BETTER FINANCE

The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Position Paper

| Retail Investment Strategy

October 2023

BETTER FINANCE's Key positions on the Retail Investment Strategy proposals

Executive summary

BETTER FINANCE welcomes the proposal for the Retail Investment Strategy (RIS) put forward by the European Commission (EC) on 24 May 2023.[1] We fully share the goals that the EC pursues with this initiative:

- 'rules that are coherent across legal instruments';
- 'adequate protection'
- 'bias-free advice and fair treatment';
- 'open markets with a variety of competitive and cost-efficient financial services';
- and 'transparent, comparable and understandable product information'.[2]

In the explanatory memorandum and impact assessments that accompany the legislative proposals, the European Commission clearly identified the key shortcomings of the current regulatory framework that severely damage the interests of retail investors. We share the EC's assessment that an ambitious overhaul of the manufacturing and distribution processes for retail investment products is necessary.

Pervasive conflicts of interest in the distribution system of retail investment products, lack of coherence across the rules applicable to different financial instruments, product information that too often lacks transparency, comparability, and is hardly understandable for the average retail investor: those are endemic in today's European retail investment markets. It is altogether unsurprising that only a third of EU citizens on average trust that the investment advice they receive from financial advisors is in their best interest.[3]

BETTER FINANCE and its members have for years called for a thorough review of the EU rules on retail investor protection. The proposed Directive and Regulation include a series of most welcome improvements to the current regulatory framework. **We thus see the proposals regarding conflicts of interest and 'Value for Money' as clear indications of the willingness of EU policymakers to finally address**

[1] The Retail Investment Strategy is a legislative package composed of a proposal for an Omnibus Directive as regards the Union retail investor protection rules, and a proposal for a Regulation amending the PRIIPS Regulation.
[2] European Commission, *A Capital Markets Union for People and Businesses - New Action Plan*, 3.
[3] See European Commission, *Monitoring the Level of Financial Literacy in the EU*, 30–31.

the pervasiveness of biased financial advice to retail investors. Similarly, proposals regarding information to investors constitute a significant step towards more transparency and comparability across products and providers.

We nevertheless find that **the RIS altogether falls short of "mak[ing] the EU an even safer place for individuals to save and invest long-term"**.[4] Scrutinizing the proposed Directive and Regulation, we identify a series of proposed provisions that either:

- are not consistent across retail investment products;
- create loopholes that will prove damaging for retail investor protection;
- or simply fail to truly tackle the real issues of conflicts of interest and lack of transparent, understandable, and comparable information.

With this position paper, BETTER FINANCE wishes to contribute to the policy debate about retail investor protection and make sure that the RIS achieves its purported objectives. We notably develop the key positions defended by BETTER FINANCE in favour of:

- **Bias-free and high-quality investment advice** (Section 1)
    - We welcome the introduction of a ban on 'inducements' (kickbacks from providers to distributors mainly on their sales) for sales without advice ('execution-only' or 'unadvised' sales) for retail investment products (mainly investment funds, structured products and insurance-based investment products or IBIPs regulated by the EU's MiFID[5] and IDD[6] legislation).
    - We welcome the introduction in IDD of the notion of 'advice given on an independent basis' – although this is, like in MiFID, quite a pleonasm and the related prohibition to receive inducements. The real impact of this measure is nevertheless likely to be modest, as the experience of such a specific ban for MiFID products since 2017 has shown.
    - We regret that the existing ban on inducements applied in portfolio management services by investment firms under MiFID is not extended to insurance intermediaries under IDD, which perpetuates a damaging inconsistency in the EU's retail investor protection framework.
    - We welcome the criteria of the new 'best interest of the client' test but remain sceptical as regards their enforceability.
    - We strongly welcome the requirements for better knowledge and competence of financial advisors, which are much needed—in particular in the area of sustainable finance—but call for delegated acts to further specify the requirements (number of training hours, assessment of existing knowledge and certification of achievement of learning outcomes).

[4] Which constitutes the key objective no.2 of the Capital markets union 2020 action plan: A capital markets union for people and businesses. The RIS is supposed to contribute to Action 8 "Building retail investors' trust in capital markets".
[5] Directive 2014/65/EU on markets in financial instruments (MiFID).
[6] Directive (EU) 2016/97 on insurance distribution (IDD).

- **Better 'value for money' for retail investors** (Section 2)

  – We welcome the efforts to better specify in the existing UCITS[7] and AIFMD[8] rules for investment funds what fund costs can be considered due and undue and the requirement to reimburse any undue costs charged by fund managers, although we call for more details and guidance to be provided on each of the proposed criteria.

  – We welcome the introduction of a 'pricing process' requirement for fund managers in UCITS and AIFMD, as well as for manufacturers of packaged retail and insurance-based products under MiFID and IDD. This requirement can contribute significantly to improving the net return of investing for consumers but its effectiveness hinges on adequate independent data on actual performances and costs and on the detailed criteria for considering costs as 'justified and proportionate' to returns. We therefore call for a simple and effective approach similar to the 'value assessment' one used recently for investment funds by the UK's Financial Conduct Authority[9].

  – We welcome the introduction of a requirement for product manufacturers and distributors to compare their costs to an external benchmark, but the process must be simplified and helped by restoring the mandatory key disclosure of actual performances of all PRIIPs alongside their benchmark or indicator of investment performance chosen by the PRIIPs managers themselves.

- **Transparent, understandable and comparable key information on products** (Section 3).

  – We regret that the Proposal does not address at all the very serious content issues of the PRIIPs KID despite the EC goal to have intelligible and comparable key product information: the incorrect, misleading and future performance scenarios, based on last 5 years' performance in addition and without the warning that past performance is not a good indicator of future performance, the elimination of any disclosure on whether the product has ever made money or not in the past for the investor, the elimination of any disclosure on whether the PRIIPs manager has met their own investment objectives or not (comparison of the PRIIP performance to its benchmark's performance), and the elimination of any actual cost data (only costs based on one of the four future scenarios and for specific holding periods only). Also, the risk scale does not take into account the time horizon of the investment and will still rate money market funds, for example, as very low risk for a pension product.

  – We however welcome the proposed digitalisation of the KID. This should allow, for example, to reintegrate actual long-term past performances of the product and of its chosen benchmark(s) alongside as a drawdown, instead of the current unspecific weblink to the manufacturer's website (which makes it an uphill battle, even for a sophisticated investor, to access this crucial information). The proposed criteria for the use of interactive tools will, however, need to be further defined and guidance provided to ensure that the

[7] Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities (UCITS).

[8] Directive 2011/61/EU on alternative investment fund managers (AIFMD).

[9] "Authorised Fund Managers' Assessments of Fund Value 2023".

KID information is indeed conveyed in full and unaltered, and that the right to obtain the classic KID in electronic or paper format is protected.

– We welcome the introduction of risk warnings for 'particularly risky' retail products under MiFID and IDD, as it is essential that retail investors are made aware of the potential risk of losses entailed by the structure of the products they buy. For the same reason, we oppose the proposed withdrawal of the 'comprehension alert' from the PRIIPs Key Information Document (KID), unless replaced by an appropriate warning about the risks entailed by particularly complex products.

– We generally welcome the proposed requirements for cost disclosures in pre-contractual information and annual statements, as clear and understandable information about the costs incurred by the client is essential for consumers to assess and compare products. We nevertheless argue that disclosure requirements should be consistent across MiFID and IDD whenever possible.

– We welcome the introduction of a sustainability section in the KID but are critical of the proposed format and indicators, as regards understandability for retail investors.

– Finally, we call for a more thorough review of the PRIIPs KID, especially as regards the information provided about costs and performance.

