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Finance for Europe

Association for Financial Markets in Europe

Recommendations for the EU Retail Investment Strategy

July 2023

In this set of recommendations, we outline our detailed views on the European Commission's ("EC") Retail Investment Strategy ("RIS") proposals for the Omnibus Directive amending, among others, the Markets in Financial Instrument Directive ("MiFID") and the Regulation amending the Regulation on key information documents for packaged retail and insurance-based investment products ("PRIIPs").

Executive Summary

- AFME strongly supports the EC's objective of growing and making more efficient the distribution of securities to European retail investors. The RIS is focused on direct and indirect retail investment. We are concerned by the many ways that the RIS impacts wholesale capital markets. The vast majority of securities distributed to retail investors are sourced and manufactured by wholesale banks, asset managers and insurers. **As such, the proposed changes need to carefully consider the impact on the wholesale to retail distribution chain**.

- We support the EC's ambition to significantly raise the percentage of European retail investors' direct and indirect participation from its current 17% level to a larger proportion such as the 43% in the United States, as cited in the EC's Impact Assessment (IA). We also acknowledge that the social welfare infrastructure to incentivise savings differs between Europe and the US, however, additional European retail investment can help provide essential further capital for European economic growth.

- **AFME supports the proposed changes to the opt-up criteria for elective professional clients.** We understand that the objective is to open up a broader range of investment opportunities for a greater range of clients and may result, overall, in an increase of capital being made available to issuers in EU capital markets. AFME members support this ambition and welcome further clarity on the approach to enable this. We also note that the RIS proposals seek to make significant improvements to the scope of the PRIIPS Regulation, which are welcomed by our members, and we have provided detailed feedback and suggested enhancements on some of the other PRIIPs proposals below.

- However, for the reasons described in this paper, **the combination of the proposed product intervention measures and certain of the proposed overly prescriptive requirements risk damaging the competitiveness of EU capital markets by potentially reducing retail investor choice.**

- With respect to the **proposed inducements ban**, although AFME welcomes the EC's pragmatism in not applying the ban to advised distribution models, our members consider that the proposed scope and rules require **further examination and impact assessment before introducing such a disruptive measure, adjustments and/or clarifications (e.g., with respect to (i) the notion of an inducement itself, which cannot disregard the fact that certain services will actually be provided by the distributor to the manufacturer in this context, and which would be remunerated by the relevant fees —i.e. not all of them relate to the services provided to the retail clients; (ii) with respect to scenarios in which execution-only firms provide support/enabling services to retail investors that fall short of investment advice; or (iii)**

portfolio level advice) to ensure that they do not cast the net wider than is required to meet the EC's stated objective in this area.

- Also, while AFME members are supportive of the principle to deliver fair value to retail investors, the prescriptive requirements (based primarily on costs and performance) associated with the Value for Money (VfM) proposal go beyond the EC's objective of pursuing better quality investment products for retail clients that yield better value for money, and appear to instead be a form of regulatory intervention on product pricing. Our members have concerns that a prescriptive benchmark-based approach (with benchmarks focussed primarily on costs and performance) as that proposed by the EC could have unhelpful, unintended consequences for retail investors and wholesale firms, such as automatic blacklisting of products that appear to perform worse than these quantitative benchmarks.

- **We believe that alternative approaches, including those used in other countries should continue to be carefully explored based on their success, in order to effectively inform and ensure the success of the EC's VfM proposals.** For example, a core assumption in the EC's IA[1] seems to presume that fees charged to retail investors in Europe are excessive, reduce confidence and discourage investment. This appears to be the rationale for imposing the VfM-with-a quantitative-benchmark-based approach. In contrast, we note that the successful US model does not rely on a VfM analysis/price regulation (based primarily on costs and performance) but rather on strong supervision and enforcement of disclosure and other standards.

- **AFME advises caution on addressing any shortfalls in the enforcement of the existing rules by the proposed one-sided set of VfM rules. We support the current EU best execution, conflicts of interests, product governance and disclosure frameworks and recommend a future approach that primarily focuses on effective NCA supervisory and enforcement actions of existing regulations.**

- AFME members' **key concerns** on the wholesale market aspects of the RIS changes to **MiFID** are as follows.

Inducements

- **The scope of the proposed ban requires further adjustments and/or clarifications to ensure that any such proposal, if enacted, does not cast the net wider than is required to meet the stated objective.**

- AFME recommends that the exemption in **Article 24a(3) is clarified to i) ensure that the rules acknowledge that non-independent advice can be provided on a "portfolio basis"**, such that even if advice is not specifically provided in respect of each individual execution this would not be treated as an "execution only service" that is subject to the proposed ban, and ii) **account for scenarios where it is not immediately possible to qualify a service as "execution only"** (e.g., where a retainer for advice is provided over the life of an investment).

- Additionally, AFME members note that certain **execution only brokers / distributors** in the market (e.g., online platforms) provide **enabling or support services to retail investors**, to support them in their investment process and selection of investments (e.g., guidance materials or research commentary) for free. These enabling or support services would not meet the definition of "investment advice" and therefore would be subject to the ban – however, our members believe that

[1] IA – Page 4.

such scenarios should similarly be excluded from the scope of the ban because the execution-only broker / distributor is providing important value-add services to retail investors to support them in their investment journey. The funding from product manufacturers is important to support the provision of these services to retail investors for free (which in turns helps ensure the accessibility of financial products and services to the broad retail market).

- Furthermore, **AFME's view is that "payments or benefits which enable, or are necessary for, the provision of the service" (such as settlement costs, legal fees, etc.) are not inducements** at all and therefore are not subject to any inducement ban in Article 24c, as is the case under the current MiFID II rules. Also, the ban on payments of inducements by portfolio managers should not apply when the portfolio manager is **servicing non-retail clients.** Finally, the intention of new Article 24a(2) (and Article 24a(1) (in the context of portfolio management)) should be that, as under current inducement rules, **relevant inducements are only banned if actually retained.**

- **AFME strongly argues against including any monetary limitation of minor non-monetary benefits (MNMBs) in the Level 1 text, given that (considering current inflationary pressures) any fixed amount could soon be out of date. Providing guidance on MNMB in ESMA Q&A and guidelines would allow more flexibility to respond to market developments.**

- In addition, **the review should occur five years** (not three years) after the RIS amendments, as a package (rather than the inducement changes in isolation), have become fully operational (i.e. after the RTS and implementation period). We also advocate that the EC should set **clear** criteria for the review, i.e. explain how they will measure the effectiveness of the revised inducement provisions in managing conflicts of interest and consider other factors, such as consumer outcomes and the supply of products for different investor requirements.

Best Interest

- We do not see a compelling rationale for existing Best Interest requirements in the MiFID inducements rules to be revised. The EC's proposals on Best Interest impose a **significant burden on firms and seem to be duplicative of the value for money proposals**. AFME is concerned that **the new Best Interest criteria may result in advisers steering retail clients only towards the lowest cost products (e.g., passive funds), which may not always lead to best investment results for retail clients**.

Value for Money

- AFME encourages the EU Co-Legislators to **avoid a prescriptive benchmark-based VfM approach and instead adopt a more outcomes-based approach**. The proposed prescriptive approach includes a presumption that once the quantitative assessment has "failed", a product would be deemed to have not met the VfM requirements. A purely quantitative approach could result in retail investors receiving products that do not offer VfM, because the benchmark overlooks factors beyond costs and performance that the particular retail investor may value.

Suitability

- **On suitability, AFME recommends that the rules should reflect that portfolio composition should be taken into account only to the extent reasonably possible and that the concept of "any existing portfolio" shall be clarified to mean only portfolio(s) held at the intermediary and not at other/third-party intermediaries.** AFME members expect that the potential

consequences resulting from also considering portfolio(s) held at other/third-party intermediaries would be extremely challenging and disruptive both for clients and for intermediaries.

