

The European Union's Packaged Retail Investment Products Initiative: Recent Developments

Following the publication in March 2011 of a joint response ("the Joint Response") from the UK's Financial Services Authority (the "FSA") and HM Treasury to the European Commission's November 2010 consultation of packaged retail investment products ("PRIPs") (which closed to responses on 31 January 2011), this *DechertOnPoint* reviews in more detail the Commission's proposals, certain related regulatory initiatives and the principal UK responses the Commission has received to its November 2010 consultation on PRIPs to date.

The Joint UK Response

In the Joint Response, the FSA and HM Treasury expressed concern with the proposed legislative approach for the PRIPs initiative. In broad terms, the Commission proposes to introduce into the Insurance Mediation Directive (2002/92/EC) ("the IMD") rules on the sales of PRIPs which are consistent with those in the Markets in Financial Instruments Directive (2004/39/EC) ("MiFID"), whilst separately developing a PRIPs regime for MiFID products. The FSA and HM Treasury believe that this raises a significant risk of discrepancies arising between the IMD and MiFID, which could in turn undermine the consistency of the new selling practices regime which the PRIPs initiative is designed to establish. In particular, they argue that the proposed split approach could lead to the creation of two separately harmonised and distinct selling regimes, which could have a negative impact and reduce clarity for consumers.

In addition, the FSA and HM Treasury believe it would be inappropriate to have a single selling regime covering PRIPs and other insurance products in the IMD. The response therefore

urges the Commission to reconsider its proposed legislative approach and adopt a more consolidated and ambitious approach to avoid continuing sectoral differences and to promote a level playing field between substitutable products.

The FSA and HM Treasury also made a number of specific comments in the response in relation to the questions posed by the Commission in the consultation. In particular they suggested that the Commission further develop the selling practice proposals which are set out in its MiFID review consultation, in order to drive choice and competition and lead to better consumer outcomes.

The November 2010 Consultation

Before considering the industry responses to the Commission's consultation, it is worth noting the principal features of the European Commission's consultation on the legislative steps for PRIPs and the reasons that gave rise to it.

Problems had been identified by the Commission in the EU retail investment

market, including weak and complicated product information, conflicts of interest and fragmented regulation. The Commission originally announced legislative changes to address these problems in an April 2009 Communication on PRIPs. The aim of the November 2010 consultation was to receive feedback on possible ways to deliver its PRIPs initiative.

The consultation itself covered the following three areas:

- **The scope of the PRIPs initiative.** The Commission defined a PRIP as a product where the amount payable to the investor is exposed to fluctuations in the market value of assets or payouts from assets, through a combination or wrapping of those assets, or other mechanisms than a direct holding, and it also discussed potential exceptions to the definition and whether it would be appropriate to develop an indicative list of products which are PRIPs.
- **The legislative approach.** The Commission discussed the use of an “instrument” which would require pre-contractual product disclosure targeted at PRIPs sold in the retail market, which would apply the same broad principles as were developed for the UCITS key investor information (“KII”) documents. The Commission also proposed to use its reviews of the Insurance Mediations Directive (2002/92/EC) (“IMD”) and the Markets in Financial Instruments Directive (2004/39/EC) (“MiFID”) to deliver its PRIPs initiative on sales rules.
- **Product disclosure.** The Commission wished to introduce a PRIPs pre-contractual product disclosure regime and discussed how this should be standardised and what the contents of a disclosure document should contain.

(The Commission had separately published a consultation on its review of the IMD, which it intends should be read alongside its PRIPs consultation.)

A study (dated 29 September 2010) on the costs and benefits of potential changes to distribution rules for insurance products and other non-MiFID PRIPs was published alongside the Commission’s November 2010 consultation.

Other Significant Responses to the Commission’s Consultation

The European Commission made available on 8 March 2011 some of the principal responses it had received to its consultation on PRIPs including those from:

- the British Bankers’ Association (the “BBA”);
- the City of London Law Society (the “CLLS”);
- the European Insurance and Reinsurance Federation (the “CEA”);
- the Joint Response from the FSA and HM Treasury referred to above;
- the Financial Services Consumer Panel (the “FSCP”);
- the Investment Management Association (the “IMA”); and
- the Joint Association Committee on Retail Structured Products (the “JAC”).

