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COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT

Accompanying the document

Proposal for a Regulation of the European Parliament and of the Council on

key information documents for investment products

{COM(2012) 352 final}
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1. INTRODUCTION

The focus of this impact assessment is product disclosures in the retail investment market.

This market is dominated by so-called 'packaged retail investment products' (PRIPs) – financial product manufacturers intercede between retail investors and financial markets, building products normally designed to satisfy specific investment goals, with the intention of being sold to retail investors either directly or through intermediaries. Examples of PRIPs include investment funds such as UCITS, retail structured products and unit-linked insurance contracts.

To protect investors, measures have grown up at the national and EU level that require defined information to be provided to retail investors (termed 'product disclosures'). These measures are however uncoordinated and patchy – requirements vary according to the legal form of products, not their economic nature or risks. This has made comparisons between products and comprehension of product features harder for investors. The measures have also not achieved the outcomes being sought for retail investors: product disclosures have often focused more on reducing legal risks for the provider rather than providing effective and balanced communication about products.

In its April 2009 Communication on PRIPs, the Commission concluded that this was an important problem with a European dimension: inconsistencies at the European level underpinned regulatory failings, which could only be addressed by legislative change at the European level.[1] (The Communication noted two areas of further work: rules applying to sales, and rules on product disclosures. This impact assessment focuses on the latter only[2]).

Addressing these regulatory failings also contributes to responses to the financial crisis. Following the crisis retail investors lost money with investments that carried risks that were not transparent or understood by those investors, partly due to deficient product disclosures. There has, perhaps rightly, been a consequent collapse in investor confidence: a recent survey of consumers across the EU showed they trust the financial services less than all other industry sectors.[3]

Addressing weaknesses in product disclosures will help rebuild confidence on a sound basis, improving the transparency and efficiency of EU retail markets.[4] Innovative steps have already been taken along these lines to improve product disclosures for UCITS (through the 'key investor information' (KII) regime).[5] The task now is to address options for similar improvements for other investment products.

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1 http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/29042009_communication_en.pdf.

2 The area of sales has ben addressed in proposals on changes to the Markets in Financial Instruments Directive (MiFID) and the Insurance Mediation Directive (IMD). For MiFID, see http://ec.europa.eu/internal_market/securities/isd/mifid_en.htm; for the IMD, [forthcoming].

3 In the fourth Consumer Markets Scoreboard the retail financial services market ranks worst out of fifty consumer markets for overall market performance, including worst for ease of comparing products and services sold by different suppliers: (SEC2010)1257: The Consumer Markets Scoreboard, 4th Edition, October 2010.

4 http://www.iosco.org/library/pubdocs/pdf/IOSCOPD343.pdf (IOSCO).

5 Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC.

2. PROCEDURAL ISSUES

2.1. Genesis of work

The genesis of the work on PRIPs is a request from the ECOFIN Council in May 2007 for the Commission to examine the coherence of disclosure and distribution regimes in EU law applying to different types of retail investment product. A first stage of work culminated in the adoption of a Communication on PRIPs by the Commission in April 2009. This was accompanied by a high-level impact assessment (hereafter, PRIPS Communication IA).[6] Following the Communication, the Commission has been further consulting with stakeholders. The work has been split into two workstreams – the current workstream, focused on product disclosure requirements, and a second workstream focused on sales rules.

2.2. Consultation of interested parties

The PRIPs work has been based throughout on extensive consultation with stakeholders, including a written call for evidence in October 2007, a Feedback Statement in March 2008, a technical workshop was held with industry representatives in May 2008, and a high-level Open Hearing in July 2008. Following the Communication, a second, more concrete phase of work and consultation began. A further technical workshop was held in October 2009, which was followed by the publication of an Update on the work in December 2009. The three level three European committees of national supervisors prepared individual reports to the Commission in 2009, followed by a joint report in 2010. Finally, the Commission launched a public consultation on concrete options in November 2010.

Records of these phases of consultation, which respected the Commission's minimum standards on public consultation, are available on the European Commission website.[7] In general, responses to the November 2010 public consultation showed support from industry, consumer and Member State stakeholders for the initiative, though there were differences of view on the scope of the work and the extent to which the UCITS KII might be taken as a model for other retail investment products.

Table 1: Preparatory Steps

Major steps / inputs	**Timing**
ECOFIN request	May 2007
Launch of Call for Evidence	October 2007
Publication of Feedback Statement on Call for Evidence	March 2008
Industry Workshop	May 2008
Open Hearing	July 2008
Communication	April 2009
CESR, CEBS, CEIOPS advice	October 2009
Technical Workshop	October 2009
Update	December 2009
Joint CESR, CEBS, CEIOPS advice	September 2010
Public Consultation	November 2010

These formal events have been supplemented by a series of discussions with consumer representatives (FIN-USE, Financial Services Consumer Group, and Financial Services User Group), regulators (Financial Services Committee, European Securities Committee, European

[6] See: http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/29042009_impact_assessment_en.pdf.

[7] See: http://ec.europa.eu/internal_market/finservices-retail/investment_products_en.htm.

Insurance and Occupational Pensions Committee) and industry representatives. The consultation process revealed a variety of stakeholder views, which have strongly informed the analysis that follows.

2.3. Supporting work

The following supporting work informs this impact assessment:

- A report produced by a joint task force of the level three committees. (3L3 Report).[8]
- A study on the costs of implementation of the KIID for UCITS. This study provides a proxy (subject to adjustments) for costs of other industry sectors for introducing similar disclosures for their products. (CSES).[9]
- A study testing developing options for the KIID for UCITS on a representative sample of EU consumers. (YouGov & IFF).[10]
- A study seeking behavioural economics insights on the different factors relevant to investor decision making. (Decision Technology).[11]
- A study on the potential costs and benefits of different options for change in the area of sales rules for the distribution of non-MiFID PRIPs; this provides market mapping evidence and also evidence on cost drivers, though its focus was primarily on product distribution. (Europe Economics).[12]
- A study seeking to assess the quality of advice being offered across the EU; this provides some market mapping evidence. (Synovate).[13]

2.4. Related initiatives and scope of this impact assessment

There are a number of related initiatives that link to the work on PRIPs product disclosures, or can be expected to benefit EU retail investors.

These include the review of the Markets in Financial Instruments Directive (MiFID), the review of the Insurance Mediation Directive (IMD), work on the Prospectus Directive (PD), current work in the area of asset management (notably in relation to Alternative Investment Funds, but also the implementation of UCITS IV), ongoing work on Solvency II, the Commission Green Paper on pensions, and upcoming work by the Commission on the Single Market Act. Other work underway can be expected to impact the retail investment markets, notable work on the protection schemes for investors when those providing investments are not able to meet their commitments to investors (deposit guarantee and investor or policyholder compensation schemes).

The baseline for this impact assessment takes into account the likely evolution of measures in these other areas.

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8 See: http://www.cesr.eu/index.php?docid=7278

9 See: [to be published – reference to be added when available.]

10 http://ec.europa.eu/internal_market/investment/docs/other_docs/research_report_en.pdf

11 http://ec.europa.eu/consumers/strategy/consumer_behaviour_en.htm

12 http://ec.europa.eu/internal_market/consultations/docs/2010/prips/costs_benefits_study_en.pdf

13 http://ec.europa.eu/consumers/rights/docs/investment_advice_study_en.pdf.

Scope of the impact assessment and key interactions

This impact assessment is focused solely on **options relating to improving information given to investors about PRIPs (their risks, costs and features)**.

This impact assessment does not address **options related to sales of PRIPs.** This area, identified in the Communication on PRIPs as a second priority alongside product information, relates to investor protection measures for investment advice and sales services. Options for improving such rules are being considered and assessed separately in the reviews of MiFID and the IMD.

The identification of options for improving product information and assessment of the impact of these can be undertaken independently from measures on sales, since the subject matter, impacted entities and underlying regulatory and market failings are separte and there are no necessary dependencies between the two areas.

Measures on disclosure and distribution can expected nonetheless to be mutually supportive, and indeed their contribution to addressing problems in the retail markets can be expected to be greater in combination than in isolation. Given this, the assessment of options and their overall effectiveness and efficiency in this impact assessment takes into account relevant synergies, and this impact assessment should be read alongside assessments of options for the IMD and MiFID.

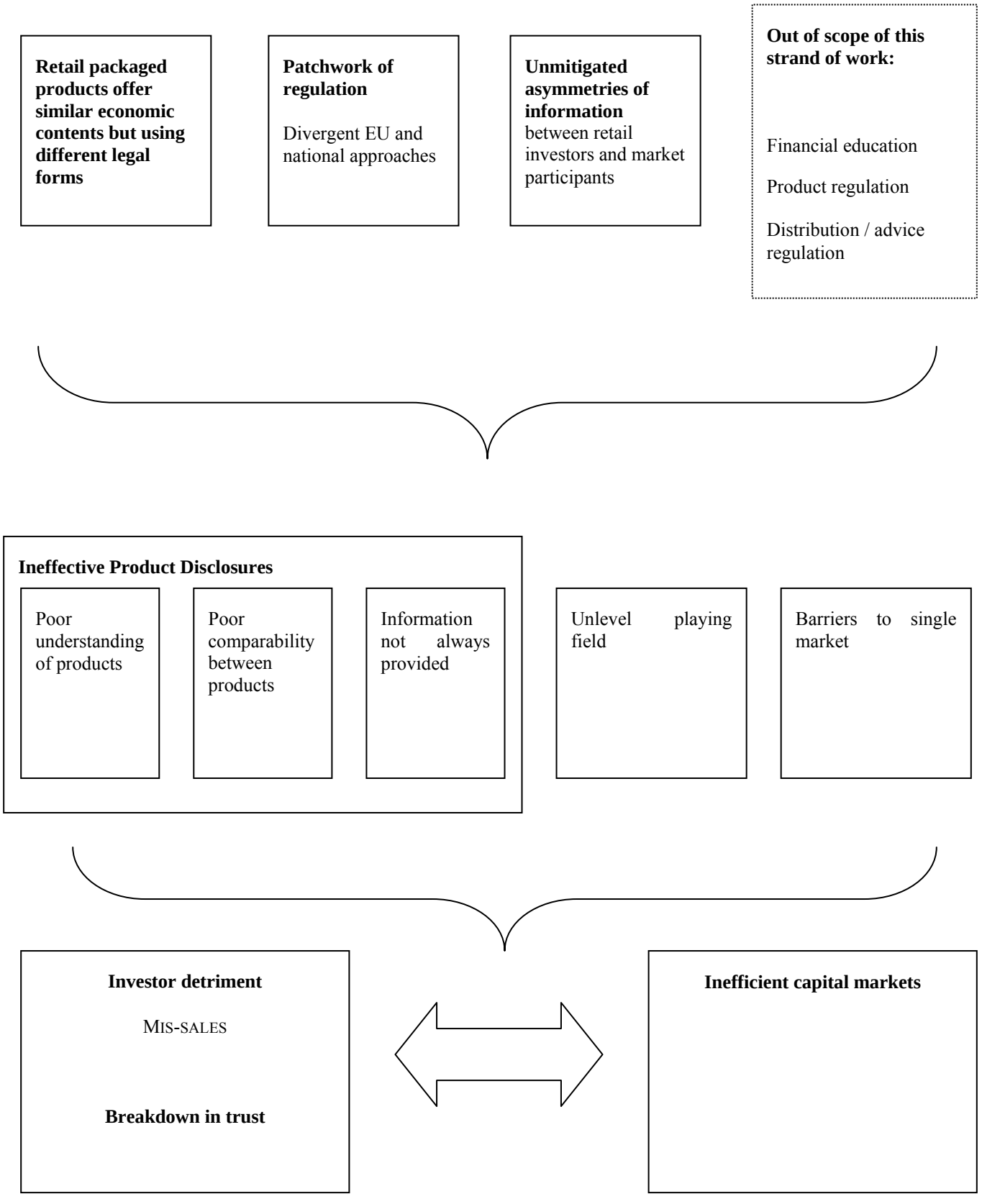
Details on linked initiatives can be found in Annex I.2.

2.5. Impact Assessment Steering Group

An Inter-service Impact Assessment Steering Group, chaired by DG Internal Market and Services, was established in November 2010, involving representatives from DG Competition, DG Taxation and Customs Union, DG Justice, DG Economic and Financial Affairs, the Secretariat General, the Legal Service and DG Health and Consumers. The Group met on 26th October 2010, 2nd February 2011 and 2nd March 2011.

The draft impact assessment report was examined by the Impact Assessment Board, and revised in line with its positive opinion of 15 April 2011. Amongst other improvements, the interaction between the proposal and other measures on investor protection was clarified, the scope of the proposal made clearer, the analysis of options improved and the analysis of other factors that are relevant for investor decision making deepened.

PROBLEM TREE



3. PROBLEM DEFINITION

This chapter should be read in conjunction with the 'problem tree' on page 9.

The analysis builds on the impact assessment completed for the April 2009 PRIPs Communication (hereafter, PRIPS Communication IA). This identified the broad market context and problem drivers for this initiative. It showed that existing regulatory requirements in the retail investment markets failed to fully address 'information asymmetries' (i.e. differences in comprehension of proposed investments between market professionals and retail clients) and 'principle-agent' misalignments (i.e. those manufacturing and selling products have incentives that are not always aligned with those of the retail clients buying the products). The patchwork of European regulation had failed to effectively reduce consumer detriment, and acted as a barrier to member states addressing such detriment themselves, while at the same time creating an un-level playing field between different products and distribution channels and erecting additional barriers to a single market in financial services and products. EU legislation was a source of the problem, so legislative change at the EU level was necessary to effectively and efficiently address these challenges.

Two strands of work were identified: improving consistency and effectiveness of the information about products from product providers, and improving consistency and effectiveness of the rules on distributors.As noted, this current impact assessment only addresses **the first** of these two strands of further work triggered by the Communication: **product disclosure**.[14]

3.1. Size of EU retail investment markets, their regulation, and the policy context

Size

There is currently no definition of the retail investment markets with the EU. If we understand this concept as the market for investment products that can (and typically do) reach the retail customer, a wide range of products can fall into this category. Examples include funds of various types, unit-linked life insurances (and other investment-based insurance products), shares and a miscellany of other kinds of products that might be characterised as 'retail structured products'.

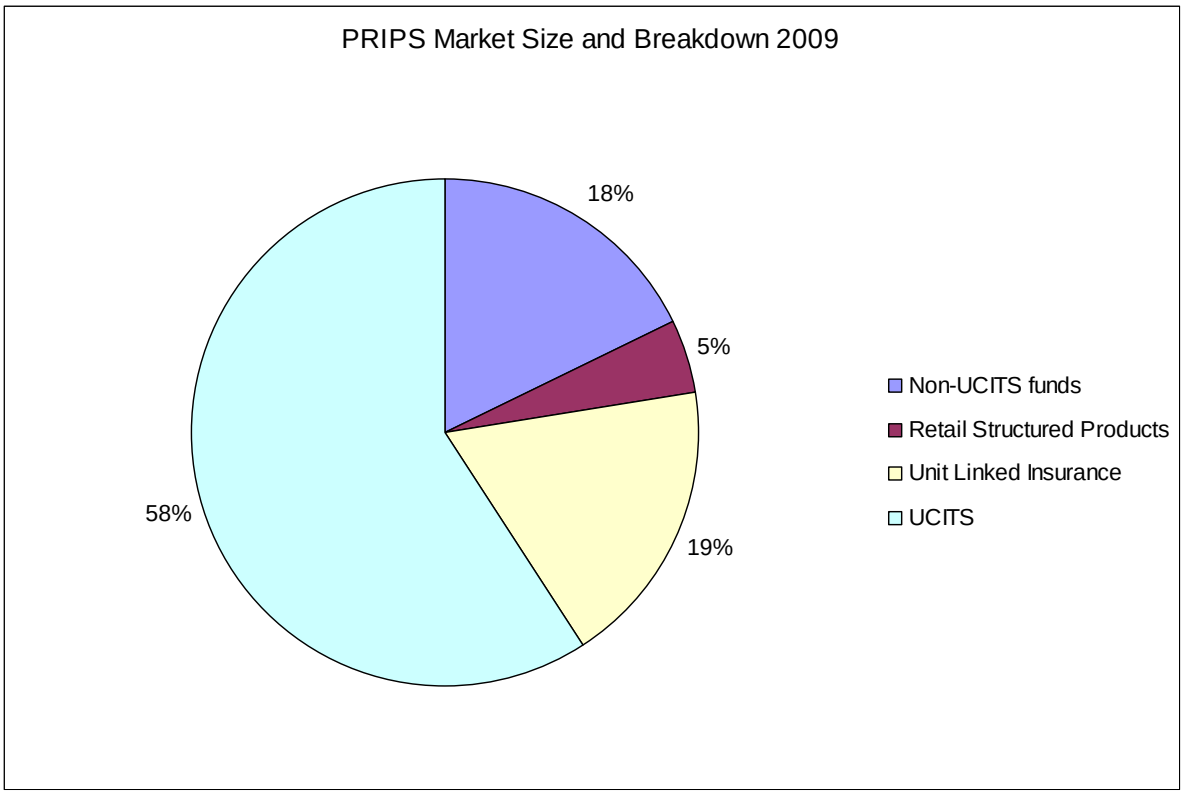
Given that the boundaries of this market are not currently determined under EU law its magnitude can only be estimated. At the end of 2009, the European asset management industry managed assets worth around €9 trillion in investment funds.[15] Of this, EFAMA estimate that roughly €3 trillion had been contributed directly by retail customers; a part of the

[14] For the purposes of this impact assessment, by product disclosure we mean information about the product provided to the investor at a pre-contractual phase, i.e. before concluding the contract. This is information about the features, risks and costs of the product itself, that can be used to compare it with other products. This is distinguished from "other disclosures" that are provided to the investor at a pre-post- or contracting phase, e.g. on the firm that sells the product, the regular info on the product's performance, etc. Other disclosure requirements may be laid down under legal rules on distribution and advice. For the description of a typical sales process, please see box 1 under section 3.1; for more detail see Annex 1.9. As set out, the area of sales processes – distribution and advice, including disclosures about these – is addressed in separate initiatives and impact analysis work by the Commission, under the reviews of MiFID and the IMD.

[15] Source: EFAMA Investment Fund Industry Fact Sheet, May 2010. This figure is equivalent to over 50% of EU GDP and around 33% of global fund assets.

remaining €6 trillion will also be 'retail' due to intermediation (where third parties intercede between the fund and its end clients so the fund cannot determine the classification of the end client), but it is difficult to assess the scale of this.[16] Looking at the insurance sector (which offers a variety of products that provide retail investment benefits), CEA data from 2009 shows insurers holding overall investments in the range of €5 trillion (these investments cover savings and pensions but also funds backing pure insurance products, some of these investments will be institutional holdings of funds such as UCITS; around a third can be roughly estimated to be held in as unit-linked life insurance).[17] Data providers linked to the retail structured product market suggest that structured products taking securities and deposit forms amounted to less than €0.5 trillion in 2009. This suggests an overall market of over €9 trillion in 2009, with a breakdown according to Graph 1.

Graph 1: Estimate on PRIPs market breakdown, 2009



Source: EFAMA, CEA, Arete Consulting; these figures do not distinguish between retail or institutional business

The Decision Technology study surveyed householders and found roughly a split of around 36% cash, 7% funds, 13% shares, 4% fixed income, and 37% insurances. However these figures are self-reported by respondents, and the precise makeup of different categories is difficult to assess, so these figures may not be reliable.

The market in general appears to be dominated by funds and insurance-based investment or savings products, with structured products currently taking a relatively small slice of the market. The Decision Technology survey suggests however that households maintain significant holdings in the form of cash or deposits (which fall outside of the retail investment market in this impact assessment).

[16] See Annex I.4 for some alternative figures, prepared for the PRIPs Communication IA.
[17] CEA Statistics N°43: The European Life Insurance Market: Data 2000-2009.

Box 1: What are PRIPs?

In simplest terms, a PRIP is an investment product sold to a retail customer. This captures the three key concepts: first, the term 'investment product' captures the two key criteria that define PRIPs. As investments, they are propositions that expose the investor to risks; the investor provides capital (whether in a lump sum or through regular savings), and the investment promises returns on this capital. As products, they are 'manufactured' by financial services intermediaries, who construct the propositions to provide cost effective access to investment propositions for retail investors who otherwise would have neither the expertise or access to make such investments. Secondly, the prescence of a retail customer. Measures designed to address the needs of retail customers may not be relevant for professional customers.

The Commission has consulted on options for defining PRIPs, including distinguishing them from ordinary savings products (that do not carry investment risks) and sought input from miscelaneous studies, so as to ensure coherent requirements apply to all the products of relevance, irrespective of their legal forms, as set above in sections 2.2 and 2.3.

The results from this consultation have informed the identification of options on scope and assessment of their impact in section 6.2 below.

Regulatory context

Regulations on product disclosures address, in particular, the needs of investors for information on the nature, risks, costs, and possible performance of specific products.

Such regulation sits within a wider context, both nationally and at the level of EU laws, with other rules covering areas such as distribution and sales, including disclosures about distributors and their costs, prudential requirements (capital and solvency rules), and other sundry areas, such as rules on product providers to ensure they are capable of undertaking the business they engage in, and rules on redress and compensation schemes to ensure customers can obtain redress in relation to fraud or return of investments in the case of the failure of firms.

As will be discussed in greater detail below, regulation of product disclosures is currently patchy and inconsistent, with divergent approaches at the EU level according to the legal form a product takes (rather than its level of risk for the investor). Some Member States have sought to harmonise requirements cross-sector, in so far as EU legislation allows. In practice requirements placed on product manufacturers vary significantly between Member States: a CEIOPS survey concluded "there are a striking number of detailed additional measures [on pre-contractual disclosure], which are unique to individual Member States … suggesting that Member States have sought to be more prescriptive than the terms of the CLD in order to, for example, protect consumers".[18]

The UCITS market – a significant proportion of the PRIPs market, and one with strong cross-border dimension – is currently implementing Commission KIID requirements. These are strongly prescriptive and standardised, and will introduce a common product disclosure document (with a simplified but objective risk rating) across all EU markets for such funds. There are no comparable requirements for other products at the EU level under existing legislation.

Box 2: Role of product disclosures within a typical retail sales process

[18] https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/CEIOPS-Report-National-Measures-Unit-Linked-Life-insurance-products.pdf, p. 24.

Most investments sold to retail customers in the EU are in practice sold through 'advised' channels (estimates vary, but Decision Technology survey suggests between 60 and 80% of sales might be generally described as 'advised').19 Product disclosures have an important role to play in such sales.

Under an advised sale the intermediary gives a personal recommendation to the client as to possible suitable investments based on the client's needs and situation. The sales process typically will have two logically separate aspects. The first aspect relates to the sales process itself, and any services being offered by the sales person, notably the service of providing advice to the investor. The advisor would typically make disclosures to the customer about themselves, about the service they are offering, and about any fees associated with the service. Following discussions between the advisor and the customer, including gathering of information by the advisor, the advisor might typical make a recommendation, providing for instance a short list of products.

Product disclosures – the focus of this impact assessment – can be defined as the information provided to the customer at this point, information about the individual products being proposed. The purpose of these disclosures is typically to ensure comprehension of products including their specific risks and costs, and, in some cases, to enable investors to better compare between products.

(For a fuller discussion of the practical context of product disclosures, see Annex I.9).

3.2. Problem drivers

Three key 'problem drivers' underpin and structure the problems covered by this impact assessment (as already discussed in the PRIPs Communication IA):

- **Driver 1:** there is a proliferation in (often complex) investment products on offer to consumers, that take different legal forms and structures yet which offer comparable risk/reward profiles; yet

- **Driver 2:** these different products are regulated in different ways according to their legal form rather than their economic nature; as a consequence

- **Driver 3:** there are powerful asymmetries of information between retail customers and the industry which remain unmitigated.

These drivers are not independent. Drivers 1 and 2 contribute to Driver 3.

3.2.1. Driver 1: Proliferation of product types aimed at same investment needs

The key types of PRIP identified through earlier consultation and impact assessment are:

- Funds (whether UCITS or non-harmonised, covering both open-ended or closed-ended structures);

- Investments packaged as life insurance policies (notably, unit-linked, index-linked and certain other 'with-profits' products); and

- Retail structured products (typically in the form of structured securities or structured term deposits; so-called 'structured' products also in some markets have taken the form of funds or life insurance policies).[20]

19 Decision Technology, p.8.

20 See Annex I.3, 4 for further data on the evolution of the market, showing in particular the relative growth – though this has recently slowed – of the retail structured product market.

Earlier market mapping by the Commission, responses to consultation, and discussions with stakeholders have underlined that functionally similar investment products are increasingly manufactured ('packaged') using a variety of legal forms, with similar investment propositions being offered across different industry sectors. This 'packaging' of products can make them appear very different for investors, even where underlying economic purposes are similar (e.g. a fund, a deposit and a unit-linked insurance contract look different, but might be equally used to have the same investment exposuire, for instance to a particular stock index).

There is a potentially bewildering variety of products; for instance, during 2009 there were over 274000 tranches of retail structured products brought to market and 36000 UCITS funds for sale.[21] Factors leading to a proliferation in types of product could include differences in tax treatment, regulatory arbitrage, and nationally specific market traditions. Yet all of these products seek to address a relatively simple need: capital accumulation by taking on risk so as to have the potential for beating a risk-free rate of return. While these products vary in what they offer – some combine the prospect of capital accumulation with a capital guarantee, while others do not; some combine an investment element with another element (such as offering life insurance benefits) – they all are offered as investments to retail customers when they approach financial intermediaries or directly product manufacturers.

Responses to the PRIPs consultation, including product providers, supervisors and consumer representatives, support the view that the product types identified above are broadly competing for the same investments of the same retail customers, offering similar investment propositions but packaged in different ways. Respondents have generally agreed that the identified product types above between them make up the vast bulk of the retail investment market as it currently stands, though a number have noted that other possible competing products or investments might emerge. Some consumer representatives and national supervisory authorities have argued in favour of widening the perspective on competing or substitutable products to include deposits and simple savings accounts, which are subject solely to interest rates. Also, some consumer representatives and national supervisory authorities took the view that 'unpackaged' assets (such as ordinary corporate equities or bonds) should be subject to the same disclosure requirements as those that are packaged. More technical views have also been raised over the details of where the 'line' between investments and products serving other client needs might sit, particularly for products which combine investments with other elements. In addition, there has been debate over the extent to which pensions (notably, personal pensions, or 'pillar three' pensions) might be considered to be competing with other retail investment products, and whether or not these might be included or excluded with the PRIPs initiative.

Nonetheless, despite differences over technical 'boundary' issues, consultations with stakeholders have revealed a general acceptance that investment products with different legal forms are currently competing with one another, and that these legally different products raise, despite their differences in form, similar needs for clearer information on costs and risks that is capable of comparison between types of products.

3.2.2. Driver 2: Patchwork of regulation

European and national regulation on product disclosures already applies to most products (structured deposits excepted).

However, Community law has developed on a largely sectoral basis, at different speeds and with different outcomes in mind. As a result, the rules governing what disclosures need to be

[21] Source: EFAMA, Arete Consulting.

prepared and what these should look like vary materially according to the sector in which the product is originated and in which an intermediary operates.

Notably, most disclosure regimes are relatively high-level and do not set out in detail the form and content (or the 'look and feel') of product disclosures. The UCITS KIID regime is an important exception: this regime is very prescriptive and detailed, and was developed to ensure disclosures in a short and investor-friendly manner capable of supporting comparisons between funds (including those sold cross-border).

The following table illustrates this 'regulatory patchwork'; see Annex I.6 and I.7 for further details on the contents of the different existing regimes, and a summary of certain national requirements that also apply to firms in this area.

Table 2: Disclosure rules and intermediary regulation in Community law for packaged retail investment products

<table>
<tr><th></th><th>UCITS</th><th>Other Open-Ended Funds</th><th>Unit-linked life insurance policies</th><th>Structured securities and closed-end funds</th><th>Structured term deposits</th></tr>
<tr><td rowspan="3">Rules on product information applying to manufacturers, issuers or intermediaries</td><td>Key Investor Information (KII) of UCITS Directive</td><td rowspan="2">MiFID

(high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td><td>Solvency II (CLD rules)</td><td>Prospectus Directive[22]</td><td rowspan="2">No rules at EU level</td></tr>
<tr><td>MiFID[23]

(high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td><td>Insurance Mediation Directive[24] for some product disclosure requirements</td><td>MiFID

(high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td></tr>
<tr><td colspan="5">E-commerce Directive or Distance Marketing of Financial Services Directive</td></tr>
</table>

This patchwork must also be understood in the context of developments at the national level. Member States have approached the retail investment market in different ways, to the extent that EU legislation affords them discretion (notably for products other than UCITS). The IMD and Consolidated Life Directive (CLD, now Solvency II) rules are not maximum harmonising, permitting national rules that are more strict; however, CEIOPS mapping work shows that the national approaches to product disclosures for unit-linked life contracts that have emerged on the basis of the IMD and CLD are not comparable with or consistent with the KII envisaged by the UCITS Directive, with strong divergences in national approaches.[25]

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22 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 and amending Directive 2001/34/EC.