We do not analyse here on the issues of marketing practices, although we strongly support action on this account. We do believe that stricter rules are necessary regarding marketing practices, to increase accountability and protect consumers against the scams that have been proliferating in relation with *finfluencers*. Regarding this issue, we notably support the proposals developed by BEUC.[10]

BETTER FINANCE, as the representative body of citizens as retail investors, will keep engaging with the EU legislator on the basis of the positions stated in the present document, looking forward to discussing ways to improve the outcome of the RIS for retail investors.

1. Bias-free and high-quality investment advice

Because retail investor is not a full-time job, consumers rely on distributors of retail investment products to help select retail investment products that will help them accumulate capital in the medium to long term. Being able to trust that advisors are impartial in their selection of products and have the capacity to match the client's needs to product features is, therefore, crucial for retail investors to engage in capital markets. The main objective of the RIS must be to ensure that retail investors *can* trust distributors. They currently *cannot*, because, as the EC noted in the impact assessment accompanying the RIS proposals:

> *'Conflicts of interest at the level of the distributor are inherent in the "commission-based" distribution model, as financial intermediaries receive remuneration from persons other than the retail investor for the products they are recommending. These conflicts of interest can be significant, since remuneration through inducements can represent an important portion of the*

[10] BEUC, *From Influence to Responsibility: Time to Regulate Influencer Marketing*.

incomes of intermediaries and the volumes of sales can also influence the bonuses paid to advisors.'[11]

Moreover, the 2018 Commission's study showed that an average retail investor is not aware and does not understand the incentive scheme of non-independent advisor and frequently assume that this advice is free. Nevertheless, the same study pointed out that in some experiments, the moment that investors became aware of such an incentive scheme / conflict of interest of their advisor (a potential wealth transfer to the intermediary), they were either much less willing to pay for advice, or to follow an investment recommendation[12].

That is why **BETTER FINANCE strongly supports the proposed new 'inducements regime'**: Forbidding the payment or reception of 'inducements' for sales of retail investment products where no advice is provided ('execution-only' or 'unadvised' sales), where the advice is given on an independent basis or where the client delegates portfolio management to an investment firm or insurance intermediary constitutes a step towards bias-free advice. Research—including BETTER FINANCE's—has shown how detrimental to consumers the inducement-based distribution system is.[13]

The currently dominant inducements-based distribution system whereby 'advisors' are remunerated by product manufacturers—investment firm or insurance company—to place their products with retail clients leads to a situation where the products most recommended by these so-called 'advisors' are also the most expensive and the least performing.[14] Table 1 illustrates this situation in the case of the French life insurance market.

Table 1: Average charges, market shares and performance of French unit-linked life insurance.

	Average charges (unit + contract)[1]	Market share	Net performance (end 2016-end 2021)
Classic units	2.96%	93%	36%
Clean share units	2.02%	1%	44%
Indexed units	1.18%	2%	58%
Index ETFs	0.25%	---	68%

[1]Ongoing charges on assets only and excluding portfolio management charges.

Source: GoofValueForMoney.eu, BETTER FINANCE, 2022

Here we clearly see that classic units—the most 'advised' products, 93% of the French life insurance market—are more than ten times more expensive than index exchange-traded funds (ETFs), which are virtually never recommended by the predominantly inducements-remunerated French insurance intermediaries. In parallel we observe that classic units are on average the worst-performing type of

[11] European Commission, *Impact Assessment Report Accompanying the Document Proposal for a Directive of the European Parliament and of the Council Amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as Regards the Union Retail Investor Protection Rules and Regulation of the European Parliament and of the Council Amending Regulation (EU) No 1286/2014 as Regards the Modernisation of the Key Information Document*, 16.

[12] European Commission, *Distribution systems of retail investment products across the European Union*, 103

[13] See, e.g., BETTER FINANCE, *Evidence Paper on the Detrimental Effect of "Inducements"*; European Commission et al., *Disclosure, inducements, and suitability rules for retail investors study*; Mullainathan, Noeth, and Schoar, "The Market for Financial Advice".

[14] European Commission, *Distribution systems of retail investment products across the European Union*, 101; Mullainathan, Noeth, and Schoar, "The Market for Financial Advice".

contracts, with **an average rate of return over five years roughly half what low-cost ETFs yield over the same period**.

Some financial industry players would have us believe that the inducements-based system enables financial intermediaries to provide 'advice' for free and that, without inducements, the cost of advice would be too high for less wealthy retail investors. The truth is that there is no free lunch: **Retail investors currently pay a hefty price for the overall poor-quality sales/marketing pitch they receive from 'non-independent advisors'.** The average amount of 'inducements' paid on French life insurance contracts stands at 0.8% per year[15], supposedly covering the cost of "advice" provision.[16] Assuming that an investor would hold such a product for 12 years (the average holding period for a life insurance policy), that **amounts to a 10% charge**, and **17.2% for 20 years** (a duration that is common for products used for retirement savings).[17]

Let us now assume that our hypothetical client makes an investment of € 25 000 and that the life insurance policy is a unit-linked contract yielding each year a net return equal to the average return rate across French unit-linked life insurance.[18] **Then, after 12 years, charges borne by the client for 'inducements' will amount to € 3 014; after 20 years, they will have paid no less than € 5 576 for this 'free advice'.**

The situation is marginally better if we assume that, as is common, our hypothetical investor spreads their investments into their insurance policy over time. Let us say that, after an initial investment of € 13 000, they save € 50 each month, paid into the life insurance policy as one annual investment of € 600 at the end of the year. Then, as all ongoing charges, inducements are calculated on both initial capital and subsequent payments. **For this initial € 13 000 investment plus € 600 in subsequent annual payments, the total amount paid towards inducements after 12 years reaches € 1 979, and € 4 109 after 20 years.**

Let us compare the cost of this purported 'free advice' to the cost of advice provided by an independent financial advisor with a fee-based charging structure. We take the real-world example of a French independent advisor who offers advice at an hourly rate of €129 VAT included. Assuming that our hypothetical investor would require three hours of financial advice (which they usually do not get with sales commission-based distributors), the total cost of advice for them would be € 387 for the duration of the contract (be that 1, 12 or 20 years).**With a one-time € 25 000 investment, this fee-based advice becomes cheaper than inducements after only two years (€ 441), and after three years if the investment is spread (€ 396)**. Figure 1 painfully illustrates this cost difference over time.

In total, for an investment of € 25 000, the 'free' inducements-based advice cost € 2627 more than the fee-based advice after 12 years if made as one-time investment or € 1 592 is spread over multiple investments. After 20 years, the one-time investment entails a € 5 189 extra charge, or € 3 721 for multiple investments.

And that is only the tip of the cost iceberg for the investor: without considering the submerged part of the cost iceberg of 'non independent advice': the generally much lower nominal performance of inducements-based products due to the induced selection bias, compared to 'clean shares' or index products.[19] No free lunch, just hidden costs.

