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COMMISSION STAFF WORKING DOCUMENT

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

{COM(2023) 278-279 final} - {SEC(2023) 330 final}

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1. INTRODUCTION: POLITICAL AND LEGAL CONTEXT

1.1 General context

This impact assessment concerns the package of measures that will constitute the Retail investment strategy, which is an initiative originating from the 2020 CMU Action Plan. The strategy seeks to place the retail investor centre stage, ensuring the development of a regulatory framework that empowers consumers to take informed financial decisions and adequately protects them in the single market. The assessed package of measures concerns improvements to the retail investor protection framework. Strong safeguards for retail investors are a pre-requisite for a well-functioning, transparent market that establishes the necessary conditions for trust and confidence.

With respect to the general economic context against which the measures in the strategy are considered, the EU market for retail investments remains, by international standards, characterised by low levels of retail investor participation. In 2021, approximately 17% of EU27 household assets were held in financial securities (listed shares, bonds, mutual funds and financial derivatives), amounting to EUR 5 610 billion, corresponding to 38.6% of GDP). In comparison, households in the US held around 43% of their assets in securities[1]. The retail investor base in the EU amounts to an estimated 50 million households, i.e. about a quarter of all EU-27 households[2]. According to a recent Eurobarometer survey[3], around half of the respondents did not consider that they had sufficient means to invest, while around another quarter gave other reasons for not investing (see below). Households in the EU-27 receive around EUR 450 billion per annum in income from their financial wealth[4], while paying between an estimated EUR 100 and 300 billion per annum to financial service providers.[5] This range represents the revenues of financial service providers from retail business.

A large share of households' financial wealth is held as bank deposits at negligible nominal yields, even though assets invested in stock markets have made substantial gains in recent years. That suggests that a large proportion of consumers may have missed out on the opportunity to benefit from capital market investment returns.

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[1] Based on Eurostat's sectoral national accounts (international data cooperation, NAID_10). If claims against insurers and pension entitlements were added, the numbers would change to 46% for the EU and 72% for the US. In consequence, the share of bonds, stocks and investment funds held by EU-27 households is much smaller than that of their US counterparts, i.e. 2.3%, 13.2% and 25.7% of all domestic economic sectors' holdings respectively in the EU versus 6.5%, 47.8% and 59.5% of the bonds, stocks and investment funds in the US.

[2] This is derived from the following sources: 26% of the respondents to the 2022 Eurobarometer claimed to have or have had an investment product (bonds, stocks, or funds), 22% said to have or have had a private pension or retirement product. 28% of the respondents to the retail investment study replied to have already invested in financial products. 26% of the respondents to this survey indicated they had a securities account. The 2017 ESCB's households' and consumer finance survey revealed that 3.2% of the households had bonds, 8.6% publicly traded shares,10.2% mutual funds and 28.4% voluntary pensions or life insurance products.

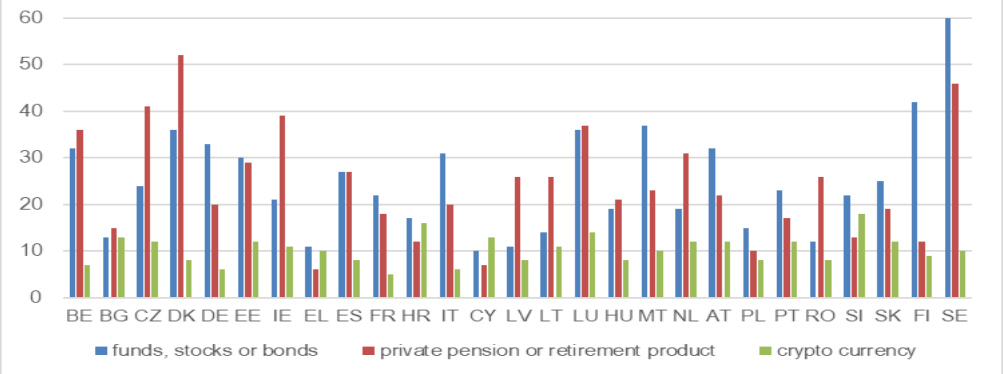
[3] Eurobarometer survey on Retail Financial Services and Products, October 2022.

[4] Eurostat, Non-financial accounts, 2021. This number includes positions that are not considered subject of retail investment such as interest on bank deposits, dividends from non-listed shares and technical reserves of non-life insurance.

[5] The lower bound was derived from an estimated need for 400,000 to 500,000 financial advisors. If these receive the average pay in the financial sector of 59,000 EUR, the wage bill including, social security contributions, would be EUR 23 to 29 billion. If, furthermore, it is assumed that the share of output to compensation is the same for financial advisors, which implies the same ratio other costs and profits for financial advice as in the total financial sector, retail investors would need to pay around EUR 100 billion for financial advice. The upper range stems from the amount derived in input-output tables for the output of the financial sector for the purpose of households' private consumption. This upper number includes receipts and payment for financial services that are not related to retail investment, i.e. for bank deposits and loans, payment services, risk life and non-life insurance.

Retail participation varies widely across Member States, reflecting different historical, economic and social conditions. It is even more heterogeneous within Member States: participation rates increase with the education level, degree of financial literacy and income. Older segments of the population hold larger savings, whereas younger generations tend to be less risk averse when it comes to investing.

INVESTMENT EXPERIENCES ACROSS EU MEMBER STATES, % OF SURVEY RESPONDENTS HOLDING SPECIFIC FINANCIAL PRODUCTS

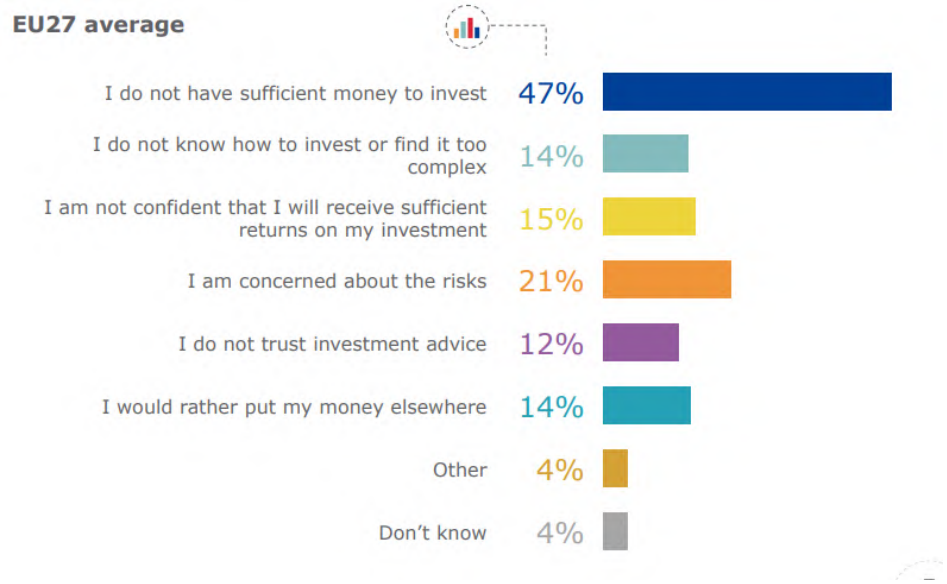


Source: Eurobarometer 509, 'Retail financial services and products' 2022

The reasons that retail investors are not investing may be manifold. In many cases, they may not be able to save and invest due to a lack of financial means. Other reasons may reflect more risk averse cultural preferences. In October 2022, the European Commission published the results of a Eurobarometer survey looking at retail financial services and products[6], which indicated that 26% of respondents have, or have had, an investment product, although around half of respondents considered that they did not have the means to invest. Other reasons for not investing reflect concerns about the risks, uncertainty about the potential returns, lack of understanding/complexity, preference to put money elsewhere and lack of trust in advisors (see Eurobarometer chart).

REASONS WHY PEOPLE DO NOT INVEST

[6] Eurobarometer survey on Retail Financial Services and Products, October 2022



Source: Eurobarometer 509, 'Retail financial services and products' 2022

The Eurobarometer survey indeed reflects a number of problems for retail investors. Retail investors perceive investment products to be generally complex. Yet, although financial literacy levels vary considerably across Member States, too many consumers have poor understanding of the investment environment. The OECD/INFE 2020 International Survey of Adult Financial Literacy has shown that on average, consumers could only reply to around 60% of questions on basic knowledge concepts and financially prudent behaviours and attitudes. Only 26% of all adults responded correctly to questions on both simple and compound interest – which are crucial concepts for investment[7]. Evidence also suggests that a significant proportion of consumers is dependent on advice[8]: that is likely to be especially the case for retail investing.

Trust levels in investment services are also very low. Consumers regularly rank investment services among the worst performing services, including on comparability and trust[9]. Lack of trust in financial advice was also mentioned in the Eurobarometer as one reason for not investing.

Finally, if they do invest, retail investors may not always get the best deal: products and services offered to retail investors often carry high fees and commissions which have a negative impact on their return on investments. For example, in 2021, retail clients were charged on average around 40% more than institutional investors across asset classes[10]. Retail investors are heavily dependent on advised services, and retail investment products[11] in the EU are largely distributed through a commissions-based model where distributors receive fees and commissions from product manufacturers for the products they recommend and sell to retail investors. The existing rules do not sufficiently mitigate the conflicts of interest which are inherent in this distribution model, and which lead to the distribution of more expensive products and deliver suboptimal outcomes for retail investors.

[7] See: OECD/INFE 2020 International Survey of Adult Financial Literacy

[8] According to Eurobarometer, 45% of Eurobarometer respondents make decisions about personal finances based on recommendations of bank staff or other financial advisors.

[9] See the consumer scoreboard under Consumer Markets Scoreboard - Making markets work for consumer - 2018 Edition (europa.eu)

[10] ESMA, Performance and Costs of EU Retail Investment Products, 2022, page 6.

[11] See page 26 of the 2018 Report on the Distribution systems of retail investment products across the European Union.

The risk of suboptimal outcomes for retail investors is exacerbated by the current economic climate and the significant shift from a low interest rate environment towards high inflation and rising interest rates. The increasing cost of living and erosion of savings means that it is even more important that returns on retail investments are not eroded by high fees and that the legal framework is effective in facilitating an efficient market that offers better investment outcomes. Against the backdrop of an ageing EU population and longer life expectancy, long-term investments in capital markets could help people achieve higher sustainable returns and a complementary income for their retirement, while at the same time providing long-term orientated capital to the economy.

Furthermore, retail investments are affected by new trends. As is true in many other areas, **digitalisation** has a profound impact on retail investments. Digitalisation offers, for example, easy access to a wide range of services, products at lower cost, low-cost automated sales (sometimes with additional investment support), robo-advice and digital information ensuring transparency and facilitating the comparability of products. That is also the case, for instance, for tools to enhance financial literacy. Many retail investors, especially from younger generations, are increasingly turning to online investment opportunities. However, digitalisation may also create risks, such as facilitating investment fraud or misleading marketing practices from influencers using social media and other online channels. The existing rules on investment services were conceived for the more traditional (face-to-face) distribution channels. They may need to be adapted to better target the needs of retail investors and to accompany them in their investment journey.

There is also an increasing focus on **sustainable investing** by retail investors, who want their investments to also contribute to tackling the climate and biodiversity crises. This needs to be duly reflected in the legal framework, in particular with respect to disclosures and the professional certification of advisors.

It is also important to stress that there are limits to what legislative changes to the retail investor protection framework can seek to achieve. For example, different rules across Member States in the area of taxation (e.g. with respect to withholding tax) add to the challenges retail investors face when considering purchasing products outside their home Member State. Although these are significant issues, taxation affecting retail investing is outside the scope of this strategy and thus not addressed in this impact assessment[12]. Another important issue that is not addressed in this strategy relates to consumer redress, in case retail investors enter into a dispute with their provider. The issue of improving redress procedures will be subject to a separate initiative planned for 2023[13].

While strengthening protections might increase the overall level of trust and confidence for retail investors, these changes alone may not lead to more people investing. However, by creating the conditions for a healthy investment environment that ensures a high-level of trust and integrity as well as better investment outcomes, it is likely that they would indirectly increase the currently observed low participation rates.

1.2 Political context

In line with the Commission's stated objective of "an economy that works for people", and as announced in the 2023 work programme[14], the Commission is seeking to ensure that the legal framework for retail investments sufficiently empowers consumers, helps them ensure improved and

[12] Such issues are dealt addressed in other initiatives, as described in the European Commission's Action plan for fair and simple taxation supporting the recovery strategy, COM(2020) 312 final.
[13] The upcoming review of the ADR Directive in 2023 will aim to ensure that consumers and traders have fair, cost-effective and user-friendly tools to solve their disputes and obtain redress where their rights are infringed.
[14] See Commission work programme 2023 COM(2022) 548 final.

fairer market outcomes and ultimately creates the necessary conditions to grow retail investor participation in the capital markets.

In its September 2020 New Capital Markets Union Action Plan, the European Commission announced its intention to come forward with a strategy for retail investments in Europe that seeks to ensure that retail investors can take full advantage of capital markets and that rules are coherent across legal instruments.

1.3 Legal context

The EU already has in place a legislative framework at EU level governing retail investor protection, which has been developed over several decades. The level of consumer protection has significantly strengthened over the years, in particular following the 2008 financial crisis.

The current legislative framework covers, with varying levels of harmonization, most aspects of the retail investor's journey, ranging from the marketing of financial products and pre-contractual disclosure of information to financial advice. It consists of different EU-level legal instruments that aim to harmonise EU rules and create an integrated financial market on a sector-by-sector basis under which investors are effectively protected, efficiency is promoted, and the integrity of the overall market is safeguarded. The rules are spread across a number of different EU legal instruments described in the following table. They provide a legal framework which is developed in more detail at levels 2 and 3 and which together form the basis of the acquis on retail investor protection.

Table 1: the EU legal framework governing retail investor protection

Legislation	Description
MiFID II[15]	Sectoral legislation setting the rules for the single market for investment services and activities aiming to ensure a high degree of harmonised protection for investors in financial instruments.
IDD [16]	Sectoral legislation that sets out the rules on how insurance products are designed and distributed in the EU and aims to harmonise regulation of the insurance market and to improve consumer protection standards.
PRIIPs [17]	Cross-sectoral legislation that sets out the obligations for those who produce or distribute packaged retail and insurance-based investment products to provide investors with key information documents (PRIIPs key information documents / PRIIPs KIDs). The regulation sets out rules on the contents of the KIDs and their presentation, as well as how PRIIPs KIDs should be provided to retail investors.
UCITS [18]	Sectoral legislation setting the rules for the creation, management and marketing of collective investment schemes.
AIFMD[19]	Sectoral legislation setting the rules for the management and marketing of alternative investment funds (AIFs).
Solvency II[20]	Solvency II is the prudential regime for insurance and reinsurance undertakings in the EU aiming at promoting transparency, comparability and competitiveness in the insurance sector.

[15] Directive (EU) 2014/65 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments.
[16] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution.
[17] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products.
[18] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).
[19] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

PEPP[21]	Sectoral legislation setting out the rules on the pan-European Personal Pension Product (PEPP) which is a voluntary personal pension scheme that offers EU citizens a new option to save for retirement.

However, while this approach ensures that investor protection rules are adapted to the specific needs of the relevant sector, it also results in a patchwork of rules viewed from the perspective of a retail investor.

To address the problems on the retail investments market, further efforts are required at EU level to modernise and update the investor protection rules and establish coherent and consistent regulatory requirements across the Union.

This impact assessment also considers the interplay with other ongoing initiatives in the area of financial services. For example, the Open finance framework will aim to facilitate the access and re-use of customer data, with consent, across a range of financial services and enable data sharing and third party access for a wide range of financial sectors and products, in line with data protection and consumer protection rules. The Open finance initiative runs in parallel with the Retail investment strategy and coordination of the two will take place especially with regards to standardisation and/or portability of customer data.

2. PROBLEM DEFINITION

2.1 What is/are the problems?

Financial markets are complex, which makes it difficult for many retail investors to understand the investment products and services on offer, including their costs, risks, and benefits. This complexity has different impacts on the behaviour of retail investors: some refrain from investing and keep their money in bank deposits, whereas others may seek to attain higher levels of knowledge before they feel able to make informed choices. The search for information and learning entails costs, which deter investment. Since retail investors will wish to avoid frustrating investment experiences and the risk of taking wrong decisions, their investment decisions are preceded by their assessment of trust in their own decision-making capacity and the quality of information and advice available to them. Information and financial advice have the character of 'credence goods' since complex information hinders investors' ability to judge their quality or that of related financial advice[22]. Complexity makes retail investors vulnerable to cognitive biases and the use of non-rational factors that may not best suit their needs. They struggle to understand critical aspects, such as how financial incentives paid by product manufacturers to distributors can bias the advice that they receive.

The relationship between financial service providers and retail investors is characterised by a fundamental information asymmetry, which intensifies such consequences. Apart from providing technical services in the administration of households' financial wealth holdings, financial intermediaries' main added value is in helping investors overcome the information gap. Financial

[20] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

[21] Regulation 2019/1238 of the European Parliament and of the Council of 20 June 2019 on a pan-European Personal Pension Product (PEPP)

[22] "Credence goods" are characterised by the consumers' inability to judge the quality of the good after purchase. For such goods, market incentives are distorted, resulting in the provision of goods that do not fit the needs of consumers and/or charged at a too high price. Market mechanisms can overcome these vulnerabilities only under specific conditions that reveal quality and value to customers, See Balafoutas, L. and R. Kerschbamer, 'Credence goods in the literature: What the past fifteen years have taught us about fraud, incentives and the role of institutions', *Journal of Behavioural and Experimental Finance*, Vol. 39 (20220), pp.1-16.

intermediaries' revenues can be understood as the remuneration retail investors pay to receive information and advice.[23] However, investors' search costs imply market power for financial service providers in the form of their ability to charge higher prices than if they were operating in a competitive environment.[24] While some investors follow the recommendations of advisors blindly, others refrain from asking for advice.[25]The broad-ranging EU regulatory framework focuses on protecting retail investors and aims to address the risks that stem from information asymmetry. It covers disclosure requirements, product oversight and governance rules as well as rules addressing conflicts of interest and governing the "point of sale" of investment products and services. Setting standards on the information given to retail investors reduces their learning costs, while regulating the services of financial intermediaries contributes to enhancing retail investors' trust.

Despite the existence of those safeguards, the evidence (the evaluation of the framework in Annex 11, the results of the public consultation, the retail investment study and advice from the ESAs) points to a failure of the legislation to reach its intended outcome. As a result, retail investors are often not purchasing products that are in their best interest.

There are two key problems that persist in the area of retail investor protection:

1. **Retail investors lack salient, comparable and easily understandable investment product information, while being inappropriately influenced by marketing communications.**

Salient, comparable and easily understandable information about investment products is important to help retail investors make well-informed decisions. That purpose is however is hindered by several factors that limit the ability of investors to use and understand the information they need – some related to deficiencies in the retail disclosure framework, others related to insufficient levels of financial literacy. As evidenced in the Evaluation (Annex 11), while the retail disclosures framework has increased investor protection, the information documents provided to retail investors are rarely engaging and their layout is frequently very dense and not reader friendly. Insufficient levels of financial literacy make it harder for investors to find and assess available information and reflect it in their investment decisions. While financial service providers are legally required to provide different types of information to retail investors on financial products or services, the rules do not appear to be fully achieving their intended objective of increasing understandability and improving investment decisions. It is not possible to quantify the size of this problem, but evidence points to such deficiencies as being one of the pieces of the puzzle that together affect retail investors' trust and willingness to invest.

The behavioural testing and mystery shopping exercise in the Retail investment study showed that the current disclosure rules are not sufficiently helping consumers overcome the underlying complexity of retail investment products. As a consequence, there is further potential for disclosures to better help retail investors make their decisions. Furthermore, a recent IOSCO study demonstrated that retail investors are increasingly exposed to the influence of social media and online marketing[26]. The current framework has not been sufficiently adapted to the increasing use of digital channels for retail investing. In addition, the current framework does not reflect the growing need of inclusion of sustainability preferences of retail investors.

[23] See Inderst, R. and M. Ottaviani, 'Financial Advice', *Journal of Economic Literature*, Vol. 50:2 (2012), pp. 494-521.
[24] See Campbell, J.Y et al., Consumer Financial Protection', *Journal of Economic Perspectives*, Vol. 25 (2011), No. 5, pp.91-114.
[25] See Annex 10 on financial advice
[26] IOSCO report on retail distribution and digitalisation https://www.iosco.org/library/pubdocs/pdf/IOSCOPD715.pdf

2. **Shortcomings in the investment product manufacturing and distribution process related to the payment of inducements and the extent to which product design reflects cost-efficiency and value for the retail investor.**

Evidence suggests that some products offered and recommended to retail investors do not deliver satisfactory investment results and do not best serve their interests, nor correspond to their investment objectives, needs and preferences. Both EIOPA[27] and ESMA[28] have found that certain products offered to retail investors (e.g. certain structured investment products or insurance-based investment products) have in recent years offered very low if not negative returns, especially after deduction of fees[29].

Particularly costly are products that include the payment of inducements for financial intermediaries in the distribution process. Despite the existing safeguards to mitigate the resulting conflicts of interest, investors are still advised products that do not offer them the best value nor help them to achieve their long-term investment goals. The European Court of Auditors (ECA) concluded in its special report on investment funds[30] that investors were not sufficiently protected against, among other things, biased advice from financial intermediaries incentivised by inducements.

Jointly, these problems have the following consequences:

1. Investors may not be duly protected or treated fairly;
2. Some investors do not achieve good outcomes on their investment due to poor quality products, making it harder to accumulate capital to finance their retirement needs or other life goals;
3. As retail investors achieve suboptimal results and do not understand why their financial products did not yield a satisfying performance, their confidence in capital markets may be undermined and their willingness to invest in the first place discouraged;
4. The resulting lower retail investor engagement may constrain efforts to achieve a more efficient, developed and integrated capital market within the EU.

Consumer organisations have long expressed concerns about consumer protection standards (one organisation set up a website displaying cases of financial detriment[31]), however actual data covering cases of consumer detriment in financial services remains underdeveloped. While questions about consumer detriment are frequently asked in surveys, the wording of the questions differs, comparisons over time are generally not available and country rankings are dissimilar across surveys. Although the interpretation of such diverse survey data is difficult, the results suggest that distrust in retail investment markets is present everywhere and that a non-negligible share of investors have experienced frustrating experiences. In both the OECD/INFE 2020 survey and the 2022 Eurobarometer on retail financial services, the share was 3.7% as an average of participating EU Member States. In a study[32] for the Commission in 2018, more than half of the surveyed consumer protection bodies reported having received frequent complaints about unsuitable products and inappropriate advice. National competent authorities receive a considerable number of complaints

[27] EIOPA Cost and past performance report 2022

[28] ESMA Performance and Costs of EU Retail Investment Products 2022

[29] See page 38 EIOPA's 2022 cost and performance report or page 37 of ESMA's Performance and Costs of EU Retail Investment Products 2022.

[30] European Court of Auditors, Special report: Investment funds, EU actions have not yet created a true single market benefiting investors, 2022, Special Report 04/2022: Single Market for investment funds (europa.eu)

[31] https://www.thepriceofbadadvice.eu/ by BEUC. The website was created in 2018, but lists scandals prior to that year, recognising that mis-selling is often detected with a considerable delay.

[32] Deloitte (2018), Distribution systems of retail investment products across the European Union, page 106. 8 consumer protection agencies and 15 alternative dispute resolution agencies participated in the survey.

about poor investment advice and mis-selling, which further illustrates the presence of consumer detriment on retail investment markets[33].

Table: Surveys on retail investors detriment – difference to average of available EU Member States measured in standard deviations, a positive number indicates that consumers have less trust than the EU average.

