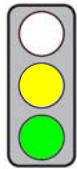


MAIN ISSUES

Objective of the Communication: The Commission wants to thoroughly revise the legal framework for retail investment products. For that purpose, it proposes uniform information duties and selling rules.

Parties Affected: Retail investors; all banks, investment funds and insurance companies, as well as brokers and intermediaries who either issue or distribute „packaged investment products“ for retail investors.



Pros: (1) The proposals announced in the Communication are well suited to correct a distortion of competition deriving from the current state of EU law.

(2) Harmonised information duties and selling rules for all types of investment products make it easier to compare products and thus promote competition.

Cons: Although full harmonization of the EU's rules on investor protection is desirable, the Commission does not clearly speak out in favour of it.

CONTENT

Title

Communication COM(2009) 204 of April 30, 2009, on **Packaged Retail Investment Products**

Brief Summary

► Objective of the Communication

- In the Communication, the Commission spells out how it wants to revise existing EU law on mandatory information for retail investors and the selling of packaged retail investment products and bring it “into line with market reality” (p. 2).
- The Communication concerns retail investment products primarily aimed at capital accumulation that are only indirectly exposed to the risks of the underlying financial assets, and are designed and administered by funds managers, insurance companies, and commercial or investment banks.
- According to the Commission, this group of products includes in particular investment funds, unit-linked life insurance policies, structured securities as well as certificates, structured bonds, warrants, and term deposits. These products are sold both by the issuers and by intermediaries such as brokers or insurance sales agents.

► The current EU legal framework as „a highly fragmented ,regulatory patchwork“

- The Commission is not satisfied with the current EU legal framework for packaged retail investment products. The Commission sees it as “a highly fragmented ,regulatory patchwork“ that “lacks coherence and relevance to the contemporary retail investment marketplace” (p. 6).
- In the Commission's view, the information handed out to retail investors is often too technical. Also, there are no harmonised rules on how to inform investors on the costs, risks and yield of an investment. This makes it more difficult to compare products.
- For the Commission, it is a particular problem that the Market in Financial Instruments Directive (2004/39/EC; “MiFID”) contains detailed rules on incentive payments to brokers as well as on the avoidance of conflicts of interest, whereas the Insurance Mediation Directive (2002/92/EC; “IMD”) contains no comparable rules for investments packaged as insurance policies.
- The Commission criticizes the fact that – depending on their legal form and distribution channel – similar products are subject to different rules. The reason for this is that the respective Directives contain rules related to specific products (such as securities, insurance policies, funds etc.), but also information duties and selling rules applying to several groups of products.

► „Horizontal Approach“

- The Commission wants to “effectively repeal and replace” all relevant product-specific measures by „horizontal“ (cross-cutting) information duties and selling rules (p. 13).
- As a result, all “packaged retail investment products” are to be subject to the same basic rules, irrespective of the legal classification of the product and the distribution channel chosen. The Commission wants to develop a “generic definition” for the term “packaged retail investment products” and publish a positive list (“white list”) of products falling into that category (p. 13).
- Nevertheless, the Commission admits that relevant differences between products should lead to different legal requirements. Such special rules for specific products are to be established by the Commission in cooperation with a committee of national experts (so-called Lamfalussy procedure).

► **„Key investor disclosures“**

- The Commission announces that it wants to propose a legal instrument requiring the highest possible degree of “harmonisation and standardisation” of “key disclosures” to retail investors. These rules are to be binding for all “packaged retail investment products” and for any person selling such products – i.e. both for brokers and intermediaries as well as issuers selling their own products (p. 11).
- These “key investor disclosures” must:
 - be “fair, clear and not misleading” for the target investors who “may have little or no investment experience”,
 - contain “the information necessary to take an informed investment decision”, especially on risks, charges, guarantees and on “how the product works”,
 - be provided to retail investors “in a timely fashion”,
 - be standardised “to the greatest extent possible” so as to facilitate comparisons between products,
 - be as “short and simple” as possible, but contain all key information,
 - be „extensively tested with investors“ to ensure they work as intended, and
 - be clearly distinguishable from marketing communications (p. 11).
- As a model for „key investor disclosures“, the Commission refers to the concept of “key investor information” in its proposal to recast the UCITS Directive 85/611/EEC [COM(2008) 458; see [CEP Policy Brief](#)] as well as to “Standard European Consumer Credit Information” as defined by the Directive on Credit Agreements for Consumers (2008/48/EC) (p. 12).

