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FRANÇAISE
DES MARCHÉS
FINANCIERS

LES PROFESSIONNELS DE LA BOURSE & DE LA FINANCE

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Retail Investment Strategy
-
Note de position commune aux associations professionnelles françaises

La stratégie de l'UE pour les investisseurs de détail (*Retail investment strategy* ou RIS) a pour objectif de donner assurance et confiance aux investisseurs qui investissent sur les marchés de capitaux et donc d'accroître leur participation au financement de l'économie.

La RIS est à ce titre une priorité affichée de la Commission Européenne.

Les propositions qui devraient résulter de cette stratégie sont attendues au cours du premier semestre 2023. L'une des principales mesures envisagées consiste en une interdiction des *inducements,* jugés sources de conflits d'intérêts et de renchérissement des produits et services. Or, en la matière, il semble que les derniers arbitrages ne soient pas encore rendus par les services de la Commission.

Dans ce contexte, les associations professionnelles françaises (AFG, AFPDB, AMAFI, FBF) ont souhaité travailler à des propositions de renforcement des exigences réglementaires de nature à répondre aux objectifs de la Commission tout en constituant une alternative solide à l'interdiction des *inducements*.

Ces propositions sont présentées dans la note jointe, selon les thématiques suivantes :

- *Value for money* des instruments financiers (I),
- Amélioration de la qualité des services fournis aux investisseurs (II),
- Amélioration de la concurrence et de la transparence sur le marché de la fourniture de data (III).

Cette note constitue une première version, qui pourra être révisée, afin de prendre en considération les observations des différents interlocuteurs rencontrés aux niveaux national et européen.

Retail Investment Strategy: addressing the challenges of the whole value-chain

Introduction

In the context of the development of the Retail Investment Strategy, we share the European Commission's priorities to ensure "*adequate protection, bias-free advice, open markets and transparent, comparable and understandable product information*"[1].

Those past years, many initiatives (MiFID II, PRIIPS, etc.) have been rightly implemented to enhance retail investor protection and to improve the quality and the pricing of financial instruments and investment services in the EU. These initiatives have allowed to maintain access to the financial markets by the largest number of retail investors, with the best level of information and protection. They also have kept European financial markets supplied with a portion of household savings and supported investment and growth in the European economy.

Our view of the value of financial instruments and investment services provided to retail investors is that it represents the final output of a global value-chain; as such, the value for money delivered to the end investor is merely the result of several steps in the value-chain.

That is the reason why we suggest a global approach to the Retail Investment Strategy through the concept of value chain that encompasses each step of the manufacturing and selling of financial products to the end retail investor. With such an approach, attention would also be paid to the costs borne by investment products' manufacturers and distributors, including those related to data.

Lastly**, it is critical to ensure that service providers and products' manufacturers can operate in an environment that fosters competition and innovation, ingrained in sufficiently profitable business models, to deliver value to retail investors and to maintain** competitiveness of the EU vis-a-vis third countries.

In this context, we would like to present several proposals elaborated as alternatives to the ban of commissions and, therefore, in an environment where the latter have been maintained.

Indeed, a ban would be incompatible with the preferences and characteristics of retail investors, as many of them are not comfortable with the alternative of fee-based advice. It would have significant disruptive consequences, including a real risk of creating an **advice gap** and discouraging retail investors from participating in capital markets, which contradicts the goal of the Retail Investment Strategy[2]. Indeed, it is well-evidenced **that investment advice is essential for EU retail investors**, and that commission-based advice remains the most suitable model for the majority of European retail investors who are unwilling or unable to pay any upfront advisory fee.

[1] EU strategy for retail investors, 2021 EU Commission consultation.

[2] See among others KPMG study https://www.afg.asso.fr/afg-document/commission-based-remuneration-vs-fee-based-remuneration-is-there-a-better-model-for-retail-investors/

Furthermore, the growing sustainable finance agenda, and the newly introduced requirements to take client's sustainability preferences into account, make it even more critical that investors have access to good quality investment advice. A commissions' ban entails the risk of excluding investors from critical guidance as they navigate through this very complex regulatory environment and the vast diversity of ESG products. For lack of qualified investment advice, this will either turn away substantial capital inflows from the green economy or lead investors alone to decide on their investments and bear the risks accordingly.

Overall, the substantial and costly efforts made to close the financial inclusion gap and move forward the Capital Markets Union and Sustainable Finance agendas risk becoming useless if the European legislation creates constraints that are incompatible with the preferences and characteristics of retail investors.

In that regard, it is worth noting that the UK FCA just consulted on potential "*ways to make financial advice more accessible*" through simplified advice for the investment in mainstream products[3]. Among the reasons put forward for doing so, which are the direct consequences of the RDRs and the inducement ban, is the difficulty identified with consumers "*put off from receiving advice through perceived high charges*", as well as the concerns raised by firms about the "*economic viability of providing advice to mass-market consumers – especially where there is a human element involved – given requirements around suitability and the initial customer fact find, adviser qualifications and adviser charging*". However, one solution proposed by the FCA, which is to lower training standards for financial advisors to create a form of "cheap advice" while still banning inducements, is not, in our view, a satisfying solution.

To conclude, we strongly advocate for **both regimes (fee-based and commission-based) to co-exist. This is one of the building blocks of a successful Retail Investment Strategy.** See figures in annex IV.

