



CJ/ SJ – n° 2351/Div

Mr Eric Ducoulombier  
Head of Unit  
Retail issues, consumer policy and  
payment systems  
Directorate General Internal Market and  
Services  
European Commission  
2, rue de Spa  
1000 Brussels  
BELGIUM

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## **AFG RESPONSE TO THE EUROPEAN COMMISSION CALL FOR EVIDENCE ON SUBSTITUTE PRODUCTS**

Dear Mr. Ducoulombier,

AFG<sup>1</sup> has a strong interest in this Call for Evidence on substitute products. We do support the European Commission's efforts in undertaking a study on the need or not to level the playing field within the whole range of saving vehicles. We believe that the European Commission should find the right balance between preserving investors' protection and encouraging innovation, while insuring a fair competition among substitute products.

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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 365 asset management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing more than 2500 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 1500 billion euros managed, i.e. 22% 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, AFG covers – beside UCITS and other general purpose funds – 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).

Before answering the questions raised by the European Commission, we would like to make a few introductory statements.

First of all, we take the opportunity of this consultation to stress the great success that UCITS enjoy at European and worldwide levels. Since 1985, when their European legal framework was first defined, they have gained a tremendous brand value. UCITS are saving vehicles that combine security and financial innovation and which are and will be used to fulfil the needs of retail and institutional investors while efficiently financing the growth of our economies and job creations.

In order to allow UCITS to play this role even more fully, we call on the European Commission to carefully review European regulatory rules that are discriminatory against UCITS in terms of competitiveness and innovation. There are indeed many regulatory differences that put UCITS in a disadvantage situation vis-à-vis other saving products and contracts. For example (i) the constraints set to the UCITS in terms of eligible assets do not have any symmetry in the regulation of substitute products, (ii) the disclosure requirement of UCITS prospectuses are heavier than the requirements of other substitute vehicles, and (iii) the notification procedure to allow the distribution of a UCITS is by far the most stringent one, resulting in delays to commercialisation both inside each European country and cross-borders. Some of these unfair regulatory differences will be exposed in further details in the answers to the questions.

We also remind to the European Commission that UCITS are the only savings vehicles subject to a very high level of regulations, composed of two sets of rules deriving from a mainly product based Directive (the UCITS Directive) and a service based Directive (the MiFID). Structured products are also subject to the MiFID rules and the Prospectus Directive, but the latter offers much more flexibility and freedom in the production and sale of the product than the UCITS Directive does.

Indeed, an “appropriateness” test should be introduced in order to avoid distortion of competition discriminating UCITS: if an obligation imposed on UCITS cannot be extended to substitute products or contracts, then it is not “appropriate” and should be scrapped.

In order to get quick and easy results, we do not intend to ask for a complete immediate review of the recently adopted MiFID - although some of its provisions should be clarified by appropriate means, but we ask the European Commission to seize the opportunity of the UCITS Directive revision to tackle some of the most blatant ‘discriminatory’ issues such as:

- (a) the cross-border notification and domestic authorisation for UCITS, that should be aligned with the Prospectus Directive to respectively provide for a maximum time-frame of 3 days and 10/20 days;
- (b) the eligible assets, that are limited to enumerated assets in the UCITS Directive. Two distinct initiatives should be taken in this respect. First, it should be made possible to complete the list of eligible assets through a Lamfalussy like approach, allowing UCITS to keep the pace of innovation and competition. Second, a European passport should be established for alter-UCITS such as HFs, FoHFs, REFs and PEFs ;
- (c) the product disclosure for UCITS should not go beyond what is mandatory for the other substitute products and its prospectus should be reviewed to be aligned with the prospectus of the products covered by the Prospectus Directive. The current work of on the KII document should follow that route.