Costs and Charges

- **Although the EC objective to standardise costs and charges disclosure has some merit, AFME members consider that proposals on costs and charges disclosures for professional investors and eligible counterparties do not seem necessary to meet the EC's objective of increasing retail investor participation in capital markets.**

- We advise caution on reversing parts of the recently enacted MiFID II quick fix changes without a proper impact assessment. If such a reversal were to go ahead, market participants would also require sufficient time to revive processes that have been completely wound down in many firms following the MiFID II quick fix.

Marketing Communication and Marketing Practices

- AFME members note that **the new (broad) definitions of "marketing communication" and "marketing practice" in the RIS proposal should be redrafted to make sure that this does not inadvertently cut across the reverse solicitation exemption and/or result in disproportionate compliance burdens for firms.** The new definitions: i) should not capture marketing activity carried out outside the EU that is not targeted at EU investors; ii) should exclude real-time communications; and iii) should make clear that a communication / practice by a third party is only attributed to an investment firm where it is made with the knowledge of and "on behalf of" the investment firm.

Risk Warning

- On proposals around risk warnings, AFME members note that having to apply guidelines and risk warnings to certain product classifications will carry an element of risk for firms and result in divergences in classifications across the market. **It would be beneficial for market participants to be involved in the creation of the guidelines and specific risk warnings to be mandated by ESMA in the new RTS**.

Implementation

- Measures of great importance are being introduced, many of which depend on future Level 2 developments for which there is not currently a draft. AFME members would ask that the implementation timeline be amended so as to allow Member States 12 months to implement the RIS changes (as proposed by the Commission), followed by a 24-month implementation period before the new requirements become applicable to firms. This should allow sufficient time for relevant Level 2 texts to be finalised and for firms to properly consider and implement relevant Level 2 requirements into their systems.

AFME members' **key concerns on the wholesale market aspects of the RIS changes to PRIIPS** are as follows.

Scope and Electronic Approach

- **AFME is broadly supportive of proposed clarifications to the scope of the PRIIPS Regulation**. However, the electronic by default approach (which in principle we support), poses some

operational and substantial issues. For example, there is a concern that a "personalised" customer journey could mean that some retail investors do not "select" to see all parts of this key information or that is used in an "improper" way (e.g., with predictive objectives). In addition, it should be clarified that provision of the interactive tool does not replace the obligation to provide the client with the KID document in its entirety.

Form and Content of the KID

- **AFME is not convinced of the necessity for the "Product at a glance" section and questions whether consumers require a further summary in light of the fact that the KID is already a very condensed statement of all key information regarding a product**.

- We note the inclusion of a new section entitled "How environmentally sustainable is this product?". Parties should be allowed to include sustainability-related information in the KID for any product if they deem that information to be key information. We are carefully considering whether (and if so how) this section should be limited to SFDR Article 8 and 9 products.

- Should the proposed new sections **be introduced into the KID, the page limit should be extended to 5 pages and should cover all PRIIPs KIDs, not just those showing past performance**.

Timing

- Our members consider the 18 months implementation period proposed by the EC to be too short and **would consider a three-year implementation period appropriate to allow for systems and processes to be changed, and for appropriate testing to be undertaken.**

Detailed Positions and Rationale

Inducements

AFME Position

- **AFME recommends that the exemption in Article 24a(3) is clarified to i) ensure that non-independent advice can relate to execution services on a "portfolio basis" without being subject to the proposed inducements ban; and ii) account for scenarios where it is not immediately possible to qualify a service as "execution only"** (e.g., in the case a retainer for advice is provided over the life of an investment).

- Furthermore, AFME's view is that:

    - the ban should not apply to execution-only firms that provide enabling or support services to retail investors.
    - "payments or benefits which enable or are necessary for the provision of the service" (such as settlement costs, legal fees etc) are not inducements at all and therefore not subject to any inducement ban in Article 24c (as per the current rules).
    - the ban to payments of inducements by portfolio managers should not apply when they are **servicing non-retail clients.**
    - the intention of new Article 24a(2) (and Article 24a(1) in the context of portfolio management) should be that, as under current inducement rules, **relevant inducements are only banned if actually retained.**
    - minor non-monetary benefits should not be defined by reference to a specific amount in the Level 1 text.

- The review clause as currently worded is highly problematic. AFME recommends to amend Article 24a(8) i) to postpone the relevant timespan (i.e. review clause not to be activated after three years but, for example, five years, after the whole RIS package, rather than just the amendments to the inducement rules, has been operational(i.e. after the RTS and implementation period), and ii) to remove reference to conflicts of interest and availability of independent advice. On the latter point, we suggest that other criteria are considered as part of the review process, such as consumer outcomes and the supply of products for different investor requirements. Also the explicit reference made to a potential ban on inducements (Recital 3) should be removed.

Rationale

- If the EC and co-Legislators decide to pursue a targeted ban, the above clarifications and drafting improvements are important to ensure the new rules do not cast the net wider than originally intended nor give rise to unintended consequences.

General remarks on the EC's approach to the issue of inducements

- The EC's prohibition is based on a fundamental assumption that only individual transactions will be subject to recommendations by intermediaries and overlooks the provision of advice on a portfolio basis. Our members also note that certain transactions may be arranged independently by clients (even within the context of an investment advice relationship and application of its protections), and

that such transactions should accordingly be considered exempt from the prohibition. **The current approach unduly affects and penalizes investment advice provided with a portfolio approach insofar as it considers investment advice as a service provided "on the spot" rather than a continuous relationship that encompasses the client's portfolio in its entirety,** including transactions carried out autonomously by the client, which are merged in the assessment of the whole portfolio for the purposes of the client's subsequent investments and in the periodic assessment of the suitability of the client's portfolio. **We deem it extremely important to preserve the characterization of investment advice as a continuous relationship with the client.** Any other framing of investment advice would generate unduly burdensome challenges that run contrary to the periodic suitability assessments carried out with portfolio approach by intermediaries providing advice on a continued basis.

- In order for the limitations and prohibitions to have an adequate and uniform scope in all the Member States, it is essential to adopt a clear and harmonized definition of the incentive concept, specifying which payments are understood to be connected with the provision of investment services to retail clients and which are legitimate payments from third parties for the provision of services to them. The entire discussion and proposed regulatory amendment regarding incentives is based on an **erroneous premise, which is that all third-party payments (by manufacturers of financial instruments) are linked to the provision of investment services to final retail clients.** In this way, the provision of legitimate services by financial institutions to the manufacturers of financial instruments (and the value of said services) is denied, thus depriving the entities of the possibility of charging those who are actually receiving the relevant services, which could also mean transferring this cost to the end customer. These services may be necessary for the final retail customer to receive the investment service and/or experience an effective service but they are not connected to that investment service in the sense in which it has been interpreted.

- For example, for the distribution of investment funds, financial institutions and firms which provide investment services not only provide services to individual clients (reception and transmission of orders, advice and portfolio management, as well as ancillary services) but also to asset managers who want to sell their products and raise funds for them (it being crucial for raising funds for many of them).

- As distributors of these funds, they provide their means, offices and channels to publicize the funds of the asset manager to the public, comply with the information obligations on behalf of asset managers, act as a communication channel between them, etc. Until now, these services were remunerated as part of the distribution commission, a commission that is compromised by the EC's proposed ban. Additionally, given the regulations of some countries, it will not be possible to charge end investors directly for such services – noting that they will also not strictly speaking be the beneficiary of those services. Entities cannot be expected to continue providing this service without remuneration (which could also pose problems from a tax perspective e.g. the need to make transfer pricing adjustments under tax rules where services between entities of the same group have not been paid for at market rate) and we would therefore recommend that the EC clarify that payments by product providers to distributors for such administrative services, would not be subject to the proposed inducements ban.

Concerns with the interpretation of the proposed ban

- AFME members note the introduction of a proposed stricter ban on inducements *paid by* portfolio managers in Article 24a(1) of the proposal. **The rules apply to portfolio managers providing services to professional investors, which is beyond the stated objectives of the proposals. This**

does not seem relevant to the EC's objective of increasing retail investor participation in capital markets.

