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EACB Answer to the Commission Call for evidence on "Substitute Retail Investment Products"

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The **European Association of Co-operative Banks** (EACB) is the voice of co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 members and co-operative banks in general. With 60,000 outlets and 4,500 banks, co-operative banks – which are privately owned entities- are widely represented throughout the enlarged European Union and play a major role in the financial and economic system. In Europe, one out of two banks is a co-operative. Co-operative banks have a long tradition in serving 140 million customers, mainly consumers, retailers and SMEs. Quantitatively, co-operative banks in Europe represent 47 millions members, 730,000 employees with a total average market share of about 20%.

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Introduction

The EACB welcomes the Commission Call for evidence regarding the need for a coherent approach to product transparency and distribution requirements for substitute retail investment products. Co-operative banks are characterised by a strong retail base and a decentralised network of branches. They provide their customers with a large variety of investment products and therefore have to comply with a number of different EU rules depending on the products they sell (funds, securities, unit-linked insurance...). As a result, they are directly faced with the situation outlined by the Commission in relation to the level playing field between investment products.

Before answering the specific questions of the Call for evidence, the EACB would like to make the following general remarks:

- First, it is important to recall that the existence of **a great variety of investment products in Europe is a good thing** which supports consumer choice and innovation. Although it entails a certain level of complexity, this diversity enables financial institutions to provide consumers with tailored-made answers to their financial needs. This diversity also reflects local history and preferences in terms of product set-up (influenced by factors such as the structure of the national pension system, tax regime, etc.). Consequently, the EACB believes that **a European harmonisation of transparency and/or distribution requirements for all retail financial products should be avoided as it is likely to result in a standardisation of the offer, meaning less choice and innovation, without bringing substantial benefits.**
- Second, it must be recognised that **there is already a very high level of transparency** provided to investors for most retail financial products. Harmonised investment funds, which are among the most successful retail investment products in Europe, are already very transparent and should not be over-regulated compared to other investment products. Indeed, adding more stringent requirements such as excessively detailed fee disclosures would give alternative products an unfair advantage without increasing investor protection. In general, the EACB believes that **retail investors need clear and easy-to-understand information rather than too detailed and complex disclosures.** Co-operative banks have a genuine interest in improving investor information and actively support initiatives in this direction. Based on their daily interactions with customers, they attempt to provide the highest quality and the most adequate level of information to potential investors. For instance, the EACB has welcomed the planned replacement of the UCITS simplified prospectus by the more flexible concept of "Key Investment Information".
- Third, **as far as the distribution of investment products is concerned, the EACB considers that the MiFID already provides comprehensive and harmonised rules at European level.** Provisions on suitability, inducements, conflicts of interests, apply to most retail investment products Europe-wide including funds and securities (equities, bonds, certificates...). In a world of increasingly diversified and complex financial products, the role of investment advice is key. This is why co-operative banks believe that the proper implementation of the MiFID provisions on investment advice and suitability are much more important to ensure that retail investors are offered adequate financial solutions than any potential standardisation of product rules across the asset management, insurance and banking sectors.

- Finally, the EACB believes that **a distinction must be made between product regulation and the rules governing intermediaries/distributors of investment products.**

On the one hand, investment products are often conceived by specialised entities within banking groups (asset management, insurance, etc.). This is why product regulation makes sense when it applies to the actual elaboration of investment products.

On the other hand, the distribution of investment products often occurs in the local branch of co-operative banks. Because they usually offer a multiplicity of products (funds, securities, insurance...), horizontal rules such as the MiFID provisions on investment advice can be seen as appropriate to ensure some coherence in the way investments are sold to consumers. As far as co-operative banks are concerned, investment products are usually elaborated centrally (in the relevant specialised house) whereas they are sold via decentralised networks. This means that, unlike the central institutions which specialise in one type of product, co-operative branches focus their resources on a client-approach, adopting as much as possible a single set of procedures for a large variety of products in order to give more choice to consumers.

The European Commission should take this reality into account in its reflection on 'substitute products'. To be both business- and consumer-friendly, **financial markets regulations should maintain a balance between producers and distributors of investment products.**

1. Scope of the review

Question 1: Do you see that different regulatory treatment of substitute products gives rise to significant problems? Please explain why you consider this to be the case.

Although the existence of different rules for different investment products can have some downsides (e.g. complexity and sometimes lack of comparability for investors, high compliance costs for banks which offer a full range of investment products), the EACB thinks that these differences do not give rise to any market failure.

Indeed, the various existing EU directives (sometimes complemented by national rules) already provide for a high level of consumer protection and require issuers of investment products as well as intermediaries to ensure that retail customers are provided with appropriate and comprehensive information on their investments.

Although the MiFID does not apply to insurance products, it has a broad scope and contains harmonised rules for the distribution of most retail investment products.

