

MEMO# 21912

November 2, 2007

European Commission Seeks Input on "Substitute" Retail Investment Products

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TO: INTERNATIONAL MEMBERS No. 31-07
INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 20-07
SEC RULES MEMBERS No. 143-07 RE: EUROPEAN COMMISSION SEEKS INPUT ON
"SUBSTITUTE" RETAIL INVESTMENT PRODUCTS

The European Commission has issued a request for evidence on the effect on investor protection of the fragmented European regulatory landscape for retail investment products. [\[1\]](#) The consultation is framed around so-called "substitute" retail investment products that offer risk/return performance comparable to retail investment funds but are sold in a variety of forms that are subject to different levels of product and fee disclosure and different selling rules. The consultation notes a "fear that less transparent or regulated products may be easier to sell, thereby displacing more heavily regulated products and exacerbating investor protection concerns." European investment products discussed in the consultation include, most notably, UCITS funds, unit-linked life insurance, and structured products. The European Commission will use the consultation to help assess whether existing rules are sufficient to protect retail investors and, if significant risks are identified, what type of corrective action is needed. Responses to the consultation will be accepted through January 18, 2008.

I. Background

The European Commission has been under pressure from many directions to do something about the different disclosure and selling requirements applicable to retail investment products that target similar financial needs. European Union Finance Ministers, committees of European financial regulators, and the European Parliament have all called for a review of legal and regulatory requirements that govern product disclosure and sales to ensure a coherent approach to investor protection. Consumer advocates and the European fund industry have also expressed concern about differing levels of regulation, product

transparency, and investor protection.

II. Scope and Intent of the Consultation

Through this consultation, the European Commission is asking for feedback in the following three areas:

1. Which investment products should be considered substitute products and what are the factors driving the promotion and sales of particular products;
2. Whether variations in regulatory treatment that may affect the relative sales of investment products harm investors through decreased transparency and investor protection; and
3. Whether there is a need for action and, if so, by whom.

A. Substitute Products

The consultation notes the dramatic evolution in the range of investment products available to retail investors who are saving for the medium or long term with the objective to maximize potential returns through direct or indirect exposure to financial markets. In this environment, traditional boundaries among investment fund, banking, and insurance products have blurred. The consultation seeks input on what products should be considered as de facto alternative ways of making investments with similar economic characteristics. The consultation then seeks opinions on the factors driving the promotion and sales of particular products, asking specifically about taxation, regulatory treatment, cultural preferences, distribution business models, and supply-side desire to sell new products.

B. Possible Harm to Investors

To the extent that variations in regulatory treatment may affect the relative sales of different types of investment products, the European Commission seeks to examine the possible harm to investors in the areas of product disclosure, conduct of business rules, conflicts of interest, and the risk of unfair marketing or misleading advertising. The consultation asks respondents to compare substitute products and the risk of harm to investors in each of these four areas, with as many concrete examples as possible.

C. The Need for Action

The European Commission is seeking to determine whether the risks of possible harm to investors from less transparent and less regulated products is material and, if so, whether those risks warrant corrective action through mandatory product disclosure and/or distribution regulation. The consultation seeks opinions on whether self-regulation and market forces may be sufficient or whether a coordinated European legal and regulatory response is required.

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If you have questions or would like to discuss the consultation, please contact Susan Olson, ICI Senior Counsel for International Affairs, at +1 202 326-5813 or solson@ici.org.

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endnotes

[1] European Commission, Call for Evidence: Need for a Coherent Approach to Product Transparency and Distribution Requirements for “Substitute” Retail Investment Products? (Oct. 2007), available at ec.europa.eu/internal_market/finances/docs/cross-sector/call_en.pdf.

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