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Report of the 3L3 Task Force on Packaged Retail Investment Products (PRIPs)

Contents

Executive Summary

1. On 30 April 2009, the European Commission published a Communication on Packaged Retail Investment Products (PRIPs), in which it committed to develop a common level of consumer protection for packaged retail investments[1]. This would be delivered by a 'horizontal approach' regarding pre-contractual product disclosures and selling practices for PRIPs.

2. The Communication provided that PRIPs could 'take a variety of legal forms which provide broadly comparable functions for retail investors':

   - 'They offer exposure to underlying financial assets, but in packaged forms which modify that exposure compared with direct holdings';
   - 'Their primary function is capital accumulation, although some may provide capital protection';
   - 'They are generally designed with the mid- to long-term retail market in mind'; and
   - 'They are marketed directly to retail investors, although may also be sold to sophisticated investors.'

3. PRIPs were grouped into four indicative 'product families' for the purposes of the Communication:

   - investment (or mutual) funds;
   - investments packaged as life insurance policies;
   - retail structured securities; and
   - structured term deposits.

4. With regard to pre-contractual product disclosures, the Communication provided that the recent work on developing a Key Investor Information document (KII) for UCITS provided 'a clear benchmark of the standard for mandatory disclosures…, though these disclosures would need to be adjusted to reflect the particular features and legal forms of other products.'

5. With regard to conduct of business and conflicts of interest provisions, MiFID was considered by the Commission as a clear benchmark which would form the basis for a common PRIPs sales regime.

6. Since the April 2009 Communication, the three Level 3 Committees (CEBS, CEIOPS and CESR) have worked to develop their thinking on this subject with a view to providing input to the Commission in the further development of its proposals. The first output of the Level 3 Committees work was the joint submission of three sectoral reports to the Commission on 18 November 2009. It was in this context that the Level 3 Committee Chairs agreed on 17 November 2009 that, in order to reach

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

a common position across the Level 3 Committees, and recognising the inherently cross-sectoral nature of the PRIPs workstream, a joint Level 3 Task Force on PRIPs should be established.

7. In conducting this work, the Task Force has focused on three central areas:

   - the scope of the PRIPs regime;
   - the product disclosure requirements for PRIPs; and
   - the regulation of their selling practices.

8. Throughout this paper, we use terminology based on the Commission's communications on the PRIPs project. We refer to the firms that produce PRIPs as manufacturers, firms that sell PRIPs as distributors and PRIP customers as investors (irrespective of the nature of the product).[2]

9. In the future, when reviewing relevant directives (e.g. IMD and MiFID), the Task Force believes the Commission should take account of the future PRIPs regime and, as far as appropriate, seek consistency between the different sets of rules.

10. In the interests of harmonisation and to avoid the potential for regulatory arbitrage, some Task Force members believe any modification to the conduct of business regime for MiFID financial instruments which are PRIPs should also be introduced for non-PRIP MiFID financial instruments.

11. It is recognised that the PRIPs regime would be easier to enforce if regulator competences and powers[3] were harmonised across the European Union, so that all products are subject to equivalent regimes as regards their structure and their marketing.

Scope

12. A majority of Task Force members agreed with the following definition for PRIPs, developed by the Task Force:

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

13. A minority of Task Force members considers this definition to be too broad (see also paragraphs 48 and 49 below) and suggests rephrasing some of its elements, as to take into account the level of investment risk and the principle of proportionality in the scope of the future PRIPs regime.

[2] These terms are used even where the firm is a natural person, as may be the case for insurance intermediaries and smaller investment intermediaries. In direct sales, the manufacturer may also be the distributor: here the different terms are used depending on the type of activity being performed (e.g. the firm is a manufacturer when creating the product or providing product disclosure documents and the distributor when selling the product).

[3] One Task Force member would have preferred the reference to "regulator competences and powers" to be replaced by "rules".

14. The Task Force collected some ideas on whether or not some kinds of pension-related products (especially when concluded by private individuals) could and should be covered by the PRIPs regime. However, the Task Force recognises that focused work on pensions is being undertaken by CEIOPS and the Commission. Considering this, it is suggested that pensions (and annuities) are left out of PRIPs scope for the moment.

15. There were different views[4] in the Task Force over whether all with-profits life insurance/traditional life insurance products should be in scope or not. In particular, it is important to note that, although products are sold in different Member States under these labels, they cover a wide variety of products and present different characteristics in different States. The Task Force recognised that this was a very complex issue and that further work would be required on this issue in the future.

16. The Task Force has considered the pros and cons of using a non-exhaustive white list of products that should be regarded as PRIPs to complement a legal definition. A majority of the Task Force can see the value of such a list. Other Task Force members have nevertheless pointed out some concerns regarding the use of a list.

Product disclosure

17. The Insurance Directives, the IMD, the Prospectus Directive, the UCITS Directive and MiFID all contain existing standards and specific requirements on the content and the presentation of product disclosure information. These should be taken into account in developing any common regime for PRIPs (e.g. in order to avoid overlapping provisions).

18. The Task Force agrees that, in principle, the concept of Investor Information provided through a Key Investor Information (KII) document, as developed for UCITS, could usefully be applied to PRIPs. However, the detail of the information that would be contained in such a document would not cover precisely the same areas as the KII template for UCITS, since some information is specific to UCITS.

19. In addition, for PRIPs that are admitted to trading on a regulated market or issued in form of securities offered to investors, it will be important for KII product information to be appropriately aligned with the information made available to investors through the required Prospectus and Summary Prospectus or Simplified Prospectus.

20. A very important purpose of pre-contractual disclosures is to contribute to investors making informed investment decisions by focusing on key information. The disclosure should be fair, clear, and not misleading. The format and language should be investor-friendly and presented in a manner which allows for comparison between products. The main objectives should be that the document is sufficiently appealing, concise and clear to encourage retail investors to read it before making a decision.

[4] Some Task Force Members were of the view that, regarding this issue, rather than referring to "different views", majority and minority opinions on this issue should have been inserted in the final report, but this did not occur due to the complexity of the issues involved and the sheer diversity of with-profits life insurance products across the EU, making it difficult to reach a clear position on this issue.

21. The legal requirements on the pre-contractual disclosure should be guided by common principles, supplemented where necessary by detailed requirements (developed at a level other than Level 1). A certain amount of tailored information will also be required by investors for some types of PRIP.

22. The Task Force also discussed the allocation of responsibilities between the manufacturer and distributor. In general, the majority of Task Force members believe that the product manufacturer should be responsible for producing the KII, and distributors should be responsible for delivering it to the investor.

23. The Task Force has considered whether the KII should be subject to prior approval by a competent authority. The majority of the Task Force does not support prior approval. Aside from the administrative burdens and possible timing delays this approach might involve, prior approval may shift the responsibility of contents of the KII from the product provider to the competent authority. Furthermore, for insurance products, systematic prior approval is not currently allowed under the Life and Non-Life Directives or under Solvency II.

Selling practices

24. The Task Force considered a number of areas where the PRIPs regime is likely to set requirements for the distribution of PRIPs. Its approach has been to take existing MiFID Level 1 provisions as the benchmark, while recognising existing provisions in the IMD and other specificities of insurance and deposit-based PRIPs. The focus of these discussions was primarily on the most difficult areas of selling practices, in order to provide the greatest assistance to the Commission.

25. The Task Force has considered whether there is merit in extending the MiFID client categorisation regime to PRIPs that are not currently covered by the same approach. However, as the PRIPs requirements would only be applicable when a product in the scope of the regime is to be sold to retail investors, the Task Force therefore considers that MiFID-style client categorisation will not add much value for insurance-based PRIPs.

26. The MiFID regime acknowledges that fundamental regulatory requirements are applied to all firms but that the measures firms adopt to comply with these requirements must be designed in a way that is best suited to the firm's particular nature and circumstances. This proportionality principle is also present in the spirit of the IMD. The Task Force believes that this principle is a very important concept and should apply across the PRIPs regime to ensure a smooth implementation of its principles and rules, by providing flexibility according to the size, structure, complexity and nature of different firms and markets. However, Task Force members believe that from an investor's point of view the same information and standards of behaviour are required regardless of the nature of the distributor.

27. At this stage, it does not appear that the high-level principles on conflicts of interest would need to be changed or adjusted in order to be applied to PRIPs outside MiFID scope. However, some Task Force members expressed the view that, in some situations, disclosure of conflicts of interest (where conflicts cannot be managed in such a way

that the firm is reasonably confident that the conflict will not lead to investor detriment) may not be sufficient. In some cases, avoidance of the action leading to the conflict may be more appropriate than disclosure.

28. The Task Force suggests a definition of advice for the purposes of the PRIPs regime as follows:

A personal recommendation to an investor, either upon their request or at the initiative of the distributor, for a specific investment that is presented as suitable for that person, or is based on a consideration of the circumstances of that person.

29. There were divergent views on whether advice (as defined above) may be given if an investor does not disclose all relevant information about himself.

- The majority of the Task Force considers that, in this situation, advice should not be given. Where advice is provided, they believe that it must be suitable. Without knowing all relevant facts, it is possible that the advice is unsuitable. Unsuitable advice would result in mis-selling and the regulatory system should not countenance this.

- A minority of Task Force members considers that advice can always be given, even if the investor chooses not to disclose all relevant information. In these cases, the advice may be based on the information that is known and the suitability standard should only be considered in relation to those facts. However, distributors are required to warn the investor of the limits of the advice provided and may choose to refuse to provide advice.