	CMM 2017		OECD 2020	EB 2022	RIS 2022
	Trust in providers to respect the rules and regulations protecting consumers (inverted scale)	Extent of detriment suffered as a result of problems experienced with investment products or supplier	Accepted advice to invest in a financial product later found to be a scam, such as a Ponzi scheme?	Have you ever considered your basic rights were breached when taking out an investment product?	Disagree with "I trust financial advisors act in the best interest of their clients"
BE	0.2	-0.5	N/A	-0.9	N/A
BG	1.8	0.2	0.4	-0.4	N/A
CZ	0.2	0.7	N/A	-0.9	N/A
DK	-0.5	-1.4	N/A	-1.6	N/A
DE	-1.1	0.2	0.9	0.2	1.7
EE	0.1	0.2	-0.5	-1.2	N/A
IE	0.5	-1.0	N/A	-0.9	N/A
EL	-1.2	2.7	N/A	0.6	-0.8
ES	1.7	0.8	N/A	0.2	-1.0
FR	-1.3	0.1	N/A	-0.6	0.2
HR	1.3	0.0	-1.0	-0.1	N/A
IT	0.5	0.0	0.6	1.3	-0.2
CY	-1.0	-1.6	N/A	0.7	N/A
LV	-0.5	-0.8	N/A	0.1	N/A
LT	0.6	-1.5	N/A	-0.8	N/A
LU	-1.2	-0.4	N/A	-2.1	N/A
HU	-2.1	1.1	-0.8	-0.5	N/A
MT	-1.2	1.9	N/A	2.2	N/A
NL	0.9	0.6	N/A	-0.6	-0.8
AT	-1.2	-0.5	-0.3	-0.7	N/A
PL	1.3	1.0	0.0	1.0	-0.2
PT	0.9	0.8	-1.4	0.8	N/A
RO	0.1	0.1	2.1	-0.6	-1.0
SI	0.2	-0.1	N/A	-0.6	N/A
SK	0.3	-0.4	N/A	-0.6	N/A
FI	0.2	-0.5	N/A	0.0	0.0
SE	1.7	-1.4	N/A	-2.5	1.9

CMM European Commission's consumer market monitor, OECD (2020) is the OECD/INFE 2020 International Survey of Adult Financial Literacy. EB is the Eurobarometer Flash No 509/2022, RIS the Retail investment study. Numbers were obtained by deducting the country observation from the sample's average and divide this difference by the sample's standard deviation.

2.2 What are the problem drivers?

Problem 1 – Informational deficiencies

Problem driver 1: information provided to investors is not always useful or relevant for their decision-making process

Current EU legislation imposes obligations on firms and their intermediaries to provide ex ante and ex post information about retail investments to their customers. Disclosure requirements are intended to alleviate the information asymmetry between financial service providers and retail clients by

[33] see ESMA, 'Monitoring retail markets via complaints data' Trends, Risks and Vulnerabilities, 1/2017 pp. 37-43.

ensuring that retail investors receive clear and comparable information, which would ultimately help them to make an informed choice. However, the relevance of disclosures is inherently limited by the fact that not all consumers are able or willing to read and understand this information.

Specific disclosure requirements are laid down across different legal instruments including sectoral, product and horizontal consumer protection legislation (e.g. PRIIPs, UCITS, MiFID, IDD, Solvency II, DMFSD, the Prospectus Regulation, etc.).

The evaluation of the legal framework, supported by evidence from the Retail investment study, concluded that while EU disclosure rules have generally led to improved (notably in terms of completeness and clarity of information) and more comparable documents for retail investors, the existing requirements do not always help them make informed investment decisions. The following reasons have been identified (see Annex 4 for a more detailed analysis):

a) The information provided is complex and not sufficiently engaging for retail investors.

Retail investors currently receive abundant information about different (key) aspects of investment products and services. While this may be useful for financially literate consumers and relevant from the point of view of consumer protection (for instance in the case of mis-selling and litigation), or may serve supervisory objectives[34], in other cases such comprehensive disclosures may be of limited usefulness in supporting retail investors in their decisions, as they are too complex to be read and understood by many. EIOPA concluded in its advice that "…*despite existing obligations for disclosures to be fair, clear and not misleading, the use of jargon or unnecessarily complex terminology is still prevalent, and information is not necessarily presented in a clear or engaging way to consumers*"[35]. Respondents to the public consultation indicated that disclosure documents for retail investors were overly elaborate (even for simple products), complex and too technical, potentially leading to information overload[36].

The Retail investment study also underlined that disclosure documents "*are rarely engaging and that their layout is frequently very dense*"[37] and that in practice consumers often did not read them. In particular, the study concluded that costs disclosure rules and practices were complex and sometimes inconsistent, making use and comparison of this information challenging for retail investors. For example, retail investors faced multiple cost items in the vast majority of product information documents that were reviewed. The behavioural experiment in the Retail Investment study showed that even when using simplified information documents, a significant proportion of consumers was not able to choose the most financially advantageous product for them in terms of costs[38].

b) Disclosures to investors are not adapted for the digital environment.

The EU legal framework (see Table 1) provides for comprehensive requirements on the type of information and the way that information should be provided to retail investors. Increased digitalization and the development of new technologies and tools are transforming how financial services are provided. Financial service providers are changing the way they interact with their (potential) clients, and these new trends enable them to adopt new approaches[39]. However, the existing disclosure requirements do not fully cater for these new trends and evolving user needs and

[34] See EIOPA advice on retail investor protection, page 35 para 50.
[35] See EIOPA advice on retail investor protection, page 36, para 54.
[36] 44% of respondents, including one consumer organisation, companies/business organisations and business associations representing banking, insurance and investment management as well as NGOs ranked disclosure as the area with the biggest room for improvement, following financial literacy (63%) and preceding digital innovation (39%).
[37] See Retail investment study, page 163.
[38] See Retail investment study page 164.
[39] ESMA advice on retail investor protection, page 23.

expectations (notably from younger generations of investors). The PRIIPs framework also does not provide for a sufficient level of flexibility to allow for the presentation of information from the key information documents to retail investors in a layered way[40], which can be considered a regulatory gap. The size of these problems cannot be measured, but they pose inconvenience to users and reduce willingness to read key information documents[41].

In the evidence presented by the Joint ESA advice on digital finance, respondents to the surveys and interviews expressed concerns that the EU disclosure framework was potentially outdated, which could hinder the ability of consumers to make informed decisions about products and services[42]. The ESAs concluded that digitalization trends are not adequately captured and although the current framework is "*supposed to be technology-neutral, it was mainly designed without considering digital distribution, and certainly before the "app-revolution*"[43]. Likewise, the Retail investment study suggested putting greater emphasis on the digital environment[44].

c) Insufficient ex post information on costs and performance.

While many regulatory disclosures focus on the pre-contractual stage, the periodic ex post disclosures to retail investors, focusing on the costs and performance of the products in their portfolio, are more limited. As identified in the EIOPA advice on retail investor protection, in the area of IDD, some Member States have developed national practices beyond the outdated rules in Solvency II, but there is currently no common standard for ex post periodic disclosure in EU legislation which would improve the comparability of different IBIPs and help inform investors of the costs and performance of their portfolio. In addition, both the MiFID and IDD rules[45] require investment firms and insurance distributors to provide investors with annual information on costs and charges related to financial instrument(s), investment and ancillary services and IBIPs. However, as regards investment services, this requirement only applies to situations where there is an ongoing relationship between the client and the investment firm and does not cover in the same report the performance of the portfolio of the investor, taking into account the performance of the financial products and the costs and fees borne by the investor.

As a result, a significant group of investors does not receive appropriate ex-post information in an easily accessible and comprehensible way, which limits their possibilities to effectively monitor the developments of the investment product purchased, including performance and costs paid.

d) Limited visibility and comparability of Environmental Social and Governance (ESG) information in standardized disclosure documents.

The increasing demand for sustainable investment, that takes account of ESG risks or impacts, is not adequately reflected in key information documents for retail investors, in particular in the PRIIPs key

[40] While the current legal text does not entirely prevent digital use of KIDs, including possible layering of information, it also does not encourage it. Specifically, it prevents changes to the order of the PRIIPs KIDs sections which would limit layering to presenting the information in a menu to display the headings and hide/unhide the information, which may not be sufficient.

[41] While this may not necessitate legislative action on its own, changes at L1 could allow more flexibility to find a more suitable solution for making PRIIPs KIDs more adapted to the digital environment.

[42] Joint European Supervisory Authority response to the European Commission's February 2021 Call for Advice on digital finance and related issues, 31 January 2022, point 164.

[43] See page 43, para 3.5.1 of the Advice of the ESA joint committee on PRIIPs, and page 36 of the EIOPA advice on retail investor protection.

[44] See pages 15 and 106 of the Retail investment study

[45] Delegated Regulation (EU) 2017/565 Article 50.9, Article 29(1)

information documents[46] prepared under the PRIIPs legal framework. This represents a regulatory gap with respect to changing expectations of consumers regarding the role of disclosures. Under the Sustainable Finance Disclosure Regulation (SFDR), new information must be collected by financial product manufacturers and presented on their websites, notably on the treatment of sustainability-related risks and principal adverse impacts of investments. Such disclosures may be rather complex for retail investors to navigate and may not be sufficiently visible to them. While current provisions allow for the inclusion of some additional information in the PRIIPs key information documents, there is no guarantee that without further policy intervention this will happen systematically and coherently in a way that facilitates comparability of retail investment products based on their ESG characteristics. Unless specified in law, there is a significant risk that different providers would prioritize different information, which may make it harder for retail investors to compare products based on such information.

Problem driver 2: retail investors tend to be unduly influenced by enticing marketing communications through digital channels and misleading marketing practices

Marketing communications can play a key role in determining consumer behaviour and influencing investment decisions. Retail investors who are subject to misleading marketing communications are more likely to be mis-sold an unsuitable/inappropriate financial product or service, even where correct information is provided through regulatory disclosures[47]. There is a growing trend towards marketing through digital channels, which brings certain benefits but also risks[48] to retail investors, including the risk of biasing investors' choice, unsolicited offers, offers targeting an inappropriate segment, a push towards unsuitable products, increased misconduct, as well as difficulties for competent authorities to control digital marketing and enforce the relevant rules.

Online platforms closed fora such as (moderated) chat groups, and influencers (or "finfluencers"[49]) are an increasingly important channel to inform and influence retail investors[50]. Financial influencers in particular have received much attention in recent years, although they represent only one of many new digital phenomena.

The current rules require *inter alia* that marketing communications are clearly identifiable as such and that the information they contain is consistent with any information the firm provides to clients in the course of providing investment services.

Several shortcomings have been identified with respect to the application of the existing framework, indicating that it is not yet fully able to address all the challenges of these new trends:

1. Marketing communications, particularly in the online environment, may tend to overemphasize the potential benefits of the product and hide information on costs and risks[51].
2. There may be confusion with respect to the definition of marketing communications as to whether online advertising and firms' private messages to clients and potential clients on social media are covered[52], both when communicated directly by the firm or through third parties' social media (i.e. 'finfluencers' who operate on behalf of financial service providers).

[46] See Table 1: the EU legal framework governing retail investor protection and Annex 9 for more detail on PRIIPs key information documents.
[47] ESMA advice on retail investor protection, page 9, point 22 and EIOPA advice on retail investor protection, page 43.
[48] IOSCO report on retail distribution and digitalisation, page 6.
[49] A "finfluencer" is an in influencer, who is usually active on social media, and generates content on financial topics such as investments.
[50] In response to Q.3.7 of the Public consultation, a majority of respondents considered that social media platforms may be used as a vehicle by some users to help disseminate investment related information and that this may pose significant risks for retail investment (e.g. if retail investors rely on unverified information or on information not appropriate to their individual situation).
[51] ESMA advice on retail investor protection, pages 10 and 14.
[52] ESMA advice on retail investor protection, page 9.

NCAs are also facing significant challenges in monitoring new forms of marketing communications, for instance as regards the use of finfluencers by firms or other developing means to engage clients via third parties through social media[53]. ESMA and EIOPA consider that greater control and oversight by investment firms and insurance companies is needed on marketing communications to ensure a consistent approach across all Member States.

3. The existing powers of NCAs to tackle aggressive online marketing practices may not allow sufficiently timely intervention[54], nor the possibility for NCAs and ESMA to impose the use of risk warnings for specific risky financial instruments which may be subject to (aggressive) online marketing and advertising campaigns[55].

A majority of respondents to the public consultation considered that there was a need for further EU coordination/harmonisation of national rules on online advertising and marketing of investment products[56].

Problem 2 – Shortcomings in the investment product manufacturing and distribution processes

Problem driver 3: some retail investment products incorporate unjustifiably high levels of costs and/or do not offer value to retail investors

High fees reduce the return retail investors can earn from their investment and the benefits they can draw from them. The challenge for retail investors to assess whether they get good value for money increases in case of complex fee structures. Both ESMA and EIOPA concluded in their monitoring of investment performance and costs that the high level of costs charged to retail investors can significantly impact risk-adjusted net returns and diminish the investment outcome for final investors. Product Oversight and Governance (POG) rules, such as in MiFID and IDD, aim to ensure that the interests of customers take prime importance during product design and throughout the lifecycle of a financial instrument/product, including arrangements for its distribution. Similarly, both the UCITS and AIFM Directives contain requirements stipulating that investors should not be charged undue costs. However, as evidenced in both EIOPA's[57] and ESMA's[58] annual cost and past performance reports, even with such rules, some products offered to retail investors offer very low if not negative returns (net of costs charged to the customer), calling into question whether they in fact represent value for money. The Evaluation (Annex 11) has found that product manufacturing process and rules governing the distribution of retail investment products do not fully tackle the issue of cost-efficiency of products and are not sufficiently effective to ensure that retail investors are offered products that are cost efficient. The evaluation of additional rules under the UCITS framework has also indicated limited scope for improvement, although the majority of the costs charged to investors are not under the control of UCITS management companies[59].

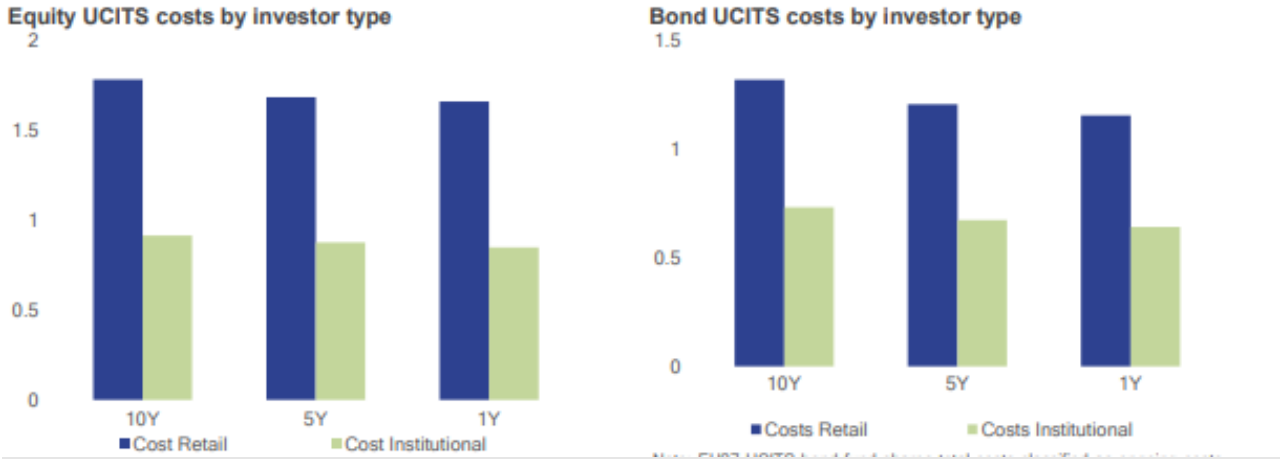
EIOPA found that some investment products sold to retail investors generate extremely low or even negative real returns, disproportionate to the risk that is taken by the investor. EIOPA identified such

[53] ESMA advice on retail investor protection, page 11, point 25.
[54] ESMA advice on retail investor protection, page 12, point 27.
[55] ESMA advice on retail investor protection, page 37, point 120.
[56] See 2021 Public consultation, Q3.6
[57] EIOPA Cost and past performance report 2022
[58] ESMA Performance and Costs of EU Retail Investment Products 2022
[59] On average, around 60% of the costs do not go to the UCITS management companies according to EFAMA Market insight, September 2021. These findings are confirmed by other sources of evidence including those discussed under the topic of inducements.

insurance products particularly in low-risk classes. Net returns were mostly in the range -1% to 6% for unit-linked and -1% to 3% to hybrids products[60].

ESMA's cost and performance report documents the substantial variation of costs of funds marketed to retail investors across EU Member States (see figure below), suggesting that there is little cost pressure from cross-border competition. It also found that retail clients were charged on average around 40% more than institutional investors across asset classes in 2021[61]. Although some difference between investor groups is to be expected, the size of the difference appears excessive. ESMA's simulations yielded negative returns for a number of structured retail products once costs were taken into account (see figure below). There does not appear to be a strong correlation between total costs and the underlying asset type, and as total costs do not appear to be lower for products that are more often sold to retail investors, this would suggest that "*economies of scale do not appear to materialise in the market for SRPs"* (structured retail products)[62].

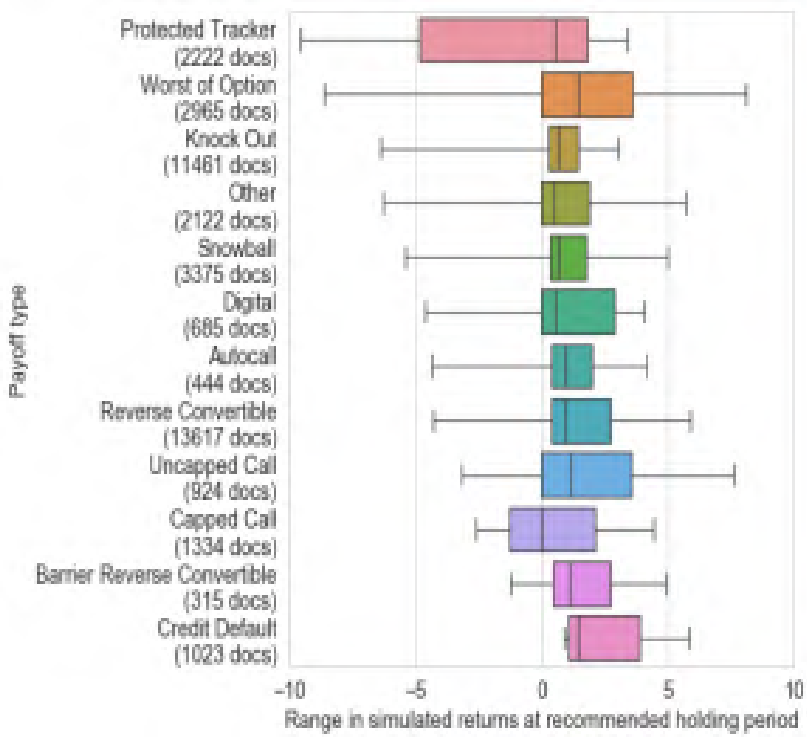
Figure 1: Cost differences when investment funds are charged to either retail investors or institutional investors,



Note: Sum of subscription fees, ongoing costs and redemption fees.
Source: ESMA 2022 Cost and Performance report, with data from ESMA and Refinitiv Lipper

[60] EIOPA Cost and past performance report 2022, page 18
[61] ESMA, Performance and Costs of EU Retail Investment Products, 2022, page 6.
[62] ESMA Performance and Costs of EU Retail Investment Products 2022, page 37

Figure 2: Returns of structured retail investment products across payoff types in the moderate scenario



Note: Means and ranges of returns of various structures retail investment products.
Source: ESMA 2022 Cost and Performance report.

Structured retail investment products often feature high complexity that prevents retail clients from understanding whether high fees reflect high quality or are instead due to high costs or profit margins. They have no means to judge the extent to which misaligned incentives between product manufacturers and distributors (which are both profit maximising entities) are driving high fees and the selection of products offered to them.

ESMA found, in its 2021 common supervisory action[63], that while firms generally follow the ESMA guidelines, the definition of target market is sometimes a formalistic exercise, made at insufficient granularity and which does not always translate into a distribution strategy that enables the product to reach the identified target market. In particular, product "*manufacturers' procedures insufficiently describe how a product's cost structure is evaluated to ensure compatibility with the product's target market*". ESMA stressed that the requirement on manufacturers to perform a charging structure analysis[64] is a key investor protection requirement. Similarly, EIOPA issued a supervisory statement concerning the assessment of value for money of unit-linked insurance issues, such as: *"high complexity, mis-selling, mismatches between actual returns and customers' expectations products that are not designed in a customer-centric manner"*[65].

Despite the efforts of ESMA and EIOPA, the current rules addressing the product manufacturing process and rules governing the distribution of retail investment products do not fully tackle the issue

[63] ESMA's Public Statement on the results of the 2021 Common Supervisory Action on MiFID II Product Governance Requirements.
[64] In relation to manufacturers there is an obligation in MiFID II to consider the charging structure proposed for the financial instrument, including by examining whether financial instrument's costs and charges are compatible with the needs, objectives and characteristics of the target market, that charges do not undermine the return expectations and that the charging structure is appropriately transparent for the target market.
[65] EIOPA Supervisory Statement on "Assessment of value for money of unit-linked insurance products under product oversight and governance".

of product cost-effectiveness and fail to ensure that retail investors are offered products which provide value for money. The rules are not sufficiently granular in relation to cost factors, which is problematic for their monitoring and enforcement. An additional practical consideration is that the lack of available cost information relating to investment products further increases difficulties to apply the rules, as assessments around cost effectiveness may be perceived as arbitrary if they are not based on data comparison and objective benchmarks. That poses a challenge with respect to their enforceability.

Problem driver 4: conflicts of interest caused by the payment of inducements negatively affect the quality of investment products offered and investment advice

Under certain circumstances, current rules (under MiFID II and IDD) allow for the payment of fees, commissions or the provision of non-monetary benefits (so called "inducements") to financial service providers by third parties (typically the manufacturer of the product). These rules provide the basis for the "commission-based" distribution model of retail investment products, whereby financial intermediaries (e.g. financial advisors) are remunerated for their services not by the retail investors directly, but by the manufacturers of those products. The rules do not, however, exclude a purely "fee-based" model, whereby financial intermediaries (e.g. independent financial advisors) are only paid directly for their services, including advice, by the retail client. Under MiFID II rules, an advisor that informs his clients that the investment advice is provided on an independent basis, cannot accept commissions from third parties but needs to rely on fees from the client. The "fee-based" model has had limited uptake in the retail segment however and the "commission-based" model is currently predominant for the distribution of retail investment products in the EU[66].

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 and selling. These conflicts of interest can be significant, since remuneration through inducements can represent an important portion of the incomes of intermediaries and the volumes of sales can also influence the bonuses paid to advisors. As an illustration, a survey[67] conducted by the Swedish supervisory authority concluded that commissions accounted for a very large proportion of the revenues of most intermediaries in Sweden. Insurance intermediaries derived 99% of their total revenues from commissions, which were also an important source of revenues for intermediaries selling securities. The Retail investment study established that non-independent advice remains the prevalent model for most distributors of retail investment products in the EU[68], suggesting that revenues from non-independent advice constitute a large portion (if not a sole stream) of revenues from advised services for most of the intermediaries.

Both the Evaluation and the Retail investment study have identified significant shortcomings with respect to the way the existing rules on inducements work in practice. They have underlined, among other things, that information documents provided to consumers rarely contain explicit information about inducements. According to the findings of the Retail investment study, while the disclosure of inducements reduces the information gap it appears not to substantially influence a consumer's choice and only a minority of consumers actually understand the concept. The existing safeguards, such as the quality enhancement requirement under MiFID II, lead to different interpretations across Member States and firms, despite convergence efforts by ESMA. A number of studies[69] have identified

[66] Study on distribution systems of retail investment products, page 26, in relation to the distribution of investment funds. The Netherlands is an exception due to the ban on inducements.
[67] Finansinspektionen, "A necessary step for a better savings market", 3 February 2016
[68] Retail investment study, page 233
[69] Danish Financial Supervisory Authority (2019), Thematic survey of quality improvement services for investment clients: Temaundersøgelse af kvalitetsforbedrende services til investeringskunder (finanstilsynet.dk) and Financial

shortcomings in the application of these rules. It is thus clear that the current protections in the legal framework and the way they are applied have not resulted in a market with lower inducements and better value products for retail investors, nor have they triggered a shift towards more independent advice[70].

Consumer and financial user organisations[71] have complained that the existing safeguards do not sufficiently mitigate the sale of investment products and services to retail investors that are not suited to their needs and/or which are too costly or underperforming. The ECA underlined also that investors were not sufficiently protected against, among other things, biased advice from financial intermediaries incentivised by inducements[72].

Inducements form a significant part of the overall product costs charged to retail investors and as such contribute to a higher level of fees for retail investment products. A study conducted by EFAMA[73] shows that distributors receive around 38% of the costs paid by retail investors through retrocessions for actively managed funds. According to a survey conducted by ESMA, the amount of inducements paid in some markets can be significantly higher, with retrocessions in France amounting on average to 50% of the management fee and with distribution costs in Spain ranging on average between 50% and 80%[74]. A study conducted by KPMG on behalf of a number of banking associations[75] also shows that inducements are a significant factor in the overall costs charged to retail investors, equalling 100% of the entry fees and on average between 49 and 51% of the yearly ongoing fees. Conversely, evidence suggests that in jurisdictions where the payment of inducements has been banned (such as the Netherlands), retail investors are accessing more cost-efficient products with consistently lower levels of fees across asset classes for investment funds[76]. The Retail investment study found that products carrying inducements are on average between 24 and 26% more expensive than those investment products on which no inducements are paid[77].

The higher fees charged to retail investors have a significant impact on the net return on investments. ESMA indicated in its 2019 Cost and performance report[78] that for UCITS funds, the total costs present a significant drain on the fund performance, impacting retail investors to a much higher extent than institutional investors (as retail clients on average pay twice as much as institutional clients), with costs on average accounting for 25% of gross returns in the period from 2015 to 2017.

