NEED FOR A COHERENT APPROACH TO PRODUCT TRANSPARENCY AND DISTRIBUTION REQUIREMENTS FOR “SUBSTITUTE” RETAIL INVESTMENT PRODUCTS

1. The French Banking Federation (FBF) is the professional body representing over 500 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organisations.

As universal banks, the FBF members are highly interested in the evolution of the legal framework of the substitute investment products, precisely on the current work of DG Markt – G4 on the need for a coherent approach to product transparency and distribution requirements for “substitute” retail investment products.

They are interested as producers, as asset managers, as distributors, and as custodians.

2. As an introduction, the FBF wishes to make two statements:

a) The regulation priority about the European passport:

Since a while now, the financial instruments sold to the retail investors over the European Union are broadly covered by an efficient European passport – the one from the Prospectus Directive for the structured products (warrants, EMTNs, certificates), the one from the Insurance Mediation Directive for the life insurance – except for the Investment Funds as the current UCITS Directive showed an excessive inflexibility.

The priority is not about regulating again or over-regulating the circulation of the structured products or life insurance contracts but to contribute to a real efficiency of Investment Funds’ passport, that is precisely one of the interests of the current reform of the UCITS Directive (the European Commission is supposed to publish its reform project in March 2008).

b) The impertinence of the timing and of the consultation itself:

While the MiFID just came into force and given that no market failure was observed in the distribution of so called substitute products to retail investors, it is not useful to start a work that could lead to new industry standards for distribution concerning all the financial instruments and therefore the timing of this call for evidence is not relevant.
No unequal treatment of financial instruments that could need a specific regulation:

Concerning the distribution of financial instruments, they are all covered by the MiFID, so all the obligations about investment advice and the conduct of business rules are applying to the UCITS and structured products. Moreover, the IMD is imposing similar rules for life insurance contracts.

The only point where regulation produces an unequal treatment of the financial instruments is the transparency on the possible inducements. Indeed, UCITS are covered by the inducements regime of the MiFID, while the structured products are not. They are not because the remuneration is not realised by retrocession but by spreads.

Also, the IMD does include no any particular provision on the transparency of the remunerations for life insurance.

Nevertheless, the FBF reckons that it is not justified to regulate these aspects to the extent that the remuneration by spreads is not an inducement, i.e. incentive remuneration.

Moreover, the transparency on remuneration is an information which does not enhance the protection of retail investors, since the relevant information in this context are:

- the fact that the product provides guarantee on the capital or not,
- the characteristics of the product: short term or long term, equities or monetary underlyings, …

The notion of “substitute products” itself:

The notion of “substitute” products is not an objective one. Products have a number of features, and in their investment decisions investors will look out for some specific product characteristics important to them in their specific situation. Thus, whether or not products are considered as possible substitutes will depend on the investor’s specific situation and needs.
Substitutability should also not be seen in absolute terms, but rather on a scale ranging from no or little substitutability to a high degree of substitutability.

**Question 4:** Which factors in your opinion drive the promotion and sales of particular investment products? In addition to completing the table, we would welcome further explanation of your views as to which factors are particularly important for each product.

The FBF considers that all the aspects suggested do play a role.

Moreover, it is important to underline that the differences between European Union member States in the distribution of the financial instruments to retail investors are likely:

- cultural: risk appetite or not, bank products appetite or financial products appetite;
- social: the development of the financial products with no capital guarantee has always been severely lower in France than in United Kingdom, since the financing of retirements was not an obvious objective for investors until four or five years ago;
- and also at a tax level: however, this aspect is not fundamental as, even in life insurance contracts, it is not systematically the element determining the subscription.

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

This is the case for all products sold under MiFID rules, as distributors have to provide a high degree of transparency and disclosure on the costs and possible outcomes of investment products.

The exact form of these disclosures depends on the characteristics of the product. In particular, the information provided for funds focuses on the cost, whilst it is difficult to make predictions about the future performance of the fund. This is as opposed to structured products that are very transparent on the possible outcome of the investment.

In addition, market standards for cost information to be given for structured products are currently developing in line with the new MiFID requirements. It is our firm expectation that these requirements will indeed be suitable and appropriate to fulfil consumers’ information requirements for a well informed investment choice.

We believe that the insurance industry is best placed to assess the suitability of transparency and disclosure requirements under the IMD.

**Question 6:** Conduct of business rules: Do differences in conduct of business regulation result in tangible differences in the level of care that different types of intermediary (bank, insurance broker, investment advisor/firm) offer to their clients? For which conduct of business rules (know-your-customer, suitability, information/risk warnings) are differences the most pronounced and most likely to result in investor detriment?
Conduct of business aspects have been broadly solved for all products distributed under the MiFID. As regards insurance products, please refer to our comments above.

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

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

The MiFID’s suitability and appropriateness rules govern very clearly the way in which investors are advised on different products and provide at the same time against conflict of interests. As regards insurance products, please refer to our comments above.

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

The MiFID does already provide a horizontal approach, targeted at the point of sale/ distribution chain of products.

The FBF did not identify problems for products that are distributed through the MiFID and believe on the other hand that the MiFID will be an extensive and effective mechanism to consistently ensure that clients are advised the investment product most suitable to them. As regards insurance products, please refer to our comments above.

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

The FBF did not identify major problems and would rather confirm that, where applicable, additional market standards on transparency and disclosure for structured products are currently being developed in line with the MiFID requirements.