MINUTES

OF THE

INDUSTRY WORKSHOP

ON

RETAIL INVESTMENT PRODUCTS

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22ND MAY 2008

TABLE OF CONTENTS

MINUTES OF THE INDUSTRY WORKSHOP ON RETAIL INVESTMENT PRODUCTS 22ND MAY 2008

DG MARKT Services hosted an industry workshop on 22nd May 2008 to discuss the results of the Call for Evidence on Retail Investment Products. The workshop brought together industry experts representing the fund management, banking, insurance, securities and distribution sectors, alongside observers from FIN-USE, CEBS, CESR and CEIOPS. Experts were chosen by associations on the basis of their subject expertise and the views they expressed do not necessarily represent those of their associations. A list of participating associations can be found at the end of these minutes in **Annex 1**.

Opening remarks

David WRIGHT, Deputy Director General, DG MARKT, opened proceedings by underlining the importance of ensuring that retail investors are treated fairly by originators and distributors and are provided with the information necessary to support informed investment decisions. This is essential to mitigate the risk of product mis-selling and to bolster confidence in retail investment markets. He recalled that EU legislation currently imposes different disclosure and distribution rules on the originators and distributors of retail investment products, depending upon the legal form of the product or the distribution channel employed. Such differences need not be a source of investor detriment, provided that the rules, howsoever formulated, embody an adequate and coherent level of investor protection. The question for workshop attendees was whether the existing regulatory framework delivers an adequate level of investor protection across the full suite of retail investment products.

Session 1: Principles of investor protection

DG MARKT Services proposed that discussion of the adequacy of existing regimes could be structured with reference to a set of high-level investor protection principles or benchmarks, drawn from existing standards and legislative sources. See **Annex 2**. These principles should be capable of application to all retail investment products, irrespective of their legal form or of the distribution channel through which they are sold. **These principles were prepared from well-established standards and legislative sources by the DG MARKT Services for the purposes of discussion at the Industry Workshop on Retail Investment Products only. They do not constitute a Commission position of any kind.**

In the first session, attendees were invited to react to these principles and to explain whether they are relevant to their particular industry sector.

- The **European Derivatives Association** stressed that many of the financial institutions present were active in multiple sectors and as such it would be wrong to characterise the current debate as a 'war' between products. There are different kinds of retail investment products, performing complementary functions. While the proposed benchmarks are relevant to the full spectrum of retail investment products, this does not necessarily imply that the same rules should apply to all products. There are fundamental differences between different types of product (e.g. securities represent a contractual obligation; fund management entails a fiduciary obligation to act in the best interests of investors), which require differential regulatory treatment. Rules that are justified for some products cannot be translated to other products (e.g. investment restrictions for funds). They felt that the required level of investor protection could be summarised in two fundamental statements: i) that investors should be supplied with the relevant product information; and ii) that it should be ensured that investors are offered the right product, which encompasses conduct of business, conflict of interest and marketing principles. In some areas, rules in the current framework go beyond the benchmarks identified. Other points addressed by the principles

identified, such as the division of responsibilities between manufacturers and distributors, are new and not covered by existing provisions. The question of who is responsible for product information and the division of responsibility between manufacturer and distributor should be approached with caution since any change in this area would call into question the fundamental architecture of EU legislation. Regarding the notion of "substitute investment products", they noted that a recent Joint Forum paper on customer suitability referred to all investment products in a very wide sense, and stated that some of the proposed principles would make it difficult to limit their application only to "substitute investment products" as defined in the Call for Evidence.

- **EFR** regretted that investor protection regulation is currently fragmented and complex and stressed that simplicity is the key to achieving the right outcome for investors. Enhancing outcomes for retail investors requires a focus on investors' financial literacy, prudential supervision (to protect investors from the failure of producers), enhanced competition; and conduct of business (how to ensure that the product is appropriate for the prospective investor). There is a lack of clarity on how to ensure that products are appropriate for investors in cases where the investor does not ask for the advice of the distributor.

- **EFAMA** broadly agreed with the list of possible benchmarks identified but queried whether there were practical measures of the success of regulation in all sectors. They pointed to disclosures by investment funds that allow for the compilation of 'league tables' of fund products, which in turn drive competition in the market. They asked why such data were not available for structured securities.

- **ISDA** recalled that the Joint Associations Committee (JAC[1]) had produced a set of principles[2], similar to the possible benchmarks identified and hence they were broadly in agreement on the components of a robust investor protection regime. However, the current MiFID regime on inducements is difficult to implement as it stands and would benefit from more clarity and consistent implementation. The best investor protection model would be that of independent advice but it was not clear that investors would wish to pay for this. It should also be noted that EU regimes for retail investment products are broadly satisfactory as shown by the absence of large scale failures to date.