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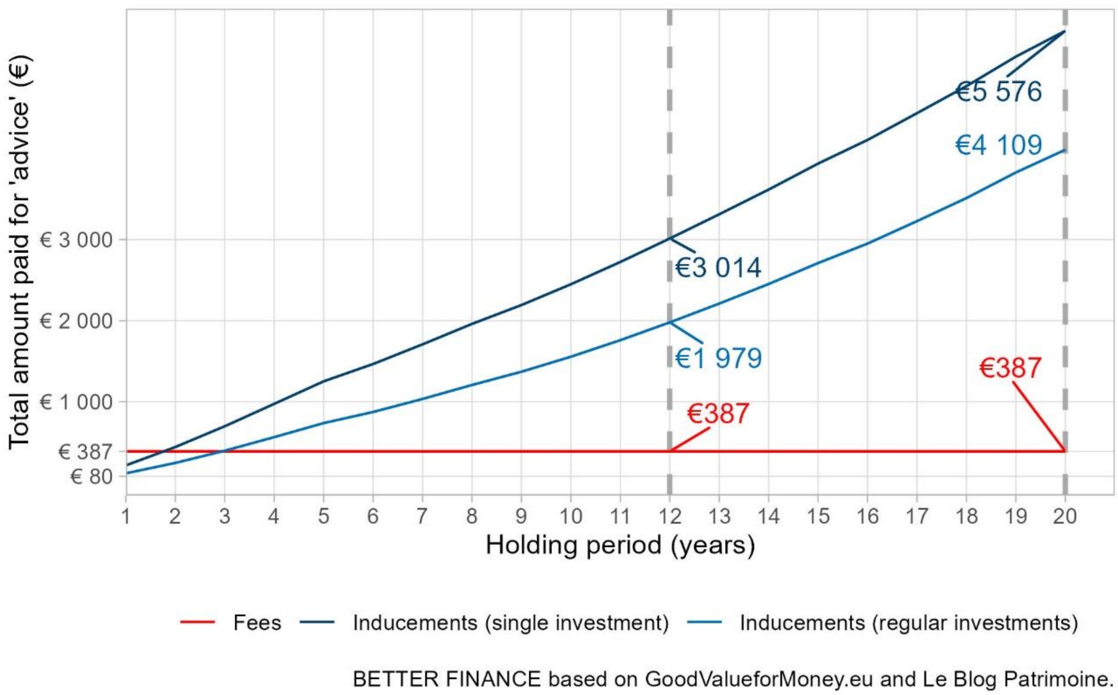
[15] And that is excluding the entry fees which typically are mostly credited to distributors.
[16] For equity asset class; Data: GoodValueforMoney.eu.
[17] Assuming here to simplify a zero nominal variation of the investment's value over the holding period.
[18] For the returns of French unit-linked life insurance from 2000 to 2021, see BETTER FINANCE, *Long-Term and Pension Savings*. For 2022, the average nominal net return on those products is -12.7%.
[19] European Commission et al., *Disclosure, inducements, and suitability rules for retail investors study*.

Figure 1: Cost of inducements vs. fee-based advice for a € 25 000 investment over 20 years

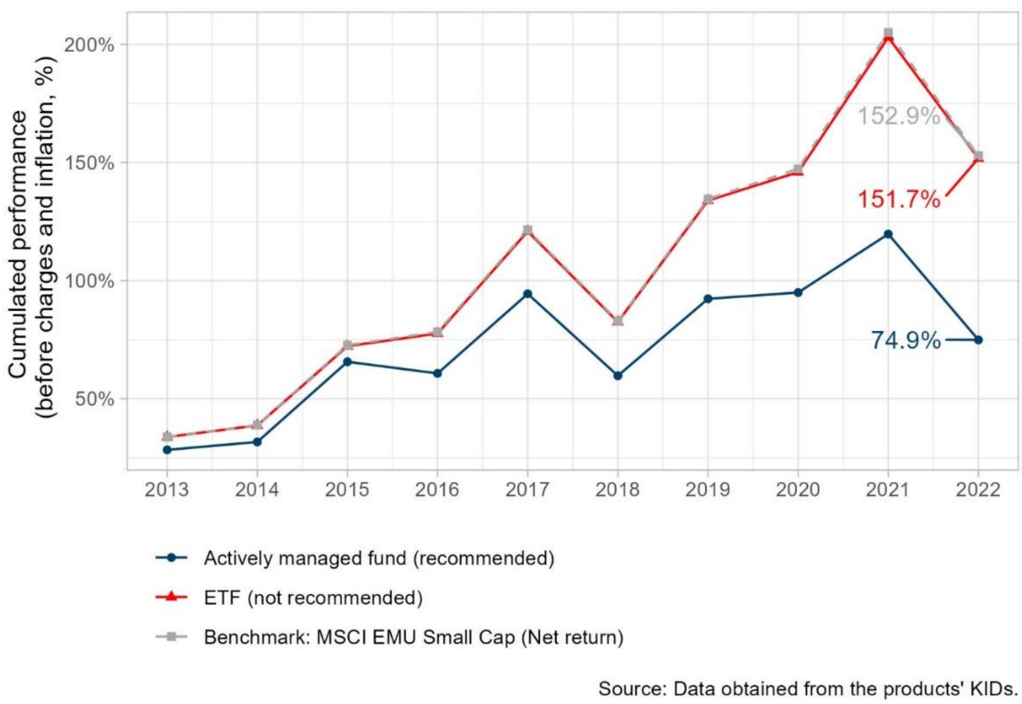


Biased advice is however not limited to insurance, in the distribution of investment funds too, expensive and underperforming products are more often recommended. **Error! Reference source not found.** displays a real case example of biased product selection. A client seeking advice to choose an underlying fund for a personal pension product asks an 'advisor' to 'recommend' a European equity small cap fund. Two funds from the same provider fit the description: one actively managed fund and an exchange-traded fund (ETF); both funds have the same benchmark—the MSCI EMU Small Cap index, net return—and the same characteristics (as displayed in their KID). In terms of costs and performance, however, the two funds are strikingly different:

- Over the past ten years, the actively managed fund (dark blue line in **Error! Reference source not found.**), while charging 1.95% per year, underperforms its benchmark (grey line) by 78 percentage points.
- The performance (net of charges 0,40% per annum) of the ETF (light blue), by contrast, is almost identical to that of the benchmark over the same period (151.7% vs. 152.9%)

The former fund charges **five times more commissions** than the latter but underperforms it and its own benchmark it has the advertised goal to overperform **by more than 50% over the last 10 years**.

Figure 2: A real case of selection bias in France



Logically and legally (primacy of the interest of the client), the advisor should recommend the product that performs best for a lower cost, should they not? And yet, in this case as in many others, the recommendation that the client got was to buy the most expensive and underperforming fund.

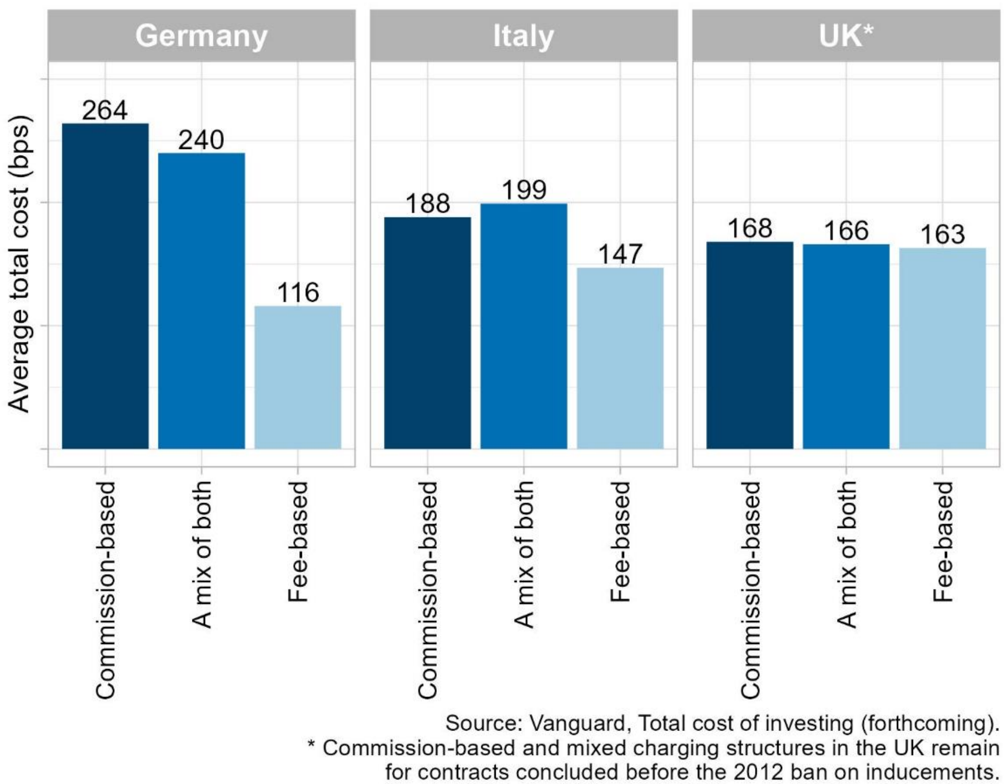
Good investment advice benefits investors in terms of risk management[20], yet it is so difficult to find that a large majority of Europeans never consult an investment advisor.[21] **Too often, clients who receive the "advice" (sales pitch) of 'non-independent' advisors instead of proper, independent advice end up with lower net returns and inferior risk-return trade-offs** compared to those receiving advice from independent advisors or even compared to self-directed investors.[22]

