



Financial Services Authority

**FSA response to the European
Commission's call for evidence
on the need for a coherent
approach to product
transparency and distribution
requirements for 'substitute'
retail investment products**

January 2008

General Orientation

1. We agree that providing satisfactory levels of consumer protection in the retail market is extremely important, as is applying a level playing field for competing retail investment products. We have tried to do this in the UK by complementing EU provisions with a domestic framework. At present, we do not see significant potential for regulatory arbitrage in our jurisdiction, and for this reason we do not believe there is an adequate case for cross-cutting EU legislation. However, there are different requirements in several EU directives in this area and, when directives are reviewed, as the Insurance Mediation Directive (IMD) will be, the potential to reduce inconsistencies and find common ground should be evaluated.
2. Any work at an EU level should take account of the better regulation process and follow research to quantify the market failure and cost benefit analysis of any proposed measures. Further, we would suggest that any proposals should look to build on existing EU standards as far as possible, including the Markets in Financial Instruments Directive (MiFID), rather than creating another discrete regime that would require regulators, Finance Ministries and firms to alter recently implemented changes, potentially creating new distinctions that may entail new potential for arbitrage. Part of this process should involve post-implementation reviews of MiFID to ensure that it is working as intended and provides a good framework on which to build.
3. We believe it is preferable to find national solutions to level-playing-field issues rather than to regulate at an EU level. This is for several reasons:
 - the volume of cross-border retail investment business is extremely small (as retail consumers prefer to deal with firms with a local presence rather than across borders, for reasons of language, culture and familiarity), suggesting that harmonising regulation at EU level is not essential;
 - it is easier for national regulation to take account of cultural preferences and regional product variations;
 - national differences in taxation, rather than differences in regulation, appear to have a significant impact on product sales; and
 - there is a range of distribution structures across the EU, which would be difficult to take into account in regulations designed at EU level.
4. While it may not be appropriate to impose detailed regulation for the whole EU, there may be more of a case to set high-level requirements for the outcomes that should be met. These would provide flexibility to meet national requirements, particularly if national regulators are given scope to implement them according to the specific needs of their jurisdiction. Accordingly, this may be an issue for Level 3 action rather than primary legislation.

Q1: Do you see that different regulatory treatment of substitute products gives rise to significant problems? Please explain why you consider this to be the case.

5. As far as possible and where desirable, the UK national regime has been developed to apply a level playing field where firms are dealing with retail clients. Generally, we do not differentiate between types of firm, and aim to apply the same standards for products that could be in competition with each other. So, at present, we do not see significant scope for regulatory arbitrage in the UK.
6. We have taken a strict approach of only extending rules to cover all substitutable products where we have observed market failures and the benefits of regulating outweigh the costs. We believe all regulation should be set at appropriate and proportionate levels for the products, clients and sales methods. On 1 November 2007, in line with the introduction of MiFID, we introduced a [new Conduct of Business sourcebook](#) in which provisions are generally set at a high level and under which regulation is more principles based. This should allow firms to be flexible in applying the rules for their particular situation, while still meeting the outcomes that we expect of them.
7. Many of the provisions in the new Conduct of Business sourcebook are set by European Directives and then applied to non-scope firms and products. For example, we have extended many MiFID provisions to apply to non-scope business to avoid the possibility of regulatory arbitrage. The requirements for financial promotions, for example, generally apply to all investment activity, without distinguishing between products. These provisions are drawn largely from MiFID. We have also used our copy out of the MiFID suitability obligations as the basis for a common standard that also applies to non-MiFID firms and investment products (though not to general insurance or mortgage lending). This common standard also reflects the applicable provisions of the IMD. Again, this approach is intended to avoid regulatory arbitrage and consumer confusion. This effectively means that in a variety of cases there is no difference in treatment.
8. We have a [Treating Customers Fairly \(TCF\)](#) initiative that should encompass all actions by firms. Principle 6 of our [Principles for Businesses](#) says 'A firm must pay due regard to the interests of its customers and treat them fairly'. Our work on TCF applies a principles-based approach to all activities and aims to ensure outcomes are fair for consumers. So we have applied the MiFID requirement for firms to act honestly, fairly and professionally in accordance with the best interests of their clients for investment business for retail clients.
9. Assessing whether this approach has had any unintended effects will be a valuable exercise. Over the next three years, and in several stages, we will carry out post-implementation reviews of certain provisions (including some derived from MiFID) but we do not yet have results. New regulation should be deferred until the new regime has been assessed to identify regulatory failures and ongoing market failures.

