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David McIntosh QC (Hon)
Chairman

31 January 2011

By Email: markt-prips-consultation@ec.europa.eu

Interest Representatives Register ID: 24418535037-82

Dear Sirs

Re: City of London Law Society Regulatory Law Committee response to the consultation by Commission Services on legislative steps for the Packaged Retail Investment Products Initiative

The City of London Law Society (“CLLS”) represents approximately 14,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultation in issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Regulatory Committee (the “Committee”). Members of the Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

The Committee wishes to comment on certain legal issues and to respond to certain of the questions raised in the Consultation, which we regard as important to our members and the financial market participants that we advise.

1. SCOPE OF THE PRIPs REGIME - PROPOSED PRIPs DEFINITION

Q. 1: Should the PRIPs initiative focus on packaged investments? Please justify or explain your answer.

Q. 2: Should a definition of PRIPs focus on fluctuations in investment values? Please justify or explain your answer.

Q. 3: Does a reference to indirectness of exposure capture the 'packaging' of investments? Please justify or explain your answer.

Q. 4: Do you think it is necessary to explicitly clarify that the definition applies to fluctuations in 'reference values' more generally, given some financial products provide payouts that do not appear to be linked to specific or tangible assets themselves, e.g. payouts linked to certain financial indices, the rate of inflation, or the overall value of a fund or business?

Q. 5: Do you have any other comments on the proposed definition? If you consider it ineffective in some regard, please provide alternatives and explain your rationale in relation to the criteria for a successful definition outlined above.

We agree that the PRIPs initiative should focus on packaged investments as opposed to direct investments, for the reasons set out in the Consultation. Broadly speaking, packaged investment products may fulfil comparable functions for retail investors, regardless of the legal form of such investments. Therefore, from the point of view of retail investors, the legal form that such packaged investments may take is not as relevant as the economic function the investments are designed to fulfil. The PRIPs initiative should ensure that a retail investor is provided with a standardised level of regulatory protection across comparable investment products (regardless of legal form).

We consider that the reference to indirectness of exposure does capture the 'packaging' of investments, given that it draws a distinction between assets and investments held directly, and those that are held by some other means (such as via a collective investment scheme).

The proposed PRIPs definition is drafted very widely, which to some extent, may be to the expense of legal certainty. For example, we note that there is a risk that certain financial instruments (such as depositary receipts) which are not usually considered to be or intended to be packaged investments may be caught (should they be sold to retail investors). However, this risk may to some extent be mitigated by the level 2 indicative list discussed below. It is essential that there is clarity on the intended scope of the definition.

We agree that the focus on packaged products and the proposed horizontal approach should

enable consumers to more easily make comparisons between products, to understand more clearly the sales process and the risks that may attach to a particular investment, and should help to avoid the risk of regulatory arbitrage, and the potential for customer detriment that may arise as a result. We agree that the MiFID regime is a suitable “benchmark” for this purpose.

2. DEPOSITS

Q. 6: Should simple (non-structured) deposits be excluded from the scope of the initiative? Please justify or explain your answer.

Q. 7: Do you consider option 1 or option 2 preferable for achieving this? Please explain your preference, and set out an alternative if necessary, with supporting evidence.

Q. 8: Should such an exclusion be extended to financial instruments which might raise similar issues as deposits (e.g. bonds), and if so, how might these be defined? Please justify or explain your answer.

We agree that simple (non-structured) deposits should be excluded from the scope of the PRIPs initiative, for the reasons set out in the Consultation (in particular because the function fulfilled by such deposits, and the risks faced by the customers who make such deposits, are different than the functions and risks that relate to packaged retail investment products).

We also agree that structured deposits should be treated as PRIPs rather than be treated in the same way as simple deposits. This is because structured deposits tend to be more complicated than other deposit products, and in general, we consider that they tend to fulfil an investment product role (albeit a low risk investment), as opposed to the role of a traditional non-structured deposit.

In terms of the approach to be taken in demarcating these structured deposits, we agree that the second option would provide the simpler approach.

In relation to bonds, we would firstly note that additional clarity is essential as to what is meant by ‘bond’ for the purposes of the retail market – should this be the narrow definition (i.e. any instrument acknowledging indebtedness) or used in a wider sense (e.g. to indicate any instrument that not a share – from insurance policies to debentures).

3. PENSIONS

Q. 9: Should pensions be explicitly excluded from the PRIPs initiative at this stage? Please justify or explain your answer.

Q. 10: Should annuities be treated in the same fashion? Again, please justify or explain

your answer.