30. There were differing views on transactions that do not fall within the definition of advice in paragraph 28 above.

- The majority of the Task Force agreed that it should, in principle, be possible to sell some PRIPs on a non-advised basis. They consider that investors who are able to make their own decisions should not be materially disadvantaged by being obliged to seek advice and having to pay higher charges for that advice. Some examples of situations where the transaction is on a non-advised basis are described in the report.

- A minority of Task Force members pointed out that their national implementation of the IMD means that insurance products – including some products that would fall within the PRIPs regime – can currently only be sold with advice[5] and insurance intermediaries are always obliged to assess the demands and needs of potential policyholders. In cases where the investor refuses to provide all relevant information, the distributor is still allowed to advise the investor based on the information received from the investor and/or on other elements available to the distributor. Nevertheless, the distributor must warn the investor of the limits of the advice and can also refuse to sell insurance

[5] N.B. This is not the same concept of "advice" as referred to in the definition of advice proposed for PRIPs in paragraphs 28 and 145 or in the definition of advice under MiFID.

products. According to this minority's view, the IMD currently provides the same regime for all sales of insurance contracts.

31. If the MiFID appropriateness regime were taken as a benchmark, there is a general expectation that most PRIPs are likely to be classed as complex products, but it was felt that more work should be done at Level 2 to determine the criteria on which this classification should be made.

32. The majority of the Task Force members believe that the PRIPs regime should specify what inducements are compatible with the general duty to act honestly, fairly and professionally in accordance with the best interests of its clients. Inducements should cover all payments (such as fees, commissions or non-monetary benefits) made to the distributor. However, a minority of the Task Force members considers MiFID provisions on inducements to be inconsistent with the distribution of insurance products by agents or other insurance intermediaries who act under a working or cooperative relationship with insurance undertakings.

Section 1: Scope

Definition and general approach to defining the scope of the PRIPs regime

33. The 3L3 Task Force has considered how best any future EU legislation might define the range of instruments that should be considered as PRIPs, and also whether a definition including general criteria for PRIPs instruments could usefully be supplemented by a non-exhaustive list of specific types of products that would be regarded as PRIPs.

Criteria to define a PRIP

34. In its issues paper for the Technical Workshop held in October 2009,[6] the Commission proposed conditions to be fulfilled by a PRIP, which included:

    (a) PRIPs expose consumers to the performance of assets or other financial measures indirectly – through other mechanisms than a direct holding of the assets or exposure to the financial measure by the consumer;

    (b) PRIPs serve a purpose of capital accumulation; and

    (c) investors in PRIPs bear the investment risk fully or partially.

35. In its Update paper of 16 December 2009,[7] the Commission underlined that it still considered that the definition of PRIPs should be based on these three broad elements, each of which must be satisfied for a product to be considered a PRIP, and presented them in these terms:

    (i) an element of packaging;

    (ii) a product capable of meeting an investor need for capital accumulation; and

    (iii) a product that creates exposure to investment risk for the investor.

36. The Task Force has considered these features further, alongside various related questions the Task Force identified for its own work.

Packaging and investment risk

37. The Task Force considers it crucial to have a cross-sectoral definition of 'packaging' that can apply to different products in different sectors (e.g. securities, banking and insurance) and can be sufficiently clear to avoid legal uncertainty and risk of regulatory arbitrage.

38. According to the Commission, 'packaged' products are those that expose investors to the performance of assets or other financial instruments

[6] http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/2009-10-22_prips_en.pdf

[7] http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/20091215_prips_en.pdf

indirectly, through other mechanisms than a direct holding[8]. This definition does not capture the link between the performance (negative or positive) of the underlying assets or reference values that are combined in the PRIP and the related payout for the investor. Task Force members consider that this link is the key element from the investor's perspective[9]. This is because the direct or indirect investment risk borne by the investor (either wholly or in part) through the PRIP depends on the fluctuation of the market value, or returns generated by, the underlying assets combined in the PRIP (or, to put it another way, according to a majority of Task Force members, the 'payout' return to the investor from the PRIP, as is the case for asset-backed securities where payouts depend on the stream of cash flows from the underlying assets).

39. A PRIP investor is exposed to other assets or reference values through other mechanisms than a direct holding of the assets. The Task Force agrees that the *indirect* holding mechanisms should include, but not be restricted to, the combination of other assets and the wrapping of a single asset. The Task Force explored the possibility of limiting the PRIP definition to the products which result from the combination or wrapping of other assets (or single asset), which would include UCITS and unit-linked insurance policies within the PRIPs regime. But the Task Force felt that, in the non-insurance sectors, it was not clear that many products which have gone through a structuring process, such as structured notes, or structured deposits, would be covered by such a limited definition.

40. The Task Force also considered how these concepts might apply to products within the insurance sector (see also paragraphs 82 to 88 later).

41. A majority of Task Force members is of the view that, where a product exposes the investor either to direct or indirect investment risk, it should be treated as a PRIP. Those Task Force members are of the view that this risk is not limited to the investment return on, or the profits emerging from, a specified investment or reference value, but may be in relation to the overall profitability of the business of a life assurance firm itself (for example, in the case of a mutual firm). Furthermore, profits or return mean not just the investment return on assets but also profits and losses in relation to other elements of an investment fund – for example mortality profits and losses in the case of some life funds. Using these criteria, according to these members, with-profits and traditional life insurance products might be classed as PRIPs (though life assurance products where the purpose is solely to provide protection – for example, on death – should be outside PRIPs scope).

42. Other Task Force members find the view expressed in paragraph 41 too broad/general. They believe that in order to include a life insurance contract within PRIPs scope, it is necessary to consider whether the market value of the underlying assets determines the value or the return on the policies, so that the policyholder is exposed to the fluctuation of the market value of these assets. Other variables (like participation in

[8] However, it is important to note that a legal definition will most likely need to further clarify this concept of an 'indirect holding' more clearly.

[9] For some Task Force members, the existence of a direct link is crucial, while for others the link does not need to be direct.

technical profits or to profits realized by the insurance undertaking in performing insurance activity) that do not expose the investor to an investment risk should not be considered as criteria to define whether the insurance contract is a PRIP. According to this view, with-profits and traditional life insurance products should not be classed as PRIPs. For more discussion on with-profits and traditional life products see also paragraphs 82 to 88.

43. As a consequence of the indirect holding mechanisms, the amount payable to the PRIPs investor (including periodic income and/or final payout), and therefore the investment's value, is exposed in some manner to the fluctuation of the market value of the underlying assets (market risk). This exposes the investor to the consequent investment risk and determines the uncertainty about the payout for the investor.

44. The Task Force agrees that investment risk should be understood as the uncertainty about the amount payable to the PRIPs investor (including periodic income and/or final payout) due to the fact that this amount depends on the fluctuation of the market value of other assets.

45. European legislation for the insurance sector (for example the Consolidated Life Directive and Solvency II) already includes a clear concept of 'investment risk borne by the policyholder': the investor bears the investment risk because the market value of the underlying assets is used to determine the value or the return on the product that will be paid to the investor. So, one view supported by some Task Force members is that in considering the concept of 'investment risk' for the purposes of PRIPs, existing definitions should be taken into account in order to avoid the introduction of a new notion of 'investment risk borne by the investor' that is inconsistent with the legal concept already existing in other European legislation. Other Task Force members, however, take the view that these references only relate to prudential issues and so are not relevant to PRIPs.

46. Further, a minority of Task Force members suggest that the level of investment risk should be considered in deciding the scope of the regime and that the principle of proportionality should be taken into account. According to this view, one must differentiate between those products where investment risk is a core component from others where such risk is, for example, marginal when compared with other components of the product, such as specific insurance elements (e.g. mortality or expenses) or a guaranteed element. A majority of Task Force members do not support this approach because they suggest it would be a difficult approach to apply and could potentially lead to regulatory arbitrage.

<u>PRIPs definition</u>

47. Taking into account the previous conditions, the Task Force has developed the following definition for PRIPs (though, as indicated, there is no consensus on all elements of this definition (see paragraphs 48 and 49 below):

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

48. A minority of Task Force members suggest rephrasing some elements of this definition in order to take into account the level of investment risk in the product (as expressed in paragraph 46 above). According to this view, products with only a marginal level of investment risk should not be caught by the definition. In the above definition, that minority of members prefer "substantially exposed" to "exposed". A minority of Task Force members also disagree with the inclusion of the reference to 'to payouts from assets', since they feel this makes the scope too broad and would capture, for example, some life insurance products whose risk profile does not justify inclusion.

49. Task Force members agree that the above-mentioned definition of PRIPs would (and should) exclude, for example:

- deposits in which the bank pays the investor a fixed and pre-determined interest rate, as they are not exposed to fluctuations in market value of other assets;
- life insurance policies, where the exact amount payable to the beneficiaries in case of death, survival or withdrawal is predetermined and fixed in the contract; and
- plain vanilla shares and bonds as there is no packaging of assets.

Other points on the definition

50. The Task Force discussed whether possible complementary elements could and should be added to the PRIPs definition and criteria.

'Retail' element

51. There was discussion of including a 'retail' element in the definition. That is, whether the intention to market PRIPs products only to retail clients is necessary for a product to be a PRIP.

52. There was a general consensus among Task Force members that incorporating the retail element within the legal definition is undesirable. Scope should not depend on whether a product was originally designed for retail customers or not. The PRIPs requirements apply only when products meeting certain conditions are to be sold to a retail customer. There is further discussion on this point in the selling practices section of this paper.

