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## **Opening Remarks**

Check Against Delivery  
Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort

Open Hearing on Retail Investment Products

**Brussels, 15 July 2008**

Ladies and gentlemen,

Retail investment products come in a variety of packages, some very complex. Even for the mathematicians among us, it can be difficult to understand some of the investments currently available in the retail market. This is why it is so crucial that those manufacturing and distributing such products act responsibly. Treat prospective investors fairly. And provide the product information necessary for informed investment decisions.

We have different European rules in place to ensure that these basic objectives are met for different products. Today's hearing asks whether these rules are sufficiently coherent. Do they deliver a level playing field? Do they provide a high and consistent level of investor protection across the spectrum of retail investment products?

These are not abstract issues. Over 10 trillion € is invested in packaged retail investments. Investor confidence will be critical to sustaining the continued successful development of these markets. If investors are burned by investments in inappropriate or opaque products, they will exit the markets. This is in nobody's interest. Investors would suffer, the industry would suffer and - at a time when state coffers are coming under increasing strain – so would the economy at large.

In my view, investors have perhaps never been better served by the range of products on offer. Product innovation is rapid. The opening up of distribution channels to third-party products, as well as the growth of new ways to buy, such as through internet platforms, has greatly improved access to financial markets for the public at large. The first panel today will give us more insight into how these markets are evolving.

These developments hold out the promise of high-performing investment solutions that are matched to the needs and circumstances of retail investors. But they also bring challenges. The market is now characterised by a much wider spread of actors and products; more complex investment solutions; and powerful distribution systems with largely passive and captive client networks. The wealth management industry, national regulators and EU authorities must work together to harness the potential benefits – to ensure that market participants can compete on the basis of offering the best value for money investment solutions to investors.

There is no hard and fast legal definition of retail investment products. Common-sense can take us a long way. If I go to my local bank or financial advisor with money to invest for a few years, and want to look beyond plain savings accounts, I may be offered mutual funds, structured securities of various types, structured term deposits, unit-linked life insurance policies. All largely interchangeable from my perspective as a medium-term investor. All of them are to be regarded as retail investment products for the purpose of this review.

Don't get me wrong. I'm not saying that the products are identical. The promise made by the manufacturer of each product is different. Some products may have to be held for a fixed period – others can be cashed in at regular intervals. Some have capital guarantees, some do not. Some are riskier than others. They are not, therefore, perfect substitutes. There are differences in performance and structuring which call for some differentiation in regulatory treatment.

However, all of these products compete for my savings. All offer the prospect of a return linked to an investment in some kind of financial market. The core economic function is just the same: however packaged, they are investment products marketed to retail investors.

Faced with the co-existence of retail investment products – often available through the same distribution channel – it is important that public policy should promote efficient market outcomes. How can public policy help?

In three ways:

- First financial education can help retail investors and consumers to find their bearings in an increasingly complex market. Our recent White Paper on Financial Education announced a set of targeted initiatives to support national efforts in this area.
- Second, effective and relevant product disclosures can help self-directed investors to make reasonably informed decisions, and support sales dialogue between investors and intermediaries.
- Third, intermediaries and product distributors can be subjected to effective duties of care towards the clients who rely upon them for advice or brokerage services.

An effective strategy in this area is like a three legged stool. Without one of the legs, the stool will collapse. I have spoken at length elsewhere about financial education. Today I will focus on product disclosures and intermediary regulation.

Improving product disclosures and point of sale regulation

If we are going to make progress, we need to be guided by clear and simple principles. We need to be clear about responsibilities and the desired outcomes. I would like to try to frame five basic principles that should guide public policy in this area:

- First, investors need clear, accurate, information, presented in a form that they can understand - on the nature of the proposed investment, charges and the expected risks and rewards. The trick is to package the information effectively. Too much information can be unhelpful. We know from bitter experience that retail investors are turned off by technical, lengthy disclosures. We also know that it is not beyond the wit of the industry and regulators to design such disclosures. We are doing it now for UCITS funds. The same level of transparency should be brought to bear on all other retail investment products.
- Second, investors need to be able to rely on distributors operating to high standards. Investment products are frequently sold on the basis of advice from financial intermediaries. In these cases, the investor needs to be confident that the distributor will only propose products that are appropriate to the investor's needs and circumstances.
- Third, prospective investors need to be confident that the advice given is driven by their needs and not by the profitability of the product for the distributor. Of course, financial intermediaries need to be remunerated for the service they provide. But if selling processes are driven by commission payments and this is not transparent to the investor, there is a real risk that the investor will be the loser.
- Fourth, we know that many customers rely on advertisements for financial products to make their investment decisions. If we cannot be sure that investors pay sufficient attention to pre-contractual disclosures, then it is all the more critical that advertisements for financial products do not paint a misleading picture of the risks and likely performance of a product.
- Fifth: the respective responsibilities of product originator and distributor need to be clear. There should be no ambiguity about which entity is answerable to the supervisor for ensuring compliance with the relevant obligations.