- **ICMA** concurred that there was common ground between the JAC principles and the possible benchmarks identified by the DG MARKT Services. However, care is required in areas where the phrasing of the principles diverges from that in IMD or MiFID.

- **EACB** explained that they represent manufacturers and distributors of the full range of products within the scope of this review. They expressed support for the DG MARKT Services' approach to analysing these issues. However, they felt that MiFID already provided the appropriate benchmark and that it would be damaging to consider superimposing new principles on the existing framework. They highlighted the differences in profile between different product types and regretted that the distinction between primary and secondary markets in retail products had not been made.

- **CEA** broadly welcomed DG MARKT's approach. However, they cautioned that existing frameworks should only be modified if there is clear evidence of significant problems with existing rules. They stressed fundamental structural differences between product types that must be taken into account, for example, the presence of biometric risk coverage in many unit-linked insurance products and the varying investment horizons. **CEA** recalled that MiFID and the

[1] The Joint Associations Committee (JAC) is composed of five trade associations: ESF/SIFMA Europe; ICMA; ISDA; LIBA; and SIFMA.

[2] JAC released in May an exposure draft of '***Structured Products: Principles for Managing the Distributor-Individual Investor Relationship***'. The principles complement those affecting the distribution of structured products to individual investors agreed and released in July 2007 by the same trade association collective, the 10 so-called '***Principles for Managing the Provider-Distributor Relationship***'.

Insurance Mediation Directive (IMD[3]) are both new directives and that, in particular, MiFID had not yet demonstrated its effectiveness. In addition, extensive discussions had taken place in Germany on the reform of insurance contract law, resulting in the adoption of a new approach to product disclosures and conduct of business, which is distinct to that applied to other investment products. They expressed a concern that there are many rules in the EU imposing complex and detailed information requirements, which ultimately make it difficult for a consumer to make an appropriate evaluation of products, understand what is essential for him and make a fully informed choice. For instance, 49 different items of pre-contractual information need to be delivered by the broker to the consumer in case of the sale of unit-linked life insurance contracts at a distance. A user-friendly format to presenting product information should be given consideration.

- **BIPAR** stressed that MiFID and IMD were relatively new pieces of legislation that had not yet been fully tested and as such it would be premature to treat them as 'benchmarks' for investor protection.
- **EFRP** welcomed the focus on the retail investor. They recalled that 2nd (work place) pillar pension schemes and 3rd (individuals) pillar pension products significantly differ from each other and should be considered as two separate markets, the latter of which could be viewed as "retail" whereas the former should be viewed as "wholesale". Each of those markets require and justify a specific approach to consumer protection. Whereas in 2nd pillar pensions the beneficiary's protection is mainly embedded in social & labour law, in '3rd pillar' arrangements one has to rely on the individual consumer protection approach. Although financial education in general deserves more public attention, we should be aware of an acute need for financial education of retail investors (= individual consumers). They questioned whether unit-linked life insurance products and investment funds should be treated as substitutes for each other.
- **EBF** recalled that extensive product and distribution regulation are in place but reiterated that MiFID and IMD are both relatively new directives. They regretted that the current review does not look more at tax treatment, which provides different incentives for consumers. They argued that the product types under review are not identical and therefore it is not abnormal that they are subject to different rules.
- **FECIF** noted that the current framework is demanding and that it is already difficult to comply with all provisions. Industry initiatives should play a greater role. For instance, the division of responsibilities between manufacturers and distributors for product disclosure should be organised by industry-driven initiatives.
- **EAPB** were supportive of possible benchmarks as presented. A distinction should be drawn between products that can be compared and those which can not; a 'one size fits all' approach to the regulation of the sale of all products would not be appropriate.
- **ESF** perceived many of the products under discussion to be complementary rather than 'competing'.
- **FIN-USE** saw a clear need for improvements in the level of investor protection, which currently depends on the nature of the product purchased. For instance, money market funds and bank term deposits or savings accounts are very similar in their economic objectives but subject to different regimes. MiFID applies only to the selling of funds and securities but not to other products. A lack of comparability for retail investors results in an "illusion of choice", despite the proliferation of products. They observed that for investors, differences between products do not really matter. While different products may be perceived as 'competing' to the industry, they are seen as substitutable from an investor perspective.

[3] Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation. The Insurance Mediation Directive (IMD) applies to indirect sales of all insurance products by intermediaries (brokers and tied agents).

