European Commission Retail Investment Strategy

September 2023

On 24 May 2023, the European published its *Retail investment strategy* with which it aims to provide retail investors a framework that empowers them to make investment decisions that are aligned with their needs and preferences while, in turn, ensuring they have a high level of protection.

By means of this initiative, the Commission seeks to achieve one of the key objectives set in its *2020 Capital Markets Union Action Plan*, which is to make the European Union (EU) an even safer place for citizens to invest in the long term since, despite their very high savings rates, their participation in these kinds of market is lower than in other jurisdictions.

The Strategy has resulted in the so-called "*Retail Investment Package*", one that includes the following two regulatory proposals:

– A proposal for a Regulation amending certain aspects of Regulation 1286/2014 on key information documents for packaged retail and insurance-based investment products (known as the PRIIPs)[1].

– A proposal for an Omnibus Directive that modifies the following rules[2]:

1. Directive 2009/65/EC on certain undertakings for collective investment in transferable securities (UCITS)[3].
2. Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance[4].
3. Directive 2011/61/EU on alternative investment fund managers[5].
4. Directive 2014/65/EU on markets in financial instruments (MiFID II)[6].
5. Directive 2016/97 on insurance distribution[7] (IDD).

The following measures stand out from among those proposed in this package:**(1) Measures relating to the adaptation of information disclosure rules to the digital age and investors' growing sustainability preferences.**
The Commission proposes de modernisation and standardisation of information on costs, together with the preparation of annual reports on the costs and returns of investments, also including information on payments related to third parties.

On the other hand, it also proposes imposing on financial intermediaries the obligation to include warnings on the risks in the information material of particularly risky financial products, specifically on the possibility of suffering financial losses.

Finally, the package contains some modifications regarding the Key Information Document (KID) required within the scope of packaged retail and insurance-based investment products. Specifically, the Commission proposes the following measures: (a) including a dashboard summary for the key information on costs and risks of these products to be visible at the start of the document; (b) allowing the information contained in the KID to be digitally displayed in layers; (c) a new section with information relating to sustainability; and (d) greater clarity on the exclusion of certain products within the scope of application of the PRIIPs Regulation.

(2) Measures relating to the application of the "value for money" principle within the scope of retail investors.

The European Securities Markets Authority (ESMA) stated in a report published in 2022 that retail investors pay, on average regarding different asset classes, 40% more costs than professional clients[8].

Facing this and the need to encourage the trust of these investors in capital markets, the Commission proposes a series of measures in this package aimed at boosting preexisting rules in MiFID II and IDD seeking to guarantee that the products retail investors can access offer good value for money.

In particular, in the area of rules on product governance, the proposal by the Commission imposes on packaged or associated product manufacturers the establishment of a pricing process forcing them to identify and quantify all their costs and charges, while also to perform a valuation on whether such costs may hinder the potential value of the product.

In order for this assessment to be as objective as possible, the Commission entrusts ESMA and the European Insurance and Occupational Pensions Authority (EIOPA) the preparation of the benchmarks to be used by manufacturers as a reference to determine whether the cost of the products offered to retail investors is justified and proportionate. The Commission confers the task of supervising these assessments to the national competent authorities.

On their part, distributors will also be subject to this process having to quantify the total costs from the information received from the manufacturers but, in turn, including new costs (such as distribution costs, for example), together with a breakdown from the total amount of those corresponding to incentives and advice.

Anyhow, if the product adds no value for retail investors, i.e., it deviates from the appropriate benchmark, neither the manufacturer nor the distributor may approve its distribution, unless they are capable of justifying that the costs and expenses are proportionate.

Furthermore, the Commission proposes imposing new obligations on manufacturers, distributors and national competent authorities regarding the information to be sent to ESMA which serves as basis to prepare such benchmarks.

Likewise, the package proposes amendments to the UCITS Directive and to that regarding alternative investment fund managers aimed at clarifying what may be considered due costs, stating the conditions to be fulfilled and including rules in the pricing process guaranteeing compliance with these[9].

(3) Measures relating to potential conflicts of interest deriving from the prevailing distribution model for investment products aimed at retail clients in the EU.

The characteristic distribution model for investment products in the EU is dominated by fees received by distributors from manufacturers for selling/advising on their products.