► **Selling rules**

- The Commission wants the MiFID rules on “best practice” and on conflicts of interest in the distribution of investment products to apply to everyone selling “packaged retail investment products”. This would concern distributors, but also issuers selling their own products.
- The selling rules are to ensure that
 - investors are given a “fair treatment”,
 - the products sold correspond to “the profile and needs of the investor”,
 - retail investors who buy investment products without prior advice are clearly communicated the “limits of the service provided and the risks for the investor”,
 - conflicts of interest relating to sales (both advised and non-advised) are avoided “where possible”, or at least be “identified, managed and disclosed in a way that investors can understand”,
 - investors receive “clear and effective disclosures” of remuneration arrangements and of all charges, commissions or fees to be paid (p. 12).

Changes Compared to the Status Quo

- Up to now, what investor information is mandatory and which selling rules apply depends on whether the product is being sold by an insurance company, an investment fund company, a bank or a broker. Distance sales of investment products under Directive 2002/65/EC on Distance Marketing of Financial Products constitute an exception, for they are already subject to harmonised rules.
- As a rule, under the Commission’s plans, different requirements for different packaged retail investment products are to be phased out. Only in exceptional cases are they to continue to exist. This would mainly affect issuers who distribute their own investment products as well as insurance brokers, who would both be subject to stricter information duties and selling rules than now.
- Up to now, there are no EU rules on structured term deposits.
- Standardised „key investor information“ is already an element of the Commission’s proposal to modify the UCITS Directive 85/611/EEC [COM(2008) 458; see [CEP Policy Brief](#)].

Statement on Subsidiarity

The Commission argues that „weaknesses“ of current EU law cannot be systematically removed by measures of single Member States or industry sectors, since the margin for national measures is limited by EU law. A more coherent EU legislation on information duties and selling practices could facilitate cross-border sales of packaged retail investment products, while uncoordinated national measures might impair the functioning of the internal market.

Political Background

In May 2007, the ECOFIN council asked the Commission to “review the consistency of EU legislation regarding the different types of retail investment products [...] so as to ensure a coherent approach to investor protection” (Press Release 9171/07, 8.05.2007, p. 9).

The Commission is aware that some Member States have already imposed, at national level, „additional requirements on mandatory disclosures and selling practices“ (Communication, p. 8). For example, an Act to improve the enforcement of liability claims based on false advice has been adopted in Germany in July 2009. It requires banks, as of January 2010, to take minutes of all investment counselling interviews and hand out a

copy to customers. Liability claims based on false advice are not subject to a limitation period of three years, as was the case up to now, unless the investor knew or had to know the advice given was false. In all other cases, the limitation period is ten years.

Since national measures are „necessarily limited in their geographical scope“, the Commission argues for a “systematic and coherent” response to the inherent deficiencies by taking „decisive action” at European level. The Commission champions a “horizontal approach” also in consumer protection matters. There, however, it takes the form of full harmonisation, which prevents Member States from introducing rules that are stricter than the uniform EU rules (COM(2008) 614; see [CEP Policy Brief](#)). Whether or not the „horizontal approach” envisaged by the Commission for retail investment products is to lead to full harmonisation does not clearly follow from the Communication.

Options for Influencing the Political Process

Responsible Directorate General:
Public Consultation:

DG Internal Market & Services
The Commission has announced that it will carry out a public consultation before presenting any draft legislation.

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

The Commission is right about removing the distortions of competition in the retail investor market, which are **caused by EU law**, by means of the measures announced in the Communication.

As a matter of fact, there are currently different information duties for essentially identical products, for which there are no sensible reasons. For example, unit-linked life insurance policies are subject to the Insurance Mediation Directive (IMD), although the major share of the customers’ funds flows into investment funds. However, if a retail investor directly puts money into such funds – which compete with unit linked life insurances – the investor information duties follow from the stricter Markets in Financial Instruments Directive (MiFID). From an ordoliberal point of view, the distortion of competition arising out of this discrepancy is not acceptable.