In summary, **N. BOHAN** noted that the industry is conscious of the need to scrutinise the current regulatory framework and that attendees were broadly supportive of the approach taken by the DG MARKT Services to investigating these issues. He stressed that the focus of this work is on mitigating risks to consumers associated with product mis-selling, commission bias, hidden costs, etc. and not on product constitution or product approval rules, nor on issues of competitive neutrality brought about by regulatory and tax regimes. Rather than comparing products, the emphasis should be on how they are described and distributed. While there were some differences in terminology, there was general agreement that the products under discussion are offered to retail investors as investment products offering the prospect of a return above the risk-free rate.

He noted that there was recognition that the set of high-level standards for product disclosure and point-of-sale discipline identified represented a good starting point for an analysis of investor protection outcomes. However, product specificities precluded uniformity of regulatory approach and participants saw no grounds for superimposing these principles onto the current framework or modifying legislation to incorporate them directly. The focus should be on the principles to achieve a certain outcome in terms of investment protection, rather than being too prescriptive in the details.

The remaining question is whether the current framework already delivers these standards of investor protection. DG MARKT research shows that there are areas in which we cannot take this for granted.

Session 2: Product Disclosures

DG MARKT Services briefly presented the main results of the call for evidence on product disclosure. The core questions for this session were whether existing regimes and market practices were sufficient to ensure that retail investors are provided with the pre-contractual disclosures necessary to take informed investment decisions and whether the respective responsibilities of manufacturers and distributors are clearly defined.

- **EFR** opened the debate with a strong statement that, as regards product disclosure, less can be more. In the UK, research by the Association of British Insurers has shed some light on what investors understand from product disclosures. It seems that investors do not always make the right choice even when provided with appropriate information. This underscores that consumer-testing is crucial to any regulatory initiative on the content and format of product disclosures.
- **EFAMA** saw the (future) KII[4] for UCITS as a benchmark for all retail products, as it is hoped that it will establish product disclosures that are relevant, timely and presented in a convenient format. They added that all principles regarding product disclosure that are mentioned in the possible benchmarks identified already apply to fund disclosures. They argued that comparable information on product performance should be made available for structured securities. **ESF** suggested that such disclosure of performance in structured securities/funds context would be misleading and therefore inappropriate. EFAMA suggested that we should consider whether there is a case for further standardisation of disclosure requirements and noted that there was no clear measure of costs and performance across Europe for structured notes. For instance, a specific standard of disclosure, which requires a benchmark-type of comparison with a risk free rate, has been introduced by the Italian regulator and proved to be directly understandable by investors.
- The **European Derivatives Association** argued that existing European and national rules provide an appropriate basis for disclosures for structured securities. They were sceptical that all relevant

[4] KII stands for 'key investor information'. It refers to the proposed replacement of the current simplified prospectus for UCITS funds by a new concept, format and content of pre-contractual product disclosure to retail investors. This work was launched by the European Commission, as part of its wider work to revise the UCITS Directive (Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities - 85/611/EEC).

product features could be presented in two pages and in a comparable way or a standardised format for all products. For instance, they argued that a two-page prospectus is not realistic for investment in a structured security, pointing to problems encountered with applying the UCITS Simplified Prospectus to structured funds. They were sceptical regarding the division of responsibility for product disclosures between manufacturers and distributors. For structured products, MiFID states that the distributor is responsible for supplying retail investors with product information. In practice, distributors ask manufacturers for the relevant product information to relay to the end investor. This works well in practice, although it is not part of the EU *acquis*. They also argued that differences in the disclosure of cost between funds and securities stemmed from the different nature of these two product types (funds creating a fiduciary obligation to act in the best interest of investors, structured securities providing for a fixed payout amount without a fiduciary obligation).

- **ISDA** argued that it is the substance, not the form, of the disclosure, that matters. Disclosures of risks and rewards are key. Pre-contractual information is not the end of the story. Investors need ongoing information throughout the lifetime of the investment. They stressed that comparability of disclosures is only desirable for 'like' investments; investor detriment may result if products with very different characteristics are forced to look similar. A key distinction here is between funds with an active investment mandate and securities with a pre-specified pay-off. The JAC principles reaffirm that there must be a partnership between manufacturers (who know the products) and distributors (who know the clients). In practice, these actors agree on who does what; additional regulation is not required here. Structured term deposits present an important issue. Product disclosure for structured term deposits is "unregulated" in many countries and outside the scope of all EU regulations.