10. We are conscious of different requirements between some EU directives. For example, when comparing the IMD and MiFID, the IMD takes a prescriptive approach to the required disclosure of shareholdings compared to MiFID's relatively high-level requirements. In cases such as this, we aim to find common ground and apply similar standards for all firms. When directives are reviewed, as the IMD will be, we are positive about the potential for that work to iron-out inconsistencies.
11. Similarly, there are rules, derived from the Consolidated Life Directive, that make unit-linked products an efficient way of accessing assets, although mainly in the wholesale sector. Currently 80-85% of new business for these products is for pension provision, and around half of this is wholesale, not retail, in nature. So the regulatory treatment needs to take note of this market segmentation.
12. We apply certain extra requirements to a specific group of products, called [packaged products](#). We try to apply consistent requirements across all packaged products. In some areas, we have provisions relating to packaged products that are super-equivalent to MiFID. We have notified the European Commission of these under Article 4 of the MiFID Implementing Directive. These are needed to give extra consumer protections because of the specific nature of the UK market.
13. *Packaged products* is a term we use to describe potentially complex and long-term investment products sold widely to the mass market: personal pensions; units in collective investments schemes; life insurance products; and investment trust savings schemes. It is a way of distinguishing these types of investment from others, such as equities, which are less opaque and are not generally traded actively by retail clients. Examples of the provisions that apply to this group of products include the requirements for [Key Features Documents](#) (requiring similar information to that for the UCITS Simplified Prospectus or Key Investor Information) and for disclosing the actual commission payable before a sale.
14. As well as provisions applying to product providers, advisers operating in the packaged product market are also expected to follow other requirements to help combat the information asymmetry suffered by retail consumers. For example, we have provisions requiring advisers to confirm recommendations in writing and specifying the conditions under which firms may describe themselves as independent. Again, some of the requirements in this area are subject to Article 4 notification under MiFID. In these cases, our market failure and cost benefit analysis has shown the importance of extra consumer protection requirements.
15. Although this call for evidence is not explicitly considering product regulation, it should be noted that Solvency 2 is expected to remove the list of eligible assets that currently restricts unit-linked firms to investments in certain specified financial assets. There is a potential for regulatory arbitrage here if life funds can invest in any asset and UCITS products face prescriptive rules.

Q2: Do you regard the perceived concerns relating to different levels of product transparency and intermediary regulation as a significant threat to the further development of EU markets for retail investment products?

- strongly agree somewhat agree no opinion
 somewhat disagree strongly disagree

16. We do not believe there is a significant threat to EU markets for retail investment products arising from a regulatory non-level playing field. This is an issue that is best addressed and managed at national level.
17. Research suggests that retail consumers prefer to deal with firms with a local presence rather than across borders (as discussed in the European Commission Green Paper on Retail Financial Services in the Single Market). Consumers prefer physically-present institutions over virtual ones, use mainly domestic products and rely on national consumer protection traditions. This is likely to be for reasons of language, culture and familiarity.
18. The preference of retail clients to deal with local firms is perhaps one of the drivers behind recent increases in European cross-border mergers and acquisitions activity. Rather than offering products across borders, there is a tendency to acquire a physical presence in other states to gain exposure to those markets. Given this, aiming to provide a level playing field among member states would not have a significant impact on cross-border sales but could be helpful for multi-national firms, reducing their costs by allowing them to follow a single set of rules rather than different rules in each jurisdiction.

Q3: Is it appropriate to regard different retail investment products as substitutable – regardless of the legal form in which they are placed on the market? Which of the products listed below should be considered as substitute investment products?

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

Additional substitutable product type: Body corporate non-ICVC

Investors in the UK can invest in equities through investment trusts and other investment companies such as venture capital trusts and real estate investment trusts. These products are not funds – they are companies that invest in the shares and securities of other companies and are subject to the same regulation and oversight as other quoted companies.

Some investment trusts have set up investment trust savings schemes, competing with other retail regular savings investments. So they are classified as packaged products and subject to the relevant rules to provide a consistent regulatory framework.

Additional substitutable product type: With-profits life insurance (especially where mortality risk level is small or nil)

In the UK, with-profits investments provide an alternative to unit-linked investment. With-profits contracts allow policyholders to participate in any surplus arising on the whole of, or any part of, the insurer's long-term insurance business. With-profits lump sum investments and regular savings plans have in the past accounted for a large proportion of retail investment (though their popularity has declined in recent years). These products compete directly with unit-linked life insurance investments.

