EACB position on the consultation by the Commission Services on Packaged Retail Investment Products (PRIPs)

31 January 2011

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eurocoopbanks.coop • e-mail : secretariat@eurocoopbanks.coop

General remarks

The European Association of Co-operative Banks (EACB) would like to thank the European Commission for the publication of its thoughts on legislative steps for the "Packaged Retail Investment Products" (PRIPs) initiative.

European co-operative banks are characterized by a decentralized network of branches with a very strong retail base serving approximately 160 million retail clients in the European Union. Co-operative banks are therefore amongst the major distributors of a large variety of retail investment products.

The EACB supports the efforts of the Commission that aim to establish a legal framework for selling practices to retail clients as already specified in the Markets in Financial Instruments Directive (MiFID). We share the goal of more efficient selling practices in order to enhance investor protection. We furthermore welcome the envisaged introduction of a level playing field concerning the rules for the sale and disclosure requirements for different types of retail products.

We would like to emphasize our view on different aspects suggested by the Commission in its paper. With respect to the scope of the initiative it is crucial to underline that simple non-structured deposits should be out of scope. We urge for a differentiated treatment of structured deposits that takes into account special features of – for instance – capital-guaranteed deposits. We welcome the differentiated view of the Commission of the added value but also of the limits of harmonized pre-contractual disclosures (KIIDs). Since a "one-size-fits-all"-approach is not possible due to the huge divergence between the singles PRIPs we welcome that – as a first step – only broad principles should be elaborated while detailed disclosure requirements will be ring-fenced at a later state for different classes of PRIPs.

You can find our detailed comments on the individual questions outlined in the consultation paper below.

Scope of the PRIPs Regime

Q. 1: Should the PRIPs initiative focus on packaged investments? Please justify or explain your answer.

We fully share the view of the European Commission that only packaged investment products should be in scope of the PRIPs-initiative. The element of packaging might result in an additional layer of complexity which might be difficult to understand for retail investors.

A different approach (i.e. including each and every product sold to retail clients) would make no sense as a wide range of legislations (MiFID, Prospectus Directive, UCITS, etc.) already deal with investment products as such, deciding on the degree of pre-contractual disclosures and rules on sales depending on its different characteristics.

There is no need for any further legislation on instruments that are not packaged. In this light we welcome the acknowledgement of the Commission that pure derivatives in retail business like – for instance – interest rate swaps or foreign exchange swaps are neither wrapped nor packaged and therefore excluded from the PRIPs-scope.

Q. 2: Should a definition of PRIPs focus on fluctuations in investment values? Please justify or explain your answer.

We would like to clarify that not every fluctuation is of the same nature and range. As a matter of fact, capital guaranteed products (where the fluctuations cannot be negative and hence do not lead to any capital loss) should be granted a special simplified regime (please see our answer to question 5).

Q. 3: Does a reference to indirectness of exposure capture the 'packaging' of investments? Please justify or explain your answer.

A reference to "indirectness of exposure" is not sufficient to deliver legal or even conceptual clarity. On the contrary, such a criterion would include derivatives which should be out of scope.

Q. 4: Do you think it is necessary to explicitly clarify that the definition applies to fluctuations in 'reference values' more generally, given some financial products provide payouts that do not appear to be linked to specific or tangible assets themselves, e.g. payouts linked to certain financial indices, the rate of inflation, or the overall value of a fund or business?

Yes, we would welcome an explicit clarification, otherwise the definition included in the proposed solution risks being too narrow and in fact could leave out of the scope products that are linked to assets that may not have a liquid and widely known "market value", which have by nature a higher degree of "complexity".

Products that link their returns to benchmark interest rate indices like – for instance – floating rate notes with EURIBOR + X, should clearly be excluded from the PRIPs-initiative since there is no element of packaging. This should be clearly stated in the definition of a PRIP.

Q. 5: Do you have any other comments on the proposed definition? If you consider it ineffective in some regard, please provide alternatives and explain your rationale in relation to the criteria for a successful definition outlined above.

We regret that the Commission did not choose the capital guarantee as a criterion for excluding financial instruments from the scope of the PRIPs initiative. From our perspective products with a capital guarantee or a guaranteed return should be subject to a different treatment. Those products do not have additional layers of risk and the fluctuations in the market value are very limited.