Some of those responses are worth examining in more detail.

The BBA’s Response

On 1 February 2011, the BBA published its response to the Commission’s consultation broadly welcoming the Commission’s proposals as a means of implementing a level playing field for the selling and disclosure of PRIPs across the EEA although its response did highlight a number of concerns. Amongst other things, the BBA:

- agreed that MiFID should be extended to cover the advised and non-advised sale only of structured deposits, given their similarity (in terms of risk exposure) to structured investment products, but warned that careful consideration should be given to how this might be achieved and cautioned against the client asset rules’ implications of applying MiFID to structured deposits;
- stated that PRIPs initiative should be limited to packaged investments and not broadened to include all types of investment, arguing that it would be disproportionate to include within the PRIPs’ scope other retail financial products that are not packaged, such as current accounts and savings accounts and plain vanilla equities and bonds (since they are more readily understood by investors);

- agreed that an indicative list of products within PRIPs' scope would be helpful, but suggested that the list is made up of product features rather than a list of individual products;
- supported the proposal to use the UCITS key investor information document ("KIID") as a means of improving product disclosure and assisting the investor's decision-making process, but pointed out that it would expect the PRIPs' KIID to rely more on signposting information, given the limits to the extent to which a common KIID can be developed to cover a wider range of products;
- for advised sales of PRIPs, supported the separation in the KIID of the cost of advice from the cost of the product to properly reflect the true cost of advice to investors;
- believed that although product providers should generally be responsible for preparing the KIID, there should be sufficient flexibility for advisers and distributors to assume responsibility for KIID preparation in certain circumstances; and
- advised against a single risk rating for all PRIPs on the basis that it would be an overly simplistic representation of different risks within the PRIPs' product range and could create misleading comparisons for investors, instead supporting the use of risk statements flagging key risks and directing investors to further disclosure on the nature of those risks.

The CLLS Response

The CLLS published its response on 1 March 2011 and commented on certain legal issues arising from the Commission's proposals. Although it agrees with many of the Commission's proposals, it raised a number of difficulties, including the following:

- The PRIPs initiative should ensure that retail investors are provided with a standardised level of regulatory protections across comparable investment products, regardless of the legal form of such products.
- Clarity is required on the intended scope of the proposed PRIPs definition, which is currently drafted very widely.
- Simple non-structured products should be excluded from the scope of the PRIPs initiative, whereas structured products should be treated as PRIPs.
- The proposed indicative list of products should explicitly indicate products that are

not PRIPs as much as products that are (the CLLS supporting technical standards and guidance to supplement this list). The list and guidance should be drafted widely to avoid products being intentionally developed in a way to avoid being included in the list. The list should be supplemental to the Level 1 legislation only and not used to bring products within the scope of the PRIPs initiative without consultation.

- Future consultations should address the fact that neither the IMD nor MiFID will apply to direct sales by insurance companies of PRIPs unless there is a change in scope of those directives for this purpose.
- To ensure that the standalone key investor information document remains streamlined, the KIID should focus on key information, based on prescriptive requirements on format and content. The KIID should be standardised as much as possible, with the content being tailored to address differences in the information required for different classes or types of PRIP. The CLLS also pointed out that a strictly prescribed length for the KIID, however, may prevent clear information being provided to investors. Other KIID-related issues highlighted include that (i) clarity is required as to when the product manufacturer should produce the KIID, and (ii) production of the KIID should not negate the production of a prospectus directive summary (since the two documents are not interchangeable as they have different objectives).
- More work by the Commission is required to consider the options for costs disclosure.

The CEA Response

On 4 February 2011, the European Insurance and Reinsurance Federation ("CEA") published its [response](#) to the European Commission's November 2010 consultation intended to be read in conjunction with the CEA's response to the Commission's review of the IMD.

The CEA's PRIPs response includes these points of interest:

- The scope of the PRIPs initiative is complex. By way of example, the CEA advised that there are no harmonised life insurance products or unique methods of insurance contract law across the EU. As a result, there can be no "one-size-fits-all" answer to the question of whether a particular traditional life insurance product is to be considered an insurance PRIP.