The existence of conflicts of interest in the distribution of retail investment products through the payment of inducements and other monetary incentives, causes product bias (i.e. inducements influence the choice for a certain product). This impairs the efficiency of the retail investment market by making it more difficult for retail investors to access more cost-effective products[79]. The resulting biases and inefficiencies can hinder retail investor participation across Member States by

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supervisory authority of Norway (2020) Temaundersøkelse om etterlevelsen av reglene for returprovisjon (finanstilsynet.no)

[70] Retail investment study, pages 24-25.

[71] Better Finance "Research paper on detrimental effects of inducements" (2022), BEUC "The case for banning commissions in financial advice" (2019), etc.

[72] European Court of Auditors, Special report: Investment funds, EU actions have not yet created a true single market benefiting investors, 2022, Special Report 04/2022: Single Market for investment funds (europa.eu)

[73] European Fund and Asset Management Association, Market Insights - Issue #6, September 2021.

[74] ESMA Cost and Performance Report 2021, page 69 – in France, retrocession rates for UCITS funds generally equal 50% of the management fees.

[75] KPMG, "Commission-based remuneration vs. Fee-based remuneration: is there a better model for retail investors?", November 2021, pages 40 and 41

[76] Retail investment study, page 293, ESMA Cost and Performance Report 2021.

[77] Retail investment study, page 263.

[78] ESMA Cost and Performance Report 2019.

[79] Further explained in Annex 7.B: the UK inducement ban resulted in cheaper products and increased trust in advice.

undermining retail investors' trust in capital markets and have a negative impact on the internal market for financial services.

With respect to insurance-based investment products (IBIPs), a report by EIOPA[80] found that monetary incentives from asset managers (managing the assets of unit-linked insurance products) to insurance companies are widespread and significant in the industry, totalling EUR 3.7 billion in 2015. According to EIOPA, monetary incentives and remuneration received represent a median value of 0.56% of assets under management (46% of total fund management charges)[81]. A majority of the insurance undertakings did not disclose these monetary incentives and remuneration nor passed on these incentives to their clients. According to EIOPA, these incentives may limit the choice for clients and result in poor investment outcomes, in particular for products with long investment horizons, as underlying investment vehicles may at times be chosen on the basis of the highest level of monetary incentives and remuneration rather than relevance or cost-effectiveness.

Evidence suggests that in many jurisdictions certain simple and cheap investment products have a limited market share and are seldom offered or recommended to retail investors, compared to more expensive and complex products. Commissions can be an important incentive to offer specific products (so-called product bias), for example, where the fund commission can be ten times higher for an actively managed fund as compared to an index fund, generating significant conflicts of interest[82]. The Commission's study on distribution systems of retail investment products[83] found that ETFs[84] (which typically carry low costs) are amongst the most commonly available products on websites in many Member States but are almost completely absent from traditional distributors' online offering in some Member States. Although marketed online, low-cost ETFs were almost never proposed in traditional physical advice distribution channels. The Retail investment study found that ETFs have gained market share in certain Member States (e.g. Finland, the Netherlands and Poland), but remain marginal in other countries such as France[85], where comparatively more expensive products, such as life insurance, were advised in the majority of cases[86]. While it is clear that these pricier products carry different features and benefits which may be suitable for different groups of retail investors, desk research, based on data provided by ESMA and EIOPA provides an illustration as to how an investor investing EUR 10,000 in a unit-linked product in the period between 2014 and 2020 would have achieved a significantly lower outcome than by investing in ETFs (EUR 2,200 versus EUR 7,600)[87].

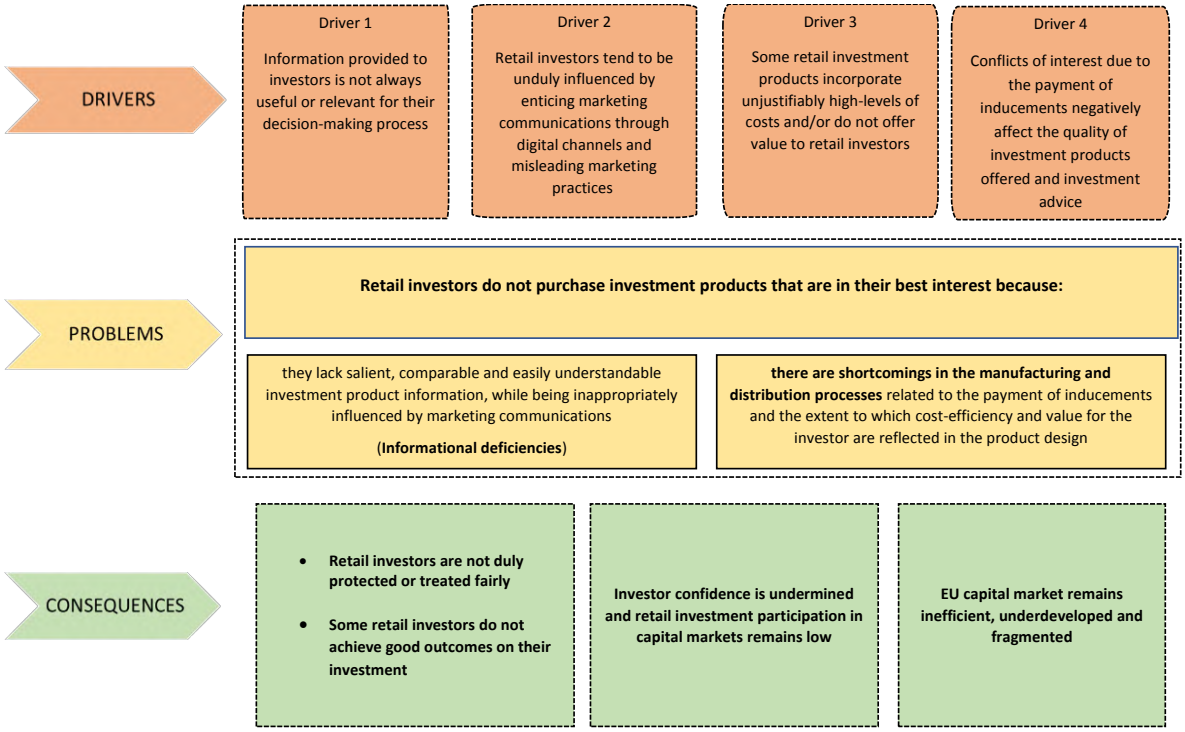
The Retail investment study pointed also to challenges regarding inadequate advice and listed a number of studies which evidenced the selling of investment products to clients that were not suitable for their profile[88]. At the same time the importance of unbiased advice was emphasised, as consumers tend to trust advisors and follow their advice, even when that advice may be evidently inadequate (as evidenced by a behavioural experiment conducted as part of the study)[89]. EIOPA has expressed

[80] EIOPA Report on Thematic review on monetary incentives and remuneration between providers of asset management services and insurance undertakings, 26 April 2017.
[81] According to the same report, less than 3% of unit-linked assets are directly managed by insurance undertakings; in-house asset managers (belonging to the same group as the insurance undertaking) manage 69% of assets; external asset managers manage 28% of assets but pay almost 50% of total remuneration.
[82] 2022 Consumer Protection Report, Swedish Finansinspektionen (FI), page 16.
[83] Study on distribution systems of retail investment products, page 33.
[84] Exchange Traded Funds which often provide index tracking or other exposure to markets.
[85] Retail investment study, page 69.
[86] Study on distribution systems of retail investment products, page 22.
[87] Calculations based on costs and performance data provided by ESMA and EIOPA. Data on unit-linked products may not be fully comparable with data on ETFs due slight differences in methodology and sample size. However, it still provides a useful approximation of how both investments would have developed over a 7-year period.
[88] Retail investment study, pages 243 and 244.
[89] Retail investment study, pages 279 to 289.

concerns relating to the possible mis-selling of unit-linked products to consumers featuring high costs and commissions as well as complex structures[90]. It also pointed to the need to tackle damaging conflicts of interest and address the risk of inducements that lead to product bias and materially impact the cost-efficiency of investment products[91].

Finally, the Evaluation points out that the divergences in inducement rules between MiFID and IDD, coupled with differences in the way these two frameworks are applied, cause market fragmentation and an unlevel playing field between distribution channels and Member States. In practice, different standards and levels of protection apply to retail investors, depending on whether a specific product (e.g. a UCITS fund) is distributed by an investment firm or an insurance undertaking (e.g. as part of a unit-linked product). Many Member States have also introduced stricter national rules on inducements under IDD and some also under MiFID (e.g. the Netherlands). On the one hand, this creates an unlevel playing field for financial service providers. On the other hand, in a cross-border context, it may expose retail investors in host Member States to different, potentially weaker, levels of investor protection. As cross-border distribution of certain retail investment products (e.g. UCITS funds[92]) increases, such divergences can negatively impact the internal market for financial services.

2.3 Problem Tree



2.4 How likely is the problem to persist?

If no action is taken to remedy the identified problems, retail investors will continue to purchase investment products which do not best serve their interests and deliver poor outcomes, undermining investor confidence and indirectly impacting the level of retail investor participation in EU capital markets.

If the identified informational deficiencies remain unaddressed, the framework will not provide a clear basis for the provision of less complex information to retail investors focusing on essential

[90] EIOPA, consumer trend report 2021, page 6.
[91] EIOPA advice on retail investor protection, page 79.
[92] ESMA Cost and Performance report 2021, page 9.

elements of the investment products, nor for the more meaningful presentation of disclosure information, particularly through digital means. Many retail investors will continue to not read nor understand the information received, affecting their ability and willingness to invest. The growing risk that marketing communications, especially through online channels, play on cognitive biases of retail investors and unduly influence their decisions will remain unmitigated.

In the absence of stronger requirements for product manufacturers and distributors at the product oversight and governance ("POG") stage, which focus on the cost-efficiency of investment products and their capacity to generate value for retail investors, the risk will persist that investment products are brought to market which carry an unjustifiably high level of costs or do not offer value to retail investors. As information asymmetry between the retail clients and intermediaries can never be fully eliminated, such products will continue to be purchased by retail investors, leading to lower returns and consumer detriment. Considering the problems on the market which have repeatedly been signalled by ESMA and EIOPA, an improvement of the existing situation is highly unlikely without a regulatory response.

Conflicts of interest due to the payment of inducement, if not addressed, will also continue to negatively affect the quality of the advice and products offered to investors. The commission-based model and non-independent advice will remain the predominant models in the EU with the continued risk that incentives at the level of intermediaries lead to the sale of investment products and services that are not suited to the needs of retail investors or are too costly or underperforming. This will continue to have a distorting effect on the market, as retail investors are not necessarily offered or do not purchase the best or most suitable products for their situation.

The identified problems are currently causing retail investors to take investment decisions where they opt for excessively costly, underperforming or excessively risky products, with severe negative consequences for their investment return. As a consequence, investor confidence is likely to be impacted and potential retail investors may be reluctant to invest in EU capital markets. The impediments to an efficient and dynamic EU retail investment market will also remain.

3. WHY SHOULD THE EU ACT?

Legal basis

Retail investor protection rules are spread across a range of legislative initiatives, as described under section 1.3. The legal bases governing these different instruments are Articles 114, Article 53, and Article 62 of the Treaty on the Functioning of the European Union (TFEU).

The primary policy measures under consideration concern the following areas: (i) disclosures and marketing communications, (ii) inducements, and (iii) value for money. Further flanking measures are assessed in the areas of: (i) financial literacy, (ii) client categorisation, (iii) suitability and appropriateness assessment, (iv) supervisory enforcement, and (v) professional qualification of advisors. As set out in section 4.2, these measures collectively target informational deficiencies which hinder investors' ability to make well-informed decisions as well as shortcomings in the investment product manufacturing and distribution processes, across Member States. In order to ensure consistency and coherence of the envisaged measures, it would be appropriate to amend the existing framework (i.e. MiFID II, IDD, PRIIPs, UCITS and AIFMD).

Article 114 TFEU empowers the European Parliament and the Council to adopt measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market. The measures identified above and throughout this impact assessment relate to improving the conditions

for the establishment and functioning of the internal market. These include the establishment of uniform conditions for all relevant players in the retail investment market while ensuring a consistent degree of consumer protection across the EU. These harmonised operating conditions include: the way retail investors in the EU are informed about investment products, how the information is provided to them, and how manufacturing and distribution processes of investment products take place. While there is an increasing amount of cross-border trade in retail investment products, divergent national approaches will lead to different levels of investor protection, which represents an impediment to the further cross-border development of the retail investment market. Such further development would also require easy comparisons between products across the EU. Divergent standards on investor disclosure make such comparisons very difficult and would therefore also create an obstacle to the further development of the internal market for retail investment products. Insofar as measures are intended to further enhance consumer protection across the EU, Article 169 TFEU would also be relevant. Article 169 TFEU allows the EU to adopt measures pursuant to Article 114 TFEU "*in order to promote the interests of consumers and to ensure a high level of consumer protection […] as well as to promoting their right to [inter alia] information [and] education […]"*.

Article 53 TFEU would also be relevant for the introduction of the measures set out in this impact assessment. Article 53 TFEU empowers the European Parliament and the Council to issue Directives aimed at making it easier for persons to take up and pursue commercial activities across the EU. The objective and subject matter of policy options considered in this impact assessment relate to harmonising national provisions concerning conduct of business rules for manufacturers and distributors of investment products. In particular, these are to harmonise safeguards against possible conflicts of interest, rules on qualifications of advisors, rules intended to provide investors with greater visibility over all costs relative to an investment product, and the supervisory framework. Article 62 TFEU, which extends the scope of activities identified in Article 53 to the provision of services, would also necessarily be relevant.

Subsidiarity: Necessity of EU action

EU action for completing the internal market has to be appraised in light of the subsidiarity principle set out in Article 5(3) of the Treaty on European Union (TEU). According to the principle of subsidiarity, action at EU level should be taken only when the objectives of the proposed action cannot be achieved sufficiently by Member States alone and thus mandate action at EU level.

The legal framework governing retail investor protection is extensive and largely harmonised at EU level. Notwithstanding this extensive body of legislation at EU level, the evidence gathering exercises have identified a number of significant shortcomings, in particular with respect to the way retail investment products are distributed and the way information is provided to retail investors. Action is required at EU level as the options considered in this impact assessment necessitate the modification of the existing legal framework, consisting of EU Directives and Regulations. Individual initiatives at Member State level are therefore not suitable, insofar as the proposed amendments will be made to EU Directives and Regulations and consequently beyond the scope of the legislative competence of Member States.

Proportionality: Added value of EU action

Ensuring a coherent investor protection framework that empowers consumers to take financial decisions and benefit from the internal market can only be achieved at EU level, in close cooperation with Member States.

As the current retail investor protection framework largely consists of different EU legal instruments, in order to address the problems identified in this impact assessment and to facilitate cross-border retail investor participation in the EU, this framework may only be amended at EU level to update

investor protection rules. Acting at the EU level and harmonising the operational requirements of service providers as well as the disclosure requirements imposed reduces the complexity and administrative burdens for stakeholders and promotes financial stability.

4. OBJECTIVES: WHAT IS TO BE ACHIEVED?

4. 1 General objectives

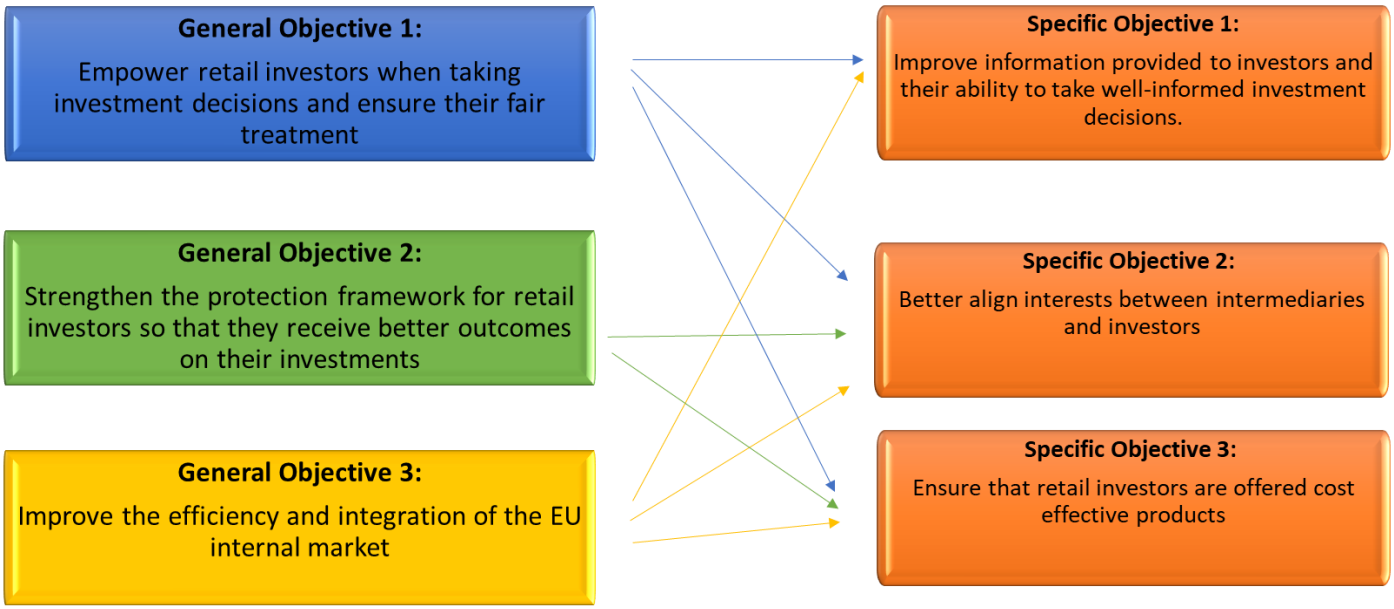
The general objectives of the initiative are to strengthen the protection framework for retail investors to empower them when taking investment decisions and to ensure their fair treatment when using investment services in order to achieve better investment performance. The retail investment strategy also aims to improve the efficiency and integration of the internal market across all retail financial services.

4.2 Specific objectives

The retail investment strategy will contribute to the achievement of the general objectives by pursuing the following three specific objectives (SOs):

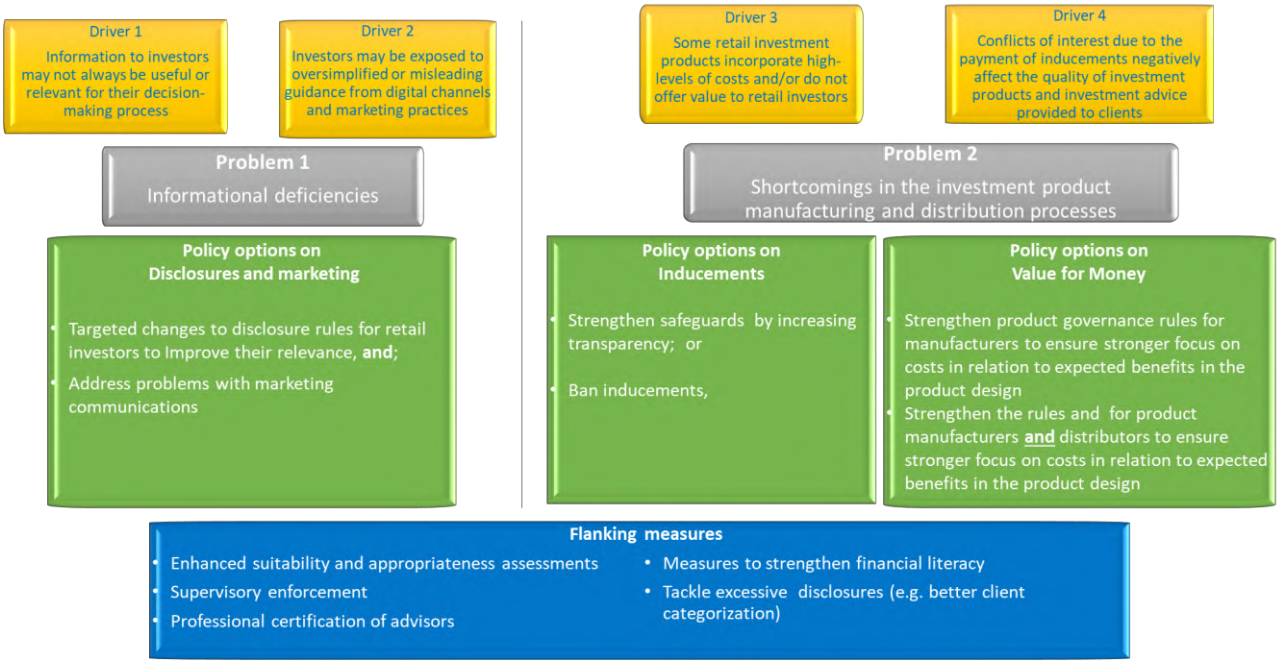
1. **SO1: Improve information provided to investors and their ability to take well-informed investment decisions.** The initiative aims to improve the legal framework by adapting disclosures to the digital environment, making disclosures more relevant for retail investors and ensuring retail investors receive marketing communications, also through online channels, that are relevant and not misleading.
2. **SO2: Better align interests between intermediaries and investors**. The improvements to the framework would ensure that the advice given to retail investors is not biased by monetary or non-monetary incentives provided by product manufacturers to intermediaries, is of good quality and adapted to their needs, preferences and objectives.
3. **SO3: Ensure that retail investors are offered cost-effective products.** A strengthened approach in the legislative framework based around the value offered aims to help retail investors achieve better returns and easier access to more cost-efficient retail investment products.

Links between general and specific objectives



The following table illustrates the intervention logic that explains how the problems and associated problem drivers lead to the main options that are assessed. In addition, this impact assessment addresses a number of flanking measures for targeted improvements of the existing retail investor protection framework to help address identified shortcomings which are assessed in the accompanying annexes.

Intervention Logic



5. DESCRIPTION OF THE POLICY OPTIONS

How is the assessment of policy options structured?

The Retail investment strategy takes a holistic approach, featuring a variety of measures aimed at addressing the identified problems. All measures included in the impact assessment (and the annexes) are aimed at enhancing the retail investor protection framework. The focus of the main part of the impact assessment report is on policy options in three principal areas, i.e. (i) disclosures and marketing communications, (ii) inducements and (iii) value for money. This choice of presentation is intended to enhance the readability of the main text and to ensure focus on the most important policy choices that directly target the two key identified problems. The selection of key issues was decided on the basis of the magnitude of their expected impacts, the political sensitivity of the underlying measures, as well as the significance attached by stakeholders to the issues concerned.

Specific elements relating to these policy options are further developed in a number of annexes attached to this impact assessment (e.g. Annex 4 contains more detailed assessment of the options for dealing with disclosures and marketing, while Annex 7 contains further assessment related to inducements).

A number of measures are presented as "flanking measures" and their impact is assessed in specific annexes, i.e. (i) financial literacy (Annex 5), (ii) client categorization (Annex 6), (iii) enhanced suitability and appropriateness assessment (Annex 8) and (v) professional qualification of advisors (Annex 10). While these measures will also contribute to addressing the identified problems and meeting the general and specific objectives, their impact is expected to be less significant than the policy options presented in the main body.

Finally, a focus on supervisory enforcement alone would not be sufficient to address the problems identified in the three principal areas in this impact assessment. It is therefore appropriate to look at supervisory enforcement in view of its cross-cutting nature and assess specific targeted supervisory enforcement measures aimed at improving the level of retail investor protection. These measures would (indirectly) contribute to addressing the identified problems (e.g. in the area of disclosures and marketing communications), and have been assessed jointly in Annex 9 as flanking measures.

The flanking measures in the annexes should be viewed as part of the overall package, conceived in conjunction with the main measures. Collectively, they contribute to addressing the identified problems and meeting the general and specific objectives. Taken in isolation, however, they would not be sufficient to fully address the core problems identified in the main part of the IA. They are complementary to the main policy options, creating synergies with a view to creating a strengthened overall investor protection framework or by complementing specific policy options (these are presented in section 7 in the preferred combination of options).

5.1 Baseline

Under the baseline scenario, no amendments will be made to the legislative framework governing disclosures and marketing communications under MiFID, IDD and PRIIPs[93], to rules governing inducements and product oversight and governance rules under MiFID, IDD and UCITS.

The principle characteristics of the baseline scenario are:

Increasing digitalisation of financial services and development of new technologies has changed and continues to change the financial services landscape and the way products are distributed to clients. On the one hand, there is a sustained and continuous increase in the number of products being sold online, and new ways to access advice, such as robo-advice or other digital advice models. The market share of such distribution models is growing, while traditional distribution channels are changing to adapt to more automated or semi-automated solutions. On the other hand, digital innovation is also changing the way investors access product and investment information and the way they are exposed to marketing communications. Mobile apps and the social media revolution are creating new opportunities for firms to reach existing and potential new retail clients, for example, through finfluencers. This however increases the risks that clients are unduly influenced or not sufficiently informed about costs, which would remain unaddressed in the absence of stronger and clearer regulatory requirements, as well as stronger powers for the NCAs to supervise and intervene[94]. Meanwhile, product manufacturers would likely not sufficiently exploit possibilities offered by digitalisation to present information from key information documents in a more user-friendly way.