Combined sale of products

53. It is the view of the Task Force that the concept of packaging goes beyond the simple combined sale of products (including 'tied' products) where each product keeps its respective original features. In consequence, the Task Force believes that the simple combined sale of products should not lead to these products being regarded as PRIPs. A PRIP is a single product that assumes a packaged form, whereas a combined sale/offering results in a situation that should be tackled

within regulations applicable to commercial practices (e.g. 'bundling' and 'tying').

54. For example, where there is a separate sale of an ordinary deposit and a contract for differences (where the investor is effectively the depositor and the investor in the CFD), the deposit would not be subject to the PRIP regime. If the sale involved a structured deposit (that can be viewed as a combination of a deposit and CFD contract) the entire product would be a PRIP.

55. The Task Force believes that the eventual PRIPs approach should avoid the result that the simplest plain vanilla investments could fall within PRIPs scope just because they are sold together with other products.

Guarantees[10]

56. After consideration and discussion in the Task Force, the majority of the Task Force members believes that the concept of guarantees (whether capital guarantees or other kinds of guarantee) should not form a condition or part of the legal definition of a PRIP.

57. However, a minority of Task Force members takes the view that guarantees should be taken into account in the scope of the PRIPs regime because they regard guaranteed products as inherently less risky than products without guarantees. These members believe that some kinds of guarantees for some products, especially in the insurance sector due to the intrinsic nature of these products, provide additional safeguards for investors. They take the view that the presence of guarantees can justify the exclusion of these products from PRIPs scope when the following conditions are simultaneously met:

- the guarantee covers the capital at maturity, a minimum interest rate consolidated year-by-year and provides a guaranteed surrender value at any time;

- the cost of the guarantee is not calculated for the individual investor and is not paid by them alone but is borne by the insurer according to the mutuality principle (sharing the cost among present and future investors, including the individual investor).

58. The majority of Task Force members has however suggested that these criteria would not work because the investor will be exposed to investment risk regardless of the type of product. For example, these regulators would not wish to exclude a product that offers capital protection and a minimum of 0.001% of interest. In addition, for the securities sector, the adoption of this additional criterion could potentially exclude from the PRIPs regime certain products, such as structured notes issued by credit institutions, which are considered as partially meeting the two conditions in bullets above in paragraph 57, except that the capital and interest rate are not guaranteed in case of redemption before the maturity of the product. Thus, if capital guaranteed securities were excluded from the scope of PRIPs, simply because of this feature, it would create an unlevel playing field to the detriment of non-capital guaranteed products or a distortion in favour of 'capital guarantees', while some of the latter pose significant risks for

[10] The notion of "guarantee" is considered further under the "Product Disclosure" section.

retail investors or are difficult for retail investors to understand. There is a risk that, if partial guarantees are used as a criterion to exclude any type of product from PRIPs scope, this will allow firms to arbitrage the rules by including spurious partial guarantees in new products.

59. For the banking sector, the introduction of guarantees in the PRIPs definition would have major implications for the considerations regarding structured deposits. If the full capital protection feature were considered as an element to exclude products from the PRIPs scope, then the effect should be to take all structured deposits out of scope given the fact that deposits must be repayable. Furthermore, the existence of deposit guarantee schemes could imply that the deposits covered present a higher overall level of investor protection than other similar products without these guarantee schemes. If structured deposits were excluded from the scope on the ground that they provide a capital guarantee, the effect could be to create a distortion to the detriment of structured securities/notes and in favour of structured deposits.

Possible use of a 'white list' to complement the legal definition of a PRIP

60. The Task Force has considered the pros and cons of using a non-exhaustive white list of products that should be regarded as PRIPs to complement a legal definition. A majority of the Task Force can see the value of such a list.

61. However, it is recognised that there are risks that products marketed under the same 'label' often have different characteristics in different markets. In particular, insurance products with the same designation largely differ from Member State to Member State (e.g. with-profits policies or variable annuities). Therefore, the white list should not solely be based on the label/designation of the product, but should also be accompanied by some kind of description/ criteria to clarify which products with the same label are in scope.

62. The Task Force recognises that there would be challenges in keeping the list up-to-date, but that doing so would be important. The list must also be sufficiently flexible to accommodate future changes.

63. Effective harmonised regulation should be based on common issues/features and should cover the common "core market" of products for which risks are similar. It is better to look at the type of risk posed to the investor rather than just the product name.

64. The main advantages of using a white list are seen as:

- The current suggested legal definitions of a PRIP under discussion are quite high level and will raise questions of interpretation on the part of investors, firms, regulators and others, as to which particular products are intended to be caught by the criteria.

- Having a non-exhaustive list of products that fall in the PRIPs scope could assist:

    - investors in knowing where they can expect PRIPs protections;
    - firms in knowing when they must comply with the obligations applying to PRIPs;

- regulators in knowing how to apply the regime and how to answer questions about its scope;
- others (e.g. Ombudsmen, consumer groups, industry groups) who need to know to which specific products the regime applies when they are handling particular cases; and
- overall would help in the creation of a level playing field.

- For these reasons, a white list approach to supplement the legal definition should also minimize the scope for fundamental national differences in interpretation and resulting potential regulatory arbitrage.

- MiFID includes such a list in its Annex I of Level 1, which serves to confirm the scope of the Directive. It is indicative to the extent that it includes categories of instruments rather than every type of instrument. Where further clarity is needed, the Directive includes a definition of the category referred to – e.g. transferable securities or money market instruments. This approach could be followed for products where greater clarity is required as to which are to be treated as PRIPs.

- A further good example under MiFID, where a list has proved useful, is in respect of types of MiFID instruments that should be treated as non-complex or complex for the purposes of the MiFID appropriateness test. This exercise, undertaken by CESR, has been well received by the industry and other stakeholders, for the reasons given above.

65. A minority of the Task Force members sees the following disadvantages in using a list:

- It should be unnecessary because the stated criteria should define clearly what is to be included within the PRIP regime so that a product will be in or out of scope solely on the basis of those criteria.

- If the criteria do not catch some products, the products are out of scope and one ought not to force the criteria to include them.

- A list of products established in the EU legislation may not be flexible enough to accommodate product innovation, and could become outdated. The time taken for formal EU legislative procedures might restrict the ease by which a white list could be updated. For example, if it were proposed to amend the IMD and MiFID Directives to include PRIPs requirements, it may not be easy to update a list of instruments in an Annex to the Directives. However, the list could be elaborated at a level other than Level 1 so that it could be easily and quickly amended, when needed.

- In life insurance (and when compared to non-life insurance), the segmentation/division between types of products is not so clear (for instance, there could be different divisions depending on the purpose e.g. accounting vs. commercial approach). Building from a clear definition of PRIPs and adopted selected criteria, Member States should be able to identify which products in national jurisdictions fall into the concept of PRIP.

66. As an exercise into the feasibility of coming up with such a list, the Task Force discussed which products they would expect to see within scope.[11] There was unanimity that the following product types should fall within scope:

- structured products of all kinds (including structured deposits);
- UCITS;
- non-UCITS funds;
- unit-linked and index-linked life insurance policies.
- warrants (including covered warrants);
- asset-backed securities and other similar debt instruments;
- convertible shares and convertible bonds; and
- capital redemption operations linked to unit-linked investment funds

67. There were different views over how to treat the following products:

- derivatives[12];
- with-profits life insurance and traditional life insurance investment that have profit sharing;[13]
- variable annuities;
- hybrid life insurance products (combining, for example, unit-linked life insurance elements with investments in traditional insurance funds); and
- with-profits capital redemption operations[14]

68. And, for the following investment products a majority of Task Force members felt that the products should be out of scope:

- subordinated bonds;

[11] The development of this list has also taken account of the work already done by each Level 3 committee individually, and by the European Commission.

[12] Derivatives can be high-risk instruments, but retail investors can buy and sell them. Some TF members regard derivatives as meeting the PRIPs definition criteria. One Task Force member argues that derivatives do not meet the criteria to be regarded as packaged and should be treated more in line with stocks and shares. This member feels that most derivative instruments are not retail products and it may be dangerous in terms of investor perceptions to present derivatives in this way, as substitutable products for other retail investments. For this member, this is particularly true when the only gap in the existing regime covering derivatives seems to be the KII document. This specific gap could be rectified through a legislative change, if there is a good case for doing so and if the KII would deliver practical benefits for retail investors using these products.

[13] The later discussion of with-profits and traditional life policies (in paragraphs 82-88) is relevant here. It may be that only some forms of these products should fall in PRIPs scope and this should be reflected in any white list.

[14] Capital redemption operations linked to investment funds and with-profits are usually contracts issued by insurers that are issued for a fixed term.

- non-financial spread bets (e.g. sports spread bets); and

- traditional life insurance investment products without profits and pure protection insurance.

69. If a white list is to be used, therefore, there are certain product types for which there is wide agreement and others that are more controversial. In addition, it has been suggested that a white list could be elaborated at a level other than Level 1 to complement the legal definition that will be enshrined at Level 1.

Other points concerning PRIPs scope

Pension products and annuities

70. The Task Force collected some ideas on whether or not some kinds of pension-related products (especially when concluded by private individuals) could and should be covered by the PRIPs regime. The Task Force recognises that focused work on pensions is being undertaken by CEIOPS and the Commission.

71. In principle, certain kinds of pension scheme (e.g. personal plans based on UCITS) may be substitutable with PRIPs from an economic viewpoint. However, Task Force members decided not to consider whether pension products (including annuities) fall within the scope of the future PRIPs regime, and to allow national discretion to extend appropriate and similar standards to such products at the implementation stage, together with any additional necessary national measures. At the same time, the specificities of pension products distribution are to be addressed in specific, solely pension-focused initiatives such as planned IORP Directive review and the Green and White papers on pensions[15].