Clarifying the definition: Possible Exceptions

Deposits

Q. 6: Should simple (non-structured) deposits be excluded from the scope of the initiative? Please justify or explain your answer.

Yes, deposits with a "simple" interest – whether fixed or variable – should not be touched by the PRIPs initiative. Deposits are non-negotiable and represent neither risky nor packaged or wrapped products. They are not exposed to fluctuations in the market value of other assets. Banks that provide saving accounts are strictly regulated and the savings are protected by deposit guarantee schemes. Deposits are well known in functioning to retail customers since decades and do not require the same disclosure obligation as securities or insurances.

Q. 7: Do you consider option 1 or option 2 preferable for achieving this? Please explain your preference, and set out an alternative if necessary, with supporting evidence.

It is of crucial importance to outline a clear distinction between simple and structured deposits. An alignment with the directive on Deposit Guarantee Schemes is desirable.

We are not sure of what is meant by the second point in Option 2 ('its principal is only repayable at par under a particular guarantee or agreement provided by the credit institution or a third party').

If this sentence excludes from the scope of PRIPs those deposits whose capital-guarantee derives from the deposit guarantee schemes of member states, we agree on option 2, because we believe that deposits (structured and non-structured) within the deposit guarantee schemes do have a different nature that deserves a special treatment.

On the other hand, if in the end structured deposits are to be included in the PRIPs initiative, we strongly argue for a different and lighter treatment that takes into consideration the special features of capital-guaranteed deposits in the European Union. In addition to their financial safety and long-standing client awareness, they represent the backbone of the European financial system, providing most of the financing to the economy – individuals and SMEs –, which is channeled through credit institutions that are first interested in assuring the best client protection and understanding of the deposits issued by themselves.

Q. 8: Should such an exclusion be extended to financial instruments which might raise similar issues as deposits (e.g. bonds), and if so, how might these be defined? Please justify or explain your answer.

Bonds with a "simple" interest – whether fixed or variable –, and that do not embed any derivative, should be out of the scope of PRIPs as they just offer a direct exposure to interest rates and, as such, do not package structured exposures to market or reference values.

Pensions

Q. 9: Should pensions be explicitly excluded from the PRIPs initiative at this stage? Please justify or explain your answer.

The EACB does not wish to comment on the pensions-related questions in detail. We note however that there are large divergences in the regulation of pension systems at national level which will require thorough consideration. Nevertheless, there are important level playing field considerations in respect of the treatment of pension products and care must be taken to ensure that pension products are generally subject to a comparable set of regulation, as regards substance and level of detail.

Q. 10: Should annuities be treated in the same fashion? Again, please justify or explain your answer.

We have no comment.

Q. 11: Do you have any comments on the proposed manner of achieving this exclusion?

We have no comment.

Q. 12: Do you agree that variable annuities might need to be treated as a special case? If so, how should these be defined, and how do you think they should be addressed?

We have no comment.

Clarifying the definition: Use of indicative lists of products

Q. 13: Do you see benefits from such an indicative list being developed? If not, please provide alternative proposals and evidence for why these might be effective.

Yes. The Commission is taking careful steps to develop the PRIPs initiative. One of its pillars is defining the scope, analyzing different exposures and vehicles. Once such assessment has been carried out, we believe that for the sake of legal certainty, such a list would be very useful. In addition, and in spite of ongoing product innovation, we believe that the concepts and criteria outlined by the Commission will lead to a stable list of PRIPs. We also would like to stress that not every product within the PRIPs initiative should end being given the same degree of disclosures and sale rules.

We would call for an elaboration of such a list at level 3. This would be a flexible and pragmatic approach that would provide sufficient legal certainty to market participants. MiFID – where such a list of financial instruments can be found in its Annex I – could serve as a benchmark.

Q. 14: Do you have any suggestions on the possible contents for such a list, including on how to define items placed on the list?

We would opt for different categories of products, rather than a list of individual products. It should be considered to design a list that contains both products to which the PRIPs regime would apply and products excluded from the scope. This list may enhance legal certainty, but should on the other hand not stifle product innovation.