Other notes: growth of platforms and other changes to investment management within products

In the UK, platforms (also known as wrap platforms) are online services, used by intermediaries (and sometimes consumers directly) to view and administer investment portfolios. Platform providers aggregate, and arrange custody for, customers' assets, including life insurance investments and collective investment schemes. Their use in the UK is of growing importance and encourages direct comparisons of investment options available for consumers within unit-linked life insurance products, UCITS and other funds – to the extent that some life insurance products are referred to as 'tax wrappers' for funds.

Various tax wrappers exist in the UK to encourage saving by granting tax advantages to the investment. Individual Savings Accounts (ISAs) and Personal Equity Plans (PEPs), for example, are tax wrappers that can hold some of the products considered above, including UCITS funds and nationally-regulated retail funds. Child Trust Funds (CTFs) are another example. These are savings and investment accounts for children that benefit from government contributions and tax efficiency. Although they invest into other products listed, it is important to consider these tax wrappers as the degree of substitutability may to an extent be driven by tax efficiency.

Another important change is the increasing use of exchange-traded funds in portfolio management instead of unit trusts or ICVCs. This is often, we believe, for reasons such as cost savings rather than because of particular differences in the products.

A further significant development is the increasing use of self-balancing collective investment schemes (e.g. funds of funds). These are increasingly being seen as substitutes for portfolios of other asset types combined with technology services allowing the customer to rebalance their assets for themselves.

19. For life insurance contracts, it is important to make adequate differentiation between contracts designed for investment and those designed to provide protection. This is not always an easy distinction to make as some products combine both elements.
20. It is not clear which annuities are referred to in the table. Most of the identified products aim to accumulate funds – annuities allow decumulation benefits (in the sense that they generally provide income but not capital growth). In the UK, tax rules determine how pension benefits may be taken. Annuitisation of pension benefits is compulsory at the age of 75 (unless an alternatively secured pension product is used to take income withdrawals from the pension fund), so it is impossible for other products to compete with annuities used for pension decumulation. Purchased life annuities, however, do allow the investment of capital, which could alternatively be invested in income-producing assets. Some annuities also have an investment element. However, unless the annuity provides a return of capital at some point, it is not clear that it would compete directly with the other products listed.

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

21. To minimise scope for regulatory arbitrage, any definition should be as broad as possible (subject to the limitations noted below). However, it will be important to focus on catching retail products without undermining institutional markets and market innovation for professional clients. So any definition should be restricted to sales to retail clients.
22. The simplest method of encompassing the range of substitutable products is to list all product types that should be included, as we do currently for packaged products. However, this does not take into account possible innovation in the market, which could possibly lead to future regulatory arbitrage if the industry created products that lie outside the range.
23. To establish what ‘substitutable investment products’ are on a national and EU level, we find it useful to think along the lines of defining a relevant market. A relevant market has two dimensions – the relevant product market and the relevant geographic market – and is effectively established as a combination of these two dimensions.
24. As described above, with respect to product characteristics, intended use and prices, most of the products covered in this call for evidence are substitutable products from an UK perspective. However, introducing the geographic dimension may alter this conclusion. Due to taxation and cultural preferences, for example, retail investment markets are still different in many EU member states. It is the case that some products may be considered substitutable at the EU level but not in some domestic markets and vice versa. For instance, UK Friendly Society Savings Plans may not be available in other markets.

25. It is also important to be aware that competing products are not necessarily interchangeable. Specific plan features would mean that a pension plan, for instance, is not interchangeable for an investment that can be accessed at any time. While both may be used for retirement planning, the same could not always be said of shorter-term needs. In addition, it may not always be appropriate for all products that meet these criteria to face the same regulations. For example, most pension contracts should include personalised projections to help consumers plan for retirement but these may not be appropriate for all investments.
26. Another consideration is the question of suitability. For example, there are several products that might fill the same basic lump sum investment need, but applying suitability criteria for different clients at different times may change the products that are substitutable. As an example, a Friendly Society Savings Plan could fill the same regular savings need as a regular saving Unit Trust ISA or a regular savings Unit Trust outside an ISA wrapper. The relative suitability – and the issue of whether substitutability is appropriate – will alter depending on the tax situation of the client and their existing investment portfolio. A further dimension to this is that products are not always necessarily discrete. For instance, it is possible for self-invested personal pensions, to hold units in collective investment schemes.
27. To conclude, there is a danger that in seeking to create a single market for ‘substitutable investment products’ something too rigid is developed, which does not take account of either national nuances (like national tax advantaged savings wrappers) or innovations in the market, such as wrap platforms.

