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BY ELECTRONIC MAIL

Brussels, 30 January 2011

Dear Mr Bassi,

COMMENTS ON THE COMMISSION CONSULTATION ON PACKAGED RETAIL INVESTMENT PRODUCTS

Please find enclosed the formal response of the European Structured Investment Products Association (eusipa) to the Consultation by Commission Services on legislative steps for the Packaged Retail Investment Products initiative published on the 26 November 2010.

It is the result of an intensive discussing within our organisation and with yourself as well as with members of your staff such as Mrs Wandel and Mr Shakesby.

We remain at the disposal of the Commission Services to provide additional material on these issues and look forward to discussing these matters further in the near future.

Yours sincerely

Dr. Nikolaus Dominik Neundörfer
Chair of the eusipa Legal Committee

Copy: Esther Wandel, Tim Shakesby
Encl.

Executive Summary

- We fully agree with the fundamental objectives of the PRIPs initiative: the creation of equivalent investor protection standards for retail investment products and the introduction of a new short form key information document.

- However, the conceptual foundations for the initiative need yet to be discussed and developed. These are of paramount importance and not just of theoretical relevance, as issues like the responsibility for the production of the KIID and the content of the disclosure standards depend on the underlying legal concept. It would clearly not be the right approach just to transfer the rules for the UCITS KII to the whole PRIPS universe.

- In terms of the underlying legal concept, the KIID has to be made either part of the prospectus rules (with a view, however, to avoid duplication of information), or of the sales rules. In the latter case, the rules will have to be inserted into MiFID and the IMD. However, format and content of the KIID could still be dealt with by a common legal act on level 2 that would apply to the whole product universe.

- A KIID cannot have the same disclosure standard as a full prospectus (all information needed by investors to make an informed investment decision). Instead, the added value of KIIDs should be seen in giving comprehensible information on the economic characteristics of the product, i.e. mainly credit risk and market risks and opportunities to which investors in the product are exposed.

- In terms of scope of the initiative, it is preferable to use "retail investment products" as a basis, and then exempt such products from the KIID requirement for which this is not appropriate - particularly where not needed by retail investors (shares and plain vanilla bonds).

- Responsibility for the production of the KIID should be with producers if defined as a prospectus, and with intermediaries if made part of the sales rules (MiFID and IMD).

- Regarding risk disclosure, we agree that a system allowing easy comparability between different product classes would be very helpful for investors. However, developing a common approach for the whole product universe covered will not be an easy task, and further work directed to this may show that it is not possible to work with one approach for all products. In any case, it would be inappropriate to simply take over the risk classification rules developed for UCITS for the whole product universe, as this would not reflect different investment horizons, and put many products merely reflecting the performance of major stock markets into the highest risk class, thereby disregarding additional riskiness following from the product structure (particularly leverage). We would suggest conducting a research study dedicated to the development of a risk classification system.
- In terms of cost disclosure within the KIID, a "value for money" approach should not be followed, as this is too vague to define disclosure requirements (e. g. for funds, this could require the disclosure of all transactions costs).

General remarks

Overall, whilst we agree with the general objectives of this initiative as regards equivalent distribution standards and the provision of comprehensible pre-contractual information, we are seriously concerned that no progress seems to have been made within the last year (since the PRIPs workshop) about the conceptual foundations of the initiative. This is the case for the scope of the initiative - as set out in more detail below -, but also regarding the introduction of a KIID. For the latter, it seems obvious that the Commission so far simply uses the KII for UCITS as the starting point and more or less proposes to transfer this concept to the whole PRIPs world. In our view, this would clearly not be the right approach. There are important conceptual differences between the scope of the prospectus requirement for UCITS, in which the KII is embedded and which accordingly also defines the exact limits of the respective obligation, and the scope of the prospectus requirement for example for securities. These differences include the relevance of the targeted investor group. For UCITS, the prospectus requirements apply in any case, even where the particular fund is only sold to non-retail investors, whereas the prospectus requirement for securities only applies where these are offered to the public and none of the prospectus exemptions apply. They also include the scope of the requirement to update the prospectus, and the actual prospectus content: Due to the insolvency remoteness of (the portfolio held by) UCITS, information about the "company" is of far less relevance for investors than in the case of securities. Accordingly, the KII - rightly - has been designed so as to focus on information about the fund itself only, whereas for other products information about the underlying company has far more importance for an investment decision.