[20] Kramer, "Financial Advice and Individual Investor Portfolio Performance"; Barber and Odean, "The Behavior of Individual Investors".
[21] European Commission, *Distribution systems of retail investment products across the European Union*, 101.
[22] See, e.g., Hackethal, Haliassos, and Jappelli, "Financial Advisors"; Bergstresser, Chalmers, and Tufano, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry".

The higher average returns for clients in the fee-based distribution system appear to arise from two sources: lower ongoing charges figures and more dynamic asset allocation. In a forthcoming study comparing the total cost of investing in Germany, Italy (where inducements are the norm) and the UK (where they are banned), asset management company Vanguard finds that the average total cost of investing in Germany amounts to 2.35%, 1.91% in Italy, and only 1.64% in the UK.[23] The higher average figures in the former two countries are driven by the higher costs of the inducements-based structure (see Figure 3).

Vanguard's research also reveals that UK advisors allocate on average 70% of their clients' asset to mutual funds and ETFs, versus only 53% and 54% in Germany and Italy, respectively. This higher allocation into mutual funds and ETFs might arise from the fact that 75% of the advisor surveyed in the UK consider retirement advice as a key aspect of their service versus only 17% in Germany and 15% in Italy. Considering the long-term orientation of a great majority of retail investment products, especially insurance-based investment products, investment advice is mostly about retirement advice and financial planning: how to accumulate capital to ensure an adequate level of retirement income.

Figure 3: Total cost of investing in Germany, Italy and the UK (weighted average by charging structure)



For all these reasons, **BETTER FINANCE regrets to see that a complete ban on inducements has not been retained in the RIS proposal**, despite the findings of the impact assessment that this would be the best policy option to eradicate conflicts of interest and reduce the cost of retail investment products. **We nevertheless support the proposed *partial* ban on inducements for sales without advice, sales with advice**

[23] Vanguard, *Total Cost of Investing*, based on a survey of 1200 financial advisors, equally split among the three countries, conducted in mid-2022.

given on an independent basis and portfolio management services, as well as the new best interest of the client test.

BF PROPOSAL: Reserve the term "advice" and "advisor", financial advisor", "investment advisor" in EU Law to advice and advisors who are not compensated essentially by sales commissions.

Distributors of investment products and services who are essentially compensated directly or indirectly from sales-related commissions are salespersons, not advisors. And the MiFID terminology of "non-independent advice is an oxymoron, which—in addition—is seldom if ever clearly communicated to retail clients. This would end the use of unclear, misleading terms (confusion between advice and sales/marketing) and labelling and enable citizens to distinguish advice services from sales ones. This would also make EU rules more compliant with the requirement that information must be intelligible to retail clients and prospects.

1.1 The new 'inducements' regime

Where no advice is provided, there is no rationale for 'inducements'. Advocates of the inducements-based distribution system argue that such commissions paid by product manufacturers—investment firms and insurance companies—to investment advisors are remuneration for the 'advice' they supposedly provide free of charge to consumers. Even if this argument held—which we dispute—inducements in 'execution-only' or 'unadvised' sales would still be illegitimate: Since no advice is provided to the client, what are inducements payment for? **It is therefore logical that inducements must be banned from sales without advice, and we support the introduction of a ban on inducements for 'execution-only' sales of packaged retail investment products under MiFID and 'unadvised' sales under IDD.**

We nevertheless note that the absence of a clear legal definition of 'execution-only' transactions in MiFID and of 'sales without advice' in MiFID leaves much room for interpretation to firms, which may render the proposed ban ineffective. If firms are free to set very restrictive conditions for a transaction to be 'execution-only' or a sale of IBIP to be 'without advice', then consumers will risk being charged inducements for merely asking for a fund's ISIN code…

BF PROPOSAL: Introduce a legal definition of 'execution-only orders' and 'sale', with supervisory guidance:

The MiFID and IDD articles laying out definitions should include a definition of '*execution-only order*' and '*sale without advice*', that sets out as unambiguously as possible that such transactions/sales are those made '*without assessment of the suitability of the transaction/product with regard to the client's investment objectives and needs, or existing portfolios*'.

Such definitions should also require ESMA and EIOPA to provide guidance to help consumers and providers alike identify which situations should be considered as 'with' vs. 'without' advice.

Where advice is provided on an independent basis, advisors should be paid only by the client. The only way to ensure the independence of advisors is to forbid them from receiving payments from anyone other than the client. This very important principle has been recognised by the EU legislator in the current MiFID: MiFID-regulated independent advisors are already prevented from receiving and retaining inducements. The absence of an equivalent limitation imposed on insurance intermediaries who present their advice as 'given on an independent basis' constitutes an inconsistency of the current regulatory framework that needs to be remedied. **We therefore strongly support the proposed introduction in the IDD of the notion of independent advice and the related prohibition to receive and retain inducements when insurance intermediaries give advice on an independent basis.**

We nevertheless note that the requirements to be met by advisors giving advice 'on an independent basis' are still vague and open to interpretation.

BF PROPOSAL: Further specify the criteria for advice to be considered 'given on an independent basis'.

As a minimum, ESMA and EIOPA should be required to draft Regulatory Technical Standards specifying what minimum number of product providers an "independent advisor" should include in his assessment, and, crucially, what kind of links between a provider and an intermediary should be considered 'close links'.

Regarding specifically links between providers and advisors, the text proposed for IDD should be amended to match the existing MiFID text that mandates that when advice is given on an independent basis, the range of products must not be limited to those provided by entities 'having close links' with the investment firm, 'or […] other entities with which the investment firm has such close legal or economic relationships, such as contractual relationships, as to pose a risk of impairing the independent basis of the advice provided' (Art. 24(7), MiFID).

Firms offering portfolio management services to retail investors should not be able to take inducements. Portfolio management does not involve *advising* the client to select investment products but *selecting* these products for them. There is, therefore, no 'advice' to remunerate, and the work of selecting products is remunerated through mandate fees. Again, this has been recognized by the EU legislator in the current MiFID: investment firms are forbidden to take inducements when offering portfolio management services. **We regret to see that such prohibition is not extended to portfolio management services offered by insurance intermediaries**, contrary to the stated objective of the RIS to have more coherent rules across legal instruments. Extending this prohibition to insurance intermediaries under the IDD would level the playing field and further the consistency of the EU's retail investor protection framework.

BF PROPOSAL: Extend to IBIPs (in IDD) a prohibition for insurers and asset managers to receive and retain inducements when offering portfolio management services.

Since many insurers and insurance intermediaries offer portfolio management services—whatever names they use for this—the IDD should include a definition of this activity, which could be copied, with the necessary adaptations, from the definition of 'portfolio management services' under MiFID.

