

Revisiting the landscape of European long-term savings -

A call for action from the
asset management industry

March 2010

sponsored by



European Fund and Asset Management Association

This report was commissioned by EFAMA as part of its long-term strategic planning efforts and is a distillation of personal visions, views and opinions expressed to McKinsey & Company, Inc. by 23 CEOs or equivalent individuals in leading European asset management firms, consultancies, pension funds, or investor associations from across Europe, and with diverse backgrounds regarding size of business. They do not necessarily represent EFAMA policy.

The eight recommendations expressed in this discussion paper are offered to help EFAMA develop its long- term policy positions.

Table of contents

Foreword	iii
Acknowledgement	v
Overview of eight recommendations	ix
Long-term savings recommendations	ix
Retail investment product distribution recommendations	ix
Recommended industry actions to underpin improvements	ix
Introduction	1
I. Challenges in long-term savings and distribution of retail investment products	3
1. Long-term savings challenges	3
2. Distribution challenges	4
II. Overview of recommendations	5
A. Recommendations to improve provision of long-term savings	5
A1. Increase total European retirement savings by encouraging governments to introduce compulsory long-term saving schemes (with opt out clauses) that are organised with employer and/ or industry scheme support	5
A2. Increase the consumer-friendliness of long-term investments by introducing a personal retirement plan that has consistent certification standards across Europe	6
A2.1. Basic requirements for Officially Certified European Retirement Plans	7
A2.2. Associated supervisory standards for Officially Certified European Retirement Plans (OCERP) and OCERP providers	9
A3. Give all product providers equal access to suitable and efficient OCERPs in order to foster competition for the best investor solutions	10
B. Retail investment product distribution recommendations	12
B1. Ensure harmonisation of distribution standards for packaged retail investment products (PRIIPs) across product categories	12
B2. Improve quality and transparency of activities at the point of sale	13
B2.1. Disclose the nature of distributors' services	13
B2.2. Full disclosure of all cost items and remuneration arrangements	14
B2.3. Introducing a standardised advisor certificate	15
B2.4. Consider granting investors the right to withdraw from an investment decision	16
B3. Promote further confidence in UCITS as a trustworthy investment vehicle	16
B3.1. Strengthen industry risk measurement and management capabilities	17
B3.2. Establish a European-wide fund-type classification with regard to portfolio holdings	17
III. Additional industry initiatives to underpin commitment	19
C. Recommended industry actions to underpin improvements	19
C1. Promote financial literacy and competence of individual investors and financial advisors	19
C2. Set industry aspirations for improved business conduct and performance	19
IV. Concluding remarks	21

Foreword

It is my pleasure to introduce this report commissioned by EFAMA. In deciding to sponsor this initiative, our ambition was to take a proactive stance in learning from the challenges thrown up by the recent financial crisis. This may not have been a crisis that we triggered, but we have certainly been severely affected. Investors have been badly shaken and we must rebuild their confidence in our abilities and our integrity. This is even more important for an industry that acts as the custodian of individuals' private savings for retirement. Our contribution to the European economy is vital and we are an important resource for its citizens. I am constantly impressed by our industry's ambition to help investors' build their financial security.

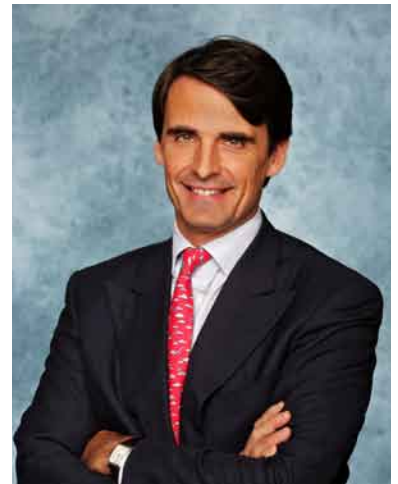
Pension solutions in Europe, where demographic challenges are forcing governments to act, are fragmented and often inadequate. We in the industry have a key role to play in building an EU pensions framework. With the UCITS vehicle we already have one of the most robust underlying investment products for retirement plans but the successful development of long-term savings and private retirement products also relies on the quality of distribution, on educating investors about the optimum solutions, and on better knowing client needs.

We are on the brink of a new period. The uncertainty that resulted from the crisis, starkly illustrated by the exceptional volatility of flows into UCITS, makes it imperative that we plan our next steps carefully. We must shift from a cyclical post-crisis response to taking more holistic structural measures in line with EFAMA's strategic agenda 2009-2011. It would be a grave error for the asset management industry to use the early signs of recovery as a chance to sit back and revert to the pre-crisis ways of doing business. We need to seize the opportunities that the crisis has presented. This calls for action and leadership and EFAMA has a key role to play in enabling bold decision-making while remaining steadfast in our commitment to investors and asset managers' fiduciary duties.

Five years ago, EFAMA set out on a journey focused on deepening the single market and increasing the global competitiveness of the European investment management industry. We have made substantial progress in that time. Since then, new tactical and strategic priorities have emerged for the industry to tackle, such as the Alternative Investment Fund Management Directive, while PRIIP, the new acronym for packaged retail investment products, has emerged as one of the most important recent contributions to levelling the playing field in distribution. Our "buy side" role has also been enhanced and the need for strong corporate governance demonstrated once again. The planned review of MiFID will provide a unique opportunity to draw upon on the last two years of experience. Understanding, managing and circumscribing investment risk continues to be a fundamental task, and has encouraged calls for further harmonisation. Finally, UCITS IV will help drive down cost and promote the attractiveness of European funds with a set of clarified roles and responsibilities for depositories.

Despite all these positive developments, the message that the interviewees for this report are sending the industry, regulators and legislators is that more needs to be done in the field of long-term savings and distribution if asset management is to remain the ultimate custodian of investors' long-term savings. The industry is ready to play its part, and wants to help improve the daily life of European citizens.

The objective of this report is to set out some practical recommendations that focus on supporting the investor. It comes at an apposite moment as Michel Barnier has just assumed the role of EU Commissioner for the internal market and services and the European Commission has just released its "agenda 2020". The eight recommendations described here should guide the industry in its dialogue and collaboration with legislators, regulators and supervisors. I believe that the best outcomes for investors - including renewed trust in financial services - are likely to come from the right balance between regulation and self-regulation.



Jean-Baptiste de Franssu
President of EFAMA
CEO Invesco Europe

On behalf of the EFAMA board, Claude Kremer (vice-president) and Peter De Proft (director general), I would very much like to thank all the contributors to this report, especially the interviewees, McKinsey & Company, Inc., and the entire steering committee. Their support has been invaluable over the past few weeks in helping us putting together this call for action from the asset management industry. For me, the recommendations are an inspiration for EFAMA in its mission to represent the collective interests of our industry and better serve the long-term needs of tens of millions of investors.

Acknowledgement

The recommendations outlined in this report have been distilled from interviews with the following industry representatives:

EFAMA Corporate Members



Naim Abou-Jaoudé
CEO Dexia Asset Management



Juan Alcaraz
CEO Allfunds Bank and Santander Asset Management, Member of the President Advisory Council of EFAMA



James Broderick
Head of JP Morgan Asset Management, Member of the Board of EFAMA



James Charrington
Head of International Retail Business BlackRock



Gregory Ehret
Head of EMEA State Street Global Advisors



Dr. Joachim Faber
CEO Allianz Global Investors
Member of the President Advisory Council of EFAMA



John Fraser
Chairman and CEO UBS Global Asset Management, Member of the President Advisory Council of EFAMA



Dario Frigerio
Former CEO Unicredit Asset Management



Robert Higginbotham
President and CEO Europe Fidelity Investments International



Dr. Wolfgang Mansfeld
MD Union Investment



Roderick Munsters
CEO Robeco
Member of the President Advisory Council of EFAMA



William Nott
CEO M&G Securities



*Renaud de Planta
Managing Partner, Pictet & Cie*



*Allan Polack
CEO Nordea Savings & Asset Management
Member of the President Advisory Council
of EFAMA*



*Paul-Henri de la Porte du Theil
Former CEO Crédit Agricole Asset
Management*



*Thomas Richter
Member of the Board of Managing Directors
DWS Investment*



*Massimo Tosato
Executive Vice Chairman Schroders Plc
Member of the Board of EFAMA*

Non-EFAMA Members



*Martin E. Beaulieu
EVP, Head of Global Distribution MFS*



*Andrew Laing
Deputy CEO Aberdeen Asset Management*



*Dr. Zeno Staub
Head of Vontobel Asset Management*

Other contributors



*Diana Mackay
Former CEO Lipper FMI
CEO Mackay Williams LLP*



*Guillaume Prache
MD EuroInvestors.org
Secretary General Euroshareholders*



*Ronald Wuijster
Head of Strategic Portfolio Management
APG Asset Management*

In addition to the industry representatives mentioned above, this report has also drawn on the valuable contributions of the following individuals who acted as a Steering Committee for this exercise. They sought to focus on the main points that arose from the interviews, aware that they did not necessarily represent their own personal views:

- Chair: Jean-Baptiste de Franssu, CEO of Invesco Europe and President of EFAMA;
- Elizabeth Corley, CEO Allianz Global Investors Europe;
- Robert Higginbotham, President Fidelity International;
- Laurent Ramsey, CEO Pictet Funds, member of the Board of EFAMA;
- Richard Saunders, CEO Investment Management Association, member of the Management Committee of EFAMA;
- Stefan Seip, MD Bundesverband Investment und Asset Management, member of the Board of EFAMA.