Legislative approach to be taken in delivering the PRIPs regime

Q. 15: Should direct sales of UCITS be covered by means of including the relevant rules within the UCITS framework?

EACB generally support that the direct sales of UCITS be subject to the same rules as the sale of UCITS through intermediaries. It is important to ensure a level playing field in this respect. The EACB does not however have a preference for the legal vehicle to deliver this outcome.

Q. 16: Do you have any comments on the identified pros and cons of this approach, and any evidence on the scale and nature of impacts (costs as well as benefits)?

We have no further comments in this respect.

A new pre-contractual product disclosure instrument

Principles underlying the design of the regime

Q. 17: Should the design of the KIID be focused on delivering on the objective of aiding retail investment decision making? If you disagree, please justify or explain your answer.

We fully share the Commission's view that the design of the KIID should focus on delivering on the objective of aiding retail investment decision making. Pre-contractual disclosure should help investors making informed investment decisions. It should focus on concise key information which is actually understandable for the investor. The format as well as the language used should be investor friendly and contain only key points relevant for retail clients. We very much welcome the idea of an attached explicit exclusion of the civil liability. This will ensure that the KIID will not become overburdened by barely comprehensive legal materials. Because of its own importance, it should have its own bullet point at the end of the KIID.

Q. 18: Should the KIID should be a separate or 'stand alone' document compared with other information that might be necessary, e.g. background information, other disclosures, or contractual information? Please justify or explain your answer.

There is one clear distinction that needs to be made. The KIID is one aspect of many to improve the information base of the investment decision. Other building blocks in this respect are the prospectus, information brochure and – more generally – financial education. The usage – for instance – of marketing tools alongside the KIID shall still be possible. The KIID may be part of a broader marketing document, albeit as a separate section. In this respect we strongly call for a clarification of the relation between the KIID and the summary under the Prospectus Directive (PD). From our perspective there should be no parallel existence of a summary under the PD and the KIID. The KIID should be part of the usual investment advice as a source of information prior to the signature of a contract. Using the KIID should be restricted to this purpose and not be diversified into other purposes like – for instance – some kind of reporting material after an investment has been made.

Q. 19: What measures do you think will be necessary to ensure KIID remain streamlined and focused solely on key information?

We welcome the outlines of the Commission that the KIID should not be overburdened with information which is not relevant for the investment decision of retail clients. The KIID shall be a standard document reflecting the features and legal forms of a product. Due to the horizontal approach of the PRIPs initiative very different types of products will fall within the scope of the legislation. It is therefore of vital importance that the future PRIPs-KIID regime will be a flexible one rendering a fair view of the different classes of PRIPs. With a rigid streamlining this would not be feasible.

Level of standardisation

Q. 20: While the same broad principles should be applied to all PRIPs, should detailed implementations of some of these principles be tailored for different types of PRIP? Please justify or explain your answer, and provide examples, where relevant, of the kinds of tailoring you might envisage.

We welcome the acknowledgement of the Commission that a "one size fits all"-approach is not feasible with respect of designing equal pre-contractual product disclosure instruments for all PRIPs. The KIID was developed as a bespoke solution for Europe-wide standardized collective investments (UCITS) and many aspects of it may not apply for other PRIPs. We therefore welcome the Commission proposal that – in a first step – only broad principles should be elaborated for all PRIPs, while detailed disclosure requirements will be ring-fenced at a later stage for different classes of PRIPs.

The "general requirements sitting at level 1" outlined by the Commission are certainly a good starting point for discussions. We strongly advocate to follow the very transparent approach chosen by the European institutions for the development of the UCITS KIID in terms of a solid preparation, consumer testing and elaborate market consultations.

Q. 21: Do you foresee any difficulties in requiring the KIID to always follow the same broad structure (sequence of items, labelling of items)? Please justify or explain your answer.

In principal we agree that the same broad structure should be followed for a KIID. However, any rigid blue-print would incur the danger of no longer rendering a true and fair view of the product differences. The standard PRIPs-KIID needs to be as flexible as possible.

Q. 22: Do you foresee any difficulties in requiring certain parts of the key information and its presentation (e.g. on costs, performance, risks, and guarantees) to be standardised and consistent as possible, irrespective of tailoring otherwise allowed? Please justify or explain your answer.

