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**International Organization of Securities Commission  
IOSCO  
Calle Oquendo 12  
28006 Madrid  
SPAIN**

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## **AFG's response to the IOSCO's consultation report on "Regulation of Retail Structured Products"**

The Association Française de la Gestion financière (AFG)<sup>1</sup> welcomes the opportunity given by the IOSCO to express the French asset management's opinion on the retail structured products topic.

As a general remark, AFG believes that many of the proposals in the Consultation Report are already applicable (or currently under discussion) at the French level or European level.

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<sup>1</sup> The Association Française de la Gestion financière (AFG)<sup>1</sup> represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 411 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing 2600 billion euros in the field of investment management, making in particular the French industry the leader in Europe in terms of financial management location for collective investments (with nearly 1600 billion euros managed from France, i.e. 23% of all EU investment funds assets under management), wherever the funds are domiciled in the EU, and second at worldwide level after the US. In the field of collective investment, our industry includes – beside UCITS – the employee savings schemes and products such as regulated hedge funds/funds of hedge funds as well as a significant part of private equity funds and real estate funds. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

**Issue 1 for consultation: Do you think the survey results accurately reflect the regulation and markets of the respondent jurisdictions? Are there any other relevant facts, regulations or dynamics that the Working Group should consider?**

Our members agree in general with the IOSCO Working Group's definition of structured products that was used to guide its work:

*Structured products are compound financial instruments that have the characteristics of combining a base instrument (such as a note, fund, deposit or insurance contract) with an embedded derivative that provides economic exposure to reference assets, indices or portfolios. In this form, they provide investors, at predetermined times, with payoffs that are linked to the performance of reference assets, indices or other economic values.*

AFG members believe the survey is very exhaustive and seems to reflect adequately the different regulation and market data. In particular, it shows quite a great variety of situations which have to be taken on board before proposing general guidelines. For example, the failure of Lehman Brother had not the same consequences at all in different respondent countries. In this respect, it is surprising that SEC has not participated in the survey.

With regards to regulatory arbitrage matters, our members are supportive in general of the objective of harmonization, especially related to different types of vehicles that do not offer the same protection level. However, regarding the structuring inner workings, our members believe that the variety of situations can make difficult to achieve a one fits all solution. Thus, an adequate approach would probably be a general principle-based common approach that gives some latitude for internal regulations.

**Issue 2 for consultation: Do you believe that inter- or intra-jurisdictional regulatory arbitrage is an issue within the retail structured product market where there is an integrated market? Why or why not? What if there is not an integrated market and different regulators within jurisdictions are involved? If so, do you think that the regulatory tool proposed above will help to address the issue? What alternative measures could IOSCO members consider?**

Regulatory arbitrage may be an issue for structured products. For example, in Europe UCITS are highly regulated products and may suffer from an unlevel playing field with other investments products providing similar features with lower regulatory constraints. It was the previous objective of the PRIPs regulation to cope with this issue.

In Europe, the draft Regulation PRIPs (Packaged retail investment products) is currently under development. It aims to harmonize key information provided to the final client on a set of investment products targeted to be sold to retail clients. Regulation related to UCITS funds and other funds will then be modified by it, although being in force only since a few years. It would be detrimental that an additional regulation modifies again this key information document. Indeed, in addition to the fact of sending a confused message to investors (who

might thus be handed 3 different documents), such an additional modification would induce too important industrial costs for an industry in crisis.

Although the objective of harmonization is wished by asset managers, it proves very difficult to coordinate regulation organized up to now on a separate mode (for instance, the European draft Regulation PRIPs sends back to MIFID and IMD directives the care to harmonize the rules of marketing).

**Issue 3 for consultation: Do you think that it would be useful for IOSCO members to take a value-chain approach to retail structured products? What issues do you think members could encounter in pursuing such an approach? How could those issues be overcome?**

A value chain approach makes sense as long as distributors have an important role through their contact with investors and the advice they provide before investment.

In any case, a value chain approach should not lead to put the whole burden on manufacturers who do not have in most cases any power of constraint on distributors. In addition, distributors and producers are generally not subject to the same regulator.

**Issue 4 for consultation: Do you think that IOSCO members (that have the legal framework that would permit them to do so) could make issuers consider improvements to their market assessment process in light of their findings (where market assessments are required)? What do you consider to be the role of IOSCO members in the development and sale of retail structured products?**

An important proposal appears in page 39 to which the Issue 4 refers:

*“To assess what investors may understand about the products that are proposed to be sold.”*

We strongly believe that it is important for retail investors to understand what level of return they may obtain from their investment (the product’s promise) and what guarantee they benefit from. But it is not useful nor possible to give an exhaustive explanation of the technical details. Such an explanation has to be given to the regulator which fulfils perfectly its role and competence by approving/authorising the product. **It is thus key that all products benefit necessarily from a regulatory pre-approval.**

Regarding “know your client” principles, our members believe it is more a question of good practices, of skill and collective experience rather than a regulatory matter.