Q4: Which factors in your opinion drive the promotion and sales of particular investment products? Please use the table below to rank these factors in terms of importance (very significant; significant; no opinion; insignificant) for each of the different products. In addition to completing the table, we would welcome further explanation of your view as to which factors are particularly important for each product.

	UCITS	Non-harmonised funds	Body corporate savings (non-SICAV)	Unit-linked life insurance products	Retail structured products	Annuities	(Structured) Term deposits	With-profits
Taxation	Significant	Significant	Significant	Significant	Significant	Significant	Significant	Significant
Financial innovation	Very significant	Very significant	Very significant	Significant	Very significant	Insignificant	Very significant	Insignificant
Cultural preferences	Significant	Significant	Significant	Very significant	Significant	Insignificant	Significant	Very significant
Distribution models	Significant	Significant	Significant	Very significant	Very significant	Significant	Significant	Significant
Regulatory treatment	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant
Guarantees	Insignificant	Insignificant	Insignificant	Insignificant	Very significant	Very significant	Very significant	Significant
Performance	Very significant	Very significant	Very significant	Significant	Significant	Significant for investment-linked annuities	Significant	Very significant

28. In our view, the fact that different investment products have different tax structures is often fundamental in deciding which product is sold. Tax-incentivised investments (like ISAs in the UK) are an obvious example of how tax can drive the sale of one investment rather than another. But even different tax treatments of taxed products can lead to different products being sold. For example, we believe the different tax treatment of UCITS funds and single-premium life insurance bonds is one of the main reasons explaining the current popularity of life insurance bonds in the UK. Retail investment products located offshore may also have potential advantages over equivalent onshore products.
29. Association of British Insurers' (ABI) statistics also show that different distribution models have a very significant impact in the sale of retail investment products in the UK. Independent Financial Advisers (IFAs) account for around two-thirds of retail investment sales. Over 90% of sales are through intermediated channels (when financial advisers working for a single firm or a limited range of firms are also taken into account). Only a small minority of retail investment sales are on a non-intermediated basis. (It should also be noted that we are looking at the current distribution models in our [Retail Distribution Review](#).)
30. UK cultural preferences are also a significant influence in product selection and distribution. Until very recently, for example, with-profits investment bonds were extremely popular.
31. Performance also has a strong influence on many of the unit-linked products. New business tends to fall after market downturns, just as improving returns attract investment. Examples of this include the popularity of technology funds in the late 1990s and commercial property funds in recent years.
32. Linked to performance is the concept of capital guarantees. With-profits funds guarantee the fund value (so long as capital is not withdrawn, at which time the value potentially becomes subject to the imposition of a market value reduction penalty during times when markets fall steeply, as between 2000 and 2003). This guarantee is one of the factors that encourage investment.
33. Innovation is generally important and the market has seen new developments in many areas. In particular, increased use of derivatives in UCITS III funds (such as in 130/30 funds), the planned use of [funds of alternative investment non-harmonised funds](#) and the increasing use of platforms should be mentioned. Self-invested personal pension wrappers are increasingly driving UCITS and other fund sales. These new developments and the greater flexibility they offer are leading to increased sales of products in these categories. There is also a growing demand for financial products which comply with Sharia law. There are very few Sharia-compliant funds in the UK but this is expected to change due to the growth in demand.
34. As noted earlier, it is unclear what is meant by annuity products in the context of this call for evidence. However, the following are some observations on different types of annuity:
 - Compulsory purchase annuities are one way to draw pension benefits. Annuity rates have fallen in recent years making them less attractive for some consumers.

However, UK legislation requires clients to use their pension funds to buy an annuity by the age of 75 (unless an alternatively secured pension is arranged).

- Purchased life annuities can be bought from capital to provide an income. Various product forms are available, including back-to-back arrangements in which some of the income is used to fund a regular premium investment that pays a capital return at maturity. With falling annuity rates, variable annuities (such as investment-linked and flexible annuities) have become more popular.

35. We believe regulatory treatment in the UK generally has an insignificant impact on driving the sale of a particular investment product compared to competing products. Our national regime largely applies a level playing field. Insurers, authorised collective investment schemes and their managers are all subject to FSA rules. It is worth noting here the regulatory framework is different for structured term deposits. These are subject to the [Banking Code](#) (a voluntary code which sets standards for banks and building societies to follow when they are dealing with personal and small business customers) and their sale is generally outside the scope of our Conduct of Business regulations.

Q5: **Product disclosures:** Do pre-contractual product disclosures provide enough information to help investors understand the cost and possible outcomes of the proposed investment? Please use the attached tables to provide your evaluation of the adequacy of the information provided with regard to the following items for each category of investment product.