72. CEIOPS pensions experts have been working on this area and also following the progress of the 3L3 Task Force on PRIPs. As agreed, CEIOPS (and its successor body, EIOPA) will be continuing to further investigate the subject.

73. Considering the above, it is suggested that pensions (and annuities) are left out of PRIPs scope for the moment. Later on, taking advantage of other EU initiatives on pensions, more work might be carried out by CEIOPS (and EIOPA) to explore how a harmonized approach aiming at improving consumer protection at EU level in the pension sector, may be achieved (considering the fact that the future PRIPs regime should be taken into account).

[15] The Green Paper can be accessed here: http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=839&furtherNews=yes. The White Paper is expected in 2011.

Structured deposits and structured investment products

Structured deposits

74. The Task Force believes that structured deposits should be within the scope of PRIPs work, though with appropriate differentiation in how specific requirements apply in order to reflect the risks posed by structured deposits and structured investment products.

75. Unlike other investment products, deposits (including structured deposits) are considered a safe product by retail investors. Consequently, two aspects should be reflected in the future PRIPs regulation:

- the notion of structured deposits without capital protection should not be allowed – products that do not provide full capital protection are not deposits; and

- in spite of some similarities between structured deposits and other structured investments, it is beneficial to clients to clearly understand when a PRIP is a deposit and when it is another type of product.

76. For the purposes of the scope of the PRIPs work, the Task Force therefore proposes a definition of structured deposits along the following lines, in order to achieve a clear distinction between structured deposits and structured investment products:[16]

Structured deposit: a deposit that is fully repayable, on terms under which any interest or premium will be paid (or is at risk) according to a formula which involves the performance of (i) an index or combination of indices, excluding variable rate deposits whose return is directly linked to e.g. EURIBOR, LIBOR or another interest rate index; (ii) a MiFID financial instrument or combination of such financial instruments; or (iii) a commodity or combination of commodities; (iv) a foreign exchange rate or combination of foreign exchange rates.

77. Fixed rate deposits are therefore excluded from the definition of structured deposits (and, in consequence, excluded from PRIPs scope). Variable rate deposits should also be excluded from PRIPs scope as these are 'plain vanilla' products that follow the market interest rates – the link to money market indices should not be considered as an indirect exposure to the performance of assets or other financial measures (the same applies to Floating Rate Notes).

78. The Task Force also believes that a key consideration will be to establish a clear distinction between structured deposits and structured investment products. This is particularly important so that customers understand the different protections that apply for deposits and investments under EU legislation. Knowing whether a product is a deposit or an investment product is particularly important when products are 'passported' across borders and for the purposes of identifying applicable compensation cover under the Deposit Guarantee Schemes

[16] This definition is not designed as a supplement to the overall PRIPs definition but may prove useful (possibly along with definitions of other types of PRIPs) in clarifying the scope of application of requirements and the appropriate level of regulation for different product types. The definition also enables a distinction to be drawn between structured deposits and other types of structured product.

Directive. For the latter reason, the definition of structured deposit for the purposes of the PRIPs work should ideally be consistent with the definition of deposit under the Deposit Guarantee Schemes Directive.

79. Additionally, non-deposit structured products present higher risks for investors than structured deposits. In fact, whereas the capital invested in other structured investment products may be (all or partially) lost as a result of the performance of the underlying variables, in structured deposits at least the initial capital deposited should be repaid after an agreed period. This difference in risks should be immediately perceived by investors by being clearly disclosed in the pre-contractual information.

80. Generally, 3L3 Members' domestic regulatory frameworks distinguish between structured deposits where the initial capital deposited must be repaid after an agreed period and structured products where the initial capital invested may not be returned in full. The Task Force believes that this distinction can be a useful one in distinguishing structured deposits and other types of structured product.

Structured investment products

81. Structured investment products meet the criteria to be considered as PRIPs:

- they expose consumers to the performance of assets or other financial measures indirectly;
- they serve a purpose of capital accumulation; and
- investors bear the investment risk fully or partially.

With-profits and traditional life insurance products

82. There is general agreement that unit-linked and index-linked life insurance policies should be included under the PRIPs scope because they share common features with the typical retail investments of the securities and banking sectors. However, the following products were considered as products which deserve closer examination and further discussion by the European Commission in the PRIPs Industry Workshop held in Brussels on 22 October 2009:[17]

- non unit-linked/index-linked life insurance such as with-profits life insurance/endowments; and
- traditional life insurance products.

83. As already indicated, there were different views in the Task Force over whether all with-profits life insurance[18]/traditional life insurance products, should be in scope or not.

[17] http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/2009-10-22_prips_en.pdf

[18] Within Europe, the terms 'with-profits' and "traditional life insurance products" cover many different types of policies, whose features vary significantly across Member States. The term 'with-profits' focuses on a common element: all these policies usually offer to the policyholder a participation in the

84. Although with-profits life insurance/traditional life insurance products share the same name, there are large differences in product characteristics from Member State to Member State. Among others, the differences include the following:

- The source of the profits: in some States the profits are 'financial profits', since they arise from the assets in which the insurance undertaking has invested the premiums, while in other States they are 'technical profits', since they arise from the positive result of technical items (such as the death hypothesis or expenses hypothesis); in some other Member States they are a mix of technical as well as financial profits as they arise from the overall performance/profit of the insurance undertaking itself in a specific period.

- The treatment of the profits already assigned: in some States the profits assigned year-by-year are permanently allocated to the policyholder, even in the case of early surrender; while in other States they are not consolidated at all or not consolidated in this manner.

- The treatment of the sum payable in case of surrender (or withdrawal): in some cases the policyholder has the right to receive the accumulated profits, while in other States the surrender value is not guaranteed (so that the insurer can decide not to pay or to pay a reduced sum if, at that time, the financial position of the company is weak).

85. Given these differences in products around Europe, it is necessary to consider both the definition and the criteria for inclusion of a product within scope (not only investment risk but the other factors, including packaging). The Task Force also recognises that this is a very complex issue and that further work will be required on this issue in the future.

86. In discussing the treatment of these products, there were <u>two</u> broad sets of views[19]:

87. A number of Task Force members believe that the scope of PRIPs should also cover insurance products other than unit-linked and index-linked life insurance policies. Under this view, where a product has either direct or indirect investment risk for the investor, it should be treated as a PRIP. This is because, among other things:

- This risk is not limited to the investment return on, or the profits emerging from, a specified fund or reference value, but may be in relation to the overall profitability of the business of a life assurance firm itself (for example, in the case of a mutual firm).

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profits realized by the insurance undertaking in performing its insurance activity. This means that these policies usually offer to the policyholder a surplus or an extra gain in respect of the initial assured benefit that the insurer is committed to pay in respect of the premium paid by the policyholder (a benefit that is calculated on the basis of demographic and financial hypotheses).

[19] Some Task Force Members were of the view that, regarding this issue, rather than referring to "different views", majority and minority opinions on this issue should have been inserted in the final report, but this did not occur due to the complexity of the issues involved and the sheer diversity of with-profits life insurance products across the EU, making it difficult to reach a clear position on this issue.

- Furthermore, profits or return mean not just the investment return on assets but also profits and losses in relation to other elements of a fund – for example mortality profits and losses in the case of some life funds. With-profits and traditional life insurance, judged against these criteria, may be PRIPs (though life assurance products where the purpose is clearly to provide protection – for example, on death – should be outside PRIPs scope).

- In some Member States, with-profits policies are structured in such a way that they present the same type of characteristics as unit-linked life insurance policies[20] and they are thus regarded by investors as substitutable with unit-linked life insurance policies. There are therefore significant benefits from an investor protection point of view in including these products in scope and it would also prevent regulatory arbitrage.

88. A number of other Task Force members believe that the general characteristics of these products - as they exist in their markets - mean they should not be within scope:

- Even if with-profits/traditional life insurance policies vary across Member States, they share a common feature: the policyholder does not bear the investment risk, because there is no direct and linear correlation between the fluctuation of the market value of the assets in which the insurer has invested the premiums and the amount or return of the policy.

- In these policies, in comparison to unit-linked and index-linked life insurance policies, the premiums collected by the insurer are invested by the insurer in order to have the financial resources to cover contractual obligations for policyholders. The market value of the underlying assets is not used to determine the value or the return on the policies.

- There is no risk of regulatory arbitrage if with-profits/traditional life insurance products are excluded from PRIPs scope, since the assets underlying these products are held on the insurance company's balance sheet.

- From the investor's point-of-view, these policies are perceived as savings products. National experience shows that the discretionary profit an investor may receive on top of guaranteed returns does not play any role in leading the investor to decide to buy such a policy. The possibility of receiving discretionary profit is not used in marketing these products to investors.

- Generally, with-profits/traditional life insurance policies can be better compared to plain-vanilla shares (which are clearly out of PRIPs scope) in the way that dividends are decided for shareholders and discretionary profits for policyholders or to non-structured banking deposits (which are also out of scope) because they offer a fixed return interest rate.

[20] For example, in some Member States, with-profits offer a 0% guaranteed interest rate and the focus is rather set on the return produced by assets isolated in a segregated account. In this type of policy, the investor gets the right to participate in the return gained on those assets.

Section 2: Product Disclosure

89. The Task Force has considered the desirable common features of a regime for pre-contractual disclosure of information about all PRIPs products to investors or potential investors.

