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THE WAY YOU DO THE THINGS YOU DO!

Watching the news on TV recently, looking at huge waves crashing ashore and ripping tiles off the roof of a lifeboat station in Cornwall, this struck a parallel with me on a project TISA is currently running on 'suitability' and 'direct to consumer' propositions. The weather has been out of our control and having a significant impact. This is a little like our project and some waves coming from Europe.

Last October, the European Parliament's Committee on Economic and Monetary Affairs voted in favour of the 'PRIPs' (Packaged Retail Investment Products) proposal. A key new part of the proposal is the requirement for investment products to introduce a label to their Key Investor Information Document (KIID) that lets investors know whether a fund is 'complex' or 'non-complex'. Certainly some TISA member firms collaborating on the project think the latest proposal contains unnecessary additions that do not do justice to certain investment products and serve to further complicate them. Will the introduction of the complexity label only serve to confuse investors?

It is acknowledged that there are already risk indicators built into the PRIPs KIID and that any new labels would merely add superfluous classifications of funds. However PRIPs now requires products that present their risk-reward profile or costs in an overly complicated manner, or those that invest in underlying assets not commonly invested in by non-professional investors, to carry a complex label on their KIID. The problem this wave presents - to define an investment as complex - is ultimately a matter of subjectivity. Inevitably, some investors may also associate complex with the word risky, which is not necessarily true. Many financial products have complex structures, without necessarily being riskier, and this may lead to investors with low risk thresholds unwittingly missing out on the full range of products that are suitable for them.

The conundrum here is that our UK regulated disclosure rules are designed to make it easier for investors to compare different investment products and understand the different strategies on offer. You need to only look at UCITS (Undertakings for Collective Investment in Transferable Securities), where a large part of the success of the UCITS framework and its KIID is the focus on adding simplicity, consistency and standardization to the marketing of different funds. Admittedly, UCITS funds will be exempt from the PRIPs regulation to begin with, until three years after the new rules come into force. It is therefore possible that in the future certain UCITS funds could also be forced to carry a complexity label.

There are also issues which challenge the FCA as it indicates that regulators should develop an online fund analyser which allows investors to calculate the end value of their investment after fees and costs have been taken into account. Surely this impacts on liability risks.

The European Parliament also wants to expand the rules even further to include shares, bonds and many other types of financial instruments. The FCA has confirmed it is expecting final rules in May which will lead to a revision in customer engagement and whether a product is 'suitable'. For those trying to build direct to consumer or execution-only propositions, it could be the wave which leads to a rebuild!

Peter Smith, Head of Distribution Engagement