23 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

24 Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation.

25 https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/CEIOPS-Report-National-Measures-Unit-Linked-Life-insurance-products.pdf.

Requirements thereby diverge strongly cross-border for non-UCITS PRIPs (an issue raised by some industry stakeholders to the Call for Evidence and PRIPs Consultation).

While common prospectus rules (under the Prospectus Directive) govern part of the structured product market, these rules are not comparable to the KII rules for UCITS (see Annex I.6 for more detail), while prospectus information may not be used by distributors in practice for informing retail clients when buying such structured products (given the complexity and length of such disclosures, and the fact there is no requirement on distributors to provide the prospectus). National rules vary in regards information provided by the distributor about such products.

Key problem 1: An unlevel playing field develops between product manufacturers

A regulatory patchwork can lead to increased administrative costs and regulatory arbitrage.

Different levels of regulatory requirements can create an incentive for products to be structured and marketed to take advantage of less onerous requirements – often within one Member State, across product groups; but potentially even across borders. Product proliferation has been indicated by some stakeholders, including consumer representatives and national supervisors, as providing *prima facie* evidence of regulatory arbitrage.[26] Ongoing work has begun at the level of the European Supervisory Authorities on financial innovation in relation to retail investment products in reaction to these concerns. It is difficult to assess the extent to which differences in transparency requirements are a sufficient motivation on their own for driving market entry or exit, however they are likely to be one factor.

In relation to administrative costs, a number of consultation respondents from the industry commented that duplication, overlaps in requirements or differences in requirements both sectorally and between Member States (where they operate cross-border) potentially raise administrative costs and reduce competition across markets. They noted that a lack of clarity as to content of regulatory requirements and associated liabilities could also lead to greater compliance costs for firms (for instance, through the need to contract for legal advice).

For UCITS, defining cross-border business can be tricky (given complex delegation arrangements by management companies related to funds); however, the fact that 41% of assets under management are domiciled in Ireland and Luxembourg indicates the high degree of cross-border business.[27] There are no indications of similar degrees of cross-border business for other PRIPs; for instance estimates put total cross-border insurance business at 4 to 5%.[28] Even if the cross-border sales of non-UCITS PRIPs are not so significant, the current legal patchwork poses a threat in two respects: first, the existing internal market in UCITS is subject to direct competition from products that are less strictly regulated in regards product disclosures – or not regulated at all. Second, the current differences in disclosure requirements are likely to be perceived both by investors and by industry as a fragmenting factor along national borders, which do not help any future positive development towards market integration.

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26 Broadly in this direction BVI (Bundesverband Investment) contribution to call for evidence "need for a coherent approach to product transparency and distribution requirements for substitute retail investment products?", p. 2-3.

27 Source: EFAMA, "Trends in the European Investment Fund Industry in the Fourth Quarter of 2010 and Results for the Full Year 2010".

28 These figures are derived from the White Paper on insurance guarantee schemes (COM(2010)370), p.4.

Key problem 2: Increased barriers to the further development of the single market

As noted, most PRIPs are not currently sold cross-border in great volumes, with the notably exception of UCITS. A regulatory patchwork of product disclosure requirements is one barrier to further cross-border business across different product types. The impact of national differences over product disclosures was strongly highlighted by UCITS stakeholders (prior to the development of the KIID), who identified such differences as a key barrier to further development of cross-border efficiencies.

Failures to effectively mitigate asymmetries of information at the EU level have encouraged action at the national level to address emergent problems, and the financial crisis has led to such action being more likely in the absence of further steps at the EU level. Such action at the national level is necessarily uncoordinated, leading to increased differences in approach across Member States. In addition, current sectoral differences in requirements at the EU level encourage Member States to address issues on a purely sectoral basis.

In addition, given the UCITS KIID, in the absence of further EU action some Member States can be expected to seek to improve disclosure requirements for other investment products, but in an uncoordinated way. It is difficult to assess the likelihood of this, but it is important to stress that the technical details of how one extends UCITS KIID-like rules to other segments are major drivers of compliance costs, which means that coordination on this could be a significant means for preventing the build-up of further regulatory barriers to market access.

3.2.3. Driver 3: Failures to effectively mitigate asymmetries of information between retail customer and the industry

The financial services are difficult to understand even for professional market participants. This is in large part due to their intrinsic complexity (exacerbated by drivers 1 and 2). This complexity can take different forms with different consequences.[29] Low levels of financial literacy and capability undoubtedly compound these issues – these however are out of the scope of the current analysis and will be / are being addressed elsewhere.

In addition, for many retail customers there are few opportunities to learn from experience in retail investment markets: customers typically do not engage repeatedly in investment activities, but do so only in relation to certain specific and widely-spaced life events (inheriting money, or investing towards a specific future liability or goal, such as buying a house, retirement or family planning).[30]

Existing regulatory requirements (driver 2) are designed to mitigate asymmetries in information.[31] However, these are ineffective and inconsistent, and a proliferation in new products and market innovation (driver 1) have also led to products being offered in forms that were not envisaged during the development of the existing disclosure requirements.

This third problem driver can be divided into three specific components (sub-drivers):

1 -- Mandatory information currently provided is not sufficiently easy to understand

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29 Complexity does not correlate (necessarily) with 'riskiness'.

30 http://www.fsa.gov.uk/pubs/consumer-research/crpr47.pdf; see also http://www.fsa.gov.uk/pubs/consumer-research/crpr76.pdf.

31 See the World Bank report noted above [ibid.] outlines academic research (p. 1-9): markets in financial services and products are not in all respects 'self-correcting'.

Existing retail disclosures about investment products have been very strongly criticised by a wide range of stakeholders, including industry, consumer representatives, trade bodies, and national supervisors.[32] There are a number of elements that contribute to perceived failings.

- Retail customers find financial services **concepts** and **jargon** are **opaque**, difficult to understand and unfamiliar. This is in a context where retail investors struggle to undertake even the simplest tasks (in the Decision Technology study, almost half of respondents failed to optimally allocated investments in a simple exercise).[33] Everyday connotations of words complicate the picture: the concept of 'risk' has strongly negative connotations for retail customers, though the financial services concept of risk is not a wholly negative concept.[34] Great care is thereby needed to communicate with retail customers in a clear and effective way, yet documents for retail customers often are written in a fashion that is only comprehensible for professional counterparts that takes no pains to communicate clearly with the typical or average retail customer. A lack of standardisation and thereby confusion between concepts, e.g., in language used to describe investments, can undermine trust, comprehension and comparability of information.[35] Responsibilities for communicating clearly are too often placed on others, with not enough ownership of such responsibilities by the senior management of the firms that produce investment products.

- Documents are very often **too long, or suffer from 'information overload'**.[36] Text and information is presented in a dense manner, without any effort to prioritise what is important or what is not. Text can appear to be simply a collection of 'caveats' or legal / contractual information; documents are too often written by lawyers rather than those trained in communicating effectively with retail customers. Key information can be hard to identify. A respondent to the UCITS KII put this well: '…documents are too long, so we just can't be bothered to read them from the beginning to the end'.[37] Financial services firms can take the view that making information available – even if this is done in a manner that is not likely to be effective for the average investor – is sufficient to discharge their responsibilities for informing those investors.

- Presentation can often be **dull, confusing** or **unengaging**, suggesting the information provided is not vital or important, or that it is not likely to be understandable for the average reader. There can be a poor use of design techniques (e.g. white space, headings, emphasis, layering of information). A desk-based survey of disclosures in the UK showed that many of these were not as physically appealing or well presented as other marketing information, so as to undermine their importance and relevance for investors.[38]

- Finally, information provided may be **partial** or **misleading** in effect for the average investor**,** even if technically correct details are included in small print. Evidence included in the PRIPs Communication IA included the example of mis-selling of equity-linked

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32 See Annex I.8 for a summary of the evidence collected during the development phase of the PRIPs initiative; see also http://ec.europa.eu/internal_market/investment/investor_information_en.htm (section relating to workshops on simplified prospectus) for further data. See www.fsa.gov.uk/pubs/consumer-research/crpr18.pdf.

33 Decision Technology p.8.

34 See Decision Technology p. 8; See http://www.abi.org.uk/Publications/ABI_Publications_Helping_Consumers_Understand_Investment_Risk_708.aspx (ABI Risk Research).

35 Decision Technology study.

36 For a good summary, see National Consumer Council, *Too Much Information Can Harm.*

37 IFF p.147.

38 See http://www.fsa.gov.uk/pubs/consumer-research/crpr55.pdf

insurance products in the Netherlands where costs were insufficiently disclosed. This problem can either be due to poor compliance standards, or due to more subjective factors related to the presentation of information and the positioning of key information in small print. For instance, one respondent to the YouGov and IFF study noted the problem of overly highlighted positives: 'they would only present beneficial features of the products…I should have read the additional information in the document but because it was written with small font I ignored it'; another remarked (in relation to a savings product) 'it was an account that I thought paid 5% interest a year, when in fact it was 5% over 2 years…I was just displeased…it was in the small print so really was my mistake'.[39]

Evidence on impact

The YouGov and IFF study showed that investor understanding of risks was very sensitive to details of the language used or presentation.[40] Other research has shown poor understanding of basic concepts of 'risk reward', and questioned the accessibility of even the basic concept of a percentage (%).[41] As another illustration, the Decision Technology study explored respondents (who had invested in the recent past) understanding of their investments, and found very strong evidence of very basic misunderstandings: for instance, nearly 40% wrongly believed that investments in equities they had made benefited from capital guarantees.[42]

This evidence (which is consistent with much other research in this area), and feedback from consultation respondents, has confirmed the findings of work on financial literacy: that average investors are currently poorly able to understand many of the investment products offered to them. Of course, failings by investors to understand investments are not solely a consequnece of poor disclosures. Low levels of financial capability are clearly relevant; also, where an investor seeks advice, the advisor takes responsibility for making suitable personal recommendations. Nonetheless, research on consumer use of information shows that respondents comprehension of information is sensitive to the presentation, comparability and clarity of the information..[43]

Ultimately, clear and understandable information is necessary (if not sufficient) for informed decision making. Improving information would therefore lead to improved decision making. In particular, the Decision Technology study shows that standardisation and simplification of information can drive such benefits.[44]

Key problem 3: Retail investors fail to understand the products they buy

2 -- Mandatory information currently provided is not comparable

39 IFF p.147.
40 See ABI Risk Research.
41 See http://ec.europa.eu/internal_market/investment/docs/other_docs/research_report_en.pdf.
42 Summarised at Decision Technology p. 7. For samples of other research see Appendix 2 to the IOSCO report.
43 See, again, Appendix 2 to IOSCO report.
44 Decision Technology p. 9.

The regulatory patchwork in EU disclosure requirements effectively prevents firms from providing consistent disclosure information to retail customers, which has the immediate consequence that it is difficult for those customers to compare different products.[45]

- General information about the nature and features of the product – what it is, how it works, how you can redeem it, how you can find out more about how it is doing – can be presented in very different ways, or use different classifications of investments or terms, making it difficult to compare.

- Information about risks is presented in incompatible or difficult to compare ways (this covers both market risk (price volatility), but also other dimensions of risk, such as counterparty risk or operational risk). When investors do try to compare information provided it can be misleading – it may be very hard to see what it truly 'low' or 'high' risk, and there is no 'objective' or neutral help available in assessing this.

- Different products have different costs and mechanisms by which costs are charged to the investor, and these costs can be presented in very different ways or according to different calculations.

Evidence on impact

Both the Decision Technology study and the YouGov and IFF study showed that presenting information in competing or different formats undermines investor comprehension and confidence. Both demonstrated startling failures on the part of investors to assess competing investment propositions. The YouGov and IFF study also showed that presenting risk information in a structured way capable of comparisons (i.e. placing each fund on a scale from 1 to 7) significantly improved the ability of investors to compare between funds, even where complex caveats might need to be taken into account.[46] Research by the UK ABI supports this finding.[47]

Failures to effectively compare products may be linked to the extent to which investors shop around for investments. Decision Technology found little evidence of extensive search behaviour in the retail investment markets; in part a lack of 'shopping around' might be related to infrequency of investment decision making, or self-perceptions of investors as to their confidence in making investment decisions.[48] A lack of comparability of information is likely to be one factor in limiting confidence, shopping around behaviour, and hence competition in the investment product markets.

While there is much behavioural evidence on difficulties investors have comparing costs, some important UK evidence supports a specific link between the introduction of regulatory steps designed to improve the comparability and transparency of costs and the manufacturer's future pricing of the products. Introducing a price comparator into product information (the so-called 'RIY' figure) where price information was otherwise complicated correlated with pricing changes in the market for life products that might not be explained through other factors.[49] This may indicate increased shopping around behaviour by customers or that firms

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45 As we will see, the Decision Technology study reached a major conclusion that regulatory interventions designed to improve standardisation and comparability of information are effective interventions for improving investor decision making (see Decision Technology p. 9).

46 See YouGov and IFF p.10-13 for summary.

47 ABI risk paper, ibid.

48 See, for instance, Decision Technology pp 186-7.

49 http://www.fsa.gov.uk/pubs/occpapers/op32.pdf; http://www.fsa.gov.uk/pubs/occpapers/op39.pdf.

themselves are choosing to compete on price (possibly in the anticipation that price was going to be of increased salience for investors). Other research also showed positive benefits to the inclusion of measures to improve price transparency into mandatory disclosures.[50]

Note that there are no equivalent measures to those for UCITS KII available for other PRIPs so as to facilitate comparisons between them and each other or UCITS. This may distort the market between UCITS and other PRIPs.

Key problem 4: Retail investors fail to compare products

3 -- Mandatory information is not made available to investors in a timely fashion

The best information disclosures would be of no value if they were not in practice read and used, or they were provided to investors too late in their decision making process to be of value in that decision making.

Evidence suggests that these problems – of actual provision or the timing of provision – are important. Notably, in the Synovate study, few participants recalled or recorded being provided with product information.[51] While there is an enforcement or compliance component to this issue there are also divergences in EU law in regards the standards that apply as to whether product information prepared by manufacturers must be used by intermediaries.[52]

The provision of information to investors is of course only part a wider picture: the information has to actually be used and read by the investor if it is to impact on their behaviour. Sub-drivers 1 and 2 contribute to information that is provided being unattractive or uninteresting, and consequently less likely to be read, which is why the three issues should be looked at and tackled together.

Key problem 5: Retail investors do not receive information

3.3. Scale of the problem and consequences

Investor side

Micro (individual) level

Investor detriment in the retail investment market can take different forms:

- Buying products which have a risk profile that is not suitable – i.e. where the risk/reward profile of the product is not understood or anticipated, leading to direct losses (e.g. during downswings, or where an investment has higher volatility than expected), or to opportunity costs (where an investor wishes to take on a higher risk/reward investment than they in fact purchased).

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50 http://www.fsa.gov.uk/pubs/other/cra_report_benefits.pdf. See in addition a conceptual model for considering the interaction between price transparency and consumer welfare: http://www.fsa.gov.uk/pubs/occpapers/op26.pdf.

51 While this is at heart an enforcement issue relating to rules applying on distributors, it underlines the importance of exploring regulatory mechanisms for ensuring delivery of information.

52 The UCITS KIID regime tackled these problems through explicit requirements on the provision of KIID to investors, on the timing of this provision, and on the overall quality of the KIID compared to other information or marketing materials.

- Buying products with features that are not suitable (e.g. products which include a lock-in period during which it is impossible to redeem or where redemptions carry penalties). This can include paying for features that are not appropriate or necessary given the investors' needs.

The PRIPs Communication IA already surveyed examples of these problems in practice (summarised in Annex I.8). Looking across the EU market as a whole to assess a possible scale for mis-selling is complicated by the fact that mis-sales are not necessarily recognised as such at the time (or indeed later), so that possible effects on competition, pricing and opportunity costs are difficult to untangle. Issues typically arise where market movements expose a practice that had hitherto gone unnoticed; such problems have been distressingly common.[53]

The recent Synovate study provides a basis for assessing the EU-wide scale of these issues however. It concluded that around 60% of sales in a mystery shopping exercise across all EU markets might be deemed 'unsuitable'.[54] In this context, a number of aspects are certainly linked to non-compliance with existing point of sale rules (for instance, insufficient gathering of personal information about the client or superficial evaluation of suitability) while the study also noticed a significant proportion of advice focusing on products that are less regulated at the point of sale (for instance, certain savings products) which may indicate a form of regulatory arbitrage. However, the study also identified problems with disclosures concerning the products recommended to clients, which is the aspect of particular relevance in this context. In addition, the provision of clear and comparable information about products and their prices could be expected to contribute to greater salience being placed on product features and prices at the point of sale, impacting the scale practices related to these other factors.

Given the complex interaction of factors at the point of sale, estimating the specific contribution of product disclosure failures to mis-sales (especially where sales are accompanied by advice) is in practice difficult; the only reliable techniques are *ex poste* in nature rather than *ex ante*, and such data is not readily available across the whole EU retail investment market.[55] Where a personal recommendation is made, the quality of that recommendation will clearly be of key importance. External factors too can be important, including the impact of non-professionals (friends and family, for instance), or 'cultural' factors (such as brand loyalty).

Nonetheless, it is clear that poor transparency and reduced comparability of information contribute or enable mis-selling. Even taking into account potential caveats on the scale of mis-sales and their link to imperfections in product disclosure requirements, given the volume

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53 Complaints data can be illustrative: for instance, the Financial Ombudsman Service in the UK has roughly received between 3000 and 11000 complaints on investments (though excluding certain insurance and pensions related investments) each year since 2003. Note complaints that following the potential mis-selling of endowments linked to mortgages in the UK, the latter generated almost 70,000 complaints in 2005 and 2006; as another example, in the Netherlands the Ombudsman dealt with significant volumes of cases related to mis-selling of equity-linked insurance and pricing transparency. See also http://www.kifid.nl/uploads/2008-03-04-Recommendation_of_the_Financial_Services_Ombudsman.pdf

54 'Mystery shopping' is a technique where researchers adopt the pretence of being an ordinary shopper, in order to assess the service offered in practice. This is a powerful tool for assessing compliance with regulation.

55 Carefully conducted longitudinal studies might be able to resolve this issue, but these would need to be set up in advance.

of the retail investment market (estimated to be around EUR 9 trillion in 2009), the impact of potential mis-sales would represent a very significant and material potential source of consumer detriment. Even if the Synovate figure of 60% was revised signficantly downwards, impacts are very material. This is compounded by the fact that detriment relates not only to losses borne – which typically drives perceptions of when a mis-sale has occurred, and only comes to the surface when risks crystalise – but also to opportunity costs and impacts through reduced competition and reduced market efficiency.

For these reasons, and given that effective product disclosure is a necessary (if not sufficient) condition for informed decision making, it is difficult not to conclude that failures in these disclosures are likely to have a substantial impact. Even if only 10% of sales in the retail investment market could be considered as 'unsuitable' this still amounts to almost 1 trillion EUR of potentially misheld products; to put this in context, even if product disclosure contributed only 1% to this, this would still amount to around 10 billion EUR (4 billion EUR for the non-UCITS part of the market). These figures need to be borne in mind when considering costs of changes.

Macro (aggregate) level

As noted, mis-sales or poor comparability of information can reduce competition and shopping around. This is clearest when considering poor comparability of products: a lack of readily comparable information by definition creates a barrier to comparing products. The UK FSA price transparency study noted above showed how improving cost transparency can lead to reduced costs overall. Price sensitivity on the part of a proportion of consumers can have benefits for the remainder of consumers. In addition, firms anticipate such sensitivity under conditions of greater price transparency (and also may independently compete more on price). Even small impacts on price can lead to a large overall benefit for consumers given the scale of business.

For instance, a 0.5% reduction of annual management costs might seem small, but in a market of EUR 9 trillion this would amount to EUR 45 billion benefits to investors, though of course lower costs would also equate to reduced surpluses for investment product manufacturers and distributors.This is in a context where research from Lipper demonstrates an EU fund market overburdened by small, relatively costly funds: in general they conclude (amongst other things) that a greater focus by investors on costs could drive important benefits.[56]

Industry side

An unlevel playing field between firms has the direct impact of varying costs of business, distorting competition. Regulatory arbitrage could encourage the development of products or sectors that are subject to the lowest levels of regulation, also undermining the effectiveness of regulation. While many stakeholders – including industry voices – have raised concerns relating to such effects it is very difficult to establish how far the design, commercialisation and marketing success of products is in practice determined by the nature of regulatory disclosure requirements, given the range of other commercial factors that can apply (such as tax regimes, culturally specific factors in particular national markets, internal firm strategies, and other regulatory requirements, such as authorisation, conduct of business or oversight requirements). However, as noted above, small steps on improving the salience of cost information, for instance, could have a large impact on consumer welfare in aggregate.

[56] Lipper FMI White Paper: *Profiting from Proliferation?* June 2009

A number of industry stakeholders indicated in the recent consultation that a lack of standardisation and consistency across different sectors can raise compliance and administrative costs, especially for firms or groups operating across sectors or national markets.

Other more direct impacts of failings in regulation are also important. Mis-sales can also have a strong impact on firms, raising levels of compensation claims and complaints and internal costs related to managing these, and damaging brand identities. More generally, reduced retail trust of the investment markets could reduce liquidity and vital investment in economic growth and jobs.

3.4. How would the problem evolve without further action?

Irrespective of the Commission's commitment to make proposals for legislative changes in this area, it is possible to assess the counterfactual of no action at the European level. Under this scenario, problems would be likely to persist, and inconsistencies at the level of Community law would not be able to be addressed at any other level.

Some Member States have already indicated that they would take further action in the absence of an intervention at the EU level. This may have a beneficial impact with respect to investor protection and the level playing field within the Member States in question. However, it would also lead to further divergence of regulatory approaches across Member States, thereby potentially impeding market cross-border business and further complicating the legislative landscape, while, differences in regulatory approach cannot be addressed effectively at Member State level as they relate to differences in approach in Community law (for instance with highly standardised disclosures for UCITS, high level requirements only for insurance PRIPs, and a mixture of these for securities subject to the PD). Also, it is unlikely that *all* Member States would take unilateral action, leaving some markets without adequate regulation. Inconsistencies in approach between Member States would raise adminstrative and legal costs for firms operating in different Member States, and increase uncertainty for investors buying cross-border.

Some self-regulatory initiatives on the part of the industry can also be expected to emerge without further stimulus from the EU; evidence from the Call for Evidence and the Consultation indicates a certain willingness to take such steps, though it is difficult to assess the likelihood of such steps coming to fruition. In addition, self-regulatory steps are unlikely – as they would tend to continue to be sectorally discrete and vary between different Member States – to effectively achieve a consistent approach between sectors and across Member States.

At EU level, in the absence of new initiatives, existing workstreams would also contribute to mitigating the problems in certain sectors and for certain products. These include:

- Implementation of KII requirements for UCITS following adoption of new standard under UCITS IV;
- New implementing measures on summary prospectus and key information it must contain for the PD;
- Work on improving financial education, in conjunction with Member States; and
- Reviews of IMD and MiFID.

However, taking together these developments would not be able to address regulatory fragmentation and inconsistencies in approach between different sectors and different legislative initiatives, since these different initiatives and measures are designed to address a wide range of other regulatory challenges, other than the problems of comparability and comprehensibility of pre-contractual information addressed in this impact assessment. For this reason it is unlikely the comparability of different PRIPs would be improved; by definition tackling this would require a coordinated approach across product types. UCITS KII requirements would only apply to part of the PRIPs market, while measures on the summary prospectus are not likely to lead to documents that are directly comparable to the UCITS KII. Strengthened rules on distributors and those providing advice also would not in themselves improve the comparability of information about products, notably on costs or risks.

In fact, fragmentation and its consequences would likely worsen, following the introduction of prescriptive rules aimed at a short document for UCITS KII but no comparable rules elsewhere. As noted, the reactions of Member States to the introduction of these requirements are also likely to vary, raising additional coordination challenges. Even where all Member States seek to tackle level playing field issues between UCITS KII and disclosures for other products, it is probable that different Member States would develop their own alternative solutions to these challenges, thereby more deeply embedding fragmentation across the single market.

4. THE EU'S RIGHT TO ACT AND JUSTIFICATION

Possible measures for addressing the problems identified in this impact assessment would be based on Article 114 of the TFEU. Given the identified problems, possible options for measures would necessarily relate to improving the conditions for the establishment and functioning of the internal market: establishing uniform conditions for the way investors in the Union are informed about investment products and how the information is provided to them, so as to harmonise operating conditions in relation to the information on investment products for all relevant players in the retail investment market, product manufacturers, persons selling and investors.

As set out in section 3.4, in the absence of such possible measures there would be a risk that obstacles to the functioning of the Single Market would emerge. Member States have already taken measures on the national level to address shortcomings in investor protection measures. It is likely that this development would continue in the absence of measures at the European level. Measures at the European level would counteract the development of divergent national approaches to investment information which would constitute an obstacle to the Single Market.

While there is increasingly cross border trade in retail investment products, divergent national approaches will also lead to different levels of investor protection, increased costs and uncertainties for product providers and distributors which represent an impediment to the further cross-border development of the retail investment market. Such further development would also require easy comparisons between products of different types across the Union. Divergent standards to investor disclosure make such comparisons very difficult and would therefore also create an obstacle to the further development of the Single Market for retail investment products.

Possible measures to address these obstacles to the Single Market would, if they were to be effective, need to apply for all relevant market players in the retail investment market. They

would thereby contribute to improving the conditions for the establishment and the functioning of the Single Market in accordance with Article 114 TFEU.

According to the principle of subsidiarity laid down in Article 5(3) of the TFEU, action on the EU level should be taken only when the aims envisaged cannot be achieved sufficiently by Member States alone and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the EU.

The problems to be addressed in this impact assessment relate to an unlevel playing field across the EU among different product manufacturers and persons selling investment products and consequent uneven levels of investor protection.

While some Member States have already acted on the national level, there are considerable differences in these national responses including Member States which have not yet undertaken any steps to improve retail investor disclosures. Responses are necessarily limited in their geographical scope and cannot be compared with or substitute a co-ordinated or systematic response on the EU level. Significant divergences exist and can, in the absence of action, be expected to continue to exist. Inconsistencies between Member States and across product sectors impede the growth of the single market, raise costs for firms operating across the Union, and reduce competition between product sectors and providers, whilst weakening the effectiveness of existing measures to aid investors in comparing between different investment propositions.

Achieving greater consistency in measures on transparency across Member States and product sectors is central to addressing the problems identified in this impact assessment. Yet such consistency cannot be achieved by action taken solely on the Member State level. Member States cannot create a Union wide level playing field for investment product manufacturers and persons selling and an even level of investor protection in relation to investor disclosures across the EU.

Therefore, action on the European level is needed.

In accordance with the principle of proportionality (Article 5(4) TEU), it is necessary and appropriate for the achievement of the objectives of this initiative to lay down principles relating to the content and form of the disclosure for retail investment products, as well as rules on drawing up and provision of these disclosures to retail investors. Such requirements should be further developed on level 2, so that a requisite level of consistency in measures can be achieved to facilitate comparisons between investment products originated in different industry sectors.

5. OBJECTIVES

5.1. General and specific objectives

The initiative seeks to improve the quality of investor decision making and the functioning of EU capital markets, tackling a breakdown in confidence and trust in the retail market. More concretely, it aims to:

- reduce levels of consumer detriment (mis-sales and mis-purchases of investment products); and

- create a more level regulatory playing field between competing products while tackling potential barriers to the single market.

5.2. Operational objectives

The operational objectives focus in on the steps needed to improve the quality of product disclosures. These steps can also tackle creating regulatory consistency, so as to achieve level playing field benefits and remove potential barriers to the single market.

- Improve **comprehensibility** of disclosures
- Improve **comparability** of products using disclosures
- **Ensure disclosures are provided** at the right time in sales processes
- **Improve regulatory consistency**

6. OPTIONS

6.1. Identification of options

Before assessing options, it is important to note that it is envisaged that any new measures to be proposed would follow a 'Lamfalussy' approach (see Annex I.10 for some further detail on this), with level 1 measures determining the objectives, broad approach, and outcomes being sought, and level 2 measures determining the detailed application of the level 1 framework to specific PRIPs.