With such a variety of different products in scope of the same initiative it is clear that a harmonized KIID is only possible on a very generic level with a narrative description of the product, the producer, risk and reward profiles, liquidity and costs. Any further harmonization is barely possible without standardizing the products themselves. Information should not be over simplifying, especially with respect to synthetic risk and reward indicators that might indicate a low risk profile giving the impression of a very safe product, although there are still risks associated to it. We therefore object the use of such indicators and opt for narrative descriptions.

Q. 23: Can you provide examples and evidence of the costs and benefits from your experience that might be expected from greater standardisation of the presentation and content in the KIID?

We have no comment.

Q. 24: Should the content of the KIID be controlled so that there is no possibility for firms to add additional information unless expressly allowed for?

We are against any prior approval procedures by competent authorities and object a rigid regulatory KIID-model.

Content of PRIPs KIIDs

Q. 25: Do you foresee and difficulties in applying these broad principles to the KIID for all PRIPs, as the building blocks on content and format for a 'level 1' instrument? Please justify or explain your answer.

No, it should be feasible to apply broad principles to the KIID for all PRIPs.

However, the EACB expects that there are limits to the requested use of "plain language". Whilst agreeing that the KIIDs should seek to describe products in the most straight-forward way possible, we note that questions of financial investments are in themselves complex, implying the need to refer to some complex notions. Avoiding such terms would mean to fail to accurately describe the products and would evoke liability concerns, notwithstanding the clarification of the limited liability that may at all be attached to the KIIDs.

The requirement to keep products up to date should only apply to products that are offered on a continuous basis. As the KIIDs are pre-contractual documents, it would not be appropriate to require their updating once that distribution has taken place and no new products are offered.

Furthermore, the EACB understands that the objective that the investor can "rely on the KIID without reference to other information" is meant to indicate that the information provided in the KIID can be read and understood without reference to additional information. We would like to point out in this context that it must nevertheless be cleary understood that the KIIDs only provide a very limited amount of information and that only the full documentation is meant to describe the product in a comprehensive way.

Q. 26: Are there any other broad principles that should be considered on content and format?

It will prove to be impracticable to include all principles mentioned on page 18 of the consultation document in a two-pager that enables an average investor to make an informed decision on the PRIP.

Allocation of responsibilities for production of KII

Q. 27: Should product manufacturers be made generally responsible for preparing a IID? Please justify or explain your answer.

Yes, the responsibility for the production of a KIID should be placed solely on the product manufacturer. Only these institutions have all necessary in-depth knowledge about a product and are therefore able to elaborate properly a KIID. The entity distributing a PRIP should be responsible for the adequate application of all provisions related to the selling of a PRIP to retail customers at the point of sale. We therefore welcome the approach chosen by the Commission to place the clear responsibility for the preparation of information on the manufacturer.
Especially, when it concerns exchange traded products or in case of distance selling it is impracticable to comply with a duty to actively provide the KIID. Therefore it is crucial that it would suffice that the manufacturer of the KIID makes the KIID available on its website.

Q. 28: Are you aware of any problems that might arise in the distribution of particular products should responsibilities for producing the KIID be solely placed on the product manufacturer?

There might be problems in cases where the distributor materially modifies a product. In this case it is clear that the manufacturer cannot be liable for changes he is not aware of. The distributor should be responsible to give the accurate information if there is any additional risk or cost.

The EACB underlines that as a result of the fact that the KIIDs are provided by the product manufacturers and will be used in a range of distribution models, it will not be possible to include distribution costs. Rather, distribution costs are subject to separate disclosure and information requirements, notably pursuant to MiFID but also other pieces of regulation. The same is true for custody costs, where these vary by distribution channel.

Furthermore, we would invite the Commission to clarify the situation where a product manufacturer is located outside the EU, and to clarify in particular that such a situation could not lead to impose the responsibility for the KIID on the distributor.

Q. 29: If intermediaries or distributors might be permitted to prepare the documents in some cases, how would these cases be defined?

Where the intermediary is product manufacturer and distributor at the same time, than it should be this entity to be responsible for the preparation of the KIID.

Labelling and enhanced transparency of PRIPs in relation to socially responsible investments

Q. 30: What detailed steps might be taken to improve the transparency of the social and environmental impacts of investments in the KIID for PRIPs?

Although it might be valuable to include a special hint in the KIID in case of socially responsible investments, a special regulation in this respect seems to be too far reaching at this stage.

