European Commission – DG Markt, G4

by electronic mail: markt-consult-substiprod@ec.europa.eu

Friday, 18th January, 2008

Dear Sir/Madam,

We welcome the Commission's invitation to express our views on the opportunity and need for a harmonised legal framework regarding product transparency and distribution requirements for 'substitute' retail investment products.

Executive Summary

The Joint Associations Committee (JAC)[1] is grateful for the opportunity to respond to the commission's call for evidence on the need for a coherent approach to product transparency and distribution requirements for "substitute" retail investment products. The JAC was formed to address the issues which arise out of the retail distribution of structured returns, and for most members this issue arises predominantly in the field of retail distribution of structured securities. Many members also distribute structured returns through structured funds, and almost all provide structures to insurance companies and other investors which may be repackaged into retail products. The committee therefore does not focus exclusively on one product type. However, it is felt that whereas the commission is likely to be provided with information from other sources on fund and insurance products, it is useful for the JAC to provide information as regards securities. This response therefore focuses on the issues which arise out of the sale of structured securities to retail investors.

Regulatory harmonization – and, in particular, the elimination of unjustified discrepancies – is, in principle, a worthy objective. However, harmonization of itself is not a sufficient reason to change things. In particular, where different regulatory

[1] The JAC is sponsored by: European Securitisation Forum (**ESF**), International Capital Market Association (**ICMA**), International Swaps and Derivatives Association (**ISDA**), London Investment Banking Association (**LIBA**) and Securities Industry and Financial Markets Association (**SIFMA**). Fuller descriptions of the associations appear within Appendix 3. In the first instance, any queries may be addressed to rmetcalfe@isda.org

mechanisms applied to different products deliver broadly similar outcomes, this is a sign that regulatory differentiation is effective. In this context harmonization would impose significant costs, be of limited benefit to investors, and would create avoidable regulatory costs for both the financial services industry generally and consumers. We do not perceive that there are significant opportunities for arbitrage between the different regulatory approaches.

If harmonization is considered to be desirable, we believe that any harmonizing measures should be applied as regards the application of suitability and appropriateness obligations arising in the distribution process rather than the imposition of restrictions on products. In this respect the model provided by the Markets in Financial Instruments Directive appears to us to be the best adapted to the creation of a "product-blind" regulatory structure. However, we note that the imposition of such a structure would result in the creation of competitive inequalities between providers of the various types of products considered in the call for evidence, and we believe that even this would represent a sub-optimal approach as against our preferred option of no regulatory change.

Key Concepts

Product Regulation is where the nature, structure or economics of a product is directly restricted by regulation. Product regulation is generally aimed at ensuring that products structured within the regulations will be fit for public distribution without restriction. Product regulation may sometimes operate as a seal of approval (as with UCITS, where non-UCITS compliant mutual funds may be established).

Distribution Regulation is where the way in which a product (or range of products) is sold is restricted by regulation. The basis of distribution regulation is generally to impose on a product distributor an obligation to satisfy itself that any such product being distributed is suitable or appropriate for the person buying it. Distribution regulation is generally aimed at enabling investors to access the widest range of investment products subject to appropriate safeguards. Distribution regulation is usually either partially or fully disapplied where the product distributed is subject to product regulation.

Know your Distributor is the process whereby a product provider assesses the knowledge, ability and sophistication of a distributor. The aim of KYD is for a product provider to determine which of its products a particular distributor is equipped to assess in order for it to provide advice on suitability to its clients.

Know your Provider is the process whereby a product distributor assesses the capability and sophistication of a product provider. The aim of KYP is for a product distributor to determine which of the products of a particular provider are likely to be suitable or appropriate for the investment strategies of its clients.

Defined Return A defined return product is a product which specifies to the investor exactly what he will receive at a future time. The return may be either absolute (A% per annum for B years) or determined (A% of the increase in the X index over B years).

Variable Return A variable return product is a product in which the investor puts his faith in the services a manager (or other mechanism) to produce returns over time. The manager does not enter into a binding commitment to produce any specified return, although he may set out a non-binding target.

European versus National Regulation in Retail Products

European retail financial markets differ significantly between each other. The causes of these differences are multifarious, ranging from different national tax and legal situations through to different cultural preferences for investment styles and vehicles. More importantly, some of these drivers for these differing investment preferences are rational, whilst others are not. It is reasonably well known that investors take a long time to respond to regulatory changes introduced in their interests, and sometimes do not do so at all. It seems to us that it follows from this that individual national regulators must play a more significant role in the regulation of retail products than may be necessary in other areas of financial regulation. Not only are national regulators best placed to understand and respond to developments in their local markets, they are also best placed to judge the type of regulatory intervention most likely to be effective in addressing a particular local market issue. Thus, effective regulation in this area must leave scope for national regulators to act in their local markets. Conversely, the imposition of Europe-wide regulation at a detailed level, if not precisely calibrated, could result in significant customer detriment in some national markets. Put simply, we doubt whether it would be possible to create a Europe-wide regime in this area capable of addressing the vagaries of all of the EU national retail financial markets.

We also note that there is nothing in the existing directive structure which prevents national regulators harmonizing the regulation of the distribution of products if they consider that to be desirable. An example is the UK FSA "packaged products" regime, which imposes a common set of rules on distribution of regulated funds and on life policies. Part of the reason that we do not believe that there are significant regulatory arbitrages present in the current European retail market is because national regulators can and have taken steps to block any such opportunities.

The EU Regulatory Environment

The EU regulatory regime, as it applies to retail sales of financial products, applies different regulatory approaches to different products. It is therefore difficult to compare these regulatory regimes. In very broad terms, the techniques which are used may be divided into *product regulation* and *distribution regulation*. The basis of *product regulation* is that if a product is itself sufficiently regulated, then its distribution should be considered broadly safe. The basis of *distribution regulation* is that if distributors are required to assess the product on behalf of their customers, then there is no need to regulate the product. The difference between the two is one of emphasis - to some extent all products are subject to both types of regulation.

One of the issues which arises with *product regulation* is that products can be analysed on three levels; these being the underlying economics, the legal form and the distribution process. These three aspects are theoretically independent, but in practice - and for regulatory purposes - are interdependent. For example, for the purposes of *distribution regulation*, the test as to whether a product triggers a mandatory appropriateness process under MiFID is based primarily on economic substance, but this can be "trumped" by legal form - for example, a set of product economics which would trigger an

appropriateness test if sold in structured security form will not trigger the application of such a test if sold in UCITS form. When regulators refer to *product regulation*, they generally refer to the regulation of the legal form of the product rather than to direct regulation of the economic underlying.

Historically, the reason for the adoption of different regulatory approaches to different products was that the regulatory structure developed in order to fit the way in which the products were traditionally created and marketed. Thus for collective investment vehicles, for example, regulation focused on what the manager could do with the assets under his control, whereas securities regulation focused on the information required to be provided about the activities of the issuer of the securities. The existence of these different approaches was not, and is not, a defect in the system - different industries should be regulated according to their typical structures rather than in pursuit of a harmonized ideal.

This is because there is no single model of retail distribution relationships which is universally applicable to all cases and all circumstances. Accordingly, we do not believe any detailed proposals could be created in such a way as to be both sufficiently specific to provide guidance on individual relationships and sufficiently general as to be universally applicable across this entire product universe. Such proposals could only achieve conformity at the cost of ineffective regulation or the risk of misunderstanding by target investors who are used to particular market structures. This is particularly true where such conformity can only be achieved at a high cost to the industry.

The reason for this is that there is a strong structural distinction between the traditional retail products markets (notably the life assurance markets) and the securities markets. In the traditional financial products markets it is the life company, fund management house, bank or other institution which develops the market, creates and advertises products and manages customer relationships, to the extent that distributors are frequently little more than introducers. In the securities markets by contrast the customer is primarily a customer of the broker, private bank or other advisor, and looks to that person for continuing support and information about the products which he has bought. The structured product market is still broadly a securities market, and therefore adopts the securities paradigm, in that the primary relationship is between the customer and the distributor, with the provider doing little more than providing information.

Product Regulation and Complexity

Because the securities markets are generally regulated on a *distribution basis*, there is no limit on the complexity of the structures which can be created. A false link is sometimes made between product complexity and product risk, which leads to the illusion that complex securities are automatically high-risk securities. This is clearly not the case - for example principal protected products are highly complex precisely because they are structured to reduce risk. It is also sometimes suggested that complex structures are unsuitable because they cannot be easily understood. This is based on another fallacy - what investors need to understand is not the underlying structure of an investment, but the risks inherent in it. In the retail structured product markets product complexity is often the result of products being structured to create more tailored – and quite possibly

less risky – investment outcomes. The complexity of many *defined return* investments delivers a simplified and more easily understandable risk exposure than does a conventional *variable return* investment.