- **CEA** explained that, as regards insurance product disclosures, many countries have taken action to enhance product transparency at national level. They noted that European law does not prescribe a standardised format. For instance, in Germany, the reformed contract law imposes a product fiche for all insurance contracts including unit-linked life insurance with key features, costs (what part of the premium goes into costs, what part is actually invested), etc. Costs have to be indicated in € not as a percentage, unlike the MiFID approach (it might however be worth considering to extend this approach to funds as well, i.e. indicate possible cost-scenarios in €). In order to establish comparability with funds (total expense ratio) the German Insurance Association suggested to its members to also indicate the reduction-in-yield. This fiche also provides scenarios of outcomes for investors. In the Netherlands, in response to concerns that unit-linked life insurance products were costly and lacking in transparency for retail investors, an initiative was launched to improve disclosures. A commission was set up to work in this area. In its report the commission recommended insurance companies to provide four models with extensive information to their clients during the lifetime of a unit-linked life insurance contract. Recommendations have been implemented in the meantime. CEA will provide written contributions on selected national approaches in due course.

- **EFPA** recalled that the effect of product disclosures varies according to the level of investor education / financial literacy. To ensure that investors buy appropriate products, more 'qualitative' product disclosures are needed. For instance, information on likely outcomes under different market scenarios would be helpful for structured securities. Such qualitative information would constitute generic advice.

- **FEAM** argued that UCITS is currently the gold standard for disclosure, though weaknesses in the existing Simplified Prospectus disclosures for UCITS had necessitated further work in this area (KII). They agreed with FIN-USE on the need for qualitative, simple and understandable information. However, it cannot be taken for granted that investors receive this information for all products. For instance, structured term deposits are subject in the UK to the Banking Code, which does not provide any disclosure rules, and the robustness of retail structured notes disclosure depends upon the quality of the marketing information. There is no disclosure document which is universal to all retail investment products. We should consider the case for this from a consumer

perspective, as all retail consumers should be certain to receive this information irrespective of which product they decide to invest in.

- **EACB** explained that structured term deposits are a largely regional phenomenon that does not require EU-level involvement. They pointed out that some of the possible benchmarks identified for product disclosure go beyond current regulatory requirements, for example on post-contractual information.
- **EAPB** stated that the current framework for products subject to MiFID works well. They also observed that there is no (universal) definition of structured term deposits.
- **BIPAR**, as insurance intermediary representatives, recalled that IMD establishes the level of information that must be supplied to investors. In cases where insurance products are sold on the basis of advice, a fair analysis must be provided to investors. In practice, proactive cooperation takes place between insurance companies and distributors to ensure that information reaches the end investor. They cautioned that IMD must be given time to work through the national regulatory frameworks that implement it.
- **FECIF** explained that the main duty of intermediaries is to provide and explain product information to prospective retail investors, as 35% of them rely on intermediaries in the EU. Retail investors need to understand: a) what the cost of the investment is; and b) what they receive.
- **FIN-USE** reiterated concerns that product disclosures must be improved in the EU and emphasised that these are serious issues for retail investors. They saw many market failures in this area which warrant further EU involvement. Product information has to be qualitative, understandable, and simple. This is not always the case. For instance, product information on complex products is not seen as sufficiently comprehensible by retail investors. In France, more than 50% of investment funds are held by retail investors within a unit-linked life insurance policy. However, product disclosure rules for unit-linked life insurance are seen as less detailed as for UCITS funds. They perceived clear deficiencies with regard to the disclosure of risks, the total cost of an investment and performance indicators. They saw some weaknesses in product disclosures for structured funds, securities, and structured term deposits. FIN-USE are hopeful that the future KII will improve matters and will serve as a benchmark for product disclosures for all retail products. FIN-USE suggested that investors would be much better off if MiFID applied to all retail investment products.

In summary, **N. BOHAN** noted that industry sectors broadly agreed on the basic disclosures that must be made on a pre-contractual basis. They also agreed that manufacturers and distributors of retail investment products should work in partnership and the respective responsibilities should be clearly established. Pre-contractual information should encompass product and cost key features and should be simple in order to be understandable. However, information is only helpful if retail investors are able to process it, hence financial education has a vital contribution to make to securing the desired outcomes for investors.

A number of initiatives underway may provide useful guidance on the optimal content and structure of disclosures, including the work on KII in the UCITS context and the recent German and Dutch work on unit-linked life insurance disclosures. It appears that work remains to be done in this area on structured securities; here too, for instance, voluntary industry codes may have an important role to play. The disclosures applying to structured term deposits require further investigation.