In the context of the coexistence of both regimes, we wish to present our approach on an assessment of value, also called "value for money" and other proposals to enhance investors' protection:

- Assessment of value (= value for money) of financial products;
- Enhancing the quality of services provided to investors;
- Enhancing competition and transparency on data providers' market.

Please note that the following developments only relate to the MiFID II perimeter.

I. Assessment of value ("value for money") of financial products including their related services

In the existing regulatory framework, the value for money ("VFM") principle, though not explicitly stated, is already present. It derives naturally from the MiFID II delegated directive and is already mentioned in level 3 (ESMA Q&A update on Product Governance, 6 November 2020).

As such, we see the assessment of the VFM of a financial product as an integral part of the Product Governance ("PG") requirements for both manufacturers and distributors.

[3] https://www.fca.org.uk/news/press-releases/fca-proposes-ways-make-financial-advice-more-accessible

In light of publications of various competent authorities[4], a successful implementation of this important provision for investor protection should first and foremost consist **in reinforcing the existing principles, at level 1, to require a periodically reviewed VFM assessment, while allowing sufficient time for more detailed work with the financial industry to design measures based on industry best practices**.

In addition, we consider that a successful implementation of the VFM principle requires taking into consideration the following points:

- VFM is more than a mere performance/cost ratio: qualitative criteria must also be taken into account in the VFM assessment;
- VFM should be a global process: quantitative and qualitative values (including product-related services) must be assessed separately;
- VFM should apply when pertinent to a targeted scope (e.g., PRIIPS perimeter with pertinent exemptions or adaptations), such an approach not being appropriate for some financial instruments such as ordinary shares and vanilla bonds. It should also be calibrated according to asset classes and product types;
- VFM involves a necessary cooperation between manufacturers and distributors: their roles are distinct, but they share a common interest in standardized, and easily accessible VFM data points (such as FinDatEx templates[5]), enabling automated process.

See our detailed proposal in Annex I.

II. Enhancing the quality of services provided to investors

We lay down hereafter several proposals to enhance the quality and disclosure of the services delivered to the retail client, while at the same time avoiding the detrimental side effects that an outright ban of commissions would have.

Our proposals are the following:

- Improving the information on value-added services provided to investors in return for any inducements perceived (commission-based model);
- Developing a harmonized EU-wide level of qualification for advisors to enhance the value of services provided to investors;
- Maintaining a clear distinction between the historical Twin Peaks distribution MiFID regime: appropriateness and suitability.
- Better calibrating investor protection and information;
- Developing more fit-for-purpose Product Governance rules;
- Adapting to digital innovation in a pragmatic way;
- Enabling the digital provision of information for the PRIIPs KID to become the default option, as it is already the case under MiFID II.

See our detailed proposals in Annex II.

[4] FCA, EIOPA.

[5] Findatex is a pan-European working group aiming at delivering standard templates of data exchange, along various regulations (Solvency II, PRIIPS, MIFID, SFDR, …) between manufacturers and distributors

III. <u>Enhancing competition and transparency on the data providers' market</u>

The access, use and cost of data necessary[6] to provide investment services and manufacture and distribute financial products are an important portion of the costs borne by investment firms, representing therefore a significant proportion of the total charges paid by retail clients.

We have the following concerns with the functioning and practices of the data industry that inevitably have an impact both the quality and price of the services and products to clients and therefore should, in our view, be dealt with:

- applying non- transparent fee policies likely to result in unfair and discriminatory pricing practices;
- rising to all-time highs the price of financial and ESG benchmark data (double digit increase by years);
- having few accountability provisions on their services which is likely to raise reliability issues of such services: data providers are most of the time, headquartered outside the EU, without any EU localization or authorization requirements (as it is in DORA for IT third-party services providers for instance).

Therefore, our proposal is to regulate private data providers to contain the costs charged to clients.

See our detailed proposal in Annex III.

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[6] Necessary for business but more and more for regulatory reasons.

ANNEX I – ASSESSEMENT OF VALUE OF FINANCIAL PRODUCTS INCLUDING THEIR RELATED SERVICES

We see the value for money (VFM) as an integral part of the Product Governance ("PG") requirements. Indeed, it adds to its central requirement of satisfying client needs, a more specific test to ensure that the manufactured/distributed financial products' costs are worth their benefits.

In the existing regulatory framework, the VFM principle, though not explicitly stated, is already present. It derives naturally from the MiFID II delegated directive[7] and the Product Governance guidelines and is already mentioned in level 3 provisions (ESMA Q&A update on Product Governance, section 16, 6 November 2020).

Considering publications of various competent authorities[8], a successful implementation of this important provision for investor protection should first and foremost consist in reinforcing the existing principles, at level 1, to require a periodically reviewed VFM assessment.

Level 2 developments, if deemed necessary, should then be based on evidence gathered after sufficient time and an examination of best practices in the market, rather than imposing too many prescriptive criteria before the sector and retail investors are duly consulted.

In addition, we consider that a successful implementation of VFM rules requires taking into consideration the following points:

a. VFM is more than a mere performance/cost ratio: quantitative and qualitative criteria are distinct and must be equally assessed.

An effective VFM relies on two legs: a total cost consideration (i.e., involving all costs linked to the ownership of a financial product, named total cost of ownership[9]) on the one side, in relation with the potential performance of the financial product including a full appreciation of the benefits provided to the clients investing in the said product (also including the services that come with the ownership of a financial product) on the other side.