The suitability of a particular product for a particular investor is a function of the investor's knowledge and experience, financial situation and investment objectives. The complexity or otherwise of a product is not a relevant characteristic in the making of this determination – what matters is whether the investor understands what the risks are and what the returns are likely to be.

Many structured products are structured specifically to provide the investor with protection – that is, the investor gives up some part of his potential return in order to increase the predictability of his final return. Products of this kind are optimised for investors with lower risk tolerances, and are likely to be unsuitable for investors who are actively seeking higher levels of risk.

Co-existence of differing regulatory regimes

The issue which is raised in the call for evidence is that whilst these differing regimes continue there may be a risk that they may be arbitraged, with market participants structuring products so as to minimise their regulatory obligations.

The first point to make in response to this is that the existence of multiple, differently-regulated distribution paths does not necessarily mean that the possibility for arbitrage exists. If there are two alternative paths to market for a particular product, both properly regulated but regulated using different approaches, then the fact that a product provider or a distributor selects one rather than the other does not necessarily mean that the investor is disadvantaged or that the system is being "gamed". There are a number of reasons for structuring particular products in particular ways - examples are tax, accommodation of distributor's systems, investor familiarity and the provision of regulatory comfort. None of these have any adverse consequence for investors, or confer any regulatory advantage on the product provider.

This point may become clearer if the relevant applicable requirements are compared in detail. They are set out in Appendices 1 and 2 to this submission.

Appendix 1 simply shows with a tick where a particular criterion is dealt with in the relevant legislation, providing a quick overview of the main distinctions between the legislation for each product (*see page 17 of this response*).

Appendix 2 comprises exactly the same series of tables, but sets out (or refers to) the relevant provisions in full by way of reference (*see page 25 of this response*).

We have not covered the DMD or the E-Commerce Directive, as these are described in detail on pages 38-39 of the call for evidence itself.

Distribution

In general securities products are offered to the public in the EU through distributors who are subject to the provisions of MiFID. The key aspect of MiFID for this purpose is the suitability obligation which is imposed on any financial intermediary executing an order on behalf of a retail customer. MiFID also permits an alternative, lower, standard of care - appropriateness - where a retail customer positively declines to seek advice from the intermediary, but it is believed that the vast majority of these products are sold by intermediaries who owe a "suitability" obligation. Securities may be sold to retail investors outside the scope of these protections, but this is only permissible for "non-complex" products, and retail structured securities will almost all fall within the definition of "complex" products in MiFID terms. Both UCITS and life policies fall outside these protections.

It is therefore on the distributor that the suitability obligation will rest. In this context, one of the key issues in this market is the relationship between a distributor and a provider. The Joint Associations Committee has therefore focused on this area, and in particular has produced the July 2007 Provider-Distributor Principles (Appendix 3). The essence of these principles is that the exact responsibilities of a firm must flow from the role it plays in the product delivery and lifecycle chain. The UK FSA has also made considerable progress in this area, and has through its "Treating Customers Fairly" initiative done valuable work in determining the proper allocation of customer responsibilities within the distribution chain for financial products generally.

The process of selection between providers and distributors is two way. Providers may well be selective about which intermediaries they will permit to deal in certain types of products. The process of determining which intermediaries should be permitted to sell certain products is known as "*Know your distributor*" (or KYD), and is being developed in the retail securities markets, possibly because of the higher levels of reliance in those markets on the suitability and appropriateness functions which distributors are required to perform under MiFID.

Distributors, on the other hand, will seek to distribute products issued by providers who have credibility in a number of areas, including risk management expertise combined with a broad range of ‘wrapping’ and product structuring capabilities. The process engaged in by distributors is known as "Know your provider" (or KYP), and involves assessment by the distributor of a variety of attributes of the provider's business model. These will include creditworthiness, transparency of pricing, willingness to educate and explain distributor staff, willingness to partner in product design and a wide variety of other factors.

Distributor preferences will frequently determine product structure. As noted above, some distributors are only configured to handle certain types of products (for example, "fund supermarkets" generally prefer to confine their product range to products which are mutual funds), and in order for them to offer a particular product it must be structured in a particular way.

In general, distributors are remunerated by commission, and expect a certain level of commission in respect of each product sold. Retail structured securities issuers are

therefore constrained to structure their securities in order to pay commission to distributors.

MiFID also requires the distributor to disclose its fees to its customers. These fees may take various forms: discount to face value on the issue price of the securities; up front commission payments, a running fee during the lifetime of the product; or some combination of all of these. The detail of the requirements of MiFID in this regard is complex, and the market is still working to establish the precise parameters and requirements of MiFID fee disclosure.

Pricing

Retail investments can be offered in two forms - *defined return* and *variable return*. A *defined return* product is a product which specifies to the investor exactly what he will receive at a future time. A *variable return* product is a product in which the investor puts his faith in a manager (or other mechanism) to produce returns over time. Investors require both types of product - thus, for example, conventionally investors will invest through *variable return* mechanisms where they are seeking long-term returns (for example a young employee investing for a pension), but *defined return*s where they are seeking short-term certainty (for example, an older employee a few years off retirement). Fixed-term fixed-rate deposit accounts are examples of *defined return* products, as are (in some respects) annuities. Mutual funds and with-profits life assurance policies are all examples of *variable return* products.

Defined return products and variable return products are priced differently. A variable return product is a packaged offer of a service, and the fees charged for the provision of that service are generally absolute and not performance related. Thus what the investor will get as his investment return will be the investment performance less the management fees charged. He therefore needs to know the management fees charged in order to be able to work out what his investment return is likely to be. A *defined return* product, by contrast, will pay the *defined return* - fees and costs are already taken into account in the calculation of the return which is defined. The issue for the investor is as to whether the price which he is being charged for that return is cheap or dear, and he - or, usually, his investment adviser or broker - can establish this by looking across the range of competing products and structures. A useful comparison can be made with bank deposits - an investor is not told, and does not need to know, the margin which the bank is making over its funding costs on the particular deposit.

Post-sale treatment of investors

One of the most important structural distinctions between securities on the one hand and deposits, funds and life policies on the other is that the latter all give rise to a continuing contractual nexus between the product provider and the investor, which impose obligations to provide post-sale information. In the securities market the equivalent obligations of a securities issuer to a holder of securities are not contractual but arise

exclusively from regulation - notably through the Transparency and the Market Abuse Directives. These directives impose minimum information provision standards, but are not precisely aligned with the requirements of investors in structured securities. Structured securities issuers have therefore been obliged to develop mechanisms for providing post-sale information and secondary market liquidity, and these mechanisms frequently go well beyond the requirements imposed by the relevant regulatory framework. The reason for this development is partially to service investors, but partly also to ensure that securities can be offered on terms that are not materially worse than those of competing - particularly fund - products.

The advantage of a structured product is that the provision of secondary market liquidity is facilitated by the structure, and may be significant. In particular market making by a product provider may be an obligation if the product is listed.

Conclusion

The basis of consumer protection in the securities market is the suitability obligation which is imposed under MiFID. MiFID adopts a service-based rather than a product-based approach to regulation, and is considerably simpler than the approaches adopted in the other directives. To the extent that it makes sense to compare the relevant regimes, we are strongly of the belief that the MiFID approach is the best and most effective approach in terms of delivering effective consumer protection. As the call for evidence itself says;

> "MiFID already provides a principles-based framework for ensuring a coherent approach to disclosure and point of sale regulation for all financial instruments, including all funds and structured securities. It sets out provisions on the management/disclosure of conflicts of interest, rules on commission payments and conduct of business rules. The challenge now is to build on the high level principles of MiFID to implement coherent and rigorous point of sale disciplines for all investment products that fall within the MiFID definition of 'financial instruments' sold by investments firms, banks and advisors".[2]

In our view, there is no need for change in this area. However, to the extent that there is a desire for regulatory activity in this area, the Commission should seek to harmonize on the MiFID requirements as representing state-of-the-art principles-based regulation of retail distribution.

Finally, we applaud the commission's approach in this area as being fully in conformity with the principles of better regulation. We are pleased that the commission is proceeding by assessing the market and seeking to identify potential harm to investors caused by market failure requiring regulatory intervention. This is, in our view, the optimal basis for any regulatory analysis, and should ensure that any proposal made by the commission will be able to be related specifically to any market failure identified by this exercise.