**Issue 5 for consultation: Could the use of modelling as contemplated by this regulatory tool have an impact on the production of better value products and products that perform as intended or better disclosure? If yes, why? If not, why? What are the risks with using modelling as contemplated by this regulatory tool? Do you think investors would benefit from having access to the results of the modelling? Could IOSCO members require issuers to provide other information on the potential performance of the product? Please explain.**

Our members recognise that the use of modelling does not improve the value (return) of the product but it may give a good idea of the potential outcomes. Thus, relative to the "financial modelling", AFG is not favorable. We believe scenarios (question 12) are appropriate and sufficient.

Indeed, the European regulatory framework that asks to provide investors with the three cases scenarios in the UCITS KIID for structured products is a good model that can be emulated. We think that these three cases scenarios give more evocative information to the investor than a single probability figure.

#### **Issue 6 for consultation:**

##### **Internal approval process**

**Do you think that a mandated internal approval process for issuers is warranted, or do most issuers already have this process in place? If the issuers already have such an internal approval process in place, how could it be improved? What should be the key elements in such an internal approval process? How effective are internal approval processes in vetting products before they are issued?**

In France, the internal approval process is compulsory at both issuer and distribution level and in our view it needs not to be strengthened.

More generally, the asset managers and their products in France and Europe are approved by the competent authorities. Certain products are also framed by specific Directives relative to their rules of investment. In addition, internal processes of validation of the products and commercial and regulatory documents are set up in all asset management companies. Conformity control is also a key feature in the internal process.

##### **Regulatory pre-approval**

**Do you think it appropriate that regulators pre-approve products before they can be issued? Does the Consultation Report correctly describe the benefits and risks of such a process? If not, what are the benefits and risks? What do you think should be the criteria, standards and requirements for approval by the regulator? Please provide reasons.**

As said before, we think that it is in the regulators role and competence to offer pre-approval of the structuration of the product. To our view, it is at least as important as the approval of the marketing documents together with the approval of the prospectus and KIID.

**Issue 7 for consultation: Do you think it appropriate that regulators play a role in setting product standards for retail structured products? If regulators do set such**

**criteria, how should they do this, and what are the risks to the regulator and the market?**

We strongly believe that in the French market, the regulator's approach (as per AMF's Position as of October 2010) is an example of one of the most constrained well running framework relative to these types of products and can be effectively used as a model. France is undoubtedly in advance on the development of this type of activity and its regulation upon this target, ie retail customers. It is thus most advisable to use the French market expertise and maturity as a model to be emulated.

The UCITS framework relative to structured UCITS that is scrupulously observed in France with retail clients is perfectly adapted to this target clientele.

It is important to recall important features related to the structured UCITS' framework in France, such as:

- explicit external guarantee of the promise (formula) – that is absolutely key on this type of subject with a retail clientele;
- margin call mechanisms that limit counterparty risks;
- balance sheet risks diversification;
- regulators' (AMF) procedure of fund by fund approval/authorization;
- best execution obligations;
- fund structuring that is subjected to AMF approval and that benefits from an internal formal validation process (whose objective is making sure of the quality of the offer and the follow-up of risks)

**Issue 8 for consultation: How prescriptive is it appropriate for IOSCO members to be in setting issuer disclosure standards? What topics or items could benefit from specific explanation requirements? Do you think that risk indicators or minimum information requirements are useful? If so, what should the indicators or requirements be? How else could disclosure to investors on retail structured products be improved? Is there any disclosure that should be prescribed or proscribed?**

The current European MIFID/KIID framework that is scrupulously observed in France is perfectly adequate when dealing with retail clients. In addition, in France, the KIID framework encompasses all other investment funds, not only UCITS.

Indeed, the KIID format of UCITS has proved to be useful and similar tools may be recommended. Risk indicators combined with case scenarii have proved to be efficient. This must be completed with the requirement of an explicit external guarantee of the promise and thus with description of the provided level of guarantee.

**Issue 9 for consultation: Do you think it appropriate that IOSCO members mandate or encourage short-form or summary disclosure? Would such disclosure be helpful to investors in understanding the products that they are purchasing? What are the risks associated with such disclosure?**

**At what point in time should investors be provided access to this disclosure and what responsibility should the issuer have with respect to the content of the disclosure?**

**What information do you believe IOSCO members could require to be included in a short-form or summary disclosure?**

**If IOSCO members require the use a short form or summary disclosure, should this disclosure allow comparisons across products and, if so, what products should be able to be compared?**

Our members believe that the use of a short-form disclosure like the KIID provides adequate information to retail investors. AFG agrees with the items proposed, except with the following:

- “Expected returns and the probability of these returns”, because we prefer the scenario analysis and because both approaches could be contradictory
- “Qualitative description of the most important risks”, because the selection of these risks would be controversial; the “potential downside risk” seems to be a sufficient information.
- “Reasonable comparison to alternative investment products”: this comparison may be done in a discussion with the adviser but it would be unworkable in a formal and written way and it cannot be compulsory.