Increasing interest in sustainability aspects. Increased citizen awareness about sustainability issues will continue to drive consumer preferences and market trends. Without policy intervention, some product manufacturers are likely to add sustainability information in key information documents, but there is no indication that the industry could clearly agree on which specific indicators should be included. Inclusion of sustainability aspects would likely be uncoordinated, thus hindering comparison of the sustainability-related characteristics of retail investment products.

Continued permissibility for firms to pay inducements to intermediaries under the current MiFID and IDD regimes and shortcomings in the application of existing rules will mean that the risk of conflicts of interest in the advice chain will remain, with the consequence that many retail investors risk being advised to purchase products that carry higher costs.

Continued exposure to high-cost products that deliver little value for money. The current actions by ESMA and EIOPA to develop guidance on value for money and undue costs are useful tools for supervisory monitoring and enforcement; however, there are limits as to how effective guidance can be as a means of addressing what is considered to be a significant problem. In addition, as shown in

[93] The scope of PRIIPs has been recently expanded. As of as of January 2023, the PRIIPs KID is also used by UCITS funds, having replaced the UCITS KIID. Further amendments in secondary legislation also apply as of this date.
[94] Currently neither NCAs nor ESMA can intervene sufficiently quickly (i.e. within less than a day) in case of a practice harming retail investors. That risk increases as use of digital marketing/social media develops.

the evaluation, currently the rules are applied only superficially, and the existing enforcement mechanisms are not sufficient to address the problem.

Potential national gold plating: the current EU investor protection regime includes harmonised rules on inducements and advice, but with the possibility of gold plating, whereby Member States can introduce further restrictions on inducements at national level. This is an option that is already used in some Member States (See Annex 7.A and B). Even though there are no signs that other Member States would follow, a lack of consistency would give the possibility to firms for jurisdiction shopping and choosing to establish themselves in certain Member States and thus possibly distorting competition in the internal market.

Under the above scenario, where no changes are made to the existing framework, the identified shortcomings will remain unaddressed. Relying on existing enforcement mechanisms would not be sufficient to tackle the identified problems and would not provide sufficient flexibility for user-friendly display of product information to help address informational deficiencies, ensure that the offer of products and services is aligned with the interests of retail investors and offers them value.

5.2 Disclosures and marketing communications

Option label	Option description
Baseline (Option 1)	Do nothing to change the legal framework – this is the baseline scenario
Option 2	Targeted changes to disclosure rules to improve their relevance for retail investors
Option 3	Targeted changes to address informational deficiencies relating to marketing communications

The options that are assessed under disclosures and marketing are complementary and not mutually exclusive. Alternative options addressing the relevant problem drivers have been considered but discarded at an early stage (see below). The two complementary options presented below are assessed against the baseline, with a more detailed assessment to be found in Annex 4.

Policy option 2: Targeted changes to disclosure rules to improve their relevance for retail investors

Policy intervention under option 2 would focus on targeted changes in EU legislation (PRIIPs, MiFID 2 and IDD) to address problem driver 1.

With regard to **PRIIPs**, this option would involve the following targeted amendments, including to the PRIIPs Regulation, to address key areas highlighted by the Joint ESA advice on the review of the PRIIPs Regulation and responding to a mix of regulatory gaps and implementation issues identified in the evaluation: (i) improving the presentation of information, notably through use of information layering[95] and a summary dashboard to make PRIIPs key information documents more engaging; (ii) adding an ESG dashboard with basic information on the sustainability-related characteristics of the

[95] Layering is a practice of organizing information into related groupings and then presenting or making available only certain groupings at any one time. In the case of PRIIPs key information documents, this implies breaking down each section of a document into layers in order to allow for a simplified view (first layer) where only several pieces of information are shown, with a possibility to expand the view in order to see more details in any section of interest.

product, based on information already collected and disclosed under SFDR requirements and consistent with the sustainable finance disclosure framework; (iii) increasing transparency of costs of Multi-Option Products (MOPs)[96] in PRIIPs key information documents; and (iv) clarification of the scope of PRIIPs with respect to certain types of corporate bonds. The latter two technical measures are described and assessed in Annex 4.

With respect to **MiFID II and IDD**, option 2 would involve targeted amendments focused on **improving the relevance of costs and performance disclosures for retail investors**. This option would encompass an obligation for investment firms and insurance undertakings to provide their retail clients with information on costs[97] presented in a standardised and easy-to-understand format, before the execution of any transaction. This option would also reinforce firms' obligations to provide an annual statement to clients, to ensure that each year all clients receive on a compounded basis a better view of the costs they have paid, together with, where applicable, any dividends or interests received, the current market value of the products and the impact of the costs on the annual performance of the portfolio. Since insurance-based investment products are typically long-term investments with a retirement or other long-term objective, the annual statement for such products would also contain additional elements, such as adjusted individual projections allowing investors to check whether they are on track to meet their objectives. Standardisation of the costs terminology and the costs statement format would facilitate the comprehension and comparability of those costs by an average retail client. Several additional technical changes to the rules are described and assessed in Annex 4.

Where the rules would require more technical specifications, these would be developed through mandates to the relevant ESAs.

Policy option 3: Targeted changes to address informational deficiencies relating to marketing communications

Option 3 encompasses legislative changes in MiFID II and IDD relating to marketing communications, as recommended in the ESMA and EIOPA advice on retail investor protection. This would involve the introduction of a new obligation for investment firms and insurance intermediaries to **include "vital" information in all marketing communications** relating to the offer of financial instruments and investment services to retail clients. Vital information would encompass the essential characteristics of the product or service presented in the marketing communication. For financial products, it would include at least the key product features and the main risks associated with them. The presentation of the vital information in the marketing communication would ensure that prominent information is accessible for an average retail client, regardless of the means of communication used. The Commission would be empowered to adopt a delegated act to define such vital information.

In addition, the notion of **"marketing communication" would be clarified** in MiFID II and IDD with a view to ensuring that all online marketing communications and advertising, made directly or indirectly by investment firms (including through third parties, such as influencers), regardless of the format or the use of any marketing techniques, are covered by the rules on marketing communications under MiFID II and IDD. Where the rules would require more technical specifications, these would be developed through mandates to the relevant ESAs. The supervisory

[96] Multi-Option Products (MOPs) are insurance-based investment products covered by the PRIIPs framework which consist of a wrapper (insurance contract) and an underlying investment where clients choose between multiple options.
[97] Costs should be understood as any costs, associated charges, fees, commissions and third-party payments (to be) paid directly or indirectly by the client and related to the financial instrument(s) and financial service(s) considered by the client.

role for NCAs to address aggressive marketing and impose risk warnings would also be strengthened (see Annex 9).

Options discarded at an early stage:

Improving the relevance of disclosure documents through a more comprehensive review of the PRIIPs framework. Some stakeholders suggested to go beyond the targeted changes included in Option 2 and to envisage a comprehensive review of the PRIIPs framework. However, a comprehensive review has been discarded as a policy option for the following reasons: the evaluation concludes that overall, disclosure rules, including those under PRIIPs, have been effective in increasing investor protection and providing retail clients with more complete, relevant and comparable information on investment products. Option 2 hence focuses on those specific issues that have been identified by the evaluation as needing to be remedied. Secondly, the timing would not be appropriate for a comprehensive review, as feedback received in the public consultation points to a high degree of regulatory fatigue in the sector; more ambitious rules changes would add to this. The content and presentation of performance scenarios and costs in the PRIIPs key information documents have been recently amended through secondary legislation, applicable as of January 2023. PRIIPs has started to apply to UCITS funds as of the same date and it will therefore take several years before sufficient experience is accumulated to assess these changes.

Several alternative options have also been considered to address the identified informational **deficiencies relating to marketing communications**. One option included the introduction of an obligation for investment firms to transmit to their relevant competent authorities all marketing communications (including those made though digital channels and those produced directly and indirectly by firms) related to financial products and the services they commercialize, prior to their release to the public or to individual clients. Another option entailed the introduction of an obligation for pre-approval of all marketing communications (including through digital channels) by the relevant competent authorities (as currently applied in some Member States in relation to certain marketing communications). Both options are likely to imply significant costs for the industry, which could ultimately be passed onto retail investors and outweigh any potential benefits. They are also likely to involve costs and the need for additional resources for the competent authorities. These options were thus discarded for reasons of proportionality.

5.2 Inducements

Option label	Option description
Baseline (Option 1)	Do nothing to change the legal framework – this is the baseline scenario
Option 2	Maintain current system allowing payment of inducements, but improve/harmonize sector specific disclosures relating to inducements
Option 3	A ban on inducements

Option 2: Maintain the current system allowing for the payment of inducements, but improve/harmonize sector specific disclosures relating to inducements

Under this option, the existing legal requirements on the disclosures of inducements would be reinforced to make them more transparent, accessible and understandable for an average retail client. Distributors would be required, in addition to existing disclosure requirements on inducements, to

disclose more prominently and clearly the level of inducements and provide a clear explanation in layman's terms what they mean for the client (concept, consequences and graphical illustration showing the accumulated effect of inducements over time). Distributors would also be required to disclose to consumers the possible choice of alternative distribution channels where no inducements are paid. Firms would be required to report the inducements paid and received to the NCAs, who on their side would report those to ESMA/EIOPA. This option would, as regards the additional disclosure requirements, also create a level playing field across sectors (IDD/MiFID).

Option 3: A ban on inducements

Under this option, the payment of inducements (i.e. any fees, commissions or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to clients), would be prohibited in relation to all retail investment products and services across the Union. Investment intermediaries, irrespective of the distribution channel or product (e.g. shares, bonds, funds, structured retail products, PRIIPs) would no longer be allowed to receive or pay any such inducements[98]. Instead, they would need to charge a clearly disclosed fee to the retail client for their services[99]. This option would also provide safeguards against intragroup inducement-like payments (in the form of cross-subsidies to distributing entities from other group entities), so that vertically and non-vertically integrated providers could compete on equal terms (see chapter 6). To address conflicts of interest also at the manufacturing stage, product manufacturers of structured products, including IBIPs, will not be permitted to receive or pay commissions from or to other product manufacturers for the inclusion of a particular asset in packaged retail investment and insurance products (PRIIPs). This option would be accompanied by an appropriate transitional period, to allow distributors and manufacturers time to adjust their business models from a commission-based to a fee-based model, and a grandfathering clause to ensure that obligations under existing contracts with retail investor would not be affected.

A variant of this option could be to introduce a partial ban restricting payment of inducements for non-advised services (execution-only). Non-advised services are those where the intermediary does not provide investment advice to the client. A partial ban could cover payments and non-monetary benefits from manufacturers to distributors (or vice-versa) in relation to (i) the reception and transmission of orders, or execution of orders to or on behalf of retail clients, under MiFID, and (ii) non-advised sales under IDD. A partial ban would address the consumer detriment that may occur due to the payment of inducements in the context of execution-only services provided to self-directed retail investors that do not seek advice.

5.3 Value for Money

Option label	Option description
Baseline (Option 1)	Do nothing to change the legal framework – this is the baseline scenario

[98] The fee models in relation to investment services to professional clients is not within scope of this initiative.

[99] This option would also include a flanking measure in the form of safeguards against intragroup inducement-like payments (in the form of cross subsidies to distributing entities from other group entities) so that vertically and non-vertically integrated providers can compete on equal terms. See infra under discussion on options for more background.

Option 2	Strengthen product governance rules for manufacturers by requiring comparison of products to relevant 'manufacturer benchmarks' and justify any departures from the benchmarks to ensure stronger focus on costs in relation to expected benefits in the product design.
Option 3	In addition to strengthening product governance rules for manufacturers (option 2), strengthen the rules for distributors by requiring comparison of products to relevant 'distributor benchmarks' and justify any departures from the benchmarks to limit fees in distribution.

Option 2: Strengthen product governance rules for manufacturers

This option strengthens product governance rules under MiFID, IDD, and the UCITS and AIFM Directives to ensure greater attention to costs in relation to expected benefits in the design of products. As part of their product oversight and governance measures, manufacturers of investment products would be required to properly identify and quantify the costs related to each product (both for existing and new products) and justify that it offers value for money to the target market, including when compared to other products on the market, based on product type-specific cost and performance benchmarks ('manufacturer benchmarks'). Products that manifestly underperform (in terms of costs and performance) compared to the relevant benchmarks would not be offered to distributors, or else manufacturers would have to justify their choice to still offer them. Product costs as well as objective reasons as to why some products should be retained (despite not being benchmark-compliant) would have to be properly documented and kept for supervisory scrutiny, upon request. Consequently, manufacturers would be encouraged to develop well-performing and cost-efficient products.

ESMA and EIOPA would be mandated to develop in a technical advice the criteria and elements upon which a value for money assessment would have to be based, including the methodology by which comparisons with other relevant products would be made and benchmarks construed in the level 2 measures to be adopted by the Commission. The number of relevant benchmarks would be determined by ESMA and EIOPA, subject to their detailed further assessment and sector consultations. The benchmarks would be compiled on the basis of cost and performance data and would need to differentiate between investments that carry different risk levels. Benchmarks would also need to be sufficiently granular, but also have enough products within one group, so as to represent a meaningful basis of comparison for similar product types and categories. In order to facilitate compilation of relevant benchmarks, manufacturers would be required to report relevant cost and performance related data to supervisors. To avoid an unnecessary reporting burden on stakeholders, the ESAs would have to consider the already collected data under any other EU legislation. ESMA and EIOPA would further specify the precise data to be reported for the compilation of the benchmarks. Benchmarks would need to be published and periodically updated.

Option 3: In addition to strengthening product governance rules for manufacturers (option 2), strengthen the rules for distributors

Under this option, the requirements for manufacturers would be strengthened as described under option 2. In addition, the product governance rules under MiFID and IDD for **distributors** would be enhanced. Distributors of investment products would be required to assess how the products they distribute compare to relevant benchmarks ('distributor benchmarks') for similar products in the market. Distributors should receive the relevant explanations and data from the manufacturer (including the cost justification of its product, and explanation of how concretely its product brings

value to the target market) and would be required to include the additional costs related to distribution that are not known by the manufacturer. The assessment could be done at a central level (e.g. compliance department at the distributor's headquarters) rather than at the level of individual advisors.

Similar to option 2, under option 3 distributors would not be able to offer to the client products that would manifestly underperform compared to the relevant benchmark, which would include distribution fees, unless they have objective reasons for doing so. Distributors would be required to document the result of their comparison to the relevant benchmarks, as well as the objective reasons in case of departures from the benchmark. They should disclose this documentation to supervisors upon request. Consequently, distributors would provide an additional discipline on manufacturers to develop cost-efficient and well-performing products.

As in the case of option 2, under option 3 the ESAs would be mandated to develop in technical advice 'distributor benchmarks' which would be distinct from 'manufacturer benchmarks', as they would also include distribution fees. To develop these benchmarks, the ESAs may need to collect additional data from distributors. ESMA and EIOPA would further specify the precise data to be reported for the compilation of the benchmarks.

It could be further envisaged, as a sub-option, to require distributors to explain the value proposition of the recommended product to the client and to disclose, as part of the suitability assessment, how the product compares to the 'distributor benchmark'. This could help establish market discipline by ensuring that distributors scrupulously follow the assessment process. At the same time, the explanations given to the client would contribute to raising the awareness of clients and their financial literacy and enhance the quality of the advice to help ensure that only cost-efficient products are offered to clients. However, imposition of a such a requirement on distributors would entail significant and disproportionate additional costs, given the large number of distributors that would need to receive training and given the additional time needed to explain the value for money assessment to clients. This sub-option is therefore not analysed further in this impact assessment.

5.4 Flanking measures

As set out in the introduction to section 5, a set of flanking measures that contribute to addressing the identified problems and meeting the general and specific objectives is analysed in the corresponding Annexes. These measures would not be sufficient to fully address the identified problems, they are however an intrinsic part of the overall package and designed to work in conjunction with the main measures.

The "flanking measures" are described in the following table.

Flanking measure - Annex	Which objective is primarily met?	Problem	Preferred Option
Financial literacy (Annex 5)	SO1: Improve information provided to investors and their ability to take well-informed investment	Low financial literacy levels in the EU reduce the effectiveness of disclosures and increase reliance on advice, be it good or bad.	Support and supplement the work of EU Member States by replicating a provision in Article 6 MCD into the relevant financial legislation on distribution of investment products, calling on

	decisions.		Member States to promote financial education/digital literacy initiatives.
Client categorisation (Annex 6)	General objective: improve efficiency and integration of the internal market.	Current rules over-protect a subcategory of experienced investors who may not easily access certain products.	Adjustment to the current MiFID criteria to qualify as a professional client on request.
Enhanced suitability and appropriateness assessment (Annex 8)	SO2: Better align interests between intermediaries and investors.	Suitability and appropriateness assessments are not sufficiently fulfilling their purpose and do not prevent mis-selling.	Standardize and enhance the suitability and appropriateness assessments, so that firms have better understanding and can better take into account relevant elements of the personal situation of their clients.
Supervisory enforcement (Annex 9)	General objective: improve efficiency and integration of the internal market and strengthen the protection framework for retail investors.	General enforcement: - Not all NCAs have powers to conduct mystery shopping. - Increased digitalisation leads to increase in the number of scams. - NCAs lack sufficient powers to tackle aggressive online marketing practices and allow them to intervene in a timely manner. - Insufficient risk warnings about the risky nature of some financial products. - Uneven level of protection across the EU due to differences in the rules and procedures.	Strengthen aspects of supervisory enforcement related to consumer protection, by: - Introducing an obligation for Member States to give powers to NCAs to perform mystery shopping activities. - Address scams in the context of new digital channels. - Empowering NCAs, ESMA and EIOPA to take timely and effective actions against misleading marketing practices. - Empowering ESMA, EIOPA and NCAs to impose on firms the systematic use of risk warnings for specific financial instruments. - Imposing specific requirements to facilitate access to complaints handling for consumers.
Supervisory enforcement (Annex 9)	General objective: improve efficiency and integration of the	Cross-Border provision of services: - NCAs responsible for the supervision of the firms	Improve home/host relationships and protect consumers in situations of cross-border provision of services, by:

	internal market and strengthen the protection framework for retail investors.	authorised in their jurisdiction (home) may face difficulties when supervising their cross-border activities, which may be more easily handled by host NCAs. - Some firms have chosen to obtain authorisation in a Member State even though they are not planning to carry out any, or at least not a considerable part, of their activities in that Member State.	- Enhancing and accelerating the process of cooperation of home and host NCAs to ensure effective supervision of cross-border service providers. - Improving safeguards in cross-border supervision of services to avoid jurisdiction shopping.
Professional qualification of advisors **(Annex 10)**	SO2: Better align interests between intermediaries and investors.	Existing rules on qualification requirements for investment advisors are deemed insufficient and can lead to clients receiving inappropriate advice and being victims of mis-selling.	Strengthening the existing standards and further harmonising some of the requirements set out in MiFID II and IDD.

6. WHAT ARE THE IMPACTS OF THE POLICY OPTIONS AND HOW DO THEY COMPARE?

In this section, each policy option considered (other than Option 1 – "Baseline") is assessed against the specific objectives presented in Section 4. The baseline scenario ("Option 1" of each problem) is not assessed. The consequences of doing nothing are outlined in Section 2 of this impact assessment.

6.1 Informational deficiencies

Option 2: Targeted changes to disclosure rules to improve their relevance for retail investors

1. Benefits

Improved presentation of the PRIIPs key investment document (notably layering of information and summary dashboard) would make it easier for retail investors to understand key characteristics of the investment product they are considering (e.g. its costs or risk level). This would contribute to some degree to facilitating the choice of a product that matches their needs. The introduction of an ESG dashboard would ensure that retail clients can clearly identify basic information on the sustainability-related characteristics of the products they own or consider buying. That information would enable better comparison of products on sustainability characteristics (due to standardisation) and give more prominence to sustainability information, in line with developing consumer preferences.

In the area of MiFID and IDD, the annual costs and performance statement and the standardisation of costs statements to retail clients would lead to greater transparency. The annual statement on costs and performance would enable all retail investors to get a comprehensive and detailed view concerning all the costs and performance associated with their investments over a one-year period. This annual statement would facilitate a better monitoring by the retail clients of the net performance of their financial products.

The creation of EU standardised cost statements, dedicated to retail clients and to be used by firms for the provision of cost disclosure before a transaction takes place or on annual basis, would facilitate

the understanding of such statements by retail clients as well as the comparison of costs and charges of products. EU standardised cost statements would also facilitate the control over costs disclosures by supervisory authorities. They might also support a data basis on costs that could be useful for national competent authorities when controlling the value for money of financial products.

Enhanced transparency would reduce information and search costs for retail investors, allowing them to make investment decisions with more confidence. Lower information costs could also foster the participation of households that had not invested in financial products because they did not know how to invest. The 2022 Eurobarometer survey identified that 14% of those respondents that said they had no financial investment justified their behaviour on the grounds they did not know how to invest or found it too complex. While a mere 12% of the respondents to the RIS survey criticised the information provided in investment documents as bad, only 28% gave a positive assessment. These numbers are likely to improve with the measures discussed here.

It is however uncertain as to the extent to which more information would contribute to reducing the complexity of investment decisions, and there is an important interaction with the financial literacy of investors. The provision of information would have a greater impact if the information processing capacity of potential investors were to be strengthened.

There is however no data available that would allow to quantify the effect of lower information or search costs or better access to information on investors' trust or participation. Data on financial literacy is still patchy, with the results of surveys available in only a few Member States and which are hard to compare over time.

The provision of more information is costly for financial firms, which entails passing on of costs from providers to retail clients and to firms that provide financial services, IT support or advisory services to financial firms. However, financial firms could benefit from the expansion of their customer base. More transparency may also lead to increased competition on the sell side, putting downward pressure on prices charged for MiFID and IDD products and services, thereby benefiting all investors. It could entice new competitors to enter the market.

2. Costs

Companies that manufacture financial products in the scope of PRIIPs will bear the costs related to adapting their PRIIPs key information documents to the new rules[100]. These costs will be one-off in nature and are expected to be very limited as these companies already have the necessary procedures in place, and the changes are tailored so as not to require additional data. The changes are either related to presentation and format (e.g. dashboards, layering) or designed to make use of existing data (e.g. ESG dashboard)[101]. The use of layering and other online presentation alternatives will be voluntary, the costs of which will not be directly attributable to the proposed legislative changes[102], although companies may face market pressures to apply them as well. The information to be included in an ESG dashboard would be limited to information that is already collected and disclosed by the

[100] Although these costs relate to the substantive requirements of the proposal which are necessary for the fulfilment of the objective of informing retail investors, they are categorised as administrative costs for "one in, one out" purposes. This consideration applies to all costs captured in this section.

[101] These costs have not been quantified in line with the principle of proportionality of analysis from the better regulation toolbox. Other evidence also points at costs of creating and updating PRIIPs KIDs as reasonable, especially considering the number of clients, size of assets under management or revenues of the companies that bear these costs, as confirmed in the Retail investment study (where costs for PRIIPs KIDs are a subset of costs of disclosure frameworks) and in the Study on the costs of compliance for the financial sector (CEPS and ICF, 2019).

[102] They will however need to respect certain rules and limitations which will be described in secondary legislation or guidelines by ESMA.

PRIIPs manufacturer, implying no further cost implications[103]. No significant impacts are expected with respect to the ongoing costs of updating PRIIPs key information documents, as this option does not change the frequency of updating and as the additional ESG data would be already collected elsewhere. The targeted changes proposed only very slightly change the amount of information to be updated.

The introduction of the ex-post annual statement on costs and performance would deepen the existing disclosure obligations in terms of (i) content, by including the element of performance and payments received (in addition to costs) to all clients under MiFID and IDD and personalized projections in relation to clients under IDD, and (ii) the circle of clients receiving such annual statement under MiFID, since the obligation to provide an ex-post annual information would apply in relation to all clients (and not only to those with whom the investment firm has an ongoing relationship or are under portfolio management)[104]. The introduction of the ex-post annual statement would imply a one-off cost for the industry, consisting of costs for adjusting the existing (IT) systems, so that the new information elements could also be provided and that the statements would be extended to all clients. For an investor base of between 49-58.5 million retail investors[105], these one-off costs could be estimated to be in the range of EUR 19 – 67.5 million (see Annex 4 for details)[106].