This is consistent with the approach adopted for UCITS for the KII and in other areas of the financial services, and reflects the need for detailed technical measures (founded on expert technical advice) that may be readily adjusted in the face of market developments. On this basis, the questions to be addressed in this impact assessment relate not to the detailed content of proposed product disclosures (e.g. different options on the presentation of risk information, including through a risk rating and the underlying methodology for calculating it), but rather to the approach to be adopted in general to the product disclosures (e.g. the extent to which all PRIPs product disclosures should contain a risk rating).

As the problem description makes clear, product information impacts investment decision making in the context of specific sales processes with their attendent dynamics, whether the sale is an advised sale or a non-advised sale. It is difficult to isolate individual factors in assessing such dynamics. For much of the retail investment market, the actions of the sales person are crucial, by means of the recommendations they make, the products they may highlight or not even where a recommendation is not made, and the subtle ways in which they interact with the retail investor. Yet this should not be taken as relegating product disclosures to a purely ancilary role. Product disclosures have a wide range of both indirect and direct impacts on sales outcomes. This includes impacts on the behaviour of sales people (providing objective benchmarks that may impede uninhibited pushing of products), on the behaviour of product manufacturers (supporting greater competition on product costs and features), and, indeed, on the behaviour of retail investors (better assessing products). The problem description has already set out the relevance of improving product information as a means for addressing mis-sales in the retail market.

Given this wider context and the strong synergies between different factors in a typical sales process, it is important to underline that while this impact assessment relates solely to addressing the identified issues relating to information about products, other proposals by the Commission with supporting impact assessments, notably on the reviews of MiFID and the IMD, are underway separately, so as to ensure a coherent overall approach is taken to all the factors in sales processes that are amenable to regulatory intervention. The reviews of MiFID and the IMD address in particular measures on the provision of services of advice and the retail investor's understanding of these services and the management of conflicts of interest related to these services, so as to seek to align the interests of those selling products to retail investors with those investors. As noted, the PRIPs initiative was undertaken to assess the overall coherence and effectiveness of all measures regulating retail investment markets, and identified the key areas of product information and the regulation of sales as priority areas for intervenion. This IA delivers on the former of these two areas; the MiFID and IMD revisions on the latter.

The Communication on PRIPs already identified, on the basis of existing legislation and prior work, the broad areas that would need to be addressed by options for addressing the problems identified above:[57]

- the broad scope and purpose of requirements (i.e. focus on informing investors' decision making, rather than, say, on providing contractual information);
- how information might be presented, including length of documents, or the kind or style of language to be used;
- the key areas of information to be included in documents, and the possibility of detailed measures (at level 2) for standardising the form and content of such information;
- who should prepare information and how to keep it up-to-date;
- steps for ensuring provision of information to the client (the medium to be used for information, and the timing of provision).

The policy options examined in this impact assessment build on this existing work, and have been grouped as follows:

(1) *Scope of initiative.* The precise scope of products that might be covered is key for ensuring all competing or comparable products are included, vital for addressing regulatory consistency objectives and comparability of information objectives.

Description of options
The scope of the regime is fundamentally bound up with its purpose: in improving comprehensibility and comparability of investment products, it is important to identify the products that can practically be compared with one another, otherwise measures to improve comparability could be misleading. Linked to this, the scope of the regime is central for considering possible regulatory arbitrage and level playing field impacts.

[57] Common elements and principles recur across existing legislation and in the recommendations of international bodies seeking to coordinate disclosure approaches; see earlier footnotes.

Previous work in the PRIPs initiative led to the development of a concept of 'packaged' investment products: under this issue we assess therefore whether this concept remains valid. Following consultation, the identified options are: (1) to set the scope wider than packaged products; (2) to maintain the focus on packaged products (see Annex I.3 for definition of these); (3) to combine (2) with a commitment to review and expand (or contract) the scope if necessary.

(2) *Degree and nature of standardisation of product disclosures.* Standardisation relates both to the degree of prescription imposed on firms in regards the content and format of disclosures provided to retail customers, and to the degree of consistency in requirements between products and financial sectors. This area is central for determining the overall approach to be developed, and is key to driving costs and benefits.

Description of options

The objectives of achieving regulatory consistency, improving comprehensibility and improving comparability of documents are linked directly to the extent of consistency of approach across different products, and the degree to which this consistency is used to achieve standardisation of the content and format of documents. Increased standardisation is (generally speaking) likely to increase benefits for investors but may increase costs for industry. (Standardisation may also reduce legal risk reducing some costs for industry).

The many possible detailed options on content and form can be broken down according to the areas identified in the problem definition relating to comprehensibility and comparability (language and length of disclosures impeding comprehensibility, and different presentations of product features, risks and costs impeding comparability). In each area, the specific options explored (outlined in table 3 below) broadly sit on a spectrum between greater and lesser degrees of prescription and standardisation.

(3) Responsibilities for preparation. Stakeholders and consultation respondents have broadly underlined the importance of clarity over who is responsible for preparing (and updating) disclosures.

Description of options

When assessing responsibilities for preparation, options range according to the degree of prescription applied in regards who should prepare the information. The identified options are: (1) not specifying who should be responsible, but leaving this to market participants to decide; (2) not prescribing responsibilities, but requiring agreements between market participants over responsibilities; (3) placing a general responsibility on the product manufacturer, but allowing for some targeted exceptions; and (4) [not mutually exclusive with other three options] requiring disclosures of responsible parties and product manufacturer in document.

(4) *Timely provision.* Ensuring effective and timely provision of product disclosures to retail investors is vital if disclosures are to be used.

Description of options

Different models for disclosure provision can be found across existing product disclosure measures, broadly ranging from (1) a 'soft' requirement whereby product disclosures are prepared by manufacturers and provided to distributors, but distributors are not required to use these for discharging their responsibilities, to (2) a 'hard' requirement whereby product disclosures prepared by the manufacturers must be given by distributors to the investor (as is now the case with UCITS). Given the variety of distribution channels across PRIPs, an additional option (3) can be identified where some flexibility is introduced as to the what counts as 'providing,' to ensure practicality requirements for all channels.

(5) *Flanking measures: civil liability and sanctions.* How should civil liabilities associated to the document be clarified, and are there steps to be taken on further harmonising the use of sanctions by competent authorities when supervising the regime?

Description of options

The UCITS KIID regime, as with the PD disclosure regime, contains specific measures to clarify the liabilities associated with the KIID, designed to ensure the document is practically treated as a pre-contractual communication document by product manufactures – the simplified prospectus had earlier become bloated through the inclusion of too much fine print. The UCITS KIID regime and other measures in the area of the Financial Sercices also take or are proposing to take steps on better coordinating the sanctions that apply at the national level following breaches of measures. Options for addressing these areas for PRIPs include: (0) remaining silent on liabilities / sanctions (baseline); (1) use of non-legislative techniques to ensure access to and use of redress; (2) clarifying liability regime attached to PRIPs product disclosures; (3) approaching sanctions in a high-level way; and (4) taking steps to harmonise aspects of sanctions.

Table 3: Summary of options

Issue			Objectives addressed	Policy options
1 **Scope (products for which disclosure requirements should be aligned and improved)**			All	0 – Take no action 1 – Set the widest possible scope 2 – Only 'packaged' products 3 – Only 'packaged' products, but set firm review date *[Options are mutually exclusive]*
2 Degree of standardisation	a	Plain language, engaging quality of document	Comprehensibility	0 – Take no action 1 – Apply high-level principles only 2 – Prescriptive rules to standardise elements of language, 'look and feel' of document 3 – Use of non-legislative tools 4 – Clarify liability attached to document *[Options 1 and 2 are mutually exclusive; option 4 also addressed under issue 5]*
	b	Length of document	Comprehensibility	0 – Take no action 1 – Set a 'soft' limit on length; prescribe contents and length where viable at level 2 2 – Set a 'hard' limit on the length of all documents (e.g. 2 pages A4) 3 – Use layering of information / signposting to other documents *[Option 3 is not mutually excusive with 1 and 2]*
	c	Accuracy, balance of information	Comprehensibility	0 – Take no action 1 – Set high-level principles only 2 – Use prescriptive requirements on form and contents to ensure balanced presentation *[Options are mutually exclusive]*
	d	Comparisons of product features, risks, costs	Comparability	0 – Take no action 1 – Seek consistent structure, layout to aid comparisons 2– Standardised risk, cost, and performance disclosures for all PRIPs *[Options are not mutually exclusive]*
3 **Responsibility for preparing product disclosures**			All	0 – Take no action 1 -- Flexibility over who prepares the document 2 -- Flexibility over who prepares the document, but requiring agreement on responsibility 3 -- Product manufacturer normally responsible for preparing the document 4 – Require disclosures of responsible parties in document *[Options 1 - 3 are mutually exclusive; 4 is not mutually exclusive with 1 - 3]*
4 **Requirements on delivery of product disclosure**			Ensuring provision	0 – Take no action 1 – 'Soft' requirement on provision and its timing 2 – 'Hard' requirement on provision and its timing 3 – Broadly follow 2, but allow for some targeted exceptions *[Options are mutually exclusive]*
5 **Flanking measures: civil liabilities and sanctions**			All	0 – Take no action 1 – Non-legislative steps to ensure access to redress 2 – Clarifying liability attached to document 3 – Clarify sanctions in high level manner 4 – Clarify sanctions in more detail

		[Option 3 is mutually exclusive with 4]

6.2. Analysis and comparison of options

For a full discussion of each issue, the identified options, and assessment of the costs and benefits of the different options, please see the relevant section in Annex II.

6.2.1. Issue 1 – What scope of products should be covered?

Defining which products are 'competing' for retail investments has been hotly debated throughout the PRIPs work. The Commission proposed in its Communication a focus on 'packaged' investments. Stakeholders have generally recognised the practical validity of the concept of packaging, and that packaged investments share features amongst themselves (and differ in important ways from non-packaged investments), and likely need stronger consumer protection measures, including steps to enhance comparability. Some take the view that the scope of the initiative should nonetheless be as broad as possible.

Box 3: Defining Packaged Products

The Commission consultation on PRIPs has steadily refined a possible definition of retail investment products of the packaged form. At its core, the definition refers to the investor's exposure to uncertainties in outcomes, and the intervention of financial engineering in this regard:

A PRIPs is any investment where the amount repayable to the investor is exposed to fluctuations in the performance of one or more assets or reference values, and where the investor does not directly purchase or sell these assets.

Products solely linked to interest rates or where outcomes are wholly guaranteed and known beforehand would be excluded, as would financial products that are pure insurance products (general insurance products, or pure protection insurance products).

Many stakeholders have views (positively or negatively) on the precise application of the concept of packaged products to particular products, e.g. as may exist in particular national markets.

Option	**Effectiveness**			**Efficiency**
	Comprehension	**Comparison**	**Regulatory Patchwork**	
0 – Take no action	0	0	0	0
1 -- Set the widest possible scope	+ Effective approach would still require boundary to be drawn between 'packaged' and 'non-packaged' products; wider scope could allow for overall better coherence.	+ Effective approach would still require boundary to be drawn between 'packaged' and 'non-packaged' products; wider scope could allow for overall better coherence.	+ Existing unlevel playing field is practically focused on 'packaged' products, but wider focus	Depending on approach, costs for industry may be comparable to focus on packaged regime, but marginally greater due to wider impact. Benefits for consumers depend on extent to which regime still segments between packaged and non-packaged products; effectively challenge of demarcation of products cannot be avoided.
2 -- Focus on 'packaged' products	+ Key benefits relate to packaged products, so only likely to be marginally less effective than 1. (May be more effective in practice due to more focused approach.)	+ Key benefits relate to packaged products, so only likely to be marginally less effective than 1. (May be more effective in practice due to more focused approach.)	+ Existing unlevel playing field is practically focused on 'packaged' products	Costs likely to be lower than for 1, as impact targeted on those products that are most relevant, and option 2.1 would likely still need to demarcate in measures between packaged and non-packaged investments. Core benefits achieved in relation to packaged products, so likely to be equivalent to option 2.1
3 -- Focus on 'packaged' products, but set	++ Key benefits relate to packaged products, so	++ Key benefits relate to packaged products, so	++ Existing unlevel playing field is	Costs likely to be lower than for 1, as impact targeted on those products that are most relevant, and option 1 would

firm review date (e.g. five years following coming into force)	only likely to be marginally less effective than 1. (May be more effective in practice due to more focused approach.) Review of scope allows possible future arbitrage and consumer detriment to be addressed	only likely to be marginally less effective than 1. (May be more effective in practice due to more focused approach.) Review of scope allows possible future arbitrage and consumer detriment to be addressed	practically focused on 'packaged' products Review of scope allows possible future arbitrage and unlevel playing field issues to be addressed	likely still need to demarcate in measures between packaged and non-packaged investments. Core benefits achieved in relation to packaged products, so likely to be equivalent to option 1. Review mechanisms allows for possible regulatory arbitrage, countering possible weakness with option 2

As the table makes clear, all approaches to scope have their merits and their problems.

Costs are likely to be similar for the bulk of the market across all options, though the precise form and cost/benefit impact of the first option is difficult to assess (it could be developed in a manner which was extremely impactful or without major impact, depending on the choices made for other options below, e.g. the degree of standardisation chosen).

However any distinction between packaged and non-packaged investments is subject to changes due to innovation. Experience has shown that wherever the boundary is drawn, the risk remains that investment propositions might be developed which are economically similar or the same as those captured by the defined scope but which fall nevertheless outside defined boundaries or sit at least at the edges of that scope. The determination of a boundary may well thereby encourage or facilitate regulatory arbitrage, contributing to further complexity in the market. This is of course without prejudice to providing the necessary legal certainty on scope (which can be achieved in a variety of ways at level one, supported as necessary through detailed implementing measures).

Nonetheless, the case for maintaining an initial focus on packaged investments is also strong, and seems more proportionate than a wider scope, as it focuses action on the products that are likely to deliver the main benefits from better disclosure regimes, without overly diluting the regulatory design process in order to address marginal cases. These are mostly directly comparable products, where a common product disclosure regime can be readily envisaged.

Given the broad issues that might arise in regards arbitrage, the option of a two step approach is strongest: to focus for now on ‘packaged’ products, being as these are financial products that are manufactured for the purposes of providing investments to retail customers, but to reassess whether a wider scope might be appropriate at a predetermined point in the near future. The scope of products that would be caught by this approach and a possible way of defining them more in detail e.g. with respect to the future legal instrument on disclosure is presented in Annex I.3.

Box 4: Pensions: a special case?

Given ongoing work following the Green Paper (see Annex I.2) it may be premature to determine the appropriate EU dimension of rules on disclosure for these, particularly as regards Pillar II pensions, but some respondents to the consultation strongly argued that products that might be determined as pensions, particularly under Pillar III , were directly, in their view, substitutable for other PRIPs in some markets. In addition, it can be argued that decision making in relation to pension and retirement planning raise additional consumer protection issues compared to other PRIPs that warrant even stronger consumer protection measures tailored to national pension systems, but at least subject to similar standards of disclosure as other investments. Issues include, for instance, achieving clarity on possible restrictions on how pension investments might be used, on the specifics of individual tax treatments, and on the typically long term nature of the investment and the need to assess the likely income that the pension might deliver in the future, which makes the calculation or assessment of possible future benefits, such as retirment income backed by an annuity, more complex and difficult to explain than for ordinary investments, and also raises additional specific factors such as the impact of changes to longevity.

Certainly, therefore, there are additional information requirements that should apply for investments used as pensions compared to other investments.

6.2.2. Issue 2 – How far and in what ways should disclosures be standardised at EU level?

As it has been mentioned above, the UCITS KII regime is highly prescriptive and strongly standardises the "look and feel" and contents of UCITS KIIDs, so as to promote comparability of information and comprehension. This approach also has benefits relating to regulatory consistency (potentially reducing costs for firms, given the cross-border nature of the UCITS market, and the role of the KIID within notification procedures for marketing cross-border).

Given that here we address other products, which are prepared and offered by different manufacturers and distributors, we should now examine how far (and in what ways) such a standardised approach might be applied more widely. This issue relates also to specific policy options for improving **comprehensibility** and **comparability** of product disclosures.

Comprehensibility

Improving use of plain language and making information more engaging

Option	**Effectiveness**	**Efficiency**
0 – Take no action	0	0
1 – Apply high-level principles only	– Experience with UCITS simplified prospectus showed that high-level requirements were not sufficiently effective in ensuring comprehensible information in documents. Ensuring firms, supervisors approach standards in consistent way would be difficult to achieve, leading to inconsistencies in outcomes.	Effective engagement by supervisors with firms could be costly / inconsistent, given lack of guidance in a high-level approach. Some lack of legal clarity for firms as to necessary standards; inconsistencies cross-border would erect barriers to single market. Flexibility may be valuable for allowing innovation in terms of communication practices.
2 – Increased prescription	+ + Experience with developing UCITS KII requirements is that higher standardisation allows for setting better 'minimum standard' for all, so that best practices can be more immediately reflected into generalised industry practice. Greater consistency in approach across all markets / sectors.	Consistency and better clarity could lead to reduced costs for firms and supervisors. Benefits for investors through wider adoption of better practices enshrined in binding EU level requirements. May be seen as a 'tick-box' approach by firms, or a regulatory 'safe harbour' if they follow the letter but not the spirit of the rules.
3 – Use of non-legislative tools	++ Can support 2, e.g. national regulators, firm trade bodies, consumer associations may be best placed to develop practical guidelines on better language, common glossaries, will better address continued scope for poor language.	Costs expected for developing and improve industry practices, but benefits for consumers from better addressing possible weaknesses Allows flexibility for allowing innovation in terms of communication practices Can overcome tick-box approach possible under 2 on its own
4 – Clarify liability attached to document	+ UCITS experience was that success (shortness, clarity of language) of document requires some comfort for firms that they may focus only on 'key' information and not include all possibly relevant information.	Lack of clarity could undermine document, as firms' concerns over liability lead to inclusion of all possibly relevant information, rather than sole focus on key information.

As our problem definition outlined, typically firms have approached product disclosures in a legalistic manner (minimizing legal risk of breach by flood of information), rather than as an opportunity to communicate effectively with potential clients in a plain manner. For the UCITS KIID therefore measures were adopted to ensure the disclosure was approached as a 'communication' document, including a clarification of legal liability and relatively strong prescription of the form and content of the document. However, some stakeholders (both industry and consumer representatives) have commented that such an approach needs careful support, e.g. through the development of common glossaries of terms, sharing of best

practice, and careful supervision by competent authorities. This option appears most proportionate, as it would better guarantee benefits, at relatively low additional costs for developing such support.

Clearly, any intervention into the current practice of disclosures will have a significant adjustment cost impact on industry compared to the baseline. Acting on the language of the disclosure alone, would trigger approximately the same magnitude of costs as action on all components of the problem driver together (i.e. language, information overload, accuracy and balance, comparability). On the other hand, benefits to consumers would increase with each additional field of action. Therefore, in this impact analysis, we decided to carry out the final cost benefit analysis of all components together as a package (under section 6.3) and explain - mainly qualitatively - marginal costs and benefits under each section.

As for marginal costs: while high level standards (1) may leave some more scope to current disclosure practices, and would therefore have lower cost impacts, it would not address the problems identified as effectively as options 2 and 3. The consumer benefits expected from more prescriptive and standardised rules will clearly be highest, while some industry benefits are also expected from this option in terms of more level playing field and less legal fragmentation to market access. Under either approach, the magnitude of costs will still greatly depend on the technical implementation at Level 2.

(Liability is analysed separately under issue 5 below).

Addressing information overload

This analysis considers the specific issue of overly complex and long documents.

Option	**Effectiveness**	**Efficiency**
0 –Take no action	0	0
1 – Set a soft limit on length: prescribe contents and length where viable at level 2	+ In practice may be similar (due to impact of prescription on content) to option 1, but flexibility may allow for better tailoring of requirements to specificities of non-harmonised products.	Varied requirements lead to inconsistencies in approach between supervisors and firms.
2 – Set a hard limit on the length (and content) of all documents (e.g. 2 pages A4)	+/- For UCITS a hard limit on the document could be readily considered because UCITS are harmonised across the EU. With other PRIPs which are not harmonised, the product features or benefits may not be always covered in 2 pages (even for UCITS this is not always possible; structured UCITS are provided with a derogation from the 2 page limit). Given this, enforcing a 2 page limit could lead to documents that do not cover all information clearly or comprehensibly. Setting a hard limit may be an effective tool for ensuring firms write in a concise manner: evidence suggests longer documents may not be read.	Simple requirement straightforward for competent authorities to supervise: consistency in approach.
3 – Use layering of information / signposting to other documents	+ Layering may be useful for targeting key information and more detailed information appropriately. Layering might undermine extent to which KIID must is capable of being used 'stand alone' (i.e. on its own) to make an investment decision – ensuring this does not happen raises risks for supervisors	Use of 'layering' or 'signposting' may require more careful supervision and assessments of compliance raising some costs,, however may allow same documents to better target range of different investors needs.

The length of disclosures – as set out in the problem definition – has long been considered a major impediment to their effective use by retail investors. On this basis, the UCITS KIID requirements set a hard limit on document length (though with a derogation for structured funds). While theoretically a hard limit would deliver the greatest consumer benefits, it is

difficult to apply this approach to non-harmonised products in practice. Therefore the preferred option is a soft limit.

An additional technique to soft limits that may serve to address length problems is the use of 'layering' or signposting, raised by both consumer and industry stakeholders. Such a technique can allow different investors with different degrees of financial literacy to be served by the same document – those requiring further information can be directed effectively to find it. It is vital however that cross-references are not used to fragment access to key information, which would undermine the effectiveness of the whole regime for investors. In all cases, that is, the KIID should be able to function on a standalone basis, as relying on other documents for key information would defeat the overall purpose of the KIID).

In terms of marginal costs, a soft limit with specific requirements tailored for particular PRIPs at level 2 might not be significantly different in impact to a hard limit at level 1.

Ensuring accuracy and balance of information

This analysis focuses on the problem of accuracy and balance in information in product disclosures.

Option	**Effectiveness**	**Efficiency**
0 -- Take no action	0	Issues identified in problem definition would continue, as set out in 3.4.
1 – set high-level principles only	- While in general the principle of being 'not misleading' covers such issues as a lack of balance in information or inaccuracy in information, without more detailed requirements inconsistencies between firms and between Member States would emerge, reducing comprehensibility of information for customers It is likely, given difficulties in enforcing principles, that presentation of information could be 'gamed' (enabling subtle investor biases to be exploited)	Could raise supervisory costs, given potential subjectivity of standards Inconsistencies in approach between supervisors or lack of legal certainty might raise compliance costs for some firms, and negatively impact consumer benefits
2 – use prescriptive requirements on form and contents to ensure balanced presentation	+ Reduced misunderstandings by investors: YouGov and IFF testing of KII proposals for UCITS suggested that precise positioning of information (e.g. putting cost information on front page, performance on back page) can be material in impacting consumer comprehension of relative importance of messages; specifying these in prescriptive rules could lead to higher minimum standards across all PRIPs	Consistency in approach could reduce some supervisory costs Legal certainty for firms

Accuracy and balance are generally applicable high-level principles across the financial services in regards communications between firms and potential investors. However, subtle juxtapositions and hierarchies of information (for instance, placing cost information on a back page) can have strong impacts as to how salient information is taken to be for retail investors. On this basis, the UCITS KII was designed carefully to prescribe a specific order to information. Given the risk of subtle biases in information, the use of prescription for other PRIPs is the preferred option; some consumer stakeholders have specifically underlined this point. In terms of marginal costs, this would likely reduce costs over a more flexible approach for both supervisors, and to a degree, firms.

Comparability

This analysis focuses on the central objective of enhancing comparability between products, and assesses the effectiveness and efficiency of standardisation / prescription in this regard, along two axes: (A) the '**layout**' of the documents (order of information and labelling of information in the document), and (B) the specific area of potentially quantitative or objective **information that can be used for comparisons** (on product risks, costs, and performance).

	Option	Effectiveness	Efficiency
A LAYOUT	0 -- Take no action	0	0
	1 – Prescribe consistent document structure to aid comparisons	+ Consistency in structure will benefit investors in comparing between products, potentially improving comprehension and confidence in using information. Consistency in structure may run the risk of taking a 'one-size-fits-all' approach that reduces effective communication of specific features of some products – care must be taken to test approach to ensure effectiveness for consumers.	Consistency may reduce some aspects of compliance costs (through simplicity) and supervision costs, though likely to be marginal in impact on costs Benefits for investors, better decision making
B INFORMATION	0 -- Take no action	0	0
	2 – Standardise risk, cost and performance disclosures	+ + Comparable disclosures crucial to informed decision making: improving capacity of investors to compare risks, performance and costs is fundamental to this initiative. Choice and technical development of information capable of guiding comparisons (including calculation of numbers where quantitative information is provided) must be very careful undertaken. Presentation also needs to be tested with investors. Improving comparability of disclosures may impact competition between providers, sectors NOTE: improving comparability of information may entail public policy choices: identification of the elements of investment products that are most salient for retail investors and which elements should be highlighted likely to have impact on consumer behaviour (e.g. question of relative balance between risks, costs, benefits).	Comparators should lead to better decision making, broader market efficiency benefits Costs may be material for providers if new methodologies for calculation are unfamiliar or require new resources to be developed/obtained Comparators may aid distributors and advisors in making personal recommendations or assessing the suitability of different products for retail investors

Standardisation appears fundamental to improving comparability, as identified by the Decision Technology and YouGov and IFF studies. The policy options in this instance relate less to the use of standardisation as such, and more to the clarification of the areas in which standardisation can be effectively applied. In practice, technical work at level 2 (to identify the methods (and possible limits to these) for achieving comparability in product features, notably in relation to risks, performance and costs, will determine the practical extent to which standardisation can be used. It is vital that assessments of the specific application of standardisation at level 2 are built on the basis of robust consumer testing of different options.

Marginal costs related to detailed options on standardised risk cost and performance disclosures are likely to vary significantly; analysis of this will be central to the level 2 impact assessment.

Summary

Putting all these areas together, an approach which might be termed **'targeted standardisation'** emerges.

Full standardisation (the application of the UCITS model to all other PRIPs unchanged, or the application of a similarly standardised / prescriptive approach) would be difficult to practically achieve given the heterogeneity of PRIPs other than UCITS. Following this approach could lead to misleading information, undermining the objectives of improving comprehensibility and comparability. Yet standardisation where used in an appropriate way is a strong effective and efficient tool for addressing comprehensibility and comparability objectives, whilst it also can be a strong tool for ensuring regulatory consistency. Indeed it is difficult to see how comparability objectives can be achieved without at least standardisation of (at the least) risk and cost information.

The impact of this approach for different stakeholders is discussed in detail under section 6.4 below. Under this option, standardisation would be applied as far as is possible to the structure of product disclosures, the use of labels and some warnings, and risk, cost and performance or benefits information. Precise application of standardisation would be

established through level 2 measures, which will be the main determinants of the costs of such a regime (as technical details of how the PRIPs regime is designed will impact on the one-off / switching costs), as well as a key to reaping the highest potential benefits (through the optimal design of what precisely disclosures should contain and look like). As referred to above, the cost impact of intervention is not as accumulative in nature as the benefits are. The overall cost-benefit analysis of preferred options is carried out in section 6.4.

6.2.3. Issue 3: Responsibility for preparing document

In the UCITS framework, there is a clear allocation of the responsibility for preparing the information to the product manufacturer or provider; a similar allocation can be found in relation to insurance products; for securities PRIPs, however, current practice does not always rely on the security originator for the preparation of information for retail customers; distributors can take a stronger role.

Respondents to the PRIPs Consultation broadly supported an approach which placed responsibility for preparing the product disclosures on the product manufacturer. Consumer representative respondents (amongst others) to the PRIPs Consultation noted the importance of clarity in a product disclosure document itself as to who produced the product and who produced the information.

Option	**Effectiveness**			**Efficiency**
	Comprehension	**Comparison**	**Regulatory Patchwork**	
0 -- Take no action	0	0	0	0
1 -- Flexibility over who prepares the document	- For the much of the PRIPs market, this may reduce clarity	- May lead to differences in approach to information about the same product	- Lack of consistency in allocation of responsibilities likely to lead to different supervisory practices between Member States and sectoral supervisors	Allows for tailoring of requirements for market realities / responsiveness to changing distribution arrangements May exacerbate legal uncertainty over responsibilities, undermining 'ownership' of the KIID and undermining its practical development in some market segments
2 -- Flexibility over who prepares the document, but agreement on responsibility	- As above	- As above	- As above in regards consistency	As above, though there would be clarity as to individual responsibilities in regards specific arrangements. Impact could be significant for providers and distributors where agreements have never been established in the past
3 -- Product manufacturer normally responsible for preparing the document	+/- Reflects existing approach in much of PRIPs market Determination of allowed exceptions would need to be subject to detailed implementing work and impact analysis in this regard to avoid impractical solutions that lead to misalignment between responsibilities and capabilities	+/- Reflects existing approach in much of PRIPs market.	+ Greater consistency depends on care taken in regards targeting of exceptions	Allows for some adjustments for practical scenarios where responsibilities and capabilities might not otherwise be appropriately aligned (split responsibilities, handling of delegations); this could mitigate possible unintended consequences, whilst still allowing for broad legal certainty for much of the remainder of the market.
4 -- Require disclosures of responsible parties in document	+ Important for investors in relation to possible complaints, also ensuring clarity as to who is actually producing product	n/a	n/a	Identification of product manufacturer may require supporting clarification work in some instances (complex chains of intermediation and 'remanufacturing' possible in some areas in PRIPs market)

For a relevant part of the PRIPs market a model that places requirements strongly on the provider both accords with current requirements and has the benefit – according to many respondents to the PRIPs consultation including from the industry – of securing legal clarity, which supports carrying across this model into a new PRIPs regime. It is not clear how this model might be applied in some circumstances however in practice; in order to reflect this, situations where responsibility for preparing the document is not practically possibly or should be shared in a different way might be clarified at level 2.