Nature of information provided	UCITS	Non-harmonised funds	Body corporate savings (non-ICVC)	Unit-linked life insurance products	Retail structured products	(Structured) term deposits	Annuities	With-profits life insurance products
Product features	Some aspects of the Simplified Prospectus required disclosures are not relevant to the investment decision and may result in the provision of too much information to retail consumers.							
Direct costs	Firms tend to provide adequate and effective information within the framework we set out.		Firms tend to provide adequate and effective information within the framework we set out.		Costs (including the cost of any guarantee) are part of the product design. It is arguable whether cost information is relevant or only the anticipated return at maturity.		Firms tend to provide adequate and effective information within the framework we set out	
Indirect costs (or foregone performance) and effect of costs/charges	We have an additional requirement for firms to provide reduction in yield details in the Simplified Prospectus as the total expense ratio on its own does not provide an adequate basis for comparison with substitutable products.		Firms tend to provide adequate and effective information within the framework we set out		Firms tend to provide adequate and effective information within the framework we set out		It is possible to provide information on the direct costs for unitised with-profits but is difficult to apportion costs for conventional with-profits. Cannot predict indirect costs and business costs (and profits) borne by the fund.	
Risks, reward and volatility	Firms tend to provide adequate and effective information within the framework we set out.							

Nature of information provided	UCITS	Non-harmonised funds	Body corporate savings (non-ICVC)	Unit-linked life insurance products	Retail structured products	(Structured) term deposits	Annuities	With-profits life insurance products
Capital guarantee	Firms tend to provide adequate and effective information within the framework we set out. In the case of with-profits investment, however, the guarantee may be difficult for retail consumers to understand.							
Likely performance	Projections are usually avoided by the mutual funds industry. The life industry, however, tends to provide projections routinely.			Firms tend to provide adequate and effective information within the framework we set out.		The life industry tends to provide projections routinely.		
Conflicts of interest	Firms tend to provide adequate and effective information within the framework we set out.							
Compensation or fee retrocession	Firms tend to provide adequate and effective information within the framework we set out.		Implicit charges may make product look free.		Firms tend to provide adequate and effective information within the framework we set out.			

Note: In the above table, we have commented on Simplified Prospectus requirements (rather than the plans for Key Investor Information documents) for relevant products (UCITS, non-UCITS retail schemes and body corporate schemes).

36. While disclosure may reduce information asymmetry, there are limitations to what the information can achieve. For example, the rules may allow firms to create excellent documents but if they do not make them engaging or consumers do not bother to read them, the effect will be limited. Our recent work and the UK Better Regulation Executive and National Consumer Council report [Warning: Too much information can harm](#) suggests there is a balance to be found between giving consumers the key information they need to make informed decisions and giving them too much, so the information becomes less engaging and more difficult to navigate.
37. So it is important to consider the effectiveness of literature as well as the breadth of information it covers. One point we should keep in view is the importance of drawing out key messages. It is important that consumers can easily find and understand the main risks associated with a product in the main disclosure material. Providing key information in a main document but signposting to supplementary detail has real benefits.
38. Our research suggests that existing product disclosure requirements, when implemented well, are enough to provide consumers with adequate and effective information. We do not believe the market failure and cost benefit analysis justifies new disclosure requirements. Instead, it is important that current requirements are implemented well. At present, we are working on a project to help firms improve their product literature and make it more effective in helping retail consumers understand the nature, commitment and the risks of their products.

Q6: **Conduct of business rules:** Do differences in conduct of business regulation result in tangible differences in the level of care that different types of intermediary (bank, insurance broker, investment advisor/firm) offer to their clients? For which conduct of business rules (know-your-customer, suitability, information/risk warnings) are differences the most pronounced and most likely to result in investor detriment?