Q. 11: Do you have any comments on the proposed manner of achieving this exclusion?

Q. 12: Do you agree that variable annuities might need to be treated as a special case? If so, how should these be defined, and how do you think they should be addressed?

We agree that pension products should be excluded from the PRIPs initiative at this stage. Pension products perform a different role for retail investors than packaged investment products, and they are subject to different legal, tax and public policy considerations than packaged investment products.

4. CLARIFYING THE DEFINITION: USE OF INDICATIVE LIST OF PRODUCTS

Q. 13: Do you see benefits from such an indicative list being developed? If not, please provide alternative proposals and evidence for why these might be effective.

Q. 14: Do you have any suggestions on the possible contents for such a list, including on how to define items placed on the list?

We agree with the approach set out in the Consultation. The benefit of an indicative list would be to provide more certainty as to whether or not a particular investment product will fall within the definition of a PRIP. However, given that the list would be 'indicative' only, as opposed to comprehensive, we have the following comments:

- To provide additional certainty, we would support an approach whereby the indicative list would explicitly indicate things that are not PRIPs as much as things that are¹;
- The indicative list will only provide certainty to the extent that a particular product is included in the list. Unlike an approach where formal guidance is issued, where a particular product type is not included in the list, there is no certainty as to whether that particular product should or should not be caught by the PRIPs initiative. We note that the Commission may supplement the list with technical standards and guidance, which could also be relatively open to revisions and updates. This is an approach that we would support;
- The list (and guidance) should be drafted fairly widely, to avoid a situation where products are purposefully developed in such a way as to avoid being included in the list;

¹ On the assumption that there will be no "negative scope" provision as per the Payment Services Directive.

- The list should be supplementary to the level 1 legislation only – it should not be used as a way to bring products within the scope of the PRIPs initiative which were not originally intended to be within scope, without proper consultation.

5. LEGISLATIVE APPROACH TO BE TAKEN IN DELIVERING THE PRIPS REGIME

Q. 15: Should direct sales of UCITS be covered by means of including the relevant rules within the UCITS framework?

Q. 16: Do you have any comments on the identified pros and cons of this approach, and any evidence on the scale and nature of impacts (costs as well as benefits)?

We agree that direct sales of UCITS should be subject to similar sales and disclosure requirements as sales of other types of packaged retail investments, as we consider that all PRIPs should be subject to the same disclosure and sales requirements to enable effective comparison, and to enhance transparency. We agree that MiFID is a suitable benchmark.

As an additional point, we note that neither the IMD nor MiFID will apply to direct sales by insurance companies of PRIPs unless there is a change in scope of those directives for this purpose. This is something that should be addressed in future consultations.

6. A NEW PRE-CONTRACTUAL PRODUCT DISCLOSURE INSTRUMENT - POSSIBLE CONTENT OF THE KIID

Q. 17: Should the design of the KIID be focused on delivering on the objective of aiding retail investment decision making? If you disagree, please justify or explain your answer.

Q. 18: Should the KIID should be a separate or 'stand alone' document compared with other information that might be necessary, e.g. background information, other disclosures, or contractual information? Please justify or explain your answer.

Q. 19: What measures do you think will be necessary to ensure KIID remain streamlined and focused solely on key information?

We agree that the design of the KIID should be focused on delivering on the objective of aiding retail investment decision making for the reasons set out in the Consultation.

We also agree that to the extent practicable, the KIID should be a separate or 'stand alone' document compared with other information that might be necessary. Having said that, we also consider the extent to which a "standalone" KIID will be viable will depend on (i) what the purpose of the document is to be, (ii) what the content requirements are to be, and (ii) the liability

regime to attach. A stand alone document, of strictly prescribed length may present significant difficulties for market participants and may threaten the ability of issuers to provide investors with clear information.

Depending on the response to the points raised above, we consider that in order to ensure that the KIID remains streamlined and that it focuses solely on key information, we consider that the Commission should set down prescriptive requirements as to the form of the KIID as well as the information to be set out in the KIID.

7. LEVEL OF STANDARDISATION

Q. 20: While the same broad principles should be applied to all PRIPs, should detailed implementations of some of these principles be tailored for different types of PRIP? Please justify or explain your answer, and provide examples, where relevant, of the kinds of tailoring you might envisage.

Q. 21: Do you foresee any difficulties in requiring the KIID to always follow the same broad structure (sequence of items, labelling of items)? Please justify or explain your answer.