He concluded that the focus here should be on substance not form and that full comparability of disclosures may not be realistic or desirable. We should however consider whether it is possible to align to a greater extent than it is currently the case the information (and its format) that is provided by distributors. Another area where work remains to be done is that of post-contractual information, notably performance disclosures.

Session 3: Marketing and advertising

DG MARKT Services opened discussion on this item by presenting the main results of the call for evidence on marketing and advertising. The discussion focused on whether the appropriate rules are in place to ensure that products are not mis-sold as a consequence of unfair or misleading marketing communications.

- The **European Derivatives Association** stated that MiFID and PD provide adequate protection from mis-selling and unfair commercial behaviour. In addition, there is in practice a strict control in the form of reputational risk for financial institutions. As a result, distributors usually refer to the manufacturer to elaborate marketing documentation. National regulators are also active in this area. In France, for instance, there is a market place consultation aiming at defining guidelines for manufacturers as regards marketing activity and possibly to harmonise marketing standards across the spectrum of retail investment products. Some regulators have opted for a system of preapproval of campaigns; others have deemed this to be an excessive burden.
- **EACB** argued that product mis-selling is less related to the complexity of investment products than to the existence of high selling fees. Mis-selling may occur instead for products offering the highest fees/remuneration or where the limits of secondary markets are not clearly explained to investors in the primary market.
- **EBF** saw MiFID as a model of regulation of product marketing.
- **EFR** would prefer the possible benchmark on advertising/marketing to be limited to the first sentence in the possible benchmarks indentified: all marketing communications should be fair, clear and not misleading. It was also pointed out that advertising/marketing is only the first point of consumer protection and regulations applicable to other parts of the sales/purchasing process provide further protection.
- **ICMA** added that at national level, for instance in the UK, there are regulatory initiatives in place to ensure that commercial communications are not misleading. Investors should not be blocked from complex products due to the perception of an increased risk of mis-selling, as this would result in investor detriment through a reduction in choice. In practice, manufacturers have strong policies in place to avoid mis-selling of their branded products. They select and educate providers through a 'know your distributor' process. An internal committee is put in place to identify whether a new product can be sold to retail investors; the level of scrutiny here is perhaps higher for complex products. Finally, MiFID is doing a lot to improve the situation. There may be work to be done to reinforce investor protection. However, there are no grounds for redrafting MiFID provisions.
- **CEA** raised the issue of the possible mis-selling of guaranteed funds, when the guarantee is provided by the management company of the fund and is not backed by own funds.
- **EACB** found that not each commercial communication should have to mention where pre-contractual information can be found.
- **FIN-USE** said that the distinction between commercial communications and pre-contractual information is not always clear to retail investors. They saw particular problems with the use of misleading marketing communications for internet-based sales. Inconsistencies in different EU legislation and gaps at national level require more regulatory action and EU involvement in this area.

N. BOHAN concluded that the analysis should not overlook possible risks stemming from misleading marketing communications. All those present agreed that commercial communications are the first point of contact for retail investors and must be clear, fair and not misleading.

Further clarification is required on the allocation of responsibility for commercial communications. Regulators take these issues very seriously, to the extent that national regulatory initiatives can become an obstacle to marketing of some products in some markets.

Information on the nature and the extent of a capital guarantee is an issue which may require further reflection at EU level.

Session 4: Conduct of business

DG MARKT services presented the main results of the call for evidence on conduct of business. The core question in this session was whether existing rules and practices ensure that retail investors are treated fairly when investing in all sectors and through all available distribution channels.

