European Forum of
Securities Associations

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EFSA position on Retail Investment Strategy and the European Commission's "Have Your Say-Consultation"

The European Forum of Securities Associations (EFSA)[1] is a strong supporter of the CMU, including the aim of increasing retail clients' engagement on capital markets in the EU. We were happy to participate in the Commission's roundtable on the 18th of July 2023 and look forward to taking part in the continuing dialogue between the Industry and the Commission in the months to come.

In respect of the "Have Your Say-consultation", we have the following comments**:**

Key points

- EFSA wants to highlight that from a CMU-perspective it is important to always make the competitiveness and attractiveness of EU capital markets, including for EU market participants such as SMEs, a part of the impact analysis. This is in particular the case as the UK has announced that it intends to simplify its regulatory framework.

- EFSA is not in favour of a total ban on inducements which in our opinion would lead to negative effects for many retail clients in the EU, by creating an advice gap and limiting the client's access to a broader product offering.

- EFSA also has strong concerns in respect of a new partial ban on inducements for execution services and wants to underline that it

[1] *EFSA is a forum of European Securities Associations gathering, the French Association of Financial Markets (AMAFI), the Spanish Asociación de Mercados Financieros (AMF), the Italian Association of Financial Markets Intermediaries (ASSOSIM), the Danish Securities Dealers Association (DSDA), the German Federal Association of Investment Firms (bwf), The Belgian Association of Stock Exchange Members (ABMB-BVBL), The Polish Securities Dealers Association (IDM) and the Swedish Securities Markets Association (SSMA).*

Internet: www.efsa-securities.eu
Mail: contact@efsa-securities.eu

is very important from a CMU perspective that retail clients can access the market through different types of services and products and that investment firms are able to compete with different business models. We also see substantial operational challenges with a partial ban for execution services which will negatively impact the provision of ongoing services to many retail clients at the same time as it provides very little benefit in terms of removing conflict of interest.

- EFSA also finds the new "best interest of client"- test to be very complex and that the proposals give rise to many questions. We are especially concerned with the cost-focus of the best interest test which we fear will limit the product offering to the detriment of retail clients and we find it difficult to understand how this new test shall be aligned with the existing suitability regime and the rules on clients' sustainability preferences.

- EFSA is supportive of the principle that clients should get "value for money" but strongly objects to the introduction of centralized EU benchmarks. In our view, this proposal is equivalent to a price regulation at EU-level, and it also gives rise to serious concerns from an implementation perspective. We do not agree with the focus on "low costs index products" since also other aspects than costs are important from a retail client perspective, e.g., the risk of the product, diversification of the client's portfolio as a whole and also other factors such as sustainability preferences or tax regime. We are also worried that the development of EU benchmarks, that will have to be granular enough to allow meaningful comparisons, will be an extremely complex exercise for the ESAs, in particular considering the very wide scope of the proposed vfm-regime and the benchmarks could also give rise to liability concerns.

- EFSA welcomes proposals that aim to simplify and tackle the existing problems with information overload to retail clients, including a review of the opt-up regime for sophisticated clients. However, we are concerned that some of the EC's proposals will have quite the opposite effect and could in fact increase the complexity to little benefit for clients, e.g., the extension of the suitability and appropriateness regime.

- EFSA is concerned by the fact there has not been a thorough cost/benefit analysis nor consumer testing of all the proposals and notes that many details will be determined on level 2 which makes the impact of the proposals difficult to analyse (such as many of the new reporting requirements).

- EFSA considers that the link between some of the proposals by the EC and the policy goal of increasing retail clients' participation on the capital market is quite weak. It is therefore important that the co-legislators require that a study is carried out ex post in order to analyse whether the amendments made by EC to MiFID II, IDD and PRIIPs actually have had any effect on the policy objective.

1. General comments

EFSA is a strong supporter of the policy objective of the CMU Action Plan on Retail Investment Strategy (RIS), i.e., to build retail investors' engagement and trust in EU capital markets. We therefore share the objective to **achieve a less complex and proportionate regime that ensures an appropriate level of protection for retail clients in the EU**.