The Steering Committee would like to thank McKinsey & Company, Inc. for coordinating and supporting the interview process.

Overview of eight recommendations

Long-term savings recommendations:

- A1. Increase total European retirement savings by encouraging governments to introduce compulsory long-term saving schemes (with opt-out clauses), that are organised with employer and/or industry scheme support;
- A2. Increase the consumer-friendliness of long-term investments by introducing a personal retirement plan (referred to as “Officially Certified European Retirement Plan” (OCERP)) that has consistent certification standards across Europe;
- A3. Give all product providers equal access to suitable and efficient OCERPs in order to foster competition for the best investor solutions.

Retail investment product distribution recommendations:

- B1. Harmonise distribution standards for packaged retail investment products (PRIPs) across product categories;
- B2. Improve quality and transparency of activities at the point of sale;
- B3. Promote further confidence in UCITS as a trustworthy investment vehicle.

Recommended industry actions to underpin improvements:

- C1. Promote financial literacy and competence of individual investors and financial advisors;
- C2. Set industry aspirations for better business conduct and performance.

Introduction

The financial crisis caused record-breaking declines in the financial assets of European individual investors, but it has also aggravated and highlighted long-standing issues these investors face in the areas of **long-term savings** and the **distribution of retail investment products**.

- **Long-term savings:** Occupational pension funds, which represent an important part of overall long-term savings, are vital in securing many investors' living standards at retirement age. During the crisis, some pension funds came under pressure and had to make quick investment decisions that ran contrary to their long-term objectives. Given the tough financial situation many of their sponsors (i.e., employers) are in, it is questionable whether all the funds can deliver fully on their promise. This could leave investors with less money than expected at retirement. Taking this together with the state of public finances, which have long ignored the impact of demographic change on the sustainability of their pay-as-you-go (PAYG) systems (longevity risk¹), it seems increasingly clear that Europe's long-term savings systems will not be sustainable without taking actions that include strengthening individual contributions;
- **Retail distribution:** Volatility in asset flows (e.g., the difference between gross and net sales, or shifts from asset management products to bank deposits) has reached a level during the crisis that is fundamentally at odds with the long-term nature of most asset management products. This has meant that many investors have withdrawn assets prematurely, thus cementing losses and missing the benefits of subsequent recoveries. This raises questions as to whether the forces at work that drive individuals' investment decisions are optimally structured and regulated.

This report seeks to address the main challenges in these two areas of concern, and to derive a set of practical recommendations with the dual objective of:

- Providing individual investors with additional solutions to meet their long-term investment goals more closely, specifically in pensions, and
- Building a strong foundation for investor trust in the wider financial services sector, especially in the asset management industry.

This dual objective places the individual investor at the heart of the effort. Together with an assessment of the state of the industry and existing European regulatory frameworks, it serves as starting point for the recommendations described herein.

Of particular concern for the group of 23 interviewees is the **need to ensure a level playing field for different long-term investment products and to create sufficient transparency at the point of sale**. More concretely:

Long-term savings: All European countries face severe challenges in getting their citizens to engage in long-term savings that provide adequate returns, for example to secure their standard of living upon retirement. Today, the lack of a level playing field:

- **Leads to regulatory arbitrage** as differing regulatory standards applied to different but competing products can create incentives for some providers to develop products that are subject to the least regulation or attract the most state aid, rather than focusing on true investor needs;
- **Adds to complexity costs** as vast differences between national legislation make it hard for providers of long-term investment products to realise efficiencies of scale that could stem from unified approaches to marketing products and managing long-term assets;

¹ In a report entitled 'Social impact of the crisis - Demographic challenges and the pension system', the EU's economic and scientific policies department states that the "impact of the crisis on pensions is in the order of 5 to 15%, while the impact of ageing is doubling the burden on the younger generation, an increase in the order of more than 100% in many Member states".

- **Impedes competition for best investor solutions** as differences in transparency requirements and/or allowable risk exposures across product categories make comparing different solutions and products difficult. This makes it harder for investors to drive the quality of long-term investment products;

Retail distribution: Previous industry and regulatory efforts have focused on investment production rather than distribution. Product regulation has been particularly thorough on asset management products, while to some extent ignoring other (substitute) investment products. This has led to distorted competition between different product types at the point of sale. In addition, given the impact that the right combination of investment products has on overall returns, and given that asset allocation is typically done at the point of sale, the focus of regulation should shift from production to distribution. This is the point at which the individual investor is significantly exposed to the risk of making bad investment decisions. In this report, therefore, references to “distribution” and “point of sale” refer not just to the sale of products but also where appropriate to the provision of advice - i.e., identifying client needs and advising on the best way to meet those needs.

The recommendations of this report build on the worldwide success of UCITS and seek to embrace the objectives expressed by the European Commission in its strategic goal for 2020, i.e., to increase connectivity through the single market to the benefit of European investors. Recommendations fall into three categories: recommendations to address long-term savings challenges, recommendations to address distribution challenges, and finally actions from the asset management industry that underpin commitment to improvements in both areas (see page VI).

The challenges and recommendations discussed in this report are, of course, not the only areas in which the asset management industry should act. Others have been highlighted in the foreword of this report and also need attention.

This paper seeks to be practical rather than academic. It focuses on distilling a few quickly applicable high-impact measures alongside other more fundamental actions that will be essential to ensuring sustainable long term savings and strengthening distribution mechanisms.

The findings are not trying to reinvent the wheel. Existing regulatory frameworks - especially asset management-oriented UCITS - already enjoy a global reputation as state-of-the-art in terms of investor protection. They have also helped the asset management industry in Europe market its products and services successfully across the EU and beyond and survive the financial crisis in reasonable shape. Nevertheless, recent events, together with broader industry trends towards convergence of product categories and diversification of distribution models, challenge both the role of asset managers (and other industry participants) as well as the validity of today's regulations in a post-crisis era.

The recommendations in this report are informed by the perspective of asset management firms as opposed to other types of financial services providers. However, the 23 interviewees firmly believe that the recommendations are in the best interests of European citizens and investors.

Some of the recommendations put forward in this report could be adopted by the industry alone. Others could be initiated only in partnership with or led by European and national legislative/regulatory bodies. The interviewees recommend that EFAMA seeks to work with industry members and policymakers to help put the proposed changes into practice.

Chapter II gives an overview of some of the key challenges retail investors face today. Chapter III elaborates on the specific recommendations for long-term savings and distribution, outlining their potential impact on the identified challenges. Chapter IV adds to these specific recommendations by putting forward two proposals that underpin the industry's commitment to the recommendations. Chapter V contains some closing remarks.

I. Challenges in long-term savings and distribution of retail investment products

Before delving into the recommendations, it is useful to examine briefly the challenges that the 23 interviewees identified, which investors face and that the industry has to overcome in both focus areas.

1. Long-term savings challenges

Within the range of long-term savings schemes that could be developed further, the interviewees focused more specifically on retirement plans given the existing challenges facing pensions in Europe.

They believe there are four stakeholders that need to be looked at (Exhibit 1): the investor, the legislator/regulator, the retirement plan provider, and the product provider, e.g., the asset manager.