90. The Insurance Directives, the IMD, the Prospectus Directive, the UCITS Directive and MiFID all contain existing standards and specific requirements on the content and the presentation of product disclosure information. These should be taken into account in developing any common regime for PRIPs (e.g. in order to avoid overlapping provisions)

91. The Task Force agrees that, in principle, the concept of Investor Information provided through a Key Investor Information (KII) document, as developed for UCITS, could usefully be applied to PRIPs. However, the detail of the information that would be contained in such a document would not cover precisely the same areas as the KII template for UCITS, since some information is specific to UCITS.

92. The detail of information (and the level of detail) to be included for different types of PRIP should be developed further at a level other than Level 1 of the EU legislative framework. In developing specific requirements, it will also be important to adhere to the principles of proportionality and materiality. Disclosure should be a concise body of relevant (and comparable) information which can be understood by the investor and does not overwhelm or confuse the investor with too much information. Specific suggestions on the possible content of such core information are set out below[21].

93. In addition, for PRIPs that are admitted to trading on a regulated market, or issued in the form of securities offered to investors, it will be important for KII product information to be consistent with the information made available to investors through the required Prospectus and Summary Prospectus or Simplified Prospectus. Following the revision of the Prospectus Directive it will be important to ensure appropriate harmonisation between the PRIPs KII and Prospectus KII. Moreover, it is suggested that the KII should be tailored to the specificities of each tranche or issue within a programme.

A common framework

94. A very important purpose of pre-contractual disclosures is to contribute to investors making informed investment decisions by focusing on key information. The disclosure should be fair, clear, and not misleading. The format and language should be investor-friendly and presented in a manner which allows for comparison between products. The main objectives should be that the document is sufficiently appealing, concise and clear to encourage retail investors to read it before making a decision.

95. The legal requirements on the pre-contractual disclosure should be guided by common principles, supplemented where necessary by detailed requirements (developed at a level other than Level 1). A

[21] One TF member would have preferred the TF report to set out further detail on the content of the PRIP KII.

certain amount of tailored information will also be required by investors for some types of PRIP.

96. The precise responsibilities of product manufacturers and distributors are likely to depend on the particular actual roles or functions undertaken by a firm in the product lifecycle. It may also be possible for a firm to act as both manufacturer and distributor at the same time in respect of certain products. However, in general, we can state that:

- product manufacturers will typically develop, manage or package products; and

- distributors will cover those persons who then make up the rest of the supply chain taking the product or service to the investor. This could include, for example, investment firms, financial advisers, credit institutions, insurance companies, insurance intermediaries or tied agents.

97. As a general framework, the majority of Task Force members believe that the product manufacturer should be responsible for producing a KII, and the distributor should be responsible for delivering the KII to the investor. The Task Force recognises that this approach may raise questions of enforcement/redress when a product manufacturer is outside the EEA or where the legal issuer of a product is an unregulated entity such as a Special Purpose Vehicle.

98. Regarding banking and insurance-based PRIPs, some Task Force members consider that the manufacturer should be responsible for the delivery of the KII because the manufacturer is party to the contract concluded with the investor. The distributor has an obligation to transmit a KII to the investor, but this obligation should arise from the contract between the manufacturer and the distributor. However, it is necessary to foresee exemptions and place the responsibility to deliver the KII on the manufacturer or jointly on manufacturer and distributor in cases of non-direct sales.

99. Task Force members are of the view that a distributor could only sell a PRIP to a retail investor if a KII is available. These issues will need to be considered further in developing the regime.

<u>Some questions identified about the production of KII documents for certain types of PRIPs</u>

100. For some PRIPs structures, questions may arise about how many KIIs need to be produced and which elements of the PRIP the KII(s) should cover. For example:

- an insurance product holding a number of funds;

- where one product wraps another (e.g. an insurance product holding a structured product);

- the underlying asset(s) was not intended to be sold standalone to retail investors but has been packaged for retail investors in a PRIPs wrapper.

101. The Task Force believes that the key principle is that the client must always receive the necessary relevant information about the underlying assets and the impact of the 'wrapper'/packaging (including e.g. the costs and charges of the underlying and the wrapper and how they work together). The detail of what this entails for different types of PRIPs should be developed at a level other than Level 1.

Tailoring

102. The Task Force has considered whether there is a need for some further responsibilities for the distributor (in addition to the delivery of the KII) to inform the manufacturer of investor-specific factors in the PRIP. This may be the case in particular for insurance-based PRIPs. Such factors may include e.g.

- specific investment funds chosen by the investor from a wide range available under the PRIP; or
- a particular rate of commission taken or other charging structure chosen;
- as well as relevant information about the investor's individual circumstances (e.g. age) which may determine the benefits provided by a life insurance-based PRIP.

103. Two approaches might be considered:

(a) The KII is a standard document reflecting the product's features and legal forms but which does not contain personalized information. The KII does not take into account the individual circumstances of the investor. As a result the distributor cannot be allowed to introduce any changes to the KII produced by the product manufacturer.

The distributor would have to collect information from the investor tailored to their situation (such as the investment amount, choice of unit-linked/underlying assets, costs or beneficiary clause) and to submit it to the product manufacturer. This proposal should be submitted and agreed by the product manufacturer.

(b) The KII is a document that recognises that different investor circumstances and investment choices will have an impact on the product itself. For example, an insurance PRIP might have a different charging structure depending on the investor's age, investment amount or fund choice. A fully standardised KII would need to cover all variables and would supply the investor with excess information, much of which would be irrelevant to the specific investor's needs. This would make it harder for investors to understand the information in the KII. So, for some PRIPs at least, the KII should be tailored where necessary. The product manufacturer should still be responsible for the content of the KII but the distributor will have a role in supplying investor details to the manufacturer to allow the document to be correctly tailored. The KII would remain a pre-contractual information document rather than a part of the distributor's advice or an individual proposal. However, the information included would be closely tailored to the investor's information requirements.

104. The Task Force's preference is for approach (a). A core standard KII should not contain personalised information about the individual investor. When a product has been tailored, this personalised information should be provided alongside the KII but in a supplementary contractual document or annex at the point-of-sale. The personalised information could be:

(i) produced by the product manufacturer on the basis of investor information obtained by the distributor;

(ii) approved by the product manufacturer on the basis of investor information obtained by the distributor; or

(iii) produced by the distributor using IT systems or software developed and provided or approved by the product manufacturer.

The Task Force members are of the view that detailed specific requirements to accommodate these points should be developed at Level 2.

Prior approval of KII by competent authority

105. The Task Force has considered whether the KII should be subject to prior approval by a competent authority. The majority of the Task Force does not support prior approval. Aside from the administrative burdens and possible timing delays this approach might involve, prior approval may shift the responsibility of contents of the KII from the product provider to the competent authority. Furthermore, for insurance products, systematic prior approval is not currently allowed under the Life and Non-Life Directives, nor under Solvency II.

106. However, a minority of Task Force members is in favour of prior approval of KIIs by a competent authority[22].

Possible detailed product disclosure requirements

107. Task Force members have considered what specific common product information should be disclosed to investors about specific types of PRIP (e.g. on the insurance element of insurance-based PRIPs or on the issuer for securities-based PRIPs). The Task Force envisages that such detail would be developed through Level 2 measures to support common Level 1 high-level principles about product disclosure.

Suggested key common areas

108. One of the main functions of the KII is to aid the comparison of different PRIPs. Here, information requirements on some key areas are discussed, having the comparison issue in mind. At this early stage, the KII is assumed to provide information about the product only, not intending to include an individual proposal for the investor (as may be required for some life insurance PRIPs, for instance).

[22] A few members see a role of the competent authority to check whether, for securities products the KII is consistent with the prospectus. Two Task Force Members maintain that national competent authorities should be allowed to review or to approve the KII document according to applicable regulation.

109. Information in the following key areas might be presented for different PRIPs so as to aid comparisons:

- Essential information describing the product, including its investment objectives, explanations of how the product works and how its performance is to be achieved, a description of the structure of the product, an explanation of any guarantees that exist etc.

- An explanation of all relevant material risks and the probability of such risks crystallising. The Task Force notes that for UCITS, a harmonized quantitative volatility based risk rating is envisaged for the KII. When developing Level 1 principles for the PRIPs regime, it will be necessary to consider whether this concept is relevant for the KII of other types of PRIP. And, when developing Level 2 measures, it would need to be considered how this concept might be adjusted for other types of PRIPs, or how analogous risk ratings might be developed for other types of PRIP.

- Information about past/expected performance.

- An explanation of all costs on the product. The Task Force notes that for UCITS, a form of 'total expenses ratio' for costs taken from the fund is envisaged and, again, the Level 1 regime should determine whether this concept is relevant for other types of PRIP or whether a different method of disclosing charges is more appropriate. The Level 2 measures should consider how this concept might need to be adjusted for other types of PRIP.

<u>Description of the product, its structure and objectives</u>

110. Though the investor should get some basic information about the functioning of the product (including the investment policy) it is even more important to give clear information about the consequences of the construction to the individual investor. In particular, the KII should stress the following features of the relevant PRIP in plain and concise language:

- a clear description of the objectives of the product, allowing investors to distinguish between the objectives and the means used to achieve them; for example 'capital accumulation with minimum return at the date of maturity as determined in the contract (or explicitly, minimum return exposed to an index such as CAC 40 at the date of maturity)', further information about insurance components (if any);

- how the invested capital/the premiums are used: the KII could simply state, for example, that a major part of the invested capital/premium is actually used for investment, but a portion is needed for the insurance component and for the costs as well – the relevant portions may depend on specific parameters, e.g. insurance sum and age; maybe modification necessary for hidden costs;

- the main underlying or the main categories of eligible financial instruments that are object of investment;

- a short summary of the investment strategy which shows how (or just that) the performance of the product depends on the underlying

investment, whether or not the investor has the power to control the investment and what the risks for the performance are – here, a reference to further information sources could be inserted (for example, for multiple unit-linked life insurance policies, there could be links to the different KIIs of the underlying funds on the manufacturer's or distributor's website);

- the features of the product that can affect the investment in case of redemption before maturity (such as restrictions regarding the availability of the accumulated capital during the contract and disadvantages/risks in the event the contract is cancelled early or not held until maturity); and

- where relevant, guarantees, their coverage, their conditions, limitations or consequences (for example, guarantees may affect the performance of the PRIP), should be clearly explained in the KII, with detail of these requirements developed at Level 2.