As a general comment, it is important to underline that retail markets in the EU today are quite different; some are more sophisticated, have a high degree of participation, digitalization, and financial literacy, whereas others are less mature. Therefore, we welcome proposals which are both targeted at facilitating and improving **existing retail clients' participation** in EU capital markets and proposals which aim at encouraging participation of those who currently **do not yet participate** in the market.

According to EFSA, it is of utmost importance from a CMU perspective that the regulatory framework in the EU **allows for different business models to co-exist**. This means that retail clients should be able to have access to different types of services to serve their needs - both advisory and execution services – and that firms should be able to structure their services and fees according to how the local distribution network is organized at Member State level. **A regulatory framework that is based on a "one size fits all approach" will not create a competitive and efficient EU capital market**, especially given the existing diversity of the term "retail clients" e.g., mass consumer, sophisticated investors, SME-companies and local public authorities.

To ensure the attractiveness of EU capital markets it is furthermore important **to consider the regulatory developments in the UK and other third country jurisdictions, especially at a time when the UK is considering "further simplifying its rulebook whilst retaining high regulatory standards"[2]**. In fact, from a CMU perspective, it is important to ensure that the amendments to the investor protection rules do not have the effect of making it more difficult for EU investment firms to offer their retail clients competitive services and products, hence forcing clients to turn outside of the EU to get their financial needs met. In particular, we consider this could be a risk for the more sophisticated segment of the retail market as well as SME-companies.

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[2] Chancellor Jeremy Hunt's Mansion House speech, link, 10 July 2023

EFSA notes that the EC's proposals include a substantial number of mandates to the EC/ESAs which makes it difficult at this stage to evaluate the meaning and full impact of several of the proposals. It is important that the co-legislators ensure in the forthcoming work that all of the new requirements – on **level 1 and level 2** - are subject to **thorough analysis, consultation, impact assessment and consumer testing**. Focus should be on amendments that are evidence-based and bring a clear positive impact for retail clients, whilst avoiding proposals that could have unintended negative consequences for clients, investment firms or the EU capital market as a whole. In this connection, EFSA also notes that there is sometimes an over-reliance on how much can be achieved by financial regulation and wants to underline that when it comes to retail investors some behaviours are structural and linked to e.g., pension systems, taxation and financial literacy in Member States. In order to avoid over-regulation in the EU (which could also be negative from a CMU perspective) it is therefore important to analyse ex post whether the proposed amendments have had the desired effect i.e., had a positive effect on retail clients' participation in capital markets.

EFSA therefore proposes that a **general review-clause** is introduced into the level 1 to assess whether the amendments have de facto had the desired effect on the retail client's engagement on the EU capital market or not. Such a review should in particular include an assessment of the impact of the foreseen measures on inducements and should not take place until after an appropriate time has passed from the implementation of level 1 as well as level 2.

Several of the EC's proposals will require extensive IT-developments, changes in legal documentation including contracts with clients, as well as changes to existing internal procedures and staff training. In order to ensure an orderly implementation and avoid legal uncertainty, it is therefore important to allow the investment firms as well as their clients sufficiently long time to adjust their business to the new requirements. In EFSA's view, **the implementation period should be at least 12 months, counted from the finalization of the level 2 rules**. A "gap" between implementation of level 1 and level 2 rules must be avoided!

2. Specific comments

2.1 Inducements

As a starting point, EFSA is **not in favour of a full ban on inducements** which we believe would be very distortive for the capital market in the EU, leading to advice gaps and limitations of product offerings to retail clients. We also note that according to the latest Eurobarometer[3], there is not a high level of trust in the financial markets in the Netherlands where

[3] https://europa.eu/eurobarometer/surveys/detail/2953

a full ban exists which makes us question the effectiveness of a ban when it comes to increasing retail clients' participation on capital markets.