<u>Dual nature of VFM: quantitative and qualitative criteria</u>

As for the financial product itself, the fact that the value of the product is subjective and extends beyond its mere return, is long accepted by economic and financial science.

As an illustration, clients with different risk appetites or desired time-horizons, investment objectives or tax situations, may notably significantly diverge in their appreciation of the value (or "utility") of a specific financial instrument.

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[7] Art. 9 MiFID II Delegated Directive.

[8] FCA, EIOPA.

[9] See KPMG study. https://home.kpmg/fr/fr/home/insights/2022/02/remuneration-des-distributeurs-commission-ou-honoraire.html (French version) – https://www.afg.asso.fr/afg-document/commission-based-remuneration-vs-fee-based-remuneration-is-there-a-better-model-for-retail-investors/ (English version).

In fact, while the financial product's value certainly encompasses the product return (itself covering both the generated income and the possible product appreciation during the recommended holding period[10]), the notion should not be limited to a mere quantitative measurement (see point b below for performance and quantitative assessments).

In practice, this means that the assessment of the product performance versus its cost, duly calibrated with the appropriate risk-levels (e.g., volatility, tracking error, active share…) and relevant recommended holding period ("RHP"), must be accompanied by another assessment, qualitative in nature, covering the product features and the services provided. The consideration of these qualitative aspects may counterbalance the initial quantitative test.

Qualitative criteria at the level of the financial product

These may notably include, without this list being exhaustive:
- Capital protection mechanism, in full or in part,
- Product liquidity features, such as guaranteed daily liquidity, other liquidity provisions,
- Early-exit conditions,
- ESG features and/or the compliance with EU or national ESG label or ESG guidelines,
- Eligibility to specific tax benefits,
- Credit quality and reputation of the product manufacturer,
- Exposure to specific assets, not easily accessible and corresponding to the client's objectives,
- Any other specific product characteristics.

As stated, VFM should use homogeneous asset classes (see below).

The assessment of services is a fundamental complement to the financial product value

For investors, financial products do not exist in isolation from the services they are provided and may not be accessed independently from this service.

Whether acquired on exchange, though a broker, through an investment advisor or an insurer, financial products cannot be separated from the services that permit this access, which constitute an integral part of the customer experience and, hence, of their value-appreciation. Often, almost literally, these services are directly connected to the product value.

As an example, in fast-moving markets especially, readily accessible investment advice service or other easily available market information or product valuation service may help investors reach the appropriate, un-delayed investment decisions that fit with the prevailing conditions and allow them to select and seize the right products for them.

- Distributor's services

Clients generally more clearly perceive these services at their distributor's end.

Such services may notably comprise (non-exhaustive list):
- **Investment advice and/or execution services**,

[10] The inflation factor is rather to be assessed at the client level together with its risk appetite; indeed, we would caution against hasty client holdings reviews "boosting revenues" while unduly exposing clients to a risk level that they are not capable of withstanding.

- **On-line tools** (e.g., online portfolio simulations…),
- **Documentation** (macro-economic information bulletins, market briefs, opinions, or sectoral research…),
- **Investor education resources** (explanation of key financial or economic concepts, introductions to various asset classes, searchable catalogues of product summary notes),
- **Other expert resources** (e.g., free consultations with experts other than investment advisors such as inheritance, tax…),
- **Available national wide assistance through in-situ office network,**
- **Selection of financial instruments and manufacturers.**

- <u>Manufacturer's services</u>

As important in the value chain, are the manufacturer's services. Though most of them may be considered as an integral part of the production process of the financial instruments, some clearly come in addition to it.

This is notably the case when manufacturers provide services that complement those of distributors (e.g., product information hotline or other expertise made available to end-investors).

This value-assessment regarding manufacturers' services may also concern the product's secondary market. This is notably the case when manufacturers play a direct role in it (e.g., asset managers for funds or banks acting as intra-day liquidity provider for structured products) and provide a specific contribution that clearly exceeds the service quality of peer solutions (e.g., integrated electronic execution platform embedding other useful applications).

The latter elements may be of particular use for distributors when defining their own product offering and conducting their own value assessment of manufacturers.

b. VFM should apply to a targeted scope of financial products (the same as PRIIPS with pertinent exemptions or adaptations) and it should be calibrated according to asset classes and product types

As stated in our initial comments, VFM tests should be seen as a component of the Product Governance. As such, their very goal should be to ensure that manufacturing and distribution processes are duly set-up and, if needed, adapted to ensure that the said manufactured/marketed products may be reasonably regarded as offering benefits to clients.

This objective assumes that the VFM information may be used at the two levels of PG:
- First, it should inform manufacturers in their decisions to continue, adapt or stop the production of the tested instruments in terms of level of costs, services included and potential performance;
- Second, crucially, it should assist distributors in the definition of their products' offer.

However, depending on the types of financial instruments, the usefulness and practicability of VFM assessments may greatly vary.

As an example, some financial instruments, such as ordinary shares or bonds, issued by corporate entities are issued with the objective of providing funding to their corporate issuers rather than satisfying the needs of the financial entities' clients. The VFM is therefore not suited to such financial instruments. The interest of clients in this respect is met by the best execution requirements which are designed to prevent clients from being charged undue costs.

In other cases, the VFM tests may not be conclusive at all or only in a generic or partial mode.