111. The description should be as standardized as possible. A glossary to the PRIPs regulation could provide for a uniform cross-sectoral presentation, or even standard text elements to support the comparison of different PRIPs and avoid confusion.

Risk

112. The Task Force believes that the most effective approach to disclosure about the risks associated with a PRIP, and the probability of them crystallising, is likely to involve a combination of some kind of overall risk rating and a narrative description.

113. The Task Force recognises that the harmonized quantitative volatility-based risk rating adopted for UCITS KIIs is based on the well-known statistical concept of (historic) volatility. In principle, this risk measure could be applied to all kinds of investment. However, the specificities of different types of PRIP have to be taken into account. The UCITS approach may work for those PRIPs whose performance is directly linked to underlying assets (the risk measure can be calculated for the linked assets), but in other cases the risk measure may need to be assessed differently (e.g. if the PRIP invests in a wide range of investment funds, it may be that the disclosure document should discuss different risk profiles based on a range of sample contract structures).

114. Since some PRIPs have a maturity date it may be that the risk measure could be complemented by an additional rating related to the required holding period of the product. This might help the investor compare products.

115. Where the product contains a specific risk due to its structure/construction, such as credit risk, counterparty risk, liquidity risk, or issuer risk, the KII should provide a narrative description, including the consequences in the event the risk occurs and the likelihood of it.

Returns and performance

116. Information on returns and performance may include information on past/expected performance (subject to further discussion).

117. The Task Force is aware that care is required in presenting past performance to ensure that it is fair, clear and not misleading, so that investors are able to compare products. Investors must be clear that past performance is not a good guide to future performance, and firms must not distort past performance data through unrepresentative or selective presentation of data and performance periods. Warnings will be required to ensure that investors appreciate the limitations to past performance data. However, the Task Force also recognises that, if appropriately caveated, the data are likely to be of more value than simply omitting past performance information.

118. Most Task Force members also recognise that it can be complicated to develop performance scenarios (whether for past or future performance) that aid rather than confuse the investor.

119. MiFID, the Insurance Directives and the UCITS Directive contain existing standards and requirements on the content and the presentation of performance information.

- For example, Article 185(5), Solvency II directive contains provisions relating to information the insurance undertaking may provide with respect to the "amount of potential payments". An insurer that wishes to present such figures has to prepare specimen calculations on the basis of three different rates of interest. The insurer must inform the policyholder in a clear and comprehensive manner that the specimen calculation is only a model of computation based on notional assumptions and that the policyholder shall not derive any contractual claims from the specimen calculation.

120. In the light of CESR's work on UCITS, annual past performance of accumulated capital (in percentages, net of all fees and other costs) may be presented in a bar chart. This presentation could enable the comparison of different PRIPs regardless of any individual parameters (such as invested capital or age). It may be that sample calculations for the life of a particular contract could be used to illustrate the impact of guarantees and the risk.

Costs

121. At Level 1, it should be required that KIIs for PRIPs provide information about all relevant costs to enable comparisons to be made between different PRIPs. This should include entry costs, ongoing costs and total costs (and the ratio of total costs involved in the PRIP – similar to the 'total expense ratio' required for UCITS). Further detailed requirements, and sectoral specificities, should be developed at Level 2.

122. It should be clear to the investor that (and how) fees and other costs (including front end and other entry fees) reduce the return on the investment.

Disclosure of information about insurance-based PRIPs

123. Product disclosures for insurance-based PRIPs need to take account of the products' specificities. It is necessary to consider how a balance might be achieved through a horizontal approach to PRIPs disclosures which does not require irrelevant disclosures nor lose the insurance-specific information that will need to be disclosed for insurance-based PRIPs. At the same time, these insurance-related disclosures would not be appropriate for all PRIPs (e.g. information on the duration, sample calculation and benefits may not be relevant for all products).

124. Some of the essential information that investors need for insurance-based PRIPs is already required by existing EU insurance legislation (such as the CLD and Solvency II).

125. A non-exhaustive list of essential pre-contractual information for insurance-based PRIPs includes information under the following headings:

- the name of the contracting party;
- the name of the supervisory authority;
- the product category and main characteristics;
- the law applicable to the contract;
- expected benefits and payout method;
- example/sample calculation;
- risks of the product;
- information about any guarantee and identity of any guarantor;
- capital investment/fund composition;
- premiums (including current and total; method/frequency of payment);
- costs;
- duration of the contract and consequences of early termination; and
- security (e.g. in case of insolvency).

Product disclosure for structured deposits

126. In respect of structured deposits, the Task Force believes that certain disclosures should be specially considered under any future PRIPs regime. These are:

- information about the structure of the product, including how the return is calculated, the term of the deposit, the identity of the

deposit-taking institution and the identity of any 'guarantor' of the initial capital deposited;

- restrictions on the use of terms such as 'guaranteed' or 'capital protected', unless effective third-party guarantees or capital protections exist. Any limits to guarantees should also be clearly explained. Level 2 should also explain to what extent intra-group guarantees can be recognised. All this would be consistent with a high-level requirement for fair, clear and not misleading communications (and should apply to all products that are described as 'guaranteed' or 'capital protected');

- full and clear disclosure of any penalties, such as for early withdrawal, which could mean that a depositor does not get their full initial deposit repaid. When early withdrawal is not available this should also be emphasized in the product disclosures; and

- the PRIPs regime could also usefully seek to indicate that banks should move away from using names for structured deposits that could confuse investors by suggesting that the products are investments (such as 'bonds'). Similarly, the name 'deposit' should only be used relative to deposits and not other products, including products corresponding to a 'package' of a deposit and another instrument.

127. These points should address some specific investor detriment that could otherwise result in respect of structured deposits. Similar issues may arise in connection with some other types of PRIPs (including the use of third-party guarantees).

Section 3: Selling practices

128. The Task Force considered a number of areas where the PRIPs regime is likely to set requirements for the distribution of PRIPs. Its approach has been to take existing MiFID Level 1 provisions as the benchmark, while recognising existing provisions in the IMD and other specificities of insurance and deposit-based PRIPs. The focus of these discussions was primarily on the most difficult areas of selling practices, in order to provide the greatest assistance to the Commission.

129. In the future, when reviewing relevant directives (e.g. IMD and MiFID), the Task Force believes the Commission should take account of the future PRIPs regime.

130. In the interests of harmonisation and to avoid the potential for regulatory arbitrage, some Task Force members believe any modification to the conduct of business regime for MiFID financial instruments which are PRIPs should also be introduced for non-PRIP MiFID financial instruments.

Client categorisation

131. The MiFID regime presumes that some types of client have more knowledge or experience than others and requirements on firms dealing with those clients are generally lighter. Apart from the exemption foreseen in Article 12(4), IMD (regarding information duties and involving large risks and reinsurance), this Directive currently makes no distinction based on the client category. Furthermore, structured deposits are not currently subject to any directive requirements on sales practices[23].

132. The Task Force has considered whether there is merit in extending the MiFID client categorisation regime to PRIPs that are not currently covered by the same approach.

- Structured deposits: the Task Force considers that structured deposits can be sold to retail or professional clients. The MiFID client categories are therefore relevant for these products.

- Insurance-based investments: where insurance contracts are based on an individual life, the Task Force does not regard many situations as allowing the investor to be categorised as professional[24].

  Capital redemption policies are used by corporate entities in some Member States, but where this is the case they tend to be non-profit policies and so have no investment element in them.

[23] The European Commission has indicated (in its MiFID Questions & Answers) that products where the initial capital deposited could be at risk would be covered by MiFID. The Task Force takes the view that such products should not be regarded as deposits if they are not repayable in full.

[24] Some Task Force members consider that, in case some insurance contracts prove to be consistently sold to sophisticated investors (like large intermediaries directly doing business in the insurance sector), a MiFID-like client categorization could be taken into account.

Some Member States have very recently seen capital redemption policies being linked to unit-linked funds and sold to retail investors. Where sold to corporate entities, unless those entities trade regularly in these policies as part of their business activities, they might not possess the knowledge and experience necessary to be regarded as professional clients.

As the PRIPs requirements would only be applicable when a product in the scope of the regime is to be sold to retail investors, the Task Force therefore considers that MiFID-style client categorisation will not add much value for insurance-based PRIPs.

The best interests of investors

133. The foundation of the PRIPs regime and its central principle to ensure a higher level of investor protection should be that, in everything a firm does, it acts in accordance with its investor's best interests. All other outcomes flow from this general duty.

134. MiFID currently requires that each firm must 'act honestly, fairly and professionally in accordance with the best interests of its clients'. The Task Force does not think there are any circumstances in which it is acceptable for a firm to deviate from this standard and therefore regards this as a desirable provision for all PRIPs.