As for product transparency, the EACB believes that existing EU rules require the provision of detailed-enough information to retail clients. Furthermore, in practice, it is doubtful that different transparency rules have a major influence over investor choice. Many other parameters such as the return/risk combination, the investment horizon and the tax treatment are used by investors to determine which products and strategies are best suited to their needs.



Question 2: Do you regard the perceived concerns relating to different levels of product transparency and intermediary regulation as a significant threat to the further development of EU markets for retail investment products?

☐ *strongly agree* ☐ *somewhat agree* ☐ *no opinion* ☒ *somewhat disagree* ☐ *strongly disagree*

The EACB acknowledges that the playing field between the different types of retail investment products is not entirely the same. But the different regulatory treatment of the products listed in Question 3 has some legal and financial justifications, for instance due to the nature of issuer and the level of protection against losses.

Thus, co-operative banks see no major concern in the identified differences and do not believe that there exists a 'significant threat' to the further development of the EU market in retail investment products.

Question 3: Is it appropriate to regard different retail investment products as substitutable - regardless of the legal form in which they are placed on the market? Which of the products listed below should be considered as substitute investment products?

- UCITS funds	<input type="checkbox"/> <i>yes</i> <input type="checkbox"/> <i>no</i>
- nationally regulated retail funds	<input type="checkbox"/> <i>yes</i> <input type="checkbox"/> <i>no</i>
- exchange traded or listed funds	<input type="checkbox"/> <i>yes</i> <input type="checkbox"/> <i>no</i>
- unit-linked life insurance (especially which mortality risk level is small or nil)	<input type="checkbox"/> <i>yes</i> <input type="checkbox"/> <i>no</i>
- retail tranches of structured notes	<input type="checkbox"/> <i>yes</i> <input type="checkbox"/> <i>no</i>
- some annuities	<input type="checkbox"/> <i>yes</i> <input type="checkbox"/> <i>no</i>
- some bank term deposits (e.g. with embedded optionality or structured deposits)	<input type="checkbox"/> <i>yes</i> <input type="checkbox"/> <i>no</i>
- others ... (please list and describe)	<input type="checkbox"/> <i>yes</i> <input type="checkbox"/> <i>no</i>

The EACB finds it difficult to determine which of the products in the above table should be included in the Commission review since their 'substitutability' often remains questionable.

What are the features/functionalities (holding period, exposure to financial/other risk, capital protection, diversification) that lead you to regard them as interchangeable? Have you encountered any legal or other definition which would encompass the range of 'substitute investment products'?

Although the features of the above-listed products might differ, the reason why they can be considered as potential 'substitutes' is because they sometimes serve the same *purpose* from the viewpoint of investors (e.g. capital accumulation over the medium term) and because their *risk profile* might be relatively similar. For instance, an investor wishing to invest in the German DAX index might hesitate between an actively managed fund which uses the DAX as benchmark for its performance and an exchange-traded-fund (ETF) replicating the performance of the DAX.

However, in a number of cases, the financial outcome, but also the legal implications of investing in these products, will be fundamentally different. The concept of 'substitute products' is therefore highly disputable. For instance, the underlying logic behind a life insurance is very different from that of a structured note or an ETF because life insurance products include biometric risk.



Even if investors sometimes hesitate between a bond and a fixed income fund or between a unit-linked insurance and a UCITS fund, the different regulatory regimes in place for each type of product reflect the substantial differences in the product features.

Question 4: Which factors in your opinion drive the promotion and sales of particular investment products? Please use the table below to rank these factors in terms of importance (very significant; significant; no opinion; insignificant) for each of the different products. In addition to completing the table, we would welcome further explanation of your view as to which factors are particularly important for each product.

In the case of unit-linked insurance and annuities, fiscal aspects are clearly very significant since national law tends to grant policy holders a favourable tax treatment. In general, the tax regime is a key differentiator between products and remains non-harmonised across Europe for private as well as institutional investments in all kinds of assets.

In the case of non-harmonised funds, the success of products such as real estate funds in certain EU countries and their relative weakness in others seems to suggest that these products reflect cultural preferences as well as the level of innovation in the local market.

Financial innovation has been driving the development of certificates which, in countries like Germany, Austria and Portugal, have been successfully sold to retail investors.

2. Is there a risk of investor detriment?

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?

Please use the attached tables to provide your evaluation of the adequacy of the information provided with regard to the following items for each category of investment product.

The EACB takes notes of the statement of the European Commission that “ongoing work on simple cost and performance disclosures for UCITS may serve as a starting point for comparable disclosures for other products”. The new concept of Key Investment Information (KII) put forward by the European Commission in relation to the review of the UCITS directive seems to be a step in the right direction as far as investment funds are concerned.

Regarding the idea of a possible extension of the KII to other products than UCITS, the EACB believes that such an extension is currently premature:

- First, it is necessary to wait until the KII has been implemented for some time before any KII-type of document can be considered for other retail investment products;
- Second, since retail investment products are not fully substitutable, the KII cannot in any case be extended as such to other products than funds.