This may notably be the case for hedging products. In these cases, the product value for investors does not stem from the product income or product appreciation but more from the adequacy of the hedging solution for the investor in terms of the protection it provides. Here an isolated product performance assessment would be totally misleading.

In addition, in the specific case of non-professional corporate investors buying a swap under the appropriateness regime (i.e., non-advised sale), it must be noted that their financial intermediary/counterparty generally has no vision of the underlying assets of these investors. As a result, these financial actors may not conduct any transaction specific VFM test that would include a full assessment of the provided hedge. They may only indicate, at a generic level, the possible use for hedging purposes of this derivative product (as indicated in their FinDatEx EMT templates[11]).

Similarly, for other derivatives (i.e., both listed derivatives and exchange-traded securitized vanilla derivatives, such as warrants), as was illustrated in the work on PRIIPS RTS, the quantitative appreciation of the performance may be problematic, notably as concerns the appropriate holding period to consider and the adequate calibration of scenarios. With an undifferentiated application of a standard methodology that would cover all financial instruments there is a high risk to yield aberrant (and factually impossible) performance values.

For derivative instruments and, especially for hedging instruments, an adapted regime (if not a full exemption) should apply, focusing on the qualitative criteria of the VFM, as an isolated consideration of product performance is likely to be misleading.

However, in terms of quantitative VFM assessment, it should also be recalled that for all the financial instruments listed above, the best execution regime (including Article 64 of the MiFID II Delegated Regulation that requires firms to check the fairness of the price proposed to the client when executing orders or taking decisions to deal in OTC products) already serves as a useful tool to prevent clients from supporting undue costs.

As a result of the above, it seems critical to precisely define the scope of products for which a VFM test should be performed, and to include exemptions and adaptations where needed. As a first approximation, **the VFM scope would correspond to the current scope of PRIIPS with the notable exception of derivatives contracts[12].**

c. The VFM methodology must differ depending on the asset classes and product types.

As is currently the case for PRIIPS, an effective VFM shall acknowledge that diverse products may call for different methodologies. This is especially true for the quantitative value assessment.

[11] FinDatEx is a pan-European working group delivering templates for data exchange between manufacturers and distributors complying with regulations such as Solvency, MiFID, PRIIPS, Sustainability…

[12] E.g., listed derivatives, exchange traded securities with pure option payoffs like warrants, and OTCs derivatives contracts which are not investment products and don't have a benchmark to compare with for VFM purposes.

For example, while funds may use past-performance as a natural reference for VFM tests, structured products, on the contrary, essentially operate with a forward-looking perspective due to the absence of historical NAV.

The desirable VFM scope may be summarized in the table hereafter.

<table>
<tr><th></th><th></th><th>Suggested VFM regime
and comments</th></tr>
<tr><td rowspan="5">Product types</td><td>Ordinary shares

Vanilla bonds</td><td>Full Exemption*
These instruments are non-complex under MIFID2, not packaged under PRIIPS (i.e., exempted from KID requirement).
Their issuers are generally not financial entities, not directly subject to PG.
Their issuance is not primarily directed towards the satisfaction of client needs but by the funding needs of their (corporate) issuers.</td></tr>
<tr><td>UCITS

FIAs

Structured products</td><td>Full VFM
(Quantitative & Qualitative)

With product specific methodologies based on industry standards to be developed
(esp. for quantitative criteria and notably performance assessment)</td></tr>
<tr><td>Listed derivatives
(other than hedging)</td><td rowspan="2">Adapted Regime
(Essentially Qualitative) *

Qualitative assessment shall be combined with target market (products not appropriate for investor lacking required knowledge/experience.
As for the quantitative aspect, due to very short recommended holding period of most products (often limited to 1 day), simulations are inapplicable and comparison with a benchmark makes no economic sense. Further, it should be noted that prices already directly reflect intrinsic product value (in or out of the money).</td></tr>
<tr><td>Exchange-traded securitized vanilla derivatives
(warrants, turbos, other than hedging)</td></tr>
<tr><td>Hedging Solutions</td><td>Adapted Regime (Qualitative only) *
Performance-based product-valuation is inadequate. Use qualitative test</td></tr>
</table>

** For such products, it could be considered that best execution and usual appropriateness or suitability requirements serve as a quantitative VFM test.*

d. The necessary cooperation between manufacturers and distributors.

Their roles are distinct, but they share a common interest in standardized, easily accessible VFM data points (such as FinDatEx EMT templates), lending themselves to automated processes.

As for the rest of the PG process, a successful implementation of the VFM relies on the ease of access of the necessary information and its standardized format. This is a prerequisite for automated processes that are increasingly the norm among financial manufacturers and distributors alike.

On the basis of this information, the distributor carries out an autonomous analysis within the framework of product governance which does not require guidance, a fortiori imperative, on the part of the manufacturers on the interpretation to be made of this quantitative or qualitative information. The client could be informed by the distributor of its value assessment policy.

Here the precedent of the FinDatEx templates, used for conveying standardized templates between manufacturers and distributors should be considered as a useful reference.

See tables hereafter that provide an illustration of a value assessment' process and give examples of the type of data that could be processed for the VFM assessment either by manufacturers (then conveying the information to distributors) or by distributors.