- **Investors** can be unaware of the need to save for the long-term as they still expect that the benefits from PAYG and traditional occupational pension schemes will suffice. Others simply delay investment decisions, as they are unsure as to what the best solution for their needs is. Investors also have insufficient incentives to save privately for retirement. Finally, they tend to have limited stamina for long-term savings, preferring to focus on short-term returns and liquidity;
- To date, relevant **legislation/regulation** has been product-focused. This has led to sizeable inconsistencies at a national level in the fiscal treatment of similar long-term investment products. This in turn has given certain product providers privileged access to state-aided retirement plans, which hinders true competition for best investor solutions. Additionally,

Exhibit 1: Main challenges identified in long-term savings



Source: Interviews with CEOs of European asset managers, pension funds, and investor protection associations.

2 When referring to plans, savings, assets, etc., the words “pension” and “retirement” are used synonymously in this paper.

there have been only limited attempts to harmonise national frameworks, which has hindered retirement plan and product providers from competing at a European level, and limiting transferability of long-term assets across plans, pillars, and countries;

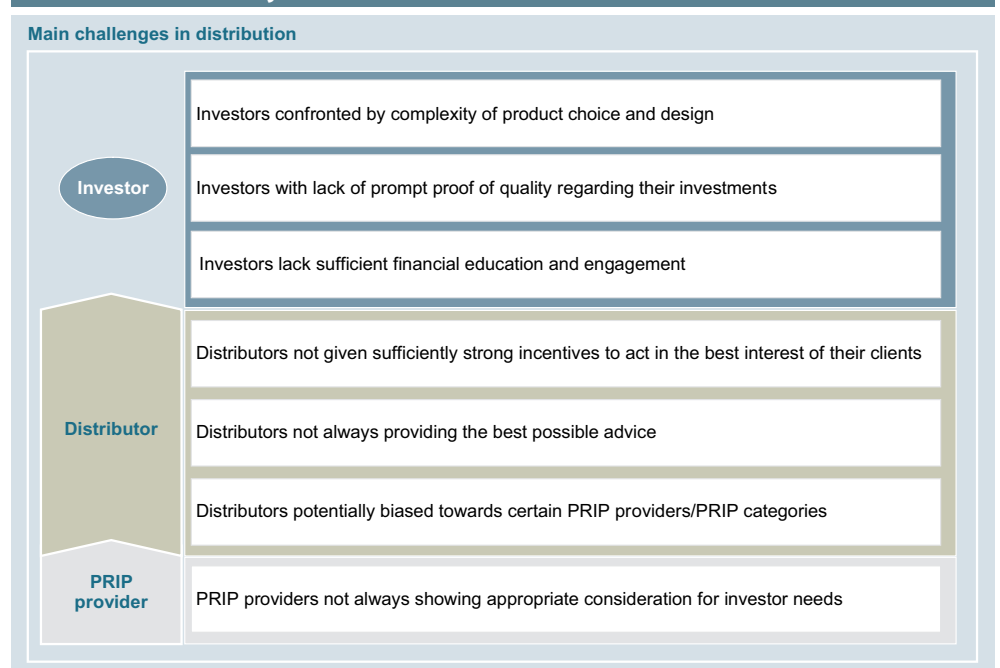
- **Retirement plan providers** do not always provide investors with sufficient transparency (e.g., on the actual investment part of retirement provisions) and commonly offer only limited asset/investment product choices. Retirement plans also do not show enough flexibility with regard to tailoring to individual customer needs;
- Faced with this situation, **some PRIP providers** tend to focus more on regulatory arbitrage than solely on investor needs. In some cases, this has reduced the attractiveness of long-term saving products.

2. Distribution challenges

The following challenges in distributing retail investment products expressed by the 23 interviewees cut across investors, product providers and, of course, distributors themselves (Exhibit 2).

- **Investors** can sometimes be challenged by the complexity of product choice and design. They also lack prompt proof of quality regarding their purchases/investments and sufficient financial education and engagement, all of which means they cannot influence the quality and price of the services they are offered;
- **Distributors** offering investment advice may not be given sufficiently strong incentives to act in the best interest of their clients, independently of existing regulatory frameworks. This could lead them to not always providing the best possible advice, potentially being biased towards certain PRIP providers/PRIP categories;
- **PRIP providers** may not always show appropriate consideration for investor needs, notably when it comes to product design. Often this is due to inadequate information flows between product providers and distributors and limited knowledge of ultimate client base.

Exhibit 2: Main challenges identified in distribution



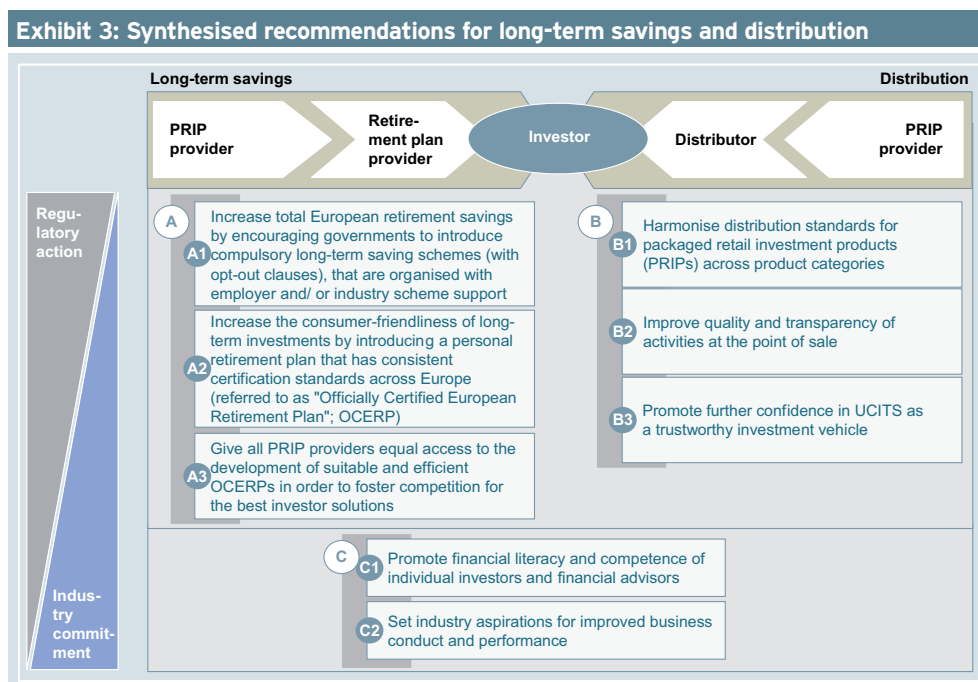
Source: Interviews with CEOs of European asset managers, pension funds, and investor protection associations.

II. Overview of recommendations

The asset management industry representatives had many different recommendations to address the challenges outlined above. Within these, a priority list of three recommendations each for long-term savings and retail distribution was defined, together with two enabling proposals to underpin improvements in these two areas (Exhibit 3).

Contributors recognised that the measures outlined in this paper should lead to greater benefits for investors, even if these are at the cost of other industry participants (i.e., distributors and retirement plan/PRIP providers). Of course, meeting investor's needs should increase the long-term viability of the European long-term savings market in general, and the European asset management industry in particular.

The recommendations require different levels of industry and/or regulatory involvement - the role of each will be described below.



Source: Interviews with CEOs of European asset managers, pension funds, and investor protection associations.

A. Recommendations to improve provision of long-term savings

A1. Increase total European retirement savings by encouraging governments to introduce compulsory long-term saving schemes (with opt out clauses) that are organised with employer and/or industry scheme support

Evidence from both within and beyond Europe suggests that introducing **compulsory savings schemes** is a viable way to enforce regular personal contributions. Effective implementation would increase employees' retirement assets, reducing dependency on national PAYG systems and therefore positively affect member states' budgets, notably in periods of low growth.

Compulsory saving schemes should have three cornerstones:

- **Automatic enrolment** of all citizens with an opt-out clause. Such systems have already demonstrated their advantages, and are being introduced in some countries, such as in the UK in 2012;
- Employers would help **collect contributions** (the state or professional associations would assume this role for the unemployed, self-employed, or small businesses). This would reduce costs due to both the scale of the operation and the bargaining power employers could exercise, for example in dealings with retirement plan providers;
- Granting the **best available tax benefits at a national level** for compulsory retirement provisions. This would reduce investors' inclination to opt out.