Finally, we have a general remark concerning the notion of savings products dedicated to retail clients and two specific remarks concerning the life insurance products and the structured products :

(a) on the notion of savings products dedicated to retail clients and which is the scope of the European Commission's consultation paper, we regret that the European Commission did not clarify the definition or at least give some criteria;

(b) Regarding the life insurance products, we want to bring the European Commission's attention to the fact that if these products are not so highly regulated at European level, in some countries, and it is the case in France, regulators have started to fill the gap between the different regulatory regimes between UCITS and life insurance, and this route should be further explored;

(c) There is no problem whatsoever with structured products when they are UCITS, as they follow the UCITS regulations. So, when we will speak of "structured products" in this answer it will not encompass "structured UCITS".

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Finally, we want to bring the European Commission's attention on retirement schemes (DB & DC) that should be added in the list of substitute and for which a level playing field needs to be ensured.

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**Question 1:** *Do you see that different regulatory treatment of substitute products gives rise to significant problems? Please explain why you consider this to be the case.*

Regarding the UCITS products, we have identified several 'discriminatory' regulatory treatments that prevent them to be easily marketed:

- a) ***cross-border notification and domestic authorisation to distribute products:*** cross-border UCITS are subject to a notification procedure within the host regulator, which is currently similar to a new authorisation process in many host member states and induces lengthy delays before marketing. The current regime – under review but still applicable- offers a maximum of 2 months examination by the host regulator before the marketing of UCITS is made possible. In addition, it should be noted that contrary to other substitute products, UCITS that are intended to be sold cross-border are also subject to the host country's marketing obligations. Since this principle is damageable for the sole UCITS industry, it should not be maintained or at least should be lightened. Although we are aware that the European Commission will probably propose to reduce the UCITS cross-border notification period from two months to three days –in accordance with the regime imposed by the Prospectus Directive- we are not aware of any intent from the European Commission to delete or even lighten the domestic marketing specificities allowed in the host countries. In addition, regarding the domestic authorisation of the UCITS, the UCITS Directive does not provide for any maximum time frame whereas the Prospectus Directive provides for 10/20 days for the authorities to deliver the domestic authorisation to distribute the products covered by the Prospectus Directive. An alignment of the UCITS regime with the Prospectus regime is necessary.

b) *eligible assets*:

- the UCITS Directive has been extended to cover HF indices and derivatives in the category of eligible assets. Although we do not discuss this extension of the UCITS eligible assets, this decision has created, in practice, unfair competition between the hedge funds indices/derivatives that can be used by UCITS funds and the (domestic) regulated funds of hedge funds that cannot enjoy the UCITS status and thus cannot be freely marketed in European countries, although it is arguable that they are more tightly regulated than the first ones.

We call on the European Commission to urgently review this inconsistency creating unfair competition between UCITS based on hedge funds indices and regulated funds of hedge funds by giving to the latter a passport through an “alter-UCITS” label.

- more globally, it should be made possible to complete the list of eligible assets through a Lamfalussy-like approach, allowing UCITS to keep the pace of innovation and competition.

c) *product disclosure*: UCITS are subject to both transparency rules and product characteristic disclosure rules, defined in the UCITS Directive and in the MiFID.

Regarding the *inducement regime* set up by the MiFID, they apply differently to funds and structured products. For the latter, the producing entity and the distributing entity is a single one, contrary to funds where the management company is a separate legal entity from the distributing/marketing entity. Inducement rules cannot be applicable to products where there is a single entity doing two different services.

We do not ask for the revision of the MiFID but we ask for a revision of the interpretation of Article 26 of the implementing Directive as made by CESR (Level 3) since its interpretation is damageable for UCITS.

Regarding the *product characteristics*, UCITS cannot be sold without providing a Simplified Prospectus to investors, which details the product characteristics, risks and fees. No other product than UCITS is subject to such a document aimed at informing investors in such details. We believe that the future simplified prospectus (KII) on which the European Commission is currently working should be more flexible and aligned with the prospectus of the structured products (deriving from the Prospectus Directive).

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**Question 2:** Do you regard the perceived concerns relating to different levels of product transparency and intermediary regulation as a significant threat to the further development of EU markets for retail investment products?

strongly agree     somewhat agree     no opinion     somewhat disagree     strongly disagree

Yes, UCITS should not be discriminated against, otherwise investors will be induced by the regulation to buy other saving vehicles. See answer to question 1 for examples of fields where a simplification of UCITS rules is required to create a more level playing field.