Q. 22: Do you foresee any difficulties in requiring certain parts of the key information and its presentation (e.g. on costs, performance, risks, and guarantees) to be standardised and consistent as possible, irrespective of tailoring otherwise allowed? Please justify or explain your answer.

Q. 23: Can you provide examples and evidence of the costs and benefits from your experience that might be expected from greater standardisation of the presentation and content in the KIID?

Q. 24: Should the content of the KIID be controlled so that there is no possibility for firms to add additional information unless expressly allowed for?

We agree with the proposed approach of a PRIPs KIID, which should perform the functions of (a) enabling customers to better understand the key features and the risks inherent in the investment they are considering, and (b) enable them to more easily compare the features of different types of investment products. In order to enable comparison, we agree that KIID should always follow the same broad structure.

Although we recognise that in practice packaged products have different main features (structures, charging etc), and this being the case, it may not be possible to have a fully standardised KIID for all types of PRIPs, we consider that in the interests of clarity, and to enable easier comparison across products, the KIID should be standardised as much as

possible. Therefore, we agree that the prescriptive requirements re the information to be contained in the KIID should be tailored to address differences in the information required for different classes or types of PRIP, and this should be based on testing on retail investors. However, we also agree that to facilitate comparison of products, the key areas of the detailed information (such as cost, risk, any guarantees etc) should be standardised to the extent possible.

8. CONTENT OF PRIPS KIIDS

Q. 25: Do you foresee any difficulties in applying these broad principles to the KIID for all PRIPs, as the building blocks on content and format for a 'level 1' instrument? Please justify or explain your answer.

Q. 26: Are there any other broad principles that should be considered on content and format?

We do not anticipate insurmountable difficulties in applying the broad principles set out in the Consultation to the KIID for all PRIPs. Additional work may be required to identify the best and most customer friendly way to illustrate some of the principles (such as the risk/reward proposition and the nature/limits of a particular product). This could be tied into the proposed retail customers testing process referred to above.

9. ALLOCATION OF RESPONSIBILITIES FOR PRODUCTION OF KII

Q. 27: Should product manufacturers be made generally responsible for preparing a KIID? Please justify or explain your answer.

Q. 28: Are you aware of any problems that might arise in the distribution of particular products should responsibilities for producing the KIID be solely placed on the product manufacturer?

Q. 29: If intermediaries or distributors might be permitted to prepare the documents in some cases, how would these cases be defined?

Generally, we agree that it should be the duty of the product manufacturers to produce the KIID, given that they would be in the best position to do so.

A key point in this to be able to identify who the "product manufacturer" is. For example, there could be a situation where a PRIP is provided by firm A, but firm B wraps it in another product and sells it to retail customers. The second wrapper is not A's product. However, clarity is required as to whether B is (or even whether B should be) responsible for the KII.

In addition, the proposals do not seem to consider the possibility of non-EU involvement. For example, if A is a non-EU provider, and B simply sells A's product is there no manufacturer. Who should provide the KII in such a situation? Would sales be banned if the KII are not produced for B to use?

As a final point, we note that the proposed PRIPs definition does not refer to 'retail' investors, on the basis that "the retail element is relevant at the point of sale in particular, when the distributor sells a certain investment product to a retail customer, or provides advice on it." Therefore, a packaged product does not become a PRIP until the point that someone tries to sell it to a retail customer, which may be out of the hands of the product manufacturers. Clarity is required as to exactly when the product manufacturer should produce the KIID – for example, where the product manufacturer has developed a product which is not specifically targeted for retail investors, but which may be sold to retail investors by distributors further down the line, must the manufacturer produce a KIID in all events, or should product manufacturers have the right to specify the types of customers to whom the product can be sold? Alternatively, should the distributors who are trying to sell the product (which may have been originally targeted at a different market) be in some cases responsible for producing the KIID?

10. LABELLING AND ENHANCED TRANSPARENCY OF PRIPs IN RELATION TO SOCIALLY RESPONSIBLE INVESTMENTS

Q. 30: What detailed steps might be taken to improve the transparency of the social and environmental impacts of investments in the KIID for PRIPs?

Q. 31: How might greater comparability and consistency in product labelling be addressed?

We have no particular comments in relation to this issue.

11. INTERACTION WITH AND AMENDMENTS TO EXISTING LEGISLATION

Q. 32: Should the summary prospectus be replaced by the KIID for PRIPs? Please outline the benefits and disadvantages you see with respect to such an approach.

Q. 33: Should Solvency II disclosures provided prior to the investment decision be replaced by the KIID for PRIPs? Please outline the benefits and disadvantages you see with respect to such an approach.