[2] Para. 2.2 on page 17 of the call for evidence

Specific Comments: Responses to questions asked by the Call for Evidence

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.*

For the reasons set out above, we do not believe that the existence of different regulatory regimes necessarily gives rise to any significant regulatory issue.

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?*

We are currently witnessing a growing diversity of products being offered to European retail investors. The nature of these products is generally heavily influenced by local considerations (in particular personal tax considerations) , and it is these which form the major barriers to the development of an EU market for retail investment products. We are not able to speculate what the position would be if these barriers were to be removed, and we do not believe that such speculation would be useful at this time.

We do not believe that the differences mentioned in the question pose any threat either to investors or to the development of the markets.

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

- nationally regulated retail funds

- exchange traded or listed funds

- unit-linked life insurance (especially which mortality risk level is small or nil)

- retail tranches of structured securities

- some annuities;

- some bank term deposits (e.g. with embedded optionality or structured deposits)

- others … (please list and describe)

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'?

All retail products are aimed at personal savings, so it is always possible to argue that a product competes with another for the savings of the investors. All products can be considered as interchangeable in this regard.

-The difference between UCITS funds and nationally regulated funds is that the former can be marketed all over Europe. They are substitute products, depending on the country concerned.

- ETF are indexed funds and are listed. They are accessed through stock exchanges, unlike ordinary UCITS funds, which are mainly sold through distributors.

- Unit-linked life insurance product may appear similar to the purchase of an underlying UCITS, but their tax regime is generally very different. They are therefore not close substitutes.

- Retail tranches of structured securities are different from the products listed above because they have a predetermined pay-off. They target investors who wish to have the ultimate transparency: a complete certainty about what they will get at a certain time horizon.

- Annuities have different payoff profiles from all of the above products, and economically have more in common with protection than with investment products.

- Bank term deposits are broadly substitutable with *defined return* structured products, but generally have very different tax treatments.

***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.*

	UCITS	Non - harmonised funds	Unit-linked life insurance products	Retail structured products	Annuities	(Structured) Term deposits	Others
Taxation	X	X	X	X	X	X	
Financial innovation	X	X	X	X	X	X	
Cultural preferences	X	X	X	X	X	X	
Distribution models	X	X	X	X	X	X	
Regulatory treatment	X	X	X	X	X	X	
Others							

It is difficult to give a specific answer to this question and rank the factors as requested because all of these factors may drive the promotion and sales of financial products. In general:

- taxation advantages play a major role in all investment decisions,

- financial innovation exists everywhere, in harmonised fund management (for example short selling, 130/30 structures, credit-based funds) in mutual funds and in insurance structures as well as in securitised products;

- national cultural preferences always play a role. For example, Germany has a "retail culture" concerning warrants and certificates, with several specialized retail magazines dedicated to them, whilst France has a culture of unit-linked contracts;

- distribution models are always important: ETFs and warrants, for example, are sold to retail investors through online brokers in some jurisdictions, by investment advisors in others;

- regulatory treatment generally plays a very minor role, except of course that if local regulation prohibits a particular product from being marketed at all then it will not be marketed.

***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.

Nature of information provided	*UCITS*	*Non-harmonised funds*	*Unit-linked life insurance products*	*Retail structured products*	*Annuities*	*(Structured) Term deposits*	*Others*
Product features	X	X	X	X	X	X	
Direct costs	X	X	X	X (MiFID inducement/Art 19(3) disclosure requirements)	X	X	
Indirect costs (or foregone performance)			-		-		
Risks	X	X	X	X	-	X	
Capital Guarantee	X	X	X	X		X	
Likely performance	X	X	X	X	-	X (back testing)	
Conflicts of interest	X	X	-	X	-	X	
Compensation or fee retrocession			X	X	-	X	

X= Sufficient information

Most funds, whether they are UCITS or not, or unit-linked contracts, are by nature not able to provide exhaustive information about their future performance because the manager must keep a certain flexibility to choose the investments of the fund, according to varying market conditions and expectations[3]. By nature, asset management relies on the trust of investors that funds will be managed according to their best interests. The marketing of funds by asset management companies is, also, not subject to the obligations of MiFID.

On the contrary, structured products can provide detailed information about the pay-off, like simulation of performances, etc. MiFID imposes an obligation to provide investors with "fair, clear and not misleading" information, and to check the "appropriateness" of the product, or its "suitability", if an investment advice is given.

Finally it should be noted that MiFID has reinforced drastically the transparency of the costs and fees received and paid in relation to the distribution of structured products. In this respect, market standards on cost information to be provided for structured products are being developed in line with the new MIFID requirements.

***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 ?*

	UCITS	*Non-harmonized funds*	*Unit-linked life insurance products*	*Retail structured products*	*Annuities*	*(Structured) Term deposits*	*Others*
Know your customer	-	-	-	X	-	-	
Suitability or appropriateness	-	-	-	X	-	-	
Risk warning				X			

[3] Tracker funds and ETFs can of course provide this information, but such funds are not typical of either harmonised or unharmonised funds.

	-	-	-		-	-	
Examples-information	-	-	-	X	-	-	
Others	-	-	-	X	-	-	

X=pronounced difference

MiFID is directed to the protection of the investors (primacy of the client's interest; fair, clear and not misleading information; cost information; suitability of the product; appropriateness of the product) whereas the UCITS Directive regulates "products". It is therefore natural that MiFID contains more conduct of business rules than the UCITS directive.

***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.*

MiFID provides rules in order to prevent and/or manage conflict of interests. Thus, investment services providers shall establish and maintain an effective conflicts of interest policy appropriate to the complexity of their business.

***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?"*

MiFID stipulates that information must be provided to investors in advance of any sale, and that that information must be "fair, clear and not misleading". It provides that all information investment firms address to retail clients or potential retail clients, including marketing communications, must satisfy specific conditions (for example, when the information compares

investment or ancillary services, financial instruments, or persons providing investment or ancillary services, the comparison must be meaningful and presented in a fair and balanced way; the sources of the information used for the comparison must be specified).

***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?*

MiFID has created general principles (as principle of "fair, clear and not misleading information") applicable to all the products, which offer an excellent protection to the clients.

However, the degree of disclosures depends of the nature of the structured product (For example, when the pay-off of the product is predetermined, important information for retail investors are those that ensure that they understand the pay-off).

In asset management, the process is different. Asset management regulation is based on the fact that a manager who has discretion over a portfolio also owes fiduciary duties to the beneficiaries of that portfolio. Investors who have given up control of their assets need to be reassured that their money will be managed in their best interests. Regulations therefore specify the way in which managers and depositaries must act.

We do not believe that it would be possible to create a single regulatory approach which applied to both of these situations on an undifferentiated basis - such an approach would necessarily involve either the imposition of a fiduciary/manager model to fixed return structures, or the application of a fixed return structure to fiduciary/manager models. Either of these approaches would create significant problems for the industry.

***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.*

Some examples of recent self-regulatory initiatives in respect of investment disclosures;

- Five leading trade associations (European Securitisation Forum (ESF), International Capital Market Association (ICMA), International Swaps and Derivatives Association

(ISDA), London Investment Banking Association (LIBA) and Securities Industry and Financial Markets Association (SIFMA) released a set of non-binding principles for managing the provider-distributor relationship in regards to Retail Structured Products (*reproduced at Appendix 3*);

- The Hedge Fund Working Group (HFWG), representing leading hedge fund managers based mainly in the UK, published a consultation document that puts improved disclosure to investors at the heart of best practice standards for the industry. The proposed new standards focus particularly on the areas of valuation, risk management, disclosure and fund governance;

- CESR published guidelines concerning eligible assets for investment by UCITS to complete the Directive adopted by the Commission on 19 March 2007 on the eligible assets under UCITS Directive . For example, CESR indicates that where a product is structured as an alternative to an over-the-counter (OTC) derivative, its treatment should be similar to that of the OTC derivative instrument, if the consistency of the Directive provisions is to be ensured

Appendix 1 – high level indication of coverage of relevant Directives

Undertakings for collective investment in transferable securities (UCITS)

I Product disclosure requirements

	UCITS DIRECTIVES	MIFID
PRODUCT FEATURES	✓	✓
CAPITAL GUARANTEE	✓	✓
RISKS / RANGE OF EXPECTED INVESTMENT PERFORMANCE	✓	✓
REWARDS	✓	✓
COSTS / CHARGES / FEES CHARGED TO INVESTOR	✓	✓
DISTRIBUTION COMPENSATION ARRANGEMENTS / FEE-SHARING	✓	✓
OTHER POTENTIAL CONFLICTS OF INTEREST	✓	✓
LEVEL OF INFORMATION DISCLOSED	✓	✓
INFORMATION CONTENTS / USEFULNESS TO RETAIL INVESTOR	✓	✓
REGULARITY OF PROVISION OF INFORMATION	✓	✓
MEANS OF ACCESSING INFORMATION	✓	✓
ADDITIONAL DISCLOSURE REQUIREMENTS: PRE-CONTRACT	✓	✓
ADDITIONAL DISCLOSURE REQUIREMENTS: POST-CONTRACT	✓	✓

OTHER POINTS TO NOTE		The MiFID requirements only apply to certain types of investment firm (see list of exemptions in Articles 2 and 3 of Directive 2004/39/EC).