Besides, it is important to understand that the issues identified by the call for evidence are not caused by a lack of investor protection. Rather than requiring more information to be disclosed to investors, the Commission should aim at tackling the lack of coherence between the various requirements imposed on investment products by EU legislation.

Finally, it must be stressed that disclosures should aim at making consumers responsible for their choices and that the role of investment advice remains an indispensable complement to pre-contractual product information for most retail clients.

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?

Since the MiFID contains relatively detailed conduct of business rules, issues mostly arise between investment products which are covered by the MiFID and investment products which are not (e.g. unit-linked insurance which are covered by the Insurance Mediation Directive).

However, the EACB does not think that differences in conduct of business rules can be seen in themselves a source of investor detriment since the level of care provided by co-operative banks to their customers (KYC, information and advice) is comparable and based on existing civil law obligations, whatever investments customers hold in their portfolios.

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.

The MiFID rules for managing conflicts of interests (especially articles 21 to 23 of the MiFID Implementing Directive 2006/73/EC) contain detailed safeguards to ensure that each investment firm puts the interests of its customers first (conflicts of interests policy). Related information obligations are also far-reaching: before the provision of investment services, investment firms must inform retail clients about their conflicts of interests' policy as per article 30(1) of the MiFID Implementing Directive. Besides, if its organisational or administrative arrangements aimed at managing conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, an investment firm must clearly disclose the general nature and/or sources of conflicts of interest to clients before undertaking business on their behalf (article 18 (2) of the MiFID).

The rules on 'inducements' (art.26 of MiFID Implementing Directive) complement these provisions and ensure that agreements on payments made or benefits provided to investment firms by producers (or vice-versa) do not distort the selling process.

Besides, the suitability and appropriateness tests introduced by the MiFID now ensure that clients are offered investment products which truly suit their needs.



Finally, the EACB does not think that banks have any incentives to 'push for' and promote non-MiFID products in order to avoid the MiFID requirements, especially because of the rules on investment advice.

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 the mis-selling of the different types of investment product resulting from unfair marketing/misleading advertising?"

No comments.

3. Is there a need for action?

***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?***

According to the EACB, the MiFID rules already provide for a horizontal approach in the field of securities. It is therefore essential to evaluate the impact of the MiFID on overall product transparency and distribution before any proposal is made to extend these rules to (or to elaborate similar rules on) other investment products.

In any case, a harmonisation of rules for disclosures and distribution across products is neither necessary nor desirable as it would almost certainly result in disproportionate costs and a reduction in innovation and choice caused by a standardisation of the products on offer. Competition between the different product segments must be preserved.

***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/or 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? Please explain.***

As mentioned in the answer to Question 1, the EACB does not think that the different regulatory treatment of retail investment products leads to a market failure. Thus, there is absolutely no need for regulatory action.

Although the EACB generally favours self-regulatory solutions, joint industry initiatives are seen as a way to tackle problems which result from deficiencies in the existing legislation. As far as the market for retail investment products is concerned, co-operative banks believe that a proper implementation of recent directives and existing rules for the distribution and transparency of retail investment products will be the best answer to concerns over a not-so-level playing field between categories of products. As stressed earlier in this paper, new rules, whether regulatory or self-regulatory, are unlikely to



benefit consumers and the industry if they result in adding new requirements on top of the already complex sectoral provisions. The EACB therefore believes that a self-regulatory initiative in the field of retail investment products is not necessary.

That said, the EACB stands ready to pursue the dialogue with the Commission on competing products. Rather than envisaging regulatory action, the discussion should focus on the ways all existing EU directives regulating retail investment products can be made compatible with each other. Indeed, some clarifications can be brought to the existing rules, for instance regarding the overlap between MiFID and UCITS rules for investment funds. The EACB recalls the ECOFIN Council Conclusions of 8 May 2007 insisting on the need for coherence between the MiFID and UCITS rules and believes that investment firms and consumers would benefit from increased coherence rather than from new rules.

Conclusion

In conclusion, **the EACB sees no need for regulation or self-regulation** in relation to product transparency and distribution of retail investment products. This is because the existence of a different regulatory regime for these products does not lead to a market failure.

Existing EU and national legislation already contain detailed rules and it is clear that the complexity and lack of comparability between 'substitute products' can best be tackled by the provision of high-quality investment advice and the performance of suitability tests, practices which are already implemented by all co-operative banks in the framework of the MiFID.

The focus of the European Commission should be to promote a consistent implementation of the MiFID throughout the EU if its main concern is to ensure that retail investors are offered with suitable financial solutions. Any reflection on substitute investment products should include an analysis of consequences of the MiFID as a prerequisite.

Contact:

The EACB trusts that its comments will be taken into account by the European Commission in its Communication on the subject to be issued in the autumn of 2008.

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