Information Document for life insurance products would be advisable and which information could be included in this possible document, taking account nevertheless that additional information requirements may result in overburdened investors. The objective should be simpler and comparable disclosures.

Kerstin af JOCHNICK saw room for improvement in EU legislation and agreed that the principles outlined by the Commissioner should be applied across the board of EU directives for financial services. Good, comparable pre-contractual information for all products is vital. She also advocated intensification of efforts to improve financial education, notably as from school age. The industry should also be invited to adopt a cross-sectoral perspective and to develop coherent industry practices accordingly.

Eddy WYMEERSCH called for a mapping exercise of how existing rules in all the sectors concerned are currently implemented at national level and how national markets differ. He suggested that a case could be made for a high-level directive setting out the core principles for conduct of business, conflicts of interest and disclosure. The Level 2 measures to implement such legislation would however be delicate. These principles should be strictly enforced at national level by regulators, in the form, for instance, of action to redress damages for investors falling victim to a distributor failing to manage a conflict of interest.

Jiri KROL urged regulators to fill the gap in existing regimes and to adopt a more horizontal approach. This should not be limited to investment products but to the full range of financial products and services, including financial advice related to generic financial needs of clients (i.e. savings, mortgages, payments products, etc.). He emphasised the importance of independent and accountable regulators, of robust enforcement and sanctions regimes as well as the need to develop effective out of court dispute settlement systems.

Questions

Vincent DERUDDER (FECIF) pointed out that conflicts of interest are ubiquitous in society and are certainly not confined to financial distribution. Financial intermediaries must be remunerated somehow and even if commissions are prohibited, potential conflicts of interest will remain in the remuneration systems for financial sector employees. Jiri KROL objected that there are many studies that demonstrate the damaging impact of commission bias on the quality of financial distribution. He noted that in saturated markets, commissions paid by product promoters tend to increase to ensure access to distribution channels. However, these higher commissions are borne, in fine, by the consumer.

Andy SMART (Zurich Financial Services) asked why consumer testing had not been mentioned in the discussion and regretted that there were so few consumers involved in the three panels. Giovanni CUCINOTTA and Kerstin of JOCHNICK acknowledged that there is a general lack of effective financial consumer representation in the EU.

Conclusion

In conclusion, David WRIGHT noted that there was a degree of consensus on the major issues, in particular on the relevance of the principles enumerated by the Commissioner. This consensus was qualified, however, by differences of opinion on the adequacy of existing sectoral rules and on where the regulatory impulse for further work to ensure the principles (enumerated by the Commissioner in his speech) are respected should come from. If the broad principles are not respected, the risk is that consumers will lose confidence in retail investment markets and put their savings somewhere else. Once lost, it will be difficult for the industry to win confidence back.

Concluding Remarks by Thierry FRANCO, Chef de Service, Service du financement de l'économie, Direction Générale du Trésor et de la politique économique, Ministère de l'Economie, de l'industrie et de l'emploi, France

Thierry FRANCO began by stressing that the issues at stake are important. Risks to retail investors cannot be underestimated. Challenges for regulators are significant.

He recalled that it is increasingly crucial that individuals make provision for their retirement to supplement state-sponsored regimes. Thus, retail investment products need to match their needs and expectations. Financial industry sectors need to be reliable and trustworthy. A lack of confidence in financial markets and operators could lead to poor allocations of savings in the overall economy.

He then summarised the main lessons from the day's discussions. Most stakeholders agreed that the current frameworks for retail investment products were not yet fully adequate and in certain respects lacked coherence. However, views diverge on the detailed problems and the avenues that should be explored to address them.

He recalled that some had advocated the extension of MiFID to unit-linked life insurance policies, while others complained that the investment restrictions for UCITS created an unacceptable 'uneven playing field' in product constitution rules. Many questioned why the rules for transparency on product features and on distributor remuneration vary from one product type to another one; or even more, why some products are not subject to any such rules at EU level. Many also questioned why requirements regarding conflict of interest management and disclosure are different according to the product nature, when all products are offered to retail investors. Questions also arose as to which distribution model is superior. All these questions must be answered.

However, he stressed that there is a clear need to avoid confusion between products that are different. For instance, indeed unit-linked life insurance policies with very little, or no,

biometric coverage are investment products. Yet, life insurance products with biometric coverage belong to the insurance universe, not to the investment world.

He then asked why European policy makers should take action in this area. It is clear that national authorities in many Member States are already taking steps to address the issues they identify. For instance, in France, the avenue of extending MiFID to unit-linked life insurance distribution is currently being explored. It would be therefore appealing to rely on national authorities' initiatives to tackle these issues. Nevertheless, he felt that this would not be enough, for three reasons.

- First, EU level engagement with the issues identified is needed since the lack of coherence between various European directives for financial services is a barrier to the coherence of national regimes.
- Second, there are indeed national and cultural preferences for some products over others in each Member State. However, similar trends are emerging in all Member States which are indicative of the emergence of a single market for retail investment products. For instance, the "*fonds à promesses*" (structured funds or formula funds) that have been typical in France for many years are now surfacing in the UK and other countries.
- Third, from a more political point of view, Europeans can't be satisfied when national authorities have no choice but to compensate for EU framework deficiencies: we should aim at eliminating EU legislation deficiencies at the EU level.

He then discussed what policy makers should now be expected to do. He argued that we should build on the five principles outlined in the Commissioner's opening remarks. These principles should be refined in co-operation with consumers. Then, we should map the different national regimes for all retail investment products with a view to assessing whether the five principles are incorporated in all regimes for retail investment products. He stressed that application of these principles to all retail investment products did not imply that identical rules are required for all products.

Equivalence of outcomes is an objective worth pursuing, not uniformity of rules.

Finally, he considered the set of policy tools at the disposal of regulators and the need to find a consensus on which will be the most helpful to make the European framework for retail investment products more coherent. He said that there was a need to allow the most recent pieces of legislation to bed in before considering any modifications. Any amendments to existing rules would have to be prepared and scheduled in a clear and transparent way. If all stakeholders, and notably market operators, can anticipate such modifications and be prepared for them, they will accept them better.

He stressed that we must also take care not to hinder the financial innovation which characterises the retail sector. Some have expressed concern that financial innovation may lead to the emergence of more and more complex products that retail investors do not understand. However, if competition between promoters and distributors is fair and takes place on a level playing field; and if distribution channels are professional, financial innovation may play a positive role.

He concluded by observing that the acid test for the robustness of the EU framework would be the next generation of retail investment products to emerge. If we do not need to amend the EU framework to take account of the challenges that such new products may present, we may then say that the existing framework is adequate.

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