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**Question 3:** *Is it appropriate to regard different retail investment products as substitutable – regardless of the legal form in which they are placed on the market? Which of the products listed below should be considered as substitute investment products?*

Yes, all of them. Some attention should be also given to “euros” life insurance contracts (although in France it is highly regulated, much more than what is made compulsory by the European directives) and to retirement schemes.

*What are the features/functionalities (holding period, exposure to financial/other risk, capital protection, diversification) that lead you to regard them as interchangeable? Have you encountered any legal or other definition which would encompass the range of ‘substitute investment products’?*

The notion of substitute products is difficult to handle by only ticking boxes. We believe that depending on the investors’ needs and objectives, products can be considered either as substitute or as complementary. For instance, the European Commission seems to consider through the list of products above that ETFs are substitute products to UCITS funds. In fact, most ETFs are UCITS funds and therefore subject to the UCITS Directive.

We believe that the European Commission should not necessarily look for setting up the same rules for different products but rather for ensuring the same level of regulation.

We also want to stress that the European Commission has only targeted retail clients in its Call for Evidence but it seems necessary to recall that institutional investors are also investing in such products and that the ultimate risk / reward of these investments is generally borne by the end investor. These institutional clients may often favour structured products (e.g. EMTN) instead of UCITS for the greater flexibility they offer (in terms of home agreement and cross-border notification process, which are faster than the ones provided in the UCITS Directive: 10/20 days versus none and 3 days versus 2 months).

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**Question 4:** *Which factors in your opinion drive the promotion and sales of particular investment products? Please use the table below to rank these factors in terms of importance (very significant; significant; no opinion; insignificant) for each of the different products. In addition to completing the table, we would welcome further explanation of your view as to which factors are particularly important for each product.*

	UCITS	Non-harmonised funds	Unit-linked life insurance products	Retail structured products	Annuities	(Structured) Term deposits	Others
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<b>Taxation</b>	Significant	Significant	Significant	Significant	Significant	Significant	
<b>Financial innovation</b>	Significant	Significant		Significant			
<b>Cultural preferences</b>	Significant					Significant	
<b>Distribution models</b>							
<b>Regulatory treatment</b>	Significant			Significant			
<b>Others</b>							

AFG considers that all the factors can play a role but believes that **regulatory treatment, financial innovation and taxation** are the principal relevant factors in the sale and promotion of the products.

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*Question 5: Product disclosures: Do pre-contractual product disclosures provide enough information to help investors understand the cost and possible outcomes of the proposed investment? Please use the attached tables to provide your evaluation of the adequacy of the information provided with regard to the following items for each category of investment product.*

<b>Nature of information provided</b>	<b>UCITS</b>	<b>Non-harmonised funds</b>	<b>Unit-linked life insurance products</b>	<b>Retail structured products</b>	<b>Annuities</b>	<b>(Structured) term deposits</b>	<b>Others</b>
<b>Product features</b>	Adequate (UCITS Directive)						
<b>Direct costs</b>	Adequate (UCITS Directive)						
<b>Indirect costs (or foregone performance)</b>	Too detailed (UCITS Directive +)						

	MiFID regime)						
<b>Risks</b>	Adequate (UCITS Directive)						
<b>Capital guarantee</b>	Adequate (UCITS Directive)						
<b>Likely performance</b>	meaning ?						
<b>Conflicts of interest</b>	Adequate (UCITS Directive + MiFID regime)						
<b>Compensation or fee retrocession</b>	Too detailed (MiFID regime)						

To answer this question, we should keep in mind that on the one hand, there are ‘fee-based products’ such as UCITS and on the other hand, there are ‘spread-based products’ such as structured products. It is therefore difficult to assess the product disclosure for products that do not have the same fee structure.