Together, these cornerstones could ensure healthier retirement savings despite the pressure on public and occupational schemes.

It is clear that the legislative power for such an undertaking lies within the **separate national legislative** bodies, which would determine minimum/maximum contributions, and the rules for opting out. In principle, recommendation A1 could be implemented on a stand-alone basis at national level. However, a unified certification standard for European personal retirement plans that set (i) minimum standards and (ii) conditions for granting best available tax benefits that are applicable to other retirement provision options would reduce national bodies' efforts to promote compulsory savings and strengthen investors' ability to reach their long-term investment goals.

A2. Increase the consumer-friendliness of long-term investments by introducing a personal retirement plan that has consistent certification standards across Europe

Irrespective of how widely recommendation A1 is adopted, those interviewed saw a clear need for a simple personal retirement plan, with unified standards across Europe. This should take the form of a simple wrapper, which could form part of both Pillar 2 and Pillar 3. Those interviewed saw the absence of such a vehicle as a critical barrier to enabling EU citizens to save more for their retirement.

Unified standards for such personal retirement plans should protect investors' retirement assets, allow for adequate investment choices to build wealth, as well as foster transparency and attractiveness from a long-term saver's point of view. Plans that meet these standards and receive certification from the appropriate regulatory body will be termed an "Officially Certified European Retirement Plan" (OCERP) in this report.

The design of OCERPs should allow plan providers (insurance companies, banks, or asset managers) to raise retirement savings in both Pillars 2 and 3.³

OCERPs are designed to be retirement plans, not the underlying investment products. As such, OCERPs are open to all providers as long as their products allow the OCERP to meet its certification standards.

The introduction of OCERPs would create a level playing field for retirement plan providers across Europe. This chapter now details OCERP certification standards (A2.1), and the associated supervisory standards in the EU (A2.2).

³ This is consistent with the call for fostering and better recognition of the two-layer structure of the private pension market in EU policy papers/initiatives on private pensions by the European Federation for Retirement Provision (EFRP), cf. EU Register ID: 5199259747-21

A2.1. Basic requirements for Officially Certified European Retirement Plans

OCERPs would create a new market segment for which a **level playing field** is needed to ensure **fair competition for the best personal retirement plans**. Therefore, a **unified certification standard** should be introduced that allows national legislators to approve plans based on uniform European guidelines.

Conceptually, an OCERP could be designed as a European Personal Pension Account (EPPA), i.e., an account in which an individual accumulates savings, retirement claims, and/or other insurance-related claims, all of which are dedicated exclusively to providing retirement income.⁴

In addition to the feedback received from interviewees, the requirements developed below integrate the feedback received by EFAMA on EPPA and the main findings of two independent studies commissioned by EFAMA.⁵ They also take into account the proposal developed by the European Financial Services Round Table for the creation of Pan-European Pension Plans.⁶

The basic requirements for OCERPs are that they should (i) be **transparent**, (ii) facilitate **investment choice**, (iii) be **transferable/portable**, (iv) provide adequate **flexibility**, and (v) be managed **cost-efficiently and safely**.

Transparency

- **OCERPs should be domiciled in an EU member state** or within the EEA (European Economic Area) to ensure that they fall under European regulation and the associated transparency requirements;
- **Transparency on all costs.** The OCERP provider would formally reconfirm costs of the retirement plan to investors annually in an itemised statement. This gives investors more information and could encourage competition between providers, i.e., insurance companies and asset managers;
- **Transparency on accumulated savings.** The OCERP provider should inform investors of their total savings at least once a year in order to increase the level of information they receive, and give them the opportunity to adjust annual contributions.

Individual choice

Individual choice allows people to structure their retirement investments according to their own needs and preferences. There are valid concerns about individuals' ability to make the right decisions when it comes to planning for their retirement, hence the need for the regulator to support this individual choice. In this context, the following should be required:

- OCERPs should **limit the range of underlying products** in which individuals can invest, and put in place mechanisms to help individuals make well-informed choices;
- OCERPs should **offer a default investment option** (i.e., a selection of underlying investment products that reflect an appropriate asset allocation given the investor's basic characteristics, e.g., age) to help individuals who are unable or unwilling to make investment choices;
- OCERPs should **provide solutions for dealing with investment risk** during the accumulation and pay-out phases. This requirement would seek to ensure adequate investment returns over the long term, while seeking to avoid individual exposure at the point of retirement to unnecessary market risk.
 - The **solutions for the accumulation phase** should offer a range of investment options. These might include guarantees of certain benefits or sophisticated asset allocation or investment approaches that ensure an automatic reduction over time of the share of risky assets in the OCERP portfolio. This would mitigate the risk of investors falling victim to a potential market collapse just before they retire.

4 More information on the EPPA proposal is available on: http://www.efama.org/index.php?option=com_docman&task=doc_details&gid=156&Itemid=35.

5 See Oxera report entitled "Defined-contribution pension schemes: risks and advantages for occupational retirement provision" and Maurer report entitled "Rethinking retirement income strategies - how can we secure better outcomes for future retirees". Both reports can be downloaded from the EFAMA website at the following addresses: http://www.efama.org/index.php?option=com_docman&task=cat_view&gid=29&Itemid=-99, http://www.efama.org/index.php?option=com_docman&task=cat_view&gid=261&Itemid=-99.

6 See <http://www.efr.be/members/upload/publications/76309EPP%202007.pdf>.

- The **solutions for the pay-out (or decumulation) phase** should offer the possibility of converting the accumulated lump sum into a recurring income stream after retirement, e.g., by supporting the use of pay-out solutions such as drawdown plans and variable/deferred annuities.

Transferability/portability

Transferability **between countries and/or employers and/or pillars** is essential within the European Union to support the free movement of people and labour. As such,

- Investors should be allowed to **merge pension or retirement accounts managed by different providers from different (former) employers** without incurring unnecessary losses. This recommendation would also lower complexity costs for providers and thus potentially for investors;
- **OCERP assets accumulated in one member state should be transferable to another.** Pay-outs should be taxed in the country in which any (potential) tax break was granted in the accumulation phase;
- **OCERPs should also be transferable between pillar 2 and 3 schemes**, so that, for example, employees moving to self-employment can keep their retirement assets.

It must be clear, however, that not all contracts provide identical benefits, (e.g., with regard to potential coverage of biometric risk within an OCERP) and that there could be some administrative costs associated with transfers. Regulation of the administrative costs, however, should stop plan/product providers from introducing prohibitively excessive charges, e.g., for pay-outs beyond national borders.

Flexibility

Flexibility further increases the attractiveness of the underlying investment products (and thus the OCERP), and should help overcome investors' limited stamina for long-term investments. As such,

- OCERPs should offer **flexible withdrawal/borrowing options** for specific reasons, such as buying owner-occupied real estate, covering old-age health care expenses, etc. Tax breaks should stay in place if withdrawals are returned within a set time frame, giving investors flexibility and increasing their propensity to save;⁷
- The EC should also require **flexible suspension rights** in OCERPs in specific cases, i.e., the right to offset retirement provisions for a set period. Specific cases could include unemployment, having children, buying owner-occupied real estate, and/or venture creation. Investors should be able to make up for suspended payments within the same fiscal year without losing (potential) tax breaks or government subsidies.

Any product provider that wants access to OCERPs (i.e., insurance companies, banks, asset managers) would need to ensure its products provide such flexibility.

Cost-efficiency and safety

Finally, to ensure cost-efficient OCERPs that benefit investors and to protect investors from an OCERP provider's potential bankruptcy, the regulator should impose:

- **Institutional management of OCERP provisions**, i.e., contributions from the same employer/employee group should be managed by a set of product providers selected by the employer (potentially pre-selected by the OCERP provider) in order to ensure sufficient scale and advantageous bargaining positions;
- **Management of OCERP investments in individual accounts** to allow transparency on the value of the individual's portfolio and ensure less disruptive (and thus less costly) asset/investment product transfers from one plan to another.

⁷ Pre-requirements (e.g., real estate appraisal, business plan certification by state-approved start-up consultant) and/or cap on withdrawal/borrowing (e.g., percentage of real estate value) to be discussed in order to protect individual investor from bad investment/reallocation decisions.

- Creation of **segregated accounts** (i.e., ring-fencing the OCERP assets from the provider's balance sheet assets), which would increase investor protection in case of product provider bankruptcy and allow economies of scale.