- **BIPAR** reiterated that MiFID provides an adequate level of protection and transparency for all products that are subject to it. The same applies to IMD with respect to insurance products. They reiterated that, since these directives were implemented only recently, it is too early to judge their effects. The results of the questionnaire on IMD implementation conducted by the IMEG of CEIOPS show that initial goals of this directive are being achieved and that conduct of business rules are seen to be as effective as MiFID rules.
- **FECIF** recalled that the only asset of an intermediary is its relationship with clients. There is no incentive to damage reputation by not duly applying full conduct of business discipline.
- **EBF** explained that commercial banks are still implementing the new MiFID rules. This forms a comprehensive (and world-class) framework for the distribution of retail investment products, which has been supplemented in some areas by market initiatives. Internet-based distribution is governed by e-commerce and distance marketing directives.
- **FIN-USE** acknowledged that the rules for conduct of business in IMD are appropriate for insurance products. However, FIN-USE perceive unit-linked life insurance products clearly as investment products, for which MiFID rules would be more appropriate.
- **CEA** noted that IMD is a "minimum harmonisation" directive which does not preclude Member States from imposing more stringent rules where deemed necessary. They explained that, in addition, public and/or market-led initiatives have also been taken where needed at national level or were in the way of being developed in certain other markets – again, time and further experience were needed.
- **EFR** mentioned also voluntary codes in AT and DK and considered that existing sectoral rules provide broadly equivalent protections.
- **EFPA** felt that current legislation in place is sufficient. In addition to consistent MiFID implementation, self-regulation would be the most appropriate approach to tackling any remaining problems (e.g. training of salespersons).
- The **European Derivatives Association** saw MiFID as a coherent regime for structured securities. These are complex products according to MiFID and they cannot be sold on an "execution only" basis. Execution-only is an exception to the dominant model for distribution: i.e. non-advised sales where suitability and appropriateness tests are performed. They called for evidence to be produced demonstrating that existing rules are inadequate and observed that the business practice which prompted the decision of the Norwegian FSA to disallow the sale of structured securities to retail investors was limited to credit-financed securities.
- **BIPAR** argued that initiatives by national regulators in some countries to supplement the conduct of business provisions of EU law in the insurance sector should not be taken to mean that IMD rules are not effective enough. Industry initiatives to complement IMD rules for conduct of

business are seen as a normal way of taking care of clients.

- **FEAM** explained that producers cannot easily assess the adequacy of their products for final retail clients since, unlike the distributors they are not in direct contact with retail investors. Therefore the relationship with intermediaries is vital. Distributors can help product manufacturers to assess product adequacy by providing information on clients.
- **FECIF** added that in practice there are ongoing discussions between producers and distributors taking place in the normal course of their relationship.
- **ESF** added that producers carefully scrutinise how investment products are sold by intermediaries because they are their products and they bear their own brand. Many producers perform due diligence on a distributing institution before using it. An agreement on division of responsibility is signed before the relationship enters into force.
- **ISDA** fully supported these clarifications on how the process operates in practice.
- **FIN-USE** disputed the assessment that IMD rules for conduct of business are broadly equivalent or as effective as those in MiFID. For instance, they do not see equivalent product disclosure rules, rules on suitability testing or rules governing inducement/conflict of interest management in IMD.

In summary, **N BOHAN** noted that there is a need to take stock of the impact of the implementation of MiFID and the IMD and that it would be premature to revisit these directives at this stage. There is a need to identify clearly any gaps in coverage or shortcomings.

Industry participants felt that existing rules provided a minimum level of consumer protection; the basic scenarios as regards duty of care to clients are covered for all retail investment products. The insurance industry and insurance intermediaries made a strong case that IMD represents a sound and satisfactory basis for investor protection. However, this was challenged by consumers. It was proposed that CEA will provide data on the national implementation of IMD provisions, showing that outcomes in terms of customer treatment are broadly satisfactory despite differences in national regimes. N BOHAN noted that the discussion had shed little light on the disciplines applying when products are sold directly by product manufacturers and via the internet. There remains a lack of clarity on the disclosure and distribution rules applying to structured term deposits.

The discussions also underlined the importance of an effective partnership between the originators and distributors of retail investment products. However, these issues are complex. There may be some room for improvement, perhaps by relying on the possible benchmarks identified.

Session 5: Conflicts of interest

After a brief presentation by DG MARKT Services of results of the call for evidence on potential conflicts of interest in retail distribution, the discussion focused on whether the appropriate controls are in place to ensure that the distributors of retail investment products do not subordinate the interests of their clients to their own.

- **FECIF** expressed the view that the disclosure of intermediary remuneration is not relevant. Investors must simply be informed of the total cost of their investment. The client relationship is vital to intermediaries and they would not wish to see it jeopardised by not acting in the best interests of their clients. However, **EFPA** disagreed and saw that transparency on distributor remuneration is an obligation to clients. **FECIF** concluded that they do not see a problem in disclosing the type (who/what remunerates the distributor) rather than the level of remuneration.
- **EBF** added they do not see obvious conflicts of interest. Thus, the results of suitability test for a particular product do not depend on the level of remuneration of the distributor. However, intermediaries put in place practical measures to prevent potential conflicts of interest. For

instance, in Luxembourg, there are "Chinese walls" between the negotiator of fees and salespersons within a distributor.