We conclude therefore that while options 2 and 3 might be seen as equally capable of achieving the same outcome, option 3 has the benefit of establishing a broad principle that product manufacturers should in general have responsibilities for the products they produce, while also reflecting the normal situation that product manufacturers can best placed to prepare information about their products.

In terms of marginal costs, options 2 and 3 could be similar, depending on the precise details of level 2 measures.

Note, for clarity, that the preparation of the document would only be necessary where a product was to be sold or distributed to retail clients.

6.2.4. Issue 4: Ensuring effective provision of product disclosure information to retail investors

The UCITS framework contains what might be called a 'hard' requirement on provision of KII to investors. Effectively, whoever is selling must provide the KII in good time before a sale is transacted. (In line with MiFID and the IMD, a 'durable medium' must be used for this purpose, but this can include the use of a website so long as certain conditions are followed.) This contrasts with other possible models – for instance, where information is 'offered' or 'made available' by product manufacturers, but where intermediaries are not required to use this information to inform retail investors about the products.

Some industry respondents to the PRIPs consultation noted that requirements on provision of KII for PRIPs would need careful assessment against the practicalities of different distribution channels, e.g. taking into account electronic, telephonic and postal sales processes.

Option	**Effectiveness**	**Efficiency**
0 -- Take no action	0	0
1 – Information made available, but not required to be actively provided, e.g. by intermediaries	-- This could potentially weaken requirements, e.g. compared with the standard now in UCITS; this is incompatible with ensuring disclosures are made to improve investment decision making Possibilities of mis-selling likely would lead to ad hoc arrangements for provision between distributors and firms, and variations between member states would emerge	Would appear low cost for firms and distributors, but mis-buying could raise costs more widely.
2 – 'Hard' requirement on provision and its timing – following UCITS model	+/- In the context of advised sales, actual provision of KII relating to proposed investment is key to effectiveness of these documents – a strong requirement on this would make clear responsibilities on this, able to act as a better basis for effective supervision, compliance and redress in this area	Hard provision may clarify legal responsibilities between providers and distributors over what information can be used to discharge responsibilities of the distributor. Hard provision may reduce flexibility over how to provide information for some distributors. Hard provision could however improve the control of providers over the information given to investors about their products.
3 – Broadly follow 2, but allow for some	+ Allowing additional flexibility over and against option 1	Additional element of flexibility could mitigate potential consequences of applying hard

targeted exceptions	would allow certain execution only and other specific distribution scenarios to be better addressed (e.g. where timing is critical).	requirement across all distribution channels.

Under this analysis, the operational objective of ensuring provision of information would seem to militate for a hard requirement on provision; however, the application of such a requirement to different sales circumstances (such as on-line purchases, or purchases without advice) might require some residual flexibility on timing of provision to ensure measures can be practical. (The Distance Marketing in Financial Services Directive and MiFID already provides for certain targeted exemptions along these lines).

6.2.5. Issue 5: Flanking measures: civil liability and sanctions

In terms of legislative design, two issues remain, both of which have been addressed in the UCITS KIID regime that need to be considered in relation to other PRIPs: the clarification of the civil liability attached to PRIPs product disclosures, and the sanctions regime applying through the relevant competent authorities.

Civil liability

On this issue, three main options emerge, (0) taking no action (that is, remaining silent on liabilities); (1) supporting non-legislative measures to build capacity for consumers to seek and obtain redress; and (2) clarifying civil liability rules. (1 and 2 are not mutually exclusive)

Box 4: The UCITS KIID experience

In regards civil liability, the UCITS KIID approach on this was developed in response to failings in regards the simplified prospectus, where uncertainty as to the liability for the 'simplification' of information (that is, whether the simplified prospectus must contain all elements in the prospectus that might be taken as material for an investment decision) had led to firms including too much information in the notionally simplified prospectus so as to avoid liability. There were cases of simplified prospectuses that were longer than the full prospectus that they were supposed to simplify.

For this reason, a delimitation of liability, modelled on that in the PD in relation to the summary prospectus, was included in UCITS IV – civil liability attached to the KIID only in relation to consistency with the prospectus. The aim was to ensure that the KIID was approached as a communication document by firms, not as a legal or contractual document.

Take no action: It would be possible to take no comparable steps on civil liability for other PRIPs, remaining silent in this regard, leaving liability to existing sectoral and national requirements. However, while prescription of the form and content of PRIPs product disclosures reduces the risk that the document be used by firms primarily as a contractual rather than communication document, respondents to the PRIPs consultation raised concerns that if liability were not clarified in some form – in particular, so as to support the requirements to use plain language and to only include key information – the PRIPs regime could be undermined in just the same way as the simplified prospectus.

Clarifying civil liability rules and facilitating redress: Two possible further options can be identified, which are not mutually exclusive. The first option would be to support the development of (non-legislative) measures to build the capacity of retail investors to seek and obtain redress in relation to failures linked to the PRIPs product disclosures. (This might include work on access to alternative dispute resultion mechanisms, facilitating national steps to inform consumers of their rights, etc.) The second option would draw on the UCITS

approach, to establish explicit (legislative) requirements on civil liability (since other contractually relevant information might be contained in a variety of documents rather than a single prospectus, a simple copy of the UCITS approach is not possible). Under this option, civil liability would be attached to firms where PRIPs disclosures are not provided, or are not clear or sufficiently plainly worded (which would cover where the document includes extraneous information that obscures the key information), contain misleading or inaccurate information, or omit information that would be necessary for the average retail investor to make an informed investment decision. On this basis, the focus would be on establishing clearly that the PRIPs product disclosure is a communication document designed to address the provision of summary information pre-contractually, which does not presuppose the form of other documents that contain fuller information as may be necessary.

Option	**Effectiveness**	**Efficiency**
0 -- Take no action	0	0
1 – Supporting non-legislative measures (to build capacity for consumers to seek and obtain redress, collective redress work, etc.)	+ builds practical capacity directed at retail investors themselves and their behaviour .	Targeted and proportionate.
2 – Clarify civil liability (but adjusted as necessary; to establish clearly that the PRIPs product disclosures on its own is a communication document and is designed to address pre-contractual rather than contractual issues)	+ could reduce uncertainty, encourage clear commitments in relation to production of product disclosure.	Likely to lead to greater confidence in industry, and ensure benefits of changes more likely to be realised. Could reduce costs related to cross border activity.

Given the need for legal clarity but also for flexibility, options 1 and 2 are both preferred options.

Clarifying civil liability would also contribute to better achievement of an effective remedy for consumers, as enshrined in the Charter of Fundamental Rights, article 47. As such this would help achieve the aims under article 38, which seek a high level of consumer protection.

Sanctions

UCITS contains a high-level requirement on sanctions, which provides for only limited convergence in this area amongst competent authorities. Other Community legislation (such as the Distant Marketing in Financial Services Directive and the e-commerce Directive) also contain regimes on sanctions, though both of these directives focus on different issues to this current initiative and exist in parallel to it (as they do already with the UCITS KII regime). Given experience in other areas, this means there could be significant differences in the sanctioning measures that Competent Authorities in those Member States are able to apply. In addition, with regard to consistency, other work is underway at the Commission on sanctions (as set out in Annex I.2), that has identified efficient and sufficiently convergent sanctioning regimes as a necessary corollary to the new supervisory system, calling for steps to this end to be taken across all sectoral financial services legislation.[58]

[58] See the impact assessment prepared to accompany the November 2010 Communication on sanctions, a summary can be found at: http://ec.europa.eu/internal_market/consultations/docs/2010/sanctions/resume_impact_assesment_en.pdf

No action: If no action was taken for non-UCITS PRIPs on sanctioning regimes, leaving these to sectoral and national legislation, then this could lead to material inconsistencies across sectors and Member States in approaches for PRIPs (including between approaches for UCITS and non-UCITS PRIPs in so far as harmonisation of sanctions for UCITS product disclosures remains). Experience from the UCITS sector is that increased convergence as regards the contents and the form of disclosure requirements alone would not create more convergent outcomes without consistently effective and deterrent enforcement. Divergences between the powers of Member States to sanction non-compliance with the new requirements could diminish their effectiveness.

Clarifying sanctions: Two possible options arise – following the high-level approach in UCITS, or specifying the form and content of possible sanctions in more detail so as to allow for greater consistency in these across the EU. In practice it would appear that product disclosures are seldom a direct target for sanctions in themselves, so overly prescriptive alignments of supervisory activities here would seem disproportionate. Under this option, consistent powers for Member States to impose sanctions (according to their view on the gravity of the breach and the necessity of action) can be perceived in a two broad areas:

- where a sale has occurred without a PRIPs disclosure being provided;
- where a PRIPs disclosure is provided but is incomplete, unclear, inaccurate, or misleading..

Assessment of existing powers suggest that where such breaches occur, sanctions typically could include – as necessary in light of the gravity of the breach -- banning further product sales, requiring restitution to investors for sales that have been made, requiring or making public statements, for instance in relation to deffective information, or requiring information disclosures to be made again to existing investors.

Option	**Effectiveness**	**Efficiency**
0 – Take no action	0	0
3 – Take high level approach on sanctions	+/- A high-level approach to sanctions might leave material differences in use of sanctions across Member States that reduce consumer protection standards overall and could contribute to continued barriers to the single market	Largely neutral for industry compared to current requirements, but may reduce effectiveness of new regime, thereby limiting scale of possible benefits (e.g. in regards those involved in cross-border business or active in more than one national market).
4 – Clarify sanctions (as regards the areas and breaches against which sanctions might need to be used and the broad kinds of sanctions that might thereby apply in these areas)	+ allows consistency with commitments in Sanctions communication Allows tailoring of liability regime to specifics of different PRIPs Level playing field between different areas of financial services business	Likely to lead to greater confidence in industry, and ensure benefits of changes more likely to be realised. Could reduce costs related to cross border activity.

Given the importance of proportionate sanctions to underlining the importance of the PRIPs product disclosure regime, and given the PRIPs regime would create consistent duties on firms across all Member States, option 4 appears most effective and efficient.

6.3. Summary of retained options and their interaction with the current legal framework

The retained options outline the establishment of a new PRIPs disclosure regime modelled on that recently developed for UCITS, though with additional flexibility and tailoring of requirements at level 2 to address the variety of non-UCITS PRIPs.

The proposal is to use a new regime (delivered through a separate legal instrument) to introduce a new PRIPs product disclosure with a common 'look and feel', and to establish comparability between PRIPs through the development of detailed prescriptive implementing measures at level 2 on the layout, content and presentation of the new document, tailored as necessary for different types of PRIP. The prescriptive measures at level 2 on the new documents would be set (in the light of testing of options on consumers) so as to allow for objective and balanced comparisons of the investment features of different PRIPs, notably in regards areas open to the use of objective indicators or 'metrics' (risks, costs and potential benefits).

In line with this IA, the new regime should clearly set out at level 1 that the responsibility (in the main) for preparing the information should sit on the manufacturer of the product, and the responsibility for providing the information to retail customers should sit on the sellers (be these the manufacturers themselves or intermediaries), subject to only minor exceptions, e.g. to the timing of the provision. It would of necessity including supporting measures setting out liabilities for the clarity, accuracy and completeness of the information and its provision, and the range of sanctions that should be available to competent authorities (as a minimum) for breaches of the requirements.

The detailed form and content of KIIDs would necessarily be determined by technical level 2 measures, as was the case with the KIID for UCITS. In developing such measures, further steps will also be necessary to identify how to apply it in a proportionate manner to certain specific scenarios that have been raised by stakeholders, such as the relationship between 'wrappers' and underlying 'funds', where a product takes the form of an account which enables access in turn to underlying investment products, the information that might be needed where investments are intended for specific uses such as retirement planning, and the application of requirements to PRIPs distributed on-line and within secondary markets.

As set out in this IA, the supported option is for a form of targeted standardisation: to seek, through detailed level 2 measures, the greatest possible degree of comparability, but to allow also some flexibility so as to reflect the wide range of products available. The degree of standardisation of information through level 2 measures will necessarily need to vary according to the kind of information involved. Information and its presentation on product risks, costs, guarantees, and performance can be invisaged in a strongly standardised format (following experience with the UCITS KIID) so as to best aid comparisons, while information on the nature and goals of a product or ancilary benefits it might provide cannot be standardised to the same degree. Nonetheless, even for areas where full standardisation is not possible, a common presentational template is envisaged in line with findings from consumer research that shows the positive impact of standardisations of layout.

It is intended that level 2 measures would be developed strongly under the guidance of such research, and that impact assessments related to level 2 measures would clearly justify the areas in which standardisation is or is not achieved, and the extent and nature of that standardisation, under the broad principle set at level 1 that the greatest degree of

standardisation should be sought, so long as it is consistent with avoiding providing misleading information to retail investors about specific products.

Interactions with existing disclosure requirements

This new PRIPS KIID is conceived as a 'communication' document, focused on providing investors with the key information needed to make investment decisions in a form they can actually use: it is not intended to form a contractual document (as such), though of course the information contained in the document may form part of a contractual arrangement. This focus implies a separation of some form between the KIID and other more legal or contractual documents. The intention is not to address or alter requirements that might apply at European or national level or under contract law in regards these other documents or disclosures but to ensure the effective targeting of requirements relating to investment decision making, to ensure a summary disclosure capable of being used to compare different investments (the same for all products) is always available.

This naturally raises the question as to the interaction of new KIID proposals for PRIPS with existing requirements, for instance in regards the PD and Solvency II. Such existing requirements by definition do not seek to address comparability of information between different types of product.

In so far as the requirements in the PRIPs initiative are the same or can serve the same function as requirements under the PD (e.g. in regards key investor information to be contained in the summary prospectus) or Solvency II (e.g. in regards information about the contract, its costs, and its risks, as addressed in the requirements consolidated into Solvency II from earlier life directives), then in order to avoid duplication, where a firm satisfies the requirements placed on it in the PRIPs initiative, then fulfilling the PRIPs requirements could be taken as also satisfying matching obligations under the other instruments. The legal instrument on disclosure will clarify the extent of such interactions in order to provide legal clarity to market participants.

Currently the PD and Solvency II include measures that cover a wider range of information areas than intended under the PRIPs regime, which focuses on comparability, comprehensibility and tackling 'too much information' challenges for retail investors. For this reason, it is not effective to simply replace requirements in the PD or Solvency II frameworks; it is likely more proportionate therefore to permit product manufacturers to rely on certain elements of the information prepared for the PRIPs KIID when preparing these other disclosures, but to keep the relevant frameworks separate.

In practical terms, PRIPs requirements will exist in parallel to the existing law, and the satisfaction of the PRIPs KIID requirements will in specific cases be capable of "discharging" matching obligations under other instruments; it will be for Member States to assess the interaction in accordance with their transposition of other instruments.[59] The intention is to achieve a clear separation between the pre-contractual product disclosure information in the KIID – to 'ring fence' this disclosure document – from more formal contractual information/ This is in the interests of ensuring key information is more likely to be read and understood by keeping it separate and identifiable. Multiple disclosures, marketing documents and contractual documents are currently the norm for most investment products, with their relative

[59] Article 34 of Directive 2006/73/EC on MiFID provides an example for such link between two different acts: In case of UCITS, the distributor is allowed to fulfil the MiFID obligations on product disclosure by providing the Simplified Prospectus (now UCITS KIID) to the client

importance or role difficult to ascertain for the retail investor; the policy goal is that the PRIPs KIID stands out from other documents and is clearly identifiable as a simple summary information sheet for retail investors.

Mandatory provision of the KIID under issue 4 option 3 (with other documents offered or available on request) is a key tool for achieving this standout quality.Under this option, it would be ensured that MiFID and the IMD intermediaries are required to use and provide the KIID disclosures (current requirements under MiFID are not so explicit except in regards the KIID for UCITS). This will ensure consumers are better and more consistently protected, and will ensure a level playing field and reduce regulatory arbitrage across product types.

Table 4: Proposed new rules

<table>
<tr><th></th><th>UCITS</th><th>Other Open-Ended Funds</th><th>Unit-linked life insurance policies</th><th>Structured securities and closed-end funds</th><th>Structured deposits</th></tr>
<tr><td>Standardised Product Disclosures</td><td colspan="5">New PRIPs KIID product disclosure regime
(UCITS KII regime coexists for a transitional period)</td></tr>
<tr><td rowspan="3">Other rules (sectoral) on information about the product or product manufacturer</td><td>UCITS

(Prospectus, annual reports, etc.)</td><td rowspan="2">MiFID

(information requirements apply to MiFID intermediaries when selling financial instruments; provision of KIID part of this)</td><td>Solvency II (CLD rules)

Apply in respect to disclosures not related to PRIPs KIID</td><td>Prospectus Directive

Apply in respect to disclosures not related to PRIPs KIID</td><td rowspan="2">MiFID

(information requirements apply to MiFID intermediaries when selling financial instruments; provision of KIID part of this)</td></tr>
<tr><td>MiFID

(information requirements apply to MiFID intermediaries when selling financial instruments; provision of KIID part of this)</td><td>IMD

(information requirements apply to IMD intermediaries when selling insurance products; provision of KIID part of this)</td><td>MiFID

(information requirements apply to MiFID intermediaries when selling financial instruments; provision of KIID part of this)</td></tr>
<tr><td colspan="5">E-commerce Directive or Distance Marketing of Financial Services Directive</td></tr>
</table>

Note that given timing issues related to UCITS KII implementation, UCITS shall be subject to a transitional arrangement. UCITS will fall under the same KIID product disclosure framework as other PRIPs once the level 2 measures for the new framework have been completed.[60] Experiences from the implementation of KIID for UCITS (which is ongoing as

[60] See section 2.4 above. The level 2 impact assessment for UCITS IV foresaw a formal study to assess the effectiveness of the KII risk indicator (in particular). Any steps to consider alignment of KII with other PRIPs should be taken in line with this work.

of the writing of this IA) should be taken into account whilst preparing the level 2 measures for

6.4. Choice of the legal instrument – directive or a regulation

As the option of a non-legislative instrument has been discarded, this leaves the options of pursuing the objectives of this initiative through either a directive or a regulation.

Traditionally, the EU financial services legislation has largely taken the form of directives. This was because the legislative proposals mainly sought to approximate national rules on the taking up of business and the provision of services in a gradual manner. The choice of a directive enables Member States to integrate rules into their different legal systems. However, the recent development in the regulatory framework prompted by the need to lay down detailed rules of technical nature which should be applied in the same manner in all Member States is marked by the increasing use of regulations, not only at level 2.[61]

The objectives of this initiative relate directly to the standardisation of the detailed content and form of disclosures, such that a harmonisation of requirements to this effect (for instance on disclosures of risks and costs), rather than simply a harmonisation of objectives is necessary. If the choice of the precise measures for raising and standardising the level of investor protection with respect to investor disclosure was left to a harmonisation of national legislation of Member States, this would incur the risk that the content and the form of disclosures would continue to diverge from a Member State to a Member State and between industry sectors, which would not address the existing un-level playing field for market participants and uneven levels of investor protection and thus undermine the objectives of this initiative.

On the other hand, it needs to be taken into account that any initiative in this area would interact, to some degree at least, with existing investor protection measures that take the form of directives, including measures related to civil liabilities.

Given the core objectives of this initiative are to achieve a new level of standardisation and comparability in product disclosures across the EU and across different product types, it would appear that a regulation might be the most appropriate legal form for the new measures, however given the interactions noted in the preceding paragraph, this must be subject to some further legal analysis.

6.5. Overall impact of retained options

Costs

Product manufacturers

In principle the new regime would require new disclosure documents to be introduced by all PRIP providers across the whole EU.

[61] Examples include Regulation 1060/2009 of the European Parliament and of the Council on credit rating agencies, Regulation 1095/2010 of the European Parliament and of the Council establishing a European Supervisory Authority or Commission Proposal for a Regulation of the European Parliament and of the Council on Short Selling and certain aspects of Credit Default Swaps.

Given that the KII for UCITS is currently being implemented, and these costs were assessed separately in relation to UCITS IV, these costs are disregarded in relation to the estimates here. Any subsequent adjustments to requirements for UCITS KII in the light of the work on KII for other PRIPs will be subject to separate impact assessment, specifically in relation detailed level 2 measures.

The CSES study on the costs of implementation of the UCITS KII offers a good benchmark for the impact of introducing a new disclosure regime of this type. Overall, the study estimated that the changes necessary for bringing in the KII – systems changes, training costs, printing costs, drafting costs, etc. – were expected to lead to an increase in ongoing costs of product disclosures on average of around 7.5%. The study estimated that a maximum for the overall one-off costs for introducing the KII for UCITS could as a maximum be in the region of 0.016% of assets under management, or EUR 730 million, but the report estimated that after adjusting for certain factors (such as the proportion of closed funds to open funds in the UCITS market, and the impact of transitional arrangements), the cost figure could instead be as low as EUR 290 million.

As discussed in Annex II.2, these figures can be adjusted for the PRIPs market as a whole (on the basis of business volumes rather than product counts), giving a ***one-off costs figure of EUR 171 million for non-UCITS PRIPs, and on going costs of around EUR 14 million per year***. As noted in the Annex, the dependency of final costs on options selected at level 2 necessarily limit the accuracy of any assessment possible at this stage.

Since the CSES study focused on costs for the UCITS, some peculiarities of that industry may pattern these costs:

- There may be a distinction between costs of change for products on continuous offer (such as funds, where a new regime requires new disclosures for existing funds), and products that are not open to continued new business in this way.

- The UCITS industry is characterised by a large number of funds, including many sub-funds. Costs for other sectors will depend on the number of discrete products on offer, and could be lower than for UCITS (the detail on this however depends on the final form of level 2 measures).

One-off costs are strongly dependent on the flexibility of transitional arrangements, and the extent to which the new regime can be introduced through pre-existing product cycles. Some larger individual industry respondents to our consultation and to the CSES study even noted that in their view that flexibility in this regard could allow changeover costs for the new regime to be more or less absorbed into normal disclosure review cycles. (Existing disclosures for continuous offer products would naturally be updated each year, for instance for annual cost or performance information). However, the new regime would clearly replace existing requirements, certainly triggering significant one-off costs in terms of drafting, IT systems, channel training, and so forth.

Distributors

Pure distributors (that is distributors who do not act as product manufacturers) are likely to face training costs related to the new regime, and they would likely bear systems costs in addition (in preparing to handle and disseminate new disclosures). The YouGov and IFF study surveyed intermediaries in relation to the development of the KII for UCITS, and these

respondents noted possible benefits from greater standardisation, though views were varied and the discussions were qualitative.

Supervisors

The new regime is likely to require greater supervisory resources, in particular during the transitional period. However, the extent that this reflects a marginal change in costs for supervisors depends strongly on pre-existing national regimes, which may already have put in place resources for targeting the quality of disclosures in the retail market.

Retail investors

Costs borne by the industry would likely be passed on to investors, at least in part. However they would also lead to higher transparency and comparability on product features and costs, with potential increase in competition. It is difficult to weigh up the impact of increased costs, on the one hand, with possible increased competition effects, on the other (evidence on the latter is discussed below). But it should be noted that it is more difficult to pass on costs to consumers in a more competitive market.

Benefits

Retail investors

The benefits of standardisation and comparability have been underlined by the Decision Technology study, which concluded that using these techniques in relation to investment decision-making is likely to lead in practice to changes in investor behaviour that contribute to better decision making.

Given mis-selling on the potential scale of 60% in a market worth around EUR 9 trillion, such an impact, even if relatively small (e.g. ***even a 1% reduction in mis-purchases***), would be of great significance in terms of consumer welfare: this alone could contribute to ***mitigate EUR 10 billion in possible mis-held products*** *(or EUR 4 billion if UCITS is not included)*. While such figures are highly approximate, they simply illustrate that incremental impacts in the retail market can be very significant when examined from an aggregate viewpoint, and to underline the scale of potential mis-purchases in this market. In addition, if findings related to price impacts of transparency are borne out more widely, additional benefits could impact all retail investors (not just those who mis-buy).

Of course, as set out in the problem definition section and already noted above in section 6.1, there are many factors that impact mis-selling, and failings in product information are only one. However, the availability of product information the average investor can actually understand and use is a fundamental basis of empowered consumers in the retail investment market, without prejudice to the role and responsibilities of intermediaries at the point of sale. Ultimately, if products cannot be explained clearly in terms investors are able to understand, then the question arises as to whether such products could be suitable for retail investors. The explanation of products to retail investors is a responsibility of the person selling the product, however this is clearly facilitated by the effectiveness of product information. For this reason, demonstrably clear disclosures are one of the necessary foundations of the retail investment market; even though on their own they cannot guarantee the soundness of the market, in their absence a sound market is not possible.

Product manufacturers

It is difficult to assess the scale of benefits for manufacturers.

One factor mentioned by some respondents to our consultation was that greater consistency (between sectors and between Member States) ultimately benefits firms that operate across sectors and cross-border, ensuring they can put in place consistent approaches themselves, with some possible economies of scale or removal of duplication (e.g. where very different documents are needed for different markets).

Without EU intervention, a proliferation in different standards across Member States and sectors would tend to fragment the market, impacting competition between sectors and erecting fresh barriers to the growth of the single market. In the context of the UCITS market (an avowedly cross-border market), differences in national approaches to retail disclosures (the simplified prospectus) were identified by stakeholders during the development of UCITS IV as a major factor serving to fragmenting that market and raise costs. This experience can be expected to be replicated across other markets as they develop deeper cross-border elements.

Consistency in requirements that allows for better comparisons between products would likely have an impact on competition in the market (as outlined above in regards pricing, for instance). This may lead to changes in sectoral competitiveness, to the benefit of one sector over another, by reducing current inconsistencies in treatment at the European level. Other factors – notably, the impact of specific tax regimes, and peculiarities of national distribution networks – can determine the prevalence of different product types and their predominance across different distribution channels.

Contributions of improved disclosures to reduced mis-buying would directly reduce cost impacts for firms, e.g. in terms of complaints, reputational damage, costs of redress and so forth.

Linked to this, a more general area of potential benefits is clear however. This relates to the low levels of 'trust' in the retail market so clearly evidenced in the latest Consumer Markets Scoreboard results. Tackling this – by facilitating more direct, clear and straightforward communications between product manufacturers and their clients – could benefit providers by encouraging retail clients to invest, driving a transfer of savings into the capital markets. This could grow the retail investment market (for all providers) whilst also providing much needed capital liquidity for investment. Whether this would in fact happen is difficult to assess.

Distributors

Some respondents to the consultation indicated that the new regime should simplify the situation faced by distributors, so that their compliance with disclosure requirements would be easier (given new consistency in information provided to them across all PRIPs). This could also impact the provision of services, allowing advisors themselves to comply better with their obligations to understand the products they deal with and to make clearer comparisons between products on offer.

Supervisors

Supervising disclosures on the basis of consistent requirements across the entire market is likely in practice to be less costly than doing so on the basis of less consistent requirements.

In addition, improved comparability of products will likely contribute to better supervisory monitoring of market developments and product suitability. Given mis-sales scandals in the past, and the impact these have had for supervisors (requiring extensive after-the-event work), preventative measures are likely to be strongly beneficial in so far as they work in practice. (Assessing the counterfactual is however rather difficult).

The following table summarises the expected net effect of the preferred proposals on various stakeholders: consumers, industry (originators and distributors of products), and national regulators.