Q. 31: How might greater comparability and consistency in product labeling be addressed?

We do not believe that special rules are necessary in this respect.

Interaction with and amendments to existing legislation

Q. 32: Should the summary prospectus be replaced by the KIID for PRIPs? Please outline the benefits and disadvantages you see with respect to such an approach.

Yes, the summary prospectus should be replaced by the KIID for PRIPs. A parallel coexistence of summary under the PD and PRIPs KIID does not makes sense, since both documents will contain substantially identical information and will be targeted at the same client group.

Q. 33: Should Solvency II disclosures provided prior to the investment decision be replaced by the KIID for PRIPs? Please outline the benefits and disadvantages you see with respect to such an approach.

We have no comment.

Q. 34: Do you agree with the suggested approach for UCITS KIIDs?

We fully agree with the suggested approach concerning the UCITS KIID and appreciate that the Commission does not envisage any changes to the content of the UCITS KIID framework. Possible adjustments might be tackled within the context of post-implementation work.

Q. 35: Are there any disclosures, e.g. required by the existing regimes, which you believe the PRIPs KIID should not include, but which should still be disclosed, e.g. separately to the KIID? Do you have any practical examples for such elements?

We are not aware of any further disclosures the PRIPs KIID should not include.

Issues to be addressed by developing appropriate implementing measures

Risks

Q. 36: What in your view will be the main challenges that will need to be addressed if a single risk rating approach is to work for all PRIPs?

As outlined by the Commission the broad principle of encouraging comparability and transparency in relation to risk information is central to addressing information asymmetries in the retail markets. We fully share this view. However the approach chosen for the UCITS KIID – a graphical presentation by means of scaling the investment risk from 1 to 7 – should not be applied to all PRIPs. Such a presentation leads to an over simplification of the investment decision on the part of the retail investor. From our perspective the risk aspects of a PRIP should be presented in an exclusively narrative way, with the special emphasis on features like a capital guarantee, difficulties in obtaining liquidity, etc.

Q. 37: Do you consider there are any other techniques that might be used to help retail investors compare risks?

As outlined in our answer to question 36, we are in favor of a purely narrative approach.

Costs

Q. 38: What in your view will be the main challenges that will need to be addressed in developing common cost metrics for PRIPs?

The problem here is that most of the fees coming from structured products are embedded in the structure itself, and it is very difficult to assess these costs, that are usually shared between the producer and the distributor. It is even possible that the producer does hedge these exposures neither fully nor at the same point of time, making it therefore very difficult to give concrete numbers on product costs. Moreover, PRIPs embed, by nature, structures that are not easy to value and hence to calculate the respective prices and costs.

Q. 39: How can retail investors be aided in making 'value for money' comparisons between different PRIPs?

We have no comment.

Performance

Q. 40: Do you consider that performance information should always be included in a KIID?

We have no comment.

Q. 41: What in your view will be the main challenges that will need to be addressed in ensuring performance information can be compared between different PRIPs?

It will be difficult to have suitable performance scenarios for both initial public offerings (IPOs) and for structured products that feature a payout profile which has been firmly fixed in advance. For IPOs a presentation of the past performance is not possible. A fictitious retrospective calculation is certainly possible. It has – however – only a limited sense. We consider it as difficult to rule out the danger of misunderstandings. The same applies to structured securities and deposits with a formula-based payout profile. Also here the meaningfulness of disclosures of performance based on historical data appears problematic.

Guarantees

Q. 42: Do you agree that a consistent approach to the description of guarantees and capital protection in the KIID should be sought, e.g. through detailed implementing measures, for different PRIPs?

Yes. However, we believe that the main message to be stated to clients is whether the product is capital-guaranteed, which extent has this guarantee and which firm is responsible for the guarantee so that the client can easily know which credit risk she/he is assuming.

Q. 43: What information should be provided to retail investors on the cost of guarantees?

We have no comment.

Contact:

The EACB trusts that its comments will be taken into account. For further information or questions on this paper, please contact:

Ms Marieke VAN BERKEL, Head of Consumer Affairs, Payments and Financial Markets
(vanberkel@eurocoopbanks.coop)
Mr Alessandro SCHWARZ, Senior Adviser Financial Markets
(a.schwarz@eurocoopbanks.coop)