Regarding the pre-contractual product disclosures, the differences existing among the substitute products is due to the application of different product-based Directives (especially the UCITS Directive and the Prospectus Directive), which are not driven by the same logic. UCITS cannot be sold cross-border if they do not comply with the regulatory rules defined in the UCITS Directive: notification to the relevant authorities; description of the product characteristics in a Simplified Prospectus, etc.

We acknowledge that UCITS sold as UCITS and UCITS wrapped into a life insurance product are not subject to the same product disclosure regime. UCITS sold as unit-linked are not subject to the simplified prospectus and to the same transparency fees linked to the inducement regime of the MiFID. However, it should be borne in mind that the contractor of a life insurance product having UCITS as underlying assets is not the owner of the UCITS. In addition, the insurance company is bearing risk and liabilities regarding the underlying assets vis-à-vis its clients. Thus the two products –UCITS versus life insurance product- cannot be compared. Nevertheless, the French regulation provides that a high level of information on the

underlying fund should be given to the client. This should become in our opinion a European rule or standard.

Structured products benefit from the Prospectus Passport and therefore do not need to comply with such burdensome requirements to be sold cross-border. We call for an alignment of the UCITS Passport (and prospectus) with the Prospectus passport (and information document) to allow UCITS to be more easily marketed cross-border.

However, we still think that product-based Directives are necessary, in order to set up European rules and “brands” for a wide range of products – which can be successfully exported out of EU afterwards.

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**Question 6: Conduct of business rules:** Do differences in conduct of business regulation result in tangible differences in the level of care that different types of intermediary (bank, insurance broker, investment advisor/firm) offer to their clients? For which conduct of business rules (know-your-customer, suitability, information/risk warnings) are differences the most pronounced and most likely to result in investor detriment?

	UCITS	Non-harmonised funds	Unit-linked life insurance products	Retail structured products	Annuities	(Structured) Term deposits	Others
Know your customer							
Suitability or appropriateness							
Risk warnings							
Examples - information							
Others							

See our answer to previous questions.

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**Question 7: Conflicts of interest:** *Are there effective rules in place to ensure effective management/disclosure of conflicts of interest (and/or compensation arrangements) by the different categories of product originators and/or intermediaries for the different types of investment product? For which type of product do you see a regulatory gap in terms of the coverage of conflict of interest rules? Please explain.*

Regarding the conflict of interest rules, all the products subject to MiFID are governed by the MiFID rules aiming at preventing conflicts of interests. However, it should be noted that UCITS are in a very complicated situation where the products are subject to MiFID rules as well as the discretionary portfolio management companies whereas the UCITS management companies are subject to conflicts of interest rules under the UCITS Directive. The unfortunate result is that management companies are subject to different sets of rules set up by two Directives, rules that would need to be simplified. We also ask, as the Commission is fully aware, for a full management company passport, allowing a management company established in a European country to manage UCITS registered in another European country.

In addition, as we already had the opportunity to tell the Commission, there is a strong concern regarding the conflicts of interest rules combined with the MiFID inducement rules and applied to management companies. Most of the time, management companies of UCITS and the entities distributing UCITS are autonomous from each other, avoiding conflicts of interests. However, under the inducement requirement, these two entities are obliged to disclose their marketing arrangements to their clients and potentially to their competitors.

First of all, this information is not needed for the client, for whom only the total cost matters (e.g. the Total Expense Ratio, which should be harmonised at EU level).

Second, this provision could have a pernicious effect on the conflict of interest rules since management companies and distributors could be tempted to merge (i.e. the same legal entity would provide for management and distribution) in order to avoid disclosing marketing arrangements (and especially the level of retrocession they have agreed) and increasing the risk of conflicts of interests.

Concerning the other substitute products, we would like to be sure of the existence, at least, of rules of practice to prevent conflicts of interests.

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**Question 8: unfair marketing / misleading advertising:** *Is the risk of unfair marketing / misleading advertising more pronounced for some product types than for others? If so, why? Can you point to concrete examples of the mis-selling of the different types of investment product resulting from unfair marketing / misleading advertising?"*

This question can best be answered by regulators.