Q. 34: Do you agree with the suggested approach for UCITS KIIDs?

Q. 35: Are there any disclosures, e.g. required by the existing regimes, which you believe the PRIPs KIID should not include, but which should still be disclosed, e.g.

separately to the KIID? Do you have any practical examples for such elements?

We would disagree that the production of a KIID should negate the need for a PD summary. Whilst it is desirable to limit any duplication of requirements to the greatest extent possible, we are of the opinion that interchangeability is likely to be unworkable primarily on the grounds that:

- (i) in context of programmes, the KIID and the prospectus summary have different objectives. The summary is general and relates to the programme as a whole whereas the KIID is product focussed;
- (ii) it is still unclear as to who will be responsible for producing the KIID. If in some cases this will be the distributor, it cannot replace the summary which is an issuer obligation;
- (iii) it is probably desirable to keep detailed issuer information out of the KIID (to limit the content that is likely to require regular updating). If the KIID is to replace the summary this may not be possible; and
- (iv) where programmes allow for the issuance of both packaged and non-packaged products (as many do) a summary would be required in any event in respect of the non-packaged products and there may then be confusion as to the relative status of the two documents.

We also agree with the suggested approach for UCITS KIIDs – given that the UCITS KIID has only recently been adopted, and is still in the implementation stage, it would cause disruption and uncertainty at this stage to propose amendments. We agree that the proposed post-implementation review work in relation to the UCITS IV regime that is already planned will provide a useful point to review the impact and effectiveness of the UCITS KIID, and this review work could usefully feed into to the PRIPs initiative.

12. ISSUES TO BE ADDRESSED BY DEVELOPING APPROPRIATE IMPLEMENTING MEASURES – RISKS

Q. 36: What in your view will be the main challenges that will need to be addressed if a single risk rating approach is to work for all PRIPs?

Q. 37: Do you consider there are any other techniques that might be used to help retail investors compare risks?

We agree that further work is necessary to consider the options for risk disclosure, and that proposed approaches should be tested with investors, although product manufacturers, distributors and other stakeholders should also be consulted.

We agree that a simple risk indicator that might work across all PRIPs would be a useful tool, if one could be developed that would illustrate the risks involved in a meaningful and broadly accurate way. However, we consider that developing a very simple risk rating (such as a numerical risk rating) that takes into account the different risks (such as counterparty risk, market risk, liquidity risk etc) that apply in different ways to different packaged investment products, will prove very challenging.

Further comments should be sought when more detailed proposals are available.

13. ISSUES TO BE ADDRESSED BY DEVELOPING APPROPRIATE IMPLEMENTING MEASURES - COSTS

Q. 38: What in your view will be the main challenges that will need to be addressed in developing common cost metrics for PRIPs?

Q. 39: How can retail investors be aided in making 'value for money' comparisons between different PRIPs?

Again, we consider that further work is necessary to consider the options for cost disclosure. For example, how will the disclosure accurately represent the different product cost structures (some products are structured so that customers pay a set fee, some are structured on the basis of performance fees, some are structured so that the fee is taken on the spread etc).

Again, proposed approaches should be tested with investors, and product manufacturers, distributors and other stakeholders should also be consulted. Further comments should be sought when more detailed proposals are available.

14. PERFORMANCE

Q. 40: Do you consider that performance information should always be included in a KIID?

Q. 41: What in your view will be the main challenges that will need to be addressed in ensuring performance information can be compared between different PRIPs?

We consider that information relating to past performance should be included in a KIID, although this should always be accompanied with a clear warning about relying on past performance as an indicator of future performance.

Q. 42: Do you agree that a consistent approach to the description of guarantees and capital protection in the KIID should be sought, e.g. through detailed implementing

measures, for different PRIPs?

Q. 43: What information should be provided to retail investors on the cost of guarantees?

Where a guarantee or other form of capital guarantee forms part of a product, this is an important part of the structure of the product and therefore should be set out in the KIID. In order to enable meaningful comparison across different products, we agree that a consistent approach should be adopted.

Where products carry guarantees, the main situations in which the guarantees will not apply should also be made clear.

Again, proposed approaches should be tested with investors.

We would be delighted to discuss the above observations and suggestions with you. You may contact me on +44 (0)20 7295 3233 or by email at margaret.chamberlain@traverssmith.com.

Yours sincerely

pp. 

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THE CITY OF LONDON LAW SOCIETY
REGULATORY LAW COMMITTEE

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