A2.2. Associated supervisory standards for Officially Certified European Retirement Plans (OCERP) and OCERP providers

The national regulatory body that has the authority to authorise retirement products should award OCERP status. Once certified in one member state, OCERP providers should be able to market OCERPs throughout the European Union.

To achieve this objective, it is essential to agree on a legal framework to:

- Provide OCERPs with a European Passport;
- Regulate the conditions under which financial institutions, in particular insurance companies and asset managers, could provide OCERPs across Europe.

One option to put this into practice would be for the new European Commission to prepare a proposal for a **new Directive** on the regulation and supervision of OCERPs and their providers.

An alternative approach would be for the European Commission to propose an **adaptation** of the Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (**IORP**)⁸.

Although the IORP Directive has only a limited track record⁹, it could be used as the basis creating a single market for pan-European personal retirement plans. For this to be possible, the IORP Directive should be adapted to:

- Include a section describing the proposed **unified framework for pan-European pension or retirement plans**. This should draw on this report's proposal on OCERPs and emphasise that these plans could be offered in Pillars 2 and 3;
- Include a section describing the proposed **regulatory requirements for OCERP providers**. In principle, insurance companies, asset managers and banks should be allowed to provide OCERPs under existing Directives. Alternatively, OCERP providers could be requested to comply with the IORP Directive. However, to improve efficiency, this approach should be coupled with the proposal in the next paragraph;
- **Create a level playing field** by allowing all regulated providers to offer OCERPs without requiring that they establish a separate new legal entity with a separate governance structure. Instead, the Directive should extend the approach offered in Article 4 to all financial institutions, which already benefit from a Community legislative framework;
- Use the opportunity offered by the revision of the Directive to **address other outstanding issues** that have been raised in the context of the review of the Directive by CEIOPS and the European authorities.

In developing a regulatory framework for OCERP and OCERP providers, it is important to recognise that the OCERP itself, so long as it is simply a wrapper around investment products, will have no need for additional solvency requirements. Existing EU capital and solvency rules would continue to apply to providers already subject to those rules. As a transparent wrapper, the OCERP would not embody any guarantees and hence not need capital backing. Of course, if an OCERP were designed in a particular member state to include guarantees within the wrapper, the relevant solvency rules would have to apply.

⁸ See http://ec.europa.eu/internal_market/pensions/directive_en.htm.

⁹ As of June 2008, only 70 cases of cross-border activity had been reported under the new IORP Directive (CEIOPS: "2008 Report on Market Developments").

In developing such a regulatory framework, the European Commission would be responding to the European Parliament's invitation "to undertake the preparation of an appropriate and feasible framework of regulation and supervision of pan-European pension products".¹⁰ It would also be responding to the understanding reached at the time of the negotiation of the IORP Directive that it would "carefully monitor the situation in the occupational pensions market and assess the possibility of extending the optional application of this Directive to other regulated financial institutions".¹¹

Developing a fair and balanced proposal for unified certification standards and harmonised tax treatment of OCERPs (at least at a national level) can be achieved only if the different European regulatory bodies work together. Also, all potential OCERP providers should be allowed to contribute in order to ensure that all relevant perspectives are incorporated.

To support such a development, interviewees recommended that EFAMA commits to launching an "Industry Research Group" to help the EU move in this direction. Its purpose would be to:

- Explore opportunities for innovation in personal retirement plans, e.g., creating marketable defined contribution schemes that contain some form of capital protection and risk coverage, and thus respond to the dilemma of costly guarantees and investors' demand for predictable but attractive investment returns;
- Further investigate the practicality of recommendations A2.1 & A2.2 in order to identify impediments and develop adequate implementation guidelines as a contribution to the European Commission's work on this matter.

A3. Give all product providers equal access to suitable and efficient OCERPs in order to foster competition for the best investor solutions

In order to ensure competition and bring about the best investor solutions, all investment product providers (i.e., insurance companies, asset managers, and banks) should be allowed to provide OCERPs as long as they comply with the OCERP certification standards outlined above.

In addition, interviewees strongly and unanimously argued that UCITS were eminently suitable to serve as the underlying investment products within the OCERP wrapper. This is understandable if one maps the proposed OCERPs certification standards against UCITS regulations:

- UCITS are domiciled in Europe, and thus fall under European regulation;
- Permissible UCITS investment strategies allow for sufficient diversification and pursuit of sophisticated asset allocation approaches. As far as guarantee-like features are concerned, e.g., coverage of biometric risks, asset managers could (and should) proactively pursue partnerships with insurance companies to bring the best of both worlds to investors;
- UCITS enjoy a world-wide reputation as a transparent investment vehicle, not least because of their provisions on (i) required cost disclosure and (ii) daily valuation of the net asset value of its shares;
- Given their divisibility into separate shares, the daily valuation of net asset values, and European-wide authorisation, UCITS funds are easily transferable across investment (retirement) plans, pillars, and countries;¹²
- Again due to the daily valuation of net asset values, withdrawals from UCITS investments are easy. In addition, suspending investment payments has not drawbacks for the long-term saver;
- As outlined, UCITS shares can be traded on a unit-by-unit basis, thus making them ideally suited for management in individual accounts.

¹⁰ See <http://www.europarl.europa.eu/oeil/resume.jsp?id=5575832&eventId=1057660&backToCaller=NO&language=en>.

¹¹ See recital 12.

¹² UCITS can, however, also offer weekly or bi-monthly valuation which may be more suitable to certain types of offerings.

Although only some asset managers are likely to opt for OCERP provider status and offer the whole retirement solution, all providers will have a keen interest in contributing to OCERPs by offering the underlying investment products. Interviewees are aware that investors might need more education to be convinced of the benefits of having pure asset management products in an OCERP. They are also sure that once this has been successful, the asset management industry can live up to its societal role and contribute to the long-term sustainability of the economy by delivering on the long-term goals of hundreds of millions of European long-term savers.

Summary

Overall, the three recommendations for long-term savings address all the relevant challenges identified in Chapter 1 (Exhibit 4). Individual recommendations have relatively little overlap, therefore implementing all three collectively is crucial if the challenges are all to be overcome effectively.

Exhibit 4: (A) Impact of recommendations on challenges in long-term savings

Degree to which synthesized recommendations are able to address challenges in long term savings

✓✓ Immediate impact
 ✓ Subsequent impact

Main challenges	A1	A2					A3
	Increase total European retirement savings by encouraging governments to introduce compulsory long-term saving schemes	Trans- parency	Indi- vidual choice	Port- ability	Flexi- bility	Cost efficiency	Give all PRIP providers equal access to the development of suitable and efficient OCERPs
Investor							
Lack of awareness of need to save for the long-term and tendency to procrastination	✓✓	✓					
Insufficient incentives to save privately for the long-term	✓✓				✓		
Limited stamina for long-term savings	✓				✓		
Legislator/regulator							
Inconsistencies at a national level in the fiscal treatment of similar investment products	✓	✓		✓			✓
Hindered true (cross-border) competition for best investor solutions				✓✓			
Limited transferability of long-term assets across plans, pillars, and countries				✓✓			
Retirement plan providers							
Not always sufficient transparency provision towards investors		✓✓					
Only limited asset/investment product choices			✓✓				✓
Not enough flexibility with regard to tailoring to individual customer needs		✓	✓✓	✓	✓		✓
PRIP provider							
Limited attractiveness of design of long-term savings products		✓	✓	✓	✓	✓✓	✓

Source: Interviews with CEOs of European asset managers, pension funds, and investor protection associations.