Similarly, the existing prohibition made to investment firms to receive and retain inducements when offering portfolio management services should be extended to all actors offering such services, starting with insurance intermediaries. We then suggest including in the new article on 'inducements' in IDD an equivalent of the MiFID prohibition of inducements for portfolio management services.

We see banning inducements from sales without advice, sales with independent advice and portfolio management as a bare minimum. Without these advances, claims that the RIS reduces conflicts of interest would lose all legitimacy.

Where inducements remain allowed, we must contain the danger of consumer detriment. We acknowledge and welcome the intentions behind the proposed **'best interest of the client' test**. The proposal sets the client's needs and objectives, and the cost-efficiency of products as the core considerations on which recommendations should be based. The proposed requirements should then, in principle, limit the negative effects of the inducements-based system on the selection of products. **The question of the enforceability of these rules however arises**: The current MiFID and IDD already include a 'duty to act in the best interest of the client', which is in practice rarely fulfilled.[24] It is dubious whether the new 'test' will be better implemented than its predecessors, considering that advisors will remain subject to strong incentives to sell high-commissioned products to clients.

We thus note that some concepts that are key to the new test are left undefined. What is meant by 'cost-efficient', for instance? The industry would contend that the notion cannot be used in relation with the 'best interest' of the client because, they say, it focuses on costs and not on product characteristics. We argue that a cost-efficient product is a product that meets the objectives and needs of the client (investment and guarantees), in line with the client's risk profile but does so at the lowest cost possible to the client.

BF PROPOSAL: Introduce a legal definition of 'cost-efficiency' or 'cost-efficient product'.

The Omnibus directive should introduce in both MiFID and IDD a legal definition of the concepts of 'cost-efficiency' and 'cost-efficient product' in relation to retail investment products.

This definition should make it clear that a cost-efficient product is a product that is likely to meet the end investment objective, the needs and demands from the client in line with the client's risk profile at as limited a price as possible. The most cost-efficient product is, therefore, not necessarily the cheapest of the universe of products available, it is the cheapest among those offering the features (and guarantees) requested by the client.

1.2 Knowledge and competence of financial advisors

Retail investors seek advice on investment products because they do not have the time nor the resources to investigate these products themselves. Retail investors need to be able to rely on their advisors' knowledge and competence as much as on their impartiality. **BETTER FINANCE, therefore, warmly**

[24] European Commission et al., *Disclosure, inducements, and suitability rules for retail investors study*.

welcomes the proposed amendments regarding the qualifications of investment advisors under MiFID and IDD as a key step towards making financial advisors the truly essential partners of retail investors. **We strongly support the explicit insertion of issues such as financial planning and sustainable investment in the list of required knowledge items, the call for life-long training, as well as the requirement to prove knowledge and competence based on certificates.** An understanding of sustainable investments as well as the introduction of a certification regime and minimum ongoing professional training are important requirements that can ensure sustainability is understood from financial advisors and by extension ensure that the apt information is given to clients, among which are the retail investors.

However, we find that the particulars of the proposed requirements fall short of the ambition to bring the profession of financial advisors up to the challenge.

First, we argue that **15 hours of training per year might in many cases be insufficient** for financial advisors to acquire the knowledge they currently lack. At least in the short term, catching up with the required knowledge list may require advisors to dedicate significantly more time to training. We would therefore suggest that the requirement should be flexible, with more hours required from advisors whose knowledge and competence are significantly lacking. We particularly insist on the **need to significantly increase financial advisors' competence in sustainable investment** and call for a significant amount of training hours to be required in that specific field of knowledge.

Second, the requirement to have knowledge and competence 'proven by certificates' needs to be further specified. Only certificates delivered after the trainee has made the demonstration that they have achieved the learning outcomes should be accepted as valid proof of competence and knowledge.

BETTER FINANCE then sees a need for delegated acts which specify how financial advisors can enhance, in particular their sustainability comprehension. Such delegated acts should develop criteria to define the minimum content and scope as well as the number of hours of training per year that an advisor should follow and criteria for certification from a recognised provider (excluding certificate of attendance for example).

BF PROPOSAL: Mandate the EC to specify in delegated acts the competence requirements for investment advisors.

The supplementary details to be defined in the delegated acts should include:

- A minimum content and scope as well as the minimum number of hours per year to be dedicated to training on sustainable investing, as part of the yearly training requirement;
- Criteria for assessing the existing knowledge of investment advisors and the need for additional training beyond the minimum of 15h per year;
- Specific criteria for 'certificates' to be recognised as proof of competence.

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2. Better 'Value for Money' for retail investors

BETTER FINANCE strongly supports the European Commission's goal to increase the quality of packaged retail and insurance-based investment products: The European market for retail investment products urgently needs better-performing products. The proposals included in the RIS regarding undue costs, product oversight and governance (POG) rules, and the requirement for firms to compare the costs and performance of their products to an external benchmark constitute much-welcome improvements on the current legal framework. When buying retail investment products—from investment firms or insurance companies—retail investors' primary goal is to obtain a good return on those investments. Good returns constitute the primary guarantee that retail investment products can offer against the risk of future poverty. **From retail investors' point of view, capital accumulation and appreciation are the primary purposes of retail investment products. Yet currently the European retail investment market is riddled with products that fail to fulfil this basic purpose.**

2.1 Undue costs

Whatever views one may hold regarding the details of the EC's proposal, **a stronger set of rules is certainly needed to eradicate the most egregious cases of "high-cost, low-performance" products**. We then strongly support efforts to introduce a clearer, explicit definition of undue costs in UCITS and AIFMD, even though we note that the criteria composing this definition will need to be further defined and operationalised to enable enforcement of the prohibition to charge undue costs.

Indeed, all three of the proposed criteria for costs to be considered due leave some room for interpretation, which may hamper uniform implementation of the Directives, and, ultimately, consumer detriment. Thus, does the requirement that costs are 'in line with disclosures' mean that they must have been listed in the KID, the fund's prospectus, or both? Similarly, it remains unclear what criteria should be used to conclude that a cost is 'borne by investors in a way that ensures fair treatment of investors'. Finally, it is unclear how flexible the notion of 'necessary for the [fund] to operate in line with its investment strategy and objective' is.

BF PROPOSAL: Provide guidance for the interpretation of the definition of 'undue costs'.

BETTER FINANCE supports the recent ESMA proposal[25] to clarify the notion of "undue costs in the UCITS and AIFMD directives and asks for it to be extended to IDD.

It also supports the ESMA Proposal to develop draft regulatory technical standards to specify the circumstances in which costs should be considered as undue/not eligible, also taking into account the investment policy of the UCITS and AIF, and asks this Proposal to be extended to EIOPA for IBIPs.

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2.2 Product approval and pricing processes

We similarly welcome the new requirements regarding the product approval process and we strongly support the introduction of a pricing process requirement for fund managers under UCITS and AIFMD, as well as manufacturers and distributors of packaged retail and insurance-based investment products under

[25] https://www.esma.europa.eu/sites/default/files/2023-05/ESMA34-45-1747_Opinion_on_undue_costs_of_UCITS_and_AIFs.pdf, pp. 9-14

MiFID and IDD. A sound product approval process for retail investment products is particularly needed to ensure that products are developed for and distributed to the right target, taking into account all the risks that these consumers will take when buying them, including the risk of misunderstanding (which is unfortunately currently listed only in the IDD version of the process).