- **ICMA** explained that the industry has adopted from MiFID implementation a three-step approach to addressing conflicts of interest (inducements) inherent to the commission-based business model (distributors are paid by producers for the product they sell): i) avoiding; ii) managing (when the conflict is unavoidable); and iii) disclosing. MiFID implementation by banks has made them take the issue of inducements very seriously. There are written policies in banks for conflict of interest management. Part of the new product development process is devoted to identifying and disclosing potential conflicts. MiFID is therefore seen as the right framework. However, there is a lack of clarity in some markets about what MiFID requires as regards inducements. Distributors perceive variations in how inducement issues are addressed at national level. Although inducement rules are supposed to be harmonised at EU level, this patchwork of rules complicates the activities of cross-border players. ICMA will provide a list of inconsistencies it sees in MiFID implementation regarding inducement rules. **EFAMA** added that different ways of implementing inducement rules in different Member States creates problems for fund industry players acting on a pan-European basis. **EFAMA** and **ISDA** concurred that CESR could bring some clarifications.
- The **European Derivatives Association** argued that the question of whether a fee-based system (the distributor is remunerated by fees it charges to client for the advice) would be better should - given that the MiFID rules on inducements have just come into force - not be pursued for the time being. They also questioned the justification for, and feasibility of, structural separation of product sourcing and selling, as the current rules do not require distributors to apply an open architecture distribution model in which such a requirement would make sense. They argued that the MiFID rules on conflicts of interest should not be applied to product manufacturers (as opposed to distributors), given the different function of product producers, which in their role as issuers do not perform a regulated activity (at least in most Member States) – and in some cases are not an investment firm or bank - and given that for structured securities this would mean that issuers would be subject to organisational requirements in connection with the issuance, which would be a complete novelty (and deviate from the general concept of investor protection by information on the production side).
- **BIPAR** explained that the commission-based system is well-established. This model remains fair. There are so many intermediaries that investors have a full choice. They expressed concern that issues surrounding the disclosure of intermediary remuneration had already been debated extensively in the context of the IMD, where it was concluded that such disclosures would overburden the investor. These discussions should not be reopened.
- **CEA** explained there are many initiatives under way to address conflicts of interest in life insurance distribution in many countries. In Germany, for instance, customers can receive advice on insurance products for a fee paid to a so-called independent insurance advisor but there is little demand for this in practice. Preparation of the insurance contract law reform led to intense discussions on disclosure of commissions of insurance intermediaries in Germany. Finally, the legislator chose not to impose such disclosure and instead to focus on disclosure of costs and product features.
- **FIN-USE** recognised the added value of distributors and that they need to be remunerated. However, conflicts of interest are inherent to the commission-based business model which is prevalent in the distribution industry in the EU. MiFID does not prevent retrocessions (from producer to distributor) but imposes that they are disclosed as they represent "inducements" for distributors that clients should be aware of. However, IMD does not impose such inducement rules for unit-linked life insurance products.

In conclusion, **N. BOHAN** recalled that the effective management of possible commission bias is crucial. Questions remain to be answered if we want to raise the quality of investor protection across the full spectrum of retail investment products and ensure distributors put client interests first. The

Commission is not questioning commission-based system as a sound business model for future financial services landscape. However, conflicts of interest arise and must be avoided, managed and disclosed.

MiFID provides a body of principles that fund and structured securities industries see as requiring clarification, since there are concerns that different implementations/approaches in Member States create unnecessary hurdles. CESR is keeping such issues under review. The DG MARKT does not envisage adding to MiFID in this respect. Nevertheless, it should be ensured that MiFID-style disciplines apply to all scenarios of retail investment product sales.

As regards unit-linked life insurance products, N BOHAN noted the finding that full disclosure of conflicts of interest may not be the best way to protect retail investors, since they are not well equipped to process such information. However, more information is required from the insurance industry and intermediaries on how possible commission bias arising from inducements is managed in the insurance industry and whether these practices are as robust and effective as those applying to the sale of funds and structured securities.

Concluding remarks

Elemer TERTAK, Director, Financial Institutions, DG MARKT delivered the closing remarks. He thanked all those present for their time and their engagement with these vital issues of investor protection. He recalled that there are significant differences between national markets for retail investment products and that the relative popularity of particular products is influenced not only (or even mainly) by the regulatory regime but also by the tax treatment of particular products, cultural preferences and financial innovation. One important question that will need to be answered is whether the current patchwork of EU legislation in this field distorts market outcomes. He also reiterated the importance of ensuring that the regulatory framework delivers an appropriately high level of product transparency and point of sale discipline, while noting that financial education has a crucial role to play in this regard.

Finally, Mr TERTAK reminded participants that the Commission will organise a high-level Open Hearing on this topic in Brussels on 15th July. Registrations will open on the Commission website shortly. He recalled that the DG MARKT Services would welcome further written contributions from industry participants, particularly in the areas highlighted in the course of the workshop.