- The rationale of the amendment suggested by the EC is by no means clear considering that the Explanatory Memorandum that accompanies the EC proposal for the Omnibus Directive clarifies that *"the existing ban(s) on inducements regarding (…) portfolio management (…) [is] maintained*".

- The proposals also seem to, inadvertently, increase the scope of the inducements ban that the EU authorities chose to specifically limit to distributors providing execution services (as to the extent that a portfolio manager is a manufacturer, it would be banned by Article 24a(1) from providing any inducements to distributors providing non-independent advice, even though such advisory distributors are not subject to a ban on receiving inducements from product manufacturers under the newly proposed inducement ban).

- Regarding the newly proposed ban on paying or receiving inducements when providing reception and transmission of orders or order execution services to retail clients, **the drafting in new Article 24a(2) (and Article 24a(1) in the context of portfolio management) should be clarified to ensure that (as under current inducement rules), relevant inducements are only banned if actually retained** (i.e. amend references to "do not pay or receive" such that they read "do not pay or receive *and retain*").

- Additionally, AFME members note that certain **execution only brokers / distributors** in the market (e.g., online platforms) provide valuable **enabling or support services to retail investors**, to support them in their investment process and selection of investments (e.g., guidance materials or research commentary) for free. These enabling or support services would not meet the definition of "investment advice" and therefore would be subject to the ban as currently proposed – however, our members believe that such scenarios should similarly be excluded from the scope of the ban. This is because the execution-only broker / distributor is providing important value-add services to retail investors to support them in their investment journey, and the funding from product manufacturers is important to support the provision of such services to retail investors for free (which in turns helps ensure the accessibility of financial products and services to the broad retail market).

- In addition, AFME members also note that the proposed new ban could benefit from the following additional clarifications:

    - **Whether a service is "execution only" may not always be straightforward to establish at the time a firm provides execution services (i.e. at the time of a particular transaction)**. For example, there may be a **retainer for advice to be provided over the life of an investment** even if no advice is being provided at the time of the initial order execution. **This type of scenario should be out of scope of the proposed inducements ban** and the exemption relating to non-independent advice (Article 24a(3)) should be clarified to reflect this.

    - Similarly, as noted above, **the exemption in Article 24a(3) should be clarified to ensure that non-independent advice can relate to execution services on a "portfolio basis"**. Where advice is being provided to a retail client (coupled with order execution) in respect of that client's portfolio, all of the firm's execution activity in respect of a retail client's portfolio should benefit from the exemption in Article 24a(3), even when not all transactions executed on behalf of a retail client were subject to specific advice.

- New **Article 24a should clarify that "payments or benefits which enable or are necessary for the provision of the service" (such as settlement costs, legal fees, etc.) are not inducements at all and are therefore not subject to any inducement ban in Article 24c** (rather than leaving this up to interpretation through Article 24a(7)). Without such a clarification, it would appear (for example) that the new proposed ban on payments by portfolio managers (Article 24a(1)) would prevent portfolio managers from making any such necessary payments because Article 24a(7) is only engaged in circumstances where a firm is "not prohibited from" making or receiving fees or benefits.

- Regarding the EC's proposal to limit MNMB to a monetary amount below EUR100 p.a., AFME members query whether it is appropriate to set a fixed amount. This is because what is "minor" depends on several factors, including the service provided, the size of the firm, and the jurisdiction in which the benefit is received. It may also be difficult to attribute an exact value to many non-monetary benefits and, again, the monetary value may differ between jurisdictions. It is also unclear how the EUR100 limit would be measured or allocated (e.g. by product or by operation), which could prove problematic for certain benefits, such as training courses. We strongly advise **against including any monetary limitation of MNMBs in the Level 1 text, given that (particularly in light of current inflationary pressures) any fixed amount could soon be out of date. Providing guidance on MNMB in ESMA Q&A and guidelines would allow more flexibility to respond to market developments**, as well as allowing greater scope for explaining the proportionality of any limit by reference to different factors (including those noted above).

Application of the inducements ban to PRIIPS

- We also question why the underwriting / placing fee exemption from the new inducement ban (Article 24a(4)) does not apply where the product subject to the "execution only" service is a PRIIPs product. It is our members' view that PRIIPs products should not be excluded from this exemption, because (as for other products) firms underwriting or placing PRIIPs may receive, legitimately, a fee from the issuer whilst also providing execution services to retail investors participating in the PRIIPs issue.

New Best Interest Criteria for the inducements rules

AFME Position

- The EC proposals on Best Interest for firms providing investment advice impose a **significant practical and evidential burden on firms and seem to be duplicative of the value for money proposals**.

- **The new criteria may result in advisers steering retail clients towards the lowest cost products (e.g., passive funds), which may not always lead to the best investment results for retail clients and may also interfere with the free market**.

- **We do not see a compelling rationale for existing requirements in MiFID to be revised.**

- The proposed Best Interest test is too prescriptive, and **firms should be given more principles-based guidance to determine if a product or service is in the best interest of their clients**.

- **It also materializes an approach towards investment advice i) of quantitative nature i.e., merely focused on costs, and ii) not attentive of other key parameters that are considered in**

the context of investment advice e.g. risk, performance of the relevant financial instrument, degree of complexity of the relevant financial instrument, sustainability features of the relevant financial instrument etc. **In the final analysis, this kind of approach risks "degrading"/"downgrading" the value of the investment advice as a whole.**

Rationale

- We understand that the policy aim is to ensure that firms recommend products that offer value to clients based on their investment objectives and that clients are not matched with more expensive products with additional features that clients may not care about. **However, the value related policy concerns will be separately addressed by the value for money proposals, and advisory firms are also subject to a broader suitability requirement. Therefore, the new requirement does not seem useful compared to the significant evidential and practical burdens it will entail**.

- We expect that firms will end up having to devote unnecessary time and costs to try to identify product features that are not relevant for the client, rather than only focussing on identifying products that are suitable / relevant for the client.

- **The new requirements would switch the investment advice services to a "low cost" advice model focused solely and exclusively on the cost of the products or instruments, without taking into account other considerations related to the quality of the service itself** (which takes into account qualitative parameters to offer customers the products that best fit their profile) **and the quality of the product** (which is not only evaluated in terms of costs but also considering the quality of the asset managers, consistency in management over time, behaviour over time of crisis, the absence of errors, issuer risk, maintenance of returns over time, post-sale management, etc.). Other potential repercussions would be: (i) promoting economies of scale, and (ii) expelling from the market smaller manufacturers and distributors, whose value contribution is based on the quality of the service and not on price.

- The concept of "best interest of the client" is not expanded on in the RIS proposal in the context of the exemption from the inducement bans in new Article 24a(1) and (2), or in the context of the general inducement rule in new Article 24a(7). However, the "best interest of the client" concept is expanded on in new Article 24(1a), in the context of investment advice to retail clients. This introduces three new best interest criteria: (a) the need for advice to assess an appropriate range of products; (b) a requirement to recommend the most cost-efficient product amongst those identified as suitable; and (c) a requirement to recommend a product or products without additional features that are not necessary to the achievement of the client's investment objectives and that give rise to extra costs.

- We set out below our concerns with the proposed criteria, while noting that more detail is to follow in an EC delegated act.

- The first criterion on assessing **an "appropriate range" of products** is difficult to establish given the multitude of factors that may be relevant in this determination (such as the breadth of investment objectives and needs of different retail investors, market conditions, economic outlook, types of products being recommended, liquidity of products etc.). **In some cases, products subject to advice may be too bespoke or specific to the particular client to have feasible alternatives**.

- Members also consider that assessing **an "appropriate range" should not require a firm to look at third party products where the firm or its group already offers a range of products and the client is aware that the advice is limited to those products**.

- The third criterion requiring firms to identify products without "additional features" would have to operate as a two-stage process, in that firms would first need to complete a suitability assessment in order to identify which features of products are "not necessary" before achieving a particular client's investment objectives. Given the potential breadth and combination of objectives of individual clients, this could prove very onerous for firms.

- We also have concerns about how firms could practically identify products without "additional features" (and particularly where different clients' objectives would lead to the exclusion of different combinations of "additional features"), or indeed whether extra costs are attributable to any particular feature of a product, and how this might be evidenced.