Accountability of product manufacturers and distributors for the charges they levy is paramount: If 'building retail investors' trust in capital markets' actually is the objective,[26] then requiring that costs and charges are 'justified and proportionate' indeed is a good place to start. **It is crucial that this 'pricing process' truly accounts for all costs and charges of a product—in particular 'inducements'—and enables scrutiny by supervisory authorities.**

The European Fund and Asset Management Association[27], in a 2021 research paper found that "[m]ost commonly, distribution and advice costs make up between 30% and 50% of the total cost of ownership" for actively managed funds distributed under the inducements-based model. A cost category that represents between a third and a half of the amounts charged to consumers must be scrutinized with the greatest attention. **Quantifying and accounting for these costs precisely will enable product providers, consumers and supervisors alike to assess whether these payments to intermediaries indeed bring 'quality enhancement' to consumers—as the industry maintains—or merely extract money from consumers without any tangible compensation.**

We contend that the documented results of the product approval and pricing processes should be made publicly accessible: Public access to product providers' assessments of their own products and demonstration of the 'justified and proportionate' character of their costs and charges is essential to enable in-depth scrutiny of products offered to consumers, notably by consumer associations.

BF PROPOSAL: Require that product providers and distributors make publicly available the documented results of their product approval and pricing processes.

The current proposal already requires that firms document the result of these processes and be able to provide them to competent authorities upon request. We argue that these documents should also be made accessible on firms' website to anyone seeking this information.

2.3 Value for money: Costs and performance benchmarking

We finally also welcome the push to have product providers assess the proportionality of their costs by comparing them to a market benchmark. Even though much work is still needed to specify the methodology and details of the proposed costs and performance benchmarks to be established by ESMA and EIOPA, this requirement can only help eradicate from the market the most overpriced and underperforming products.

We note that the retained approach requires, for the benchmarking system to be operational, that the Directive be adopted, then delegated acts on the basis of which ESMA and EIOPA will be able to collect data

[26] Action 8 of the CMU 2020 action plan, which the RIS is supposed to accomplish.
[27] European Fund and Asset Management Association, *Perspective on the Cost of UCITS*.

to produce the benchmarks. This, we fear, will delay a much-needed market-wide benchmarking exercise and the phasing-out of those products that offer no 'value for money' to retail investors.

This is why BETTER FINANCE proposes a simpler, more effective and quicker approach with the same objective. BETTER FINANCE research found that already more than 90% of UCITS funds do declare a benchmark in the investment objectives section of their KID. And any of the remainder UCITS do have an implicit benchmark (for example they have a performance fee when overperforming a given benchmark, or they are "active" funds, meaning implicitly at least having an objective to outperform their investment universe, which is the UK FCA's approach in its recent "value assessments"). By default, as the UK FCA, one can expect that any investment product has the objective not to lose money for their investors on a real basis (net of inflation) over their recommended holding period. So, this UCITS requirement to clearly disclose how their manager quantifies the assessment of meeting or not their investment objectives should be extended to all PRIIPs. These benchmarks can then be used by the supervisors to assess value for money.

BF PROPOSAL: require all PRIPPs manufacturers to disclose in their KID how they measure their performance with regard to their investment objective.

This self-designed performance yardstick by PRIIPs managers should be always arm's length and referring to the average performance of their underlying portfolio investment universe;

- typically a capital market index,
- or, at least by default, the inflation over the recommended holding period, for example, for "absolute performance" managers who do not want to disclose a more quantified goal to their clients.

These benchmarks can then be used directly by supervisors to assess the value for money of the PRIIPs. Most UCITs managers are already doing that.

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3. Transparent information on products' costs and performance

Since its creation, BETTER FINANCE has consistently argued that **transparent and understandable information is the foundation on which any sound retail investor protection framework relies**.

Especially in a system where remuneration of advisors implies conflicts of interest (see Section 1), it is paramount to provide prospective and existing clients with information that they can use to assess and compare the products that are recommended to them. **Information that is concise and understandable to the average retail consumer is key to empower retail investors in their relations with financial advisors as well as increase savers' awareness about financial planning.**

3.1 Risk warnings

BETTER FINANCE welcomes the proposal to introduce risk warnings in pre-contractual information about 'particularly risky' products. We argue that information documents should raise retail investors' awareness of the risks involved by the structure of the investment products they buy. Therefore, the proposed risk warnings **should be applied to products that are structured in a way that makes it particularly difficult to the average retail investor to identify what risks they would be exposed to**. While all investments entail a risk, we find that products involving derivatives, hybrid structures or complex mechanisms for the distribution of bonuses should be deemed 'particularly risky'.

BF PROPOSAL: Specify in the Directives a list of product structures and features that should make the use of risk warning automatic.

The MiFID and IDD provisions on the use of risk warnings should include a non-exhaustive list of complex product structures and features that should always be considered as likely to entail a difficult-to-identify risk of financial loss for retail investors and should, consequently, always be accompanied with a risk warning.

Furthermore, we believe that the definitions of 'particularly risky' products in the particular contexts of MiFID- vs. IDD-regulated products should be embedded in legally binding regulatory technical standards rather than guidelines, and take into account the specificities the two categories of products.

BF PROPOSAL: Require that the definition of 'particularly risky' products be enshrined in a legally binding text.

Defining what products are to be considered 'particularly risky' for retail investors should not be left to guidelines. Since this definition constitutes the basis for the use of risk warnings, it should be set in a legally binding document that applies uniformly to all market participants. Regulatory Technical Standards would be appropriate, as they can still be amended in a way that is sufficiently flexible to follow the pace of financial innovation.

3.2 Cost & performance disclosures

BETTER FINANCE also strongly supports the proposed improvements to pre-contractual cost disclosures for packaged retail products sold by MiFID-regulated distributors as well as for insurance-based investment products sold under IDD. **We particularly welcome the proposed requirements to always disclose third-party payments—including 'inducements'—and their cumulative impact on net returns: This information is essential for clients to free themselves of the myth that inducement-based distributors provide 'advice' for free**. As EFAMA, the representative body of the asset management industry, itself acknowledged, the bundling of costs under the inducements-based distribution model *"creates a problem with cost attribution, where it is not clear how much fund management, distribution and advice drive cost levels"*.[28] In other

[28] European Fund and Asset Management Association, *Perspective on the Cost of UCITS*, 1.

words, the inducements-based distribution model hides away the true cost of distribution from consumers. **Clearly disclosing to the consumer how much of the ongoing charges figures will cover the cost of the sales pitch they receive may help dissipate the illusion that there is such a thing as ‘free’ investment advice.**

BETTER FINANCE would like to stress once again that **comparability of information is a key aspect of retail investors’ empowerment** and that the proposed enhanced disclosures constitute a significant step in this direction.

We note some divergences between the rules proposed for MiFID and IDD-regulated products and would like to reiterate that **consistency of the regulatory framework across all retail investment products is paramount**. We note, for instance, that only the proposal for IDD **explicitly requires duration of payments, distribution costs and cost of advice to be disclosed in pre-contractual information**. Similarly, we note that only the IDD version of the proposed annual statement requires the annual performance of products to be **compared with previous years’ past performance**. We consider that this information is essential for all types of retail investment products and call the legislator to require providers of MiFID-regulated products as well to disclose it to prospective clients.

BF PROPOSAL: Explicitly require the MiFID pre-contractual documentation to include information on the duration of payments, distribution costs and cost of advice, and require MiFID annual statement to include a comparison of annual performance to previous years’ performance and against the relevant market benchmark.

This information, included in the IDD version of the requirements, is equally useful for holders of MiFID-regulated products and should be provided. Aligning the requirements across the two legislations would furthermore increase comparability across retail investment products.

Also, the PRIIPs KID for multi-option products (MOPs), especially for unit-linked insurance products, does not currently disclose the full annual cost of the product, as the overall MOP KID discloses only the wrapper cost, and the investor is invited to look for the specific costs of underlying “units” in their specific KIDs. The investor is then implicitly supposed to compute the weighted average overall annual cost of his MOP. This is not acceptable, as investing is not a full-time job and this is extremely difficult to do (when buying a car, the client is provided with the overall price and not only with the prices of the car parts). The MOP investor must be provided annually with the actual annual total cost of his product.