Global Value Assessment Process

Manufacturer	**Distributor**
Common nomenclature of data	
Step 1: Quantitative assessment[13], where relevant and applicable to the product type *Leads to identification of outliers*	**Step 1: Quantitative assessment** *Leads to identification of outliers*
Step 2: Qualitative assessment *Applied to outliers identified in step 1*	**Step 2: Qualitative assessment** *Applied to outliers identified in step 1*
Step 3: Product governance global assessment *for outliers that were not conclusive after step 2*	**Step 3: Product governance global assessment** *for outliers that were not conclusive after step 2*
⇨ **Maintain or suspend marketing and/or modify the product**	⇨ **Maintain or suspend marketing**
• Internal process[14] • Manufacturer data and/or relevant public data • Where applicable, annual review/specific review in case of material events	• Internal process • Manufacturer data and/or public data and/or distributors data • Annual review/specific review in case of material events

[13] Several approaches may be used: assessing the product on its own merits against a benchmark, or peer comparison within a specific product range (where peers are available).
[14] Detailed methodologies should remain internal, however the outcomes can be shared with distributors.

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<table>
<tr><th colspan="5">Examples of the type of data that could be processed for the value assessment
Industry needs time to develop their best practices before any level 2 or 3 regulation.</th></tr>
<tr><th></th><th></th><th>MANUFACTURER</th><th></th><th>DISTRIBUTOR</th></tr>
<tr><td rowspan="2">QUANTITATIVE</td><td rowspan="2">Product</td><td>Funds
Perf.: past perf. or combination past. perf. + forward, on RHP perf. vs objective; vs risk indicators.
Charges: ongoing fees (+ perf. fees if any)
And where relevant peer group review

Structured products
Perf.: e.g., forward-looking Monte-Carlo perf. simulations (net of costs) compared with benchmark in one of 3 scenarios (bull, bear, neutral)
Charges: cost review</td><td rowspan="4">Standardized fields / communication to distributors possible through automated templates</td><td rowspan="2">Same nomenclature of data points (but own analysis)
+
Other fees according to distributors' pricing policy:
• Entry fees
• Cost of investment services (such as investment advice)
• Distributors' transactions fees, execution fees, spread fees,
• Wrapper fees…</td></tr>
<tr><td>Derivatives, securitized derivatives
(warrants, turbos): with adapted performance methodology. In light of the very short RHP of most products (often limited to 1 day), simulations are inapplicable, and comparison with a benchmark makes no economic sense.</td></tr>
<tr><td rowspan="2">QUALITATIVE</td><td>Product</td><td>Where relevant:
• Capital protection (in part or full)
• Product Liquidity (e.g., daily liquidity, other liquidity provisions)
• Early exit conditions
• ESG characteristics, objectives or ESG label
• Eligibility to specific Tax regime
• Other Fields</td><td>Same nomenclature of data points (but own analysis)</td></tr>
<tr><td>Services</td><td>Services, directly benefiting investors:
• Liquidity provision scheme (unless already covered in product assessment)
• Investor assistance services (i.e., product info hotline, if distinct from distributor services)
• Other fields</td><td>Standardized fields on services:
• Investment advice/execution services
• On-line tools (e.g., distributors' IT systems, on-line portfolio simulations…)
• Documentation (macro-economic info bulletins, market briefs, opinions or sectoral research…)
• Investor education resources (explanation of key financial or economic concepts, intro to various asset classes, searchable catalogues of product summary notes…)
• Other expert resources (e.g., free consultations with experts other than investment advisors…)
• Available national wide assistance through in-situ office network</td></tr>
</table>

ANNEX II– ENHANCING THE QUALITY OF SERVICES PROVIDED TO INVESTORS

Another crucial part of the value chain stands in the services delivered to investors.

We believe some improvements could be brought to the quality of services provided to clients.

a. **Improving the information on added-value services (in the commission-based model)**

We believe that, in the commission-based model, the information on added-value services provided to investors in return for the inducements perceived can be improved.

In fact, we often observe that clients are not conscious of all the added-value services that have been developed and made available to them by the distributors when the latter are remunerated through retrocessions (inducements).

Therefore, we suggest informing the clients on the added-value services provided to them:
- when opening a securities account and when subscribing to a new associated investment service (such as investment advice), and
- annually with the *ex-post* costs and charges disclosure.

b. Developing an harmonised EU-wide level of qualification of advisors to enhance the value of services provided to investors

Financial advisors play a critical role in the distribution of retail investment products, however standards (levels of qualifications, knowledge, skills, etc.) differ across Member States.

In order to reduce the risk of mis-selling, increase individual investors' confidence in advice and create a level playing field for market operators offering advice in different Member States, we support the introduction of harmonised professional qualification standards for advisors, which would be declined at national level in order to take into account local specificities. Such harmonised standard would also have the merit of facilitating staff movements from one member state to the other.

c. Maintaining a clear distinction between the historical Twin Peaks distribution MiFID regime: appropriateness and suitability

While we share the overarching aim put forward by the Commission under its CMU plan to attract retail clients towards capital markets, we do not see the proposal to shift to a unique distribution regime in the form of a suitability regime as the best way forward. Neither do we see as an efficient way forward the proposal, in all cases, to provide clients with a list of suitable asset classes and an asset allocation strategy for their portfolio.

On the contrary, we see as essential to maintain the possibility for clients to make their own investment decisions without being advised, for the following reasons.

First, we did not see any evidence showing that the current distribution regimes do not work properly.