- The implication of the "additional features" criterion seems to be that, even though a product with certain features is compatible with its identified target market, there may need to be more "basic" sub-products (i.e., without certain specific features or a combination of certain features) available to the same target market. It also appears to imply that the concept of suitability should be disregarded in the best interest test, since the additional low-cost product option may not be suitable to the client but should be presented to them anyway.

- The focus of the "best interest" test on costs is also problematic, as this ignores the many other factors which are relevant to clients' investment return and which investment advisers may consider as part of their advice. The "best interest" test materializes an approach towards investment advice i) of quantitative nature i.e., merely focused on costs and ii) that is not attentive of other key parameters that are considered in the context of investment advice e.g. risk, performance of the relevant financial instrument, degree of complexity of the relevant financial instrument, sustainability features of the relevant financial instrument etc. In the final analysis, this kind of approach risks "degrading"/"downgrading" the value of the investment advice as a whole. Also, what may be cost-efficient for one client or in one transaction / circumstance, may not be regarded as cost-efficient by other clients or in other circumstances. This proposal would therefore again impose a significant practical and evidential burden on firms – and again seems to be duplicative of the value for money proposals.

- Finally, the rules, as proposed, do not make it clear that costs (and other factors taken into account by investment advisers) could be looked at on a portfolio basis, where advice relates to a portfolio of products.

- Our members are also concerned that, by implication, certain aspects of the three criteria "best interest" test in new Article 24(1a) could be interpreted as applying to the exemption from the portfolio management and retail execution-only inducement bans in new Article 24a(5), or more generally in the context of inducements in respect of services provided to professional clients. In our members' view it would be inappropriate to limit what might be considered to be in the "best interest of the client" in such a broad manner – particularly for business related to professional clients, which does not seem to be relevant to the RIS policy objectives.

Value for Money (VfM)

AFME Position

- **AFME members support the EC's focus on fair value for retail investors, but would encourage the EU legislators to move away from the proposed prescriptive benchmark-based VfM approach to a more outcomes-based approach.**

- The current VfM proposal goes beyond the EC's objective of pursuing better quality investment products for retail clients that yield better value for money, and instead seems to materialize as a form of intervention on product pricing that is unique in the regulatory landscape in the EU and globally.

- The proposed benchmarking could also stifle innovation and new product development to the significant disadvantage of retail investors in the EU, noting that, for example, certain new products such as funds are subject to significant costs in the initial stages.

- While the EC proposal on VfM already suggests some combination of quantitative factors (i.e. comparison against cost/performance benchmarks, where they exist) and qualitative factors (i.e. the ability for firms to complete an additional "proportionate and justified" assessment as a second layer of the VfM assessment, where needed), **there would be benefit in having either a more qualitative approach (similar to the UK Consumer Duty) or an approach which is more fluid between quantitative and qualitative factors**.

- Where necessary, **this could be subject to an EC review after a certain period** (but allowing sufficient time for the new requirements to bed down after becoming fully operational), with the EC empowered to issue more prescriptive VfM requirements if it finds them necessary (akin to the approach proposed by the EC in the context of inducements).

- We are assuming that the EC's intention is for the VfM requirements to only apply to PRIIPs which meet both the packaged element and the retail element of the PRIIPs definition (i.e., which are actually sold to retail clients). **We would welcome a clarification to that effect, as a number of packaged products are sold to professional clients and ECPs only, and we understand that the intention is not to capture such products.**

- Finally, we note that the successful US model does not rely on VfM analysis/price regulation but rather strong enforcement of disclosure and other standards through regulations and FINRA guidance requiring market-based and reasonable fees. The EC could also have regard to the FCA's outcomes-based value for money requirements in its recently introduced Consumer Duty rules, which require manufacturers and distributors to assess value based on a set of mandatory and voluntary criteria (having regard to retail customer outcomes) and then take appropriate steps (including information sharing within the distribution chain on value, product intervention and reviews).

Rationale

- **It would be difficult to set up a taxonomy of products which are "comparable enough" for any such benchmark to give a fair indication of cost / performance of the product type.** The calibration exercise that is embedded in the benchmark framework poses a risk that benchmarks would be either too general (and therefore not necessarily represent a fair comparator for all

products covered by the benchmark) or too granular (thereby reducing the number of products that would actually be represented by certain benchmarks, such that it would be hard to produce a meaningful average). Also, benchmarks could become out of date very quickly, meaning that firms would have to undertake costly additional testing and assessments to prove that products meet the "proportionate and justified" requirements, or withdraw particular products or services if evidencing compliance with those requirements would prove too costly or be considered to involve too much "regulatory risk".

- The prescriptive approach proposed by the EC includes a presumption that – once the quantitative assessment has "failed" – a product does not meet the VfM requirements.

- The additional assessment and testing to establish that costs are still "proportionate and justified" is a high bar with associated legal / regulatory risks.

- In addition, focusing purely on cost (and performance), without also acknowledging that there may be related benefits to investors, or that the value of a product may differ depending on the service provided or specific characteristics of the investor, does not permit a full assessment of all relevant factors in providing value for money to such investors.

- A purely quantitative approach could therefore also result in retail investors receiving products that don't offer VfM, because the benchmark overlooks factors beyond costs and performance that the particular retail investor may value. The UK Consumer Duty is more flexible in including relevant qualitative factors as part of the VfM assessment. A qualitative / outcomes-based approach also places the onus on the firm to get comfortable (and evidence) that its products / services deliver fair value, and so would be more effective in addressing anomalies that could arise with a quantitative benchmarking approach (for example, a distributor would more easily be able to recommend or provide products which the distributor considers do / do not offer fair value based on the circumstances of a retail investor, even where the products fail / pass the prescriptive benchmark).

- Finally, the proposal requires distributors to largely replicate the assessments carried out by the manufacturers and establishes a negative presumption placing on manufacturers and distributors a legal requirement to prove the contrary.

General remarks on the EC's proposals

- An approach focusing purely on cost (and performance), without also acknowledging that there may be related benefits for the investor, or that the value of a product may differ depending on the service provided or specific characteristics of the investor, does not permit a full assessment of all relevant factors in providing value for money to such investors.

- **The value of a product/investment to a particular investor depends on many factors, such as quality of service or sustainability features. It depends on what the retail investor is looking for and typically extends beyond the narrow parameters of cost**. Indeed, the MiFID II best execution requirements, which also seek to ensure best investor outcomes, specifically acknowledge that price/cost is not the only measure for best outcomes by including speed and likelihood of execution among the relevant factors. AFME members feel that any value for money proposals should reflect the breadth of potential factors that may be relevant when assessing "value" to particular retail clients.

AFME's views on the proposed highly prescriptive approach by the EC

- <u>Tailored solutions:</u> **The proposed benchmark-based approach would not make sense for PRIIPs products that are bespoke and tailored to specific clients' circumstances**. For example, OTC derivatives are PRIIPs products but they would naturally be tailored to specific retail investors and therefore any attempt to create a one size fits all / universal benchmark to compare the cost/performance of these products is unlikely to be effective. It would also leave derivative manufacturers with the very challenging task of having to demonstrate value against a benchmark that is far removed from the facts of the relevant OTC derivative, and which overlooks the value received by the retail investor from the tailored specifications of the derivative.

- <u>Like for like comparison:</u> If there were to be cost/performance benchmarks, **it would be necessary to ensure that they provide a "like for like" comparison across the individual products captured within each benchmark**. For example, there would need to be more detail on the costs (e.g., specific types of service cost) to be included in these benchmarks, to avoid interpretation risk resulting in different manufacturers / distributors including different costs in their reporting to the EU authorities or their value assessments. Our members submit that it would be extremely difficult to define the costs that should be included in a comprehensive way.