BF PROPOSAL: amend IDD to require that the IBIP Multiple Option Product (MOP) distributor communicates to the MOP investor the total annual cost of his investment product (cost of the wrapper plus the cost of the underlying “units”). Similarly, the distributor should also disclose the most recent full cost evaluation of the considered MOP on a pre-contractual basis to the MOP client/prospect.

This crucial information is indeed not available anywhere and not even in the KID on a pre-contractual basis.

Furthermore, BETTER FINANCE would like to remark once more that retail investor is not a full-time job: **Information must focus on the key items that investors need to assess and compare products and ask the right questions to advisors**. As a consequence, we support the proposed requirement to provide itemised breakdowns of costs *upon request* in pre-contractual information and annual statements, as long as **aggregate figures provided proactively are exhaustive and truly account for all costs**. We strongly support the proposal to have third-party payments always itemised separately, as this information is essential to identify potential conflicts of interest.

Finally, as regards the format and cost of providing pre-contractual information and annual statements, **BETTER FINANCE insists that the right to obtain a paper version, free of charge, of the documentation, and the obligation of product providers to inform the client of that right must be explicitly stated in both MiFID and IDD**.

BF PROPOSAL: Whenever the electronic format is set as the default for the provision of information to retail investors (pre-contractual information, annual statement, KID), ensure the right to obtain a paper version free of charge.

The MiFID and IDD provisions regarding the provision of documents should be harmonised to require that, where the provision in electronic format is the default option, then:

- Consumers can always request a paper version of the document;
- This paper version is provided free of charge upon request;
- Distributors have an obligation to inform the (prospective) client of their right to obtain this paper version free of charge.

Regarding specifically annual statements, we call for caution on the possibility to waive the requirement provide such statements where an 'easily accessible' platform is made available with the same information. The use of such platforms places the onus on the investor to proactively seek information on the functioning of the platform and then to regularly consult their data; the effort that such tasks require from the investor should be as limited as possible.

BF PROPOSAL: Require that, where annual statement information is provided through a platform, product providers send at least annually a reminder to clients to access the information.

- Such reminders should be in electronic format (email) by default, but on paper whenever a client has expressed the wish to receive information on paper, and include:
- A reminder of the importance of monitoring costs and performance of one's portfolio;
- Clear instructions to access the platform;
- A reminder of the possibility for the client to require that information to be sent (classic annual statement).

3.3 Key Information Document

Whilst BETTER FINANCE supports the modernisation of the PRIIPS Key Information Document (KID), **we believe that a more thorough review of the KID content remains necessary to make this document a truly empowering tool for retail investors**. We note that the proposal put forward by the EC does not include any initiative to make the information on cost and performance more understandable, comparable or reliable for consumers. **BETTER FINANCE then reiterates its view that future performance projections are unreliable, based as they are on only five years of past data, undisclosed assumptions and not probability weighted**.[29]

BF PROPOSAL: Reinstate minimum 10 year past performance data compared to the benchmark/ manager's investment objective, and actual most recent costs in the KID.

Past performance data, while not indicative of future performance, is a good indicator of whether the PRIIP has ever made money or not for the investor, and of an asset manager or insurance company's ability to meet its investment objectives, and to generate returns for the client.

Furthermore, it is comparable across product providers and timelines, as it does not rely on assumptions and hypothetical scenarios; the past performance of various products shows how their respective providers weathered a similar set of real-world circumstances.

Finally, displaying past performance in comparison with the product's stated benchmark enables the prospective investor to clearly see whether the provider has been able to make good on their commitment to meet its target.

This being said, we welcome the proposals for the modernisation of the PRIIPS key information document (KID), albeit urge **caution as regards the deletion of comprehension alerts, as well as the criteria for the use of interactive tools**.

It is important that retail investors are sold products that they understand. Whilst acknowledging that the current comprehension alerts might be less than optimal, we maintain that **retail investors who are about to buy a product should be warned about its complexity and the risk of them misunderstanding its features**. We read this proposal from the EC to delete comprehension alerts as inconsistent with the introduction of risk warnings on 'particularly risky' products in MiFID and IDD pre-contractual information.

BF PROPOSAL: Replace the current 'comprehension alerts' with a new warning on the specific financial risks arising from complex product structures and features.

The new warning should be included in the KID of any product for which a 'particularly risky' product warning is included in pre-contractual information (see above, Section 3.1). It should alert the prospective investor, in a clear and concise way, of the presence in the product, of a complex structure or features that makes it difficult to assess the risk of financial losses.

[29] BETTER FINANCE, *Costs and Performance Scenarios in the PRIIPs KID*.

BETTER FINANCE supports allowing the use of interactive tools to present the information of the KID. The potential for interactivity offered by mobile and web applications offers new avenues to convey this essential information to investors, especially young and first-time investors, and raise awareness about key aspects of investment decisions (risk, costs and performance, sustainability, etc.). **This possibility must however be tightly controlled**: the four criteria outlined in the proposal for this use of interactive tools therefore constitute essential guarantees.[30] The regulatory technical standards will need to specify these criteria in a way that truly ensures that interactive tools **convey unaltered information while increasing comparability and understandability**. We also argue that KIDs conveyed through interactive tools should inform the user of their possibility not only to download the classic electronic version of the KID, but also to **request a paper version free of charge**.

BF PROPOSAL: Require that when KID information is displayed through interactive tools, the possibility to download the electronic version or request a paper version free of charges is always displayed prominently.

On the content of the PRIIPS KID, **we support the inclusion of the proposed 'Product at a glance' section**. We stress that this new section should be kept as concise as possible, as an entry point to a 'layered' KID. Following a layered approach, the items of the 'Product at a glance section' should include internal links taking the reader to the corresponding section of the KID for more information.

BETTER FINANCE supports the inclusion of information about the sustainability characteristics of products in the KID. Evidence shows that retail investors seek sustainability-oriented products,[31] but are too often disappointed with the advice they receive on sustainability features,[32] especially in a context where the actual sustainability orientation of investment funds is difficult to ascertain.[33] **For investors to be able to act upon sustainability information they receive, it must be concise but also intelligible and link to more detailed information.** Given the evolving nature of sustainability disclosures, BETTER FINANCE is of the view that as a minimum the PRIIPs KID should be inclusive of summaries of key terms (such as sustainable investment and EU Taxonomy); and inclusive of easy-to-understand icons, as seen with the SFDR pre-disclosure templates. Both of those requirements would ensure investor understanding and reinforce legislative harmonisation. Furthermore, the PRIIPs Regulation should keep the door open to further developments of the EU's regulatory framework on sustainability: while at the moment the environmental part of the EU's ESG framework are the most developed, we hope that future works will equally develop the social and governance parts; the KID should offer manufacturers the possibility to also account for those non-environmental sustainability features of their products.

[30] The PRIIPs proposal requires that interactive tools (a) do not alter the understanding of the KID, (b) that all the KID information be presented, (c) that there be an 'easily accessible' link to download the classic (i.e., static PDF) version of the KID and (d) that the tool allows the user to make simulations of costs over the recommended holding period (proposal for the new Article 14[2] PRIIPs).
[31] 2° Investing Initiative, *A Large Majority of Retail Clients Want to Invest Sustainably. Survey of French and German Retail Investors' Sustainability Objectives*.
[32] DSW, "Anlageberatung zu nachhaltigen Produkten".
[33] Pina et al., *SFDR*.

BF PROPOSAL: Further develop the 'sustainability section' of the KID, including summaries of key terms and easy-to-understand icons.