Even if, as the Investment Trends study[15] showed, most clients highly value investment advice, all clients do not wish to be accompanied in their investment decisions. For the time being, we do not see any good reason for depriving them of their freedom to do so, considering the existing protections afforded by the MiFID II regulatory framework:

- The requirement, under the appropriateness regime, to check their ability to understand the consequences of such investment decision or to warn them in case such ability has not been proved;
- The product governance regime that prevents investment firms from actively marketing risky products to retail clients which profile is either not known or non-compatible with such products (e.g. because clients' risk appetite or financial situation are not compatible with such products).

A study published by the AMF on 30 November 2021 showed the renewed interest of retail investors in financial instruments and was followed by a 14 January 2022 publication showing that "more than one million new retail investors have entered equity markets in France over the last 3 years". Although such studies do not provide any information on the service through which those transactions were made, the second study shows that in Q3 2021, at least 55% of the transactions made by new clients were carried out presumably through non-advised services (through online banks and neo brokers). If the suitability regime, which will necessarily be more expensive for clients due to the extra costs investment firms will have to bear, was to be the standard distribution regime, we have doubts on the fact that some clients would not be discouraged to invest in capital markets.

Due to the operational and data challenges involved, such amendments would inevitably entail a drastic drop in the number and variety of financial products offered to clients, which, to us, is a very poor outcome. Preserving the possibility for retail clients to have access to a lively and open investment universe seems to us of primary importance. It also seems essential to achieve the CMU objective to attract retail clients towards capital markets. Indeed, shifting towards a unique suitability regime would represent a major challenge for firms historically providing execution services (execution of orders and RTO) on a broad array of financial instruments (as an example, one trading day on Euronext markets represents at least 150 000 different ISIN codes). In order to be able to match their clients' profiles, they will have to collect detailed information on all financial instruments' characteristics, which is an unachievable goal. In fact, this can only be done on a limited subset of financial instruments.

We also see it as essential not to blur the lines between execution and advice services.

We clearly see a risk with the European Commission's proposals, that the lines between advice and execution services would become very confused for clients: to us, even for non-advised services, clients would frequently be in a position to consider that they are being advised.

If all suitability criteria were to be considered for the provision of execution services, the frequency of the alerts sent to clients to warn them of the discrepancies between their personal profile and the envisaged financial instrument will necessarily drastically increase. In such circumstances, it is very likely that clients will have the perception that they are being advised, considering that under recital 87 of the MiFID II Delegated Regulation "investment firms should undertake a suitability assessment not only in relation to [when] recommendations to buy a financial instrument are made but for all decisions whether to trade including whether or not to buy, hold or sell an investment".

[15] https://investmenttrends.com/wp-content/uploads/2021/11/EuropeAdviceAccessibilityReport.pdf

Such impression of being advised will be reinforced by the provision to clients of the list of suitable financial instruments and the personal asset allocation strategy. All this is very likely to introduce confusion in the clients' minds between situations where they are being advised and those where they are not, which in our view is definitely not in their best interest. This will be detrimental to the necessary clarity (required by Article 24. 3 MiFID II) of the information provided by investment firms to their clients and is likely to open the door to many litigations with such clients. It could even deprive certain clients from the protection afforded by the provision of a proper advice service they would need in case they would wrongly, out of confusion, go for a non-advice service.

Therefore, we believe it is essential not to blur the lines between advised and non -advised services.

That said, we would be interested in discussing further with the Commission on possible ways:
- **To better prevent the risk of selling risky financial products to retail clients not willing or not being in a capacity to bear such risks;**
- **to provide some form of guidance to clients in their investment decisions, as long as the boundary with advice is clearly not crossed.**

d. Better calibrating investor protection and information

There is still room for improvement in that regard and attention should be paid to:

- **Reducing still existing superfluous information**, in particular, given that the suppression of best execution reports (RTSs 27 & 28) is being considered under the MiFIR review, with regards to the information on **costs and charges** required under MiFID II (e.g., impact on return).

- **Using consumer testing to help fine-tuning the content and format of key information,** instead of a dashboard with key information, as suggested by ESMA in its technical advice on Retail Investment Strategy, as this would be a duplication of the information provided in the *ex-ante* MiFID disclosure documents and/or the PRIIPs KID.

- **Stabilising the PRIIPs Regulation "package**", avoiding any further level 1 or level 2 changes for several years ahead, except for some targeted adjustments: i) for instance on autocallable products and the presentation of cost and performance scenarios; ii) on the scope that should not include OTC derivatives with corporate clients classified as retail; iii) on the inclusion of past performances instead of performance scenarios for linear category 2 products.

- **Facilitating retail investors to opt in the professional category while maintaining however the current system of MiFID II categorization of clients** by:
  - allowing investment firms to propose to their relevant clients to be treated as professionals;
  - allowing investment firms to treat a professional client "on request" as a professional client "per se";
  - modifying the 1st and the 3rd criteria of opt-in procedure from Annex II of MiFID II to: (i) adapt the number of transactions to the nature and category of financial instruments, and (ii) allow individuals who work in financial related fields/with financial educative background, or firms to have their employees (authorised persons), passing a formal stricter financial knowledge test.

e. Developing more fit-for-purpose Product Governance ("PG") rules, with non-packaged/simple/plain vanilla instruments (bonds and shares) not being subject to this regime to encourage retail investments

The MiFID II Quick Fix published on 26 February 2021 has brought several welcome reforms, in particular the alleviation of the product governance requirements for simple corporate bonds with make-whole clauses. However, such amendment did not embark **other simple vanilla bonds nor ordinary shares**, whereas product governance requirements are not suited to these securities, especially when traded on the secondary market.