Undertakings for collective investment in transferable securities (UCITS)

II Product distribution conduct of business requirements

	UCITS DIRECTIVES	**MIFID**
KNOW YOUR CUSTOMER (KYC) CHECKS		✓
SUITABILITY / APPROPRIATENESS TESTS		✓
INFORMATION / RISK WARNINGS	✓	✓
CONFLICT OF INTEREST MANAGEMENT	✓	✓
PROMOTIONS / ADVERTISING / MARKETING	✓	✓
ADDITIONAL COB REQUIREMENTS	✓	✓

Unit-linked life insurance

I Product disclosure requirements

	LIFE INSURANCE DIRECTIVE	INSURANCE MEDIATION DIRECTIVE
PRODUCT FEATURES	✓ (but not comprehensive or detailed)	
CAPITAL GUARANTEE		
RISKS / RANGE OF EXPECTED INVESTMENT PERFORMANCE		
REWARDS	✓ (but not comprehensive or detailed)	
COSTS / CHARGES / FEES CHARGED TO INVESTOR	✓ (but not comprehensive or detailed)	
DISTRIBUTION COMPENSATION ARRANGEMENTS / FEE-SHARING		
OTHER POTENTIAL CONFLICTS OF INTEREST		✓
LEVEL OF INFORMATION DISCLOSED		Not comprehensive or detailed.
INFORMATION CONTENTS / USEFULNESS TO RETAIL INVESTOR		Not comprehensive or detailed.
REGULARITY OF PROVISION OF INFORMATION		
MEANS OF ACCESSING INFORMATION		✓
ADDITIONAL DISCLOSURE REQUIREMENTS: PRE-CONTRACT	✓ (but not comprehensive or detailed)	✓

ADDITIONAL DISCLOSURE REQUIREMENTS: POST-CONTRACT	✓ (but not comprehensive or detailed)	✓

Unit-linked life insurance

II Product distribution conduct of business requirements

	INSURANCE MEDIATION DIRECTIVE
KNOW YOUR CUSTOMER (KYC) CHECKS	
SUITABILITY / APPROPRIATENESS TESTS	✓
INFORMATION / RISK WARNINGS	
CONFLICT OF INTEREST MANAGEMENT	
PROMOTIONS / ADVERTISING / MARKETING	
ADDITIONAL COB REQUIREMENTS	✓ (complaints and research/comparison with other products). This is a minimum harmonisation Directive, so national regimes for sales of unit-linked life insurance products can be more prescriptive. It applies to indirect sales of insurance products by intermediaries (brokers and tied agents). Conduct of business requirements are sparse.

Structured securities

I Product disclosure requirements

	PROSPECTUS DIRECTIVE	MIFID
PRODUCT FEATURES	✓	✓
CAPITAL GUARANTEE	✓	✓
RISKS / RANGE OF EXPECTED INVESTMENT PERFORMANCE	✓	✓
REWARDS		✓
COSTS / CHARGES / FEES CHARGED TO INVESTOR	✓	✓ (advice on structured note sales).
DISTRIBUTION COMPENSATION ARRANGEMENTS / FEE-SHARING		[Application to disclosure of fees and costs related to distribution under consideration.]
OTHER POTENTIAL CONFLICTS OF INTEREST		✓
LEVEL OF INFORMATION DISCLOSED	✓	✓
INFORMATION CONTENTS / USEFULNESS TO RETAIL INVESTOR	✓	✓
REGULARITY OF PROVISION OF INFORMATION	✓	✓
MEANS OF ACCESSING INFORMATION	✓	✓
ADDITIONAL DISCLOSURE REQUIREMENTS: PRE-CONTRACT	✓	✓
ADDITIONAL DISCLOSURE REQUIREMENTS: POST-	✓	✓

CONTRACT		

Structured securities

II Product distribution conduct of business requirements

	MIFID
KNOW YOUR CUSTOMER (KYC) CHECKS	✓
SUITABILITY / APPROPRIATENESS TESTS	✓
INFORMATION / RISK WARNINGS	✓
CONFLICT OF INTEREST MANAGEMENT	✓
PROMOTIONS / ADVERTISING / MARKETING	✓
ADDITIONAL COB REQUIREMENTS	✓

Appendix 2 – for reference: Relevant provisions in Directives

Undertakings for collective investment in transferable securities (UCITS)

I Product disclosure requirements

	UCITS DIRECTIVE	**MIFID**
PRODUCT FEATURES	Detailed disclosure requirements are set out in Directive 85/611/EEC (as amended) Annex I, Schedule A, B and C. See further under "Information contents" below. Also Commission Recommendation 2004/384/EC of 27 April 2004 recommended that Member States interpret Annex I Schedule C as requiring "a statement, where relevant, that the UCITS is intended to track an index/indices, and sufficient indications to enable investors both to identify the relevant index/indices and to understand the extent or degree of tracking pursued".	Directive 2006/73/EC sets out detailed requirements in Chapter III Section 2 (Information to clients and potential clients) regarding the conditions with which information supplied to retail clients must comply in order to be fair, clear and not misleading, including requirements for disclosure of comparative performance, past performance, simulated past performance and future performance.
CAPITAL GUARANTEE	Commission Recommendation 2004/384/EC of 27 April 2004 recommended that Member States interpret Annex I Schedule C as requiring "a clear statement of any guarantees offered by third parties to protect investors and any restrictions on those guarantees".	Directive 2006/73/EC, Art.31 (Information about financial instruments) lists disclosure requirements relating to guarantees.

RISKS / RANGE OF EXPECTED INVESTMENT PERFORMANCE	"In order to ensure investor protection through disclosure, UCITS should describe their strategies, techniques and investment limits governing their derivative operations" (Directive 2001/108/EC, recital 11). "1. The prospectus shall indicate in which categories of assets a UCITS is authorised to invest. It shall mention if transactions in financial derivative instruments are authorised; in this event, it must include a prominent statement indicating if these operations may be carried out for the purpose of hedging or with the aim of meeting investment goals, and the possible outcome of the use of financial derivative instruments on the risk profile. 2. When a UCITS invests principally in any category of assets defined in Article 19 [including derivatives] other than transferable securities and money market instruments or replicates a stock or debt securities index in accordance with Article 22a, its prospectus and, where necessary, any other promotional literature must include a prominent statement drawing attention to the investment policy. 3. When the net asset value of a UCITS is likely to have a high volatility due to its portfolio composition or the portfolio management	See under "Information contents" below. "Member States shall require investment firms to provide clients or potential clients with a general description of the nature and risks of financial instruments, taking into account, in particular, the client's categorisation as either a retail client or a professional client. That description must explain the nature of the specific type of instrument concerned, as well as the risks particular to that specific type of instrument in sufficient detail to enable the client to take investment decisions on an informed basis". (Directive 2006/73/EC, Art.31 (Information about financial instruments)). This Article lists further disclosure requirements for the content of risk warnings.