- <u>Investor needs:</u> **Creating cost/performance benchmarks for products offered to "retail clients" as a blanket category does not adequately reflect the fact that some products covered by a particular benchmark may not be offered to all retail clients, but rather only to a subset of sophisticated or high-net worth retail clients (who are not eligible to, or have chosen not to, opt up to elective professional client status).** The investment objectives and needs of more sophisticated retail clients can be very different to those of the "average" retail investor on the street and, therefore, measuring the "value" of a product offering to those investors against the same benchmark applicable to products offered to the "average" retail investor will not be appropriate. **This could also have the unhelpful consequence of product manufacturers ceasing to offer such products to sophisticated / high net worth clients in the EU because of the perception that their products don't offer value as compared to the benchmark** (designed for a blanket category of retail investors) or because they are concerned about the high costs and potential legal risks associated with the additional testing / assessments proposed under the rules to justify that the relevant product meets the "proportionate and justified" requirements in any event, as noted above. **This would have severe implications on the range of investment products and services made available within the EU, which runs contrary to the aim of deepening the Capital Markets Union**. Firms who offer certain products only to a sophisticated subset of retail investors already require such investors to meet specific criteria, controls or tests, set by the firm, to "qualify" for investment in a specific product which, alongside other controls and protections (such as target market assessments and risk warnings), are aimed at ensuring that relevant products are appropriate for these more sophisticated or high-net worth investors (i.e., provide "value" in light of their specific objectives and needs).

- <u>Distributors and manufacturers obligations:</u> Regarding the proposed reporting obligation for distributors, which is to cover costs of distribution and "other costs" not taken into account by the manufacturer, our members query the rationale for this. **Given that the cost structure of products is defined by manufacturers, it does not appear appropriate for distributors to reassess and report costs, other than the costs associated with the distributor's own distribution of the product. Doing so would mean that distributors replicate the assessments already carried out by the manufacturers and result in duplicative information being reported to the EU authorities.** In practical terms, it is also unclear what information distributors would need to receive from manufacturers in order to assess the cost analysis already made by the manufacturer

and how distributors should go about assessing costs already approved and deemed justified and proportionate by manufacturers.

- **Impact on innovation:** we are concerned that the proposed benchmarking could also stifle innovation and new product development, noting that, for example, certain new products such as funds are subject to significant costs in the initial stages.

- **Regional variations: AFME members also note that setting cost/performance benchmarks at a pan-EU level could be problematic. This is because the benchmarks would not take account of regional variations, such as local market conditions or market conventions, which can impact products' cost/performance profile**. For example, a product which compares well against local Government bond rates of return and other products offered in the local market may not compare favourably against a pan-EU benchmark. This could adversely impact firms offering products, and issuers seeking to raise funds, in some EU jurisdictions.

- **Proprietary information:** The fact that firms may be unable to include certain data on costs or performance because it constitutes proprietary information that firms are unable to disclose or which is commercially sensitive will be a further complicating factor when specifying the required data inputs.

- **Quality and Comparable data:** There would also need to be agreed data standards to ensure quality and comparability of submitted data.

- **Stale benchmarks:** Also, benchmarks could become out of date very quickly, meaning that firms would have to undertake costly additional testing and assessments to prove that products meet the "proportionate and justified" requirements, or withdraw particular products or services if evidencing compliance with those requirements would prove too costly or would involve too much "regulatory risk".

- **Other existing benchmarks:** Our members also note that the process for assessing whether costs are "proportionate and justified" in proposed Article 16-a(1) MiFID II should be clarified to address the situation where no ESMA cost/performance benchmark exists. In particular, our members are concerned that, in those circumstances, there should be no requirement for firms to identify any other "benchmarks" or comparisons for relevant products, as it would be difficult (and in the case of some structured products impossible) to identify comparable products.

- **Grandfathering of existing products:** Finally, it is unclear whether and how the proposed value for money requirements would apply to existing products, both before and after the rules come into effect (and before a benchmark is made available for a particular product type). **We consider that existing products should be grandfathered (i.e., not become subject to the VfM requirements).** It would be complex to retrospectively assess VfM for existing products and, where firms are unable or unwilling to make the required systems changes, they would be forced to exit particular product offerings, which could also be to the detriment of retail investors and markets.

A brief comparative assessment

- The introduction of VfM requirements into the customer journey is a feature that has been recently introduced, or otherwise addressed, in regulatory regimes in other jurisdictions.

- Noting our concerns about the proposed approach to VfM in the EC proposals, we would like to recommend that the EU legislators take account of / consider approaches taken by other

jurisdictions in response to VfM concerns, which are generally more outcomes-focused and principles-based, and which we think would result in better retail investor outcomes.:

- In the UK, the new FCA consumer duty introduces new rules on a "price and value" outcome for retail customers, which firms across the distribution chain need to meet by having regard to the proposed target market of retail customers for the product. The UK Consumer Duty does not impose benchmarking against average cost/performance of similar products[2]. Instead, the assessment is essentially qualitative / outcomes-based, including a consideration of the particular role the relevant firm plays in the distribution chain. Manufacturers and distributors have to assess if their products deliver fair value based on a set of mandatory and voluntary criteria and then take appropriate steps (including information sharing within the distribution chain on value, product intervention and reviews). As noted above, the benefit of a qualitative and outcomes-based approach like the FCA's is that it avoids many of the anomalies / issues noted above, that can result from a quantitative benchmark comparison – such as the failings of a one size fits all benchmark approach or the risk of other relevant value factors being overlooked. Under the consumer duty, firms will have the onus of confirming and evidencing that the product delivers value to the retail target market or, in the case of firms dealing directly with the retail investor, the specific retail investor.

- In the US, while there are no specific VfM requirements, concerns about what value retail clients receive have been addressed in other ways, namely through mandatory disclosure and strong transparency rules, strong suitability/best interests regulation, and caps on fees (representing the lower of standard market rate or 5% for investment advice) and focused enforcement of all of these requirements.

- We would be happy to engage further on alternative VfM approaches the EC could adopt and on the local regimes summarised above.

Opt-up criteria for professional clients

AFME Position

- **AFME members support the proposed changes to the opt-up criteria for elective professional clients.** We understand that the objective is to open up a broader range of investment opportunities for a greater range of clients which may result, overall, in an increase of capital being made available to issuers in EU capital markets. We support this ambition.

- However, there is scope to improve the proposals so that they have the intended effect of facilitating greater opportunities for retail investors to access EU capital markets.

Rationale

- We welcome additional guidance and clarity to support firms in understanding how best to approach client re-classification. We are carefully reviewing the proposals and, in the interim, make a series of initial recommendations below.

[2] We note that the FCA's value for money rules for UK authorised funds (which exist separately from the Consumer Duty), require their fund managers to assess value by having regard to the costs of similar products – but that is again a qualitative assessment, rather than imposing an objective standard or a benchmarking approach similar to the one being proposed in the RIS.

- To enable retail clients to meet the categorization to opt-up professional we suggest replacing the requirement of "transactions of significant size in the reference market" to a different requirement that values having held certain even complex instruments in the portfolio for a significant period (e.g., 3 years).

- We also suggest that **future technical standards or guidelines provide a non-exhaustive list of examples of the evidence required to demonstrate financial expertise**.

- It is not clear whether the proposed criteria to opt-up legal entities as professional clients upon request mandates that the relevant criteria shall be exhaustive, or if they should be added-on to the criteria applicable for physical persons.

- Our members would also welcome clarity that firms may actively suggest to relevant retail clients that they could opt up to be treated as elective professional clients, provided that firms properly disclose the benefits and risks of making the election, which would also require related ESMA Q&A to be updated to that effect.

- We also urge the EC to expand the scope of this proposal to include those entities which are facing Special Purpose Vehicles (SPVs) created as part of a project finance which have sponsors classified as professional clients. It would be appropriate for those entities to be assigned the categorisation of *per se* professional clients.

Suitability and Appropriateness Assessments

Suitability

AFME Position

- AFME recommends that the rules should reflect that portfolio composition should be taken into account only to the extent reasonably possible.