- The complexity of the PRIPs initiative is increased by the fact that it is taking place in parallel to revision of both the IMD and MiFID and the CEA expected that the outcome of these two reviews will heavily impact on the debate on the scope of PRIPs.
- The CEA considered that in some markets certain deposits can compete with insurance products, and as a result, a consistent approach is necessary to avoid an uneven playing field, although it supported the exclusion of pensions and annuities from the PRIPs initiative.
- The CEA agreed that the KIID should be designed in a user-friendly format to facilitate the decision-making process for consumers. However, it is important that any proposal for a short disclosure document does not come at the expense of the consumer's level of understanding of the product. It should also be possible to adapt the KIID to local consumer needs and product specificities. Too prescriptive an approach would restrict innovation and require a change to EU legislation every time products with new key features are developed.

The Joint Industry Associations' Response

The Joint Associations Committee on Retail Structured Products (the "JAC") published its response to the consultation on 3 February 2011. (The JAC is sponsored by a multiplicity of organisations including the Association for Financial Markets in Europe ("AFME"), the International Capital Market Association ("ICMA"), the Futures and Options Association ("FOA"), the International Swaps and Derivatives Association ("ISDA") and the Italian Association of Financial Intermediaries ("Assosim").

The JAC's response focused on the impact of the proposals on product producers (i.e., firms involved in creating PRIPs) and distributors (i.e., firms which enable investors to acquire or enter into PRIPs). The JAC summarised, with reference to its own members' experience, why a "one-size-fits-all" approach to regulating the PRIPs market will be counter-productive. In particular, it called on the Commission to recognise the following to ensure that any new rules for PRIPs are sufficiently flexible to be applied appropriately to different frameworks. Its main points include:

- **Product diversity.** Any new regulatory structure should take account of the variety of structured investment products available in the EU (often offering similar returns but through different legal structures). The fact

that it does not always follow that an investment product with a complex legal structure will also have a complex risk and reward profile should also be taken into account. The JAC expressed the view that any new rules for PRIPs should not seek to cover every eventuality, and should avoid being overly detailed and prescriptive.

- **Distribution chain diversity.** The Commission should adopt a flexible approach which takes into account the many different channels through which retail investors come to acquire or enter into investment products, and the different roles played by product providers and distributors and the response outlines the role of JAC financial firm members as product producers.
- **Investor responsibility.** Investors should take responsibility for ensuring appropriate outcomes. The JAC pointed out that although this assumption underlies all relevant regimes in this area it is not expressly stated. Any new rules should be subject to an overriding principle that no regime should seek to protect investors who are insufficiently responsible and, as a result, suffer loss.

The IMA's Response

Of particular interest to many of our readers will be the response of the Investment Management Association (the "IMA") published on 1 February 2011.

In its response, the IMA stated that it welcomed the Commission's PRIPs initiative, but the Association was concerned that it has moved away from its original proposal to create an overarching piece of legislation covering all PRIPs, together with product disclosure and selling practices. In the IMA's view, the Commission's proposal to proceed with a number of legislative instruments could give rise to a significant risk of continuing inconsistencies in the requirements as they apply across the different financial sectors to PRIP providers and distributors, and would not be in the interests of retail consumers.

The IMA broadly supported the scope of the Commission's proposed definition of PRIPs, and argued that a wide definition which focuses on the economic function of the product rather than its legal structure will protect retail consumers. In this respect, it considers that personal pensions and annuities (in particular, variable annuities) should also be in its scope since in the eyes of retail consumers, and in terms of their economic effect, they are PRIPs.

The European Commission's Announcement on PRIPs in November 2010

It is also worth noting that on 19 November 2010, the European Commission published a summary record of the 72nd meeting of the European Securities Committee held on 9 November 2010, at which it provided information on future Commission legislative initiatives. In relation to PRIPs the Commission announced that it intends to publish three separate further consultations on PRIPs:

- a consultation on product transparency rules and the scope of the PRIPs initiative;
- a consultation on sales rules, in the context of the MiFID review, which will relate to MiFID products, and is expected in Q2 of 2011; and

- a consultation on sales rules, in the context of the review of the IMD, which will consider applying MiFID-style rules on conflicts of interest and conduct of business to insurance-based PRIPs, which is expected in Q4 of 2011.

(The two consultations on sales rules will also address non-PRIPs issues).

These consultations are now eagerly awaited by PRIPs providers and marketers alike.