Unjustified differences can also be found in selling rules. For example, under the MiFID, sellers of investment funds must disclose or avoid conflicts of interest under which they operate. Although distributors of insurance policies are in an identical situation when they stand to gain different commission fees from different service providers for the conclusion of a contract, they are not subject to such a duty. Removing this distortion of competition by setting uniform standards of information on intermediaries’ pay and commissions and costs to be borne is thus adequate.

The content of the „white list” will be of essential importance, since it will show exactly which products are subject to the uniform information duties and selling rules, and which are not. In any case, **the Commission should abstain from extending the “white list” to products** that are **typically bought by institutional investors**. Since institutional investors have detailed knowledge in the field, they can negotiate from a stronger position. Thus they do not need the same level of investor protection as retail investors. As far as institutional investors are concerned, the aspirations of the Commission might just increase bureaucratic expenditure without delivering any added value.

Impact on Efficiency and Individual Freedom of Choice

A higher degree of investor protection necessarily causes higher costs, which will have an influence on the distribution of retail investment products. **Direct distribution of retail investment products** – which was only partly covered by EU regulation so far – **could become more expensive. Insurance brokers will also have to deal with substantive adjustment costs** due to the fact that the MiFID selling rules are stricter than the IMD rules. This in turn makes investment products offered by insurances more expensive for retail investors.

The **standardisation of “key investor information”** has a positive influence on efficiency: It makes products more easily comparable and thus **promotes competition**. Although the adjustment costs arising from uniform information duties will be lower than the ones caused by uniform selling rules, it is to be expected that they predominantly affect insurance companies.

The Commission does not clearly state whether the horizontal approach should eventually lead to **full harmonisation of investor information duties and selling rules**. However, some of the Commission’s statements indicate that it is indeed striving for full harmonisation. This would reduce transaction costs resulting from the current state of cross-border distribution of retail investor products, and **should therefore be welcomed**.

Impact on Growth and Employment

Depends on the details of the announced measures.

Impact on Europe as a Business Location

Depends on the details of the announced measures.

Legal Assessment

Legal Competence

A harmonisation of information duties and selling rules for retail investment products would reduce obstacles to cross-border trade and can therefore be based on Art. 95 TEC.

Subsidiarity

Depends on the details of the announced measures.

Proportionality

The Commission misses out on clarifying whether it is striving for partial or full harmonisation of investor protection law in the EU. If the aim is only partial harmonisation, the Member States are free to pursue a higher level of protection than the one laid down in EU law (ECJ, Case No. 120/78, Cassis de Dijon). Conversely, a full harmonisation prevents Member States from adopting new and even maintaining existing stricter consumer protection rules (ECJ, Case No. C-52/00, Commission/France). Since obstacles to cross-border trade with retail investment products can only be reduced if stricter national rules are abolished, a full harmonisation is needed in order to achieve this goal.

Compatibility with EU Law

Depends on the details of the announced measures.

Compatibility with German Law

Depends on the details of the announced measures.

Possible Future EU Action

The Commission has begun to draft legislative proposals, but their publication is to be preceded by a public consultation. A Commission proposal to revise the Insurance Mediation Directive (IMD) is to be expected until the end of 2010.

In line with a June 2009 request from the Council, further Commission initiatives aimed at „adequate regulation“ in the field of retail investment products must be expected.

Conclusion

The announced measures are well suited to remove the existing distortion of competition in the market for packaged retail investment products: Standardised „key investor disclosures“ make different investment products more easily comparable and thus strengthen competition. The Commission should not extend the “white list” of products to which uniform information duties and selling rules are to apply to products typically bought by institutional investors, for the latter do not need any special protection. Stricter requirements for the direct distribution of retail investment products and for insurance brokerage will increase costs, which will make investment products more expensive for retail investors; however, in the interest of the “level playing field” pursued by the Commission, this effect is unavoidable. The Commission does not clearly state whether it is aiming at partial or full harmonisation of EU investor protection law; however, only full harmonisation could effectively remove obstacles in the internal market.