Instead of a full ban, EFSA's position has been in favour of **improving the inducement regime within the current framework** by clarifying and making the rules more coherent and by increasing the supervisory convergence (e.g., as regards "quality enhancement" and proportionate criteria), thus ensuring that fee disclosures become easier for retail clients to understand, in combination with an effective supervision and enforcement.

As regards the **partial ban for execution services**:

- EFSA notes that the partial ban for execution services is not part of EC's impact assessment, and we are concerned with the fact that there has not been an in-depth analysis of this proposal.

- In EFSA's experience, execution services to retail clients serve an important function on the EC capital markets and we fear that a partial ban could distort competition between different types of service providers and between inhouse and external products. An open architecture is to the benefit of retail clients as competition brings down costs and increases investor choice.

- EFSA questions the rationale for a ban on inducements for non-advised services since by definition, under these services, the retail client will make his/her own investment decision by him/herself and there will be no room for any influence by the firm (no conflict of interest).

- For a full-service investment firm, offering both advisory and execution services, a partial ban would require firms to separate between products and to limit the product offering for execution services. This could have negative consequences for retail clients who have an ongoing relationship with a full-service firm and are used to being able to switch between execution and advisory services. In fact, the proposal would in practice limit the retail client's freedom to choose when and where and how to invest which could result in those clients becoming less active on the capital market, contrary to the policy objectives.

- From the full-service investment firms' perspective, it will also be technically challenging to implement this separation between products as it would require keeping track of through what type of service a retail customer has invested. In particular, we are concerned that the proposal for a partial new ban appears not only to apply to new investments, but also existing ones and EFSA therefore strongly suggests that a grandfathering clause is introduced for existing products and existing portfolios in case of on-going inducements.

- It should also be recalled that under current MiFID II rules, inducements are only allowed for execution services if they are linked to the provision to retail clients of value-added services such as: *"objective information tools"* or "*periodic reports of the performance and cost and charges associated with the financial instrument"*. If a ban is introduced, there is a high probability for retail clients to be deprived of access to such value

adding services or guidance. This seems all the more regrettable as retail clients now have to face the challenge of dealing with the extreme complexity of the new sustainability requirements. In that respect, it seems important to recall that the Retail investment strategy Study requested by the ECON Committee of the European Parliament to the Policy Department for economic, scientific and quality of life policies Directorate notes[4] that: "*Rather than simply concentrating on the alternatives between allowing or prohibiting inducements, what legislation should ultimately ensure is that investors are able to effectively understand and evaluate whether, in a certain context or transaction, they are indeed being provided with some kind of "support" for their investment decisions or not, and, if so, what this support effectively consists of.*"

- EFSA welcomes the exemption for fees paid in by issuers for underwriting and placing services but questions that the ban on inducements should apply to PRIIPs products, which according to ECs interpretation also includes some plain vanilla bonds. In our view, it would be very damaging to the EU capital markets if investment firms would no longer be able to be compensated by corporate clients when providing services in relation to a bond issuance. For other PRIIPs products such as investment funds and insurance products, placing and underwriting fees do not exist in the same way as on the primary market. Therefore, excluding them explicitly from the exemption to the ban on inducements is not relevant.

As regards **"accept and retain" vs. "pay or receive"**:

- For portfolio management and independent advice, the EC states in the explanatory text that the intention is to keep the regime unchanged. However, EFSA notes that for portfolio management, the wording has changed in a way that suggests that it should no longer be possible for investment firms to receive and transfer the inducement on to clients. We are not certain if this amendment is intended, in particular considering that article 24 a, par 7, second subparagraph still mentions transfer of inducements to clients "where applicable" and also the fact that this very significant change has not been subject to an impact assessment.