Table 5: Impacts on Stakeholders

Stakeholder / Issue	**Consumers (retail investors)**	**Originators**	**Distributors**	**National regulators**
Pre-contractual disclosure	+ (↑ investor protection, ↑ confidence in market)	+ (↑ investor protection , ↑ market activity, ↑ certainty and consistency offsetting ↑ costs)	+ (↑ investor protection, ↑ market activity, possibly ↓costs through better availability of quality, consistent product documentation)	+ / - (↑ market conduct and relation with investors, may be ≈ where effective pre-existing requirements already in place, may be ↑ supervisory costs)

Legend: + overall positive effect, - overall negative effect, +/- overall mixed effect, ≈ effect not significant, ↓ decrease, ↑increase

7. IMPACTS ON OTHER STAKEHOLDER GROUPS, EMPLOYMENT, SMES, ENVIRONMENT AND THIRD COUNTRIES

7.1. SMEs

In general it is not clear that these proposals would impact SMEs that are distributors directly in any significant regard. The proposals introduce changes / greater standardisation in information, but these costs are largely borne by product manufacturers as the parties mostly responsible for preparing and disseminating the disclosures. The research on costs for asset management companies of UCITS already to a degree reflected differential potential costs for SMEs, as that survey was carefully designed to take account of the size of the asset management firm.

Consistency and better availability of information suitable for the use of retail investors could well reduce costs for SME distributors, who would no longer need to search for such information or prepare their own information in some cases.

In general for product manufacturers that are SMEs (though these may to a degree cluster in the asset management sector and already be covered by UCITS changes) costs can be expected to be proportionately higher than for larger entities (though of course in absolute terms smaller); though the CSES study did not show a simple pattern in this regard in the UCITS market, data from other sectors and in respect of other requirements suggests such a relationship.

The true nature of these costs will only be capable of being analysed once detailed measures are finalised at level 2, since the selection of options at that level could have an important impact on costs for SMEs. The impact on SMEs will therefore be a vital criterion for assessing options at that stage.

7.2. Employment and social impacts

Impact for employment will, as for SMEs, likely be low, given that the initiative is more focused on changes to content and form than introduction of wholly new requirements that might have general impact. In general terms, new requirements may have some marginal impacts (training needed, some higher costs and thereby possible manpower consequences, particular in the niche case of the new requirements for structured deposits), but it is not expected that direct impacts could be material.

Indirectly, as with SMEs, more efficient capital markets and greater levels of investor confidence should contribute to growth in EU financial services more generally.

In regards social impacts, these are expected to strongly positive to the extent this initiative better protects consumers, by reducing the extent of mis-buying of investment products. As such this measure contributes to Article 38 of the Charter of Fundamental Rights, which calls for a high level of consumer protection.

7.3. Environment and third countries

Environmental impact is likely to be minimal. (Simpler, more focused information could in practice reduce 'paper weight' of financial services).

In regards third countries, the application of requirements relating to who may or may not produce disclosures is of particular significance, given that in some cases a product that would be a PRIP in the EU, but produced in a third country, is sold in the EU. The proposed option relating to the preparation of information seeks to address this circumstance; distributors in these cases might prepare the KIID.

7.4. Administrative burden

Annex II.2 contains a detailed analysis of the possible administrative burdens associated with the preferred options identified for this initiative. In general terms, since this initiative would by definition seek to require a new product disclosure to be prepared, disseminated and provided to retail customers for all PRIPs, this would impose one-off costs for this change on all PRIPs manufacturers (and to a lesser degree distributors). Ongoing costs are also likely to be impacted. The Annex outlines how the CSES study on the costs of introducing the KII for UCITS can be used to estimate the administrative burden for the remainder of the industry, but notes that an estimation of impacts at level 1 for an initiative such as this is necessarily going to be rather rough; more accurate estimations will only be possible once analysis of possible level 2 measures has been undertaken. The estimate on the basis of the CSES figures is a one-off cost of EUR 171 million, and incremental on-going costs (per year) of EUR 14 million.

7.5. Risks and uncertainties

Proposals for improving product disclosures face certain important limitations in regards their direct capacity to improve investor decision making. The timely provision of information in a comprehensive and comparable format does not guarantee that that information will be in fact

used by retail investors, while other factors might be also vital in determining the behaviour and choices of retail investors.

In practice consumer protection measures in the retail investment markets must be understood in a holistic manner: a variety of tools (product regulation, product controls by supervisors (banning, 'naming and shaming', conduct of business and conflicts of interest requirements on product manufacturers, conduct of business and conflicts of interest requirements on intermediaries (distributors and advisors), and improvements in financial education and capability amongst retail customers) are important and support one another.

However, it is clear that effective product transparency is a vital foundation stone for many of these other regulatory tools. Without effective product information in a form that retail investors can use to understand and compare products, it is unlikely that the certain other steps will be effective. Also, there are synergies: improvements in financial education and in the quality of sales processes would likely support greater and more effective use of and reliance on product disclosures. The converse also may hold.

The effectiveness of requirements on product disclosure depends on commitments by supervisors and firms across the retail investment markets to commit resources and develops skills. While this impact assessment has underlined a case for greater prescription and standardisation, this does not make the production of effective disclosures for retail customers a simple exercise. No amount of prescription can absolve firms of taking the commitment to find new and effective ways of communicating with retail customers about the nature and features of their products. The detail – on what products are and how they work – that is crucial for investors cannot be codified into a simple 'tick-box' recipe for firms (or supervisors) to follow. Using plain language – finding simple ways to explain complex products – is a skill that takes commitment of resources to develop. Further tools and supporting work by supervisors at the EU and national level as well as engagements with all relevant stakeholders needs to be explored to ensure effective implementation (cf. also Annex II)

This dimension of the outcome being sought by this initiative remains uncertain: it is not clear whether the steps outlined in this work including possible supporting work on the European and national level as mentioned will be sufficient to address this challenge.

7.6. Monitoring and evaluation

Table 6: Monitoring and ex poste evaluation

Issue	**Indicators**	**Sources**
Comprehensibility	Levels of complaints Mis-selling scandals Controlled assessments of quality	Stakeholder feedback Supervisory / ESA monitoring Follow up survey
Comparability	Market impacts of new 'comparators'	Baseline survey and follow up survey to monitor market evolution (linked to that on monitoring market evolution) Technical evaluation of efficacy of underlying calculation methodologies

Ensuring provision	Is document used in practice	Mystery shopping to assess compliance / timing of provision
Regulatory coherence	Regulatory arbitrage	Baseline survey and follow up survey (5 years) to monitor market evolution around boundaries of scope

8. CONCLUSIONS

Clear and comparable information about products is a necessary foundation for informed decision making, and key to empowering retail investors. Effective product information will also aid distributors in serving their retail clients.

The EU retail investment market remains beset by market, and, importantly, attendant regulatory failings. The emergence of increasingly complex products across a range of different sectors has undermined the effectiveness of existing product disclosure frameworks, which have not been designed with cross-sectoral comparability in mind. Currently EU law imposes a patchwork of regulation which Member States are unable to sufficiently address at their own level.

New requirements, developed on the basis of testing with consumers themselves, and designed to improve comprehension and comparability of information, have already been introduced for UCITS; these requirements apply across the whole EU, and are highly prescriptive.

In assessing options for the remainder of the PRIPs market in the EU, the preferred policy options that emerge clearly build on the approach developed for UCITS – following that model in introducing much greater standardisation and prescription in requirements at the EU level – but do not entirely follow the UCITS model.

The heterogeneity of non-harmonised products entails a need for some wider flexibility in the requirements for other products. This is termed **'targeted standardisation'** in this impact assessment. The analysis concludes that such an approach offers the best chance to achieve clearer and more comparable product disclosures whilst reflecting the practical realities of complex and varied products.

If clear and comparable information is not made available, informed decisions cannot be taken. **The wider significance for the regulation of retail markets of any continued failure to enable better, more informed decision making should not be understated.** For this reason, the effort and care needed to develop effective disclosure requirements and the costs and effort needed to implement them in practice are small prices to pay for putting retail investment markets onto a surer footing.

ANNEX I

1. LIST OF ACRONYMS

3L3	Lamfalussy Level 3 Committees
AFM	Dutch Financial Markets Authority
AIMA	Alternative Investment Management Association
AILO	Association of International Life Offices
BIPAR	European Federation of Insurance Intermediaries
CEBS	Committee of European Banking Supervisors (now EBA)
CEA	European Insurance and Reinsurance Federation
CEIOPS	Committee of European Insurance and Occupational Pension Supervisors (now EIOPA)
CESR	Committee of European Securities Regulators (now ESMA)
CLD	Consolidated Life Directive
EBA	European Banking Authority
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EIOPA	European Insurance and Occupational Pensions Authority
EVCA	European Venture Capital Association
ESMA	European Securities Markets Authority
FECIF	European Federation of Financial Advisers and Financial Intermediaries
FSUG	Independent expert forum, comprising consumer protection and small business experts, academics and consumer organisation representatives
FSA	Financial Services Authority (UK)
FSAP	Financial Services Action Plan
IFA	Independent Financial Adviser
IMD	Insurance Mediation Directive
IOSCO	International Organization of Securities Commissions
MiFID	Markets in Financial Instruments Directive
PD	Prospectus Directive
PFSA	Polish Financial Supervision Authority
SME	Small- and Medium-Sized Enterprise
UCITS	Undertakings for Collective Investment in Transferable Securities

2. RELATED INITIATIVES

- Review of MiFID

The MiFID framework is currently subject to review on a number of issues including investor protection rules. Proposals were adopted by the Commission in Autumn 2011, and are currently subject to negotiation by the European Parliament and the Council. Given that the MiFID framework has been identified as a key element and benchmark of the horizontal approach being sought for the regulation of all sales of PRIPs, consistency between the review of MiFID and the PRIPs initiative was of key importance in the development of the Commission proposals. The review of MiFID is thereby being used to deliver certain elements of the PRIPs initiative as regards selling practices.

- Review of IMD

The Insurance Mediation Directive (IMD) is also under review. The IMD currently determines the regime for sales for a significant element of the retail investment market – investments packaged as life insurance products. For this reason, the development of policy on sales rules for insurance products more widely through the review of the IMD will be relevant to the development of policy for PRIPs. Moreover, it is envisaged to use the IMD to deliver the part of the PRIPs work on sales rules for insurance based PRIPs.

- Sanctions

The Commission launched further work on sanctions by means of the Communication of 8th December 2010.[62] The Communication highlights that sanctions provided for by Member States diverge as regards the types of sanctions and the level of fines. It has therefore been concluded it is necessary to strengthen the sanctioning regime by further convergence of rules. The measures foreseen for the effective implementation and enforcement of the new provisions as regards product disclosure should therefore be coordinated with such sanction work.

- Prospectus Directive

Due to the recent amendments[63] to the Prospectus Directive 2003/71/EC the concept of key information within the summary prospectus review was introduced so as to ensure effective standards of investor protection. This concept needs further development on the level of delegated acts. Given that some securities subject to the Prospectus regime are also going to fall into the scope of the PRIPs work, it is important to coordinate the work in these two initiatives, so as to ensure a coherent overall approach from the perspective of investors and so as to avoid unnecessary duplication.

- UCITS IV implementation

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62 http://ec.europa.eu/internal_market/consultations/docs/2010/sanctions/COM_2010_0716_en.pdf.

63 Directive 2010/73 the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

UCITS IV is currently being transposed by Member States,[64] and the key investor information document defined within the KII regulation is currently being implemented by firms (it comes into force on 1 July 2011, though there is a 12 month transitional applying in some cases, so in practice the new document will only be used throughout the EU from 1 July 2012. UCITS funds fall within the scope of the PRIPs initiative. Given the current implementation of the KII by firms, and given that the UCITS KII functions as the 'benchmark' for product disclosures for other PRIPs, it is crucial to underline that the PRIPs initiative would not apply immediately to UCITS (the timing of the PRIPs inititiave could provide a sufficient transitional period, to minimise incremental changes and disruption). During the development of the KII for other PRIPs, any necessary consequential adjustments to requirements on the KII for UCITS will be made, bringing UCITS KII under the same harmonised requirements as all other PRIPs. In addition, it will be important to reflect on practical experiences with the implementation of the KII for UCITS during the development of detailed requirements on KII for other PRIPs.

- Pensions Green Paper

The Commission consulted in 2010 on a Green Paper on next steps in the EU pensions landscape.[65] The consultation period ended in mid-November 2010, and the Commission is considering the responses and its future direction in this area. This consultation addresses, amongst other things, transparency and disclosure questions relating to different kinds of defined contribution pensions (including personal or individual pensions under Pillar III). The same disclosure approach as developed for other PRIPs might be applied to many pensions (though additional disclosures may also be necessary in relation to the sale of pensions compared to non-pension investments). A pensions White Paper has now been published.

- Solvency II

Solvency II[66] which is a recast of life and non-life directives consolidates among others high level measures on disclosures to be made to clients. While work is ongoing on level 2, this work does not relate to these measures. The work under PRIPs could overlap with requirements for disclosures under Solvency II; as with the work under the Prospectus Directive, it will be important therefore to ensure no unnecessary duplication of requirements on firms.

- Single Market Act

Under the Commission work to improve the functioning of the single market and its effectiveness for citizens, steps have been identified to specifically improve the EU framework relating to social business, including possible ways in which the investment industry (including its retail wing) might contribute.

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64 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast).

65 http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=839&furtherNews=yes

66 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

3. WHAT ARE PACKAGED 'RETAIL INVESTMENT PRODUCTS'?

There is currently no definition of a 'packaged retail investment product' in Community law, nor is there a common definition in Member State legislation. We define the concept here with reference to the characteristics of the products on offer and the set of investors to whom they are sold. The core characteristics are as follows:

- They are 'packaged' products which combine investments in (usually) multiple financial instruments;
- They are typically held for a medium to long term period;
- Their core economic function is capital accumulation; and
- They are normally designed for and sold to retail investors.

This set of products should not be confused with retail *financial* products or services in general, which may include credit products (mortgages, loans), insurance products, payment services etc. PRIPs are however a sub-set of retail financial products.

Determining a definition of PRIPs has formed a strong part of the Commission's consultation with stakeholders. From this work a broad approach has emerged which uses an 'economic' definition (to be supported as appropriate by targeted exceptions):

The Commission services consulted on the following definition (as a refinement of earlier work and drawing on input from the 3L3 joint task force on PRIPs):

A PRIP is a product where the amount payable to the investor is exposed to fluctuations in the market value of assets or payouts from assets, through a combination or wrapping of those assets, or other mechanisms than a direct holding.

Such a definition of PRIPs would include products with capital guarantees, and those where, in addition to capital, a proportion of the return is also guaranteed. However, products where the precise rate of return is set in advance for the entire life of the product would be out of scope, since here the amount payable is not subject to fluctuations in the values of other assets.

It would rule into scope all investment funds, whether closed-ended or open-ended, and all structured products, whatever their form (e.g., packaged as insurance policies, funds, securities or deposits). Derivative instruments would also be in scope. The definition would appear to rule out – as required – many 'vanilla' shares and bonds, insofar as these do not contain 'a mechanism other than a direct holding of the relevant assets'. It would also rule out deposits which are not structured deposits (explicit clarification of the definition however may be needed in this regard).

Pure protection products would not be covered since they do not have a surrender value. Other insurance products would not be covered where any surrender value offered is not wholly or partially exposed, directly or indirectly, to market fluctuations. On the other hand, the range of insurance products caught would include those whose surrender values are determined indirectly by returns on the insurance companies own investments or even the profitability of the insurance company itself.

The mechanisms by which pay outs are made would not be relevant for determining scope: products that yield an income, or provide a single pay out at maturity, or that adopt some other arrangement, would all be in scope in so far as they satisfy the general definition.

The definition does not include any reference to a product being intended for retail use. This is due to the fact that the retail element is relevant at the point of sale in particular, when the distributor sells a certain investment product to a retail customer, or provides advice on it. A KIID would only be required however where a retail sale is underway.

Note that while all of the product families covered by such a definition offer comparable economic functionality, there is still considerable variation in product characteristics both within and between product families. The key differences include:

- The products are structured differently. For instance, investment in a fund entails the delegation of fiduciary responsibility to a fund manager, and with actively managed funds the return is affected by the decisions taken by that manager over the lifetime of the investment. By contrast, the calculation of the return on a structured security at maturity is determined in advance by a fixed algorithm.

- The legal relationship between the investor and originator varies. The client remains the beneficial owner of the assets in a fund investment, whereas this is not the case when an investment is made through an insurance wrapper: the underlying assets are legally owned by the insurance company. The company promises to provide a return to the policy holder based on the investment performance of the assets.

- The (non-investment) risks associated with the products differ. For example, an investor in a structured security bears a counterparty risk against the issuer of the security. An investor who entrusts his/her assets to a fund manager accepts the risk that the manager will not act in his/her best interests. There can also be differences in the exposure to liquidity risks between different types of product.

- The characteristics of the products may differ, for example in terms of the types of market exposure they offer and the existence and nature of a capital guarantee. The liquidity and accessibility of the products may also vary significantly, with some having lock-ins or penalties if the investor needs quick access to their capital.

- Average holding periods may vary; anecdotal evidence suggests that insurance-based products in particular are typically held for longer than the average maturity of a structured security.

- They are subject to differential tax treatment, according to the policy preferences of national authorities.

- Some products may offer additional functionality, such as biometric risk coverage in a unit-linked life insurance policy.

It is important that product disclosures are suitable tailored or flexible to allow for all of these differences to be clarified.

However, it is clear that, from the perspective of the retail investor, all of these products perform comparable economic functions. Work conducted on these issues in other public fora (e.g. Joint Forum, IOSCO, 3L3 and at national level) has variously referred to the same set of products as 'competing' or 'substitute' products. While these descriptions may apply to a subset of the products in question, we do not consider these terms to be generally applicable. For the reasons given above, we do not consider all of the products under consideration to be perfect substitutes. Moreover, while they do compete for retail savings, it is not always

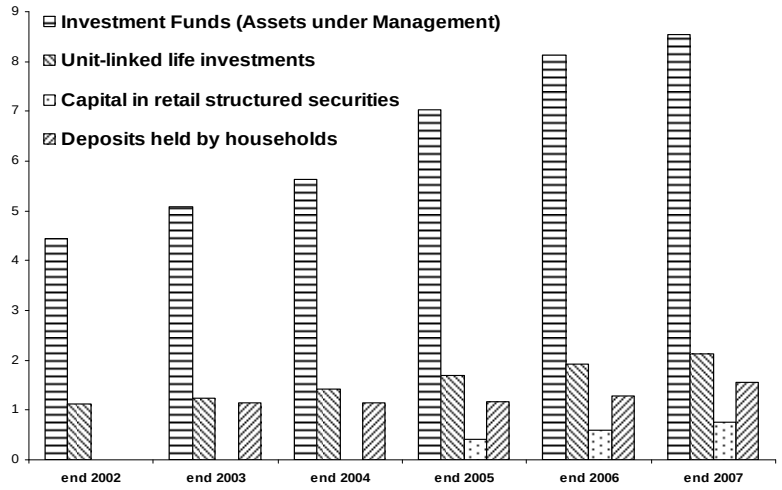
accurate to treat them as being in direct competition. For example, unit-linked life policies often serve simply as a 'wrapper' for an investment in an underlying fund. In this case the 'competing product' is more accurately described as an alternative channel for the distribution of the investment fund.

4. HOW BIG IS THE MARKET FOR PACKAGED RETAIL INVESTMENT PRODUCTS?

It is not straightforward to arrive at an accurate estimate of the size of the market for retail investment products. The available data on unit-linked insurance investments do not distinguish between those products offering significant biometric risk cover and those that do not. Data on term deposits do not distinguish between those that are structured and those that are not. There is also a problem of double-counting, to the extent that investments in units of investment funds through unit-linked life wrappers are included in both product categories. Nevertheless, an estimate of total market size of €8-11 trillion is not unreasonable. As noted in section 3 of the main text, 2009 estimates sat at around €9 trillion.

(Note that this estimate does not distinguish between retail and non-retail investments, as reliable data is not available across the whole market in this regard. However, EFAMA estimates that around 33% of fund investments are direct retail; the remainder however is also contain intermediated retail investments, so this figure itself will understate the retail market).

Capital outstanding (EURO trillion)[67]



Source EFAMA, CEA, retailstructuredproducts.com and ECB

5. HOW ARE PACKAGED RETAIL INVESTMENT PRODUCTS DISTRIBUTED?

On the supply side, it is necessary to distinguish between the *manufacturers* of retail investment products and their *distributors*. Manufacturers include fund managers, securities issuers, banks and insurance companies. These entities may distribute their products directly

[67] Investment funds: includes UCITS and non-UCITS but not hedge funds or private equity. Unit-linked life investments: includes life insurance policies with biometric risk component. Term deposits held by households: with Monetary and Financial Institutions: includes deposits without embedded optionality

to retail investors – in which case the manufacturer and distributor are the same – or through an intermediary.

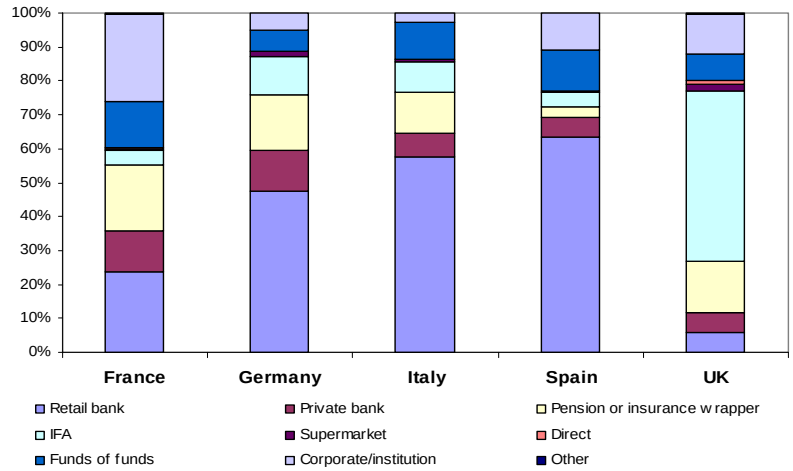
Funds and structured securities are distributed predominantly by banks in many Member States, although independent financial advisers are prevalent in the UK. Financial institutions also distribute the majority of unit-linked life insurance policies, along with insurance company employees, agents and, in some countries, insurance brokers. Greater detail is given in the sections that follow.

Traditionally, financial institutions distributed products developed 'in house' by fund managers and financial 'engineers'. In recent times, however, funds and securities distributors have moved towards more open models of distribution, with third-party products offered alongside own-brand products ('open architecture'). It is also common for different types of investment product to be made available from the same distribution channel. For example, a prospective investor seeking to purchase an investment from branch of a bancassurer or from an independent financial advisor may be offered products from any of the product families. There are also signs of developments whereby intermediaries offer services which blur some of the distinctions between intermediation and product manufacturing, such as distributor managed funds and wrap platforms.

Investment funds

Industry estimates suggest that, in continental Europe, commercial banks and insurance companies remain the largest distributors of investment funds but that their market share in fund distribution fell from 97% to 75% between 1990 and 2005. In the UK, independent financial advisors (IFAs) are the main distribution channel.

Distribution channels by country, 2007

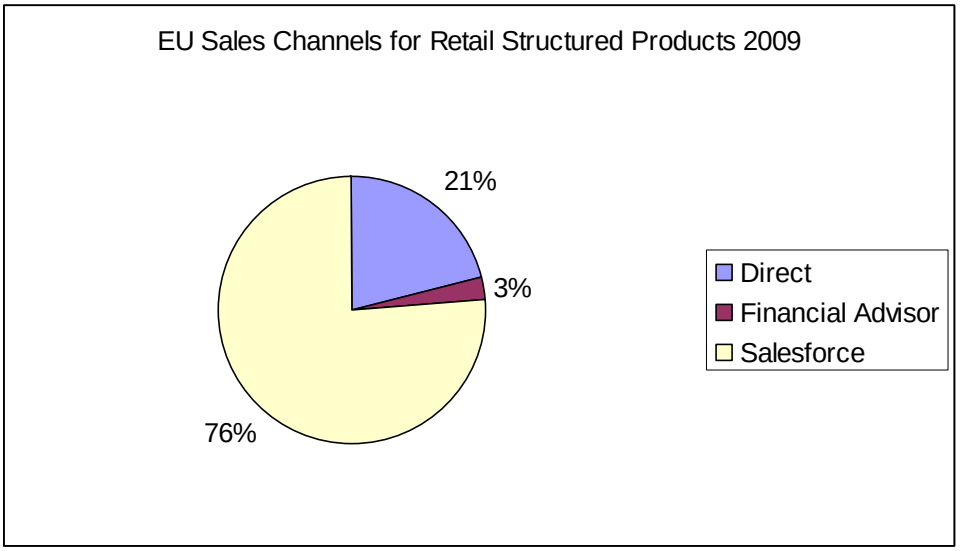


Source: Lipper FERI, *European Fund Market Data Digest 2007*

Structured securities

In 2006, banks were the primary distributors of retail structured securities, with a market share close to 86%. IFAs and brokers, which can either sell structured products from multiple issuers or from a single issuer, accounted for 12% of structured product retail sales in 2006.

Distribution channels, EU, 2009

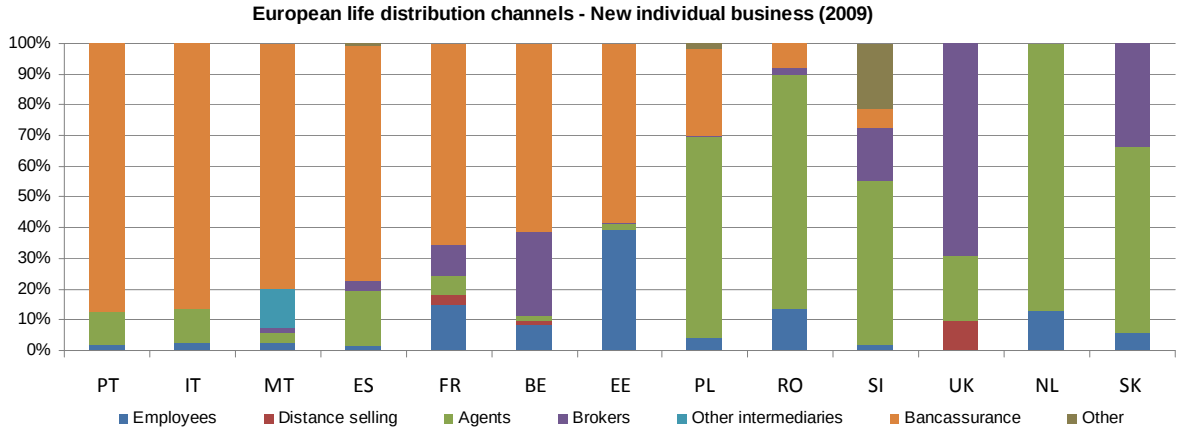


Source: www.structuredretailproducts.com

Unit-linked life insurance

The available data do not distinguish between distribution channels for unit-linked life insurance policies, and life insurance more generally. Financial institutions remain the main distribution channels, with the exception of the UK and the Netherlands, where brokers and agents predominate. Life insurance products are also distributed through networks of insurance company employees.

Life insurance (new individual contracts) distribution channels, EU, 2009



Source: CEA

Structured deposits

No data are available on distribution channels for structured deposits. However, it can be reasonably assumed that, by their nature, structured deposits are distributed by deposit-taking institutions, i.e. commercial banks. In some Member States, financial advisers might well propose these as part of their range of products.

6. EUROPEAN DISCLOSURE RULES FOR RETAIL INVESTMENT PRODUCTS

Requirements for different types PRIPs

Investment funds

For funds covered by the UCITS Directive a Key investor information document (KIID) must be provided to the investor before the conclusion of the contract (s. Annex …). On request, a full prospectus, an annual report and a half-yearly report have to be provided. Concerning nationally regulated retail funds, many national laws follow the structure of the UCITS Directive by requiring a full prospectus and a shorter document (simplified prospectus/KIID) whereas others require additional disclosure documents. Details of the KII regime are set out below.

Structured securities

Structured securities which are to be offered to the public on a pan-EU basis are subject to the Prospectus Directive 2003/71/EC and hence to the publication of a prospectus. Article 5 states that the prospectus "*shall contain all information which, according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities. This information shall be presented in an easily analysable and comprehensible form*". The prospectus shall also include a summary, which following the amendments of Directive 2010/73/EC shall "*in a concise manner and in non-technical language, provide key information in the language in which the prospectus was originally drawn up. The format and content of the summary shall provide in conjunction with the prospectus appropriate information about the essential elements of the securities in order to aid investors when considering whether to invest in such securities."* The summary shall be drawn up in a common format in order to facilitate comparison between different summaries and its content shall contain key information on the security. Key information here means essential and appropriately structured information which is to be provided to the investor and which comprises a short a description of the risks associated with the issuer, of the risks associated with the investment into the security, the general terms of the offer and details of the admission to trading. The prospectus has to contain all the information required by the annexes of the Prospectus Regulation (Commission Regulation N° 809/2004), depending on the issuer and the securities offered. The prospectus has to be approved by the relevant competent authority.