- We note that the concept of "any existing portfolio" is not clarified and it is unclear whether it encompasses portfolio(s) held at other/third-party intermediaries. We request that this is clarified in the level 1 text, **so as to mean only portfolio(s) held at the intermediary and not at other/third-party intermediaries.**

Rationale

- AFME members expect that the potential consequences otherwise deriving from also considering portfolio(s) held at other/third-party intermediaries would be extremely challenging and disruptive both for clients and for intermediaries.

- Moreover, it will often be difficult to collate the required data on a client's portfolios, particularly where the client's investments are conducted through different investment firms. Clients will not always be willing to share with one firm details of investments made through, or held with, another firm.

- We note the proposed enhancements to the suitability assessment, in particular the need to take account of (and collate data related to) the composition of a client's existing portfolio with a view to assessing, amongst other things, their need for portfolio diversification.

- Our members are concerned that the new requirement to assess a client's portfolio when providing advisory services might blur the line between the advised services subject to the suitability assessment and any non-advised execution services a firm may be providing to the same client. From the client's perspective, retail clients may be confused and may assume that they are receiving advised services rather than execution services. This is because the suitability assessment for the advised services would require firms to look at the client's entire portfolio, which would include products subject to advice as well as those not subject to advice. Firms are concerned that there may be a risk that they would be considered to have provided some form of advice on those parts of the portfolio on which they have provided non-advisory services. Blurring the line between a firm's advisory and non-advisory offering is unhelpful as it would have many knock-on consequences regarding the firm's compliance obligations (beyond just suitability assessments).

- Related to the previous point, if the portfolio-related enhancements to the suitability assessment were to result in a firm being "deemed" to be providing investment advice to a retail client across the portfolio, this would then push that firm into the "best interest" criteria for retail advice in new Article 24(1a) (which we discuss in more detail above). This would be problematic, as firms that really seek to provide execution only services in respect of specific acquisitions will not be in a position to meet the criteria in Article 24(1a) (i.e., offering a range of products including ones without particular features that are not necessary for the client's investment objectives but which add costs, etc.).

- Our members would, therefore, welcome a clarification that the suitability assessment itself will not impact the type of service being provided by the investment firm performing that assessment.

- We would have many concerns as to a scenario where the investments held by the clients at other/third-party intermediaries are to be included within the scope of the "existing portfolio" for the purposes of suitability assessment. This is because:

    - taking the composition of the investments which are being held at other/third-party intermediaries into account for the purposes of suitability recommendations, risks raising significant operational challenges for the mere fact that it implies a real time and continuous sharing of all client's investments;
    - the same client may pursue a plurality of different investment objectives when she/he uses the investment advice and portfolio management services provided by a plurality of intermediaries;
    - the profiling questionnaires and the methodologies used for the purposes of suitability assessment are closely related to the specific model of service used by each intermediary and instrumental thereto - this implies that the outcome of a suitability assessment provided by different intermediaries may not necessarily be the same, even when referring to the same investment.

- The rationale underlying the proposal to make the outcome of the profiling and of the suitability assessment available to "potential" clients is unclear, considering that no contractual relationship exists with potential clients (and, consistently with this, neither a profiling nor suitability assessment will have been performed). We would therefore request that this proposal is not taken forward.

Appropriateness

AFME Position

- AFME members consider that the proposal to include an assessment of a client's capacity to bear losses and risk tolerance in the appropriateness assessment is a significant expansion which would impose unjustified costs and burdens on impacted firms, as it would essentially blur the lines between the appropriateness assessment and suitability assessment.
- **The proposal does not specify if this measure is only for retail clients.** It is important that this is limited to retail, due to the unnecessary administrative burdens that it would place on clients who do not need these procedures and who would see their transactions in the markets slowed down – we note that under the current rules, firms can assume "appropriateness" with professional clients.

Rationale

- If it is also applicable to professional clients, it would imply that they must now pass the appropriateness test before operating: i) to assess their investment objectives in the case of professional clients per se (Annex II, Section 1), and ii) to assess their risk tolerance and investment objectives (Annex II, Section 2).
- This modification does not seem necessary nor is it appropriate when, at the same time, obstacles are being imposed on the remuneration of entities providing execution and RTO services, through the inducements ban we discussed above (and as noted above, in many cases the charges are largely to compensate distributors / intermediaries for the services they provide to manufacturers, which cannot then be charged to end retail investors – also because of legal limitations existing in some Member States).

- In addition to the above, the friction which is being introduced by requiring a specific request from the client to proceed where a firm makes a "negative" appropriateness assessment is potentially problematic in practice.

Costs & charges disclosures

AFME Position

- AFME members consider that **the proposals on costs and charges relating to professional investors and eligible counterparties (ECPs) will not benefit retail investors** and **do not seem necessary to meet the EC's objective of increasing retail investor participation** in capital markets.
- We consider that a full cost benefit analysis should accompany any partial reversal of the MiFID II quick fix. If such a reversal were to go ahead, market participants would also require sufficient time to revive processes that have been completely wound down in many firms following the MiFID II quick fix.

Rationale

- The relaxations to the costs & charges disclosure requirements following the MiFID II quick fix have been widely welcomed by sell-side and buyside firms, having led to a reduction in compliance costs/burdens that were found not to have commensurate benefits.

- As was acknowledged in the MiFID II quick fix, professional clients / ECPs tend to request disclosures that are more tailored to their specific needs, rather than relying on MiFID II mandated costs disclosures.

- Reintroducing costs & charges requirements in respect of professional clients / ECPs would be an additional cost to firms, who would have to reintroduce processes and update their systems for agreeing and documenting limited application, produce limited disclosures or stand ready to produce detailed (and, following the RIS proposals, standardised) costs & charges disclosures where limited application cannot be agreed.

There were also significant practical challenges associated with the provision of costs disclosures, *pre-trade*, under the old MiFID II rules, which the Omnibus Directive effectively reintroduces – and the requirement to provide ex-ante disclosures in a standardised format to professional clients / ECPs will further exacerbate those practical challenges.

- In 2021, the EU MIFID II quick fix eliminated the need for costs & charges disclosures when providing products or services (other than investment advice or portfolio management) to professional clients (as per Article 29a MIFID II) or any product or service to ECPs (as per Article 30 MiFID II).

- **We note that the EC proposal introduces a new MiFID II Article 24b on costs & charges disclosures without also amending Article 29a to limit the application of Article 24b to retail business and investment advice / portfolio management for professional clients.** In respect of ECPs, Article 30 is amended to refer to new Article 24b, but the ex-ante costs and charges disclosure requirement in new Article 24b(1) would seem to remain applicable where services are provided to ECPs. As a result, the proposed Article 24b partially reverses the MiFID II quick fix as it reintroduces the requirement for investment firms providing *any* services to professional clients or to ECPs to produce full ex ante costs & charges disclosures.

- It would also appear that costs & charges disclosures to professional clients / ECPs would need to follow the same enhanced standardised format proposed in Article 24b for retail clients, unless limited application of this disclosure requirement can be agreed with any particular professional client / ECP (as was the case prior to the MiFID II quick fix) – which, as noted in the green box above, would be a burdensome development for the industry in the wholesale / professional clients only context.

- AFME members also consider that the new annual statement on costs and performance to retail investors in proposed Article 24b(4) would be an unnecessary change to information already produced by intermediaries when complying with their normal ex ante and ex post costs and charges disclosure obligations. Our members consider this to be a costly and burdensome new requirement which would not appear to bring about additional benefits for clients.

Marketing communications and practices / Digital marketing

AFME Position

- The definitions of "marketing communication" and "marketing practice" should be made clearer.
- In particular, the definitions: i) should not capture marketing activity carried out outside the EU that is not targeted at EU investors; ii) should exclude real-time communications; and iii) should make it clear that a communication / practice by a third party could only be attributed to an investment firm where it is made with the knowledge of and "on behalf of" the investment firm.

Rationale

- The above clarifications are necessary to avoid an unduly wide interpretation of the newly proposed marketing requirements, which may, amongst other things, inadvertently cut across the reverse solicitation exemption and also result in disproportionate compliance burdens for firms.