As such, we believe the current regime does not actually bring significant value to the retail investors' protection objective. To the contrary, it may discourage financial firms from distributing shares to retail investors (and notably with very low risk appetite) whereas (i) diversification of risks is the key for efficient investments and (ii) it is detrimental to limit retail investors from investing in shares, in terms both of the long-term performance of their investment, and of the financing of the economy. It must be reminded that even without PG protection, retail investors would still benefit from disclosure and information requirements as well as from appropriateness and suitability protection features.

While the activity of distributing plain vanilla products plays an important role in the financing of the economy, current PG requirements place objective constraints on the distribution of ordinary shares to as many investors as possible which is a major issue in the current economic recovery context.

In any case, it is of primary importance it would be acknowledged that an investment firm advising an issuer on a new issuance of such financial instruments on the primary market should not be viewed as the manufacturer of such products when it comes to the secondary market. Indeed, on the secondary market, all securities are fungible so that in case of capital increase, it would not make any sense, nor bring any enhanced investor protection, to view the investment service provider having advised on the last capital increase, or former capital increases, as the manufacturer of all outstanding securities. This issue will be even more crucial when it comes to the sustainable characteristics of such bonds or shares, which should not only be determined at the time of the issuance but also regularly.

f. Adapting to digital innovation in a pragmatic way

We acknowledge the necessity to consider the ongoing development of the industry towards more digitalised services.

However, attention should in our view be paid to:
- **Enabling the incorporation of the digital dimension in every piece of legislation** through an interpretation/adaption of the current framework rather than taking a stand-alone digital text;
- **Leaving sufficient leeway to financial institutions with regards to the techniques used for digital disclosures**, which are becoming the core of their communication with their clients, though not too overly prescriptive ESMA Guidelines.

Besides, we believe that adopting a balanced approach about open finance is crucial, due to the specificities of financial instruments, compared to payments.

Therefore, sufficient attention should be paid to the two following risks attached to making information on clients' investments in financial instruments widely available:

- a risk of misselling and/or unfair marketing and solicitation practices,
- a risk of hampering innovation if firms were to make public their "production secrets" in the form of proposed allocation strategies or product offer.

We would also like to raise the European Commission's attention to the quality of services provided by robo-advisors that might not fulfil all investors needs as most often these robo-advisors propose exchange-traded funds (ETFs) with limited diversity, offering pure correlation to the market without any protection against the fluctuations of the latter.

g. Enabling the digital provision of information for the PRIIPs KID to become the default option, as it is already the case under MiFID II.

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ANNEX III – ENHANCING COMPETITION AND TRANSPARENCY ON DATA PROVIDERS MARKET

Retail investment products and services' prices are being influenced by data prices

Data are essential to the correct functioning of financial markets, and to the provision of quality investment services to clients. However, such data are diverse, pursue different objectives and have different challenges: some of them relate to issuers, be it financial or non-financial data, and others to transactions (with specific real time challenges) and others to peer group benchmarking needs. Nevertheless, what is in common for these different sets of data is the absolute necessity of their reliability and accessibility at fair cost.

EU financial markets' participants depend on data providers to provide their services and to comply with EU regulations. Key aspects of the EU investment value chain (client information, investment allocation, supervision, transparency, and reporting...) are based on a handful of providers which furthermore appear to be insufficiently if not regulated.

This oligopoly's structure is detrimental to the value-chain on several aspects, all the more as most of the time, such firms are headquartered outside of the EU, without any EU localization or authorization requirements (as it is in DORA for IT third-party services providers for instance):

- It leads to questionable commercial practices, subject to weak accountability requirements regarding valuation methods used and their transparency, pricing policy and reliability of services.
- It results in skyrocketing prices for financial and ESG data (double digit increase by years), which impact financial intermediaries' costs and eventually prices to retail investors.

Addressing the competition aspects of the current oligopolistic situation of data providers is key to ensure that EU actors have access to reliable financial and non-financial data. Data providers should be subject to a duty of transparency to reduce the opacity of their pricing policy. **In particular, they could draw on the FRANDT (fair, reasonable, non-discriminatory, and transparent) principle existing in the EMIR Regulation, and which should be extended to other regulations.**

Transparency regarding data fees should contribute to a decrease in costs ultimately beneficial to end investors –especially retail investors.
In any case, it seems essential that such prices should comply with the principals requiring them to be fair and reasonable.

This issue has specifically been identified by the European Parliament in its 2020 annual report on competition policy[16].

Furthermore, clear EU regulatory requirements for the creation and authorisation of data providers offering services to European users are necessary, to avoid any disruption in the provision of critical market data to EU professional users which might severely disrupt the EU's financial markets and economy.

[16] *"The European Parliament […] considers that in the digital economy, the concentration of data in the hands of a small number of companies leads to market failures, excessive rent extraction and blocking of new entrants".*

The Capital Markets Union should be built on transparency of financial and non-financial activities and players. However, there is currently a striking similarity of the current opacity of data providers with the one of Credit Ratings Agencies which lead to the 2008 crisis and disastrous consequences for the economy, before the implementation of a dedicated EU framework. We believe the EU should act pre-emptively and create a comprehensive regulatory framework for data providers.