Unit-linked life insurance

Directive 2009/138/EC (Solvency II), indicates in a list the information to be provided to the policyholder prior to the conclusion of the contract. The information will relates to the insurance undertaking and to the commitment itself. Article 185 of Directive 2009/138/EC requires that before the life insurance contract is concluded, at least the information set out in paragraphs 2 to 4 shall be communicated to the policy holder. As regards unit-linked policies, such information includes the definition of the units to which the benefits are linked as well as an indication of the nature of the underlying assets.

The Article further requires that

- The policy-holder shall be kept informed throughout the term of the contract of any change concerning certain elements of information mentioned in Article 185 including information on the underlying assets in case of unit linked life insurance .

- The Member State of the commitment may require assurance undertakings to furnish information in addition to that listed in Article 185 only if it is necessary for a proper understanding by the policy holder of the essential elements of the commitment".

The required elements of pre- and post-contractual disclosures "*must be provided in a clear and accurate manner, in writing, in an official language of the Member State of the commitment*".

Structured deposits

There are no European pre-contractual disclosure rules applicable to structured term deposits.

Details on KII regime for UCITS

Purpose of the KII

- Replacement of the simplified prospectus

  The requirement to produce a simplified prospectus in addition to the existing full prospectus was introduced into the UCITS Directive in 2001 (Directive 2001/107/EC). The simplified prospectus was to be designed as an investor-friendly tool, a source of valuable information for average investors, giving key information about UCITS in a clear, concise and easily understandable way and offered to them before the conclusion of the contract. It soon appeared that the simplified prospectus did not fulfil the role it was designed for: it has become as ineffective and unengaging for investors as the full prospectus due to its length, structure, and the common use of jargon. In fact, it has been difficult to distinguish between those two documents.

  Learning from this experience, the Commission embarked on a extensive testing exercise with consumers themselves in order to develop those elements of the disclosure which could improve the quality and effectiveness of information to be provided to retail investors. The outcome of the testing exercise was a main point of reference for the CESR advice on which the new regulatory framework of UCITS IV (Directive 2009/65/EC) and its implementing measure (Commission Regulation (EU) no 583/2010) are based.

  KII has therefore become one of the documents (others being a prospectus and periodical reports) which are obligatory for a management company or an investment company. (this sentence seems not entirely clear to me, language wise, not contents)

  The main purpose of the KII is to provide investors with appropriate information about the essential characteristics of the UCITS concerned, so that investors are reasonably able to understand the nature and the risks of the investment product that is being offered to them, and, consequently, to take informed investment decisions (art. 78(2) of Directive 2009/65/EC).

- Specific contexts

Apart from its main role as a pre-contractual disclosure instrument, the KII has also an important role with respect to the UCITS product passport (maybe we skip merger, it is abit too technical, maybe just one sentence, important role with respect to cross border fund mergers.)

UCITS passport - in order to ensure that investors in all MS where a given UCITS is marketedreceive the same information, the Directive provides that the KII, translated as required, forms part of the notification file and is provided to investors in a Member State where the UCITS is marketed;

Fund mergers – KII of the receiving UCITS (if established in a different Member State) should be provided, among other documents, by a merging UCITS to its competent authorities in order to obtain authorisation of the merger. Once a merger is authorised, KII of the receiving UCITS should be provided to unit-holders of the merging and receiving UCITS. It should help unit-holders to take the decision whether to stay invested in a fund or redeem the units of a UCITS.

Main requirements laid down in the level 1 directive

- Addressees of the requirements:

  The fund manager should draw up for each fund it managers; the entity selling should provide the KII to the client or potential client.

- Aim of KII:

  Pre-contractual obligatory disclosure – it should contain information about the essential characteristics of the UCITS concerned so that investors are reasonably able to understand the nature and the risks of the investment and take investment decisions on an informed basis.

- Main characteristics of KII:

  It should be fair, clear and not misleading, consistent with relevant parts of the prospectus.

- Main requirements with regard to the form of a KII document and its language

  - short document,

  - common format, information should be presented in a specified sequence allowing for comparison between different UCITS,

  - information presented in a way that is likely to be understood by retail investors,

  - non-technical language should be used,

  - specific, self-standing document: its essential elements should be comprehensible to the investors without any reference to other documents.

- List of essential elements KII should contain in respect of the UCITS concerned:

  - identification of the UCITS,

- a short description of its investment objectives and investment policy,

- past-performance presentation, or, where relevant, performance scenarios,

- costs and associated charges,

- risk/reward profile of the investment including guidance and warnings in relation to the risks associated with an investment in a given UCITS.

- Civil liability

  Was constructed in a way which supports the restrictive character of the KII underlying the fact that it should not repeat the information included in the prospectus. The civil liability was therefore limited to situations where KII is misleading, inaccurate or inconsistent with the relevant parts of prospectus.

- Provision of KII and its availability:

  To investors (in good time before they subscribe units of UCITS; free of charge, in a durable medium or by means of a website; in a paper copy on investor's request (also free of charge)).

  To competent authorities of UCITS home Member State.

  KII should also be made available on the website of the investment or management company.

- Revision of KII

  The essential elements of KII should be kept up to date.

- Translation of KII

  The requirements relating to the translation of KII apply in a passport situation, which means where a UCITS authorised in one Member State is marketed in another Member State.

- Verification of KII by competent authorities

  Directive 2009/65/EC does not require UCITS competent authorities to ex-ante approve the KII. However, Member States have a general obligation (laid down in art. 99 of Directive 2009/65/EC) to ensure the enforcement of national rules adopted pursuant to this Directive. Furthermore, the Directive requires Member States to lay down effective, proportionate and dissuasive measures and penalties concerning the duty to present KII in a way that is likely to be understood by retail investors.

  The obligation requiring management companies or investment companies to send KII and all amendments thereto to UCITS competent authorities is to facilitate the verification of KII by these authorities either ex-ante or ex-post, depending on their national law or administrative practice.

Level 2 requirements supported by level 3 guidelines

Directive 2009/65/EC foresees the adoption of implementing measures related to the detailed and exhaustive content of the KII as well as specific conditions to be met when providing KII in a durable medium other than paper.

In order to achieve consistent application of the provisions on KII in all Member States being a precondition for satisfactory level of comparability of funds, and due to the technical character of the rules, those measures have been adopted in a form of a regulation (Commission Regulation (EU) no 583/2010). During the preparation of the legislative act it became clear that there was a need and expectations from stakeholders for more precision which would not compromise the flexibility, possibility to adjust rules to changing market conditions. CESR responded to these needs by adopting several guidelines. This is a bit unclear. Some of them contain detailed elements for the underlying methodologies so that information in KII document can be truly comparable across the whole fund universe.

The table below reflects main elements covered by the regulation and supporting guidelines

Level 1 principles	Level 2 rules	CESR guidelines
Requirements relating to the form and language of KII document	- content exhaustive; - specification of the the title of the document, the order of contents and sections' headings; - requirements in relation to: • language that should be used (e.g. avoidance of jargon or technical terms), • use of colours and branding, • document size: no more than two pages of A-4 sized paper. - details on the use of cross-references to other sources of information .	CESR's guide to clear language and layout for the KII document. CESR's template for the KII document.
Essential elements of KII	Specification of all elements of KII listed in level 1 directive. In particular: risk and reward profile of the fund should contain a synthetic indicator supplemented by narrative descriptions of the indicators and those categories of risks which are material for a given UCITS but not adequately captured by an indicator. charges should be presented in a certain form (a table annexed to the Regulation) and what sort of information it should contain.	CESR guidelines on the methodology for the calculation of the synthetic risk and reward indicator in the KII document. CESR guidelines on the methodology for calculation of the ongoing charges figure in the KII document.

Revision of KII	clarification on the review of the KII and the situations which trigger the publication of the revised version of KII Document.	
Exceptions to main rules – specific situations	specific requirements (complimentary to or different than those laid down for UCITS in general) for specific UCITS structures: - an investment compartment of UCITS; - one class of units or shares; - a fund of funds - a feeder UCITS - structured UCITS	CESR guidelines on selection and presentation of performance scenarios in the KII document for structured UCITS.
Provision of KII	conditions which should apply when KII Document is provided in a durable medium other than paper or by means of a website.	

To aid visualisation of this regime in practice, CESR prepared a 'template KIID'. This can be found at http://www.cesr.eu/index.php?docid=7336.

7. MEMBER STATE APPROACHES TO THE REGULATION OF RETAIL INVESTMENT PRODUCTS

Many Member States have supplemented the provisions of European directives with additional provisions within their own jurisdictions. This section provides examples from four Member States, which are included for illustrative purposes only.

United Kingdom: At the time of the implementation of MiFID, the UK introduced a new Conduct of Business sourcebook[68]under which many MiFID provisions, particularly on conduct of business and conflicts of interest were applied to non-scope business, e.g. certain life insurance products. In this context also the need to prepare a Key Features Document (KFD) and a Key Features Illustration (KFI) for "packaged products" was introduced. A Key features document has to include information which enables retail clients to make an informed decision about their investment. Firms which sell such products to retail clients have to provide these documents to their clients in good time before conclusion of the contract.

In **Italy**, the amended Consolidated Law on Financial Intermediation[69] adopted a homogeneous approach for both product disclosure and rules on conduct of business. Any public offering of securities, investment funds (both UCITS and non-UCITS) or "*financial products issued by banks or insurance undertakings*" is subject to the same rules concerning the prospectus as well as to the supervision of the CONSOB. Moreover, Italy introduced transparency requirements for supplementary pension schemes, providing investors with pre-contractual and contractual information similar to that required for retail investment funds.

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68 New Conduct of Business Sourcebook (COBS) applying to firms with effect from 1 November 2007

69 Legislative Decree n° 58 of 24 February 1998 - Consolidated Law on Financial Intermediation - (as subsequently amended)

In **Portugal**, the Decree-Law No. 357-A/2007 of 31 October 2007 (as subsequently amended) which transposes MiFID into national law transferred the powers of supervision and rulemaking on assurances linked to investment funds and the individual subscription contract to open-end pension funds, from the Portuguese Insurance Institute (ISP) to the Portuguese Securities Commission (CMVM) with regard to the conduct of business rules for distribution. In this context, the CMVM supplemented the existing requirements for unit-linked insurance contracts and open-ended pension funds with some relevant MiFID provisions. In addition, the CMVM Regulation nº 8/200770 supplemented the existing requirements for these two types of products with disclosure requirements following the UCITS model. More recently and alongside these requirements, CMVM Regulation No. 1/200971 introduced an information document on complex financial products. Such document needs to be presented in a language which is clear, concise and easily understandable language for the investor.

In **Germany**, it is foreseen to introduce a product information sheet for all financial products under MiFID which is to be provided to the investor by the distributor in case of advised sales. Such changes shall enter into force by summer 2011. [72] The document shall be short and understandable for retail investors. Its model has been inspired by the information sheet which accompanies medicines distributed by pharmacies ("Beipackzettel").

8. EVIDENCE ON ISSUES FOR RETAIL CLIENTS FROM 2008 CALL FOR EVIDENCE

Unit-linked life insurance policies

Many responses to the Call for Evidence on unit-linked life insurance policies highlighted deficiencies with regard to the disclosure of likely performance and of the costs associated with this type of investment.

The response from the insurance supervisors in CEIOPS highlighted the disclosure of 'chain costs' as a particular problem (the use of insurance 'wrappers' entails the addition of costs both at the level of the insurance company and the originator of the underlying investment).

More broadly, the Dutch AFM and other regulators have reported that differences in regulation between life insurance products and mutual funds have caused significant problems. They argue that transparency of costs and inducements is not achieved in the insurance sector solely on the basis of EU requirements, so to the extent that the EU requirements set the standard of disclosures, prospective investors are unable to weigh these factors up against other features that might be highlighted, such as the tax advantages of the product. This is considered to have resulted in the sale of insurance products even where mutual fund investments offering similar asset exposures with lower charges might have offered better risk-adjusted performance.

A recent example of such a potential distortion in sales is the alleged misselling of equity-linked insurance products in the Netherlands, which resulted in a class action lawsuit. The complaint was that there was insufficient disclosure of the costs associated with those policies, leading to investment returns that were significantly lower than investors had been led to expect and penalties on early withdrawal that were not

70 CMVM Regulation n.º 8/2007 "Selling open-ended pension funds with individual adhesion and insurance contracts related to investment funds"

71 CMVM Regulation n.º 1/2009 "Information and advertising on complex financial products under supervision of the CMVM"

72 Gesetzentwurf zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarkts, BT-Drucks.17/7410, p. 14

expected. Following intervention by the Dutch Insurance Ombudsman and its replacement, the Financial Services Ombudsman, out of court settlements were reached with certain distributors of such products.[73]

There are other examples. For instance, a Belgian consumer association has warned that rules for advertising on unit-linked life insurance in Belgium do not specify how information on past returns should be presented so as to avoid misleading prospective investors.[74] The association encountered an insurance company advertising a unit-linked life contract by referring to the return achieved in 2006, without mentioning the return earned in 2007, which was considerably weaker. The same association is currently suing an insurance company for misleading advertising. In particular, the company is considered to have given undue prominence in its marketing material to the return on only one of the funds underlying the insurance policy (the best performing fund), rather than the basket of funds in which client's assets were invested.

Investment funds

Consultation on possible amendments to the UCITS Directive revealed that most respondents felt that the Simplified Prospectus (a shorter summary document required for all UCITS since 2005) had failed to provide key information in a form that was easily understood by the average retail investor.[75] (This finding triggered the work on developing Key Investor Information.) Respondents to the Call for Evidence reported similar problems for non-harmonised funds and closed-ended funds.

In France, the Final Court of Appeal recently sanctioned a commercial bank over failure of compliance with the combination of rules on product disclosure and marketing communications. The Court found that the firm did not mention in its advertisement the downside risk that a formula (structured) fund presented.[76] Problems with formula funds were also noted elsewhere in the French market.

In Belgium, a consumer association recently criticised an advertising campaign for a structured fund distributed by a Belgian commercial bank.[77] It is claimed that adverts placed undue emphasis on a guaranteed rate of return, without a clear indication that this return would only be achieved on half of the capital invested.

The Dutch AFM have reported that the mandatory information provided in the prospectus for closed-ended real estate funds is not well-tailored to this type of investment, which is growing in popularity in the Netherlands. The result is that investors cannot understand the expected return, the costs and most importantly the level and nature of the risks involved in these investments.

In Germany, a number of legal proceedings have highlighted problems of mis-selling, unfair marketing, and misleading or inaccurate product information with respect to closed-ended funds.

In the United Kingdom, the FSA have recently published an assessment of the standards of disclosure documents across the whole range of retail investment products, which found many to be inadequate and unlikely to be understandable for their target audience.[78]

Retail structured securities

Many stakeholders have argued that structured product disclosures do not adequately describe the costs associated with the product or the likely range of performance outcomes. Prospectuses produced in accordance with the Prospectus Directive – including the summary

73 See http://www.kifid.nl/uploads/2008-03-04-Recommendation_of_the_Financial_Services_Ombudsman.pdf

74 See http://www.test-achats.be/map/src/522123.htm.

75 See http://ec.europa.eu/internal_market/investment/investor_information_en.htm, section on workshops on Simplified Prospectus.

76 See *Arrêt n° 740 du 24 juin 2008 06-21.798 Cour de cassation - Chambre commerciale.*

77 See http://www.test-achats.be/map/src/522123.htm.

78 See http://www.fsa.gov.uk/pubs/other/key_features.pdf.

prospectus - were not considered to be effective disclosures for structured securities, since they focus on the issuer rather than the product and are both lengthy and technical. (Separate work is now underway to further develop requirements on the summary prospectus).

The European Securities Markets Expert Group, in their review of the functioning of the Prospectus Directive, found that "'[...] from the point of *view of the investors, the Prospectus Directive has failed to produce an effective means of communication. For example, the average length of prospectuses has increased dramatically due to the requirement for additional information. The length and complexity of prospectuses make them more a sort of 'liability shield' for the persons involved in the preparation (issuers, intermediaries, auditors, law firms and competent authorities), effective ex post in minimizing the risk of potential litigation, rather than a document to be used ex ante by an investor when making investment decisions.*" They added that "*many investors have difficulties in understanding the technical language and the complex structure of information as well as analyzing the importance of various types of information. As a consequence, most retail investors rely only on the marketing material prepared in connection with a public offering. The summary is often a simple "cut and paste" exercise of various parts of the prospectus without any attempt to simplify the language of such parts (often very technical) as required by the Prospectus Directive.*"[79]

Obligations in the Prospectus Directive are supplemented by additional disclosure requirements on intermediaries in MiFID, which relate primarily to the services provided by the intermediary but also to the financial instruments they may be selling. However, many stakeholders argued that these provisions are subject to inconsistent implementation in Member States and do not go far enough in ensuring that the relevant items are clearly disclosed.

In a cross-country survey, Deloitte found that *'material differences exist between investment funds and structured notes in the nature and level of detail of information disclosed to the investors … this is clearly the case for characteristics, risks and costs. These differences make it difficult or even impossible for investors to compare in detail all characteristics of the products. The differences also result in a different quality of information given to investors*.'

The Dutch AFM published an analysis of developments on the market for structured products in May 2007, arguing that *many* are difficult for retail investors to understand. These developments constituted grounds for an 'exploratory analysis of structured products',[80] which concluded that …' *the information provided to investors is not as it should be. Prospectuses do not focus sufficiently on the information that consumers need to make well-considered investment decisions. In addition, the legal entity chosen for the products means that financial information leaflets are not obligatory … The AFM feels investors may select an unsuitable product, which will jeopardise the proper operation of the market and, if investors are disappointed in their choices, the confidence in the market'.*

In another example of the issues being raised, the Czech National Bank has expressed concerns in relation to an index-linked bond, the yield of which is based on a specific underlying asset (for example the performance of an index or an exchange rate). The product was sold as a 'guaranteed bond', while it in fact presented a significantly higher risk than standard guaranteed bonds.

In the United Kingdom, the FSA has fined or some cases banned a number of product manufacturers and intermediaries in relation to sales and marketing of certain kinds of complex 'high income products', typically known as precipice bonds.[81] The FSA had previously issued a series of warnings in relation to the products, such as an alert in December 1999 which urged consumers to consider carefully the level of risk they were willing to

79 See http://ec.europa.eu/internal_market/securities/docs/esme/05092007_report_en.pdf.

80 http://www.afm.nl/corporate/default.ashx?DocumentId=9246.

81 These so-called "precipice bonds" were linked to derivatives such as the performance of an index or indices or baskets of stocks. They were often structured as offshore investment companies or offshore insurance companies and so are not regulated by the FSA. They were structured to deliver a high income without protection against loss of the initial capital invested; return of the original capital was linked to the performance of an index/indices or a basket of stocks. The risk of capital loss (particularly high given the income being taken) was often not clearly explained.

accept before investing in so-called high income products; the FSA reiterated in later communications that consumers should be cautious when investing in bonds that promise income but carry a high risk that investors may not receive back all, or any, of their original investment, and required regulated firms to improve the information they provided to consumers..[82]

Structured deposits

Many responses to the Call for Evidence noted that there were no European rules that applied to structured term deposits as a class of product. (In this area, no specific targeted examples of investor detriment were provided.) The Joint Forum reiterated the point, and noted that there are retail investment products (such as structured term deposits) that are not subject to disclosure regulation at EU level. Noting that similar lacunae existed in other jurisdictions, they suggested that '*this is [an issue] that governments should consider*'.[83]

There is evidence that some of same issues as are raised for other classes of PRIP apply. For instance, in Poland in the first half of 2008, the Polish Financial Supervision Authority (PFSA) ordered some banks to withdraw advertisements of structured term deposits due to the violation of professional standards and ethical codes in operation. The PFSA was concerned that these placed excessive emphasis on a product's benefits for the customer and deliberately omitted other important product characteristics, e.g. penalties for early withdrawal of funds.

9. NATURE OF PRODUCT DISCLOSURES AND THEIR RELATIONSHIP WITH THE SALES PROCESS

This impact assessment is focused on assessing regulatory failings related to the effectiveness of product disclosures in aiding retail investment decision-making. It may be useful however to better clarify what product disclosures cover and how product disclosures might relate to other regulatory disclosures aimed at retail customers.

Perhaps the best way of tackling this is to examine the broad process by which an investor makes a purchase of an investment product, so that the different kinds of information (and sources of that information) involved can be clearly identified.

Many sales of investment products are accompanied by advice. A retail customer enters a branch of a high street bank, for example, and makes an appointment to see and advisor. At that appointment or prior to it, the advisor will typically provide the customer with information about the service of advice that is being proposed: about who the advisor is, and such matters as what the scope of the advice will be, who the advisor works for, and possibly how the advisor is remunerated for the advice or whether there are any fees that the customer will have to pay to get the advice. These might be described as 'sales disclosures'. They will include, where necessary, information about inducements.

Once the customer agrees to engage in this advised sales process, the advisor will typically gather information from the customer about the customer – for instance about their financial situation and knowledge and experience of financial matters, about their investment needs, and about their attitude to risk and capacity to take on risk. As part of this process the advisor

82 See for example FSA/PN/122/2002 of 15/12/2002 'Precipice bond' investors may not get their money back, FSA warns". See also http://www.fsa.gov.uk/pubs/guidance/guidance7.pdf.

83 Joint Forum, *Customer Suitability in the retail sale of financial products and services*, April 2008.

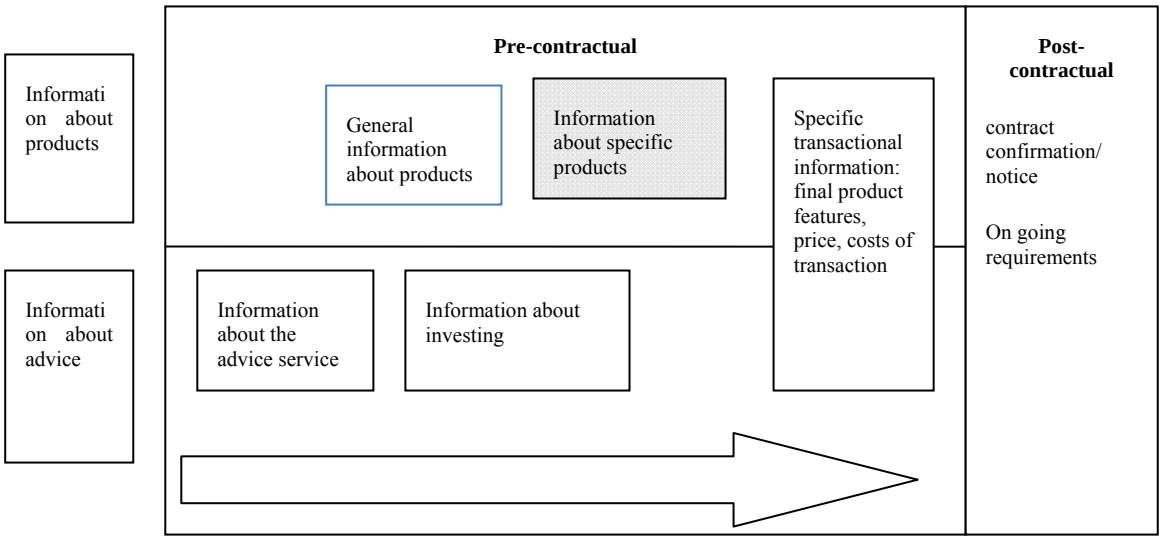
may well provide the customer with general information about investments, types of product, different kinds of assets and the risks associated with them.

(It may very often be the case that the retail customer enters a branch of his bank, with he already has a contract for the provision of services. In this case, the advisor will build on existing information concerning the client that has resulted from the client's earlier dealings with the bank, and/or advisor.)

Under these two different scenarios, the advisor would typically make a recommendation or (more normally recommendations) to the customer as to possible suitable investment products. At this point the customer will (perhaps after a period of reflection) be required to make or agree on a choice as to where to put their money.

Following their choice, further information will typically be provided to the customer, such as a contract note or contractual document relating to investment, information about the actual price paid for the investment. Specific information may also be provided at this point confirming the scale of payments the advisor may receive from the product manufacturer in relation to the transaction.

In broad terms these stages of a purchase can be outlined as in the following diagram.



The policy options to be addressed in this impact assessment do not relate to all of the kinds of disclosure covered in this diagram: the focus is **information about specific products**, and the role this can have in improving investors' decision-making (i.e. information provided ***before*** a decision has been taken).

Given sales persons are obliged to know and understand the products they sell to clients, and to explain the key features of these to clients, such information may serve two purposes. Firstly, since products are often produced by different entities to the distributor who is selling them, the distributor may find it most effective to rely on the information prepared by product manufacturers to explain the features of the products. (Typically, the person producing the product will be best suited to explaining the product – so it makes sense to require that person (the product manufacturer) to prepare information for others about the product). Secondly, the

information serves the purpose of providing the retail investor themselves with key facts about products in a form they can use, e.g. to compare between products.

10. THE LAMFALUSSY PROCESS

The regulatory structure of the so-called Lamfalussy process was initiated by the Stockholm European Council Resolution of 23 March 2001 on "more effective securities market regulation". The Lamfalussy process is based around the four-level regulatory approach recommended by the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Baron Alexandre Lamfalussy.[84]

The Lamfalussy process was designed to make Community legislation on securities markets more flexible, so that it can be agreed and adapted more quickly in response to innovation and technological change in financial markets; to allow the Institutions to benefit from the technical and regulatory expertise of European securities regulators and from better involvement of external stakeholders; and to focus more on even implementation and enforcement of Community law in the Member States.

One of the key innovations of the Lamfalussy process was the creation of two Committees to advise the Commission on Level 2 implementing measures – the **European Securities Committee (ESC)** representing the Member States and functioning as a so-called 'regulatory committee' under the Comitology arrangements[85] – and the **Committee of European Securities Regulators (CESR)**. The two Committees were set up by Decisions of the Commission on 6 June 2001.[86] Till 1 March 2011 the ESC acted in its capacity as a regulatory committee, assisting the Commission in the exercise of its delegated executive powers, within the terms defined in the Directives adopted at Level 1. After this date, on the basis of the new 'comitology' rules the ESC will act as an Advisory procedure committee or Examination procedure committee if an examined draft act will be of general scope.[87]

Transparency is another important feature of the process. The Lamfalussy process has established a rigorous mechanism whereby the Commission seeks, *ex-ante*, the views of market participants and end-users (companies, investors and consumers) by way of early, broad and systematic consultation, with particular regard to Level 1 proposals, but also at Level 2.

The Lamfalussy regulatory approach has been impacted recently by the new European supervisory architecture in financial services; this has notably replaced the Committee of European Securities Regulators (CESR) with a new authority (the European Securities and Markets Authority, ESMA). The other two sectoral authorities are also for relevance for

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84 The Lamfalussy report, published on 15 February 2001, can be found on the Commission's website: http://europa.eu.int/comm/internal_market/securities/lamfalussy/index_en.htm

85 See Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission, OJ L 184, 17.7.1999, p. 23.

86 See Commission Decision of 6 June 2001 establishing the Committee of European Securities Regulators (2001/527/EC), amended by Commission Decision of 5 November 2003 (2004/7/EC), and Commission Decision of 6 June 2001 establishing the European Securities Committee (2001/528/EC), amended by Commission Decision of 5 November 2003 (2004/8/EC).

87 Regulation of the European Parliament and of the Council laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers, adopted by the Education, Youth, Culture and Sport Council on 14 February 2011.

PRIPs, given the cross-sectoral nature of the initiative -- the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA).

ANNEX II

1. DETAILED ANALYSIS OF OPTIONS

1.1. ISSUE 1: What should the scope of any new regime be?

Scope relates directly to all operational objectives. Targeting a reduced regulatory patchwork and improved comparability and comprehensibility depends on drawing into scope all the products that compete with one another as investments and might readily have the same standardised approach applied to them.

Scope directly interacts with the identified problems of an unlevel playing field, and to a degree single market barriers. These issues also relate to the possibility of 'regulatory arbitrage'. If the scope of the new regime is set too narrow, then products on the 'inside' might be put at a disadvantage to products on the 'outside' (in so far as they are substitutable). Products in the 'outside' might be able to present themselves as more attractive or competitive than those on the 'inside', since information on the products on the 'outside' could be less comparable or comprehensible. This could lead to market distortions, and regulatory arbitrage on the part of product originators and distributors.

This issue was highlighted already in the Communication on PRIPs, and the impact assessment that accompanied it. Failing to adequately address this issue could undermine the whole initiative.

The key question to face in addressing scope is whether to seek to demarcate the scope of the work to focus on so-called 'packaged' products (options 2 and 3), or whether to wide the work to cover all kinds of possible investments (option 1). (The definition of 'packaged products' was developed initially in the Communication, and refined subsequently following consultation; see Annex I.3 for detail on this definition, which would be used as a basis for options 2 and 3.)