- AFME members note the broad definitions of "marketing communication" and "marketing practice" in the EC's RIS proposal. In particular, we note that both definitions capture marketing activity undertaken by any third-party that is remunerated or incentivised through non-monetary compensation by the investment firm. This raises several concerns about where the line may be drawn between marketing activity which would be in, or out of, scope of the new requirements.
- AFME members consider that the proposed requirements need to be clarified as follows.
    - **There should be a minimum nexus between the communication / practice and its potential to reach EU investors**, as well as between a communication / practice and any monetary / non-monetary remuneration or incentive that may have been received by a third party.
    - **The new requirements should not capture marketing activity carried out outside the EU that is not targeted at EU investors**. In the context of digital marketing, it may not always be easy to identify whether a marketing communication or practice occurs in the EU (particularly given their wide proposed definitions) and any proposed rules / guidance should be mindful of this point.
    - Practical guidance should also be provided on when a communication is in fact targeting EU investors – noting that just having a website that can be accessed by investors in any jurisdiction should not be sufficient.
- **The definitions of "marketing communication" and "marketing practice" should make it clear that a communication / practice by a third party could only be attributed to an investment firm where it is made with the knowledge of and "on behalf of" the investment firm** (i.e., where the investment firm has inputted or directs the creation of, or instructs the third party to make, the relevant communication / practice).
- **Real-time communications, such as communications by a financial promoter, should be excluded from the definitions of "marketing communication" and "marketing practice"** given

that compliance with some of the proposed requirements (in particular the record-keeping requirements) would seem close to impossible.

- Pursuant to Article 24c(2), second sub-paragraph, all marketing communications must present in a prominent and concise way the essential characteristics of the financial instruments or the investment services and related ancillary services that they refer to.

- This new requirement is problematic especially insofar as it is due to apply to "all" marketing communications i.e., regardless of their format, channel etc. **For example, there are some marketing communications, such as those via radio or television adverts or social media posts, that require a degree of conciseness that will potentially not meet this requirement**.

- We would therefore suggest adopting the approach adopted by ESMA in its guidelines on marketing communications under the Regulation on cross-border distribution of funds (CBDF Guidelines). In a nutshell, under those guidelines, there is no strict mandatory requirement to describe the characteristics of the instruments. Rather, some criteria are set out that could operate as guidance when it comes to describing the characteristics of the instrument. In light of the above, we would suggest i) amending the EC proposal so as to clarify that the description of the characteristics should be only an option and ii) also amending Article 24c(8)(a) so as to make reference simply to the CBDF Guidelines (and not to a legally binding delegated act that the EC would be empowered to produce).

- Pursuant to Article 24c (3), Member States shall ensure that marketing practices are developed and used in a manner that is fair and not misleading and shall be appropriate for the target audience. This new requirement is problematic since it may not be so straightforward to identify, for all products/services that are the subject of marketing communications, a target audience which displays such clear or distinct features, which then in turn provides a clear indication to the marketing firm on the content the marketing communication should have. This is made even more problematic considering that nothing prevents one product from being directed to a plurality of diversified segments of clients. In light of the above, **we would suggest amending the EC proposal and, in particular Article 24c(8)(b) so that both "target audience" and the related concept of "appropriateness for the target audience" are clarified in a flexible manner to accommodate for the challenges noted above.**

Risk warnings for "risky" products

- AFME members consider that any standardised risk warnings proposed in new Article 5a MiFID II should be consistent with requirements for risk disclosures under the PRIIPs Regulation.

- While details of the proposed categorisation of products as "risky" are to follow in ESMA guidelines, AFME members note that having to apply guidelines to classify products will carry an element of risk for firms and result in divergences in classifications across the market.

- We welcome industry-wide consultations on this set of guidelines as different categories of products should apply different risk warnings. AFME members would see benefit in producing different risk warnings for different types of products (such as equity vs. non-equity products), noting that the industry should be involved in agreeing the categories of products to which different risk warnings should apply.

- Additionally, as noted in the section just above, certain types of marketing communications will be constrained in terms of word / character limits (e.g., social media posts) – and so any proposed rules

which impose risk warnings on marketing communications, should take that into account and be appropriately tailored and again mirror the guidance (where appropriate) provided under the CBDF Guidelines.

MiFID Implementation: Timing

- AFME notes that many of the proposed Level 1 changes would be accompanied by numerous EC delegated acts, guidelines, and ESMA / EIOPA RTS and ITS. Most of these are proposed to be produced by relevant stakeholders within 18 months of the Omnibus Directive entering into force. Many of these will include additional details relevant to the interpretation and implementation of the proposed Level 1 requirements. For example, the process for creating benchmarks for Value for Money/undue costs assessments, and the detailed reporting requirements which will apply to manufacturers and distributors in this context, will have a real impact on how the Value for Money/undue costs requirements will work in practice. In addition, many of the RTS will contain new data or disclosure formats, standardised risk warnings etc., the impact of which firms cannot properly assess at this stage, and which will, in due course, need to be reflected in firms' systems and information flows.

- This presents several challenges, both in commenting on the proposals (some of which cannot be fully assessed without a better idea of what the related delegated acts and RTS/ITS may cover) and in terms of implementation and timing. In commenting on the proposals, we have tried to highlight potential concerns or issues that may arise from the Level 1 text. However, some of our comments would clearly be impacted depending on the further detail to be contained in delegated acts, RTS / ITS and guidance. There is, therefore, a real concern that our members, and other respondents to the EC's RIS proposals, will not be able to undertake a full assessment, and comment on, all potential impacts of the proposals. We would therefore strongly encourage the EU authorities to be mindful of the concerns we have raised in this response as part of any Level 2 / 3 work, and to work with the industry in drafting the Level 2 and 3 standards.

- In terms of timing, the EC proposals suggest an implementation period of 12 months for Member States, followed by a 6-month implementation period for firms. Even assuming that Member States meet the implementation deadline (which we consider challenging given the breadth of sectoral legislation impacted, and the breadth of topics covered), our members consider a 6-month implementation period too short. AFME members would ask that the implementation timeline be amended so as to allow Member States 12 months to implement the RIS changes (as proposed by the Commission), followed by a 24-month implementation period before the new requirements become applicable to firms. This should allow sufficient time for relevant Level 2 texts to be finalised and for firms to properly consider and implement relevant Level 2 requirements into their systems.

Changes to the PRIIPs Regulation

AFME Position and Rationale

- **AFME is broadly supportive of proposed clarifications to the scope of the PRIIPS Regulation,** namely the exclusion of (i) retail products (including corporate bonds) with make-whole clauses, provided they are redeemed at fair value; and (ii) pension products providing immediate annuities without a redemption phase:

- We consider that it would be beneficial to clarify that a product with a make-whole clause will be regarded as "redeemed at fair value" if the make-whole clause meets the definition given to it in the MiFID II quick fix, namely "*that, in the event of early redemption of a bond, the issuer is required to pay to the investor holding the bond an amount equal to the sum of the net present value of the remaining coupon payments expected until maturity and the principal amount of the bond to be redeemed*", or the EU authorities should otherwise clarify when redemption would be at fair value (having regard to the concerns we have flagged above regarding the value for money proposals).

- We also welcome the clarification in Article 10(2) of the PRIIPs Regulation to the effect that PRIIPs that are no longer made available to retail investors do not need to be revised.

- **However, the electronic by default approach (which in principle we support), poses operational and substantial issues**. For example, given that the KID is already a very condensed document and contains information which is meant to be "key", there is a concern that a "personalised" customer journey could mean that some retail investors do not "select" to see all aspects of this key information.

- We are cognizant of the fact that the interactive tool enabling the retail investor to generate personalized key information would represent only one of the possible means by which the electronic format of the KID may be provided i.e. it is not a requirement but, rather, an option. **That said, our main concern in respect of this tool relates to the risk that it can be eventually used by retail investors in an "improper" way meaning, for example, with predictive objectives**.

- As to the new requirements on forms and content of the KID, **AFME members are perplexed about the new "Product at a glance" section and whether consumers would require a further summary** in light of the fact that the KID is already a very condensed statement of all key information regarding a product.