Proportionality

135. The MiFID regime acknowledges that fundamental regulatory requirements are applied to all firms but that the measures firms adopt to comply with these requirements must be designed in a way that is best suited to the firm's particular nature and circumstances[25]. This proportionality principle is also present in the spirit of the IMD. The Task Force believes that this is a very important concept and should apply across the PRIPs regime to ensure a smooth implementation of its principles and rules, by providing flexibility according to the size, structure, complexity and nature of different firms and markets. However, the Task Force also believes that, from an investor's point of view, the same information and standards of behaviour are required, regardless of the nature of the distributor.

136. Task Force members believe it is important to take into account the fact that, in the insurance sector, distributors are mostly natural persons and the future regime should reflect this characteristic.

Conflicts of interest

137. MiFID conflicts of interest provisions build on the principle that firms must act in the best interests of their investors. Allowing a conflict of interests to lead to the detriment of an investor is clearly a breach of this principle. The Task Force agrees that this holds true for all PRIPs.

[25] This is particularly relevant, for instance, in the cases of natural persons acting as intermediaries or small firms.

138. Investor protection requires, among other things, that conflicts of interest are identified, prevented or managed and – where risks to investor interests remain – disclosed.

139. In the way they are drafted, those requirements can be regarded as universal: they state the logical steps that a firm should take regarding conflicts of interest and thus, they appear to be readily and widely applicable to all PRIP distributors as well as to all PRIPs. This is further confirmed by the fact that MiFID is shaped to address firms of different sizes and levels of complexity.

140. At this stage, it does not appear that the high-level principles on conflicts of interest would need to be changed or adjusted in order to be applied to PRIPs outside MiFID scope.

141. However, some Task Force members expressed the view that, in some situations, disclosure of conflicts of interest (where conflicts cannot be managed in such a way that the firm is reasonably confident that the conflict will not lead to investor detriment) may not be sufficient. In some cases, avoidance of the action leading to the conflict may be more appropriate than disclosure.[26]

142. In any case there is a need for uniform standards to protect investors from the adverse impact that could arise from conflicts of interests between the selling entity and its clients.

143. When Level 2 measures are discussed in the future, to provide more detail on how these requirements will be applied to PRIPs, it will be necessary to consider how best to provide the right level of customer protection in each PRIP market. It may be that certain types of PRIP face particular issues that need to be taken into account in the provisions.

144. Although subject to further work, as noted above, the Task Force discussed a possible model for conflicts of interest provisions, based largely on MiFID. This is reproduced as Annex 1 to this paper.

<u>Advised sales</u>

145. The Task Force suggests a definition of advice for the purposes of the PRIPs regime as follows:

A personal recommendation to an investor, either upon their request or at the initiative of the distributor, for a specific investment that is presented as suitable for that person, or is based on a consideration of the circumstances of that person.

146. Whenever these conditions are met, the advice given to the investor must be suitable. The standards expected in the suitability assessment should be consistent for all PRIPs in order to ensure a uniform level of investor protection. The following would be examples of situations in which advice is provided.

[26] This approach was already adopted at national level by several Member States and was also considered in the on-going revision of the IMD.

- An investor has a face-to-face meeting with an adviser. The adviser asks for information about the investor's circumstances and needs, then conducts research as to which investment meets those needs. The adviser tells the investor that the recommended investment is suitable for them.

- The distributor reviews the existing client database to decide which investors might be interested in a particular investment. The distributor writes to all of these investors to explain that research shows that the investment is suitable for their circumstances.

147. The suitability assessment (taking MiFID provisions as a benchmark) will entail the distributor gathering all relevant information from the investor so as to be able to recommend a suitable PRIP. In order to be suitable, the investment must meet the investor's objectives, be consistent with their risk profile and take account of their financial situation and the investor must have the necessary experience and knowledge in order to understand the risks involved in the transaction.

148. The Task Force also recommends that the PRIPs regime learn from the IMD where additional investor protections are desirable.

- Before the service is provided to the investor, distributors must explain the basis on which any advice is to be provided. To meet this requirement, distributors should explain whether they conduct a fair analysis of the market or are restricted (for example by contractual arrangements) to sell only the products of certain manufacturers.

- Where the distributor informs the investor that advice is based on a fair analysis of the market, that analysis must be based on consideration of a sufficiently large number of investments.

- There should be a requirement for distributors to provide investors with a summary, in writing, of how the advice meets the investor's demands and needs and the underlying reasons for any recommendation.

149. These conduct of business rules constitute a fundamental achievement in terms of investor protection which should be granted to all investors equally, irrespective of the PRIP that is being advised.

150. There were, however, some divergent views on whether advice (as defined in paragraphs 28 and 145 above) may be given if an investor does not disclose all relevant information about themselves.

- The majority of Task Force members consider that, in this situation, advice should not be given. Where advice is provided, they believe that it must be suitable. Without knowing all relevant facts, it is possible that the advice is unsuitable. Unsuitable advice would result in mis-selling and the regulatory system should not countenance this.

- A minority of Task Force members considers that advice can always be given, even if the investor chooses not to disclose all relevant information. In these cases, the advice may be based on the information that is known and the suitability standard should only be considered in relation to those facts. However, distributors are

required to warn the investor of the limits of the advice provided and may choose to refuse to provide advice.

151. A possible model for advice provisions for PRIPs has been included in Annex 2. This is a draft model considered by the Task Force to aid discussions and would need to be updated and amended to take account of further detailed discussions, particularly at Level 2.

Non-advised sales

152. There were differing views on transactions that do not fall within the definition of advice in paragraphs 28 and 145.

- The majority of Task Force members agreed that it should, in principle, be possible to sell some PRIPs on a non-advised basis. They consider that investors who are able to make their own decisions should not be materially disadvantaged by being obliged to seek advice and having to pay higher charges for that advice. The following would be examples of situations where the transaction is on a non-advised basis.

    - The investor goes to the manufacturer's website, reads the investment information available online and chooses to make an application online with no further contact with or from the firm.
    - The investor picks up an investment brochure in a branch office, reads through the information, completes the application form in the brochure and submits it, by post, to the firm.
    - The investor visits a branch and sits down with a distributor. The investor tells the distributor that they want to invest 100,000 Euros in a specific investment. The distributor has made no recommendation to the investor. However, it was noted that this situation will be extremely difficult to manage in practice without giving an impression that advice has been provided.
    - The investor visits a branch and sits down with a distributor. The distributor provides the investor with information about available investments and takes the investor through a guided sales path using a decision tree format. Each step in the decision tree is decided by the investor. The distributor is only able to provide information, never to offer advice as to which option is best for the investor's needs or circumstances. Again, it was noted that it would be extremely difficult for the firm to manage this transaction in such a manner that it is clear to the investor that no advice has been provided.

  If at any stage the distributor offers an opinion on the suitability of a product or gives the impression that advice is being provided on the basis of the customer's circumstances, the transaction becomes an advised sale and the full suitability test is required.

- A minority of the Task Force members pointed out that their national implementation of the IMD means that insurance products – including some products that would fall within the PRIPs regime – can currently only be sold with advice[27] and insurance intermediaries are always

[27] N.B. This not the same concept of "advice" as referred to in the definition of advice proposed for PRIPs in paragraphs 28 and 145 or in the definition of advice under MiFID.

obliged to assess the demands and needs of potential policyholders. In case the investor refuses to provide all relevant information, the distributor is still allowed to advise the investor based on the information available. Nevertheless, the distributor must warn the investor of the limits of the advice and can also refuse to sell insurance products. According to this minority's view, the IMD currently provides the same regime for all sales of insurance contracts.

- This minority considers that allowing non-advised sales of PRIPs, and consequently applying the MiFID-derived appropriateness test, will reduce investor protection since, in their interpretation, the appropriateness test does not include consideration of the demands and needs of investors. Therefore they also consider it unnecessary to introduce the MiFID concept of 'complex/non complex' products for insurance-based PRIPs.

- The majority of Task Force Members on the contrary believes that, to allow distributors to present a PRIP as suitable for the client without knowing relevant specificities, will be detrimental for the investor. The majority of the Task Force members also believes that the MiFID-derived appropriateness test would offer a sensible safeguard.

153. Where it applies, the appropriateness test requires the distributor to assess whether the investor has the necessary knowledge and experience to be able to take an informed investment decision based on a proper understanding of the features of the product and the related risks. It was agreed that, if non-advised sales are permitted, such an assessment is relevant for PRIPs as they can be difficult for the average retail investor to understand.

154. The majority of those who agree that non-advised sales should be permitted, feel that it should be possible for PRIPs to be either complex or non-complex.

155. There is a general expectation that most PRIPs are likely to be classed as complex products but it was felt that more work should be done at Level 2 to determine the criteria on which this classification should be made. The MiFID criteria are designed for certain investments and different criteria may be needed for non-MiFID PRIPs. Additionally, it may be that some types of non-MiFID investments should always be regarded as complex.

156. As most PRIPs have complicated structures, a minority of Task Force members felt that all potential PRIPs should simply be regarded as complex. This would have the effect of making the appropriateness test compulsory for all non-advised sales of PRIPs and would prevent execution-only sales (under which the distributor makes no assessment of the suitability or appropriateness of the product for the investor).

157. MiFID currently regards all UCITS as non-complex. The MiFID review may suggest a change to this approach so that some UCITS with more complicated structures become classified as complex. However, this would still mean that many UCITS are still classified as non-complex. This approach might need to be adjusted to preserve the level playing field if no other type of PRIP can be classified as non-complex.

Inducements

158. It is essential that inducements are adequately regulated to ensure the proper protection of investors. They can provide an incentive for distributors to sell one product rather than another that would be more suitable or appropriate for the investor.