	techniques that may be used, its prospectus and, where necessary, any other promotional literature must include a prominent statement drawing attention to this characteristic. 4. Upon request of an investor, the management company must also provide supplementary information relating to the quantitative limits that apply in the risk management of the UCITS, to the methods chosen to this end and to the recent evolution of the main instrument categories' risks and yields." (Directive 2001/108/EC, Art.14). "Member States may authorise UCITS to invest… up to 100% of their assets in different transferable securities issued or guaranteed by any Member State… each such UCITS… must include a prominent statement in its prospectus and any promotional literature drawing attention to such authorisation and indicating the States, local authorities and/or public international bodies in the securities of which it intends to invest or has invested more than 35% of its assets". (Directive 85/611/EEC, Art. 23). Directive 2001/107/EC, Art.1 amends the list of information required to be included in the	

	full prospectus set out in Annex I Schedule A of Directive 85/611/EC to include: "Historical performance of the unit trust/common fund or of the investment company (where applicable) - such information may be either included in or attached to the prospectus". The periodic reports are required in Annex I Schedule B to include a "comparative table covering the last three financial years and including, for each financial year, at the end of the financial year: the total net asset value, the net asset value per unit". Schedule C requires the simplified prospectus to disclose the "historical performance of the unit trust/common fund/investment company (where applicable) and a warning that this is not an indicator of future performance - such information may be either included in or attached to the prospectus". Commission Recommendation 2004/384/EC of 27 April 2004 recommended that Member States interpret Annex I Schedule C as requiring "where relevant, a warning that, whilst the actual portfolio composition is required to comply with the broad legal and statutory rules and limits, risk-concentration may occur in regard of certain tighter asset	

	classes, economic and geographic sectors... (a) a statement to the effect that the value of investments may fall as well as rise and that investors may get back less than they put in; (b) a statement that details of all the risks actually mentioned in the simplified prospectus may be found in the full prospectus; (c) a textual description of any risk investors have to face in relation to their investment, but only where such risk is relevant and material, based on risk impact and probability… a brief and understandable explanation of any specific risk arising from particular investment policies or strategies or associated with specific markets or assets relevant to the UCITS such as: (a) the risk that the entire market of an asset class will decline thus affecting the prices and values of the assets (market risk); (b) the risk that an issuer or a counterparty will default (credit risk); (c) only where strictly relevant, the risk that a settlement in a transfer system does not take place as expected because a counterparty does not pay or deliver on time or as expected (settlement risk); (d) the risk that a position can not be liquidated in a timely manner at a reasonable price (liquidity risk); (e) the risk that the investment's value will be affected by	

	changes in exchange rates (exchange or currency risk); (f) only where strictly relevant, the risk of loss of assets held in custody that could result from the insolvency, negligence or fraudulent action of the custodian or of a subcustodian (custody risk); (g) risks related to a concentration of assets or markets… (a) performance risk, including the variability of risk levels depending on individual fund selections, and the existence, absence of, or restrictions on any guarantees given by third parties; (b) risks to capital, including potential risk of erosion resulting from withdrawals/cancellations of units and distributions in excess of investment returns; (c) exposure to the performance of the provider/third-party guarantor, where investment in the product involves direct investment in the provider, rather than assets held by the provider; (d) inflexibility, both within the product (including early surrender risk) and constraints on switching to other providers; (e) inflation risk; (f) lack of certainty that environmental factors, such as a tax regime, will persist". It also recommends interpreting disclosure of	

	past performance as requiring disclosure of: "(a) the UCITS' past performance, as presented using a bar chart showing annual returns for the last 10 full consecutive years. If the UCITS has been in existence for fewer than 10 years but at least for a period of one year, it is recommended that the annual returns, calculated net of tax and charges, be given for as many years as are available; (b) if a UCITS is managed according to a benchmark or if its cost structure includes a performance fee depending on a benchmark, the information on the past performance of the UCITS should include a comparison with the past performance of the benchmark according to which the UCITS is managed or the performance fee is calculated. Member States are recommended to require that comparison to be achieved by representing the past performance of the benchmark and that of the UCITS on the same bar-chart and/or separately… Additionally, Member States are recommended to consider requiring disclosure, either of the cumulative performance, or the cumulative average performance of the fund over specific periods of time (such as on three, five and 10 years). In case they use either of	

	these options, Member States are recommended to require also a comparison with the cumulative performance, or cumulative average performance (where relevant) of a benchmark, when comparison to a benchmark is required".	
REWARDS	Commission Recommendation 2004/384/EC of 27 April 2004 recommended that Member States interpret Schedule C as requiring "a concise and appropriate description of the outcomes sought for any investment in the UCITS".	See under "Product features" above.
COSTS / CHARGES / FEES CHARGED TO INVESTOR	Directive 2001/107/EC, Art.1 amends the list of information required to be included in the full prospectus set out in Annex I Schedule A of Directive 85/611/EC to include: "Possible expenses or fees, other than the charges mentioned in paragraph 1.17 [information concerning the charges relating to the sale or issue and the repurchase or redemption of units], distinguishing between those to be paid by the unit-holder and those to be paid out of the unit trust's/common fund's or of the investment company's assets". Annex I Schedule C lists the above and also "entry and exit commissions" and "in the case of UCITS	See under "Information contents" below. "The client must receive from the investment firm adequate reports on the service provided to its clients. These reports shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the client". (Directive 2004/39/EC, Art.19). Directive 2006/73/EC, Art.33 (Information about costs and associated charges) lists disclosure requirements for costs and charges for retail clients.

	having different investment compartments… the charges applicable [when passing from one investment compartment into another]" as required contents for the simplified prospectus. Commission Recommendation 2004/384/EC of 27 April 2004 recommended that Member States interpret the fees requirements of Schedule C as requiring disclosure of a total expense ratio (TER), the expected cost structure, all entry and exit commissions and other expenses directly paid by the investor, an indication of all the other costs not included in the TER, the portfolio turnover rate and an indication of the existence of fee-sharing agreements and soft commissions.	
DISTRIBUTION COMPENSATION ARRANGEMENTS / FEE-SHARING	"A UCITS that invests a substantial proportion of its assets in other UCITS and/or collective investment undertakings shall disclose in its prospectus the maximum level of the management fees that may be charged both to the UCITS itself and to the other UCITS and/or collective investment undertakings in which it intends to invest. In its annual report it shall indicate the maximum proportion of management fees charged both to the UCITS itself and to the UCITS and/or other collective	See Article 26 (Inducements) of Directive 2006/73/EC concerning disclosure of commissions, fees and non-monetary benefits.

	investment undertaking in which it invests". (Directive 2001/108/EC, Art.11).	
OTHER POTENTIAL CONFLICTS OF INTEREST	"If Member States permit management companies to delegate to third parties… the UCITS' prospectuses list the functions which the management company has been permitted to delegate" (Directive 2001/107/EC, Art. 1).	See also Chapter II Section 4 of Directive 2006/73/EC) "Conflicts of interest".
LEVEL OF INFORMATION DISCLOSED	Detailed: see "Information contents" below.	Detailed. Art.27 of Directive 2006/73/EC requires that information addressed to retail clients satisfies certain requirements, including the requirement that "It shall be sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received".
INFORMATION CONTENTS / USEFULNESS TO RETAIL INVESTOR	"To take into account developments of information techniques, it is desirable to revise the current information framework provided for in Directive 85/611/EEC. In particular, it is desirable to introduce, in addition to the existing full prospectus, a new type of prospectus for UCITS (simplified prospectus). Such a new prospectus should be designed to be investor-friendly and should therefore represent a source of valuable information for	"Appropriate information shall be provided in a comprehensible form to clients or potential clients about: the investment firm and its services, financial instruments and proposed investment strategies; this should include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies, execution venues, and costs and associated charges so that they are

	the average investor. Such a prospectus should give key information about the UCITS in a clear, concise and easily understandable way. However, the investor should always be informed, by an appropriate statement to be included in the simplified prospectus, that more detailed information is contained in the full prospectus and in the UCITS' yearly and half-yearly report, which can be obtained free of charge at his/her request" (Directive 2001/107/EC, recital 15). "Both the simplified and the full prospectuses must include the information necessary for investors to be able to make an informed judgement of the investment proposed to them, and, in particular, of the risks attached thereto. The latter shall include, independent of the instruments invested in, a clear and easily understandable explanation of the fund's risk profile. 2. The full prospectus shall contain at least the information provided for in Schedule A, Annex I to this Directive, in so far as that information does not already appear in the fund rules or instruments of incorporation annexed to the full prospectus in accordance with Article 29(1). 3. The simplified prospectus shall contain in summary form the key	reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. This information may be provided in a standardised format". (Directive 2004/39/EC, Art.19). See Directive 2006/73/EC Art.30 (Information about the investment firm and its services for retail clients and potential retail clients) for detailed requirements.