■ ■ ■

This update was written by Martin Day (+44 20 7184 7564; martin.day@dechert.com).

Practice group contacts

For more information, please contact the author, one of the attorneys listed, or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/financial_services.

If you would like to receive any of our other *DechertOnPoints*, please [click here](#).

Karen L. Anderberg
London
+44 20 7184 7313
karen.anderberg@dechert.com

John Gordon
London
+44 20 7184 7524
john.gordon@dechert.com

Declan O'Sullivan
Dublin
+353 1 436 8510
declan.osullivan@dechert.com

Peter D. Astleford
London
+44 20 7184 7860
peter.astleford@dechert.com

Andrew Hougie
London
+44 20 7184 7373
andrew.hougie@dechert.com

Achim Pütz
Munich
+49 89 21 21 63 34
achim.puetz@dechert.com

Gus Black
London
+44 20 7184 7380
gus.black@dechert.com

Angelo Lercara
Munich
+49 89 21 21 63 22
angelo.lercara@dechert.com

Marc Seimetz
Luxembourg
+352 45 62 62 23
marc.seimetz@dechert.com

Martin Day
London
+44 20 7184 7565
martin.day@dechert.com

Angelyn Lim
Hong Kong
+852 3518 4718
angelyn.lim@dechert.com

Hans Stamm
Munich
+49 89 21 21 63 42
hans.stamm@dechert.com

Peter Draper
London
+44 20 7184 7614
peter.draper@dechert.com

Stuart Martin
London
+44 20 7184 7542
stuart.martin@dechert.com

James M. Waddington
London
+44 20 7184 7645
james.waddington@dechert.com

Olivier Dumas
Paris
+33 1 57 57 80 09
olivier.dumas@dechert.com

Michelle Moran
Dublin
+353 1 436 8511
michelle.moran@dechert.com

Jennifer Wood
London
+44 20 7184 7403
jennifer.wood@dechert.com

Richard Frase
London
+44 20 7184 7692
richard.frase@dechert.com

Antonios Nezeritis
Luxembourg
+352 45 62 62 27
antonios.nezeritis@dechert.com

Dechert internationally is a combination of limited liability partnerships and other entities registered in different jurisdictions. Dechert has more than 800 qualified lawyers and 700 staff members in its offices in Belgium, China, France, Germany, Hong Kong, Ireland, Luxembourg, Russia, the UK, and the US.

Dechert LLP is a limited liability partnership registered in England & Wales (Registered No. OC306029) and is regulated by the Solicitors Regulation Authority. The registered address is 160 Queen Victoria Street, London EC4V 4QQ, UK.

A list of names of the members of Dechert LLP (who are referred to as "partners") is available for inspection at the above address. The partners are solicitors or registered foreign lawyers. The use of the term "partners" should not be construed as indicating that the members of Dechert LLP are carrying on business in partnership for the purpose of the Partnership Act 1890.

Dechert (Paris) LLP is a limited liability partnership registered in England and Wales (Registered No. OC332363), governed by the Solicitors Regulation Authority, and registered with the French Bar pursuant to Directive 98/5/CE. A list of the names of the members of Dechert (Paris) LLP (who are solicitors or registered foreign lawyers) is available for inspection at our Paris office at 32 rue de Monceau, 75008 Paris, France, and at our registered office at 160 Queen Victoria Street, London, EC4V 4QQ, UK.

Dechert in Hong Kong is a Hong Kong partnership regulated by the Law Society of Hong Kong.

This document is a basic summary of legal issues. It should not be relied upon as an authoritative statement of the law. You should obtain detailed legal advice before taking action. This publication, provided by Dechert LLP as a general informational service, may be considered attorney advertising in some jurisdictions. Prior results do not guarantee a similar outcome.

Dechert in Ireland is an Irish partnership regulated by the Law Society of Ireland.

© 2011 Dechert LLP. Reproduction of items from this document is permitted provided you clearly acknowledge Dechert LLP as the source.

EUROPE Brussels • Dublin • London • Luxembourg • Moscow • Munich • Paris • **U.S.** Austin
Boston • Charlotte • Hartford • Los Angeles • New York • Orange County • Philadelphia
Princeton • San Francisco • Silicon Valley • Washington, D.C. • **ASIA** Beijing • Hong Kong