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**Question 9:** *Is a horizontal approach to product disclosures and/or to regulation of sale and distribution appropriate and proportionate to address the problems that you have identified? Can you specify how this objective of coherence between different frameworks would address the problems? What are the potential drawbacks of such an approach?*

We call mainly for lightening the UCITS regime and making it more flexible and when deemed necessary for applying an ‘equivalent rules’ approach (adjusted to the nature of the products) to ensure fair competition together with investors’ protection.

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**Question 10:** *Can market forces solve the problems that you identified (fully/partially)? Are there examples of successful self-regulatory initiatives in respect of investment disclosures or point of sale regulations? Are there any constraints to their effectiveness and/or enforceability? Are you aware of effective national approaches to tackle the issues identified in this call for evidence? Should it be left to national authorities to determine the best approach to tackling this problem in their jurisdiction? Is there a case for EU level involvement? Please explain.*

We do not believe that national approaches are the right solutions to tackle the issues since they would result into the fragmentation of the Single European market and would harm European brands (such as the ‘UCITS’), which are crucial for our industry and whose extension to alter-UCITS is highly needed. We also bring the European Commission’s attention to the fact that implementation of European rules at national level by regulators may also end up into a fragmentation of the Single European market. It is the function of the European Commission to check that national regulators, in the implementation and application of the MiFID for example, are not creating national divergences or distortions.

To conclude:

We call on the European Commission to create more flexibility for UCITS products by lightening the existing rules (cross-border/domestic notification, conflicts of interest rules as well as transparency rules, easy and regular adaptation of the list of eligible assets...). The European Commission should also review the coherence between the UCITS Directive and the MiFID since there are still some grey areas (in terms of marketing/distribution) and redundant/diverging rules (especially in terms of outsourcing and conflicts of interests) due to the coexistence of these two Directives.

Finally, to ensure fair competition among savings vehicles, avoid the use of the Prospectus Directive to ‘circumvent’ the heavy regulatory rules imposed on UCITS, and develop a European brand for innovative and safe funds, we ask the European Commission to consider either extending the scope of the eligible assets for the UCITS to regulated hedge funds/funds of hedge funds, real estate funds and private equity funds or creating a separate regime for the alter-UCITS funds (FoHFs, HFs, real estate funds and private equity funds, etc).

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Should you have any questions, please contact myself at 01 44 94 94 14 (e-mail: [p.bollon@afg.asso.fr](mailto:p.bollon@afg.asso.fr)); Stéphane Janin, Head of International Affairs Division, at 01 44 94 94 04 (e-mail: [s.janin@afg.asso.fr](mailto:s.janin@afg.asso.fr)); or Catherine Jasserand, Deputy Head of International Affairs Division, at 01 44 94 96 58 (e-mail: [c.jasserand@afg.asso.fr](mailto:c.jasserand@afg.asso.fr)).

Yours sincerely,

(signed)

Pierre Bollon

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ANNEX: summary chart

	UCITS funds	Unit-linked life insurance products	Structured notes	Bank term deposits
Product production	UCITS Directive	Life Insurance Directive	No rules at EU level	No rules at EU level
Eligible assets	UCITS Directive		No rules at EU level	
Capital requirement	UCITS Directive	Solvency I (to be replaced by Solvency II)	Capital Requirements Directive	Capital Requirements Directive
Independent oversight	Depositary of UCITS Directive	None at the insurance company level	No rules at EU level	No rules at EU level
Rules for disclosure to investors	Simplified Prospectus of UCITS Directive	Life Directive	Prospectus Directive	No rules at EU level
	MiFID for high-level types of disclosure requirements	Insurance Mediation Directive for some disclosure requirements	MiFID for high-level types of disclosure requirements	
	E-commerce Directive or Distance Marketing Directive			
Rules for selling	MiFID	Insurance Mediation Directive	MiFID	No rules at EU level
	UCITS Directive			
E-commerce Directive or Distance Marketing Directive				
Reporting rules	UCITS Directive + MiFID Directive			
Account audited by auditors	UCITS Directive			