	UCITS	Non-harmonised funds	Body corporate savings (non-ICVC)	Unit-linked life insurance products	Retail structured products	Annuities	With-profits	(Structure) Term deposits
Know your customer	<p>All of these investment products are <u>designated investments</u>. Our suitability rules apply to all regulated firms making a personal recommendation or managing designated investments. A firm must assess suitability by obtaining information about a client's knowledge and experience, financial situation and investment objectives. The standards required are the same for all these products. An exception exists for <u>basic advice</u> for a small number of lower risk, simple products categorised as <u>stakeholder products</u>, which may only be carried out by firms subject to the Article 3 exemption in MiFID. Firms providing basic advice must follow a simplified sales process, which uses a set of scripted questions.</p>							
Suitability or appropriateness	<p>Suitability: As above, our suitability requirements apply to a personal recommendation in relation to designated investments. A firm must take reasonable steps to ensure that a personal recommendation is suitable. The firm must, except in a few defined circumstances, also provide a <u>suitability report</u> to a retail client in respect of certain retail investment products.</p> <p>Appropriateness: This is a new requirement in the UK. The test must be carried out (with some exceptions) for all MiFID instruments arranged by firms which are not exempt under MiFID Article 3. We carefully considered whether there was a case for extending the appropriateness test to non-MiFID firms and/or non-MiFID products (e.g. life insurance products, pensions, cash-ISAs) which can be sold on a non-advised basis. Our conclusion was that there were not adequate grounds to extend the test beyond what MiFID requires in retail markets, with the exception of derivatives and warrants sold to retail clients by direct offer financial promotion (this extension includes non-MiFID derivatives and also non-MiFID firms).</p>							
	<p>Our Conduct of Business rules do not generally apply to deposits (a deposit is not a designated investment). The conduct of deposit taking by banks and building societies is covered by the Banking Code.</p>							

	UCITS	Non-harmonised funds	Body corporate savings (non-ICVC)	Unit-linked life insurance products	Retail structured products	Annuities	With-profits	(Structure) Term deposits
Risk warnings	<p>There are considerable differences between the disclosure requirements of the Consolidated Life Directive and the UCITS Directive. However, we have had for some time, through our packaged product regime, rules to ensure that investors receive similar pre-sale information so that an informed choice can be made. We have adopted Article 31 of MiFID as a core requirement for all firms advising on or managing any type of designated investment. We require additional information to be disclosed for any designated investment that is a packaged product. This requires disclosure in the form of a Key Features Document (KFD) with a Key Features Illustration (KFI) or a Simplified Prospectus (SP). We also require a KFD to be produced for cash deposit ISAs and cash deposit CTFs, which are not packaged products. The KFD for a life insurance product encompasses the information requirements of the Consolidated Life Directive.</p> <p>If the investment is a UCITS fund, the information must be presented in the form of an SP. We also allow the providers of non-UCITS retail schemes (NURS) to produce an SP rather than a KFD.</p>							
Examples – information	<p>A KFI must also accompany the KFD for a packaged product. This will set out the projected returns at prescribed rates of return, taking into account the charges of the investment. The illustration must also include a reduction in yield to illustrate the effect of the charges. There is no requirement for a separate illustration to be produced for an authorised collective investment scheme. However, we have made it easier for consumers to compare collective investment schemes with life insurance products by requiring both to include a table of the effect of charges and a figure showing the reduction in yield in their pre-sale information. This is also helpful for intermediaries.</p>							

Q7: Conflicts of interest: Are there effective rules in place to ensure effective management/disclosure of conflicts of interest (and/or compensation arrangements) by the different categories of product originators and/or intermediaries for the different types of investment product? For which type of product do you see a regulatory gap in terms of the coverage of conflict of interest rules? Please explain.

39. There is some divergence between MiFID and the IMD regarding prescription when disclosing conflicts. This may be an area where greater consistency can be achieved when the IMD is reviewed, perhaps to bring IMD requirements in line with MiFID.
40. MiFID and the CRD, however, share common ground in terms of the high-level standards for risk management and the systems and controls they require. Given this, we decided to create a common platform to implement the requirements of the two directives through the same Handbook rules (differentiating between MiFID and CRD firms where necessary).
41. The conflicts of interest rules in the Senior management arrangements, systems and controls handbook ([SYSC 10](#)) apply to [common platform firms](#) which provide services to clients in the course of carrying on [regulated activities](#) or [ancillary activities](#) or providing [ancillary services](#) (but only where the ancillary services constitute MiFID business). The scope of the rules is therefore defined on the basis of activity/service and type of firm. The scope of SYSC 10 is not based on the financial instrument involved or the status of the client involved.
42. In essence, firms are required to identify and have effective organisational and administrative arrangements to manage conflicts of interest. Where a firm is not confident that the measures it has in place to manage conflicts are enough to ensure there is no material risk of damage to the client, then the source of the conflict must be disclosed before providing the service. We see this approach as being applicable across the range of financial instruments considered in the call for evidence.
43. In December 2007, we began consultation on extending the common platform for the SYSC 10 rules so that the conflict of interest rules apply to all firms (except insurers) in respect of activities or services involving a client (see [Consultation Paper 07/23](#)). In the meantime, we have retained conflict of interest provisions, which generally achieve the same outcomes, for non-common platform firms ([COBS TP.2.12R](#)).
44. On the basis of this, we do not see a regulatory gap in terms of the coverage of our conflict of interest rules.