Options for scope of regime	
1	Set the widest possible scope
2	Focus on 'packaged' products
3	Focus on 'packaged' products; set firm date for reviewing scope

Analysis of options

Setting the scope of the regime as wide as under option 1 could have practical consequences related to steps on improving comparability and comprehensibility and improving consistency of regulation, since it would mean including in the scope of the regime potential types of investments that would be difficult to incorporate into a single approach on disclosure (such as 'plain vanilla' equities, bonds, and deposits). In terms of consistency of regulation, a very wide regime would interact with a wider range of other existing legislation, and would

duplicate requirements; MiFID already, for instance, places general disclosure requirements in regards financial instruments as such on all entities caught by MiFID.

This is in a context where, as the problem definition outlines, key issues for investors appear to have emerged mostly in relation to more complex 'packaged' retail investment products rather than investments in general, and where existing regulatory interventions (which have generated the problem of a regulatory patchwork) have concentrated more on these 'packaged' products than investments in general. Packaging can be understood generally as the introduction of an indirectness or mediation in the investment, whereby a product is manufactured or engineered in some manner; financial services professionals 'mediate' between the investor and the ultimate assets the investment is exposed to. The PRIPs Communication and subsequent 3L3 report on PRIPs both came to broadly the same conclusion that a focus on 'packaged' products rather than investments in general was sensible.

Indeed, from the retail investor's standpoint the financial engineering that characterises packaged products raises specific challenges for comprehension and comparison which justify the development of targeted product disclosure measures. For instance, packaging typically introduces complexity in terms of how investments function, and may entail more complex risk and cost profiles which are harder to understand and compare between products.

Consultation responses

In general terms respondents to the PRIPs consultation supported a focus on 'packaged' investments, as offered under option 2, though there were a number of divergences over technical questions relating to how best to define in technical terms the boundary between packaged and non-packaged investments. A number of respondents, including consumer representatives, considered that a wider scope might be advisable, e.g. to include deposits, bonds and shares in individual companies, but nonetheless recognised that the complexity of structure of packaged products warranted specific regulatory attention.

Regardless of this general support for focusing in on 'packaged' investments, a number of respondents expressed concerns over how best to define the concept of 'packaged' investments.

Assessment of costs and benefits of options

It is not clear that option 1 could effectively avoid issues related to regulatory arbitrage, since standardised and detailed requirements on product information (e.g. relating to costs, risks and product features) are likely only to be relevant for packaged products, so that the application of requirements to these packaged products would still entail drawing distinctions between types of investment product, with a potential for arbitrage around these distinctions.

If an approach was adopted that did not develop standardised and detailed requirements on disclosure, but was higher level in form to account for the wide range of possible investments in scope, this would reduce the extent to which the new regime could address comparability and comprehensibility objectives or level playing field objectives in regards different products, undermining the ability to deliver benefits. On this basis it is not clear that option 1 would better address regulatory arbitrage challenges, while it could either lead to a dilution of the effectiveness of changes or additional uncertainty or duplication in requirements, and associated costs for industry.

It needs to be recognised that however the boundary is determined between 'packaged' and 'non-packaged' investments, there is always the risk that it will be diluted in practice. It will

always be possible to develop an investment proposition which is economically similar or the same as the one captured by the defined scope but which falls nevertheless outside the defined boundaries or sits at least at the edges of that scope. This is also due to financial innovation: market developments could well lead to new types of product not foreseen by the original definition. Such developments could distort competition, undermining firms that operate 'within' the packaged definition compared to those 'outside. In view of these difficulties but taking into account that there is broad support for a specific focus on 'packaged investments', and also given the concern that regulatory arbitrage may in the future lead to market distortions where the scope is not determined appropriately, a two phase approach seems advisable (option 3).

Under this approach, the scope of products falling within the disclosure regime would initially be focused on 'packaged' investments which will be clearly defined in the legal act on disclosure.[88] However, a commitment would be made to gather baseline and market evolution data so that the impact of the new regime might be assessed, and in particular so that possible evolutions in the market towards non-PRIPs could be identified. This data would be used at a set future review date (say, after the regime had been in place sufficiently long for market reactions to become clear, at most 5 years) to consider whether the scope of the regime might be widened. The data gathered in this way might also be used to identify further the extent to which certain savings and investment products.

Given the potential for developments in the retail investment markets, commitments to monitor and review the boundaries of the regime would be prudent. This monitoring should clearly address, in the light of market evolution data, whether widening the scope of the regime would be appropriate.

All options would need to be supported by strong supervisory coordination, to ensure consistency in application across Member States.

On the grounds that it combines a practical focus on the key products where comparability of disclosures makes most sense, with a commitment to consider widening this scope in the future, option 3 is retained.

Option	**Effectiveness**			**Efficiency**
	Comprehension	**Comparison**	**Regulatory Patchwork**	
0 – Take no action	0	0	0	0
1 -- Set the widest possible scope	+ Effective approach would still require boundary to be drawn between 'packaged' and 'non-packaged' products; wider scope could allow for overall better coherence.	+ Effective approach would still require boundary to be drawn between 'packaged' and 'non-packaged' products; wider scope could allow for overall better coherence.	+ Existing unlevel playing field is practically focused on 'packaged' products, but wider focus	Depending on approach, costs for industry may be comparable to focus on packaged regime, but marginally greater due to wider impact. Benefits for consumers depend on extent to which regime still segments between packaged and non-packaged products; effectively challenge of demarcation of products cannot be avoided.
2 -- Focus on	+	+	+	Costs likely to be lower than for 1, as impact targeted on those products that

[88] Annex I 3 contains a definition on which we consulted and which might be used as a basis for such definition in order to achieve necessary certainty.

'packaged' products	Key benefits relate to packaged products, so only likely to be marginally less effective than 1. (May be more effective in practice due to more focused approach.)	Key benefits relate to packaged products, so only likely to be marginally less effective than 1. (May be more effective in practice due to more focused approach.)	Existing unlevel playing field is practically focused on 'packaged' products	are most relevant, and option 1 would likely still need to demarcate in measures between packaged and non-packaged investments. Core benefits achieved in relation to packaged products, so likely to be equivalent to option 1
3 – Focus on packaged products, but set firm review date (e.g. within 5 years of coming into force)	++ Key benefits relate to packaged products, so only likely to be marginally less effective than 1. (May be more effective in practice due to more focused approach.) Review of scope allows possible future arbitrage and consumer detriment to be addressed	++ Key benefits relate to packaged products, so only likely to be marginally less effective than 1. (May be more effective in practice due to more focused approach.) Review of scope allows possible future arbitrage and consumer detriment to be addressed	++ Existing unlevel playing field is practically focused on 'packaged' products Review of scope allows possible future arbitrage and unlevel playing field issues to be addressed	Costs likely to be lower than for 1, as impact targeted on those products that are most relevant, and option 1 would likely still need to demarcate in measures between packaged and non-packaged investments. Core benefits achieved in relation to packaged products, so likely to be equivalent to option 1. Review mechanisms allows for possible regulatory arbitrage, countering possible weakness with option 2

1.2. ISSUE 2: How far and in what ways should disclosures be standardised at EU level?

The PRIPs Communication IA made the case for steps at the EU level to address regulatory inconsistencies and raise levels of consumer protection. It did not however address detailed options for the content and form of legislative changes, though it identified the UCITS KIID as a clear benchmark for future work.

In considering the content and form of legislative changes, the overarching question that needs to be addressed is the extent to which the UCITS KIID model might be applied to other PRIPs.

At heart this is a question of standardisation: the UCITS KIID is strongly standardised, through highly prescriptive rules. Every document should look (relatively) similar for all UCITS, and across all Member States, with variations only due to translations and some residual flexibility over form and content. UCITS cannot add information to the document not allowed for in the UCITS KII regulation. Neither can Member States require additional information to be included.

However, the UCITS are 'harmonised' products – a European framework exists that defines how UCITS operate, the risks they can expose investors to and how to manage these risks, how they be valued and how often, and so forth. Other PRIPs are not harmonised in this way: PRIPs can vary significantly in their legal form and particular features, though they share a common focus on serving investment. A standardised approach that follows the level of standardisation developed for UCITS is therefore impossible for other PRIPs.

(Note that a distinction might be drawn between *prescriptiveness* (the use of requirements which set out in great detail the content and form of disclosures, e.g. including specific phrases, warnings or titles, the order of information, the visual presentation) and *consistency* (the extent to which requirements are the same across different product types, sales channels

or Member States).[89] These are two linked dimensions of 'standardisation': to achieve certain kinds of consistency in approach prescription is likely necessary.)

The broad issue of standardisation will be addressed by exploring detailed options for tackling the operational objectives of improving the comprehensibility of information and the comparability of information, as derived from the problem analysis for problem driver 3, to see to what extent standardisation or prescription is appropriate across these different areas.

We will then draw together the analysis, to consider consultation responses and costs and benefits overall, and the effectiveness of the proposed approach in addressing our other operational objectives.

Options on degree of standardisation	
Plain language, engaging quality of document *[Options 1 and 2 are mutually exclusive]*	
1	Apply high-level principles only
2	Prescriptive rules to standardise elements of language, 'look and feel' of document
3	Use of non-legislative tools
4	Clarify liability attached to document
Length of document *[Option 3 is not mutually excusive with 1 and 2]*	
1	Set a 'hard' limit on the length of all documents (e.g. 2 pages A4)
2	Set a 'soft' limit on length; prescribe contents and length where viable at level 2
3	Use layering of information / signposting to other documents
Accuracy, balance of information *[Options are mutually exclusive]*	
1	Set high-level principles only
2	Use prescriptive requirements on form and contents to ensure balanced presentation
Comparisons of product features, risks, costs *[Options are not mutually exclusive]*	
1	Seek consistent structure, layout to aid comparisons
2	Standardised risk, cost, and performance disclosures for all PRIPs

Improving comprehension

In our problem definition we identified a number of specific problem areas relating in general to the 'comprehensibility' of product disclosures: financial services concepts and jargon used in documents are **opaque**, **difficult for average investors to understand** and **unfamiliar**; documents are very often **too long,** or suffer from '**information overload**'; presentation of the

[89] Note, that while consistency is sometimes considered solely from the perspective of the content of rules, our focus in this impact assessment is on likely consistency in outcomes.

documents can often be **dull, confusing** or **unengaging**; and, finally, information provided may be **partial** or **misleading.**

To address these areas, policy options can be broken down under **three headings**:

- improving use of plain language and making information more engaging;
- addressing information overload; and,
- ensuring accuracy and balance of information.

Improving use of plain language and encouraging more engaging documents

Financial services legislation typically requires communications with clients to be undertaken in a clear, understandable and comprehensible manner. However, prepared communication documents, including those related to product information, often fail to be clear, understandable or comprehensible.

Four options emerge: apply high-level principles only; to use more prescription to set out common standards in more detail; to use non-legislative tools (improved supervision, self-regulation by industry to improve consistency in use of 'plain language'); and finally, to clarify liability attached to documents (so as to reduce firms' focus on including fine print so as to reduce exposure to liability).

Option	**Effectiveness**	**Efficiency**
0 – Take no action	0	0
1 – Apply high-level principles only	- Experience with UCITS simplified prospectus showed that high-level requirements were not sufficiently effective in ensuring comprehensible information in documents. Ensuring firms, supervisors approach standards in consistent way would be difficult to achieve, leading to inconsistencies in outcomes.	Effective engagement by supervisors with firms could be costly / inconsistent, given lack of guidance in a high-level approach. Some lack of legal clarity for firms as to necessary standards; inconsistencies cross-border would erect barriers to single market. Flexibility may be valuable for allowing innovation in terms of communication practices.
2 – Increased prescription	+ + Experience with developing UCITS KII requirements is that higher standardisation allows for setting better 'minimum standard' for all, so that best practices can be more immediately reflected into generalised industry practice. Greater consistency in approach across all markets / sectors.	Consistency and better clarity could lead to reduced costs for firms and supervisors. Benefits for investors through wider adoption of better practices enshrined in binding EU level requirements. May be seen as a 'tick-box' approach by firms, or a regulatory 'safe harbour' if they follow the letter but not the spirit of the rules.
3 – Use of non-legislative tools	++ Can support 2, e.g. national regulators, firm trade bodies, consumer associations may be best placed to develop practical guidelines on better language, common glossaries, will better address continued scope for poor language.	Costs expected for developing and improve industry practices, but benefits for consumers from better addressing possible weaknesses Allows flexibility for allowing innovation in terms of communication practices

		Can overcome tick-box approach possible under 2 on its own
4 – Clarify liability attached to document	+ UCITS experience was that success (shortness, clarity of language) of document requires some comfort for firms that they may focus only on 'key' information and not include all possibly relevant information.	Lack of clarity could undermine document, as firms' concerns over liability lead to inclusion of all possibly relevant information, rather than sole focus on key information.

The experience under UCITS with regards the failure of the simplified prospectus was that a combination of prescription and standardisation (to set out in more detail expectations as to a minimum standard of language, common labels and warnings to use), with the use of non-legislative tools (self-regulation by industry, work with supervisors), is most likely to effectively address the challenge of raising the quality of 'plain language' in product disclosures. Certainly, full prescription is not possible (particularly for non-harmonised products), so option 3 is an important element of the preferred approach.

In relation to liability, please see the discussion under issue 5 below. For UCITS it was clear that a focus on only 'key' information was vital if the failure of the simplified prospectus was to be avoided. This issue is also linked to options below related to information overload.

Addressing information overload

One of the issues most often raised by consumer representative stakeholders is the problem of 'too much information' in financial services documentation. To address this issue, the UCITS KII is limited in most instances to only two sides of A4 paper. The document was also developed to focus only on key information. (The requirements on the content of the KII are also extremely prescriptive, so that firms do not have the flexibility to include any other information they might wish to include).

Option	**Effectiveness**	**Efficiency**
0 – Take no action	0	0
1 – Set a hard limit on the length (and content) of all documents (e.g. 2 pages A4)	+/- For UCITS a hard limit on the document could be readily considered because UCITS are harmonised across the EU. With other PRIPs which are not harmonised, the product features or benefits may not be always covered in 2 pages (even for UCITS this is not always possible; structured UCITS are provided with a derogation from the 2 page limit). Given this, enforcing a 2 page limit could lead to documents that do not cover all information clearly or comprehensibly. Setting a hard limit may be an effective tool for ensuring firms write in a concise manner: evidence suggests longer documents may not be read.	Simple requirement straightforward for competent authorities to supervise: consistency in approach.
2 – Set a soft limit on length: prescribe contents and length where viable at level 2	+ In practice may be similar (due to impact of prescription on content) to option 1, but flexibility may allow for better tailoring of requirements to specificities of non-harmonised products.	Varied requirements lead to inconsistencies in approach between supervisors and firms.

3 – Use layering of information / signposting to other documents	+ Layering may be useful for targeting key information and more detailed information appropriately. Layering might undermine extent to which KIID must is capable of being used 'stand alone' (i.e. on its own) to make an investment decision – ensuring this does not happen raises risks for supervisors	Use of 'layering' or 'signposting' may require more careful supervision and assessments of compliance raising some costs,, however may allow same documents to better target range of different investors needs.

Under this analysis, prescriptive requirements on content and strong requirements on length, appear most effective in addressing 'too much information,' in that these approaches clearly control the amount and nature of information that can be included. However, an overall hard prescription on length would appear impractical for non-harmonised products (too little flexibility could lead to documents that are paradoxically too dense and difficult to use). This approach can be supported by permitting the use of signposting (cross-references to other documents) or layering of information, so long as the KIID itself remains functional as a 'stand alone' document.

Ensuring accuracy and balance of information

The UCITS KIID requirements strongly determine how certain information – e.g. on costs or on performance – is presented, in order to minimise possible ways in which information can be subtly presented in an unbalanced way. For instance, the relative positioning of information in a document can influence perceptions of its salience by retail investors. (Putting charges information at the end of a document implies, for instance, that this information is of lower importance.)

Option	**Effectiveness**	**Efficiency**
0 – Take no action	0	0
1 – set high-level principles only	- While in general the principle of being 'not misleading' covers such issues as a lack of balance in information or inaccuracy in information, without more detailed requirements inconsistencies between firms and between Member States would emerge, reducing comprehensibility of information for customers It is likely, given difficulties in enforcing principles, that presentation of information could be 'gamed' (enabling subtle investor biases to be exploited)	Could raise supervisory costs, given potential subjectivity of standards Inconsistencies in approach between supervisors or lack of legal certainty might raise compliance costs for some firms, and negatively impact consumer benefits
2 – use prescriptive requirements on form and contents to ensure balanced presentation	+ Reduced misunderstandings by investors: YouGov and IFF testing of KII proposals for UCITS suggested that precise positioning of information (e.g. putting cost information on front page, performance on back page) can be material in impacting consumer comprehension of relative importance of messages; specifying these in prescriptive rules could lead to higher minimum standards across all PRIPs	Consistency in approach could reduce some supervisory costs Legal certainty for firms

Under this broad analysis, steps on responsibilities and liabilities might be supported also by the use of detailed prescription to ensure a strong minimum standard of balance in documents. In addition, details on keeping documents up to date.

Comparability

Comparability of information has two elements:

- the general layout of information in a document facilitates effective comparisons: documents laid out in similar ways are easier to compare;

- comparisons of particular features of products require consistent approaches both to the layout and presentation of information about those features, but also to the calculation of information, such as quantitative data.

The notable examples of areas where such comparisons are or may be possible are the risks of the product, the costs of the product, its performance (whether in the past, or possible performance as projected into the future), and on guarantees or capital protection.

The UCITS KII was designed specifically to improve comparability between funds on risk information, cost information and performance information; the YouGov and IFF study goes into detail as to the various options and approaches that were tested; in general terms that research concluded in favour of a structured approach to the presentation of information in these areas. (The focus of the research was on the presentation of information; CESR members worked separately to develop detailed methodologies to ensure consistency in underlying data so that comparisons between UCITS on the basis of risk and cost data in the KII could be made without being misleading).

At this stage (i.e. in relation to level 1 measures) the key question to address in this area is not so much the detailed application of methodologies for comparisons, but the principle of the techniques to be followed for pursuing comparability.

(Note that we do not analyse other options than standardisation in relation to comparability, as from the wider context it is not clear what viable options might emerge: it might be possible to address comparability using different tools, such as websites designed to allow comparisons of costs or risks, but such options are not within the scope of this impact assessment).

Option	**Effectiveness**	**Efficiency**
0 – Take no action	0	0
1 – Prescribe consistent document structure to aid comparisons	+ Consistency in structure will benefit investors in comparing between products, potentially improving comprehension and confidence in using information. Consistency in structure may run the risk of taking a 'one-size-fits-all' approach that reduces effective communication of specific features of some products – care must be taken to test approach to ensure effectiveness for consumers.	Consistency may reduce some aspects of compliance costs (through simplicity) and supervision costs, though likely to be marginal in impact on costs Benefits for investors, better decision making
2 – Standardise risk, cost and performance disclosures	+ + Comparable disclosures crucial to informed decision making: improving capacity of investors to compare risks,	Comparators should lead to better decision making, broader market efficiency benefits Costs may be material for providers if new

	performance and costs is fundamental to this initiative. Choice and technical development of information capable of guiding comparisons (including calculation of numbers where quantitative information is provided) must be very careful undertaken. Presentation also needs to be tested with investors. Improving comparability of disclosures may impact competition between providers, sectors NOTE: improving comparability of information may entail public policy choices: identification of the elements of investment products that are most salient for retail investors and which elements should be highlighted likely to have impact on consumer behaviour (e.g. question of relative balance between risks, costs, benefits).	methodologies for calculation are unfamiliar or require new resources to be developed/obtained Comparators may aid distributors and advisors in making personal recommendations or assessing the suitability of different products for retail investors

The key issues relating to options on how to enhance comparability in product disclosures relate not so much to the use of standardisation (which is intrinsic to this objective), but to technical details on the application of standardisation to particular types of PRIPs. These technical issues will be assessed as part of follow up work on detailed implementing measures to support the overall PRIPs framework.

General assessment

In general the foregoing analysis has identified a detailed range of options that range from the adoption of high-level approaches, to seeking standardisation, but combining this with some flexibility for addressing different product forms, to approaches which seek the maximum degree of standardisation.

Benefits of standardisation of disclosures

A key conclusion of the Decision Technology study was that greater levels of standardisation (and simplification, via standardisation) are likely to be effective regulatory tools for achieving benefits for consumers. Standardisation can aid comprehension, and offer a way of ensuring common minimum standards in regards information – it provides a recipe for disclosure documents that can be careful developed on the basis of consumer testing, and so its design can build on best practices. Standardisation also crucially underpins possible ways of improving comparability in information (there are other ways such as standardising products themselves) – showing information in a structured and consistent way is a key precondition for aiding investors in comparing between different products. Consumer representative respondents to the PRIPs consultation broadly underlined the value of standardisation techniques in ensuring better comparability of information.

However, there is a relationship between the degree of standardisation possible and levels of product heterogeneity or homogeneity.

The greater the variety in products and their features, the greater the extent to which a single 'one-size-fits-all' approach can lead to results that are potentially misleading. For instance, specific products might possess features that standardised prescriptive requirements do not take into account. This could either lead to misunderstandings on the part of those relying on the information, or a reliance on other information tools, reducing the impact and relevance of the standardised disclosure. This implies that rules should reflect to some degree the heterogeneity of products (and thereby places an absolute limit on the degree of prescription that is advisable).

Standardisation is not the only way to raise the general quality of disclosures; non-regulatory tools (supervisory cooperation, industry-led action) could in principle contribute to raised standards of clarity for disclosures. Under such a scenario, the burden of raising the standard of disclosures would be borne partly through increased supervisory work, increasing costs for supervisors.

However, the fundamental weakness (other than efficiency problems) of such an approach is that it could not lead to greater comparability at the level of the disclosures. Different supervisors would likely take different views on the application of the principles, even where supporting coordinator work is undertaken at the level of the European Supervisory Authorities. In addition, so as to address the objective of regulatory consistency, any such approach would need to give little additional flexibility to Member States to augment the principles, so that comparability could not be readily tackled even at the level of the Member State.

This could also undermine the extent to which improved consistency in regulatory requirements could be achieved cross-border or between sectors where these are supervised on a sectoral basis (as is the case in many Member States).

Impact of standardisation for industry and supervisors

In respect of the product manufacturers and distributors, some stakeholders have noted certain possible benefits of further standardisation: greater legal certainty in regards disclosure responsibilities on behalf of product manufacturers, reduced search costs for advisors and provided a potential basis for improved quality of advice when considering different products, and, for those operating cross-border, reduced barriers to entry to new markets. It is difficult to assess the extent of such benefits (similar arguments were made in respect of UCITS KII compared to its predecessor, the Simplified Prospectus, yet the CSES study showed many providers anticipated an increase in costs for the standardised document; such increases may however be factoring in uncertainty and a period of adaptation).

For supervisors, greater standardisation could reduce costs, as there would be less discretion for firms and the assessment of the adequacy and compliance of disclosures would in some regards be more straightforward.

However, the industry – and indirectly investors, in so far as immediate costs are passed on to them – would carry the incremental and ongoing costs of changing to a new regime, and greater standardisation implies change for providers.

Summary

Comparability of disclosures depends on standardisation of information provided for different products, but the benefits in terms of comprehensibility of disclosures can become attenuated if this standardisation is taken too far. Comprehensibility does not depend on standardisation, but standardisation contributes to it, and standardisation is likely to be more efficient at improving comprehensibility across all EU markets.

Costs for firms are largely driven by the extent to which changes practically have to be made and the precise nature or extent of the procedures that have to be followed in making such changes. Standardisation drives costs to the extent that it requires a changeover to a new regime (less flexibility is available to adapt existing approaches). However non-standardised approaches which require improvements could also be costly, as these too can lead to changeovers to disclosures: where changes are to be made, standardisation potentially reduces costs against a more ‘principles-based’ approach since it provides a more detailed 'recipe' to follow when preparing the product disclosure.

The preferred approach is therefore to pursue standardisation, by building on the KIID model, but in a targeted way which allows for adaptations and tailoring of the details of this model for other kinds of PRIP.

1.3. ISSUE 3: Responsibility for producing document

For the UCITS KII, responsibility for producing the KII is clearly allocated to the fund manager. Is it possible to apply this general approach to all other PRIPs? Options range from leaving this open for the market to determine (i.e., specifying the outcome being sought, but not harmonising who would be deemed responsible for doing it), to making a hard rule that product originators are the only entities who can be responsible. A separate (not exclusive) option raised by stakeholders would be to always require disclosure in the KIID of who was responsible for manufacturing the product, and who for preparing the document (normally the same).

Options for responsibility for producing documents [Options 1-3 mutually exclusive]	
1	Flexibility over who prepares the document
2	Flexibility over who prepares the document, but requiring agreement on responsibility
3	Product manufacturer normally responsible for preparing the document
4	Require disclosures of responsible parties in document

Consultation responses

Responsibilities for preparing and producing or disseminating (printing and making available to clients or distributors, including electronically e.g. as a 'PDF' or in some other electronic format) the KIID have been an important area in debate amongst stakeholders, but the materiality and impact of different options have proved difficult to assess. Consultation respondents note that determining responsibilities in a manner that does not match capacities to deliver on responsibilities could drive significant costs for the industry or lead to structural changes in distribution models with impacts that might be difficult to assess beforehand.

In response to our consultation with stakeholders, and also in our engagement with supervisors and their independent work on PRIPs, a majority of respondents argued that product manufacturers should be responsible for the document (and that disclosure of responsibility was a vital element of the regime). In general, it has been argued that the product manufacturer are the best placed entities in distribution chains to prepare the KIID so that it is accurate, given their knowledge and responsibility for the product. The 3L3 report on PRIPs came to the same conclusion.[90]

Some respondents also argued that placing responsibility on providers ensures that they can better control when their products might be sold to retail investors. In addition, a number of

[90] [Reference: joint 3L3 report on PRIPs, November 2010].

respondents noted that it is important for investors to both know who produced the product, and who prepared the information about the product and is responsible for its accuracy. Respondents generally felt that this latter entity would in practice for much of the market be the product producer.

In developing the UCITS KII requirements greater legal clarity (and transparency through the KII) was introduced precisely on this point of responsibilities, following feedback that a lack of legal certainty in the prior framework had led to additional uncertainty for investors.

On the other hand, some industry respondents, notably those producing PRIPs in the form of securities that may be sold on secondary markets outside the control of the product manufacturer, argued that making the PRIP provider solely responsible for preparing disclosures could lead to a misalignment between the allocation of responsibilities and the capacities of different entities to practically discharge those responsibilities, for instance if third parties might have some responsibility for providing information to be included in disclosures.

Analysis of costs and benefits

In practice, for banking, insurance and fund sectors a clear allocation of responsibilities for preparing the document – and linked to this a clear 'ownership' of the PRIP by a clear PRIP manufacturer – appears relatively non-controversial.

However, despite much debate on this point with stakeholders, it remains difficult to assess the practical consequences of applying such a model in the securities sector.

An additional complexity would be where there is a product that would be a PRIP in the EU that has originated in a third country not subject to EU rules; in these cases, in principle it would seem reasonable that a distributor might take responsibility for preparing a KIID where the product originator – not directly subject to EU rules – has failed to do so. In addition, distributors might be permitted to prepare a KIID (to bring a product to the retail market) where the product producer has not done so (not intending the product for retail distribution themselves), so long at they take full business responsibility for this.[91]

Note, for clarity, that the preparation of the document would only be necessary where a product was to be sold or distributed to retail clients.

Option	**Effectiveness**			**Efficiency**
	Comprehension	**Comparison**	**Regulatory Patchwork**	
0 – Take no action	0	0	0	0
1 -- Flexibility over who prepares the document	- For the much of the PRIPs market, this may reduce clarity	- May lead to differences in approach to information about	- Lack of consistency in allocation of responsibilities likely to lead to different	Allows for tailoring of requirements for market realities / responsiveness to changing distribution arrangements May exacerbate legal uncertainty over responsibilities, undermining

[91] This reflects the extent to which the allocation of responsibilities can be a tool which controls what PRIPs can in fact be sold to retail customers.

		the same product	supervisory practices between Member States and sectoral supervisors	'ownership' of the KIID and undermining its practical development in some market segments
2 -- Flexibility over who prepares the document, but agreement on responsibility	- As above	- As above	- As above in regards consistency	As above, though there would be clarity as to individual responsibilities in regards specific arrangements. Impact could be significant for providers and distributors where agreements have never been established in the past
3 -- Product manufacturer normally responsible for preparing the document	+/- Reflects existing approach in much of PRIPs market Determination of allowed exceptions would need to be subject to detailed implementing work and impact analysis in this regard to avoid impractical solutions that lead to misalignment between responsibilities and capabilities	+/- Reflects existing approach in much of PRIPs market.	+ Greater consistency depends on care taken in regards targeting of exceptions	Allows for some adjustments for practical scenarios where responsibilities and capabilities might not otherwise be appropriately aligned (split responsibilities, handling of delegations); this could mitigate possible unintended consequences, whilst still allowing for broad legal certainty for much of the remainder of the market.
4 -- Require disclosures of responsible parties in document	+ Important for investors in relation to possible complaints, also ensuring clarity as to who is actually producing product	n/a	n/a	Identification of product manufacturer may require supporting clarification work in some instances (complex chains of intermediation and 'remanufacturing' possible in some areas in PRIPs market)

1.4. ISSUE 4: Ensuring effective provision of product disclosure information to retail investors

Evidence (such as the recent Synovate study) shows that mandatory disclosures may often be either not provided or downplayed at the point of sale, or they may be delivered only at the point of conclusion of the contract (not at a point sufficiently early in the decision making process so as to effectively contribute to the investors' deliberations on what investment to make). In respect of requirements for mandatory provision, this is primarily an enforcement matter.

