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Proposals for an EU Retail Investment Strategy

Wide-ranging changes to improve consumer outcomes

> The European Commission has published proposals for an EU "Retail Investment Strategy" as part of its Capital Markets Union initiative, following its 2021 consultation. The proposals aim to modernise and streamline the investment framework in order to increase trust, transparency and investor participation. Notably, ESMA and EIOPA will have important roles to play, with increased powers and resources.

The Commission's initial considerations were debated and discussed by the industry, including the introduction of a *"semi-professional"* client category and a potential ban on inducements. On the former, the Commission proposes only some adjustments to the definition of professional client. On the latter, the Commission now proposes only a partial ban. However, various other amendments are proposed to enhance investor protection, including a form of *"value for money"* assessment. Given the provisions would apply only 18 months after the amendments enter into force, and the scale of the proposed changes, the implementation timeline is likely to be challenging.

This article summarises the proposals and their practical implications.

EU firms impacted

A wide range of firms will be impacted by the proposals, including fund, wealth and asset managers, banks providing retail investment services, insurers offering investment products, platforms, investment advisers and retail brokers.

The proposals mainly apply to MiFID and insurance firms (the latter via amendments to the Insurance Distribution Directive (IDD)), but aspects of the undue costs and pricing proposals will also apply to UCITS and AIF managers:

PROPOSED AMENDMENTS AND NEW REQUIREMENTS	MIFID INVESTMENT FIRM	INSURANCE UNDERTAKING OR INTERMEDIARY	UCITS MANAGEMENT COMPANY OR AIFM
Value for money and product governance	✓	✓	✓
Simplifying disclosures	✓	✓	
Marketing communications	✓	✓	
Client categorisation	✓		
Standards for advisers/wealth managers	✓	✓	
Advice suitability and the appropriateness test	✓	✓	

The proposed changes

The Commission's package sets out new requirements and enhancements to the investor protection framework in a wide range of areas. The most important aspects are around:

- **Value for money (VFM) and product governance:** The proposals take account of ESMA's recent **opinion** on considering "undue" costs in UCITS and AIFs, including assessing the eligibility of costs, developing a structured pricing process that takes into account various factors, and reimbursing investors on a timely basis, where required. MiFID and IDD firms will also need to implement a structured pricing process. Notably, ESMA and EIOPA would be given a mandate to regularly update cost and performance benchmarks, against which manufacturers would need to compare their products before offering them to the market. New reporting obligations on costs and charges would inform these publicly available benchmarks, although the goal is to base the reporting requirements on existing data where possible. In addition to the VFM proposals, aspects of the product governance requirements are amended (e.g. on the product approval process).
- **Simplifying disclosures:** Firms would need to display risk warnings for "particularly risky" products (to be defined by ESMA and EIOPA); disclosures would be provided in electronic format by default (aligning IDD requirements with MiFID); a new annual statement would be provided by firms to clients; there would be a standardised presentation of information on costs, associated charges and third-party payments; and a standard disclosure document would be introduced for life insurance products.
- **Stricter rules on marketing communications:** New obligations are being consulted on, such as the requirement for management bodies to define, approve and oversee a policy on marketing communications, a clearer division of responsibility between manufacturers and distributors, and enhanced record keeping requirements.
- **Client categorisation:** Changes to MiFID, for clients requesting to be treated as "professional", would include reducing the minimum wealth criterion from €500k to €250k, and adding a new criterion around professional experience or education.
- **Enhanced standards for investment advisers/ wealth managers:** New requirements to strengthen the knowledge and competence of investment advisers and wealth managers, including maintaining this through annual continuous professional training and development (to be evidenced by obtaining a certificate).
- **Adapting the advice suitability and appropriateness test requirements:** New obligations (such as explaining the purpose of the assessment in a clear and simple way) and expansion of the appropriateness test to encompass the client's capacity to bear full or partial losses and risk tolerance. Notably, a streamlined suitability assessment is envisaged where firms could provide advice on a limited range of financial instruments that are diversified, non-complex and cost-efficient.

- **Tackling bias in the advice process:** A ban on inducements paid from manufacturers to distributors for execution-only sales (i.e. no ban on advised sales — but this position would be reviewed three years after the proposals come into force), rules to "further substantiate" the need for firms to act in their clients' best interests, and new tests for advisers to consider when recommending products.
- **Strengthening supervisory enforcement:** New powers would be given to National Competent Authorities to act where investors may be harmed (for example, to take prompt action on misleading market practices and carry out "mystery shopping" exercises), and to introduce reporting for firms on cross-border services.
- **Promoting financial literacy:** Member states would be required to promote measures supporting the education of retail clients.
- **Amendments to the PRIIPs Regulation:** In addition to the above changes that will be brought about through a new directive, the Commission has proposed amendments to the PRIIPs Regulation. They include changes to the PRIIPs Key Information Document (KID) to introduce a new section ("product at a glance"), removing elements that are not considered effective (e.g. the "comprehension alert"), and the addition of a new sustainability section that builds on existing ESG disclosures (titled "how environmentally friendly is this product?"). There are also measures to modernise and simplify the KID and a preference for electronic format.

Implications

The Commission's proposals will now be debated, negotiated and agreed between the European Parliament and the Council, which could result in various amendments to the proposals. The Commission is assuming the legislation will enter into force in 2025. In the meantime, some may question whether the proposals go far enough to improve retail customer outcomes, but others may argue that some developments are better than none.

Whatever the final outcome of the legislative process, there will be a significant amount of implementation work for firms.

We foresee many implementation challenges – for example scoping the changes needed on a legal entity basis and performing gap analysis, establishing value for money frameworks (which will be a fairly new concept for some firms), evidencing good outcomes (similar to reasonable steps under the Individual Accountability Regime), meeting additional MI and data requirements and reviewing governance structures (similar to that set out within the Individual Accountability Regime).

Careful thought will need to be given in approaching this from a regulatory change perspective, considering lessons learned, and ensuring that the requirements are fully embedded at all levels in the business to ensure good consumer outcomes.

How can KPMG help?

Please reach out to our experienced Asset Management and Regulatory Change team for further information on these proposals or any Asset Management or Regulatory Change need you may have.

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