This is not to say that the scope of a KIID requirement for PRIPs generally could not be defined in parallel to that applying for UCITS (at least in certain points). However, this should be the result of a discussion of the underlying conceptual questions, which so far has not taken place. One important issue in so far is whether the KIID requirement should be justified with (more abstract) "market transparency" objectives, which generally underlie the existing prospectus requirements under EU rules (particularly those of the Prospectus and UCITS Directive), or whether it should be constructed as a sales rule, i. e. a condition for the protection of individual investors to which products are distributed (generally contained in the MiFID and the IMD). Again, this question is not just of theoretical relevance, as the scope of a KIID requirement would be different in both cases. For example, if the former approach is followed, there would have to be exemptions corresponding to those applying to the prospectus requirement for securities under the Prospectus Directive.

Even leaving the conceptual foundation of a KIID requirement aside, it seems unclear how this requirement could be constructed based on the proposed allocation of responsibilities. The requirement can only apply where products are offered to retail investors; however, making the product provider responsible for the production of a KIID each time a product is offered to retail investors (or a retail investor) would not be appropriate, as it is the intermediary, not the provider, that is responsible for the distribution.

Also, there has not been a debate so far about the general standard of information to be applied for a KIID, and in how far this is to differ from that applicable for prospectuses (under the Prospectus and the UCITS Directives). The Consultation document (under 4.2 a)) now addresses this question, but gives the impression that (full) prospectuses contain information not relevant for retail investors making an investment decision, but necessary for other reasons (for example "increasing market transparency in the broader sense"). We do not agree with this understanding of prospectuses. For both securities and UCITS, the prospectus content follows from the requirement that prospectuses have to provide investors with all information necessary to make an informed investment decision and, of even more importance, the full prospectus governs the contractual relationship (sets the rights and obligations) between the issuer and the investors. It would not be justified or practically possible to make the content of a KIID subject to the same basic requirement and scope. Due to their limited length, KIIDs can always only **aid** investors in making their investment decision. In our view, the particular added value of a KIID should be seen in describing the main economic characteristics of the product itself, not the details of the product provider. This would allow for a practical differentiation between the purpose of (full) prospectuses and that of KIIDs.

Finally, regarding risk disclosure, we strongly support the goal of fostering comparability between different types of PRIPs. The objective of risk comparability of different structured products led to the development of the risk classifications approaches of the German derivatives association (DDV) in 2006 and the Swiss structured product association (SVSP) in 2009. The DDV scaling system applies a risk rating scale from 1 to 5, the classification system of the SVSP a scale from 1 to 6. Both classification systems are widely recognized by the issuers and distribution banks. The DDV risk classification currently covers more than 430,000 certificates and is updated weekly. The SVSP risk classification covers more than 30,000 retail structured products. Both classification systems are based on value at risk with a 99 % confidence level and a holding period of 10 days.

Risk classification can help to compare different financial products. However, we believe that the CESR rating scale is too conservative, especially as regards the boundaries of the risk classes (volatility buckets). A well diversified blue chip stock fund (e. g., on January 3rd, 2011, the EuroStoxx 50 had an annual CESR-volatility of 25.87 % and would fall in the highest risk class 7) and similar retail structured products should not fall into the highest risk class since otherwise, a leveraged or single stock investment could not be differentiated appropriately.

We therefore suggest conducting a research study in order to benchmark the proposed CESR rating approach and alternatives for different asset classes and financial products such as UCITS and PRIPs. A re-calibration of the rating scale and the definition of new boundaries should be based on the results of that study and also on current classification practices. We suggest choosing the number of risk classes that is most frequently used in practice, as this would lower the implementation costs for the industry. However, more important is the adequacy of the risk class boundaries and the risk calculation approach.

Detailed Comments

Q1: Both in terms of theoretical justification of the concept and practicality, we would regard a scope covering all kinds of investment products offered to retail investors as more convincing. Particularly on the side of sales rules, there is no objective reason why investment products without an element of packaging should not be subject to e. g. the rules on investment advice or conflicts of interest. For the financial instruments covered by MiFID, this question is only of theoretical importance anyhow, as the scope of this directive is not limited to packaged products. On the other hand, the introduction of a category of "packaged retail investment products" will without any doubt lead to difficult questions of interpretation, which will increase the cost of compliance with any new rules based on the concept.