Although the Commission seemed to initially consider a total prohibition of incentives, similar to that in place in Holland, in order to avoid any possible conflicts of interest deriving from this model, it has finally chosen a process in stages. Initially, this process comprises the following three measures: (a) the prohibition of incentives for sales of investment products without advice; (b) in the case of sales with advice, the current service improvement test is substituted for a new test, acting in the best interest of clients; and (c) in the case of permitted incentives, the obligation is included for the distributor to inform clients about them, their cost and the impact they have on the performance of the product. In a second stage, three years after adopting this package, the Commission will evaluate the impact these measures have had and, if the consumer continues to be harmed, it will probably adopt stricter measures regarding this.

Likewise, in order to improve the quality of the advice, the Commission proposes imposing on advisors the obligation to act in the best interest of their clients, in compliance with the following requirements: (a) basing their advice on a sufficiently wide range of investment products; (b) recommending those that are most efficient from the point of view of costs within such range; (c) offering clients at least one financial product without additional characteristics which are unnecessary for them to attain their investment objectives without them giving rise to additional costs, in such a manner alternative options – even more cost-effective – are presented to the retail investors.

Finally, it should be highlighted that the Commission proposes to transfer to the insurance scope the guarantees already collected in MiFID II relating to independent advice, that is to say, the prohibition of incentives and the obligation to include a wide range of products in the advice.

(4) Measures to guarantee a better assessment of the situation of retail investors.

At present, aiming to guarantee retail clients adopt correct investment decisions, MiFID II imposes on intermediaries (financial advisers and/or IFs in our sector) the performance of two different tests before providing their services. The first of these, the more detailed suitability test[10], is to be applied before providing the financial advice or the discretionary portfolio management service. The second one, the simpler appropriateness test[11], is to be applied when dealing with operations only executed with complex products.

The following stand out from among the proposals contained in this package intending to improve to operation of both these tests: (a) the appropriateness test will also require assessing, apart from the knowledge and experience of retail clients, their capacity to suffer losses and their risk tolerance; (b) in the case that the appropriateness test gives a negative result, the operation may only proceed under express request by the client; (c) if the advice service is provided, the suitability of the product should be assessed in terms of the composition of the client's portfolio; and (d) clients will receive the report on their suitability or appropriateness assessment sufficiently in advance to carrying out their operations so as to be able to ask for clarifications, should these be necessary.

Furthermore, in order to enable retail clients to access the independent advice service, reducing its cost, the Commission will allow the assessment of their knowledge, experience or the composition of their portfolios to be foregone as long as advice is provided on a sufficient but limited number of non-complex financial instruments that are efficient from the point of view of costs – i.e., profitable –.

(5) Measures related to advertising communications, including those using digital channels or coming from influencers.

The Commission includes a series of proposals relating to advertising communications as a novelty in this package. The following stand out from among these: (a) in relation to the content of these communications, the obligation to include the risks and benefits of the financial products offered in a balanced manner, highlighting their main characteristics; (b) in relation to possible responsibilities of the entities deriving from their advertising activity, the assumption by its management bodies of the ultimate responsibility in this matter, highlighting from among its proposals the previous approval on their part of the advertising communications policies and the marketing practices of the entity, together with receiving annual reports on the use of the advertising communications and the strategies regarding the marketing practices in the same way as the potential irregularities and possible solutions; (c) in relation to the task of supervising the advertising activity of the entities, it attributes to the supervisors better tools to guarantee that advertising communications are clear, fair and not deceptive, independently from the communication channel used; and (d) the extension of the entity's obligation to register all its marketing strategies and advertising communications.

Finally, regarding "finfluencers", the Commission proposes requiring IFs to undertake responsibility for all advertising the former perform in their names, independently from whether they have received payment for this or not, with there being the chance that the entity may even be sanctioned if the content is illegal.

(6) Measures to improve financial education.

The Commission is working with the OECD on the preparation of the financial competence frameworks. The framework for adults was published in January 2022 and that for children and teenagers will be published in autumn this year. Moreover, the Commission is also working on specific plans related to promoting financial education in different Member States. The Commission encourages Member States to implement measures at national level regarding financial education for their citizens.

(7) Measures related to the improvement of knowledge and competence of financial advisors.