Exhibit 5: (A) Contributions of the AM industry and the regulator to implement long-term savings recommendations

Synthesised recommendations	Contribution of the AM industry	Recommended regulatory action
<p>A1 Increase total European retirement savings by encouraging governments to introduce compulsory long-term saving schemes (with opt-out clauses), that are organised with employer and/ or industry scheme support</p>	<ul style="list-style-type: none"> - 	<ul style="list-style-type: none"> Promote introduction of compulsory long-term savings schemes at a national level with automatic enrolment and an opt-out clause Encourage national legislative bodies to involve employers (or states/professional associations) in the contribution collection process Promote granting of best available tax benefits at a national level for compulsory retirement provisions (or alternatively, for certified retirement plans)
<p>A2 Increase the consumer-friendliness of long-term investments by introducing a personal retirement plan that has consistent certification standards across Europe (referred to as "Officially Certified European Retirement Plan"; OCERP)</p>	<ul style="list-style-type: none"> Individually prepare for meeting all recommended OCERP certification standards, e.g., by developing solutions (i) for dealing with investment risk during accumulation/payout phases or (ii) with sufficient flexibility, e.g., withdrawal/borrowing options Contribute to the development of a fair and balanced proposal for unified certification standards and harmonised tax treatment of OCERPs Launch an Industry Research Group to <ul style="list-style-type: none"> Explore opportunities for innovation in personal retirement plans Further investigate the practicality of the outlined OCERP recommendations 	<ul style="list-style-type: none"> Define unified certification standards for eligible retirement plans with regard to transparency, investment choice, portability, flexibility, and cost-efficiency/safety Define a certification process and associated supervisory standards for OCERPs, e.g., by adapting the IORP Directive to <ul style="list-style-type: none"> Allow for a European OCERP Passport Regulate the conditions under which financial institutions could provide OCERPs across Europe
<p>A3 Give all PRIP providers equal access to the development of suitable and efficient OCERPs in order to foster competition for best investor solutions</p>	<ul style="list-style-type: none"> - 	<ul style="list-style-type: none"> Ensure equal access for all PRIP providers to OCERPs as long as they comply with the OCERP certification standards

Source: Interviews with CEOs of European asset managers, pension funds, and investor protection associations.

B. Retail investment product distribution recommendations

The validity of the following recommendations is subject to full implementation of PRIP in order to ensure same rules across product categories. Also, when referring to distribution, these recommendations include selling and advising.

B1. Ensure harmonisation of distribution standards for packaged retail investment products (PRIPs) across product categories

Different investment product categories have different transparency and selling rules. The resulting distorted competition hampers investors' ability to compare alternative investment options and weakens their position with both distributors and product providers.

In order to create a level playing field, the same distribution standards should apply across all retail investment product categories.

In this context, the asset management industry, as represented by the contributors to this effort, welcomes the EU initiative on Packaged Retail Investment Products (PRIP). PRIP's objective is "to introduce a horizontal approach that will provide a coherent basis for the regulation of mandatory disclosures and selling practices at European level, irrespective of how the product is packaged or sold".¹³

In order to establish an effective level playing field, the scope of PRIP should be extended to capture the full universe of substitute investment products.¹⁴ This could eliminate existing inequalities and thus improve comparability across product categories.

Building on UCITS and MiFID frameworks, PRIPs should oblige product providers to publish a consistent and standardised Key Information Document (KID) containing, for example, investment policy, risk/reward profile, charges, past performance, etc. - some tailoring to product specificities might be required.

13 Communication from the Commission to the European Parliament and Council on PRIP COM (2009) 204.

14 EFAMA supports the Commission's proposal to use a broad approach based on a principles-based economic definition, to include among them structured products under the Prospectus Directive, structured term deposits, unit-linked insurance products as well as all insurance products with an investment/accumulation component and funds (including closed-end funds).

Furthermore, distributors should comply with specific selling rules, i.e., (i) avoid, manage or disclose any conflicts of interest that might arise in the sales or advice process, (ii) assess the suitability of investment products in meeting investors' needs, and (iii) disclose remuneration arrangements.

As PRIIP is still in development phase, the regulator should ensure (i) that it adequately captures product specificities (e.g., specifying counterparty risks of structured products) without compromising on a consistent ruling across categories, (ii) uniform implementation in all member states.

Once effective, PRIIP will give investors a better view of the potential consequences of their investment decisions. Additionally, a level playing field at the point of sale is established as all PRIIPs are subject to the same regulatory framework.

Finally, effective implementation will foster fair competition among product providers but also among distributors. This should ultimately lead to increased incentives for product delivery that correspond with the needs of investors.

All participants encourage EFAMA to continue to offer its support during the regulator's consultation processes, while fully acknowledging the regulator's leading role in advancing this initiative.

B2. Improve quality and transparency of activities at the point of sale

Harmonising distribution standards across product categories might not be sufficient to overcome all the challenges of distribution, as omissions or room for interpretation in current Directives can lead to business practices at the point of sale that are not in the spirit of investor protection.

The regulator should therefore seek to improve the quality and transparency of activities at the point of sale by adding to existing regulations. Specifically, it should:

- **Disclose the nature of distributors' services**
- **Ensure full disclosure of all cost items and the principles of remuneration arrangements**
- **Introduce a standardised advisor certificate**
- **Consider granting investors the right to withdraw from an investment decision.**

These additions would ease implementation, ensure effectiveness and extend the impact of PRIIP for all the investment products mentioned under recommendation B1. In order to ensure a level playing field, it is essential to ensure consistent application of these requirements for all PRIIPs, i.e., all recommendations outlined below apply to product providers and/or distributors across product categories.

B2.1. Disclose the nature of distributors' services

Today's requirements on disclosure and suitability of advice under MiFID aim to give investors the necessary transparency regarding the nature of the services the distributor is offering (knowing that as part of their services, distributors across Europe do not always provide investment advice). However, there is reason to believe that this is not enough to ensure that the aims are always met. Therefore, MiFID should also set standards as to how exactly this disclosure should take place, notably at the point of sale (e.g., design of disclosure form, etc.).

A crucial requirement for effective implementation is that the information is provided **proactively**, in an **understandable format** and **early in the sales/ advisory process**.

In this respect, the customer needs to know the nature of the advice he or she is receiving. In particular, the following information should be disclosed:

- **The distributor's duties to the client**, including general duties under MiFID. In particular the advisor should make clear at the outset of the provision of advice whether she/he is acting independently and will be remunerated solely by the client, or whether she/he will receive remuneration from a product provider or distributor.
- **The range of investment product categories** on which the distributor advises, e.g., mutual funds, investment products within life insurance policies, etc.;
- **The number and names of product providers** on which the distributor advises, identifying any product providers with whom the distributor has a potential affiliation;¹⁵
- **The basic principles of the fee arrangements** that the distributor has with different product providers and distributors for different product categories together with a table of comparable commissions/revenues payable on related, competing PRIPs by notably clarifying MiFID Level 2 Art. 26;
- **The basic criteria and process for selecting products** on the distributor's shelf;

Restoring the balance between investors and distributor helps the former better compare the offering of different distribution channels, with the understanding that clients are not necessarily best served by incurring the lowest possible cost but rather by finding the right product combination that meets their investment goals. It ultimately increases competition for products that best serve investors' needs. Effective implementation would also lead to more competition between distribution channels for the most client-centric distribution model.

B2.2. Full disclosure of all cost items and remuneration arrangements

For all PRIPs, the advisor should additionally be obliged to **disclose proactively all cost items and the principles of all remuneration arrangements**. The UCITS Key Information Document (KID) as foreseen by CESR's advice for UCITS IV Level 2 already requires UCITS to meet a very high level of disclosure for fund costs. In addition, MiFID Level 2 Art. 26 (inducements) and 33 (cost disclosure) provide relevant disclosure requirements at the point of sale. However, varying levels of implementation of the Directive weaken the impact of these rules for the investor. Furthermore, the scope of MiFID does not require all PRIPs to adhere to the high standards that apply to UCITS.

This disclosure must be delivered in a form that the investor can easily understand, comprising all items and arrangements whether they be (i) direct or indirect, (ii) one-off or recurring, (iii) at the time of purchase, in the holding period, or at the exit of the investment. The UCITS KID should be a benchmark for all PRIPs.

The investor should understand exactly what he or she is paying in order to make better informed investment decisions.

In detail, the **distributor's** obligations towards its clients should include:

- Communication of product/solution costs (including performance fees) as given by the product provider and clear specification of any kind of distribution fees/margin;
- An indication of which part of the fees is paid by the investor directly, any ongoing charges and any fees paid out of any PRIP, as already provided by the UCITS simplified prospectus and, in the future, by the KID (e.g., for UCITS funds);

¹⁵ E.g., corporate integration, exchange of goods and/or services not related to the financial product itself, e.g., IT, marketing, etc.

- Disclosure of all information (in particular the costs mentioned above) at the point of sale before the customer is bound by any contract, so that he or she is fully aware of the distributor's remuneration for selling the PRIIP. As far as UCITS are concerned, CESR has issued clear recommendations to the European Commission with the support of the industry.

To be effective, recommendation B2.2 would need to be enforced prior to any sales (be it advice or execution only). Repeated non-compliance on the part of the advisor should lead to the suspension of the advisor certificate detailed in recommendation B2.3.