It is true that the proposed wider approach would not be appropriate for all products as far as the introduction of a pre-contractual disclosure of the key economic characteristics in a new disclosure document is concerned, as these seem obvious for products like plain-vanilla bonds. However, the answer to this could be to work the other way around and explicitly exclude such products from this obligation for which such document would not be appropriate. For this discussion, however, again the concept of PRIPs would not seem to be the right starting point; rather, the decisive questions should be for which kinds of products there is either no need for particular short form product information from the perspective of retail investors, or the production of such document would be particularly difficult in practical terms. These questions would for example point to the exclusion of shares and plain vanilla bonds from this requirement.

Q2: Within the PRIPs concept, we agree it would make sense to look to potential fluctuations in investment values as one defining element. This would not only ensure the required investment character of the product, it would also exclude plain vanilla bonds from the scope of the initiative.

Q3: Again, we agree that within the proposed PRIPs concept, the proposed concept of indirect exposure would make sense. This approach would capture the idea underlying the PRIPs concept that there is a special need for investor protection if investors do not invest into capital markets directly.

Q4: From our perspective, it would be helpful if the definition would define the scope as clearly as possible. As there may be an uncertainty if e. g. indices can be regarded as "assets", the definition should make clear that all products linked to reference values are covered.

Q5: We welcome the statement in the Consultation document that derivative instruments would also be covered by the proposed definition. Leaving products like options, futures and contracts for difference (CFDs) out of the scope would create an unequal playing field for instruments like warrants with which they are competing, particularly given that some of these products (particularly CFDs) are heavily marketed to retail investors.

Q6: Yes, simple deposits should be excluded from the scope of the initiative. These do not constitute investment products, and only for such products there is a need for sales rules equivalent to those of MiFID and a pre-contractual disclosure document.

Q7: Only option 1 would be appropriate in our view, as this would be in line with the market exposure requirement underlying the PRIPs concept. Option 2 would exclude deposits where just the yield is subject to fluctuations in the market value of underlying assets (e.g. shares), while capital protected investment products would qualify as PRIPs.

Q8: In our understanding, instruments where "simple" interest is paid (like fixed and floating rate bonds, certain covered bonds, German Pfandbriefe etc) would not fall under the proposed definition in the first place, as they do not comprise an element of "indirectness". For this purpose it would be appropriate to provide such a definition of “simple” interest bearing bonds.

Q13: Yes, within the proposed PRIPs concept, we would regard an indicative list as a necessity to provide for sufficient legal certainty. It would also be necessary to update such list in accordance with market developments.

Q15: We agree it would not make sense to create a wholly new PRIPs sales regime. However, in our view the rules on a pre-contractual disclosure document would better also at least be based upon the existing "distribution" directives (MiFID and IMD), either by inserting these rules directly into the mentioned directives, or by aligning the scope of other rules used to that of MiFID and the IMD (taking account of the necessary exemptions, as set out in our answer to Q1). Otherwise, there would be no guarantee that the scope of the rules on the disclosure document will correspond to those of the relevant sales rules, as instruments not covered by the MiFID or the IMD could still be regarded as PRIPs by virtue of the definition contained in the legal instrument governing the disclosure document. Even if the principle KIID rules would be inserted into MiFID and IMD themselves, content and format of the document could still be developed and negotiated jointly, as the principal rules within MiFID and IMD setting up the requirement for a disclosure document could leave the details to a common level 2 instrument applicable to the whole PRIPs product universe. We are also highly concerned about the apparent lack of considerations how the new disclosure document would tie in into the general framework of product and distribution related rules, as set out above.

Q17: As set out above, the particular added value of a KIID should be seen in describing the key economic characteristics (opportunities and risks) of the product itself, not the details of the product provider. This would allow for a practical differentiation between the purpose of (full) prospectuses and that of KIIDs. Otherwise, we agree with the proposed general design principles, but not with the statements regarding the difference between a KIID and a (full) prospectus (as set out above). Also, in the interest of providing investors with valuable information, care needs to be taken to make the KIID a balanced document and not mainly a list of risk warnings.

Although not addressed in the Consultation document, we would also like to mention that the procedure of making the KIID available for retail investors will not be straightforward in all cases. Particularly for products aimed at self-directed investors and traded on-exchange (like warrants in some EU member states), which are typically traded through a trading system provided by a broker, it may be practically almost impossible to build in functionality into the system providing the KIID to investors before they enter into a transaction. It will therefore be highly important to design the "publication" requirements for KIIDs in a way which does not hamper the acquisition of certain products.