159. Inducements provisions must be regarded as complementary (and not substitutes or alternatives) to the requirements on managing conflicts of interest to avoid investor detriment.

160. The majority of the Task Force members believes that the PRIPs regime should specify what inducements are compatible with the general duty to act honestly, fairly and professionally in accordance with the best interests of its clients. Inducements should cover all payments (such as fees, commissions or non-monetary benefits) made to the distributor.[28]

161. The MiFID Level 1 inducements provisions were agreed to be a good starting point for the PRIPs regime. However, further work is necessary at Level 2 to ensure that the regime adequately accounts for market specificities for different types of PRIP. In particular, it might be necessary for the non-exhaustive list of proper fees included in MiFID Level 2 Article 26(c) to be amended to take into account the specificities of the different types of PRIPs.

162. However, a minority of the Task Force members considers MiFID provisions on inducements to be inconsistent with the distribution of insurance products by agents or other insurance intermediaries who act under a working or cooperative relationship with insurance undertakings. They consider that the general remuneration paid by the undertaking to intermediaries is not comparable with MiFID 'inducements' because insurance undertakings are not a 'third party' within the meaning of MiFID. On the other hand, a majority of the Task Force members sees the two situations as identical to what can be observed in the securities sector and therefore, there is no contradiction and the same need for protection of the investor exists.

163. Some members also questioned whether MiFID provisions might need further clarification. Where inducements are disclosed for example, is this sufficient to protect investors? Are they able to use the information in a meaningful manner? For example, where an adviser can earn more money by recommending one product rather than another, disclosure of the remuneration from the recommended product will not necessarily enable the investor to understand how this may have undermined the quality of advice or led the distributor to offer one product rather than another that would have been better for the investor. It appears, therefore, that further work is needed at Level 2 or Level 3 to address this problem.

164. In addition, it is necessary to ensure that the volume of disclosures required by the regime is not disproportionate and does not make it difficult for the investor to digest that amount of information.

[28] One Task Force member suggests that this should be subject to a *de minimis* test so that, for example, stationery and other trivial non-monetary benefits are not caught by the inducements provisions. Other Task Force members, however, believe that the inducements provisions should always apply, but should apply in a manner proportionate to the inducement under consideration.

165. Annex 3 includes the model used in discussions by the Task Force for inducements provisions that could be applied to PRIPs. This may form a helpful basis for future work but would need to take account of the above considerations.

Annex 1: Possible model for PRIPs conflicts of interest

Level 1 requirements

1. PRIPs firms[29] must take all reasonable steps to identify conflicts of interest between themselves and their investors or between one investor and another.
2. PRIPs firms must manage conflicts of interest in such a way to ensure, with reasonable confidence, that risks of damage to investor interests will be prevented.
3. Where the management of conflicts of interest cannot ensure, with reasonable confidence, that risks of damage to investor interests are prevented, PRIPs firms must disclose the general nature and/or sources of conflicts of interest to the investor before undertaking the business [30].

Level 2 requirements

4. PRIPs firms must establish, implement and maintain a conflicts of interest policy, set out in writing, that is appropriate to the size and organisation of the firm and the nature, scale and complexity of the conflicts of interest.
5. The policy must identify the conflicts of interest that may lead to a material risk of damage to the interests of one or more investors and must specify procedures to be followed and measures to be adopted to manage such conflicts.
6. Individuals engaged in the services that give rise to the conflicts of interest must carry on those activities at a level of independence appropriate to the size of the PRIPs firm and the materiality of the risk of damage to investors.
7. Effective procedures to manage conflicts include the following:

    - measures to prevent or control the flow of information between relevant persons;
    - the separate supervision of relevant persons;
    - the removal of any direct link between remuneration or relevant persons engaged in the activity and the remuneration, or revenues generated by, different relevant persons engaged in another activity where a conflict of interests may arise;
    - measures to prevent or control any person from exercising inappropriate influence over the way in which investment services are carried out; and
    - measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate services where such involvement may impair the proper management of conflicts of interest.

[29] The 'PRIPs firm' term used in this annex covers all firms (manufacturers and distributors) in the PRIPs regime.
[30] As mentioned in paragraph 141.

8. Disclosure of conflicts of interest must be made in durable medium and include sufficient detail, taking into account the nature of the investor, to enable the investor to take an informed decision with respect to the investment service in the context of which the conflict of interests arises.

9. A record must be kept of services in which a conflict of interests has arisen that has entailed a material risk of damage to the interests of one or more investors, or in which such damage may arise.

10. Common examples of potential conflicts of interest include:

    - where a distributor has a holding, direct or indirect, representing more than 10% of the voting rights or of the capital in a given manufacturer;

    - where a manufacturer or parent of a manufacturer has a holding, direct or indirect, representing more than 10% of the voting rights or of the capital in the distributor;

    - the distributor is likely to make a financial gain, or avoid a financial loss, at the expense of the investor;

    - the distributor has an interest in the outcome of a service provided to the investor or transaction carried out for the investor, that is different from the investor's interest in the outcome;

    - the distributor has a financial interest or other incentive to favour the interest of another investor, or group of investors, over the interests of the investor;

    - the distributor carries out the same business as the investor;

    - the distributor will receive from another party other than the investor, an inducement in relation to the service provided, other than the standard commission or fee for that service;

    - registration as an insurance intermediary in more than one category (with different levels of formal independence), or simultaneously as a reinsurance and insurance intermediary, which may give rise to arbitrary placement of insurance contracts. For example, broker/agent where an intermediary is both a broker (and thus representing interests of insurance policy seekers) and an agent (representing interests of insurers); or

    - the distributor's interest in the insurance contract (e.g. in relation to which he is a beneficiary; occurring, for instance, in situations where a bank registered as an insurance intermediary is a beneficiary of a life insurance associated to a mortgage) potentially conflicting with the insured person's contractual interest.

Annex 2: Possible model for PRIPs advice

Level 1 requirements

1. When providing personal recommendations or advice the distributor shall obtain the necessary information regarding the investor's or potential investor's knowledge and experience in the investment field relevant to the specific type of investment, his financial situation and his investment objectives so as to enable the distributor to recommend to the investor or potential investor the PRIPs that are suitable for him.

2. Distributors shall also explain the basis on which advice is to be provided, before the service is provided to the investor.

3. When the distributor informs the investor that it gives its advice on the basis of a fair analysis, it is obliged to give that advice on the basis of an analysis of a sufficiently large number of financial investments available on the market, to enable it to make a recommendation, in accordance with professional criteria, regarding which investment would be adequate to meet the investor's needs.

4. On the basis of the information obtained about the investor, the distributor shall specify, in writing, the underlying reasons for the advice given to the investor on a given PRIP, including details of how the advice meets the investor's demands and needs. These details shall be modulated according to the complexity of the PRIP being proposed.

5. Where, when providing advice, a distributor does not obtain the relevant information required, the distributor shall not recommend a PRIP to the investor or potential investor.

Level 2 requirements

6. Member States shall ensure that distributors implement policies and/or procedures to obtain from investors or potential investors such information as is necessary for the distributor to understand the essential facts about the investor and to have a reasonable basis for believing that the specific transaction to be recommended satisfies the following criteria:

   (a) it meets the investment objectives of the investor in question;

   (b) it is such that the investor is able financially to bear any related investment risks consistent with his investment objectives;

   (c) it is such that the investor has the necessary experience and knowledge in order to understand the risks involved in the transaction.

7. The information regarding the financial situation of the investor or potential investor shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

8. The information regarding the investment objectives of the investor or potential investor shall include, where relevant, information on the length of time for which the investor wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

9. Distributors shall inform their investors before conclusion of the contract of the features of the service that is going to be provided specifying whether:

   (i) they give advice based on the obligation to provide a fair analysis (Level 1, paragraphs 2 and 3); or

   (ii) they are under a contractual obligation to give advice exclusively with one or more PRIPs manufacturers. In that case, he shall, at the investor's request provide the names of those PRIPs manufacturers; or

   (iii) they are not under a contractual obligation to give advice exclusively with one or more PRIPs providers and do not give advice based on the obligation to provide a fair analysis (Level 1, paragraphs 2 and 3). In that case, they shall, at the investor's request provide the names of the PRIPs manufacturers with which they may and do conduct business.

   In those cases where information is to be provided solely at the investor’s request, the investor shall be informed that he has the right to request such information.

Annex 3: Possible model for PRIPs inducements provisions

Level 1 requirements

1. A firm must act honestly, fairly and professionally in accordance with the best interests of its investors.

Level 2 requirements

2. Distributors will not be regarded as acting honestly, fairly and professionally in accordance with the best interests of their investors if they receive any inducements other than the following:

    - any payments (such as fees, commissions or non-monetary benefits) paid or provided to or by the investor or a person on behalf of the investor;

    - any payments (such as fees or commissions, including contingent commissions) and non-monetary benefits paid or provided to or by the manufacturer, a third party or a person on behalf of the manufacturer or a third party, where the following conditions are satisfied:

        - clear prior disclosure is made to the investor; and
        - the item is designed to enhance the quality of the relevant service to the investor and does not impair compliance with the firm's duty to act in the best interests of the investor;

    - proper fees which are necessary for the service and cannot, by their nature, conflict with the distributor's duty to act in the best interests of its investor.

3. The receipt by a distributor of an inducement in connection with investment advice or general recommendations, in circumstances where the advice or recommendations are not biased as a result of the receipt of the inducement, should be considered as designed to enhance the quality of the investment advice to the investor.