Retail structured products – PRIPS, PD and Product Governance

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Retail Structured Products – the three pillars

- PRIPS
- Product governance / intervention
- Prospectus Directive
PRIPS - Timeline

Communication on Packaged Retail Investment Products – April 2009

Consultation on legislative steps – November 2010

Level 1 Regulation - Proposal – 3 July 2012

Level 2 - Designated acts

Implementation - end 2014
PRIPS market size and breakdown

- Non-UCITS funds: 18%
- Retail Structured Products: 5%
- Unit Linked Insurance: 19%
- UCITS: 58%
### Disclosure rules and intermediary regulation

<table>
<thead>
<tr>
<th>UCITS</th>
<th>Other Open-Ended Funds</th>
<th>Unit-linked life insurance policies</th>
<th>Structured securities and closed-end funds</th>
<th>Structured term deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rules on product information applying to manufacturers, issuers or intermediaries</td>
<td>Key Investor Information (KII) of UCITS Directive</td>
<td>MiFID (high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td>
<td>Solvency II (CLD rules)</td>
<td>Prospectus Directive</td>
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<td>MiFID (high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td>
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<td>E-commerce Directive or Distance Marketing of Financial Services Directive</td>
<td>Insurance Mediation Directive for some product disclosure requirements</td>
<td>MiFID (high-level product disclosure requirements apply to MiFID intermediaries when selling financial instruments)</td>
<td>No rules at EU level</td>
</tr>
</tbody>
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Product Scope

“An investment where regardless of the legal form of the investment the amount repayable to the investor is exposed to fluctuations in reference values or in the performance of one or more assets which are not directly purchased by the investor”

<table>
<thead>
<tr>
<th>IN SCOPE</th>
<th>OUTSIDE SCOPE (Article 2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• structured deposits</td>
<td>• securities that do not embed a derivative</td>
</tr>
<tr>
<td>• structured notes</td>
<td>• deposits where rate of return limited to interest rate</td>
</tr>
<tr>
<td>• investment funds</td>
<td>• insurance products which do not offer a surrender value or where that surrender value is not wholly or partially exposed to market fluctuations</td>
</tr>
<tr>
<td>• UCITS (not for 5 years – transitional provisions)</td>
<td>• occupational pension scheme</td>
</tr>
<tr>
<td>• insurance products</td>
<td>• certain pension products</td>
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Form and content of KID (Articles 6-11)

What is the investment?
• Type of product
• Objectives
• Performance scenarios (if relevant)

Could I lose money?
• Capital protection
• Compensation scheme

What is it for?
• Indication of recommended holding and expected liquidity profile

What are risks and what might I get back?
• Risk and reward profile of investment product
• Summary indicator of risk/reward profile

What are the costs?
• Costs associated with the investment (direct and indirect)
• Summary indicator of these costs

How has it done in the past?
• Past performance (if relevant)

What might I get when I retire?
• For pension products
Current issues in relation to PRIIPS

- Extension to vanilla products
- Potential overlap with MiFID 2
- Liability of product providers/reversal of burden of proof
- Risk/reward indicator
- Allocation of responsibility between the product provider and distributor.
- Interaction with the product terms and conditions
- Interaction with the PD summary
- Approach of regulators in relation to PD reflecting a more interventionist approach
Product Governance

- Product design & development
- Stress testing and modelling
- Identification of target market
- Selection and monitoring of distribution channels
- Point of sale disclosure
- Product approval process
- Business models
- Post sales responsibility
## FSA Guidance

<table>
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<tr>
<th>Key area</th>
<th>FSA Guidance</th>
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</table>
| **Business Model and product approval** | - Ensure adequate controls around developing and marketing of products  
- Balance pricing and market pressures to ensure fair consumer outcomes  
- Embed delivery of fair outcomes to consumers in process |
| **Identification of target markets** | - Identify consumer needs and objectives (e.g. risk profile, ability to bear loss and investment objectives)  
- Take account of changes in financial markets |
| **Product design and development** | - Ensure product features are visible and understandable to consumer  
- Ensure complex financial engineering is transparent |
| **Stress testing and modelling** | - Back testing and scenario analysis is not sufficient  
- Quantitative assessment of external financial and market risks is required  
- [Probability and simulations based on market variables/different risk conditions required]  
- Cash comparator may be appropriate |
| **KYD/MI**                        | - Review and monitor financial capability and sophistication of distributors  
- Assess training needs of distributors and any materials provided to them |
| **Post sales**                    | - Review products to ensure are reaching and continue to meet needs of target audience  
- Carry out post sales due diligence and stress testing |
Regulatory Revolution Tracker

‘Regulatory Revolution Tracker’ including a specific recourse on Retail Structured Products brings together information on the regulatory initiatives taking place globally in one online resource. To access the site click here (elexica registration required).
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