- Regarding the inclusion of the new section entitled "How environmentally sustainable is this product?", AFME members note that parties should be allowed to include: AFME members note that parties should be allowed to include sustainability-related information in the KID for any product if they deem that information to be key information. We are carefully considering whether (and if so how) this section should be limited to SFDR Article 8 and 9 products.

- In light of the new sections ("Product at a glance" and "How environmentally sustainable is this product?") proposed by the EC in its RIS PRIIPs proposal, the limit should be extended to 5 pages and should also cover all PRIIPs KIDs, not just those showing past performance.

- **Our members would consider a three-year implementation period appropriate** to allow for systems and processes to be changed, and for appropriate testing to be undertaken.

- **AFME members support the changes to Article 14 of the PRIIPs Regulation regarding the provision of the KID in electronic format**. We agree that retaining the ability to provide documents in paper format if a client so requests will be important to ensure appropriate client information is provided; for some it is their preference, for a smaller minority it is a necessity since they do not have access to electronic devices. Further, the practical experience of our members is that, in some cases, even existing and new clients do not wish to receive electronic communication (e.g., they do not provide the firm with an email address or other details). It is therefore important that firms can continue to provide paper documents to clients.

- **In relation to the interactive tool,** we believe this would also pose additional compliance challenges for firms, for example in trying to build systems to check and record which information within a KID each retail investor has actually accessed and (if this were to be a requirement) in ensuring that the retail investor is provided with any information from the KID which they did not specifically choose to access.

- The relevant compliance framework, as well as the creation of the interactive KID itself, would be very costly for firms and so should be accompanied by a detailed cost / benefit analysis, prior to any such requirements being introduced.

- The adoption of the interactive tool is likely to generate material impacts mainly related to the need to satisfy/fulfill the request for personalization in relation to i) IT systems and architectures; ii) layouts; and iii) methodologies. Considerable updates of the KIDs already issued could also be necessary to ensure the different sections of the KID make sense in an interactive format.

- Regarding the proposed changes to the PRIIPs KID template, AFME members question whether the proposal for the **new "Product at a glance" section** is based on evidence that consumers require a further summary in light of the fact that the KID is already a very condensed statement of all key information regarding a product. There may also be a risk that retail investors will only read the "Product at a glance" section, rather than the full KID. This may not always be in the best interest of retail investors, as selecting only some of the KID's key information would not give the investor the full picture of a product, its costs and risks.

- AFME members note the inclusion of a new section entitled "How environmentally sustainable is this product?". Parties should be allowed to include sustainability-related information in the KID for any product if they deem that information to be key information. We are carefully considering whether (and if so how) this section should be limited to SFDR Article 8 and 9 products.

- **AFME members consider that this section should also not be limited only to the two specified data points from the Taxonomy Regulation and the SFDR RTS, but should also include a free text summary of the product's environmental or social characteristics / sustainable investment objectives**. The exclusion of this broader sustainability information from this section, would risk confusing investors (particularly as they compare the KID to the various disclosures and reports they will see under SFDR) and would also result in the exclusion of key sustainability information that our members believe will be significant for retail investors to make informed investment decisions regarding ESG aspects of a PRIIPs offering.

- Additionally, **our members believe that the data points for this section would be better included in Level 2 standards rather than Level 1 amendments to the PRIIPs rules**, as Level 2 would be easier to amend and expand to accommodate the evolving regulatory and market landscape as the EU, and other jurisdictions, continue to build their ESG regulations and as ESG products, data points (noting the increased focus on the "social" and "governance" aspects of ESG) and investor demand further develops.

- If evidence suggests that a new "Product at a glance" section is needed, **AFME members note that the 3-page limit of the PRIIPs KID has not been extended to account for this additional section (or the new section entitled "How environmentally sustainable is this product?")** and that it is envisaged that the KID may be submitted in a layered format. We consider that it would be challenging for firms to fit all prescribed information into a 3-page KID document without compromising the readability (e.g., due to significantly reducing the font size) of the KID. We note that the European Supervisory Authorities (ESAs) recommend that the length of the KID be

increased to 4 pages for those KIDs which show past performance. In light of the new sections proposed by the EC in its RIS PRIIPs proposal, we believe that the limit should be extended to 5 pages and that it should cover all PRIIPs KIDs, not just those showing past performance.

- We are also concerned that the new requirement for publication of PRIIPs KIDs on the distributor's websites (in new Article 14(6)) does not distinguish between primary and secondary market nor between instruments which are, or are not, subject to a placing or other distribution. This may result in a situation where an agreement between a distributor and a client, for example, does not cover secondary market trading, but the distributor may still be selling or advising its clients on the relevant PRIIP. In this case, we do not believe that the distributor should still be required to make the KID, or any subsequent updates, available on its website. Another example would be where Firm A sells or advises its clients on hundreds of PRIIPs issued by third party issuers on the secondary market without any agreement with their issuer. In this case, Firm A should not be required to make hundreds of KIDs, and any subsequent updates, available on its website. We therefore propose that the requirement for publication on the distributor's website should only apply when the distributor has an agreement in place with the issuer for the placement of the relevant PRIIP.

Other MiFID Issues

Competency requirements for investment advisers

- AFME members are concerned that individual Member States will be able to set relevant assessment criteria under the new competency / certification requirements for investment advisers. This could lead to a divergence in the criteria which need to be met by advisers, depending on the rules of the relevant home Member State. It could also lead to unnecessary operational complexity and increased costs for groups operating across different EU jurisdictions (for example, if groups wanted to design relevant training for advisers across different jurisdictions, which is often the case in practice).

- As drafted, the proposed Article 24d infers that the assessment criteria would be set by the home Member State and would then apply to a firm's advisers, irrespective of where the advice is provided within the EU. Any divergence in these assessment criteria set by home Member States could therefore result in a non-level playing field if some jurisdictions were to take a "lighter touch" approach to these criteria than others. We encourage the EC to consider a harmonising approach across Member States.

Cross-border services, marketing and reporting

- **The proposed reporting in respect of cross-border activities under EU cross-border services passports**, as currently proposed in new Article 35a, **would unduly capture some of our members' business activities, such as where services are provided across EU markets from an EU hub and would be disproportionately burdensome** compared to the marginal benefits these proposals will likely result in, in terms of investor protection. We note that the list of information which is proposed to be reported in the Level 1 text is detailed (including, for example, details of the type, scope and scale of services provided and activities carried out in each host Member State, and on marketing communications used in host Member States) and is to be supplemented with RTS.

- AFME members consider that these obligations could be onerous and costly to comply with, whilst at the same time cutting across the benefits of cross-border passports and the seamless Single Market, and in practice, will generate doubts and confusion regarding when it should be understood that the entity is providing an investment service (eg: between two eligible counterparties, who provides

the service to whom in a particular context?) and where it is provided (eg: platforms, reverse inquiry, brokers).

- **Our members would advocate for a more targeted approach to these reporting requirements, such that they would only apply in circumstances where there are concerns about a particular investment firm's cross-border activities.** If these reporting requirements were to apply more widely, from a proportionality and costs perspective, our members would advocate for high-level reporting, perhaps with powers for local competent authorities or the relevant ESA to request more detailed reporting in certain circumstances.

- **For the reasons outlined above, reporting to the authorities should also be limited to activities with retail clients and not professional clients or ECPs.**

Financial literacy

- AFME members are supportive of the EC's proposals to encourage greater financial literacy of retail investors through education of retail clients and prospective retail clients in relation to responsible investment when accessing investment services or ancillary services. This should not be seen as an exclusive duty for firms

AFME Contacts

Rick Watson
Managing Director
Head of Capital Markets, Membership & Events
Rick.watson@afme.eu
+44 (0) 20 3828 2737

Giulia Pecce
Associate Director
MiFID and Wholesale Investor Protection
giulia.pecce@afme.eu
+44 (0) 20 3828 2746

Pedro Pinto,
Director
Advocacy
Pedro.pinto@afme.eu
+32 (0)2 883 55 48