- If the change to "pay or receive" is intentional, EFSA wants to underline that a prohibition to accept (and transfer) inducements to clients could have a significant distorting effect on existing market structures in the EU. Moreover, we do not understand what the rationale behind this is since the conflict of interest that the receipt of an inducement can entail is de facto removed if the inducement is transferred to clients. The change would entail significant implementation costs for the industry to little use for retail clients or capital market as a whole. Against this background,

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EFSA strongly proposes that the previous wording "accept and retain" should be re-inserted into the text.

- For the sake of level playing field, the same rule (i.e., accept and retain) must apply to all situations where there exists a ban on inducements, i.e., to independent advice, portfolio management and, if implemented though RIS, execution services to retail clients.

As regards the **review clause**:

- EFSA considers that a 3-year review clause for inducements is much too short in order to analyse the effects of the proposals regarding inducements and suggest that this time is extended to 5 years. From a legal certainty perspective, it must also be clear from the outset which criteria the EC shall take into consideration in such review.

2.2 Best interest of clients - test

- From an operational perspective EFSA finds the new "best interest of clients test" to be complex and unclear in many respects. For example, we note the introduction of several new and not defined concepts into MiFID II (e.g., "additional features" and "cost-efficient") which need to be clarified before it is possible to fully understand and evaluate the proposal.

- In particular, EFSA is concerned with the fact that the EC's view seems to be that the "most cost-efficient" (i.e., the "cheapest") product is always in the best interest of retail clients. This position fails to recognise that also other factors are important for clients receiving investment advice which are taken into consideration in the context of a suitability assessment, including the sustainability preferences. Thus, the alignment between the best interest test and other parts of MiFID II, especially the suitability test, needs to be clarified.

- EFSA understands from the explanatory text that the best interest of client's test is intended to replace the existing quality enhancement regime. However, we note that this new test is much wider in scope. In fact, it covers all firms providing investment advice under MiFID II, i.e., regardless of inducement. In addition, to our understanding it would by legal reference also becomes applicable to management companies subject to UCITS/AIFM when providing investment advice which could lead to strange results, e.g., noting the obligation to assess an "appropriate range".

- It should also be taken into consideration that the test with its narrow cost-focus could have secondary effects on the product offering on the market, e.g., if investment advisors primarily will be able to recommend only low-cost products without many other quality parameters. This could largely favour passively managed index funds, ETFs, and the like and thus also the larger product manufacturers on the market that are able to offer lower prices due to economies of scale-effects. (see also below comment in relation to "suitability light" proposal)

2.3 Product Governance – value for money

EFSA supports that retail clients should get "value for money" (vfm) for investment services and products. However, we strongly object to the proposal that value for money should be determined by centralized EU benchmarks. In our view, such a proposal is resemblant to introducing a price regulation at EU-level which is not in line with the fundamental principles of EU law, based on market economy and free competition.

We also question whether it is even feasible for the ESAs to take on such a complex task of developing EU-benchmarks, considering the large number of investment products in EU. In fact, the scope of the regime is very concerning since the reference to PRIIPs means that it would include also some plain vanilla bonds and hedging derivatives.

Moreover, EFSA is concerned with the fact that the proposed approach to EU-benchmarks is exclusively quantitative, with a sole focus on costs. There is no consideration for qualitive criteria either attached to the product (e.g., capital protection, liquidity and more importantly ESG criteria) or to the associated services provided which in our view is very problematic.

Furthermore, as the Vfm-proposal is set out, we see a clear risk that it would hamper innovation and competition since it could create barriers of entrance i.e., make it hard for new market participants and products to enter the market and compete with established and large market participants and products due to their economies of scale. We are also concerned that the focus on costs will limit the product offering to clients e.g., to more passively managed funds that are cheaper to produce and maintain and which do not necessarily include other (otherwise valuable) investment objectives such as sustainability. This development is not in retail clients' best interest, considering that retail clients have different needs.

From a practical perspective, EFSA is also concerned with the fact that the vfm- proposal seems to require sharing of very sensitive price information between investment firms. It is therefore important to analyse the proposal from a competition law perspective which we understand has not yet been the case. We want to underline that the Vfm-proposal will increase the operating costs of producers and distributors (and even NCAs) due to the need to create and submit new reports to ESMA and local supervisors. In the end these costs are likely to be borne by the retail investor and considering the limited benefits and negative consequences mentioned above, EFSA questions whether this can be justified from a cost/benefit perspective.