Ongoing costs for investment firms and insurance undertakings are not expected to increase in relation to clients who already receive annual information, since after the adjustment of the systems, the information that is already available at the level of the firm (or easily retrievable from trading venues platforms/websites) could be provided to clients without any significant additional costs. This is particularly relevant for investment firms, who could incur an increase in ongoing costs in relation to clients who currently do not already receive such information (e.g. clients with whom the firm is not considered to have "an ongoing relationship"). For those clients, investment firms would incur new ongoing costs estimated at EUR 5 per client/per year. Considering the divergent interpretation and practices of the investment firms and Member States on the qualification of "ongoing relationship" in the context of costs disclosure (see above), it is not possible to estimate the number of new clients under MiFID who at present do not receive annual information on costs.

It is not expected that there would be any material increase of costs for NCAs, as such controls already exist and existing IT tools should be able to absorb a larger amount of data. No significant impact is expected on the resources of ESMA and EIOPA, as their involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

Finally, this option would impose no new direct costs on retail investors, but there is a risk that investment firms and insurance companies may pass their additional costs linked to the provision of enhanced annual statements onto their retail clients via an increase of their investment and ancillary services costs.

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[103] Other than the need to add the information to the layout and updating it, as discussed above more generally. It can be safely assumed that the underlying sustainability information does not change too frequently and can be tackled as part of regular updates of the KIDs.

[104] Under the IDD, insurance undertakings are already under an obligation to provide information on costs to all clients.

[105] Based on the assumption that about 25-30% of the households hold capital market instruments, which given 195.4 million households in the EU, results in a total of 49-58.5 million households/clients. The number of estimated retail investors could vary, although probably not significantly, as some investors might have accounts with different intermediaries or as some retail investors might be categorized as professional investors in the future (see Annex 8).

[106] It should however be noted that it was not possible to estimate the number of new clients under MiFID who at present do not receive annual information on costs, nor was it possible to gather data on the number of clients under portfolio management who already receive information on costs and performance, to be able to deduct these costs from the estimated one-off costs.

The introduction of an EU template on costs disclosure, would imply a one-off cost for the industry to adjust existing (IT) systems to the new template. It may also require firms to adjust their costs strategy in light of this new format and the enhanced competition it might create. The exact impact will also depend on how the format is developed, which will be assessed in the context of the development of the relevant level 2 measure. No significant increase in ongoing costs is expected for investment firms and insurance distributors, as they are already under an obligation to disclose costs. These disclosures are aimed at achieving clear and unbiased information to clients, hence the associated costs relate to the substantive requirements of the proposal necessary for the fulfilment of the objective of informing retail investors. Nevertheless, they are categorised as administrative costs for "one in, one out" purposes.

3. Overall assessment: Effectiveness, efficiency and coherence:

With regard to *effectiveness*, the targeted measures on PRIIPs, MiFID and IDD would contribute to SO1 by making key features of investment products, including their sustainability profile, more visible and easier to understand. They would also help increase transparency on costs before and after an investment has been made as well as the annual performance of financial products, contributing indirectly to SO3. In this regard, Option 2 therefore presents an improvement over the baseline. Nevertheless, if applied alone, these measures would be unlikely to substantially improve retail investors' ability to take well-informed investment decisions as it would not address marketing communications.

From an *efficiency* perspective, the outlined costs seem reasonable and proportionate to the expected results for retail investors. As discussed above, costs related to targeted measures on PRIIPs would be very limited and mainly one-off in nature. Updating the PRIIPs key information documents to comply with the new rules would not require collection of further data by PRIIPs manufacturers. Some further one-off costs may arise due to use of layering, depending on the voluntary choice of the PRIIPs manufacturer. Ongoing costs would not be significantly impacted. The situation is expected to be essentially the same for the requirement to use EU templates for cost disclosures and an annual cost and performance statement under IDD and MiFID. MiFID firms and insurance undertakings would essentially have to upgrade existing disclosure documents, causing limited one-off costs. If the number of retail clients becoming the recipients of annual ex post statement on costs and performance is expected to increase, it is also expected that such delivery would be made via digital tools, limiting thus the costs for the firms.

Better visibility of the most important information in PRIIPs key information documents would contribute to the *coherence* of the overall retail investment strategy, by helping to counter information overload and make disclosures more useful for investors[107]. Allowing greater flexibility for layering of information and digital presentation would also be coherent with the approach taken for the PEPP KID. The proposed changes in PRIIPs are coherent and complementary with inclusion in ESAP. While ESAP will improve access to and digital use of information in PRIIPs key information documents (enabling digital use such as extracting the data on costs or performance and comparing them across a range of products), targeted changes proposed here would make this information more user-friendly for readers[108]. The addition of an ESG dashboard would be consistent with the aim of the Sustainable Finance Strategy to empower retail investors to access sustainable finance opportunities by making relevant information more accessible and visible in the KID and it would be developed using data points from existing sustainable finance disclosure frameworks, to promote

[107] These actions are notably good complements with increasing financial literacy, which could also lead to greater use of PRIIPs KIDs.

[108] Easier digital use is unlikely to significantly affect the need to read the KID by retail investors and financial advisors, notably when assessing characteristics of a specific investment products. As the KID presents key information about a product in one place and in 3 pages, it is expected to remain a crucial document.

maximum coherence. Similarly, setting up EU templates for costs disclosure and the introduction of the annual costs and performance statement under IDD and MiFID will further strengthen the coherence of the framework. The use of EU templates for disclosure on costs should favour more comparability on costs and increase market efficiencies. The annual statement would also be consistent with the Pension Benefit Statement provided for pension products under the IORP II Directive and the PEPP Regulation which pursue similar goals.

4. Affected groups of stakeholders

Industry: Manufacturers of financial products under PRIIPs would benefit from more flexible rules to present required information in a more attractive way. They would also be able to adapt PRIIPs key information documents to more modern digital formats and devices. This could present a more effective way to deliver this information, particularly to younger retail investors and those with sustainability preferences, thereby helping to attract them to these products. While this option would not directly impact marketing communications, more user-friendly PRIIPs key information documents might to a certain degree compete with them and slightly limit the possibilities for presenting misleading information[109]. The update of PRIIPs key information documents to reflect the changes would imply limited one-time costs for the manufacturers of PRIIPs, as detailed above.

From the perspective of investment firms or insurance undertakings, the cost and performance disclosures would constitute increased costs. As the new requirements on cost and performance disclosure build on already existing requirements, it is assumed that existing processes and ICT solutions would help to limit these costs.

Consumers: the proposed measures would make PRIIPs key information documents more engaging to read and would assist retail investors in finding important information about investment products, including on sustainability-related aspects. PRIIPs key information documents would also become more accessible to users looking for investment opportunities through smartphones or tablets. This is expected to benefit retail investors considering these products, especially younger investors, who tend to be more active users of smartphones. Indirectly, this could lead more retail investors towards more diversified and less costly products that suit their needs. The proposed measures under IDD and MiFID II would increase transparency on costs and performance and comparability for the benefit of retail clients. This would help retail clients take well-informed investment decisions. Transparency could also have a downward effect on costs charged for MiFID II and IDD products and services.

Supervisory authorities: The targeted changes to PRIIPs key information documents would have only a negligible impact on supervisors who would have to adapt their supervision to the new formats. The measures under MiFID II and IDD would help NCAs in their control processes. In particular, it would allow them to check on a bigger scale and based on EU standards the ex-ante costs communicated to retail clients and the costs effectively charged (as disclosed in the annual report). It would also allow them to get a better view on the effective value for money of financial instruments marketed to retail clients.

Stakeholder views: This policy option, in particular regarding the changes proposed to the PRIIPs key investment document, has broad support across different stakeholder groups. Stakeholders from the financial sector have notably called for providing greater flexibility for layering and digital features. At the same time, some PRIIPs manufacturers have complained about regulatory fatigue[110] as there has recently been a revision of the PRIIPs RTS, which entails significant changes to the

[109] In this case mainly due to expected greater use of PRIIPs KIDs and their easier digital use, which could make it easier to detect information that would be incompatible with those included in the KID.

[110] These concerns have been reflected by narrowing down the option of targeted changes to PRIIPs to four elements which are generally considered as not burdensome (stakeholders have not indicated any concerns in this direction) and are largely non-controversial.

content of the KID and entered into application on the 1 January 2023. Supervisors are also overall supportive of the initiative. Representatives of consumer associations and non-profit organisation support measures on digitalisation and sustainability, and greater transparency on costs.

As regards the introduction of the annual statement in relation to IBIPs, consumer associations and insurance intermediaries have expressed support[111]. There may be limited support from insurance undertakings and investment firms who may argue that this increases the provision of information to retail investors.

***Option 3*: Targeted changes to address informational deficiencies relating to marketing communications**

1. Benefits

The measures under option 3 would ensure better protection of retail clients by ensuring: i) more transparency on the nature of the marketing communication made, directly or indirectly, by investment firms, also in relation to online marketing (e.g. through social media); ii) the benefit of reinforced firm's procedures and policies on marketing communication and on management's responsibility, facilitating legal actions in case of misleading marketing communication[112] and iii) the inclusion of key elements related to the financial products and investment services, in all marketing communications.

Addressing the risk of unbalanced presentation of information in marketing communications on financial products and financial services would improve the quality and transparency of information provided to retail clients via marketing communications, thus ensuring that such communications would be a reliable source of information for retail clients. The obligation for investment firms and insurance distributors to include vital information in a visible way in all their marketing communications would make it easier for investors to identify key characteristics of financial products or services at 'a glance' and would in particular ensure a balanced presentation of positive and negative elements of products or services. For retail investors, the understanding and comparability of products would be improved, which could to a certain extent mitigate the risk of purchasing products which are not appropriate for them.

By increasing the quality of information that distributors provide to investors, the measures under option 3 aim to enhance trust between providers and retail investors. Rather than providing more information as in option 2, this option would reduce the likelihood that customers' cognitive biases are exploited. While it is commonly accepted that cognitive biases matter in investment decisions, no data is available to quantify the impact. The more limited scope under option 3 would imply more limited impacts than under option 2.

2. Costs

This option is not expected to generate significant ongoing costs, as MiFID II and IDD[113] already require that all information, including marketing communication, addressed by investment firms and insurance distributors to their clients/customers shall be fair, clear and not misleading. However, despite this existing obligation, the relevant key information can be diluted across various or lengthy marketing (and contractual documents)[114] or presented in an unbalanced way. Requiring investment firms and insurance distributors to include vital information, in a visible way, in their marketing

[111] See responses EIOPA's advice on retail investor protection, page 14.

[112] With a clear legal definition of marketing communication, mandatory vital information and more duties and obligations for firms' management regarding marketing communication, retail clients would have a legal base should they seek to claim compensation.

[113] See article 24.4 of MiFID II; article 17(2) of IDD.

[114] ESMA advice on retail investor protection, page 21.

communication would imply some incremental costs either to adjust existing marketing communication templates or to create new templates. These costs arise due to the measures aimed at the objective of achieving clear and unbiased information to clients, hence they relate to the substantive requirements of the proposal. Nevertheless, they are categorised as administrative costs for "one in, one out" purposes.

3. Overall assessment: Effectiveness, efficiency and coherence:

This targeted measure would contribute to the SO1 by ensuring that marketing communications contain, in a balanced and visible way for the targeted group, the key information which could help retail investors in their decision-making process. It would be an effective measure as it would ensure consistency of the overall information provided to retail investors. It would be important that the vital information remains limited in its scope and properly calibrated[115]. Nevertheless, if applied alone, these measures would be unlikely to substantially improve retail investors' ability to take well-informed investment decisions as it would not address disclosure documents.

In terms of *efficiency*, the costs for an enhanced obligation for the firms would not be significant (as discussed above) and could possibly be passed onto retail investors. That impact would, however, be justified in light of a reduction in the risks of investing in inappropriate investment products.

In terms of *coherence*, the obligation to include vital information in marketing communications would apply to all marketing communications used by distributors selling investment products and IBIPs in the EU. It would ensure harmonisation across the Union, strengthening the internal market and ensuring the same level of protection to all retail clients. As the level of digital marketing communication is increasing both domestically and across borders, coherence in the level of regulatory requirements is becoming even more important to ensure a level playing field in the domain of investor protection. This option would likely facilitate comparison between investment products and services and have a positive effect on competition between investments firms in the EU and cross-border investment transactions.

4. Affected groups of stakeholders

Industry: The requirement to have vital information in all marketing communications and the clarification as to the concept of marketing communication, enhanced with reinforced organisational and responsibility rules, would require additional oversight by investment firms and insurance distributors, leading to higher costs. However, higher costs could to a certain extent be mitigated as the measures would also be expected to provide further clarity on the regime and reduce grey areas, providing additional certainty to ensure proper compliance with the existing rules. This could lead to cost reductions for compliance and legal advice, especially for smaller firms, due to the additional clarity provided by the definition.

Retail investors: The measure would help ensure that digital marketing of financial products is clearly identified as such, and compliant with applicable provisions on investor protection, also as regards influencers and other alternative means of advertisement. This measure would also help address the risk of misleading or otherwise illegal digital marketing on active or potential retail investors and facilitate legal actions of retail clients as well as increase their protection. The measure does not entail costs for consumers.

Supervisors: The requirement for firms to have vital information, presented in all marketing communication would facilitate the control of those communications by the competent authorities, without triggering any material additional costs. Clarification as to the concept of marketing

[115] ESMA advice on retail investor protection, page 14.

communications would allow for easier intervention and enforcement by NCAs. In particular, this measure would provide a basis upon which the enforcement in relation to novel marketing techniques such as influencer campaigns could be streamlined. No significant impact is expected on the resources of ESMA and EIOPA, as their involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

Summary of the preferred option

The table below summarises the assessment of *effectiveness*, *efficiency* and *coherence* discussed under each option. Option 2 and Option 3 are complementary and both present an improvement compared to the baseline at a reasonable cost. Hence both Option 2 and Option 3 are both part of the preferred option.

	Effectiveness			Efficiency	Coherence
	(SO1)	(SO2)	(SO3)		
Option 1 - Do nothing	0	0	0	0	0
Option 2 - Targeted changes to disclosure rules to improve their relevance for retail investors	+	+/-	+	+	++
Option 3 - Targeted changes to address informational deficiencies relating to marketing communications	+	+/-	+/-	+	++

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect
0 = no effect - = Slightly negative -- = Negative --- = very negative

6.2 Inducements

Option 2: **Maintain current system allowing payment of inducements, but improve/harmonize sector specific disclosures relating to inducements**

1. Benefits

The aim of increasing transparency would be to help retail investors to better understand how inducements work, increase comparability between products and incentivise them to assess alternatives. Conversely, this could incentivise distributors to offer products that are better suited to their retail clients' needs and investment objectives. While this may improve market transparency about inducements and foster competition between market players, evidence from behavioural testing carried out in the Retail investment study, suggests, however, that many consumers do not understand the concept/impact of inducements so that disclosures on inducements do not directly influence their resulting choices (see below).

This option would also ensure better understanding by the NCAs and ESMA of the inducements paid[116]. As the additional disclosure requirements would be streamlined across MiFID and IDD, this

[116] The ESMA annual statistical report on costs and performance shows that, due to lack of legal requirements, the aggregated inducements are not comprehensively reported to ESMA by the NCAs.

would help create a level playing field across sectors (IDD/MiFID) and also have a positive effect on the coherence of the framework.

2. Costs

Requiring greater transparency would generate further one-off administrative costs, which are expected to be limited. The additional transparency requirements would not significantly increase ongoing administrative costs which market parties already incur in relation to existing disclosure requirements on inducements.

3. Overall assessment: Effectiveness, efficiency and coherence:

Option 2 could raise awareness about conflicts of interest by increasing information to retail investors about the existence and consequences of inducements. However, this measure would not be effective in eliminating the root cause of conflicted advice resulting from the payment of inducements. In terms of efficiency, increased awareness might result in retail investors taking better informed decisions based on a clearer understanding of inducements paid and their impact, and as such contribute to the SO1, "*Improve information provided to investors and their ability to take well-informed investment decisions*". This would require that retail investors receive the information, understand it and act upon it, while evidence from the Retail investment study suggests that many consumers may not understand the concept/impact of inducements.[117] In terms of coherence, this measure would ensure coherence between the existing legal framework (MiFID and IDD), but not between European and national rules, where divergent approaches to inducements would continue.

4. Affected groups of stakeholders

Option 2 would increase burdens for all providers and distributors (administrative costs), as well as for the NCAs/ESAs who would have to collect, quality check and analyse data, as well as supervise that the information is properly and coherently disclosed to retail clients. While this option would only have minimal effects to address the identified issues, it could possibly slightly increase costs for retail investors as compared to the status quo.

Stakeholder views: Two main diverging stakeholder positions can be identified. On the one hand, consumer organisations consider enhanced transparency of inducements to be insufficient to fully address the conflict of interest. In their view, retail clients are at an information disadvantage and will often not be able to understand the effects of inducements and act upon it to take informed, good investment decisions. On the other hand, as evidenced by the public consultation, the majority of financial service providers generally consider the current disclosure framework together with the existing rules curtailing the practice of inducements to be satisfactory[118].

Option 3: **A ban on inducements**

1. Benefits

Option 3 would eliminate the main source of conflict of interest in retail distribution and thus increase the value and quality of distribution services (in particular advice, but also non-advised services) and of the products offered and sold to retail investors. As an expected outcome, the ban would eliminate product bias (i.e. incentives by distributors to distribute products that yield the highest commissions) and positively contribute to the distribution of products that better target the retail investor needs and

[117] Retail investment study, page 248. In its survey only 36% of respondents responded correctly to what they are and only 26% paid attention to this feature in their investment decision.

[118] Replies to the public consultation, Q8.5 (How should inducements be regulated?). Out of a total of 151 replies, 91 replies came from trade or business associations, four replies came from consumer organisations and the remaining replies from citizens, NGOs, public authorities, trade unions or other.

objectives[119]. As shown by the experiences in the Netherlands and in third countries like the UK, the offer and purchase of simpler cost-efficient investment products would likely significantly increase and the costs of investment would likely be significantly reduced[120]. In the Netherlands, the number of households investing in low-cost index funds more than doubled from 8% to 20% between 2016 and 2021[121]. Moreover, in the Netherlands, management fees for mutual funds fell on average by 40% after the introduction of the ban on inducements[122]. This would contribute to improved investment outcomes for retail investors**.** As higher costs of investment products reduce net return of investments[123], a ban will contribute to improving net investment performance and help channel retail investments into cost-effective products that better meet retail investors' investment needs and objectives (SO2 and SO3).

The ban is expected to improve market efficiency on the supply side by allowing providers and distributors to compete on the basis of the merits of their investment product offering rather than commissions. It would also foster innovation and likely enhance the development of digital and automated, cost-efficient distribution tools better targeted to customer needs[124]. A unified and simplified framework across sectors (MiFID and IDD) would also ensure a level playing field across and within the investment and insurance-based investment segments, as well as within the Union. Eliminating conflicts of interest would also enhance trust in financial markets and thus provide additional incentives for consumers not previously active in financial markets to invest[125].

The expected benefits for consumers of an EU level ban can be examined by looking at the total value of inducements charged to investors on an annual basis. However, the calculation of the value of inducements is not the only component of benefits for retail investors, since the removal of conflicts of interest and product bias as explained above is also an important benefit. An accurate estimation of the total amount of inducements paid is difficult to establish, due to strong data limitations regarding the share of inducements in total product costs and the exact number of products in the market that carry inducements. Based on a series of assumptions[126], an illustration can be provided for certain segments of the market (i.e. actively managed UCITS funds which are directly held by retail investors). The total annual costs of inducements at an EU level for these funds represented an estimated EUR 5.13 billion (in 2019), EUR 5.25 billion (in 2020) and EUR 6.1 billion (in 2021). If dynamic effects of the ban were considered (e.g. investors switching to lower costs products), the benefits of the ban on inducements would be even higher. For example, assuming that 5% of investments in the EU would shift to low-cost investment products (such as ETFs), this could generate further aggregated cost savings of EUR 0.5 billion (2019), EUR 0.6 billion (2020) and EUR 0.8 billion (2021)[127]. The above estimates of the value of inducements are limited to only one market segment and should therefore be seen as a significant underestimation.

As a consequence of a ban on inducements, retail investors would have to pay separately for investment services, including financial advice, as these costs would no longer be incorporated into

[119] The analysis on these impacts also applies *mutatis mutandis* to the product manufacturers when they compose structured products and select underlying asset, i.e. the benefits of Option 3 will be that product manufacturers will be incentivised to select products (underlying assets) on the basis of their merits and not on the basis the level of commissions received from other product manufacturers.

[120]See infra, Section IV below with further description of impacts on retail investors and industry together with evidence (also describing UK experience). See also Annexes A & B on the Netherlands and UK examples.

[121] Ibid.

[122] Ibid.

[123] See Morningstar studies 2019 and 2021 and ESMAs annual reports on cost and performance regarding NL and UK.

[124] See Annex 7.A and 7.B on the Netherlands and UK examples.

[125] These benefits are further explained below under impacts on stakeholders.

[126] See Annex 7.C2

[127] Based on total annual costs of ETF UCITS provided by ESMA: 0.7% in 2019 (2021 costs and performance report), 0.5% in 2020 (2022 costs and performance report) and 0.43% in 2021 (2023 costs and performance report).

the overall fees. The costs of such payments could not be quantified, but it is expected that they would be significantly lower than the cost of inducements currently being paid.

Finally, the partial ban variant of Option 3 would benefit those retail investors that wish to invest via execution-only services: those retail investors would avoid any charges arising from inducements; the partial ban would remove incentives to give more prominence to certain products in the product offering; and retail investors could be more confident that products purchased without advice would not include additional charges linked to the payment of inducements, thereby giving them access to products carrying lower costs.

Inducements amount to sizeable costs paid by retail investors in the EU, in the order of billions of Euros. If these cost savings were passed on to households, they could contribute to wealth creation for retail investors and be further re-invested into the economy. Academic research from the University of Regensburg (2023)[128], compares the effect of commission bans on household wealth in a panel data analysis and shows that countries with a (partial) ban on commissions experience higher household wealth growth.

2. Costs

Providers and distributors would incur one-off adjustment costs to transform their existing commission-based business models into fee-based models. As product manufacturers would no longer transfer back fees to distributors, the latter would have to adjust their charging models. Such adjustments would also include new contractual frameworks and adjustment of billing systems. These changes and their justification would need to be implemented and communicated by firms to clients. There would also be one-off adjustment costs for product manufacturers for the transitioning of asset holdings which incorporate inducements into inducement-free asset holdings (e.g.in the case of investment funds the migration into inducement-free share classes). After the initial set-up, we expect similar or lower ongoing compliance and supervision costs compared to the baseline scenario. This is because some of the costs would be offset[129] by the elimination of administrative costs for the application of the quality enhancement (MiFID)/non-detrimental effects (IDD) criteria under the baseline scenario. No significant impact is expected on the resources of ESMA and EIOPA.

It has not been possible to gather EU wide statistical evidence to quantify the one-off and possible ongoing costs for the industry. However, the previous reform experiences in the Netherlands and the UK can provide some illustration.

The Netherlands have carried a high-level estimation of the costs in 2012 and 2014 which pointed to total one-off adjustment costs in the range of EUR 3.72 million to 16.9 million[130] for intermediaries and EUR 130,000 to EUR 4.3 million for product manufacturers. No ongoing costs were envisaged, except for insurance providers which totalled EUR 3.4 million.

In the UK more detailed cost estimates were presented for the incremental compliance costs possibly faced by the industry (not only for the ban on inducements but for a broader set of measures). Those costs were also subject to an ex-post evaluation. The revised estimates pointed to one-off (aggregated) adjustment costs for intermediaries segments ranging between EUR 2.9 million and EUR 37.9 million, depending on the segment (asset managers distributions arms at the lower end against banks at the higher end), whereas aggregated ongoing adjustment costs ranged between EUR 5 million for conglomerates and EUR 32.7 million for financial advisors that are directly authorised.

[128] Sebastian-Noth-Grafe_Commission-Ban.pdf (uni-regensburg.de)
[129] Data on those costs is not available.
[130] All figures presented in this paragraph are for illustration purposes aligned to latest consumer prices and presented in EUR.

With respect to providers, aggregated one-off adjustment costs ranged between EUR 164.6 million (asset managers) and EUR 408.9 million (insurers), while aggregated ongoing adjustment costs could reach between EUR 5.1 million (conglomerates) to EUR 38.2 million. The total compliance costs across all segments were estimated at EUR 819.4 million (ongoing) and EUR 181.9 million (one-off); Annex 7.C provides more details on the estimates and assumptions[131].

As mentioned above, the ban on inducements was introduced as part of a broader set of measures and prior to the introduction of MiFID II and IDD. These cost indications also relate to other measures introduced at the same time (e.g. a wide set of disclosure obligations which are already implemented across the EU) and could therefore not be attributed solely to the ban. This might also explain a significant portion of the ongoing costs, which does not appear to be directly linked to the ban on inducements. It should furthermore be noted that the cost estimates included assumptions relating to ICT costs that were reasonable in 2010, but which require adjustment in light of technological advancements and the emergence of third-party providers servicing the industry. The ex-post review of the set of measures published in 2014, pointed also to over-estimations and under-estimations in selected areas (see annex 7.C)[132]. In the UK, these costs were also presented against the backdrop of expected benefits, by the use of specific examples illustrating potential consumer detriment and were in the range of EUR 314 million annually.