	information provided for in Schedule C, Annex I to this Directive. It shall be structured and written in such a way that it can be easily understood by the average investor. Member States may permit that the simplified prospectus be attached to the full prospectus as a removable part of it. The simplified prospectus can be used as a marketing tool designed to be used in all Member States without alterations except translation. Member States may therefore not require any further documents or additional information to be added. 4. Both the full and the simplified prospectus may be incorporated in a written document or in any durable medium having an equivalent legal status approved by the competent authorities. 5. The annual report must include a balance-sheet or a statement of assets and liabilities, a detailed income and expenditure account for the financial year, a report on the activities of the financial year and the other information provided for in Schedule B, Annex I to this Directive, as well as any significant information which will enable investors to make an informed judgment on the development of the activities of the UCITS and its results. 6. The half-yearly report must	

	include at least the information provided for in Chapters I to IV of Schedule B, Annex I to this Directive; where a UCITS has paid or proposes to pay an interim dividend, the figures must indicate the results after tax for the half-year concerned and the interim dividend paid or proposed… 1. The fund rules or an investment company's instruments of incorporation shall form an integral part of the full prospectus and must be annexed thereto. 2. The documents referred to in paragraph 1 need not, however, be annexed to the full prospectus provided that the unit-holder is informed that on request he or she will be sent those documents or be apprised of the place where, in each Member State in which the units are placed on the market, he or she may consult them". (Directive 2001/107/EC, Art. 1). Annex I Schedule A lists the minimum information to be included in the full prospectus for the unit trust, the management company and the investment company. Directive 2001/107/EC, Art.1 amends the list to include: "Profile of the typical investor for whom the unit trust/common fund or the	

	investment company is designed". Similar disclosure is also required in the simplified prospectus by Schedule C. Annex I Schedule B lists the detailed financial information on the units and portfolio to be included in the periodic reports. Annex I Schedule C details the required disclosure in the simplified prospectus, which includes a description of the UCITS and its promoter together with certain investment, economic and commercial information. "The accounting information given in the annual report must be audited…. The auditor's report, including any qualifications, shall be reproduced in full in the annual report". (Directive 85/611/EEC, Art.31).	
REGULARITY OF PROVISION OF INFORMATION	"An investment company and, for each of the unit trusts and common funds it manages, a management company, must publish a simplified prospectus, a full prospectus, an annual report for each financial year, and a half-yearly report covering the first six months of the financial year". "The essential elements of the simplified and the full prospectuses must be kept up to date". "1. The simplified	See Chapter III Section 4 (Reporting to clients) of Directive 2006/73/EC.

	prospectus must be offered to subscribers free of charge before the conclusion of the contract. In addition, the full prospectus and the latest published annual and half-yearly reports shall be supplied to subscribers free of charge on request. 2. The annual and half-yearly reports shall be supplied to unit-holders free of charge on request. 3. The annual and half-yearly reports must be available to the public at the places, or through other means approved by the competent authorities, specified in the full and simplified prospectus". (Directive 2001/107/EC, Art. 1). "The annual and half-yearly reports must be published within the following time limits, with effect from the ends of the periods to which they relate: four months in the case of the annual report, two months in the case of the half-yearly report". (Directive 85/611/EEC, Art.27(2)). "A UCITS must make public in an appropriate manner the issue, sale, re-purchase or redemption price of its units each time it issues, sells, re-purchases or redeems them, and at least twice a month. The competent authorities may, however, permit a UCITS to reduce the	

	frequency to once a month on condition that such a derogation does not prejudice the interests of the unit-holders". (Directive 85/611/EEC, Art. 34).	
MEANS OF ACCESSING INFORMATION	See under "Regularity of provision of information" above.	See "Conditions applying to the provision of information" (Directive 2006/37/EC Art. 3) regarding the media used by an investment firm for transmission of information to clients. See under "Additional disclosure requirements: post-contract" below.
ADDITIONAL DISCLOSURE REQUIREMENTS: PRE-CONTRACT	"The simplified prospectus should always be offered free of charge to subscribers before the conclusion of the contract. This should be a sufficient precondition to meet the legal obligation under this Directive to provide information to subscribers before the conclusion of the contract" (Directive 2001/107/EC, recital 15).	See Directive 2006/73/EC Art.29 (General requirements for information to clients) regarding pre-contract disclosure to retail investors.
ADDITIONAL DISCLOSURE REQUIREMENTS: POST-CONTRACT	See under "Regularity of provision of information" above.	See Directive 2006/73/EC Art.29 (General requirements for information to clients) for certain post-contract disclosure requirements.
OTHER RELEVANT PROVISIONS		The MiFID requirements only apply to certain types of investment firm (see list of exemptions in Articles 2 and 3 of Directive

		2004/39/EC).

Undertakings for collective investment in transferable securities (UCITS)

II Product distribution conduct of business requirements

	UCITS DIRECTIVE	MIFID
KNOW YOUR CUSTOMER (KYC) CHECKS		"When providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him". (Directive 2004/39/EC, Art.19). See Directive 2006/73/EC Chapter III Section 3 (Assessment of suitability and appropriateness).
SUITABILITY / APPROPRIATENESS TESTS		See under "Know your customer (KYC) checks" above. See Directive 2006/73/EC Art.28 (Information concerning client categorisation) and Chapter III Section 3 (Assessment of suitability and

		appropriateness).
INFORMATION / RISK WARNINGS	See under "Disclosure requirements - Risks" above.	"In case the investment firm considers… that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client. This warning may be provided in a standardised format. In cases where the client or potential client… provides insufficient information regarding his knowledge and experience, the investment firm shall warn the client or potential client that such a decision will not allow the firm to determine whether the service or product envisaged is appropriate for him. This warning may be provided in a standardised format". (Directive 2004/39/EC, Art.19).
CONFLICT OF INTEREST MANAGEMENT	"…the competent authorities of the home Member State having regard also to the nature of the UCITS managed by a management company, shall require that each such company: …is structured and organised in such a way as to minimise the risk of UCITS' or clients' interests being prejudiced by conflicts of interest between the company and its clients,	"An investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as defined in Article 18 from adversely affecting the interests of its clients" (Directive 2004/39/EC, Art.13)

	between one of its clients and another, between one of its clients and a UCITS or between two UCITS. Nevertheless, where a branch is set up, the organisational arrangements may not conflict with the rules of conduct laid down by the host Member State to cover conflicts of interest". "If Member States permit management companies to delegate to third parties… a mandate with regard to the core function of investment management shall not be given to the depositary or to any other undertaking whose interests may conflict with those of the management company or the unit-holders". "Each Member State shall draw up rules of conduct which management companies authorised in that Member State shall observe at all times. These principles shall ensure that a management company…. tries to avoid conflicts of interests and, when they cannot be avoided, ensures that the UCITS it manages are fairly treated". (Directive 2001/107/EC, Art.1).	"1. Member States shall require investment firms to take all reasonable steps to identify conflicts of interest between themselves, including their managers, employees and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof. 2. Where organisational or administrative arrangements made by the investment firm in accordance with Article 13(3) to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the investment firm shall clearly disclose the general nature and/or sources of conflicts of interest to the client before undertaking business on its behalf". (Directive 2004/39/EC, Art.18). See also Chapter II Section 4 of Directive 2006/73/EC) "Conflicts of interest".
PROMOTIONS / ADVERTISING / MARKETING	"All publicity comprising an invitation to purchase the units of UCITS must indicate that prospectuses exist and the places where they may be obtained by the public or how the	"All information, including marketing communications, addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading. Marketing

	public may have access to them." "If a UCITS proposes to market its units in a Member State other than that in which it is situated, it must first inform the competent authorities of that other Member State accordingly. It must simultaneously send the latter authorities: an attestation by the competent authorities to the effect that it fulfils the conditions imposed by this Directive, its fund rules or its instruments of incorporation, its full and simplified prospectuses, where appropriate, its latest annual report and any subsequent half-yearly report, and details of the arrangements made of the marketing of its units in that other Member State. An investment company or a management company may begin to market its units in that other Member State two months after such communication, unless the authorities of the Member States concerned establish, in a reasoned decision taken before the expiry of that period of two months, that the arrangements made for the marketing of units do not comply with the provisions referred to in Article 44(1) and Article 45". "If a UCITS markets its units in a Member State other than that in which it is situated, it must distribute in that other Member State, in	communications shall be clearly identifiable as such" (Directive 2004/39/EC, Art.19). See Directive 2006/73/EC Art.27 (Conditions with which information must comply in order to be fair, clear and not misleading) and Art.29 (General requirements for information to clients) for content requirements for marketing materials.

	accordance with the same procedures as those provided for in the home Member State, the full and simplified prospectuses, the annual and half-yearly reports and the other information provided for in Articles 29 and 30. These documents shall be provided in one of the official languages of the host Member State or in a language approved by the competent authorities of the host Member State". (Directive 2001/107/EC, Art.1). "A UCITS which markets its units in another Member State must comply with the laws, regulations and administrative provisions in force in that State which do not fall within the field governed by this Directive. 2. Any UCITS may advertise its units in the Member State in which they are marketed. It must comply [with] the provisions governing advertising in that State". (Directive 85/611/EEC Art.44).	
ADDITIONAL COB REQUIREMENTS	Directive 2001/107/EC, Art.1 sets out detailed conduct of business requirements for management companies offering additional services directly to clients.	"Member States shall require that investment firms provide appropriate information to their clients on their order execution policy". (Directive 2004/39/EC, Art.21). See extensive conduct of business requirements in Articles 5 (Organisation), 6

		(Compliance), 7 (Risk management), 8 (Internal audit), 9 (Responsibility of senior management), 10 (Complaints handling for retail clients), Chapter III Sections 4 (Reporting to clients), 5 (Best execution) and 6 (Client order handling) of Directive 2006/73/EC.