Ensuring high-quality, transparency, and availability of ESG and financial data

In the current state of the legislation, some challenges need to be addressed:

- The opacity of methodologies makes difficult to understand variations in ESG data and ratings. Data and rating providers can change methodologies from year to year making historical comparisons difficult. In this context, transparency is even more at stake, as it is essential for both rated issuers and users to fully understand the changes undertaken and their impacts on the final rating.
- There is a heterogeneous coverage of companies with a satisfactory coverage of large capitalizations and companies from developed countries, but data are lacking in other areas.
- ESG data and rating providers have inherent conflicts of interest (particularly providers both evaluating companies or portfolios and offering paid advisory services).

Our main recommendations are the followings:

- Ensuring coherence between the few pieces of EU legislation (MiFID II, BMR and CRA notably) mentioning data provision services;
- Facilitating direct access to data to reduce the dependency on data providers and to ensure the reliability, comparability, and auditability of non-financial data. We fully support CSRD, ESAP and properly calibrated EU consolidated tape initiatives;
- Implementing new transparency and accountability requirements for data providers' activities as:
    - As underlined in 2021 EU Commission study, methodologies vary between data providers, resulting in widely different results even when analyzing the same companies. In addition, data providers do not take any responsibility for these gaps and the risk of greenwashing;
    - ESMA[17] and AMF/AFM support a regulatory approach to create a transparency framework for these activities;
- These new requirements should notably focus on:
    - Enhancing the transparency on the methodologies used as well as on how data is obtained (source of the data, estimated data or not…) and verified. Greater transparency should not lead to a standardization of such methodologies;
    - Providers should have robust operational and control process in place to ensure a continuous service and should provide sufficient detailed information on such processes;
    - Transparency of data fees;
    - Accountability requirements tackling notably conflict of interests and market abuses ESG data providers must be required to detail their governance and internal controls, and their compliance practices for managing conflicts of interest;
    - ESG data providers should disclose their conflict-of-interest policy on their website.

[17] "*I would like to address the unregulated and unsupervised nature of the market for "ESG" ratings and ESG assessment tools and the need to match the growth in demand for these products with appropriate regulatory requirements to ensure their quality and reliability*", Steven Maijoor, 2021.

The EU should implement a horizontal European regulation for data providers and their activities, which should be accompanied by increased supervision of all data providers at the European level. In ESMA Strategic Orientation 2020-2022, the European authority states its ambition to strengthen its reputation as the supervisory authority of credit rating agencies, critical benchmarks and data service providers.

In this context, we welcome the current work of the European Commission with regards ESG rating. While a legislative intervention on the matter is more than welcomed, we believe that such intervention should not only focus on "ESG ratings" but should also consider the entire "data value chain" (ESG data providers but also financial data providers).

It would be a guarantee of quality for the process put in place by financial intermediaries in order to provide clients with the most transparent and adequate investment service, notably when it comes to ESG questions.

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ANNEX IV – STUDIES RELATED TO REMUNERATION FRAMEWORK

Hereunder some information and data from studies previously submitted to the European Commission.

1. Investment Trends "Europe advice accessibility report" (July 2021)[18] polled consumers in France, the UK, and the Netherlands, and shows that:
   - 75% of French investors consider that the current regime of investment advice takes personal circumstances sufficiently into account;
   - 66% of French investors are satisfied with product diversity while this is only 46% in the Netherlands;
   - 60% of French investors believe they would buy fewer financial products if they had to pay a fee for investment advice (on top of the product costs).

2. KPMG study "Commission-based remuneration vs. fee-based remuneration: is there a better model for retail investor?" (November 2021)[19] shows that there is no causal link between the inducement regime and the cost of products and services provided to investors:
   - For an identical service level, the total cost of ownership of a financial product in the UK is higher than the average of France, Italy and Spain;
   - However, the access to some investment services (such as the protection provided by suitability tests) has disappeared for the less wealthy investors in the UK and in the Netherlands (the so-called advice gap).

	Invested assets	Countries	Equity funds	Mixed funds	Bond funds	Retail structured products
Average annual TCO for a 5-year investment for retail investors (data as of 2020)	10 000 €	FR, IT & ES	2,04%	1,65%	1,15%	0,58%
		NL	client does not have access to the service			
		UK	client does not have access to the service			
	100 000 €	FR, IT & ES	2,04%	1,65%	1,15%	0,58%
		NL	client does not have access to the service			
		UK	2,51%	2,08%	2,23%	1,04%
	500 000 €	FR, IT & ES	2,04%	1,65%	1,15%	0,58%
		NL	1,93%	1,58%	1,58%	0,41%
		UK	2,51%	2,08%	2,23%	1,04%

[18] https://investmenttrends.com/wp-content/uploads/2021/11/EuropeAdviceAccessibilityReport.pdf

[19] https://www.fbf.fr/en/kpmg-study-distribution-models-retail-investors/

3. Finally, it is worth noting that the UK FCA just consulted on potential "*ways to make financial advice more accessible*" through simplified advice for the investment in mainstream products[20]. Among the reasons put forward for doing so, is the difficulty identified with consumers "*put off from receiving advice through perceived high charges*", as well as the concerns raised by firms about the "*economic viability of providing advice to mass-market consumers – especially where there is a human element involved – given requirements around suitability and the initial customer fact find, adviser qualifications and adviser charging*".

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[20] https://www.fca.org.uk/news/press-releases/fca-proposes-ways-make-financial-advice-more-accessible