With a view to quantifying the compliance costs in connection with the inducement ban, the cost estimates performed in the Netherlands and UK were extrapolated to the EU-26 (cf. Annex 7.C). These extrapolations are subject to a number of assumptions and caveats, which are presented in Annex 7.C. The results show orders of magnitude which range between EUR 58 million to EUR 69 million in terms of relevant compliance costs on the basis of the Dutch estimation (covering only investment firms and asset managers), whereas potential costs based on the UK's estimates are substantially higher, ranging between EUR 14bn and EUR 15bn, as that analysis also covered the sale of insurance-based investment products. Both cost estimates refer to one-off costs, although these could be spread over any potential transitional period to avoid cliff effects and achieve gradual compliance.

The costs of the introduction of a partial ban would be expected to be lower than compared to the introduction of a full ban, as a partial ban would not impact all investment products and services. A partial ban may imply one-off costs for product manufacturers and distributors, including in relation to the creation of separate asset classes without inducements, the change of billing systems and communication to clients. The amount of these costs would depend on the degree to which firms currently manufacture and offer products with inducements through execution-only channels and the choices they would make for their business model and product offering after the introduction of a partial ban. These costs are in any case expected to be lower than compared to a full ban on inducements. As an illustration, and extrapolating on the basis of the UK figures, the one-off costs of EU stockbrokers' firms[133] - potentially the segment most affected by a partial ban (which targets pure brokerage services) - would be estimated to be in the vicinity of EUR 48 million[134]. This amount can be considered an underestimation, as it does not take into account the one-off costs that could be incurred by other investment firms and insurance intermediaries.

[131] Ibid footnote 120

[132] These over and under estimates from the ex-post evaluation have been included for illustration purposes in the amounts presented in this paragraph.

[133] Stockbrokers are defined as MiFID firms, with a license for the receipt and transmission of clients' orders or the execution of orders, but who do not offer investment advice to clients and that are not banks.

[134] See Annex 7.C (i.e. EUR 89,600 x 427 firms x 1.25 (scale factor))

These above estimates should not be seen as actual estimates of the possible cost impacts in the EU as a whole. Given the wide ranges, the series of assumptions and caveats and significant differences between them, they do not permit a reliable extrapolation to the EU. They can however illustrate an order of magnitude as to the possible adjustment costs incurred as a result of an inducement ban.

3. Overall assessment: Effectiveness, efficiency and coherence:

Option 3 would be *effective* in achieving the prescribed objectives by removing the major source of conflicts of interest of intermediaries. As advisors are no longer rewarded to "push" products that pay the highest commissions but, due to their cost structure, are often not aligned with the objectives of the client (product-bias), intermediaries would be able to focus on the clients' needs and objectives in the product selection[135]. This would contribute to the availability of bias-free distribution services, including advice, resulting in an improved "product-client match" of products. A ban would also likely improve market efficiency by allowing providers to compete on the basis of the merits of the product offering[136] (as opposed to competition based on the amount of inducements that distributors receive). Adjustment to business models would be necessary and certain existing market structure trends might further be enhanced.

The clear-cut nature of a ban would be *efficient* compared to the baseline, according to which inducements are allowed when they enhance the quality of the service (under MiFID) or are non-detrimental to the quality of service (under IDD). As identified in the evaluation, the current requirements are not sufficiently efficient to deter against the negative consequences and are also costly to supervise and subject to diverging interpretation and application across the Union. Despite the expected one-off adjustment costs, the measure is expected to be efficient considering the expected benefits.

A ban of inducements across the different sectors would *increase coherence* by harmonising the requirements across the Union and strengthen the internal market by granting the same level of protection to all retail investors, irrespective of Member State, type of product or distribution model. Particularly in light of increasing digital distribution, and the corresponding boost to cross-border passported services, this coherence would ensure a level playing field in the Union.

As in the case of a full ban on inducements, a partial ban relating to execution-only services would be effective, coherent and efficient in addressing the identified problems in this market segment. Such a measure would not however address the identified problems in the advice segment.

4. Affected groups of stakeholders:

Industry:

Option 3 would affect all financial institutions in the value chain that provides investment services to retail investors. The shift to a ban on inducements would mean that distributors would no longer be able to receive commissions from product manufacturers and as a consequence would have to move to a fee-based model. Accelerated by increasing digitalisation, the ban on inducements would imply changes to market structures and business/ distribution models, which may affect the cost and revenue base both for individual financial institutions and the industry in general. Besides changes in the cost structure, a ban on inducements may imply a loss of revenues, but may also create new opportunities for financial institutions. The exact impact would depend on existing business models, the choices that financial institutions would make in the transition to a new fee model and the duration of any transitional period.

[135] The same thing applies to product manufacturers, when selecting underlying assets for structured products.
[136] See Annexes 7A and 7B on the Netherlands and UK examples.

The existing market structures vary across Member States and product segments. Both vertically and non-vertically integrated value chains co-exist (in the former, the supply chain is within the same corporate control). Another prominent feature is 'closed architecture' models (i.e. where distributors favour investment products from manufacturers belonging to the same group or from favoured third parties)[137]. Irrespective of the corporate structure and business model, investment products are predominantly distributed on the basis of commissions.

An inducement ban is expected to reduce the market-wide interconnectedness and break close ties between investment product manufacturers and distributors that exist as a result of commission payments. By removing the financial incentives created by the payment of inducements, financial intermediaries and financial providers would be able to compete more easily on the merits of their investment product offering (as opposed to competing on the level of commissions) and to use an open architecture model (including through availability of independent advice).

In its technical advice, ESMA pointed to a risk that vertical integration between banks and asset managers might result from a ban on inducements, in particular in markets with bank-centric models, possibly resulting in the offer by such groups of only in-house products to end-clients. This risk has not however materialised in the Netherlands, where on the contrary, following the ban there was a shift towards open architecture models. The three largest credit institutions divested their asset management businesses and opened their distribution channels to third party asset managers, leading to an increased offer of third party and more cost-efficient products. Those asset managers that had been divested from credit institutions built up their own direct distribution to retail clients, thus competing with the credit institutions[138]. The availability of independent advice in the Netherlands is as high as 50% of the market[139].

In order to enhance the effectiveness of the ban, Option 3 provides safeguards against intragroup inducement-like payments (in the form of cross-subsidies to distributing entities from other group entities), whereby vertically integrated distributors would be prevented from providing advice below cost and, consequently, their ability to favour inferior in-house or preferred third party investment products would be impacted[140]. The preferred options on value for money will also serve as a flanking measure in this regard, helping to ensure cost efficiency of investment products, also when offered through vertically integrated models.

Independently of the distribution structure or models chosen (vertically integrated or open architecture), the ban on inducements would incentivise increased competition on the merits between investment products. This is because Option 3 applies to all distributors who would need to adapt the attractiveness of their investment product offerings to compete with that of other distributors[141].

Option 3 would also likely result in a change of the relative portion of the different types of investment service provided to retail investors. The main channels through which products reach retail clients are advice, portfolio management, or non-advised services (for certain IBIPs)/execution-only (for financial instruments). Overall, the provision of advised sales would be expected to decrease

[137] An overview of market structure, market participants and products is provided in Annex 7.D.
[138] See Annex 7.A.
[139] See Annex 7.A. Compared to well below 1% in Italy and Germany, see supra.
[140] ESMA Technical advice 2020, at page 13. In the Netherlands where, as a part of the ban on inducements, groups operating in-house distribution must recover cost of distribution at the level of the distribution entities, thus barring the possibility to allocate costs elsewhere. There are standard requirements on cost allocation and apportionment and third-party auditing. A similar requirement was introduced in the UK where "the allocation of costs and profit between the adviser's charge and product cost should be such that any cross-subsidisation is insignificant in 'the long term'.
[141] The exact impact in terms of mix between vertical and non-vertical integration as well as open versus closed architecture remains uncertain and is likely to vary among Member States.

in favour of the provision of portfolio management services and non-advised/execution sales respectively, at least initially. In the Netherlands, for example, the split between clients using advice, portfolio management or execution-only in 2021 was 5% for advice (down from 21% in 2013) while (automated) portfolio management services increased to 33% (up from 20% in 2013). Execution-only services, including those with additional guidance[142] remained stable (62% versus around 60% in the preceding years)[143]. In the UK there was an increase of self-directed activities. Under Option 3 there may be lower demand for advice and some financial institutions may decide to scale down their advisory activities and/or focus on other services. Within the advice category, a shift towards independent advice is expected[144]. It would also be easier for independent advisors to compete with non-independent advisors[145], as they would no longer need to explain why they charge a fee for their services directly to the retail when most market participants do not[146].

As regards insurance intermediaries, a ban would be confined to the sale of IBIPs and would not apply in the case of other insurance products. It is likely that a portion of insurance intermediaries would specialise in IBIPs, terminate their intermediation activities or shift to non-life products, not covered by the ban on inducements[147].

The above developments will be facilitated as well as accelerated by technological developments and the ongoing trend of digitalisation of financial services. While the extent of physical sales versus digital sales of investment services varies significantly across the EU, distribution channels and consumer habits are shifting generally strongly towards digital sales[148]. As Option 3 would render costs and the value of products and services more visible (both to investors and distributors), it is expected that this option would further incentivize firms to enhance operational and other efficiencies, notably through digital solutions, especially for products directed towards low-income/low net-worth clients[149]. Robo-advice or other digital advice models currently represent only

[142] Approximately 10% of the Dutch execution-only clients invest via so-called guided execution only services. These are execution-only services, where a pre-determined, cost efficient and well-diversified range of products in offered to the clients. The estimated percentage of clients investing through guided execution-only services in the Netherlands was 10% in 2021.

[143] See experience from the Netherlands at Annex 7.A. See also infra as regards the UK, and at Annex 7.B.

[144] See Experience with the ban on inducement ban in the Netherlands at Annex 7.A.

[145] As is the case currently for independent advisors (see under problem definition the resulting insignificant uptake of independent advice). For example, in Italy, only 428 out of 52,328 advisers are independent (0.8%), see report Relazione Annuale 2021 by Organismo di vigilanza e tenuta dell'albo unico dei Consulenti Finanziari, page 68. In Germany BaFin's registers shows 17 "fee-based" advisors (Honorarberater).

[146] See further in Annex 7.A. The issue is not whether a fee will be charged, but the level of fees and the scope/value of the services, something facilitated by the fact that the advice is impartial. Where distributors provide added value advice to their clients, they will be able to retain them. If not, it is likely that retail clients will over time shift towards non-advised sales/execution only sales. This is what happened in the UK, see Annex 7.B.

[147]See Experience in the Netherlands at Annex 7.A. Note however that with respect to a potential shift to non-life products, the Dutch ban on inducements was broader and not confined to IBIPs products only. Any such expected shift cannot be directly compared to the Dutch ban. Self-employed advisors, making up 85% of the Dutch market, indicated that more than 50% of their total turnover came from non-life insurance consultancy and intermediation.

[148] In the EU, on average, the number of bank branch office has decreased from 220,000 in 2010 to about 140,000 in 2022. See ECB, Banking structural indicators, as at 19.11.2022. See Market structure overview at Annex 7.C**.** Also a 2021 by Oliver Wyman shows that, in line with this trend, the percentage of clients holding online brokerage accounts in Germany increased from 34% to 37% in 2021. Furthermore, in Germany for example there is an increasing trend towards online banking across all age segments, but due to the Covid lockdown this jumped from 50% in 2019 to 64% in 2020. (Deutsche Bankenverband/ Kantar 2020).

[149] Increasing digitalisation is also contributing to the ongoing consolidation of distribution systems in Member States. It cannot be excluded that shifting to a fee-based distribution model could further accentuate this trend. This is driven by the need to reach higher scale economies (bigger volumes of (low cost) advice to clients) or scope economies (larger mix of products) than what is currently the case.

a very small share of total retail business, but this is increasing[150]. Traditional distribution channels already innovate and will likely have greater incentive to do so and use more automated or semi-automated solutions in their advice and other service offerings in order to target client needs, reduce costs and improve operational efficiency[151]. Given the technological advances and changing consumer habits, large scale market restructuring and changes of business models is likely to be easier today than compared to a decade ago when the ban was introduced in the Netherlands and third countries like the UK.

The impacts of a partial ban on inducements relating to execution-only services would be considerably more limited than for a full ban on inducements, since it would only target the part of the industry that manufactures and distributes products to retail investors through execution-only channels. The impact of a partial ban on inducements relating to non-advised sales would be even more limited for IBIPs, as advised sales are the predominant distribution channel in most Member States. This is partially due to regulatory requirements, since a significant number of Member States either do not allow execution-only sales or require compulsory advice for the sale of IBIPs; if those Member States maintain such requirements, a partial ban would have no impact on non-advised services relating to IBIPs in those markets.

Retail investors:

A ban on inducements would eliminate conflicts of interest and increase the value and quality of advice and other distribution services offered to retail investors. A ban could also be expected to result in the sale of lower cost and less complex products to retail investors (see section on benefits).

A ban on inducements would lead to more transparent pricing for retail investors, who would be charged directly for investment services (including advice). Under the commission-based model, the price of advice is embedded in the product and its cost is not visible to the client. The advice is nonetheless not "for free", but the client pays indirectly for this service (which they may not realize). A fee-based model would provide retail investors with a salient reference point to consider the value of the services/products provided to them (i.e. the price). As under the commission-based model, no explicit service fees are charged to retail investors at the point of sale, however retail investors have a tendency to underestimate the cost of advice, which also severely undermines their ability to assess its actual value. Transparent fees would allow them to better consider the value of advice and make an active decision as to whether or not they wish to solicit it[152] or instead engage in self-directed investments[153]. While a number of investors would be willing to pay for bias-free advice, other retail investors may change to self-directed investing or decide to opt for portfolio management. Therefore, it cannot be excluded, at least initially, that advised sales of investment products would decrease in some markets[154].

Some stakeholders (from the industry, but not the consumer side) have expressed concerns in the public consultation about a risk of *the emergence of an advice gap* as a consequence of the inducements ban. According to these stakeholders, some consumers might not be willing or able to pay for advice and thus not invest at all. Consumers investing only small amounts of money might

[150] Study on distribution systems of retail investment products page 130; Report ESA Joint Committee Report on the results of the monitoring exercise on automation in financial advice EIOPA, 2018, where they note a slight increase since the 2015 report.

[151] This is the case in the Netherlands, see Annex 7.A; and third countries examined, e.g. UK See FCA 2020 Report, Impact of the RDR and FMR, page 21, and Europe Economics at page 51, See Annex 7.B.

[152] And whether they want independent or non-independent advice.

[153] See experience from the Netherlands at Annex 7.A.

[154] As evidenced by the experiences in the Netherlands and the UK. in the UK there was an increase of self-directed activities whereas in the Netherlands there was a shift to portfolio management services whereas self-directed investments remained stable, but where guided execution-only services emerged as an offering.

not be able to find distributors willing to advise them. In addition, there could also be consumers who independently of their investment needs and ability would remain 'unengaged' and who could use a "nudge" in order to invest. According to this argument, intermediaries would cease to serve those (potential) retail investor segments, because they would be unable to recover their costs[155]. On the other hand, other stakeholders, in particular consumer organisations, argue that non-independent advice is currently mis-qualified as "advice", whereas in practice it could better be described as a sale of a financial product. These stakeholders consider that given the dominance of the commission-based model across the Union, "*there is already an advice gap",* which would be removed by a ban on inducements[156].

The experience in the Netherlands shows that the levels of retail investment remained stable and even slightly increased since the introduction of a ban on inducements from 20% in 2013 to 23% in 2021[157]. That suggests that any reduction in advice services would not result in an investment gap, but rather in retail investors accessing investment services via other channels (see above)[158]. It can also be expected that (as experienced in the Netherlands) different types of portfolio management services and various types of execution-only services could emerge[159]. Investment advice, portfolio management and execution only, in the form of guided execution-only concepts, have been broadly available in the Netherlands since the introduction of the ban[160], with fees as low as 0.8% -1% and without minimum investment amounts[161], meaning that a person investing 10,000 EUR is charged no more than 100 EUR for the service and products acquired[162].

Unwillingness to seek/pay for advice may be due to reasons other than affordability[163], e.g. lack of understanding of the value that advice can provide, lack of engagement and limited interest in investing altogether ("not for me") or also lack of trust in the advice. It can also be the result of retail investors preferring to do their own research and take their own investment decisions[164]. Introducing

[155] See for example 'Commission-based remuneration vs. Fee-based remuneration: is there a better model for retail investors?' (2021) KPMG, page 64; and 'The future of advice: A comparison of fee-based and commission-based advice from the perspective of retail clients' (2021) KPMG, page 20.

[156]Better Finance Research Paper on Detrimental Effects of "Inducements": Evidence & Arguments for Banning Inducements in Retail Investment Services' (2022) and Better Finance, 'Additional evidence on the detrimental impact of sales commissions ("inducements")' (2022).

[157] See experience from the Netherlands at Annex 7.A. See Retail investment study pages 247 and 277. In the UK, as noted (infra), while there was a slight decline of total retail investments volumes in 2012, they have gone up again constantly to above those levels by 2020 (2.9 million units sold compared to 2,3 million units). See Annex 7.B.

[158] See infra.

[159] See supra as well as Annex 7.A.

[160] Desktop research, websites from various NL providers, see table at Annex 7.A.

[161] As regards the UK, there is inconclusive evidence on the issue of minimum investable amounts for advice services. Survey research points to suggested minimum amounts between £20,000 up to £100,000. However, crucially, the study did not compare the situation to availability of advice prior to the ban in 2012. Also, the number of clients that were "asked to leave" remained insignificant and the number of clients of the firms surveyed increased over the period. Europe Economics 2014 report (p. 50 et al.). In addition, crucially, eight years after the reform, the FCA 2020 report observed that only 40% of firms declared having formal minimum thresholds for pensions/investments, but there was no indication that firms without a formal minimum investment size targeted or served less affluent customers. (FCA 2020, page 39). See, Annex 7.B. Also, see infra on the availability of low cost robo-advice.

[162] And where amounts of advice costs and management fees are clearly separated and disclosed (which, as noted above, decreased by 40% on average in the Netherlands). See experience from the Netherlands at Annex 7.A.

[163] There is mixed evidence available as to the portion of retail investors that might be unwilling to pay for advice when they know the price of it in the form of a fee (Retail investment study, page 282 et al). In its consumer survey, 42% of respondents stated that they either strongly or slightly agreed that they would pay for financial advice if it was affordable. The people who have savings and are considering investing are in particular the most likely to say they would pay for advice if it was affordable (54%).

[164] See UK experience with ban at Annex 7.B. In the Netherlands there is an increase of investment product comparison websites, which shows that there is demand among retail investors for services that assist them to engage in self-directed

a ban would therefore incentivize investment advisors to better communicate with and demonstrate to their clients the value of the advice.

It is clear that consumers can benefit from support and assistance in their investment journey, including through un-biased advice, which is currently not sufficiently available or not available at all in many Member States. Option 3 would address this problem. Furthermore, evidence from the Netherlands (as discussed above) does not suggest that a ban on inducements would lead to an investment gap or an advice gap[165].

Increased operational efficiencies made possible through technological developments and digitalisation are also expected to contribute to improving access to investment services, especially for the category of potentially 'unserved' retail investors (with small investments amounts) but also for retail investors more generally. This goes hand in hand with improving access to advice also for small investment amounts through for example semi or fully automated solutions[166]. A recent AFM survey in the Netherlands has shown that the proportion of retail clients that use or consider engaging with robo-advisors/semi-automated portfolio management has risen from 25% in 2016 to 53% in 2018. Of those, 9% already used semi-automated portfolio management in 2018, compared to just 1% in 2016. Those services typically provide access to low-cost index funds[167].

At the same time, other flanking measures are expected to facilitate access to cost efficient investment services and increase retail investor engagement. These flanking measures would help guide investors and reduce barriers to affordable advice. In particular, the following measures are envisaged: (i) improvements to the suitability and appropriateness assessments (Annex 8), as well as adjustments of the legal framework for investment services aimed at fostering the availability for retail clients of cost-efficient investment support, (ii) by facilitating access and exchange to client and other relevant data, the Commission's initiative for an open finance framework[168] should allow for

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investments. It could be the case that such services will increase in importance across the EU following a ban, although this aspect has not been assessed. See experience from the Netherlands at Annex 7.A.

[165] The FCA, when reviewing the impact of its inducement ban, noted that there was already falling demand for investment advice between 2008 – 2012 prior to the ban, but later noted that the number of adults that received advice actually increased again from 6% in 2017 to 8% in 2020. At the same time, by examining a time series between 2012 when the ban was introduced and 2020 there was a large increase of non-advised sales volumes. Non-advised sales became the lion's share of sales of investment products (products examined included bonds, decumulation products, individual savings accounts (ISA), occupational pensions, personal pensions, scarps, trusts and open-ended investment company (OEICs)). The reason for this was identified as being that consumers "*who would previously have paid for full regulated advice are increasingly turning to alternatives such as investing on a non-advised basis, e.g. via platforms*". This is because *consumers have become more confident at directing their own financial affairs. [In fact] 74 per cent thought that it is better to research financial products before considering financial advice, and 44 per cent thought that it is actually better to make the investment decisions without obtaining professional advice."* Europe Economics 2014 paper page 42. Also, *"most respondents said that they hadn't sought out advice because it was not needed, or that they felt they could make these decisions themselves (66%) and 22% had simply not thought about it."* FCA Report, Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review (2020), page 35. See Annex 7.B.

[166] Study on distribution systems of retail investment products, page 130 et al.

[167] See experience in the Netherlands at Annex 7.A. While in the UK, between 2017 and 2020 the consumer engagement with automated advice services remained low and stable, at 1.3% and 1.4% of UK adults, the amount invested on such platforms has increased eight-fold between 2016 and 2019. FCA, Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review, page 40, See Annex 7.B.

[168] In 2020, the Commission identified promotion of data-driven finance as one of the priorities in its Digital Finance Strategy and stated its intention to put forward a legislative proposal on an open finance framework. Open finance refers to the access to and processing of customer data upon customer request across a wide range of financial services. As such, it constitutes the next EU policy step on access to customer data in the financial sector after the data sharing provisions on payment accounts introduced by the revised Payment Services Directive (PSD2). The main objective of open finance is to give more effective control to customers of financial service providers – whether consumers or firms – over how their financial data are accessed and used in order to stimulate innovation, promote market transparency and enhance access to finance. Open finance aims at unlocking this data to increase consumer choice, reduce costs and stimulate competition.

operational efficiencies and data sharing which should facilitate automated or semi-automated models and stimulate the uptake of affordable advice, in both hybrid and digital forms, and (iii) efforts to raise financial literacy levels should also contribute to stimulate retail investor engagement and increase their willingness and ability to invest (see Annex 5). These measures would benefit all retail investors, including the less wealthy or less engaged retail client segments.

Finally, the partial ban variant of Option 3 relating only to execution-only services would offer benefits to retail investors: those retail investors would no longer incur inducement charges for self-directed sales; the partial ban would remove incentives to give more prominence to certain products in the product offering; and retail investors could be more confident that products purchased without advice would not include additional charges linked to the payment of inducements, thereby giving them access to products carrying lower costs. But while a partial ban would address the consumer detriment resulting from the payment of inducements in the execution-only segment, it would not address the consumer detriment relating to advised services.

Stakeholder views: similar to Option 2, stakeholders' views diverge, although two main positions can be identified. Consumer organisations are favourable to a ban, pointing out that this measure would be the most effective way to address the inherent conflict of interest in the current system. Introducing a ban would not create, but rather eliminate an advice gap that already exists, and thus decrease the cost of investment, enhance quality of services and improve investment outcomes and more generally restore investor confidence in financial markets. Other solutions would risk increasing the complexity of the legal requirements without effectively addressing the core conflict of interest problem. The majority of financial service providers on the other hand, as indicated in the public consultation, would oppose a ban, referring primarily to the risk of an advice gap due to retail investors' unwillingness to pay for advice and the increased risk of bad investment outcomes should they engage in self-directed investments. They would prefer to address problems relating to the payment of inducements through increased transparency.

Summary - Choice of the preferred option

Option 3, the introduction of a Union-wide ban on inducements, is judged to be the most effective measure to reach the overall objectives of the retail investment strategy and in particular Specific Objectives 2 and 3. It would remove or significantly reduce conflicts of interest in the investment decision process uniformly across the Union, to the benefit of all retail investors. A ban would reduce an important source of consumer detriment. The expected long-term benefits for retail investors are in particular access to better performing, less costly and more relevant investment products.