Unit-linked life insurance

I Product disclosure requirements

	LIFE INSURANCE DIRECTIVE	INSURANCE MEDIATION DIRECTIVE
PRODUCT FEATURES	Sparse: see under "Additional disclosure requirements below".	
CAPITAL GUARANTEE		
RISKS / RANGE OF EXPECTED INVESTMENT PERFORMANCE		
REWARDS	Sparse: see under "Additional disclosure requirements below".	
COSTS / CHARGES / FEES CHARGED TO INVESTOR	Just the premium itself (Directive 2002/83/EC Annex III (Information for policy holders)).	
DISTRIBUTION COMPENSATION ARRANGEMENTS / FEE-SHARING		
OTHER POTENTIAL CONFLICTS OF INTEREST		"It is essential for the customer to know whether he is dealing with an intermediary who is advising him on products from a broad range of insurance undertakings or on products provided by a specific number of insurance undertakings". (Directive 2002/03/EC, Recital 18). Art.12 requires disclosure of holdings by

		the intermediary in insurance undertakings and by insurance undertakings in the intermediary. It also requires disclosure of contractual ties covering exclusivity arrangements between the insurance intermediary and any other insurance undertakings.
LEVEL OF INFORMATION DISCLOSED		"…all intermediaries should explain the reasons underpinning their advice". (Directive 2002/03/EC, Recital 20).
INFORMATION CONTENTS / USEFULNESS TO RETAIL INVESTOR		Not comprehensive or detailed. See "Additional disclosure requirements" below.
REGULARITY OF PROVISION OF INFORMATION		
MEANS OF ACCESSING INFORMATION		"1. All information to be provided to customers in accordance with Article 12 shall be communicated: (a) on paper or on any other durable medium available and accessible to the customer; (b) in a clear and accurate manner, comprehensible to the customer; (c) in an official language of the Member State of the commitment or in any other language agreed by the parties. 2. By way of derogation from paragraph 1(a), the information referred to in Article 12 may be provided orally where the

		customer requests it, or where immediate cover is necessary. In those cases, the information shall be provided to the customer in accordance with paragraph 1 immediately after the conclusion of the insurance contract. 3. In the case of telephone selling, the prior information given to the customer shall be in accordance with Community rules applicable to the distance marketing of consumer financial services. Moreover, information shall be provided to the customer in accordance with paragraph 1 immediately after the conclusion of the insurance contract". Directive 2002/03/EC, Art.13.
ADDITIONAL DISCLOSURE REQUIREMENTS: PRE-CONTRACT	"1. Before the assurance contract is concluded, at least the information listed in Annex III(A) shall be communicated to the policy holder. 2. The policy-holder shall be kept informed throughout the term of the contract of any change concerning the information listed in Annex III(B). 3. The Member State of the commitment may require assurance undertakings to furnish information in addition to that listed in Annex III only if it is necessary for a proper understanding by the policy holder of the essential elements of the commitment. 4. The detailed rules for implementing this Article	Directive 2002/03/EC, Chapter III (Information requirements for intermediaries) lists in Art.12 pre-contract disclosure about the intermediary, its complaints procedures and potential conflicts of interest.

	and Annex III shall be laid down by the Member State of the commitment". (Directive 2002/83/EC, Art.36). Directive 2002/83/EC Annex III (Information for policy holders) sets out detailed pre-contract disclosure requirements covering the assurance undertaking and the commitment, including: "(a)11 For unit-linked policies, definition of the units to which the benefits are linked. (a)12 Indication of the nature of the underlying assets for unit-linked policies".	
ADDITIONAL DISCLOSURE REQUIREMENTS: POST-CONTRACT	See under "Additional disclosure requirements: pre-contract" above. Directive 2002/83/EC Annex III (Information for policy holders) sets out some disclosure requirements for the term of the contract covering the assurance undertaking and the commitment.	See under "Means of accessing information" above.

Unit-linked life insurance

II Product distribution conduct of business requirements

	INSURANCE MEDIATION DIRECTIVE
KNOW YOUR CUSTOMER (KYC) CHECKS	
SUITABILITY / APPROPRIATENESS TESTS	"Prior to the conclusion of any specific contract, the insurance intermediary shall at least specify, in particular on the basis of information provided by the customer, the demands and the needs of that customer as well as the underlying reasons for any advice given to the customer on a given insurance product. These details shall be modulated according to the complexity of the insurance contract being proposed". (Directive 2002/03/EC, Art.12.3).
INFORMATION / RISK WARNINGS	
CONFLICT OF INTEREST MANAGEMENT	
PROMOTIONS / ADVERTISING / MARKETING	
ADDITIONAL COB REQUIREMENTS	"Member States shall ensure that procedures are set up which allow customers and other interested parties, especially consumer associations, to register complaints about insurance and reinsurance intermediaries. In all cases complaints shall receive replies". (Directive 2002/03/EC, Art.10). "When the insurance intermediary informs the customer that he gives his advice on the basis of a fair analysis, he is obliged to give that advice on the basis of an analysis of a sufficiently large number of insurance contracts available on the market, to enable him to make a recommendation, in accordance with professional criteria, regarding which insurance contract would be adequate to meet the customer's

	needs". (Directive 2002/03/EC, Art.12.2). This is a minimum harmonisation Directive, so national regimes for sales of unit-linked life insurance products can be more prescriptive. It applies to indirect sales of insurance products by intermediaries (brokers and tied agents). Conduct of business requirements are sparse.

Structured securities

I Product disclosure requirements

	PROSPECTUS DIRECTIVE	MIFID
PRODUCT FEATURES	Covered.	"If an investment firm provides a retail client or potential retail client with information about a financial instrument that is the subject of a current offer to the public and a prospectus has been published in connection with that offer in accordance with Directive 2003/71/EC, that firm shall inform the client or potential client where that prospectus is made available to the public". (Directive 2006/73/EC, Art.31.3). "The provision by an investment firm to a client of a copy of a prospectus that has been drawn up and published in accordance with Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading [the Prospectus Directive] should not be treated as the provision by the firm of information to a client for the purposes of the operating conditions under Directive 2004/39/EC which relate to the quality and contents of such information, if the firm is not

		responsible under that directive for the information given in the prospectus". (Directive 2006/73/EC, Recital 52). Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
CAPITAL GUARANTEE	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
RISKS / RANGE OF EXPECTED INVESTMENT PERFORMANCE	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
REWARDS		Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
COSTS / CHARGES / FEES CHARGED TO INVESTOR	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. Covers advice on structured note sales: as for UCITS above.
DISTRIBUTION COMPENSATION ARRANGEMENTS / FEE-SHARING		Relates to certain types of investment firm who are distributors/intermediaries. Application to disclosure of fees and costs related to distribution under consideration.

OTHER POTENTIAL CONFLICTS OF INTEREST		Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
LEVEL OF INFORMATION DISCLOSED	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
INFORMATION CONTENTS / USEFULNESS TO RETAIL INVESTOR	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
REGULARITY OF PROVISION OF INFORMATION	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
MEANS OF ACCESSING INFORMATION	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
ADDITIONAL DISCLOSURE REQUIREMENTS: PRE-CONTRACT	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.
ADDITIONAL DISCLOSURE REQUIREMENTS: POST-CONTRACT	Covered.	Relates to certain types of investment firm who are distributors/intermediaries. As for UCITS above.