Q 18: The introduction of a KIID only makes sense if this is a separate document compared with other available information. However, given the strict size limits that are likely to apply, it will be important to select the items required for a KIID carefully, as this document can never fulfil the same information standards as for example (full) prospectuses. The KIID should also include a section detailing where an investor can obtain further comprehensive information.

Q20: Yes, a certain degree of tailoring will certainly be necessary in connection with different types of PRIPs. For example, it seems likely that the size limit(s) in force for UCITS KII will not be sufficient for some products. Certain non-harmonized funds (e. g. closed-ended funds) may be one case. In general, tailoring would definitely be necessary in the description of risks, costs, and performance of different products.

Q21: Only a detailed review of all products types covered will show if complying with a common structure will not work in some cases.

Q22: Please see our answers to questions 36 to 43.

Q 24: Yes, in the interest of uniformity, it makes sense to control the KIID content as proposed.

Q25: We do not agree with a general principle that KIID must be "kept up to date". An obligation to regularly update the KIID would be unduly onerous and often impracticable. As set out above, the scope of an updating requirement is merely the function of the general legal concept underlying the KIID. If the KIID would be made subject to the general rules on prospectuses, for securities the updating requirement could only apply as provided for in Art 16 of the Prospectus Directive. If an updating requirement is introduced, the circumstances requiring an update to a KIID would have to be very clearly defined, particularly regarding changes in any risk classification introduced. It would also have to be clarified whether all versions of a KIID would have to be archived (and made available to investors).

Q27: We agree that in practice, the KIID will often have to be written by product manufacturers, as even if intermediaries will be made responsible many intermediaries will ask product manufacturers to provide them with some of the required contents which they may not be capable to elaborate or produce. For example, it seems likely that certain intermediaries would not be capable of producing simulations or certain complex risk indicators' calculations. In legal terms, however, as set out above, the allocation of responsibilities has to follow the conceptual framework behind the KIID requirement. If this requirement is justified with (more abstract) "market transparency" objectives and therefore effectively integrated into the general prospectus rules (particularly those of the Prospectus and UCITS Directive), product manufacturers should be made responsible; if it is constructed as a sales rule, i. e. a condition for the protection of individual investors to which products are distributed (as generally contained in the MiFID and the IMD), responsibility should be given to distributors. – If integrated into the prospectus rules, it should be noted that the document would pursue goals similar to the ones of the Summary Note of the prospectus under the Prospectus Directive. As a consequence, and in order to avoid duplication of information, the KIID could become the template of the Summary Note (or of a part thereof).

Even leaving the conceptual foundation of a KIID requirement aside, it seems unclear how this requirement could be constructed based on the proposed allocation of responsibilities. The requirement can only apply where products are offered to retail investors; however, making the product provider responsible for the production of a KIID each time a product is offered to retail investors (or a retail investor) would not be appropriate, as it is the intermediary, not the provider, that is responsible for the distribution.

It should also be noted that intermediaries in some EU countries such as Italy are already responsible for producing and actually delivering to their customers, e. g. in the case of Italy the so called "*scheda prodotto*", which fulfils disclosure requirements similar to the ones of the KIID. Also in light of this experience, intermediaries appear to be, in principle, well suited to produce and be responsible for the KIID. In any case, an obligation to translate the KIID (and ensure accuracy of translation) should sit with local distributors, which will be best placed to do this.

Q 32: Yes. Under the revised Prospectus Directive, the summary prospectus will be subject to the same general information standard as the KIID; accordingly, we do not see any case for a duplication of disclosure requirements.

Q34: No. Exempting the UCITS KIID from the application of the same standards underlying the KIID concept for the rest of the PRIPs universe would not be justified, and could create a dangerous precedent to the disadvantage of other PRIPs. It is true that the rules governing the UCITS KIID have just been finalised, and that changes to documents and procedures which have just been introduced have to be avoided. In our view, the right way to approach this would be to ensure that the changes necessary within the UCITS framework to bring this in line with the overall PRIPs concept are codified at the same time as the other PRIPs rules, but only enter into force a number of years after 2011.

Q. 36: The main challenge that needs to be addressed is the issue of comparability. The proposed CESR-approach for structured UCITS requires the calculation of a 99 % value at risk (VaR) for a holding period that equals end of maturity. The 99 % value at risk is then converted into an annual volatility (see for details the CESR rule for UCITS in CESR/09-1026).