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ANNEX 1: List of participants (and abbreviations used for stakeholder names)

BIPAR	European Federation of Insurance Intermediaries
CEA	European insurance and reinsurance federation
EACB	European Association of Co-operative Banks
EAPB	European Association of Public Banks
EBF	European Banking Federation
	European Derivatives Association
EFAMA	European Funds and Asset Management Association
EFPA	European Financial Planning Association
EFR	European Financial Services Round Table
EFRP	European Federation for Retirement Provision
ESBG	European Savings Banks Group
ESF	European Securitisation Forum
FEAM	Forum for European Asset Managers
FECIF	European Federation of Financial Advisers and Financial Intermediaries
ICMA	International Capital Market Association Limited
ISDA	International Swaps and Derivatives Association
FIN-USE	Forum of user experts in the area of financial services
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESR	Committee of European Securities Regulators
	French Permanent Representation to the EU (incoming Presidency)

ANNEX 2: Investor protection principles identified

The principles described below were prepared from well-established standards and legislative sources by the DG MARKT Services for the purposes of discussion at the Industry Workshop on Retail Investment Products only. They do not constitute a Commission position of any kind.

1) Product Disclosures

Retail investors should be able to take investment decisions on an informed basis. To achieve this, a retail investor must be provided with pre-contractual product disclosures that are:

- accurate, clear, fair, not misleading and contain all information that is material to investors' decisions;
- timely, i.e., provided before a contractual agreement is entered into; and
- as far as is reasonably possible, provided in a customer/user-friendly format that facilitates comparison of the features of different investment propositions.

While the precise form and content may vary according to the nature of the specific product, the disclosures should include, where relevant, information on the following:

- key product characteristics (that may vary according to product type), including the possible existence and features of any capital guarantee;
- investment risk;
- performance indicators; and
- direct and indirect costs.

It is the responsibility of the **product manufacturer** to supply this information to the intermediary or, when the product is sold directly, to the end investor in a timely manner and appropriately presented.

It is the responsibility of the **intermediary** to supply this information to the end investor prior to a sale and to supplement the product disclosure with additional disclosure on:

- costs added by the intermediary;
- the service it provides to the end investor as intermediary; and
- potential conflicts of interests (ownership links, monetary and non-monetary inducements) [See section on conflicts of interest].

The **product manufacturer** is also responsible for making relevant **post-contractual** information publicly available on a regular basis, to notify any material changes in the characteristics of the product and to allow the investor to track the evolution of their investment.

2) Advertising and Marketing

All marketing communications should be fair, clear and not misleading and should be clearly identified as commercial communications. They should be consistent with the content of pre-contractual investor disclosures but should be clearly distinguished from them. It should be clearly indicated where pre-contractual disclosures can be found.

3) Conduct of Business

Distributors of investment products – whether product manufacturers themselves or intermediaries – should treat retail investors honestly, fairly and professionally. Irrespective of the distribution channel employed (including distance marketing and internet-based sales) or the legal form of the product sold, distributors should exercise a duty of care towards (act in the best interests of) retail investors.

When products are sold on the basis of **advice** from the intermediary, distributors should ensure that they understand the products they distribute and take all reasonable steps to inform the client of the key characteristics of the product (including through the disclosures described above); to 'know the client' through the collection of all relevant information about the client; and to ensure that the characteristics of the product being sold are consistent with the client's investment needs.

When products are sold **without advice**, the intermediary should take all necessary steps to ensure that the product is appropriate for the investor to whom it is being sold.

These principles should apply not only to the distribution of third-party products but also to direct distribution by product manufacturers.

4) Conflicts of Interest

Manufacturers and distributors of retail investment products should not place their interests above those of their clients. Conflicts of interest in the manufacturing and distribution of retail investment products should be **avoided** where possible.

Where the potential for conflicts arises, manufacturers and distributors should **manage** conflicts so as to minimise the risk of investor detriment. Structural separation of product sourcing and sales functions should be considered as a minimum.

The existence of potential conflicts in product distribution should be **disclosed** to end investors. These disclosures should include all monetary and non-monetary factors liable to influence the advice given by the intermediary, including ownership links with product manufacturers, commission payments, retrocessions and other monetary and non-monetary incentives.

For instance, when a product is distributed through a 'wrapper', remuneration arrangements between the intermediary, the contract provider and the manufacturer of the underlying investment should be disclosed to the end investor.

When a product is distributed directly by a product manufacturer, exclusively or in parallel with the distribution of third-party products, this should be transparent to the end investor.