More transparency on cost should lead to investors being able to drive the prices of services offered and/or increase the quality of advice provided.

The regulator should keep in mind that the requirement to disclose the actual cost for advice could lead to distributors having to withdraw from the business if they cannot attract customers or to revert to non-regulated products.

For asset managers, clear disclosure of costs could give them increasing bargaining power with distributors. This assumption, however, only holds as long as the level playing field detailed in recommendation B1 is achieved.

Interviewees also acknowledged that one of the challenges facing the industry relates to investors' education and their ability to understand product descriptions, which can be very technical.

B2.3. Introducing a standardised advisor certificate

Although MiFID has included advice in the range of investment services, some improvements should be considered to meet investors' expectations better. In particular, the interviewees believe that:

- The distributor or advisor must ensure that she/he and the client have a common understanding of the client's investment goals, their investment time horizon and their risk willingness;
- The distributor or advisor must ensure that she/he has a clear understanding of the products being recommended to the client, e.g., return/risk profile;
- The distributor or advisor must ensure she/he is equipped to follow up and explain the products' performance at any time after the investment decision has been taken.

Therefore, everyone advising on retail investment products should prove their capabilities by achieving a **standardised advisor certificate or equivalent standards of advisor education and competence**. These could be differentiated by products, product complexity, or customer types. Such a certificate should be mandatory for all PRIIP distributors that have direct retail investor interaction (including insurance advisors), in order to increase the quality of service at the point of sale.

A standard certificate would increase investor trust as it would ensure that advisors assessing the suitability of products for the individual investor fully understand the products' features as well as their duties towards their clients. Additionally, it would further level the playing field across distribution channels, which differ fundamentally in their advisor requirements or have no requirements at all.

Given previous industry efforts at the national level, self-regulation alone does not seem feasible for the effective implementation of this recommendation. The European regulator could, however, define high-level guidelines for an advisor certificate and the certification process, which would then be subject to further detailing on a national level. These high-level guidelines should be a result of the ongoing MiFID review of the rules for business conduct.

In the light of national differences in existing standards, training programs, and educational levels of asset managers' sales forces - the interviewees recommended that EFAMA investigate the feasibility of introducing a European-wide sales force certification program that would (i) certify members' existing training programs, (ii) monitor compliance, and (iii) promote the certification within its sphere of influence. This should have an indirect but significant effect on the quality of advice provided at the point of sale. Additionally, and to further support the distributors'/ advisors' ability to understand and explain the products they sell/ advise on, the group of interviewees called for more simplicity in marketing and sales support materials, as well as increased efforts in the training and development of the sales forces of PRIIP providers.

B2.4. Consider granting investors the right to withdraw from an investment decision

The interviewees raised the idea of giving investors the **right to withdraw from an investment decision** within a sensible time frame.

This recommendation, while requiring further investigation given the increased complexity it would entail, aims to reimburse a portion of the transaction fee if the customer decides to withdraw from an investment decision. This could lead investors to engage more fully in the advisory process. Furthermore, investors would be more likely to solicit additional external advice and make more effort when comparing offerings. Any right would of course exclude reimbursements for losses due to market fluctuations etc.

Distributors could commit themselves to make such a right to withdrawal standard practice. The regulator should intervene only if such a negotiated agreement does not prove effective.

In either case, restrictions on the types of reimbursement should be part of the negotiated agreement or regulation.

Effective implementation of this recommendation, which all parties recognise as highly complex, should enable investors to verify the information provided by the advisor during the advisory process (e.g., via objective third-party sources) and freely reconfirm the investment decision taken. The interviewees believe that EFAMA should commit to investigating the concerns expressed by some of them regarding the feasibility and impact on complexity costs that ultimately would be borne by all remaining investors.

B3. Promote further confidence in UCITS as a trustworthy investment vehicle

UCITS should be promoted more strongly as a trusted pan-European investment vehicle. The wide spectrum of asset classes and investment strategies allowed within UCITS has proved beneficial in optimising risk/return profiles that were not previously possible. On the other hand, this extension of allowable asset classes and investment strategies has made it difficult for investors and advisors to keep track of the UCITS universe and what it represents. This suggests that a comprehensive classification is needed regarding (i) risk/return profiles of UCITS and (ii) fund type based on a UCITS' portfolio holding.

An ideal classification would allow investors (and advisors) to compare different UCITS, and thus to distinguish suitable products. Such a classification would lay a strong foundation for investor trust in UCITS.

However, a simplistic risk/return classification of UCITS into basic and complex funds based on asset classes is not advisable, given that "complex" does not automatically equate to "high-risk", and "basic" does not necessarily mean "safe". Furthermore, a uniform fund-type classification with regard to portfolio holdings has not been established fully at a European level.

In order to move ahead, it is recommended that the asset management industry:

- Strengthen industry risk measurement and management capabilities
- Scales up efforts to establish a European-wide fund type classification with regard to portfolio holdings.

B3.1. Strengthen industry risk measurement and management capabilities

CESR has already advised the European Commission on including a risk/return indicator in the UCITS KID. CESR's proposed methodology to calculate such an indicator - the Synthetic Risk and Reward Indicator (SRRI) - is based on historical volatility of the respective fund and provides a visual, standardised numerical scale for these risk categories.¹⁶ The European Commission will make the final decision on the concrete methodology for computation of the SRRI in its Level 2 proposals for UCITS IV.

Although not fully convinced of the benefit of the SRRI in its current form - especially in the light of expected distortions that applying the SRRI would have if restricted to asset management products - interviewees suggested that EFAMA sponsors an industry initiative to develop an inventory of risk management practices from which it can derive proposals for strengthening risk analytics capabilities, and to promote where relevant more rigorous product stress testing. This initiative would be independent of any roll-out of the SRRI, yet it would help the industry by providing further indicators to investors to help them make decisions.

B3.2. Establish a European-wide fund-type classification with regard to portfolio holdings

Confusion around available UCITS funds can stem from the lack of a robust, mutually agreed standard for fund-type classification regarding the underlying portfolio holdings. There is a call for EFAMA to scale up its efforts within the European Fund Classification Forum (EFCF).

This group was founded in 2002 with the objective to:

- Develop a robust fund-type classification at a European level that allows UCITS funds to be compared easily;
- Commit national asset management associations to promote and use consistently the fund classification endorsed by EFAMA;
- Set up a system of independent and transparent controls of the classification results. Such a system would ensure adequate monitoring and accountability for the fund type classification.

Several milestones have been achieved (e.g., defining classification criteria and process, nominating an independent classification administrator), but full harmonisation has yet to be reached. In the months ahead, it is recommended that EFAMA develops a strategy to achieve this goal and works together with CESR/ESMA to see how it could be implemented across Europe (along the lines of what is being done for money market funds).

For the overall effort, described under B3.2, EFAMA is seen as the appropriate partner to engage with fund rating agencies and other bodies whose role is to distribute information on fund investment performance. An industry-wide consultation would seek to promote more discipline and better standards of classification that would be used widely in marketing and distribution efforts.

It is recognised that in some countries fund classifications are driven by national regulators.

¹⁶ For structured products, implicit volatility is extracted from a Value-at-Risk computation; cf. CESR/09-949.

Summary

The recommendations on retail distribution address most of the identified challenges. The summarised impact assessment (Exhibit 6) shows that challenges are often addressed by multiple recommendations. Yet, implementing all the recommendations is advisable in order to maximise their impact.

Exhibit 6: (B) Impact of recommendations on challenges in distribution

✓ Immediate impact
✓ Subsequent impact

Degree to which synthesized recommendations are able to address challenges in distribution

Main challenges		Synthesised recommendations for distribution				
		B1 Harmonise distribution standards for packaged retail investment products (PRIPs) across product categories	B2 Improve quality and transparency of activities at the point of sale Disclose the nature of distributor's services and of all cost/remuneration items	Introduce standardised advisor certificate and potentially investor withdrawal right	B3 Promote further confidence in UCITS as a trustworthy investment vehicle Strengthen industry risk measurement and management capabilities	Establish European-wide fund-type classification regarding portfolio holdings
Investor	Investors confronted by complexity of product choice and design	✓		✓	✓✓	✓
	Investors with lack of prompt proof of quality regarding their investments		✓	✓		✓
	Investors lack sufficient financial education and engagement	✓	✓✓	✓✓	✓	✓✓
Distributor	Distributors not given sufficiently strong incentives to act in the best interest of their clients		✓	✓		
	Distributors not always providing the best possible advice	✓	✓	✓✓	✓	✓
	Distributors potentially biased towards certain PRIP providers/PRIP categories	✓✓	✓			
PRIP provider	PRIP providers not always showing appropriate consideration for investor needs	✓	✓	✓		

Source: Interviews with CEOs of European asset managers, pension funds, and investor protection associations.