Structured securities

II Product distribution conduct of business requirements

	MIFID
KNOW YOUR CUSTOMER (KYC) CHECKS	As for UCITS above.
SUITABILITY / APPROPRIATENESS TESTS	As for UCITS above. "In accordance with Article 19(4) of Directive 2004/39/EC, a firm is required to assess the suitability of investment services and financial instruments to a client only when it is providing investment advice or portfolio management to that client. In the case of other investment services, the firm is required by Article 19(5) of that Directive to assess the appropriateness of an investment service or product for a client, and then only if the product is not offered on an execution-only basis under Article 19(6) of that Directive (which applies to non-complex products)". (Directive 2006/73/EC, Recital 58).
INFORMATION / RISK WARNINGS	As for UCITS above.
CONFLICT OF INTEREST MANAGEMENT	As for UCITS above.
PROMOTIONS / ADVERTISING / MARKETING	As for UCITS above.

ADDITIONAL COB REQUIREMENTS	As for UCITS above.

Appendix 3 – for reference

Retail Structured Products: Principles for managing the provider-distributor relationship [*published, July 2007*]

A. Introduction

These Principles seek to address issues that financial services firms have in practice found helpful to consider when performing the function of either provider or distributor in connection with the process of delivering structured products to retail investors.

It should be noted that **the Principles are non-binding and, as such, intended purely to help inform firms' thinking.** The sponsoring associations believe market participants should be free to agree their relationships and relative responsibilities on a case-by-case basis, to the extent these are not prescribed by local law or regulation. The Principles are intended to be sufficiently broad in their applicability to provide a reference framework for managing the provider-distributor relationship in retail structured products markets globally.

The Principles are the product of a global working group of firms, taking in the views of both distributors and providers and supported by a coalition of trade associations: European Securitisation Forum (ESF), International Capital Market Association (ICMA), International Swaps and Derivatives Association (ISDA), London Investment Banking Association (LIBA) and Securities Industry and Financial Markets Association (SIFMA). Furthermore, the associations issued the Principles for public comment, obtaining constructive feedback from other trade associations and market participants.

Structured products include a variety of financial instruments that combine various cash assets and/or derivatives to provide a particular risk-reward profile that would not otherwise be available in the market. The exact risk-reward profile varies from instrument to instrument.

The arrangements between the parties, the applicable regulatory regime and the fact that structured products combine various components may in practice result in different financial services parties being responsible for different aspects of the related regulatory obligations (even though the universal-bank model may entail a 'proprietary product distribution' arrangement). In particular, it is common for the distributor to have a direct interface with the retail investor while the provider does not. These Principles therefore particularly focus on how to address this issue, wherever it arises, given that all parties within this distribution 'chain' have a common interest in ensuring that investors obtain satisfaction with regards to their legitimate expectations as to the nature of the investment.

Retail investors in this context will mean natural persons and may include high-net-worth individuals. The Principles do not, unless otherwise indicated, address the role of entities acting solely as issuer of a product.

The Principles are drafted with no single jurisdiction in mind; they are, on the contrary, intended for global use, at a high level. The specific and possibly more detailed procedures that any firm might in practice (and subject to appropriate cost-benefit analysis) adopt to help it manage provider-distributor relationships with regards to retail structured products will be a function of factors such as the jurisdiction or jurisdictions involved, the distribution channel(s) utilised, the precise nature of the products and the nature of the relationship between the parties.

Regulatory treatment may depend on the nature of the component instruments; for instance, depending on the jurisdiction, structured deposits or exchange-traded notes acquired by investors via brokers on a 'reverse-enquiry' basis may each require separate analysis. Among other matters, due consideration will need to be given to post-sale arrangements such as secondary market-making activity and information provision. The sponsoring associations invite industry to consider adapting the Principles, as appropriate, to take account of such specific factors.

The European Securitisation Forum (**ESF**) is a 160-member association comprising leading participants in all sectors of the European securitisation, structured products and CDO industries. Participants include issuers, investors, arrangers, rating agencies, lawyers and accountants, stock exchanges, trustees, valuation providers and information services. The ESF is a forum of the Securities Industry and Financial Markets Association, which is described below, and shares its mission.

The International Capital Market Association (**ICMA**) is the self-regulatory organisation representing the financial institutions active in the international capital market worldwide. ICMA's members are located in some 50 countries across the globe, including all the world's main financial centres, and currently number over 400 firms.

ISDA®

ISDA, which represents participants in the privately negotiated derivatives industry, is the largest global financial trade association, by number of member firms. ISDA (the International Swaps and Derivatives Association) was chartered in 1985, and today has over 725 member institutions from 50 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

LIBA

The London Investment Banking Association (**LIBA**) is the principal trade association in the United Kingdom for firms active in the investment banking and securities industry. The Association represents the interests of its Members on all aspects of their business and promotes their views to the authorities in the United Kingdom, the European Union and elsewhere. For more information, please visit www.liba.org.uk.

The Securities Industry and Financial Markets Association (**SIFMA**) is a trade association that results from the November 1, 2006 merger of the Securities Industry Association and The Bond Market Association. It brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests in the US and globally. It has offices in New York, Washington DC, and London and is associated with the Hong Kong based Asia Securities Industry and Financial Markets Association.

B. Principles

These Principles should be read in conjunction with the Introduction above, which contains important overarching comments on the nature and scope of the Principles. Moreover, the Principles are to be taken collectively, rather than viewing any one Principle in isolation from the others.

1. Distribution to the retail investor in structured products in many, though not all markets, is effected through intermediaries, eg, private banks, rather than directly by the product 'provider' (sometimes referred to as 'manufacturer').

2. Where a product provider and a private bank (or other retail-facing business) operate within the same institution, they may operate quite distinctly; they may even be subject to different regulation; or have different reporting and management structures. Any such formal separation is generally robust and will be driven by legal, compliance, confidentiality and other requirements. Thus, even where a product is originated and distributed by the same institution, there can, in practice, be a separation between the manufacturing and distribution functions to which these Principles refer.

3. Product providers should consider what internal approval processes are appropriate for retail structured products; any such processes might address such issues as sign-off, product structuring, risk-reward and distribution.

4. The distribution structure means that it is often the distributor who interfaces with the individual investor and whose client that investor is. In such circumstances, investor suitability (as determined in the local market) is accordingly exclusively an issue for distributors, since it must be considered in the context of confidential information provided by the client to the distributor.

5. Distributors must understand the products they distribute. In jurisdictions where distributors provide not only the issuer's prospectus document but also term-sheets or other marketing material (such as brochures) to their clients, the distributors take responsibility for the accuracy and completeness of those marketing materials, even if they incorporate material provided by the product provider; in these circumstances, a distributor must be satisfied with and take responsibility for such materials and their compliance with local law and regulation.

6. Product providers should ensure that their term-sheets are accurate, fair, balanced and clear (respecting, as appropriate, jurisdiction-specific regulation to this effect); and that they are presented in a way which is consistent with their agreed obligations to the distributor. (For example, where the parties understand that the product will be distributed by the distributor to high net worth individuals, the termsheet should not contain rubric that the product is

not suitable for retail investors.) Where providers agree to assist the distributor by supplying information, this should be clear and of the kind requested by the distributor in preparing its own term-sheet or product description for its client; this may include scenario analyses and relevant-to-product risk factors.

7. When commencing dealings with a distributor, product providers should consider whether the distributor is an appropriate distributor for the placing of particular types of products and, where they consider it necessary, practical and appropriate to do so, should conduct a "know your distributor" approval process. There is no fixed form for this process, which can vary according to the circumstances, and there are a number of means by which a provider can gain comfort as to the integrity of a distributor's processes. Issues which may typically be considered include a distributor's typical client type (and whether the distributor deals directly with them or via sub-distributors), suitability determination processes, regulatory status, reputation and compliance with selling laws; though the specific details considered will vary widely depending on the distribution, the particular product and the relevant jurisdiction or jurisdictions. Each party does, in any case, retain its own regulatory obligations; no party takes on the regulatory obligations of another or the oversight of that other party's compliance with those obligations.

8. Distributors should also evaluate product provider counterparties ("know your product provider"), particularly as regards the product provider's performance with respect to those items mentioned in 6 above.

9. To the extent that law and regulation may not distinguish sufficiently between the roles of product providers and distributors, this may create points of uncertainty as to where legal or regulatory liabilities may fall. Providers and distributors should be aware of this and its consequences.

10. Product providers and distributors should seek to agree and record their respective roles and responsibilities towards investors.

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