At present, the knowledge and competence requirements demanded from financial advisors are laid down in some ESMA Directives. In this package, the Commission proposes to raise such demands to law status by means of a modification in MiFID II to include them, together with the inclusion of an additional demand related to knowledge and experience on sustainable investments. Furthermore, it proposes compliance with such requirements being accredited by means of a certificate and for continuous training to be obligatory.

(8) Measures related to the categorization of investors introducing a modification of the eligibility criteria for professional investors.

The Commission intends to make the criteria more flexible so that clients may be considered professionals, upon request by the interested party. In this sense, it proposes reducing the wealth requirements from €500,000 to €250,000, although demanding that this amount has been held the past three years, while introducing a fourth criterion relating to the pertinent education or training. It also intends to allow legal entities to be qualified as professionals upon request, complying certain criteria related to the balance sheet, net turnover and equity.

(9) Measures to reinforce supervision cooperation between national competent authorities and European Supervisory Authorities.

In this package, the Commission attributes new supervisory powers to the national competent authorities.

Specifically, it empowers them to adopt the following measures, among others: (a) to suspend or prohibit advertising communications or marketing practices whenever they consider there are reasonable grounds to believe they may be infringing the regulations; (b) to restrict access to websites that are a threat to investors; (c) to carry out mystery shopping activities; and (d) to have appropriate procedures to prevent unauthorised activities or services from being offered through digital media, particularly those related to advertising communications.

On the other hand, the Commission performs a series of proposals aimed at reinforcing cross-border supervisory activity. The following measures stand out from among those proposed: (a) requiring IFs to annually provide information on their cross-border activities (whenever the number of cross-border clients is over 50); (b) establishing collaboration platforms between the national competent authorities and the European Supervisory Authorities to tackle cross-border issues; (c) sharing the reasons for which the authorisation of an IF has been refused or removed by the national competent authorities, centralising that information at ESMA; and (d) requesting the national competent authority of the home Member State a revision on whether a specific company continues complying with the authorisation condition, by ESMA or any host Member State.

Similarly, in order to speed up the cooperation process between the national competent authority of the home Member State and that of the host Member State, the Commission proposes, within the scope of the preventive measures, to foster the exchange of information and to make the conditions for a national competent authority to adopt measures more flexible (as long as the home authority has not acted or has not done so appropriately). Also, a national competent authority may refer directly to the conclusions extracted by the host authority that started the procedure, whenever it observes similar harmful activities in its territory and the home authority acted appropriately.

[1] Regulation (EU) No. 1286/2014 of the European Parliament and of the Council, of 26 November 2014, on associated retail investment products and investment products based on insurance. [2] One of the aims sought by the Commission with this proposal consists in aligning, as far as possible, certain obligations of the insurance and pension plan sector with those of the securities markets sector. [3] Directive 2009/65/EC of the European Parliament and of the Council, of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to certain undertakings for collective investment in transferable securities (UCITS). [4] Directive 2009/138/EC of the European Parliament and of the Council, of 25 November 2009, on the taking-up and pursuit of the business of Insurance and Reinsurance. [5] Directive 2011/61/EU of the European Parliament and of the Council, of 8 June 2011, on alternative investment fund managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010. [6] Directive 2014/65/EU of the European Parliament and of the Council, of 15 May 2014, on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II). [7] Directive (EU) 2016/97 of the European Parliament and of the Council, of 20 January 2016, on insurance distribution. [8] ESMA Annual Statistical Report 2022 on the performance and costs of European Union (EU) Retail Investment Products. This report includes a study on costs in UCITS funds, alternative investment funds aimed at retailers and structured investment products. Page 6. esma_50-165-1677_asr_performance_and_costs_of_eu_retail_investment_products.pdf (europa.eu) [9] ESMA opinion on undue costs of UCITS and AIFs, 2023. In this ruling sent to the Commission, ESMA informed on the lack of convergence regarding undue costs. ESMA34-45-1747_Opinion_on_undue_costs_of_UCITS_and_AIFs.pdf (europa.eu). [10] At present, this test comprises an analysis of the following parameters: Knowledge and experience of clients regarding the specific type of product or service, together with their financial situation, capacity to suffer losses, investment objectives and risk tolerance. [11] At present, this test comprises an analysis of the following parameters: Knowledge and experience of clients regarding the type of product or service offered or requested.

Link of interest: Retail investment strategy: Retail investment strategy (europa.eu)