Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Consumer Panel response to CESR consultation document: Complex and non-complex financial instruments for the purposes of the Directive's appropriateness requirements

The Financial Services Consumer Panel was established under the Financial Services and Markets Act 2000 by the Financial Services Authority to represent the interests of financial services consumers. The Panel is independent of the FSA. The main function of the Panel is to provide advice to the FSA, but it also looks at the impact on consumers of activities outside the FSA's remit. The Panel represents the interests of all groups of consumers.

This is the Panel's response to CESR's consultation paper on complex and non-complex financial instruments for the purposes of the Directive's appropriateness requirements. We are pleased that CESR has opened up a public debate in this important area.

The Panel is not in a position to answer the detailed questions in the paper but, given the importance of the MiFID conduct of business requirements and the significance of the appropriateness test in particular, we would like to respond to some of the wider issues raised.

Classification of investment products

The Panel is supportive of the consumer protection measures that are encompassed within MiFID. We agree that there should be provisions in place to prevent complex products being sold on an execution only basis to retail investors who do not have the knowledge or experience to understand the risk of such products. The 'classification' of investment products is therefore of paramount importance if the correct level of consumer protection is to be applied effectively.

As the paper says, the Commission's background note of February 2006 contains helpful comments on the purpose of the distinction between complex and non-complex instruments, particularly that "... the complexity of a financial instrument per se is not necessarily synonymous with the risk associated with that instrument … complexity for the purposes of the Directive is determined by the way that an instrument is structured … typically, the level of complexity of a financial instrument's structure will affect the ease with which the risk attached to the product may be understood." This is a logical approach given that the principal purpose of the classification is to establish whether it would be appropriate for business to be conducted on an execution only basis. However there is also an argument that the key issue is not product complexity and the possible impact on the investor's own ability to assess risk, but rather the level of potential risk or detriment that a purchase or sale of a particular investment on an execution only basis would present to the investor.

Again, as is acknowledged within the paper, there are currently some contradictions within the complex/non-complex split. The most striking is the automatic classification of all units or shares in UCITS as non-complex, given for example that some UCITS funds invest in derivatives. The Chairman of CESR has been quoted in the media as saying that a lot of hedge funds are moving into the UCITS field. The Panel would not wish to see retail investors who are justifiably confident in the UCITS 'brand' investing on an execution only basis in UCITS funds which are, in reality, little different in terms of structure and risk to products that are rightly classified as complex.

Execution only business

Given the concerns we have already expressed, we acknowledge that there is a careful balance to be struck between a conservative but sensible set of classification criteria and an over-cautious approach that could unreasonably inhibit investor flexibility. In the current economic climate there is a risk that too many products will be assessed as complex and that investors' ability to undertake execution only business will be unreasonably curtailed as a result. There could also, of course, be an increase in the charges and fees to be met by retail investors if firms were obliged to apply the appropriateness test where execution only would in fact be entirely appropriate.

Similarly, the Panel is also concerned that any move to extend MiFID conduct of business requirements to packaged products such as life policies and investment trust savings schemes could have an adverse impact on the flexibility currently enjoyed by investors to buy these products on an execution only basis and on overall cost.

Overall, the Panel's view is that there is now a real need for a more fundamental review of the classifications and, importantly, the basis on which the classifications are made, and that the starting point should be for CESR and/or the Commission to undertake comprehensive research into consumer understanding of both the complexity and the levels of risk of the products concerned.

Adam Phillips
Acting Chairman

Financial Services Consumer Panel

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