Under the UCITS framework there is a 'hard' requirement on provision, such that an investor seeking to buy a unit in a UCITS must be provided with KII before they buy the units, though this provision may be undertaken by means of a durable medium or website (under certain conditions). This requirements was adopted following uncertainty in the prior UCITS framework as to relative responsibilities for handing over or giving the KII to the investor. Delivery of the document, particularly in advised sales, was identified as necessary for better ensuring its effective use by investors.

Currently, for non-UCITS PRIPs caught by MiFID intermediaries are not required to use any particular document to satisfy information requirements.

Some stakeholders have noted that hard requirements on provision might create costs around certain distribution models, or require clarification in relation to, for instance, online sales channels.

Three policy options emerge: (1) provision is not addressed directly, leaving arrangements to market participants to decide; (2) a 'hard' requirement analogous to that within the UCITS directive is applied to all sales of PRIPs, stressing that the KIID must be provided sufficiently early in the sales process as to be of value in the investors decision making; (3) specific timing and media exceptions permitted, the precise scope of which to be strongly controlled through detailed implementing measures.

Options for responsibility for provision of documents	**[Options are mutually exclusive]**
1	Soft requirement on provision and its timing
2	Hard requirement on provision and its timing
3	Follow 2, but allow for some targeted exceptions

Consultation responses

Some consultation respondents have noted that hard provision may not always be appropriate, for instance in cases of 'execution only' sales where the retail investor has already made a decision to invest, and is requesting a broker to execute a deal, possibly in a time critical manner. The question of what technical might be appropriate in terms of 'providing' the KIID arises in this circumstance.

Analysis of costs and benefits

For the UCITS KIID a 'hard' provision requirement has been considered key to ensuring regulatory documents actually get used. National supervisors, when working on the detailed implementing measures to those proposals, noted that a more permissive regime in this regard could create great cost for the industry (satisfy regulators that they have produced documents that are compliant with the requirements) but no benefits to investors if the documents are not provided to the investors by distributors or intermediaries.

It is difficult to assess the extent to which detailed level 2 provisions might be necessary to tailor the provision model to different distribution channels; however, the heterogeneity of the PRIPs market suggests scope for such provisions would be sensible. **For this reason, option 3 appears preferable over option 2.**

Option	**Effectiveness**	**Efficiency**
0 – Take no action	0	0
1 – 'soft' requirement on provision -- information made available, but not required to be actively provided, e.g. by intermediaries	-- This could potentially weaken requirements, e.g. compared with the standard now in UCITS; this is incompatible with ensuring disclosures are made to improve investment decision making	Would appear low cost for firms and distributors, but mis-buying could raise costs more widely

	Possibilities of mis-selling likely would lead to ad hoc arrangements for provision between distributors and firms, and variations between member states would emerge	
2 – 'Hard' requirement on provision and its timing – following UCITS model	+/- In the context of advised sales, actual provision of KII relating to proposed investment is key to effectiveness of these documents – a strong requirement on this would make clear responsibilities on this, able to act as a better basis for effective supervision, compliance and redress in this area	Hard provision may clarify legal responsibilities between providers and distributors over what information can be used to discharge responsibilities of the distributor. Hard provision may reduce flexibility over how to provide information for some distributors. Hard provision could however improve the control of providers over the information given to investors about their products.
3 – Broadly follow 2, but allow for some targeted exceptions	+ Allowing additional flexibility over and against option 1 would allow certain execution only and other specific distribution scenarios to be better addressed (e.g. where timing is critical).	Additional element of flexibility could mitigate potential consequences of applying hard requirement across all distribution channels.

1.5. ISSUE 5: Civil liabilities and sanctions

As is clear from the above discussion of responsibilities for preparation (and separately under issue 4 for delivery), important questions arise as to what additional steps might be taken to ensure effective and practical compliance with the new framework by firms. The practical effectiveness of a disclosure regime involves a much wider range of factors than simply the establishment of a sound regulatory framework that sets out requirements and outcomes in a clear and unambiguous manner. The supervision and enforcement of the requirements are clear and key elements. In addition, preparing effective documents that communicate well with retail customers is not a trivial 'tick-box' exercise for firms. It can involve developing new skills, and even the use of consumer testing and focus groups by the firm itself to ensure its communications are hitting their target and working as intended. It is clear that 'buy in' from all stakeholders is a necessary precondition for maximising benefits. Respondents to the PRIPs consultation noted a number of different tools that could be used to ensure the practical effectiveness of any new disclosure regime. These included clarifications on the liabilities that should attach to the document. The sanctions regime applied by competent authorities was also underlined; , some industry stakeholders have expressed the view that inconsistencies in supervisory approach between Member States in the consumer protection area were a significant barrier to the further development of the single market.

In addition, respondents mentioned a number of other possible steps. These included the possibility of pre-approval of documents by supervisors (to check ex-ante their accuracy and compliance), though a number of respondents questioned the practicality or coherence of this.[92] A number of respondents underlined that developing prescriptive requirements on the content and form of documents would be a practical way of driving overall improvements by ensuring a common minimum standard. Others noted the vital importance of improving the

[92] The FSA in its recently published paper on product interventions noted that pre-approval of products (and/or disclosures about them, which may be taken to amounting to the same thing) had some strong disadvantages in their eyes, for instance it could lead to a transfer of risk onto the regulator from the industry, that would thereby take less responsibility for the design of products being marketed at the retail client.

overall consistency and clarity of the language used by the financial services for describing investments, investment strategies, asset types, and so forth. (A number mentioned the possibility of developing a common 'glossary' of terms).

When considering the supporting measures that might be taken to ensure practical success of the new regime, these can be split between those measures that relate to the legal framework itself (civil liability and sanctions), and properly need to be considered when developing that framework, and those measures that relate more to the effective implementation of that framework. (This impact assessment will consider the first area as an immediate concern, but further work will be needed as this initiative matures to clarify the necessary additional steps that might be taken, and to clarify in particular who might be best placed and responsible for taking these additional steps.

In terms of legislative design, two issues remain, both of which have been addressed in the UCITS KIID regime that need to be considered in relation to other PRIPs: the clarification of the civil liability attached to PRIPs product disclosures, and the sanctions regime applying through the relevant competent authorities.

Civil liability

On this issue, three main options emerge, (0) taking no action (that is, remaining silent on liabilities); (1) supporting non-legislative measures to build capacity for consumers to seek and obtain redress; and (2) clarifying the civil liabilities. (1 and 2 are not mutually exclusive).

The UCITS KIID experience

In regards civil liability, the UCITS KIID approach on this was developed in response to failings in regards the simplified prospectus, where uncertainty as to the liabilities for the 'simplification' of information (that is, whether the simplified prospectus must contain all elements in the prospectus that might be taken as material for an investment decision) had led to firms including too much information in the notionally simplified prospectus so as to avoid liabilities. There were cases of simplified prospectuses that were longer than the full prospectus that they were supposed to simplify.

For this reason, a delimitation of liability, modelled on that in the PD in relation to the summary prospectus, was included in UCITS IV – civil liability attached to the KIID only in relation to consistency with the prospectus. The aim was to ensure that the KIID was approached as a communication document by firms, not as a legal or contractual document.

Take no action: It would be possible to take no comparable steps on civil liability for other PRIPs, remaining silent in this regard, leaving liabilities to existing sectoral and national requirements. However, while prescription of the form and content of PRIPs product disclosures reduces the risk that the document be used by firms primarily as a contractual rather than communication document, respondents to the PRIPs consultation raised concerns that if liabilities were not clarified in some form, the PRIPs regime could be undermined in just the same way as the simplified prospectus.

Clarifying civil liabilities: But how might civil liability be addressed? Two possible options can be identified, which are not mutually exclusive. The first option would be to support the the development of (non-legislative) measures to build the capacity of retail investors to seek and obtain redress in relation to failures linked to the PRIPs product disclosures. Option 2 would draw on the UCITS approach, to buld explicit (legislative) requirements on civil liabilities (since there may not always by a prospectus or other full disclosure document to refer to, a simple copy of the UCITS approach is not possible). On this basis, the focus would be on establishing clearly that the PRIPs product disclosure is a communication document

designed to address pre-contractual rather than contractual issues, but not presupposing the form of other documents.

Option	Effectiveness	Efficiency
0 -- Take no action	0	0
1 – Supporting non-legislative measures (to build capacity for consumers to seek and obtain redress, collective redress work, etc.)	+ builds practical capacity directed at retail investors themselves and their behaviour	Targeted and proportionate
2 – Clarify civil liabilities (but adjusted as necessary; to establish clearly that the PRIPs product disclosures on its own is a communication document and is designed to address pre-contractual rather than contractual issues)	+ could reduce uncertainty, encourage clear commitments in relation to production of product disclosure	Likely to lead to greater confidence in industry, and ensure benefits of changes more likely to be realised. Could reduce costs related to cross border activity.

Given the need for legal clarity but also for flexibility, option 1 and 2 are both preferred options.

Clarifying civil liabilities would also contribute to better achievement of an effective remedy for consumers, as enshrined in the Charter of Fundamental Rights, article 47. As such this would help achieve the aims under article 38, which seek a high level of consumer protection.

Sanctions

UCITS IV currently contains a high-level requirement on sanctions, which provides for only limited convergence in this area amongst competent authorities. Other Community legislation (such as the Distance Marketing in Financial Services Directive and the E-Commerce Directive) contain sanctions regimes, however, this legislation has been drafted to address specific issues that are separate from those addressed in this initiative. In addition, the regimes within these other areas of legislation can co-exist with those that might apply in regards this initiative; this is already the case in relation to the UCITS KII regime, which is in parallel to those in these two other areas.

Other work is underway that has identified efficient and sufficiently convergent sanctioning regimes as a necessary corollary to the new supervisory system.[93] More convergence as regards the contents and the form of disclosures requirements alone do not create by themselves a more convergent regime in this area. Such requirements should be flanked by common supervisory tools for national authorities. Certainly, also other non legislative measures would be important to flank such regime. A more harmonised approach to sanctions alone will not be sufficient. However, divergences between the powers of Member States to take action with respect to non-compliance with the new requirements could be one important factor which incurs the risk diminishing the effectiveness of the new requirements. Therefore, national authorities need to act in a coordinated and integrated way. The new European Supervisory Authorities (ESAs) will bring about improvements in the coordination of national authorities' enforcement activities. Nevertheless, in order to achieve such convergence it would be necessary to equip supervisors across Europe with the same supervisory tools on the legislative level at the first instance.

[93] See the impact assessment prepared to accompany the November 2010 Communication on sanctions, a summary can be found at: http://ec.europa.eu/internal_market/consultations/docs/2010/sanctions/resume_impact_assesment_en.pdf

Take no action: If no action was taken for non-UCITS PRIPs on sanctioning regimes, leaving these to sectoral and national legislation, then this could lead to material inconsistencies across sectors and Member States in approaches between UCITS and non-UCITS PRIPs. In particular, the PRIPs product disclosure requirements may not be clearly covered by other legislation, which would undermine the goals of this initiative. More convergence as regards the contents and the form of disclosures requirements alone do not create by themselves a more convergent regime in this area without effective and deterrent enforcement. Divergences between the powers of Member States to sanction non-compliance with the new requirements could diminish their effectiveness. In addition, with regard to consistency, other work is underway at the Commission on sanctions (as set out in Annex I.2), that has identified efficient and sufficiently convergent sanctioning regimes as a necessary corollary to the new supervisory system, calling for steps to this end to be taken across all sectoral financial services legislation.[94]

Clarifying sanctions: Taking steps on sanctions for PRIPs raises two possible options – following the high-level approach in UCITS, or specifying the form and content of possible sanctions in more detail so as to allow for greater consistency in these across the EU. In practice it would appear that product disclosures are seldom a direct target for sanctions in themselves, and mechanistic or overly prescriptive alignments of supervisory activities here would seem disproportionate. Under this option, sanctions can be perceived in three broad areas:

- the power for competent authorities to require sales of PRIPs to cease where preparation of the PRIPs disclosure document has not occurred or it has breached requirements on its contents;
- the power for competent authorities to publically name a PRIPs producer where that producer has breached requirements on the product disclosure's contents; and
- the power for competent authorities to fine a PRIPs producer where that producer has breached requirements on the product disclosure's contents.

0 – Take no action	0	0
3 – Take high level approach on sanctions	+/- A high-level approach to sanctions might leave material differences in use of sanctions across Member States that reduce consumer protection standards overall and could contribute to continued barriers to the single market	Largely neutral for industry compared to current requirements, but may reduce effectiveness of new regime, thereby limiting scale of possible benefits (e.g. in regards those involved in cross-border business or active in more than one national market).
4 – Clarify sanctions (as regards the areas and breaches against which sanctions might need to be used and the broad kinds of sanctions that might thereby apply in these areas)	+ allows consistency with commitments in Sanctions communication Allows tailoring of liability regime to specifics of different PRIPs Level playing field between different areas of financial services business	Likely to lead to greater confidence in industry, and ensure benefits of changes more likely to be realised. Could reduce costs related to cross border activity. Level playing field between different areas of financial services business

[94] See the impact assessment prepared to accompany the November 2010 Communication on sanctions, a summary can be found at: http://ec.europa.eu/internal_market/consultations/docs/2010/sanctions/resume_impact_assesment_en.pdf

Given the importance of proportionate sanctions to underlining the importance of the PRIPs product disclosure regime, and given the PRIPs regime would create consistent duties on firms across all Member States, option 4 appears most effective and efficient.

2. ESTIMATION OF ADMINISTRATIVE BURDEN

The administrative costs that this initiative would lead to cannot be assessed solely on the basis of the measures being examined in this impact analysis, as it is proposed that the initiative follow a Lamfalussy structure, and the whole package (level 1, level 2 and supporting guidance) would only come into force once the detailed level 2 measures had themselves been developed and their administrative costs assessed. We will however provide here an estimate of magnitude of administrative costs and burden that such a package may lead to in the future.

The Commission Impact Assessment Guidelines define administrative costs as "the **costs incurred** by enterprises, the voluntary sector, public authorities and citizens **in meeting legal obligations to provide information** on their action or production, either to public authorities or to private parties."

The preferred options emerging from this impact assessment include stronger standardisation and prescription at the EU level of retail product disclosures for PRIPs. Under the Guidelines legal requirements on information disclosure to investors, as in the form of a financial prospectus, qualify as administrative costs.[95] In fact, broadly all costs relating to a future PRIPs regime will fall within the category of administrative costs, as the new regime will of necessity require all firms to replace existing product disclosures with new ones.

As noted, the envisaged PRIPs product disclosure instrument would take the form of a level 1 framework regulation, supported by detailed implementing measures at level 2. While level 1 requirements would determine that new product disclosures should be introduced for all PRIPs, the precise form and content of these disclosures, which is important for assessing administrative costs, would be determined through technical implementing measures at level 2. In other words, the alternative options analysed in this impact assessment – apart from the scope[96] – are not as strong drivers of the compliance and administrative costs as the future Level 2 measures that are likely to determine the magnitude of costs, which, depending on the precise details of those measures, could be very substantive or moderate. One example is the number of product disclosure documents that need to be prepared for certain types of product. An impact assessment at level 2 will address various implementation options and make the case for any such choices on the basis of a more detailed analysis following the standard cost model to assess administrative burden. However in this impact assessment we provide already a forecast estimate of the magnitude of administrative burden that could result from these Level 1 and future Level 2 measures.

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95 See IA Guidelines Annex p. 49. available at: http://ec.europa.eu/governance/impact/commission_guidelines/docs/iag_2009_annex_en.pdf

96 Different options on the scope of the regime could materially impact costs, to the extent that the chosen option on the scope of the regime would determine the degree of standardisation adopted. A wide scope that applies only high-level principles to non-packaged retail investments, but standardises disclosures for packaged investments, would functionally be very similar to the proposal being assessed here. The impact of a wider scope that standardises disclosures across the board would require much further work to assess its likely impact.

The case of costing UCITS KII

To do this for PRIPs, a reasonable proxy exists. For the introduction of the KII for UCITS, the form and content of the proposed changes was already in large part available during the latter phase of policy development for UCITS IV implementing measures. On this basis CSES were commissioned to survey a representative sample of the UCITS industry, including both smaller and larger firms across different national markets and distribution models.[97] This survey was designed to address both the one-off costs of introducing the KII and any incremental impact on ongoing costs. These figures can be used for indicating the broad possible order of magnitude of costs, but again, level 2 work will be necessary to clarify more detailed options and thereby final overall costs.

CSES focused on *administrative burden*.[98] This means that they identify the incremental costs of introducing KIID, over and above existing costs borne under *business as usual*[99] (be it industry practice or national legal requirements that lead to disclosures on a "business as usual" basis). Following the prescription of the Guidelines, the figures cover the production costs of a disclosure document,[100] including translation costs, use of external advisors or graphic designers, and so forth, which fall under various types of required action[101] along the different phases of introducing a KII, such as drafting of the document or arranging its printing or dissemination. Having identified the target groups and relevant cost parameters, the study sought estimates from firms[102] of the hours of professional and other staff, and other fixed costs that might be incurred. The costs were split between one-off costs and ongoing costs.

CSES estimated one-off administrative burden of around EUR 10100 per KIID (EUR 10100 for preparation and dissemination, and EUR 5900 for regulatory costs). Ongoing costs (for updating documents) were EUR 5700 (EUR 5700 for preparation and dissemination, EUR 1500 for regulatory costs). The regulatory costs under both of these estimates relate to approval and notification requirements that are specific to the UCITS market. Such measures

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97 "Study on the Costs and Benefits of the proposed UCITS Key Investor Information" Final Report 2009 December; prepared by CSES for the European Commission, (hereafter referred to as the CSES study).

98 Administrative burdens are administrative activities that an entity only conducts because of legal obligations. (See p.47 of the Annexes to the Impact Assessment Guidelines). "Given the design of the KID as shown above, as part of the study we needed to design an approach to costing the KID. What we were trying to cost is the additional cost of the KID over and above existing requirements. So it is the marginal costs that were sought – not the cost of providing underlying information which are incurred anyway." CSES study, p.6.

99 Business as usual costs are created by administrative activities that an entity would continue if legal obligations (at EU level) were removed. (See p.47 of the Annexes to the Impact Assessment Guidelines)

100 For the types of obligations that qualify as "administrative", see p.49, box 1 of the Annexes to the Impact Assessment Guidelines.

101 For the typology of required actions see p. 51, box 3 of the Annexes to the Impact Assessment Guidelines. The types of information obligation assessed in the CSES study fall under the categories 1 to 11 and categories 13 and 14.

102 Concerning the methodology of surveying firms, it should be added here that assessing compliance and administrative costs and burdens of proposed changes is in practice very difficult for firms on an ex ante basis, where precise details of all the measures are not yet in place; any assessment requires many assumptions to be made. This problem applies for the PRIPs changes being assessed here, as much of the detail necessary for firms to understand the likely changes will be prescribed at level 2 rather than level 1. Nonetheless, we use these figures for a rough estimate of possible administrative burdens flowing from this initiative once the Level 2 measures are determined.

are outside the scope of PRIPs proposals covered in this impact assessment, so these costs are disregarded here.

Grossing these costs up for the UCITS market (on the basis of the number of funds that need to have a KIID prepared), CSES calculated a best estimate of *overall one-off administrative burden* for introducing KIID of around EUR 389 million; roughly adjusted for regulatory costs, this stands at *EUR 246 million*.[103] Incremental increase in *ongoing costs* was calculated to be around EUR 25 million; again, adjusted for regulatory costs, this is *around EUR 20 million*. This represents a 7.5% increase in the costs of previously existing disclosures.

Estimating the PRIPs compliance costs, administrative costs and administrative burdens

A rough estimate of administrative costs for all PRIPs can be achieved by grossing these figures up on the basis of proportions of business relative to UCITS. Under such an approach we arrive at **one-off figures of around EUR 171 million for non-UCITS PRIPs**, and **on going costs of around EUR 14 million**.[104] In broad terms, if cost structures for the rest of the industry are similar for UCITS by volume of business, the impact of requiring a KIID for all the other PRIPs will be of the same broad scale as for UCITS given the size of the UCITS market.

The CSES study suggests the 'cost per product' might be used to estimate a more accurate figure, by multiplying the cost per product by the numbers of products on offer / turnover in product offerings across all PRIPs sectors. This is because the cost per product was not dramatically different for different sized firms (of course some economies of scale apply for larger firms).

However it is not possible to use an estimate of this kind at this stage, as it will only be at level 2 that the precise application of the requirements to different PRIP product forms will be determined. For instance, within the retail structured product market (covering structured deposits and structured securities) there were a total of 274000 products brought to market in 2009 (for reference there were 36000 UCITS registered at end December 2009).[105]

What might impact the costs/burden at Level 2 measures?

Level 1 measures assessed here do not determine whether a KIID would need to be produced for each individual product, or whether a single KIID might be used for multiple tranches (releases) for a product (updated as may be necessary). In the retail structured product market, this could have a very strong impact on costs: if the 10100 EUR one-off costs were accurate per product, a market with 274000 products could face potential costs of almost 2.8 billion EUR. Likewise, for the unit-linked insurance market the application of requirements at the fund or product level, and the extent to which insurers may rely on KIID produced for underlying funds where the insurance contract is to link to these, will be important determinants of costs, and the details of these arrangements will be established at level 2 rather than level 1. On this basis a more sophisticated assessment of burdens seeking to tailor the precise impact of proposals on different market sectors could at this stage be premature

103 See CSES Table 7.6, page 24. Some assumptions were made in grossing up: a possible range of overall.

104 2009 basis, on a conservative assessment: unit-linked as proportion of life insurance business held as securities or units; Arete Consulting data for outstanding retail structure products (with securities or deposit forms), EFAMA market data on size of UCITS and non-UCITS fund markets in EU.

105 Source: Arete Consulting, EFAMA.

and potentially misleading. Such assessment will be carried out within the impact assessment leading up to the Level 2 implementing measures.

However, it would be useful to explore some of other factors – other than the volume of issues for which a KIID might be required – that are likely to impact on the scale administrative burdens.

As noted above, the CSES study focused on the broad administrative burden of replacing, in effect, a more high-level disclosure regime with one which is more prescriptive. For this reason, the study assessments have some wide relevance. Cost drivers for the one-off costs of change over – systems changes, staff training, consultancy fees and data gathering – are broadly likely to be similar for all financial services firms. In terms of ongoing costs, changes to the number of disclosures required (related to the stand-alone nature of KII proposals, such that the new document needed to be produced for most sub-funds and share classes, where as before a combined document could be produced) appeared the largest cost driver, whilst otherwise it was anticipated that the new requirements would be similar in impact to old requirements.

The CSES research saw no major differences between smaller and larger firms in terms of the costs, though larger firms in general were better placed to absorb ongoing costs, and smaller firms found it harder to reliably assess possible costs (it was in fact difficult to ensure a representative sample from smaller firms). This to a degree is reflected in a number of respondents' comments in regards the PRIPs consultation, which indicated a view on the part of the larger firms that the ongoing costs of the new regime might be readily absorbed, so long as reasonable transitional arrangements were put in place.

To be clear, for most of the PRIPs market regulatory disclosure requirements, at national or EU level, already apply. The only area where a gap has been identified is in regards structured term deposits. According to Arete data, this is likely to be a relatively small part of the overall market – 14% of the retail structured product amount outstanding in 2009, or 0.6% (roughly) of the EU PRIPs market. For 99.4% of the PRIPs market (by volume of existing business), therefore, the proposals in this impact assessment are largely a matter of one-off costs of change from one approach to product disclosures under regulatory requirements to another, and possibly a maximum of 7.5% increase in ongoing costs for the new requirements.

The **one-off compliance costs** of the PRIPs regime would clearly fall under the category of **administrative burden** – these are the costs for the whole industry of introducing *new* disclosures; these costs are incurred irrespective of whether such a disclosure might be produced under business as usual. However, for **ongoing costs** the situation is more complex. The CSES study specifically asked respondents to identify incremental costs over and against what they would do as 'business as usual'; on this basis these estimates (a maximum increase of costs of 7.5% over existing disclosures) are a proxy for the ongoing administrative burden.

Comparing estimated costs to estimated benefits

It is important to note, however, that these costs are dwarfed by the scale of potential mis-selling or buying in the retail investment market. As set out above, even if disclosure failings were seen as only contributing 1% to such problems, our analysis still suggests potentially 8 billion EUR of mis-placed investments attributable to such failings.

3. POSSIBLE IMPACTS OF HORIZONTAL PRIP ACT ON EXISTING SECTORAL LEGISLATION

Sectoral legislation	Possible impacts of horizontal PRIP act on existing sectoral legislation
PD	**Impact on Article 5(2)** Art. 5(2) of PD requires drawing up of a summary of a prospectus which should provide appropriate information about essential elements of the securities concerned in order to aid investors when considering whether to invest in such securities. These essential elements are defined in Art. 2(s)(i) – (iv): (i) a short description of the risk associated with and essential characteristic of the issuer and any guarantor, including the assets, liabilities and financial position: (ii) a short description of the risk associated with and essential characteristic of the investment in the relevant security, including any rights attaching to the securities; (iii) general terms of the offer, including estimated expenses charged to the investor by the issuer or the offeror; (iv) details of the admission to trading So as to avoid duplication, the proposed PRIPs disclosure rules could be designed so as to ensure that information in the KIID can be regarded as appropriate for certain pieces of key information to be provided in the summary such as e.g. information on risks and costs.
Solvency II	**Impact on Article 185** Art. 185 specifies types of information the insurance undertaking is to provide to the policy holder before a life insurance contract is concluded. So as to avoid duplication of requirements, the proposed PRIPs disclosure rules could be designed so that the information contained in the KIID in accordance with the overall PRIPs act (regime) (level 1 and 2) would be regarded as equivalent to the information required by Art 185(3) and (4), such that information under Art 185(3) and (4) would not need to be supplied again if a KIID has been provided. The precise degree of equivalence depends, however, on an assessment of detailed level 2 PRIPs measures as these may develop.
UCITS	UCITS will be excluded from the scope for a transitional period.
AIFMD	AIFMD only regulates marketing of AIF to professional investors. The marketing of AIF to retail investors is left to national law. Therefore, the PRIPs act requiring that retail clients are to be provided with a KII will apply independently from AIFMD
Transparency Directive	As the Transparency Directive establishes requirements in relation to the disclosure of periodic and ongoing information about issuers whose securities are already admitted to trading, its scope is different than that of PRIPs disclosure, which will play its role before a contract is concluded (pre-contractual disclosure).
e-Commerce	**Impact on Article 5**

Art. 5 contains a list of information which the service provider should render accessible to the recipients of the service and competent authorities. The list is not exhaustive and it has a complementary character with regard to other information requirements established by Community law.

Art. 5(2) requires, 'in addition to other information requirements established by Community law' that Member States should 'at least ensure that, when information society services refer to prices, these are to be indicated clearly and unambiguously and, in particular, must indicate whether they are inclusive of tax and delivery costs'.

Since these requirements are in addition to other information requirements in community law, both regimes can generally exist in parallel; detailed requirements at level 2 to the PRIPs act would be designed so as to avoid unnecessary duplications.

Distance marketing

Impact on Article 3(1)

Art. 3 requires that certain information concerning the financial service will be provided to the consumer before the consumer is bound by any distance contract or offer., like, for instance:

- a description of the main characteristics of the financial service,

- the total price to be paid by the consumer to the supplier for the financial service, including all related fees, charges and expenses and all taxes paid via the supplier,

- information on special risks related to specific features of the instrument to which the financial service is related.

Since these information requirements are mainly service related, both regimes can generally exist in parallel; where relevant with respect to product information, detailed requirements at level 2 to the PRIPs act would be designed so as to avoid unnecessary duplications