**Issue 10 for consultation: Do you agree that disclosure of disaggregated costs be made public or, alternatively, exchanged between the issuer and the distributor or the IOSCO member? Do you consider there to be an alternative mechanism to make disaggregated costs more transparent for retail investors? Do you think that the disclosure of such disaggregated costs would be useful to retail investors? Please explain.**

AFG believes that the best approach is an approach where actors are easily identifiable by the client: the producer, the distributor, the guarantee.

Relative to costs, disaggregated costs would be very difficult to understand for retail investors and even for distributors and it would not provide interesting information. The only useful information for investors is the total cost of the product. The disaggregated costs may be of interest at the regulator level, in addition to the description of the structuration.

Furthermore, we think that comparing the pay-offs (net of fees) is a better indicator of the quality of the product for the investor who contemplates similar investment solutions.

Indeed, asset managers are favourable to transparency, however, too much information kills information and the final client is likely to lose sight of what information is useful for him, namely what is the total cost for him.

**Issue 11 for consultation: Do you think disclosing the estimated fair value of a structured product at the time of issuance will be helpful to investors? If so, why? If not, why not? What alternative information could be disclosed?**

It seems to us that the disclosure of the fair value of a given product may be complicated to apprehend for non-professionals. And not very feasible for issuers: how do you establish and compare fair-value of structured notes and highly regulated, diversified, collateralized Structured UCITS? One single value cannot summarize all characteristics of a product. By giving such a 'fair value' to retail investors, one could actually mislead them: a product may have a higher fair value than another one, while being much riskier than the other one.

**Issue 12 for consultation: Do you think it appropriate that IOSCO members prescribe disclosure of scenarios? If so, what should these scenarios be? Do you consider there to be an alternative/simpler method of disclosing scenarios to retail investors? Please explain.**

As said before, the three scenarios method (the worst, the break-even and the best cases) seems appropriate for most structured products because it will make sense to bring face to face these scenarios with the situation of the financial market at the moment of the investment. It is worth mentioning here that this method does not fit so well for open ended products.

**Issue 13 for consultation: Do you think that disclosure of backtesting is useful to investors? What are the risks associated with such disclosure? Is there any other way to use backtesting to help retail investors?**

Our members are of the opinion that the three cases scenarios method provides more evocative, useful and understandable information to investors than backtesting figures.

**Issue 14 for consultation: What education tools could IOSCO members use when educating retail investors on retail structured products? What guidance could IOSCO provide to its members to facilitate better investor understanding of retail structured products?**

We think that the KIID is already in itself a kind of educational step. In addition, our members believe that any explanation and educational tool on regulators' website should be encouraged.

**Issue 15 for consultation: Do you think it appropriate for IOSCO members to require or encourage issuers to take some form of responsibility for the actions of the distributors that distribute their products? What impediments might IOSCO members face in implementing these type of requirements? Would the requirements have an effect on distributor behaviour?**

Issuers cannot be responsible for the conduct of the distributor though they have to be cautious when selecting them. The responsibility of the distributor has to be covered by his own regulation.

Indeed, the funds' distribution is organized in such a way that the producer cannot be responsible for his distributors. For example, when funds are subscribed through an adviser on a platform, the producer knows the platform. There are no contractual bounds connecting the producer to the advisor. Thus, the European regulation set up MIFID rules to frame the distribution of products and on parallel product Directives (UCITS) or producer Directives (AIFM) frame the investment product's set-up.

**Issue 16 for consultation: What other areas of activity could IOSCO members consider in the post sales period? Please explain. Are there issuers, that are not distributors, that make a secondary market in retail structured products (i.e., would the regulatory tool on secondary market making ever be relevant)?**

Regarding the regulatory framework relative to marketing, AFG believes the current framework is already in place and adequate.

The after-sales service could constitute an improvement area. However, our members have serious concerns with some proposed post-sales practices, in particular with:

- Cooling-off: most structured products are closed-ended and are sold during a period of time which precedes the effective launch of the product. During this product offering period (that can go up to 6 months for instance) investors have the power of cancelling their reservation; therefore any other cancellation right should be banned.
- Secondary market making which does not exist today and would probably be very difficult to put in place. A pricing policy would probably make more sense and would be workable.
- Market enforcement actions public: if we must understand something like class actions, our members believe it is not adequate for products sold with advice as they are sold individually with a customised perspective linked to the individual investor's situation/preferences; it would also probably lead to many abuses in the field of investment products and we believe a dispute resolution process is much preferable.
- Product intervention powers: if a pre-approval process like what have been described above is in place, there should be no room for post-issuance banning which would be very detrimental for the industry and unworkable for most structured products which are sold in one strike.

If you need any further information, please don't hesitate to contact Eric Pagniez ([e.pagniez@afg.asso.fr](mailto:e.pagniez@afg.asso.fr)) or Adina Gurau Audibert ([a.gurau.audibert@afg.asso.fr](mailto:a.gurau.audibert@afg.asso.fr)) or Servane Pfister ([s.pfister@afg.asso.fr](mailto:s.pfister@afg.asso.fr)) or myself at +33.1.44.94.94.29 ([p.bollon@afg.asso.fr](mailto:p.bollon@afg.asso.fr)).

Sincerely Yours,

(signed)

Pierre Bollon