Q8: unfair marketing/misleading advertising: Is the risk of unfair marketing/misleading advertising more pronounced for some product types than for others? If so, why? Can you point to concrete examples of the mis-selling of the different types of investment product resulting from unfair marketing/misleading advertising?

45. In the retail investment area, problems with advertising tend to arise for complicated products as these are often more difficult to explain to a mainstream audience. Some of the products for which we have observed problems include:
- Products that involve tax benefits (such as alternative investment market share portfolios, enterprise investment schemes, self-invested personal pensions and venture capital trusts). These products include special terms that sometimes are not explained clearly or sufficiently.
 - Specialist products sold to the mass market (again including enterprise investment schemes, self-invested personal pensions and venture capital trusts but also spread betting products). Many of these contracts have been developed for professional clients, better-informed clients or advised markets. So financial promotions aimed at a more mainstream audience need greater care to protect consumers.
 - Products with complicated plan features that customers struggle to understand, including structured products. Sometimes the risks and commitments involved in these products are explained insufficiently and promotions over-emphasise the benefits.
 - Some adverts for banking products are unbalanced, emphasising high interest rates without adequately explaining the limitations on these high returns (such as minimum or maximum investment amounts or withdrawal frequencies).
46. However, while we have noticed a greater tendency for unfair or misleading advertising of these products, they are already subject to our regulation. In the UK, requirements relating to promotions apply to investment activity, not to specific products. So, the same rules generally apply equally for all products, even those listed above (although promotions of deposits have slightly different requirements). Misleading advertising in these areas is more a case of failure to meet the outcomes we expect of firms than of an exploitation of regulatory arbitrage or a lack of regulation.
47. Deposits are regarded as lower-risk savings plans and exemptions in Articles 22 and 23 of the [Financial Promotion Order \(2005\)](#) are available for promotions of these products. Where promotions are not exempt, they will need to follow our provisions. However, only a limited number of Handbook rules apply to promotions of deposits (such as the key ‘fair, clear and not misleading’ requirement and certain high-level requirements such as the requirement for benefits to be balanced by a fair and prominent indication of any relevant risks).
- Q9: Is a horizontal approach to product disclosures and/or to regulation of sale and distribution appropriate and proportionate to address the problems that you have identified? Can you specify how this objective of coherence between different frameworks would address the problems?
48. A horizontal approach does have advantages for consumers and firms and is the one we have pursued in the UK. In our national regime, regulations for different products are not too dissimilar in substance (and in certain areas they are identical). This should reduce the possibility of regulatory arbitrage and mis-sales.

49. Being able to compare products is important, especially those fulfilling broadly similar needs, and as products are often not recommended in isolation but as part of a portfolio. However, it is equally important to be proportionate in addressing the risks associated with particular product types and the market in which they are sold. (For example, any regime needs to allow for particular national initiatives such as ISA/CTF wrappers in the UK and innovations such as platforms that may develop at different speeds in different member states.)
50. One area where this can be demonstrated is in respect of the reduction in yield statistic. The SP does not envisage using this measure, yet it is an important addition when comparing the cost of a collective investment scheme with an investment bond (as the total expense ratio does not cover all charges).
51. It is important that, as in MiFID, provisions should not be too prescriptive and should allow flexibility for firms to take account of the specific needs of their clients, products and sales channel.

What are the potential drawbacks of such an approach?

52. Different markets have different needs. Too much regulation may be as damaging as too little. It is important for provisions to be proportionate and appropriate to each market and only to be implemented following thorough consumer testing, market failure analysis and cost benefit analysis. This might result in a common set of principles intended to lead to a set of desired outcomes for consumers rather than more prescriptive regulations, which might not properly reflect product differences and could stifle innovation.
53. Market evolution is another significant factor. If provisions are too narrowly focused on specific products and situations, there is a possibility the market will evolve in new ways, undermining the intentions behind the regulations. This has been seen, for example, in member states that have not used national regulation to apply similar provisions to products that fall outside the scope of different directives. Within the UK, the development of new markets (such as for platforms) has led to questions about which provisions apply. We are relying increasingly on high-level rules that apply to all designated investment business as we believe this enhances consumer outcomes. Appropriate supervision and enforcement of higher-level rules may, in many cases, be more effective in ensuring firms address the information needs of their consumers than more prescriptive requirements.
54. We have carried out consumer research on the potential benefits of disclosure. This research suggests we should only continue with extra regulation of product disclosure after extensive consumer research. It is important that the benefits of the additional disclosure are clear and that this does not just result in additional costs for firms without reducing the information asymmetry in the market. The research also suggests that improving the quality and professionalism of advisers is desirable.