What happens if these principles are not complied with? Unfortunately, we have seen in Europe and around the world many instances of investor detriment caused by breach of these principles. In many of these cases, the risks associated with the products were not sufficiently transparent to retail investors. We need to ensure that investors are not left holding under-performing or inappropriate investments because of product opacity, distorted incentives for distributors, or lax selling practices.

We also need to ensure that these principles are respected for the full suite of retail investment products – and to all distribution channels. The quality of product disclosures must be consistently high across the board. The level of care shown to the investor should not depend on the type of product or intermediary. Conflicts of interest resulting from commissions should be effectively managed and disclosed throughout the industry. Misleading marketing should be eliminated for all products.

This does not mean that product disclosures and intermediary regulation need to be identical for all investment products. There are differences between products which might require different metrics for cost or risk-reward disclosure. There may be a need for some differentiation in the finer detail. However, I see no reason why the five principles set out above should not apply fully to all retail investment products.

I would go further. If these principles are not applied comprehensively and effectively to all retail investment products - they will be circumvented and quickly rendered redundant. Institutions and products that comply with these requirements will be undermined by products which do not. We cannot allow products that do not embody high levels of investor protection to drive out those that do. Therefore, it is a case of 'one in, all in'.

### **What needs to be done at EU level?**

The institutions structuring and selling retail investment products are generally subject to EU legislation. However, these EU rules have evolved in a piecemeal fashion. They have not been shaped by a coherent approach to product disclosure and distribution. Given the growing dependence of European investors on packaged investment products, we need to move on from the present scatter-gun approach.

I have asked my services to evaluate how existing EU rules measure up to the 5 principles introduced above. This work has attracted a great deal of attention from the industry, consumers and from the regulatory community. Perspectives differ widely. Our review has identified a range of areas where financial institutions appear to be operating subject to different levels of fiduciary and transparency obligations. I would like to highlight three examples:

- First, product disclosures. Retail investors do not currently receive key information in a clear and accessible format. Not enough is being done to disclose investment direct or implicit costs. Investors, and intermediaries, are not generally in a position to assess or compare the likely performance and risks of their investments. This is an area where progress is badly needed.
- Second, management and disclosure of conflicts of interest. Questions have been raised about the robustness of EU rules for conflict of interest management and disclosure for intermediaries distributing unit linked life insurance products.
- Third, products outside the scope of EU regulation. Certain product types, notably structured term deposits, are not currently subject to disclosure and distribution rules in European law.

Variations in European rules are only part of the story. National implementation and effective enforcement are even more important in determining outcomes. Many national regulators have already added to the baseline provided by EU rules in their own jurisdictions. The three European committees responsible for banking, insurance and securities' markets are stepping up their engagement with these issues so as to promote convergent outcomes. Some parts of the industry, too, have been active in developing best practices for disclosures, advertising and selling practices, and clarifying the respective roles of product originators and distributors. We will hear more about these initiatives in the second and third panels today.

However, it is already clear that the status quo can be improved upon. We have to raise the bar – in terms of product disclosures and point of sale regulation – for all retail investment products. We want to make sensible adjustments that improve outcomes on the ground without undue disruption to established markets and business models. I am conscious that new rules on retail distribution – notably in MiFID and the Insurance Mediation Directive – need time to work their way through the system. I am also well aware of the cost to industry - and ultimately the consumer - of adapting to changes in the regulatory environment. It will be a challenge to identify sensible ways to move forward. But if we do not rise to the challenge, we will pay a heavy price in the form of a misfiring and distorted single market for investment products.

## Conclusions

Ladies and gentlemen,

I am convinced that these issues deserve to mobilise the collective efforts of everybody with a stake in the sustained success of the EU market for retail investment products. The current difficulties besetting the EU financial industry are important – but they should not lead us to lose sight of these longer term challenges.

There will be a million reasons why progress will be hard to achieve. There will be thousands of voices defending the status quo. But we need to take the longer-term view. Lack of transparency and regulatory gaming are not a good basis on which to build sustainable markets or successful businesses.

There is a lot that we can do – particularly through effective product disclosures – to improve the quality of investor outcomes and facilitate competition based on the quality of products. These do not require us to turn the European financial rule-book on its head. By the end of the year, I would like to be able to set out a number of steps that we can take to start the necessary progress towards this objective.

I am sure that today's hearing will provide many ideas that will guide us in mapping the way ahead on this issue.

I will now pass the floor to Mr Othmar Karas, *rapporteur* of the recent EP report on retail financial services, who will provide a perspective from the European Parliament.