The level of knowledge and extent of participation of retail investors in capital markets varies greatly across the Union, but a common feature in all Member States is that retail investors are at an information disadvantage compared to providers, in particular with respect to the value of the service and products provided to them. As a result of the conflicts of interest inherent in commission-based models, independently of the level of development of the retail markets and level of knowledge of investors at Member State level, inducements have had a detrimental effect on the quality of service provided to retail investors and ultimately on their investment outcomes.

While Member States already have the option to introduce an inducement ban or other intermediary solutions at national level, a common Union-wide ban, together with enhanced common investor protection standards, would ensure a level playing field between Member States and across

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Wider data reuse should give consumers and small and medium enterprises (SMEs) access to a wider range of services and products. More broadly, should contribute to better information for customers, as third-party providers accessing the data have the potential to generate additional insights.

distribution channels, thus improving the efficiency of the internal market, in line with General Objective 3. That would benefit all retail investors across the EU. The trend towards increasing digitalization will continue and further underlines the need to strengthen investor protection rules throughout the Union for all service providers.

A transitional period to introduce a ban on inducements would be necessary to ensure that distributors and manufacturers have time to adjust their business models from a commission-based to a fee-based model. Examples of the steps that need to be taken are adjustments to the current fee schedule and billing systems, informing clients of the new structures, creating new share classes without inducements in the case of investment funds and upgrading IT systems where necessary.

Option 2, enhanced transparency, will increase the information available to investors to make informed decisions but is expected to be less impactful on retail investors' ability to assess the implications of the value of the services and products provided to them and, therefore, would be unlikely to act as a deterrent or mitigating factor to effectively address the consequences of conflicts of interest.

The variant to Option 3 (partial ban on inducements for execution-only services), would address the consumer detriment resulting from the payment of inducements in the execution-only segment, but would not address the consumer detriment relating to advised services. However, a partial ban could be a first step that left open the possibility of further expansion to a full ban and could be a means of ensuring a smooth and gradual transition into a new system that avoided shocks from sudden major changes both in terms of impacts and adjustment costs for the industry. The situation relating to the payment of inducements and the types of products purchased by retail investors could be closely monitored and, should the implemented measures be considered insufficient, a comprehensive ban that included advised services might then be considered.

	Effectiveness			Efficiency	Coherence
	(SO1)	(SO2)	(SO3)		
Option 1 - Do nothing	0	0	0	0	0
Option 2 – Additional disclosures	++	+	+	+	+
Option 3 – A ban on inducements	++	+++	+	++	++

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect
0 = no effect - = Slightly negative -- = Negative --- = very negative

6.3 Value for Money

***Option 2*:** **strengthened governance rules at the product manufacturing level**

1. Benefits

Strengthening the rules on product governance would require manufacturers to pay greater attention to costs to ensure that their products offer value for money. Increased controls and pressure to always maintain the cost-effectiveness of products would enhance discipline among manufacturers. The mechanism introduced by this option would significantly enhance the enforcement of Value for

Money, by shifting the burden of proof from NCAs to manufacturers; manufacturers would need to demonstrate that the costs of their products do not deviate excessively from the appropriate benchmarks, or else to justify any such deviations. That would help eliminate from the market those products that are likely to present investors with poor value for money, as well as contributing to ensuring retail investors benefit from more cost-effective products (SO3), including wider availability of lower cost and potentially less complex (hence easier to understand) products that would better match their needs. It would also help ensure that the cost of each product is better aligned to its quality, i.e. the relationship between return expectations and the level of risk, taking into consideration other product features that would reasonably be expected to bring value for investors.

In its 2021 Supervisory Statement, EIOPA clarified that, as part of the assessment of value for money risks in their products, *"manufacturers should be able to present a structured pricing process in their POG reporting to competent authorities*"[169]. ESMA also considers the control of the cost/fee structure of the fund at the authorisation stage as a positive development[170], and has encouraged competent authorities to perform a timely assessment of funds' cost and fee structures in order to address investor protection risks.

Furthermore, the establishment of benchmarks would stimulate competition among manufacturers and help increase the overall cost efficiency of retail investment products. Benchmarks would also facilitate the task of supervisory authorities and ensure more effective supervision.

The benefits for retail investors would depend on the effectiveness of the new measures. Scenarios are presented under option 3 (below) illustrating the impact on the net returns that households could expect to earn on investment funds and insurance-based investment products, using existing microeconomic benchmarks and macroeconomic variables. Since option 2 is limited to manufacturing benchmarks, this analysis requires additional assumptions, which are explained below. The higher returns that investors could earn would amount to slightly below EUR 15 billion per annum in a scenario where yields in Member States with below average returns have converged half ways to the EU average.[171]

2. Costs

Since well-run product manufacturers should already have in place functioning cost accounting systems, the costs of producing comparisons against benchmarks should not generate high administrative costs. Article 9 of the MiFID delegated directive[172] already contains a number of obligations on manufacturers in respect of determining the target market and ensuring product

[169] See EIOPA Supervisory Statement on "Assessment of value for money of unit-linked insurance products under product oversight and governance", page 5. The assessment should include evidence on the quantification and breakdown of costs and charges, that adequate and sufficient testing has taken place on whether the product offers value for money taking into account the target market specificities, and that elements such as performance, costs and charges are adequately and periodically reviewed.

[170] Page 22, ESMA's Final Report on the 2021 CSA on costs and fees.

[171] For details, see Annex 3. Given the narrower scope in option 2, the benefits would be a proportion of the broader benchmark. Assumptions are based on the proportion of manufacturers' revenues relative to distributors'. These numbers, however, must be considered in light of the validity of the assumptions and are strongly driven by observations in two Member States.

[172] Commission delegated directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits Directive

quality, including the need to undertake a scenario analysis to assess the risks of poor outcomes for clients. Article 22(4) of the UCITS level 2 Directive requires management companies to prevent undue costs being charged to the UCITS and its unitholders and for each Member State to draw up rules of conduct for management companies. Similar requirements are also present in Article 17(2) of the AIFMD level 2 Regulation, as well as in Articles 4 to 8 of the IDD delegated regulation on product oversight and governance[173]. EIOPA also issued on 30 November 2021 a Supervisory Statement[174] explaining that Article 25 of the IDD and the delegated regulation on product oversight and governance require manufacturers of IBIPs to assess whether their products offer value for money in line with needs, objectives and characteristics of their target market.

The value for money ("VfM") assessment would therefore represent a refinement of existing rules but including specified criteria and reference to benchmarks. The main adjustment costs resulting from this process would concern adjustment of processes to incorporate VfM aspects, involving one-off changes to IT systems. As calculations can be automated, this option would also not be expected to generate significant additional ongoing adjustment costs. The adjustment cost of the assessment against VfM benchmarks would be limited as most of the data and IT infrastructure are already in place in order to comply with existing disclosure requirements e.g. under the PRIIPs framework and existing product governance rules.

However, reporting to supervisors will entail additional administrative costs. The magnitude of these administrative costs will depend to a significant extent on how VfM is ultimately implemented, and the degree of granularity required. It will also depend in part on possible synergies with the supervisory reporting introduced by the AIFMD review[175]. Estimates (but which do not take account of such synergies) point to possible one-off costs for supervisory reporting about €60 million (range €13 to €252) million and ongoing annual costs of €2.3-22.6 million. The reason for this wide range is due to the uncertainty related to the underlying assumptions.[176] ESMA and EIOPA would be expected to refine these cost figures as part of their mandate to develop VfM benchmarks.

ESMA and EIOPA would be allowed sufficient time to develop the relevant benchmarks as part of their existing regulatory roles. Any additional burdens should also be seen against the background of cost savings that ESMA and EIOPA will achieve (e.g. as a result of more targeted supervision, the availability of more granular data for their cost and performance reports, more tools to identify problems in specific sectors and in relation to specific products, etc.). It can be expected that additional costs for NCAs to receive the relevant information from product manufacturers and pass it on to the ESAs would likely be very limited. Some NCAs may need to intensify supervisory efforts to police the more rigorous rules, and staff would need to acquire new skills via training.

3. Overall Assessment: Effectiveness, efficiency, and coherence

[173] Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors, OJ L 341, 20.12.2017, page 1.
[174] EIOPA Supervisory Statement on "Assessment of value for money of unit-linked insurance products under product oversight and governance"
[175] Proposal for a directive of the European Parliament and of the Council amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds, COM/2021/721 final
[176] See Annex 14.

Option 2 (limited to the product manufacturing level) would be an effective means to improve the cost effectiveness of retail investment products. It would be achieved via relatively limited amendments to existing product governance rules which would not entail substantial additional costs for product manufacturers. The elaboration of benchmarks to facilitate comparison with market standards would facilitate their tasks but would require additional resources for ESMA and EIOPA.

It would be efficient, as the benchmarks developed and provided by the ESAs would give manufacturers an objective standard against which to measure their products in the product approval process and facilitate their task.

A common approach developed at EU level would contribute to the further integration of EU capital markets and thereby increase coherence.

4. Affected groups of stakeholders

Retail investors

Retail investors would benefit from a higher level of protection, in particular as a consequence of improvements at the product design stage that could eliminate poor value investment products from the market, ensure better alignment of costs of products to a measure of their quality (i.e. relation between return expectations and level of risk), as well as increased market efficiency due to the introduction of benchmarks that enabled easier comparisons against market standards.

Industry

Manufacturers would benefit from greater clarity as to what is expected under product governance rules (in the form of criteria and benchmarks) detailing how to assess whether their products are designed appropriately so as to meet the target market's needs and the supervisory expectations of their national authorities. They would need to adjust their processes and would no longer be able to put into the market products that offered poor value for money. That would prevent them from incorporating high fees into products if they could not be justified. Distributors would be limited to selling only cost-effective products, thereby enhancing the attractiveness of product offerings in the market. Some transitional costs would be borne by the industry, but these would be expected to be marginal. Firms that were profiting from excessive fees would see revenue streams reduced. This could lead to some consolidation in the asset management industry. Currently, there are many manufacturers of investment products with a low average fund size, in which implies further potential to achieve economies of scale and a more efficient provision of financial products. A reduction in investment opportunities for retail investors appears a very unlikely consequence of increased competitive pressure on the manufacturers of investment products. Clearer standards would make the task of supervision more effective and straightforward.

Supervisors

NCAs will benefit from greater clarity as to how the supervision of costs should be applied. The new VfM provisions will equip NCAs with a tool, based on access to sufficiently broad-ranging data on costs of products, which will enable them to make evidence-based assessments. The burden of proof will be transferred from NCAs onto manufacturers who will need to justify deviations in their costs

from relevant benchmarks. Supervisors will collect data on costs from manufacturers to pass on, possibly in aggregated form, to ESMA or EIOPA.

Stakeholder views: consumer organisations have broadly welcomed the idea of a strengthened VfM approach and set out clear ideas on how that might be framed in the legislation. This included developing market benchmarks against which the VfM prospect of proposed products might be compared (as opposed to comparing only to the distributor's portfolio). All consulted consumer organisations recommended that VfM should be extended to all product categories, with all products falling in scope. Doubts were nonetheless expressed by some consumer organisations that the impact of any measure would be dependent on the extent of enforcement. Industry representatives had more mixed reactions and were generally more sceptical about how a VfM approach might be framed and how it might be able to capture a notion of value across a broad range of very different products.

Option 3 – strengthened product governance rules for manufacturers and distributors

1. Benefits

Option 3, in addition to the benefits as described under Option 2, would also oblige distributors to focus more clearly on identifying the most cost-effective products for their clients. It would ensure that the distribution costs[177] borne by the retail client would also be taken into account in the VfM assessment, together with the product costs. Distribution costs are important for the VfM assessment, as they are among the main cost drivers for retail products. For example, EIOPA found that distribution fees were among the main cost drivers for the most expensive retail insurance products (unit-linked and hybrid products)[178].

Distributors would be helped to assess VfM by the availability of benchmarks and criteria for the assessment, as well as being able to base their assessments on information provided to them by product manufacturers. The available benchmarks, which would include distribution costs, and the need to document how products approved for distribution performed against these benchmarks, would ensure an additional level of accountability on the part of distributors.

It is expected that this option, involving the application of VfM assessments by both product manufacturers and distributors, would reduce the risk of poor investment outcomes for retail investors.

The introduction of benchmarks would limit the pricing power of providers and force inferior providers to adjust, either by offering higher returns or exiting the market. This would lift average returns that retail investors can earn and reduce their likelihood of encountering frustrating investment experiences. The exit of inefficient providers is unlikely to cause a reduction in the supply of products and remaining competitors should be able to absorb additional demand, as production costs of financial products increase only marginally with the number of products offered and since cross-border providers might be keen to expand business to other Member States.

[177] i.e. the costs related to the service provided by the distributor.
[178] EIOPA's Costs and Past Performance Report – 2022, page 4.

Convergence scenarios can indicate the likely magnitude of the welfare gains stemming from the introduction of Value for Money benchmarks. At the onset, it should be noted that the numbers are strongly dependent on the assumptions made. For the below scenario, it was assumed that the net return of investments in investment funds and insurance unit linked products converges to the EU average in all those Member States in which the return has been below this average. The assumption is that increased competition resulting from benchmarks would close a certain proportion of the difference between the yield observed in these Member States and the EU average. Since there is no precedent to determine the proportion, scenarios were calculated with assumptions ranging from 10% to 50%. A less conservative approach would be to assume that returns converge to best practices, i.e. highest in the EU.

ESMA's and EIOPA's cost and performance reports provide comparable information on the current return of these products. Both ESMA and EIOPA however caution on data gaps and methodological differences that should condition our assumptions. Since ESMA's and EIOPA's reports do not indicate the extent to which retail investors actually purchase these products, a second complimentary data source was used, namely information on households' investment income from investment funds and insurance policies from the sectoral non-financial accounts. Using the latest observations for the returns and combining these assumed increases in returns to the EU average with the value of investment funds and life insurance products held by households in the EU Member States, allows us to design scenarios that quantify the welfare gains in monetary terms under different assumptions. The scenarios suggest that benefits could reach EUR 2.8-13.8 billion for investment funds, and between EUR 1.7 and 8.4 billion for insurance products per annum, once convergence is accomplished.

Given the more limited scope of option 2 compared to option 3, monetary benefits under option 2 would be a share of those under option 3 and would depend on the extent to which revenues from the sales of the investment products go to either the manufacturer of the product or the distributor. A survey of distribution costs in the funds sector undertaken by ESMA in 2020 documented sizeable heterogeneity in this share, varying from at least 50% and up to 80%[179]. EIOPA's report points to a much lower share of distribution costs for insurance investment products, but the lack of transparency around distribution costs and in particular payments of inducements, make estimates extremely difficult. The majority of observations for unit-linked products ranged from 10 to 30%.[180] Assuming that the revenue sharing is proportional to the cost shares, a benchmarking of manufacturing could reach a maximum share of 50% of the benefits of option 3 for investment funds and about 90% of the benefits for insurance products. This would amount to monetary benefits of between EUR 1.4 and 6.9 billion for fund products and 1.5 to 7.6 billion for insurance products.

2. Costs

In addition to the costs for manufacturers, as outlined under option 2, there would also be costs for distributors. Article 10 of the MiFID delegated regulation already contains a number of obligations on distributors to ensure that the products and services that they recommend are compatible with the needs, characteristics and objectives of an identified target market. Article 25 IDD and the Delegated Regulation on product oversight and governance provides similar requirements for insurance distributors, who must establish and regularly review product distribution arrangements to ensure that the objectives, interests and characteristics of customers are duly taken into account. They must also feed information back to the manufacturer in case of problems. The VfM assessment would represent

[179] ESMA cost and performance report 2021.
[180] EIOPA cost and past performances 2022, Figure 25.

an additional element to the assessment that distributors already need to undertake. Beyond the adjustment costs, additional ongoing administrative costs would not be expected to be significant, as this process could take place at a central level (e.g. the compliance department), and as costs must already be disclosed to retail clients and are hence known by distributors. Distributors would benefit from the availability of information on product costs that they would receive from product manufacturers, and from the possibility to base their assessments on objective available benchmarks. Some additional administrative costs would, however, result from the additional reporting on their distribution costs (as outlined in option 2). The cost relating to additional reporting should not be significant, as relevant cost data should already be known and available to distributors in accordance with existing MiFID and IDD rules, where such data must be disclosed to retail investors.

Some NCAs may need to intensify supervisory efforts to police the more rigorous rules, and staff would need to acquire new skills via staff training. This option would not significantly increase the work for supervisors by comparison to option 2. It would allow supervisory action to focus more on distributors.

For the ESAs, additional resources may be required in particular to develop the methodology and monitor the market.

3. Overall Assessment: effectiveness, efficiency and coherence

Option 3 would be a more effective means to improve cost effectiveness of investment products because it addresses both the product manufacturing and distribution stages. In so doing, it would ensure that investment products offer value for money by design, as well as providing a full overview of the cost effectiveness of investment products sold to clients, combining the product costs with the costs of distribution.

Both options 2 and 3 would be equally efficient, in particular due to the objective standard provided in the form of benchmarks compiled by the ESAs, against which a value for money assessment can be made. The development of such benchmarks should be done in line with the principle of proportionality, to avoid disproportionate adjustment and administrative costs on smaller distributors.

Similar to option 2, a common approach developed at EU level would contribute to the further integration of capital markets. Given that the VfM rules would be introduced for retail products across the different sectors, both options would be coherent.

4. Affected groups of stakeholders

Retail investors

Retail investors would benefit from a higher level of protection, in particular as distributors would be obliged to factor in the VfM prospect of the distributed products (in clearer terms than under current rules). As a consequence, retail investors should no longer purchase products that offer poor value for money, and the obligation to compare products against benchmarks should improve market efficiency.

Industry

The implications for product manufacturers would be the same as described under option 2. Distributors would be limited to selling only cost-effective products, thereby enhancing the attractiveness of product offerings in the market. They would be required to undertake a VfM assessment in addition to the existing obligations under product governance rules. Some transitional costs would be borne by the industry, but these would be expected to be marginal. Firms that were profiting from excessive fees would see revenue streams reduced. Both manufacturers and distributors of investment products could be subject to more intense competitive pressure. This is likely to intensify the consolidation and adjustment pressure on distributors of financial products, complementing the competitive pressure from the growth of digital distribution channels. Given low entry barriers and technical progress, it seems very unlikely that the intensification of consolidation pressure could lead to a reduction in the supply of investment products to retail investors. Clearer standards would make the task of supervision, and also compliance, more effective and straightforward.

Supervisors

NCAs will benefit from greater clarity as to how the supervision of costs should be applied. The new VfM provisions will equip NCAs with a tool, based on access to sufficiently broad-ranging data on costs of products, which will enable them to make evidence-based assessments. The burden of proof will be transferred from NCAs onto manufacturers who will need to justify deviations in their costs from relevant benchmarks Supervisors will collect data on costs from manufacturers and distributors to pass on, possibly in aggregated form, to ESMA or EIOPA.

Stakeholder views: Consumer organisations stressed the importance of ensuring that intermediaries should be obliged to compare products with equivalent products offered in the market. They were favourable to the use of benchmarks, noting that a market-wide benchmark would ensure clarity with respect to product comparisons should be made. This would enhance the efficiency of the market. Most consulted industry organisations expressed scepticism with respect to the introduction of VfM duties for distributors, as they lacked the necessary data. They were in particular opposed to an assessment of VfM and disclosure to the client at the advice stage (i.e. the discarded sub-option 2), on account of the potential for more information to confuse clients and as the VfM test would be unsuited for direct communication to clients.

Summary - Choice of the preferred option

Option 2, strengthened product governance rules applied to only product manufacturers, would be an effective measure to tackle the problem of excessive cost and poor value for retail investors. While it would focus on the way products are designed at the outset and require manufacturers to make costs transparent and consider how each cost element can be considered justified and proportionate and provide value to the intended target market, this option would not address the way products were actually distributed to retail investors.

Option 3, which would include the improvements to the product approval process set out in option 2, and additionally require distributors, as part of their product governance duties, to make a similar assessment that included additional distribution costs, would help ensure that products are offered only to an appropriate client base. This would ensure that costs of distribution that are not known to the product manufacturer would also be included. As in the case of Option 2, the value for money assessments would require the development of clear criteria and benchmarks against which the notion of "value" can be measured and compared to market standards. The compilation of benchmarks would rely on access to data relating to various cost components that are included in investment

products, which may necessitate additional data reporting from firms to supervisors, wherever possible on the basis of data that is already known by firms (e.g. due to existing disclosure obligations). The development of these benchmarks should avoid imposing disproportionate costs on smaller distributors.

The more comprehensive approach – which is more effective than Option 2 – that includes the costs of distribution, set out in option 3, is the preferred option.

	Effectiveness			Efficiency	Coherence
	(SO1)	(SO2)	(SO3)		
Option 1 - Do nothing	0	0	0	0	0
Option 2 – VfM for manufacturers	0	+	+	++	++
Option 3 – VfM for manufacturers and distributors	0	++	++	++	++

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect
0 = no effect - = Slightly negative -- = Negative --- = very negative

7. PREFERRED COMBINATION OF OPTIONS

The selection of certain options has been made with the aim of maximising the effectiveness in addressing the specific objective related to a problem, while limiting the costs and potential negative side-effects on other specific objectives.

The preferred combination of options is as follows:

Problem driver	Preferred Option	Which specific objective is met?
Information provided to investors is not always useful or relevant for their decision-making process	Targeted changes to disclosure rules to improve their relevance for retail investors (Option 2)	SO1: Improve information provided to investors and their ability to take well-informed investment decisions
Retail investors tend to be unduly influenced by enticing marketing communications through digital channels and misleading marketing practices	Targeted changes to address information deficiencies in marketing communications and lack of clarity as to the concept of marketing communication (Option 3)	SO1: Improve information provided to investors and their ability to take well-informed investment decisions
Conflicts of interest caused by the payment of inducements negatively affect the quality of investment products offered and investment	A ban on inducements (Option 3)	SO2: Better align interests between intermediaries and investors.

advice		
Some retail investment products incorporate unjustifiably high levels of costs and/or do not offer value to retail investors	Strengthening product governance rules for manufacturers and distributors with focus on costs, also by requiring comparison of products to relevant benchmarks and justification of any departures from the benchmarks (Option 3).	SO3: Ensure that retail investors are offered cost-effective products.

The combination of preferred options was designed to address the two key identified problems (informational deficiencies and shortcomings in the manufacturing and distribution processes). Retail investors should benefit from improved disclosures, in the form of more targeted and engaging information aimed at facilitating decision-making, while being better protected against increasing exposure to misleading marketing. At the same time, they should be faced with a choice of products that offer them better value for money and advised in ways that help them achieve better investment outcomes due to the removal of conflicts of interest in the advice process.

During the preparation of this initiative, various alternative combinations of options were considered. In particular, they assessed whether a package of measures that did not include an inducement ban, but rather increased transparency around the payment of inducements might be effective. Such an approach would have also included a stronger emphasis on disclosures (e.g. cost disclosures) as well as a stronger suitability test (e.g. including an obligation on distributors of retail investment products to draw up a personal investment plan with an asset allocation strategy), in addition to a Value for Money option with stricter obligations for distributors. They concluded, however, that as long as conflicts of interest remained in place due to the continued payment of inducements, such a package of measures was unlikely to be as effective in helping retail investors achieve optimal outcomes from their investments. Therefore it was decided that the preferred option should feature a full inducement ban to eliminate conflicts of interest, which was assessed to be the most effective way to address a fundamental shortcoming.

The "flanking measures" (see section 5.4 and corresponding annexes) help to address the identified problems. They are an intrinsic part of the overall package under the preferred option. The measures are valuable as stand-alone measures but also amplify the effect of the main measures via synergies, for example:

- Increasing the level of financial literacy empowers investors to deal with investment information, assess the value their investment brings to them and take sound investment decisions. By promoting efforts to enhance **financial literacy**, the proposed disclosure measures could also become more effective. The financial literacy measures also complement the proposed measures on digital marketing because more literate investors will be better at identifying bogus or poor-quality investment offers.
- The possibility for investors with appropriate knowledge, experience and ability to bear losses, to request the status of 'professional investor' as proposed in the measures on **investor categorisation** will allow these investors to obtain more suitable and cost-efficient investment portfolios that match their profile. In addition, they would receive more targeted information, which fits in the aim of making disclosures more relevant for retail investors.
- The measures on **enhanced suitability and appropriateness assessments** should improve the quality of advice given to retail investors, or when no advice is requested, the appropriateness assessment should provide a minimum protection. The enhanced

appropriateness assessment would include stronger warnings to help clients avoid investments in highly complex and often costly products that are not compatible with their financial capacity and ability to bear losses. These measures would improve the advice given to investors, complementing the measures to tackle the conflicts of interest stemming from inducements. In addition, they contribute to an investment environment in which retail investors receive value for money. Measures aimed at raising the standards of **professional qualifications** across the EU should further support the efforts to improve the quality of investment advice and increase trust.