Q10: Can market forces solve the problems that you identified (fully/partially)? Are there examples of successful self-regulatory initiatives in respect of investment disclosures or point of sale regulations?

55. It is worth noting there are different levels of market solution in the UK, from complete non-intervention through to trade body guidance endorsed by us.
56. We conduct market failure analysis and cost benefit analysis before introducing any provisions. We do not introduce requirements (unless required to do so by UK legislation or EU directives) unless there is evidence of a market failure that market forces cannot address adequately and the benefits of increased regulation outweigh the additional costs that it will generate. There are many instances where we have not imposed regulation as market forces are seen to be sufficient to reduce consumer detriment satisfactorily. Examples of market solution seen in the UK include the following:
- In line with MiFID, we have simplified our rules for investment products and set them at a high level. For example, we now do not specify which risk warnings must be included for different products. We only specify that firms must disclose appropriate risk warnings and that, where benefits are discussed, the relevant risks are given equal prominence. Similarly, our general insurance Handbook has recently been amended to take a simplified and more principles-based approach (see [Consultation Paper 07/11](#)). Both of these examples show situations where we believe the market is able to function adequately when steered by high-level rules.
 - Another relevant FSA initiative relates to industry guidance. We will consider confirming industry guidance if we agree that it applies adequate standards and meets the requirements in our rules (see [Policy Statement 07/16](#)). Industry guidance is information created, developed and freely issued by a person or body, other than the FSA, which is intended to provide guidance from the body concerned to the industry about the provisions of our Handbook. This guidance may take various forms, including case studies, questions and answers, factsheets and detailed guidance on one way in which firms might meet the high-level requirements in specific situations.
- If we confirm industry guidance it means we will regard firms correctly following such confirmed guidance as complying with the relevant Handbook rule. But we will not treat failure to comply with such guidance as indicating the firm has necessarily breached that rule, as in many cases there will be more than one way to comply.
- There is also a role for firms to give feedback when they encounter bad practice in competitors. As an example, we have a telephone hotline and online feedback form for firms and consumers to [report misleading financial promotions](#).
 - Another example of a potential market solution is seen in one of the suggestions put forward in our Retail Distribution Review for trade bodies to take a more active role in improving adviser professionalism.
57. In all of these instances, firms have a role in enabling regulation to achieve its intentions. The industry has a key role in raising market standards, particularly under a principles-based regime.

Are there any constraints to their effectiveness and/or enforceability?

58. Trade bodies and other market participants have a role in enabling high-level regulation to function properly, but this does not replace our role. There is always a place for regulators to monitor the market and to enforce against breaches.
59. While market forces may correct some market failures at one time, there is no guarantee they will continue to do so. It is necessary to review the situation regularly to check problems do not re-appear.

Are you aware of effective national approaches to tackle the issues identified in this call for evidence? Should it be left to national authorities to determine the best approach to tackling this problem in their jurisdiction? Is there a case for EU level involvement? Please explain.

60. We believe our approach in the UK national regime tackles the issues effectively. At present we do not observe significant scope for regulatory arbitrage.
61. Different issues arise in different jurisdictions (seen in the different markets in Annex 2 Section B2 of the call for evidence) and cross-border markets for retail investments other than UCITS funds are not large. So we believe it is more proportionate and appropriate for national authorities to determine the best approach to tackling problems in their own jurisdiction. This allows authorities to be more sensitive to the specific needs of their markets.
62. In line with the Better Regulation initiative, regulation should only be introduced after research to quantify the market failure. Regulation should be proportionate to the identified problems and the benefits of additional regulation should outweigh the costs to avoid introducing regulatory failure to the market. Any future consideration should also look to build on existing EU standards as far as possible (including MiFID), rather than creating another separate regime that would require firms to alter recently implemented changes, potentially creating new distinctions that may create new potential for arbitrage. Part of this process should involve post-implementation reviews of MiFID to ensure it is working as intended and provides a good framework on which to build.
63. While it may not be appropriate for prescriptive rules at EU level, there may be more of a case for principles setting out at high level the outcomes that should be met. These would still give firms flexibility when meeting requirements and allow national regulators to tailor their response according to market needs (particularly if any new requirements are not maximum harmonising). There is a potential role for Level 3 work in this area, giving guidance and helping to achieve greater EU-wide consistency.

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