2.4 Appropriateness and suitability

In EFSA members' experience, the MiFID II rules on appropriateness and suitability work well, as they accommodate for different access needs to the market while providing protection to investors. In our view, it is particularly important that the MiFID II framework maintains the

distinction between execution and advisory services, considering that these services serve diverse needs for clients.

We are therefore concerned with the EC's proposal that investment firms should collect information on clients' ability to bear loss and risk tolerance when conducting the appropriateness test. Such proposals blur the distinction between suitability and appropriateness assessments. This will increase the complexity of the rules and not be to the benefit of clients. One of the main goals of the RIS is to simplify the rules for the clients.

EFSA questions the introduction of a more flexible regime for suitability assessment for "well-diversified, non-complex and cost-efficient financial instruments ". The proposal seems to create a clear bias in favour of low-cost index funds such as ETFs.

We fear that the proposal could distort competition between different business models and create an undue unlevel competition in the market, i.e., between independent and dependent advice. We see no reason why the client should not receive the same level of protection for all types of advice. Thus, if a simplified regime is implemented, we propose that the same rules shall apply for both types of advisory services (regular and simplified advice).

2.5 Disclosure re. cost & charges

EFSA supports initiatives to reduce the complexity of the framework. Evidence show that retail clients are interested in price and total costs, not detailed breakdowns, or methods of calculation. Unfortunately, we note that the disclosures proposed by the EC are still at a very granular level (e.g., annual statements at product level) that may even be greater (e.g., detailed annual statement on costs and performance for firms providing a service of safekeeping and administration of financial instruments together with an investment service; or product ongoing cost disclosure for investments services provided without safekeeping and administration of financial instruments) and encourage co-legislators to take further steps towards a more proportional regime for retail clients that decreases information overload. It is also important to ensure that all disclosures work well in a digital environment.

Finally, EFSA notes that some of the alleviations for cost and charges disclosures for professional clients and eligible counterparties that were adopted in the context of MiFID Quick Fix seem to have been re-introduced by the EC's proposal. We wonder if this is intentional. If so, EFSA strongly opposes to these changes and wants to underline that in order to ensure that EU capital markets are attractive to professional investors and eligible counterparties that can look after their own interests, it is important to avoid administratively burdensome rules that provide no or little benefit such as the cost & charges disclosure rules.

2.6 Client categorization – opt-up

EFSA welcomes a review and relaxation of the opt-up criteria in the annex to MiFID II. Based on our members' experience it is also important to review the transaction criteria, as 10 transactions/quarter is difficult to fulfil when it comes to less liquid instruments such as corporate bonds, OTC-derivatives, and private equity products at least in some local markets. One suggestion would be to give a mandate to ESMA to develop the transaction criteria per asset class at level 2.

2.7 PRIIPs scope

According to EFSA, it is important that co-legislators take the opportunity in RIS to deal with the existing problems and uncertainty related to PRIIPs scope. In our view, PRIIPs KID requirements are only suitable for packaged investment products used for investments. All plain vanilla bonds and tailormade OTC derivatives that are only used for hedging should be excluded from PRIIPs scope: tailormade OTC derivatives should instead fall under the general pre-contractual information requirements that follow from MiFID II, which can be more easily adjusted to the type of instrument at hand. As for plain vanilla bonds, they will fall under Prospectus Directive requirements that cater to provide full information to clients. This is important to ensure that the information is relevant to retail clients, to avoid information overload and to not impair the possibility for corporates to use the bond market for financing/OTC derivatives market for hedging. By excluding plain vanilla bonds from PRIIPs scope, the co-legislators would simultaneously solve some of the difficulties anticipated on the scope of contemplated value for money and inducements-rules noted above.

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