Very few – if any – retail investors will read the SFDR-required sustainability section in the Prospectus of the PRIIP. The key sustainability information should also be disclosed in the "Key information Document". This new KID section should build upon the work already done for the SFDR pre-disclosure templates. Terms such as 'sustainable investment' or 'EU Taxonomy' should be defined concisely, with appropriate links towards further information.

Re-using the SFDR pre-disclosure templates would ensure investor understanding and reinforce legislative harmonisation.

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4. Financial education: Welcome, essential, but insufficient

BETTER FINANCE warmly welcomes the EC's call for more financial education initiatives and Member States' apparent willingness to act on that front, as financial education is currently critically missing in many EU Member States. We need to **differentiate financial education for children of school age from financial education for adults**: the channels used for and effects to be expected from each are very different.

Although it is welcome and necessary, we stress that **financial education for children will not solve the core issue of biased advice** on retail investment products, for two main reasons.

1. Even in the unlikely event that the place of financial education in school curricula would be dramatically increased in the short-term, **the effects of this policy would only be felt when children currently of school age will reach the age where young adults start saving and investing**. Whatever the effects of financial education offered in this way could be, they will not be observable before at least a couple of decades. **We cannot wait that long to fix the dysfunctional market for retail investments.**
2. **No amount of financial education will ever make a retail investor sufficiently equipped to compensate for biased, poor-quality advice**. Being equipped with a solid basis in financial education empowers consumers by enabling them to understand the key concepts and the general functioning of capital markets. However, being able to assess potentially complex products, their suitability to one's specific situation and compare the large number of products available on the market usually requires amounts of time that are not available to the average retail investor, however financially literate they are. As rightly pointed out by behavioural economists like Paul Adams at the 2021 EIOPA workshop on disclosures "Financial products (especially insurance and pensions) are inherently complex and intangible, involve trade-offs between the present and the future, involve risk and uncertainty, allow limited opportunity to learn from past mistakes, can be sensitive and emotional for some people (…). Financial services are complex. And we're just not wired to understand them (even with complete information)".

Financial education for adults can be obtained mainly from two places: at the retail point of sale and through Employee Share Ownership plans.

At the retail point of sale, consumers are educated by their 'advisors'.

- As already mentioned, the role of the advisor is to provide the client with their competence and knowledge in order for the client to choose the product most suitable to their objectives and needs.
- That process entails passing knowledge about investing and investment products to the client, using pre-contractual documentation and the KID as educational material. It is the most common of situations that a first-time investor would walk into the office of an advisor, explain that they have little knowledge of the whole thing and ask for a general introduction.
- **It is crucial that this education channel provide clients with unbiased and high-quality information**, hence our insistence on calling for the eradication of conflicts of interest and enhancing the professional capacity of advisors.

Employee Share Ownership Plans (ESOP) also provide a way for adults to get acquainted with equity investing, through the workplace, in an unbiased way, but are currently much underdeveloped.

- ESOP have a proven and direct link to increased financial literacy and knowledge in equities and capital markets, as employee shareholder can draw lessons from holding shared of their employing company to assess performance, sustainability and governance of other companies they might invest in;[34]
- ESOP leads to an increased long-term engagement of employee shareholders with the companies they are invested in, which benefits the development of European companies, especially SMEs.
- The European Federation of Employee Share Ownership (EFES)has put forward in 2020, at the height of the Corona-crisis, a proposal for a generic European ESO model.[35] The proposed model would help develop ESOP in Europe, offering a new investment opportunity for retail investors, a new funding channel for SMEs and a very potent way of raising awareness about financial investing.

BF PROPOSAL: Create a generic European ESOP model to boost the development of employee share ownership.

Based on the EFES proposal for a generic European ESOP model, the EU legislator should promote ESOP. Such a promotion would contribute to solving the issue of low financial literacy, direct funding towards European firms—especially SMEs—which is one of the core goals of the CMU and offer employee investors with a meaningful investment opportunity.

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5. 'SOPHISTICATED' RETAIL INVESTORS

BETTER FINANCE has consistently argued that retail investors should have access to a large array of financial products, provided a sufficient retail investor protection framework be in place. We then welcome the EC's intention to reduce the administrative burden for 'sophisticated' retail investors to access products normally reserved to professional investors.

[34] Ellerman and Gonza, "Coronavirus Crisis".
[35] European Federation of Employee Share Ownership, *A Generic ESOP Employee Share Plan for Europe*.

We nonetheless call for caution regarding the proposed relaxation of the MiFID criteria for retail investors to opt for a 'professional' status. We fear that the proposed new criteria make it too easy for retail investors without sufficient experience and knowledge of financial markets to shed the protection offered to retail investors in search for higher yield in complex and risky products.

As a starting point, we would contend that the classification of clients need not be binary: a new, intermediate category of 'qualified', 'sophisticated' or 'semi-professional' retail investors should be created for retail investors who can show proof of their experience with financial transactions and products and wish to access a wider array of products. Clients in this category should have access to some, though not all, products normally reserved to professionals, but would still benefit from most of the protections offered to retail investors. This is a proposal that we have already developed in 2020 in the context of the review of the MiFID II/MiFIR framework.[36]

BF PROPOSAL: Create an intermediate category of clients for 'qualified' non-professional investors.

A retail investor wishing to opt for the status of qualified investor would have to meet the criteria and formulate an explicit request in that sense to their investment service provider. The investment service provider should then check whether the client fulfils the relevant admission criteria.

The financial intermediary shall inform the client of both the advantages and disadvantages of the status compared to the regular 'retail investor' status, and the choice of the 'qualified investor' status should be revocable by the client without further conditions.

The protection offered by these investors should not be lower but as high as those enjoyed by 'retail' investors. The differences would be:

- Information provision should be adapted to the superior level of knowledge and experience of these investors.
- Qualified investors should have access to certain investment products or markets normally not accessible to retail investors, in particular listed shares or bonds and non-EU sometimes more competitive mutual funds.

Regarding specifically the criteria proposed for allowing a retail investor to opt for a 'professional' status, we have some reservations.

First, we would argue that the size of an investor's portfolio does not constitute a decisive proof of their capacity to handle complex products and transactions but merely indication of their capacity to bear financial losses. We therefore do not object to lowering the 'wealth criterion' to € 250 000. However, since wealth does not necessarily imply ability, we would suggest that this criterion should have a lower status than the other criteria, on experience and education.

Regarding the proposal for a new 'education criterion', i.e., that '*the client can provide the firm with proof of a recognised education or training which evidences his/her understanding of the relevant transactions or*

[36] BETTER FINANCE, *BETTER FINANCE Response to the European Commission Public Consultation on the Review of the MiFID II/MiFIR Regulatory Framework*.

services envisaged and his/her ability to evaluate adequately the risks', we are concerned that the proposal does not include any conditions regarding said 'recognised education or training'. **We believe that, in order to avoid consumers to be mis-led into opting for a professional status, the MiFID requirement should require the training programme to:**

- **be independent from any kind of financial services provider.**
- **cover a minimum list of knowledge items** considered necessary for an investor to understand at least the fundamentals of capital markets, investment and financial planning.

Without these two requirements, it would be much too easy to fulfil the condition without having gained any actual knowledge.

BF PROPOSAL: Specify criteria to be met by any 'education or training' programme to be considered as a valid proof of understanding of the transactions/services and ability to evaluate adequately the risks.

As a minimum, it should be required that:

1. the education or training be proven;
2. the proof be issued by an educational/training institution independent from any kind of financial services provider;
3. the programme covers at least fundamentals of capital markets and investments, and the proof be delivered only upon testing the achievement of learning outcomes. This should be automatically assumed for proofs of achieving university/higher education degrees for example.

ABOUT BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non- governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

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