Exhibit 7: (B) Contributions of the AM industry and the regulator to implement distribution recommendations

Synthesised recommendations	Contribution of the AM industry	Recommended regulatory action
B1 Harmonise distribution standards for packaged retail investment products (PRIPs) across product categories	<ul style="list-style-type: none"> Support the consultation process of PRIP 	<ul style="list-style-type: none"> Create equal transparency requirements and selling rules for all retail investment products by advancing the PRIP initiative, provided PRIP captures the full universe of retail investment products, in particular <ul style="list-style-type: none"> Ensure adequate capturing of product specificities without compromising on a consistent ruling across product categories Ensure uniform implementation of the new directive in all member states
B2 Improve quality and transparency of activities at the point of sale	<ul style="list-style-type: none"> Support introduction of a standardised advisor certificate, e.g., by <ul style="list-style-type: none"> Investigating the feasibility of a European-wide certification standard of asset management sales force training programs Simplifying marketing/sales support materials in order to enable distributors/advisors to better inform investors Further investigate practicality and feasibility of granting withdrawal rights to investors 	<ul style="list-style-type: none"> Demand "disclosure of nature of distributor's services" proactively, in an understandable format, and early in the sales/advisory process (e.g., by leveraging MiFID review) Require advisors to proactively disclose all cost items and remuneration arrangements for all PRIPs Define high-level guidelines for an advisor certificate and the associated certification process (as result of the ongoing MiFID review of the rules for business conduct)
B3 Promote further confidence in UCITS as a trustworthy investment vehicle	<ul style="list-style-type: none"> Strengthen industry risk measurement and management capabilities, i.e., <ul style="list-style-type: none"> Raise an inventory of risk management practices and derive proposals for strengthening risk analytics capabilities Promote, where relevant, more rigorous product stress testing Scale up efforts to establish a European-wide fund-type classification with regard to portfolio holdings and develop a strategy to achieve this goal 	-

Source: Interviews with CEOs of European asset managers, pension funds, and investor protection associations.

III. Additional industry initiatives to underpin commitment

The recommendations thus far have mainly looked at regulatory intervention, although the asset management industry acknowledges its obligation to contribute to the measures outlined.

In addition, the contributors to this effort have reiterated the need for further action to **reinforce the fiduciary role of asset managers**. Such actions will need a coordinated effort. EFAMA seems to be the appropriate forum to seek ways to:

- Promote financial literacy and competence of individual investors and financial advisors;
- Set industry aspirations for good business conduct and performance.

C. Recommended industry actions to underpin improvements

C1. Promote financial literacy and competence of individual investors and financial advisors

This recommendation addresses individual investors' lack of financial literacy and low levels of engagement when dealing with financial products. Effective promotion of financial literacy would enable investors to (i) **make better informed investment decisions** and (ii) **drive the quality of the investment products and services offered** in the market.

It is seen as part of EFAMA's responsibility to provide practical support to the European Commission and European governments in contributing to investor education.

The group of 23 interviewees recommends that EFAMA should be committed to the following initiatives:

- Conducting a **"European financial literacy campaigns survey"** on existing public and private financial literacy initiatives in EU member states. This survey would aim to share good practices in financial education throughout the EU. It would provide a detailed description and impact assessment of existing practices;
- Developing an **"Introduction to investments"** glossary that is freely available on EFAMA's website. This will provide general investor information with a focus on investment funds, e.g., elaborating on different investment purposes, explaining risk and return, different fund types, fees, and investment jargon. EFAMA will encourage national asset management associations to adopt this glossary.

To be truly effective, any promotion of financial literacy needs broad-based support from all financial services participants. As part of such a joint effort, EFAMA could roll out selected initiatives that have been successful in raising investor knowledge and increasing engagement. Additionally, the financial services industry can provide valuable and practical input at a national level in adjusting school curricula to ensure pupils receive basic economic and financial education.

C2. Set industry aspirations for improved business conduct and performance

To ensure the best possible investor protection, it is recommended that EFAMA promotes high standards for the asset management industry. To this end it is suggested that EFAMA reviews its existing code of conduct.

Moreover, EFAMA should drive the establishment of a European Industry Research Group amongst its members. This group would then be asked to develop an industry **best practice library** that will collect practical recommendations to improve business conduct and performance according to targets set in the code of conduct. Concretely, it is recommended that EFAMA undertakes to:

- **Identify best practices throughout the asset management industry** for delivering on a code of conduct, potentially differentiated by type of asset management company;
- **Develop a systematic evaluation** for all identified practices. Evaluation should enable EFAMA to certify quality and award a seal;
- **Promote EFAMA quality seal to distributors and investors** in order to generate interest in products from endorsed asset managers;
- **Introduce annual awards**, e.g., for the most client-centric asset managers (selected by an independent jury).

IV. Concluding remarks

Every participant in this industry has a role to play in improving the provision of long-term savings and distribution of investment products for the benefit of investors. Only when all stakeholders join forces in this critical endeavour will they be able to shape an even more attractive market place. Investors will benefit by being able to achieve their individual investment goals and the wider financial industry will benefit from the improvement in investor trust. Some of the recommendations above may negatively affect some distributors' and product providers' economics, particularly in the short-term. Once effective, they might even lead to changes to their business models. It will be up to each of these industry participants to anticipate these effects and adapt accordingly.

The investor is at the heart of this effort. Some interviewees felt that the industry has placed too little emphasis on the investor for too long, and that the pivotal axis has been between producers and distributors. This imbalance, where it occurs, must be corrected. An investor-centric industry is a prerequisite for the sustainable long-term success of the wider financial industry, and is therefore crucial for all participants.

As this report shows, key senior executives from the asset management industry are committed to meeting the industry's responsibilities and to contributing to improvements in long-term savings and distribution. But the asset management industry cannot drive the necessary change alone. Success depends on facilitation and action by European legislative bodies as well as European-wide regulators.

As fiduciaries with a focus on client interests and needs, the asset management industry is committed to supporting high standards of efficient, effective regulation, consumer/investor protection, corporate governance and financial reporting standards. Therefore, in addition to the recommendations identified in this report, the authors and sponsors commit to engage fully with regulators, supervisors and accounting standards bodies to ensure rules, regulations and standards are:

- **Evidence-based** with high quality data available from the industry to relevant parties, notably through the consultation process;
- **Effective and efficient** such that cost-benefit analyses and impact assessments are supported by practitioner input that is factual, relevant and of good quality;
- **Cost effective and practical to implement** such that European consumers benefit from enhanced standards without a cost burden.

This report can serve only as a starting point for a promising if challenging journey. The pressure to reassess the traditional models of offering long-term savings products and distributing investment products to retail investors has been highlighted by the financial crisis. Now, it is industry participants' turn to drive the necessary changes. In doing so, they will of course have to elaborate on the actions required. As the asset management industry's leading European representative body, EFAMA must reach out to all relevant stakeholder groups to discuss the recommendations further and to initiate a joint effort that should lead to success for producers, distributors and - crucially - investors.

More about EFAMA

EFAMA is the representative association for the European investment management industry. It represents through its 26 member associations and over 40 corporate members approximately EUR 12 trillion in assets under management, of which approximately EUR 7 trillion was managed by approximately 52,000 funds at the end of December 2009. Just under 36,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds.

The mission of EFAMA is to:

- Support a high level of investor protection through the promotion of high ethical standards, integrity and professionalism throughout the industry;
- Promote the completion of an effective single market for investment management and the creation of a level playing field for competing saving and investment products;
- Strengthen the competitiveness of the industry in terms of cost and quality through seeking and obtaining improvements in the legal, fiscal and regulatory environment.



Contact point:

EFAMA - European Fund and Asset Management Association
18 Square de Meeûs, B-1050 Bruxelles
T. +32 2 513 39 69 - F. +32 2 513 26 43
Email: info@efama.org - <http://www.efama.org>