However, this approach fails to compare risks of different investment products adequately. For illustration purposes consider the following example: If an investor wants to invest for five years, a fully capital protected investment product with five years maturity provides no losses, while the same product with only two years maturity carries a reinvestment risk (uncertainty of future investment opportunity). For an investor who wants to invest for two years, the shorter product implies no losses, however, the five-year product bears e.g. interest rate risk after two years with three years remaining lifetime since the price at that time is dependent on the future level of interest rates. Comparability of the different risk figures is suggested by annualizing the CESR results of different investment horizons, but, as the example above shows, this mere conversion leads to spurious results. For both products to be really comparable, the same holding period has to be applied for calculating risk. Because of this fundamental problem the German derivatives association (DDV) and the Swiss structured product association (SVSP) adopted an identical holding period of 10 days for value at risk calculation purposes for all structured products irrespective of their maturities. Although investors usually have much longer holding periods, the short-term perspective offers several advantages: First, the problematic issue of realistic drift (expected return) estimation needed for any kind of long-term risk forecasts is avoided since the drift is almost irrelevant and can be ignored for short holding periods. Second, if the holding period is less than the products maturity, the impact of risk factors other than the underlying price (e.g. volatility, interest rates) can be analyzed. Third, the short holding period is in line with current market standards and regulatory requirements. In addition, many retail structured products have a maturity of less than a year and could not be assessed for a holding period of one year (or even longer). More importantly, however, the relative risk of two different products would remain almost the same for longer (more realistic) holding periods if the drift parameter could be estimated correctly. Hence, the absolute level of risk is dependent on the assumed holding period, but the relation between the products is basically not. To conclude, the risk comparability of different investment products can be best realized with a short holding period.

Q. 37: Many retail structured products are exchange-listed and thus very liquid. If the products are illiquid, a risk adjustment in terms of bid-ask-spread could be applied (liquidity adjusted risk measures). Of course this approach cannot be applied for products without listings or where there are no bid-ask spreads. As liquidity measures the cost and the time period to unwind an investment position and therefore addresses different product attributes as well as investors' preferences, we suggest developing an additional rating scale for liquidity. There is a broad literature on liquidity that can help to develop an appropriate liquidity rating system that can consider liquidity and liquidity risk.

If structured products are not fully protected against issuer risk, one could adjust for issuer risk via the default risk and rating specific interest rates. The German risk classification approach based on value at risk incorporates the rating specific issuer risk. We would appreciate the opportunity to illustrate the currently adapted approach as well as potential modifications for default risk.

Q38: Probably the main challenge in so far will be to take account of the structural differences between different product types when developing the disclosure requirements for the KIID. For example, product related costs - in a wider sense - have a very different relevance for investors in the case of products with no predetermined payout leaving the investment to the discretion of an investment manager (such as classical investment funds) than for products with a defined payout where the return depends on objective market factors and "structuring cost" does not affect the payout. Information regarding costs, in general, should be included only if they impact the return. Not recognising structural differences amongst products when developing the disclosure requirements would be one fatal example of a "one size fits all" approach.

Q39: We do not agree with a "value for money" approach. This concept is too vague to be made a guideline for the required KIID content. For example, in the case of UCITS, it would be doubtful if "value for money" would not also include all transactions costs which a fund incurs. Such approach would also not recognize the structural differences between different product types (see our answer to the previous question).

Q40: We agree that further work will be necessary to evaluate the possibility of introducing common standards for performance information. It seems too early to say if for certain products contained in the PRIPs universe the provision of performance information will not be possible or useful, or if specific templates for such information will be needed in some cases.

Q41: We are very sceptical vis-à-vis the possibility of creating uniformity over the whole product range for this point. In our view, the primary objective has to be to ensure that such information is appropriate and meaningful for the individual product.

Q42: We agree that the existence of a guarantee or capital protection for a product are of high relevance for investors and should therefore have to disclosed in a KIID, preferably in a prominent position. However, given the huge variations in the structure products, we are sceptical as for the possibility of creating uniform description standards.

Q43: At least for “defined payout products” (see our answer to Q38), a requirement for disclosure of a specific “cost of the guarantee” would not be justified, as this would be part of the structuring costs which do not have relevance for the entitlement of the investor under the product.