- The various measures aimed at enhancing **supervisory enforcement** should result in a better general retail investment environment and strengthen and complement different specific measures across the preferred option package. For example, following the proposed measures NCAs would be in a better position to more rapidly address aggressive marketing practices and impose risk warnings. In addition, strengthening rules to facilitate complaints handling in cross-border situations, for instance, should have a positive effect on the level of trust in the retail investment market.

Economic impacts and impacts on SMEs

The package of measures assessed in this impact assessment would enhance retail investor protection by addressing two types of market failure that determine the relationship between retail investors and providers of financial services: asymmetric information and misaligned incentives (conflicts of interests). Enhancing disclosures and oversight on marketing communications would reduce the information costs for retail investors that accrue in the selection of financial distributors and products. Value for Money benchmarks would have a comparable effect on investors' search and information costs, as they would provide them with information on the value of investment products. Investors' capacity to benefit from better disclosure and benchmarks would be improved by flanking measures that increase their financial literacy and access to high-quality advice, consistent with findings in economic literature that the better informed and educated the retail investors are, the better they are able to make use of advice and benefit in terms of improved investment performance[181].

The relationship between disclosure and retail investors' financial literacy is self-reinforcing. An improvement in financial literacy enables investors to make better use of the information at their disposal to avoid financial products that do not correspond to their needs. Without useful information, however, better financial education may on the contrary actually reduce the confidence of investors to make good choices, with the likely outcome of even higher search and information costs. Moreover, since financial literacy goes hand-in-hand with some investors becoming overconfident[182], efforts to increase financial education without at the same time introducing measures to improve the information set available to investors may even lead to an increase in cases of mis-selling. The obligation to subject retail investors to a suitability assessment or appropriateness test addresses detrimental effects from investors becoming over-confident, implying that they would take on more importance the better informed and more literate retail investors become.

[181] See Bucher-Koenen, T. and J. Koenen, ‚Do Seemingly Smarter consumers get better Advice', Max-Planck Institute for Social Law and Social Policy, *MEA Discussion Paper* No 01-2015, Belofatto, A. et al., Subjective financial literacy and retail investors' behaviour, *Journal of Banking and Finance*, Vol. 92 (2018), pp. 168-171, Prasad, S. et al. Influence of financial literacy on retail investors' decisions in relation to return, risk and market analysis, I*nternational Journal of Finance and Economics*, Vol. 26 (8), 2020.

[182] Overconfidence seems to depress the benefits of financial investment, see Gaudecker, H.-M., 'How Does Household Portfolio Diversification Vary with Financial Literacy and Financial Advice?, Journal of Finance, Vol 70, April 2015, pp. 489-507.

Measures to reduce information asymmetry would not be sufficient to address the issue of conflicting interests. Academics have suggested that under specific theoretical conditions, more information could even make the investor worse off[183]. Measures that address conflicts of interest reduce the importance of trust and hence the need for both investors and distributors to develop longer-term relationships. For example, a ban on inducements paid by manufacturers to distributors could reduce reluctance of investors to interact with other distributors or to take advice from them. Value for Money benchmarks improve investors' access to more cost efficient products. Standards on the qualification of financial advisors would allow investors to change their advisor more frequently. Likewise, trust in supervisory enforcement would provide reassurance to investors that they receive a certain level of advice and guidance independent from which specific supplier they approach.

Overall, better investor protection would translate into fewer incidents of mis-selling and lead to a better selection of investment products. It would also enhance transparency around costs and the ESG profile of investment products and improve investors' ability to understand and select between investment products and ultimately could improve the level of trust of retail investors. Multiple measures included in the preferred options would improve market efficiency and innovation and jointly contribute to a shift towards cheaper and higher quality investment products.

Higher trust levels might also entice population groups that had not yet invested to consider reallocating their financial wealth from both traditional savings instruments or possibly more speculative and risky instruments towards well-regulated retail investment products. As a consequence, both new and existing investors would stand to benefit from higher long-term returns on their financial assets, better protection against inflation and better diversification of their wealth. This also would help consumers accumulate capital for their retirement and other life objectives.

The combination of adjustment costs, reduced pricing power and overall more competitive pressure are likely to lead to a decline in financial firms' profit margins. The combined effect of the policy measures would be a redistribution of rents from financial corporations to the household sector and, for those cases where financial firms need to upgrade IT and skills of staff to comply with new requirements, the transformation of their profits into higher revenues for suppliers of IT and professional training. The comparison of the estimates of benefits and costs, however, suggest that the net welfare increase will be positive.

Table: Benefits and costs for policy measures where it was possible to estimate numbers, in EUR[184]

	Benefits p.a.	One off cost	Ongoing costs
Disclosure	N/A	19-67.5 million	250 million
Inducement ban	5-6 billion	14 - 15 billion	Not significant
Value for Money	4.4 to 22 billion[185]	13-252 million	2.3-22.6 million
Suitability/appropriateness tests	N/A	12.5-48.5 million	7.1 to 19.1 million

[183] This would be the case if the investors learn that they have no alternative to the offer.

[184] The estimates are based on numerous assumptions, which are detailed in the Annexes. The wide ranges are due to the lack of data at sufficient granularity and the uncertainty surrounding several critical parameters, which were necessary to undertake the estimates.

[185] The range depends on assumptions about the effectiveness of convergence pressure, see Annex 14. Since convergence pressure depends also on the effectiveness of the other policy measures, the benefits estimated for Value for Money encompass those from the other measures and should not be added to those. This estimate includes investment funds and insurance-based investment products.

The above numbers assume that the investor base remains constant. Firms would benefit from improved consumer protection if more symmetric distribution of information and better alignment of incentives succeeds in fostering investor participation. The available data suggests that about a quarter of EU households hold investment products, while three quarters do not. When asked in the Eurobarometer survey, why they did not invest, about half responded that they had not the financial means to do so. The remaining respondents, that would extrapolate to around 70 million households, quoted other obstacles, to which the policy measures analysed in this impact assessment would contribute to overcoming. Measures to improve information disclosure and financial literacy could foster participation of households that had not invested because they considered investment as too complex. Aligning incentives through the inducement ban, improving the quality of advice and stronger supervisory enforcement could contribute to unblocking reluctance of some households that are concerned about risks. Availability of more cost-efficient products resulting from the new Value for Money approach could convince some of those households that refrained from investment because of too low returns. Although the results from the Eurobarometer allow an estimation of how large the untapped retail investor base might be, the impact of the measures on higher investor participation cannot be quantified with any confidence, since there are no good coefficients available from academic research to do so.

Table: Reasons for non-investment and policy measures that could impact on them

Reasons given why households do not invest, EB*	**Share of responses in %, EB***	**Households concerned in million****	**Policy measures that could impact on these reasons**
I do not have sufficient money to invest	47.1	68.0	N/A
I do not know how to invest or find it too complex	14.0	20.2	Information disclosure, financial literacy
I am not confident that I will receive sufficient returns on my investment	15.0	21.7	Value for Money, ban on inducement, investor categorisation
I am concerned about the risks	20.9	30.2	Information disclosure, suitability assessment/appropriateness test, supervisory enforcement
I do not trust investment advice	12.3	17.8	Marketing communication, suitability assessment/appropriateness test, supervisory enforcement, qualification of advisors

Notes: * EB := Eurobarometer No 509, 2022; multiple replies were possible. ** 26% of the respondents to the Eurobarometer survey indicated they were holding investment products. The basis for these questions were those that replied they did not hold an investment product. These shares were multiplied with 145 million households in the EU that did not hold investment products (out of 195 million total households in the EU).

Any resulting increase in retail investor participation would also have implications for the size of the EU capital market investor base: the resulting scale effects would contribute to making EU capital markets more efficient and attractive. Over time, corporations might benefit from more access to funding, reduced bank dependency and new restructuring opportunities allowing them to adapt and grow.

The problems this impact assessment aims to address occur throughout the market. The proposed measures, such as the ban on inducement, therefore apply to all relevant active intermediaries, independent of their size. The measures are expected to contribute to a more equitable and

competitive market in which those intermediaries, whether large or small, that offer (provide) good value-for-money products (services) can thrive.

The transition from a commission-based to a fee-based model will lead to temporary costs for large firms and SMEs but might also accelerate the development of alternative (digital) sale channels or services and encourage innovation. The regulatory changes might support the ongoing trend towards increased consolidation, depending on industry dynamics[186].Regarding the partial ban, the same considerations would likely apply to those financial service providers which are SMEs.

Adjustment costs and other compliance costs are unavoidable, for instance to implement the Value-for-Money framework but are considered to be reasonable in view of the benefits they will bring to all stakeholders[187]. Fulfilment of any additional reporting requirements[188] should, to the extent feasible, be based on already reported or existing data and collected in the most efficient way in order to minimize administrative burden for large and small entities, which will be explicitly requested in the Level 2 empowerments of the ESAs.

The overall benefits and costs of this initiative are summarised in Annex 3.

External impacts

This initiative would not have any significant external impacts. Financial advisors and other entities from third countries may only be affected if they do business in the EU and in the same way as their EU-domiciled competitors.

Impact on environmental and social factors, fundamental rights and on Sustainable Development Goals (SDGs)

This initiative can be expected to have a slightly positive impact on environmental and social factors, notably though the inclusion of an ESG dashboard in PRIIPs key information documents. This would contribute to greater visibility of environmental and social characteristics of investment products for retail investors and could lead indirectly to greater use of such information when comparing and selecting products. This measure would hence contribute positively to multiple SDGs and notably to SDG no. 13.

The overall initiative would indirectly contribute to SDG no. 8 – decent work and economic growth – as it would shift incentives to favour the interests of retail investors and over time contribute to their greater participation in capital markets. Further detail on the impact on SDGs is included in Annex 3. No potential negative impacts on fundamental rights have been identified.

Digital by default

This initiative can be expected to have slightly positive impacts on the promotion of digitalisation, notably due to the adaptation of PRIIPs key information documents to the digital age by enabling greater use of layering and adapting PRIIPs key information documents to be compatible with digital

[186] Evidence from the Netherlands shows that since the introduction of the ban on inducements, the decline in the number of self-employed financial advisors has ranged between 2% and 4.4% per year. However, that is in line with the observed trend towards increased consolidation in the sector since the global financial crisis.

[187] E.g. investors will be able to reach better investment decision and access to more cost-effective products and unbiased advice. Intermediaries can compete in a more competitive and equitable business environment. Increased clarity of rules reduces compliance costs for intermediaries and supervisory costs.

[188] See mandate to the ESAs to define detailed measures at level 2, subject to further assessment by the ESAs. The ESAs should consider specifically the impact on and ways to alleviate the burden on small firms.

formats and use on smartphones. Furthermore, the ban on inducements could contribute to a digital shift in investment product distribution, such as greater use of robo-advice or direct digital marketing.

Application of the 'one in, one out' approach and REFIT (simplification and improved efficiency)

With regard to cost savings and simplification, the main objective of the strategy is to enhance retail investor protection; any assessment of its potential for simplification and burden reduction should not compromise this objective. Moreover, the Evaluation (Annex 11) has concluded that overall, the retail investment protection framework does not generate high costs (especially administrative costs) for the financial industry. Hence the potential for simplification is limited, even as the team has assessed it and identified the following measures[189] expected to reduce administrative costs ("OUTs" under "one in, one out"):

1. Savings on existing requirements on inducements[190] due to the ban on inducements: A ban on inducements is considered a more straight-forward solution to the issue of misaligned incentives and would replace existing administrative obligations. This benefit cannot be feasibly quantified[191].
2. Investor categorisation: regulatory alleviations for investors with appropriate knowledge, experience, and ability to bear losses. This implies a reduction in information overload for these investors and that product manufacturers and distributors would be able to save resources dedicated to assessing clients' needs and objectives and providing information to them. However, as this benefit is expected to affect only a small number of retail investors and to be rather small, it has not been quantified in line with the principle of proportionality of analysis.

Additional administrative costs ("INs" under "one in, one out" offsetting) would arise from supervisory reporting against the Value for Money benchmarks and changes to the disclosure rules. The new obligations under Value for Money would imply one-off costs estimated approximately at €13-252 million and ongoing costs estimated approximately at €2.3-22.6 million per year (both figures present an EU-wide total). Important practical specifications will be decided at a later stage, as part of a mandate to the ESAs, so these estimates are subject to considerable uncertainty. Further assessment of these costs would be made at Level 2 by the ESAs, with the intention of obtaining more precise estimates. Only some of the administrative costs[192] related to the changes to disclosure rules and marketing communications could be quantified: these amount to €19-67.5 million in one-off costs. None of the other measures are expected to lead to significant administrative cost implications. Other costs resulting from this initiative are discussed in Annex 3. Since not all "INs" and "OUTs" could be quantified, it is not possible to establish which element would be larger.

8. HOW WILL ACTUAL IMPACTS BE MONITORED AND EVALUATED?

The Commission will monitor how the implementation of the proposals on disclosure and marketing communications, inducements, and value for money achieve the objectives set out in this impact assessment. An evaluation of these initiatives will be carried out five years after its entry into application. Any externally commissioned study conducted in preparation of the evaluation may also assess structural changes in the retail investment and distribution market, including in relation to advice and its availability and the proportion of advised to non-advised services, and their relation

[189] The latter two are flanking measures assessed in Annex 6 and Annex 8 due to the expected lower impact.
[190] Notably disclosures and quality enhancement / no detriment test.
[191] Any estimations made by stakeholders would be unreliable as the evidence gathered points to a potentially sizeable degree of non-compliance with the existing requirements.
[192] Although these costs relate to the substantive requirements of the proposal which are necessary for the fulfilment of the objective of informing retail investors, they are categorised as administrative costs for "one in, one out" purposes.

with the above measures. Relevant developments related to the implementation of the flanking measures described in annex will be also considered[193].

Objectives	Indicator/ subject of evaluation	Source of information	Data already collected?	Actor(s) responsible for data collection
Improve information provided to investors and their ability to take well-informed investment decisions	ESMA and EIOPA will be tasked with monitoring the effectiveness of digital disclosures.	Based on mandate to ESMA and EIOPA	No	ESMA and EIPOA
	Change in number of complaints regarding quality/lack of information	ESMA market monitoring EIOPA market monitoring	Yes(2)	ESMA and EIOPA
	Evaluation of role of disclosure to take well-informed investment decisions	External study or study by ESMA and EIOPA	No	Commission or ESMA/EIOPA
	Number of risk warnings regarding (aggressive) marketing	ESMA an EIOPA based on info from NCAs	No	ESMA and EIOPA
	Evaluation of investor's ability to discern essential product information from new marketing disclosure format	External study or study by ESMA and EIOPA	No	Commission or ESMA/EIOPA
	Emerging marketing-related trends and risks	Based on mandate to ESMA and EIOPA(3)	No	ESMA and EIOPA
Better align interests between intermediaries and investors	Distribution of retail investment products per investment type	ESMA and EIOPA cost and performance annual reports	Yes	ESMA and EIPOA
	Change in total number of complaints regarding investment advice, portfolio management and execution of orders	ESMA complaints database EIOPA market monitoring	Yes(2)	ESMA and EIOPA
	Change in number of complaints according	ESMA complaints database	Yes(2)	ESMA and EIOPA

[193] Flanking measures are considered to have a less significant and direct impact on achieving the objectives set out in this Impact assessment. Monitoring will thus be more general to remain proportionate, especially in cases where data sources are not readily available. Developments on financial literacy can be monitored via the existing ESAs repositories on financial education initiatives. Relevant supervisory enforcement developments could be considered through peer reviews.

	to firm type	EIOPA market monitoring		
Ensure that retail investors are offered cost-effective products	Distribution of costs and performance per investment type	ESMA and EIOPA cost and performance annual reports CMU indicators	Yes	ESMA and EIPOA
	Change in cost of value-for-money related benchmarks	ESMA and EIOPA	No	ESMA and EIOPA
	Change in number of complaints regarding fees and charges	ESMA complaints database EIOPA market monitoring	Yes(2)	ESMA and EIOPA

1. For published 2014-16 data, see ESMA report on Trends, Risk and Vulnerabilities, 2017, No. 1
2. ESMA and EIOPA will be tasked to develop guidelines and ensure regular monitoring of how marketing practices are changing, including any new emerging risks.

ANNEX 1: PROCEDURAL INFORMATION

Lead DG, Decide Planning/CWP references

Directorate-General for Financial Stability, Financial Services and Capital Markets Union.

[PLAN/2021/12340]

Organisation and timing

The initiative is included in the Commission Work Programme 2023. Furthermore, the initiative covers topics from action points 7 and 8 from the Capital Markets Union action plan[194].

Consultations Inter-service Steering Group (ISSG)

The first ISSG meeting took place on 27 January 2022 with the attendance of the representatives from the following Directorates-General (DGs) of the European Commission: Justice and Consumers; Competition; Employment, Social Affairs and Inclusion; Taxation and Customs Union; Trade; Internal Market, Industry, Entrepreneurship and SMEs; Regional and Urban Policy; Migration and Home Affairs; Communication Networks, Content and Technology; Structural Reform Support; Environment; Research and Innovation; Legal Service; Secretariat General; Financial Stability, Financial Services and Capital Markets Union. There were two more ISSG meetings that took place on 29 September 2022 and 5 December 2022.

DG FISMA has considered the comments made by DGs in the final version of the impact assessment. In particular, DG FISMA has provided more clarity about the seriousness of some of the problems, as well as the links between the flanking measures and the main areas addressed in the impact assessment. FISMA has also strengthened the coherence of this impact assessment with the evaluation. The analysis of impacts and the preferred option takes account of the views and input of different DGs.

Consultation of the RSB

The Impact Assessment report was examined by the Regulatory Scrutiny Board (RSB) on 18 January 2023. The Board gave a positive opinion with reservations on 20 January 2023 following which the Commission made changes in order to address the Board's requests for improvements in the final version of the Impact Assessment.

The main areas in which this Impact Assessment was reinforced following the Board's recommendations on the impact assessment are summarised as follows:

The Board's request to reinforce the presentation of the scope and scale of the problem and its effects on the retail financial services ecosystem was addressed by strengthening the text, notably by inserting additional data and better explanation of the underlying economic context. Consumer detriment has been more clearly explained and the description of issues has been improved, highlighting the need to take urgent action. The presentation of the key policy choices and

[194] Communication from the Commission on a Capital Markets Union for people and businesses-new action plan, COM(2020)590 final, 24 September 2020.

flanking measures have been improved by elaborating and clarifying further on certain elements of the policy options

In addition, the quantitative analysis impact has been improved and the revised text now includes additional estimates of the impact of the inducement ban and value for money, explaining where necessary the limitations around quantifying disclosure measures. The discussion of qualitative economic effects has been deepened and enlarged, including a clearer explanation of the connection to relevant economic concepts and interlinkages with the flanking measures. An SME test has been added as additional annex.

The overall presentation of the costs and benefits of the preferred option package has been improved. With respect to the flanking measures, the text now includes an additional table setting out the flanking measures that are assessed in annex, the problem that they seek to address and the objective they seek to achieve. The text also includes an explanation as to how the flanking measures interact with preferred options and produce synergy effects. A paragraph has been added outlining an alternative combination of options that was considered, which did not include an inducement ban, as well as an explanation as to why this was not taken up.

Consultation with the Member States

The Commission held separate meetings with the Government Expert Group on Retail Financial Services (GEGRFS) on 3 December 2020, 7 December 2021 and 2 March 2023.

The views expressed by several Member States at the first meeting included the need for the Retail Investment Strategy to be coordinated with other workstreams, in particular on sustainable finance, the need for comparability and simplification of information as well as greater cost-efficiency for retail investors. Investor protection, also in relation to inducements, and the importance of disclosures were also stressed.

At the second meeting, following a presentation of the preliminary results of the public consultation on the retail investment strategy, Member States expressed their support for work on financial literacy, for further efforts to streamline and improve disclosure requirements as well as the need to update the existing framework to accommodate digitalisation challenges. Some Member States also noted their support for a ban on inducements, while other expressed concerns that access to advice should remain available. Member States also highlighted the need to address aggressive marketing techniques, and the need to facilitate access to suitable and simple investment products.

During the third GEGRFS meeting, the Retail investment Strategy was discussed, with a specific focus on inducements. In the beginning, representatives from both the consumer and financial sector were invited and provided opposing views on the issue of inducements, including a potential ban on inducements. In addition, the Dutch AFM presented its experience with the ban on inducements underlining that the results were positive and the ban achieved its goal of eliminating conflicts of interest. The Commission services gave an overview of the Retail investment Strategy. During the following discussion, a large majority of Member States expressed concerns about a potential impact of a ban on retail investment distribution systems.

Evidence, sources and quality

In line with the general principles in the Better Regulation guidelines on the need for evidence-based impact assessments, this impact assessment is based on the following data and information sources:

1. European Commission, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, Uličná, D., Vincze, M., Mosoreanu, M., et al., Disclosure, inducements, and suitability rules for retail investors study: final report, Publications Office of the European Union, 2022, *https://data.europa.eu/doi/10.2874/647061* (*Retail investment study*)
2. European Commission, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, Distribution systems of retail investment products across the European Union: final report, Publications Office, 2018, https://data.europa.eu/doi/10.2874/037900 (*Study on distribution systems of retail investment products*)
3. A new Vision for Europe's capital markets Final Report of the High Level Forum on the Capital Markets Union, June 2020
4. Final Report on the European Commission mandate on certain aspects relating to retail investor protection, 29 April 2022, ESMA (*ESMA advice on retail investor protection*)
5. Final Report on technical advice to the European Commission regarding certain aspects relating to retail investor protection, 29 April 2022, EIOPA (*EIOPA advice on retail investor protection*)
6. Call for Advice on PRIIPs: ESA advice on the review of the PRIIPs Regulation, 29 April 2022, Joint Committee of the European Supervisory Authorities (*Advice of the ESA joint committee on PRIIPs*)
7. Joint European Supervisory Authority response to the European Commission's February 2021 Call for Advice on digital finance and related issues, 31 January 2022
8. IOSCO, 'Report on retail distribution and digitalisation' Final report, The Board of the International Organization of Securities Commissions, October 2022 (*IOSCO report on retail distribution and digitalisation*)
9. Publicly available studies, reports, position papers and other relevant documents drawn up by private and public stakeholders.

ANNEX 2: STAKEHOLDER CONSULTATION (SYNOPSIS REPORT)

With a view of developing an EU strategy for retail investors, the Commission launched a number of consultations with the objective of gathering stakeholders' views on how the existing framework for retail investments can be improved. The Commission also collected feedback in the course of dedicated workshops and interviews with stakeholders, including industry representatives and consumer organisations. To obtain additional evidence, moreover, the ESAs were requested to provide the Commission with their technical advice on the retail investment framework and the PRIIPs Regulation. This Annex provides an overview of the feedback received to support this impact assessment.

1. Public stakeholder consultation: A Retail Investment Strategy For Europe

A public consultation on 'A Retail Investment Strategy For Europe' was launched by DG FISMA on 11 May 2021 to gather views from a broad group of stakeholders on various aspects pertaining to retail investments, namely: pre-contractual disclosures (including PRIIPs), quality of advice in light of current inducement practices, the suitability and appropriateness assessments, financial literacy, complexity of products, the impact of increased digitalisation of financial services, investor categorisation, redress, the ESAs' product intervention powers and sustainable investing. The consultation ran until 3 August 2021, and all contributions were submitted online.

Overview of respondents

A total of 186 respondents participated in the public consultation. The types of organisations most widely represented were business associations (59) and company/business organisations (51), together representing 59% of all respondents. Respondents also included 4 consumer organizations (2%), 9 NGOs (5%), 17 public authorities (9%), 4 trade unions (2%), 35 citizens (33 from the EU and 2 from outside the EU, in total 19%) and 8 classified as 'others' (4%).

The largest group of respondents selected investment management as the sector of belonging (37%, 58 respondents), followed by banking (35%, 54 respondents), a third group which indicated "other" (32%, 49 respondents) and insurance (14%, 26 respondents). Among industry stakeholders only, the most represented sectors were investment management (43 or 39%) and banking (also 43 or 39%), followed by insurance (18 or 16%), market infrastructure (12 or 11%) and a group which only indicated "other" (21 or 20%)[195].

The majority of respondents came from the EU (91%, 170 respondents), from 22 Member States. The highest number of respondents came from Germany (21%, 39 respondents), followed by France (14.5%, 27 respondents) and Belgium (12.9%, 24 respondents). There were also 16 responses (9%) from five countries outside the EU (Australia, Norway, Switzerland, UK and the United States).

[195] Industry stakeholders could select more than one sector of belonging, hence this sectoral breakdown contains overlaps between respondents (e.g. an industry stakeholder may belong to both the banking and insurance sectors at the same time).

Respondents' feedback to the general questions[196]

A majority of respondents (86 out of 150, or 57%, including company/business representatives of the banking, insurance and investment management industries, as well as a 9 public authorities) were of the view that the current framework sufficiently empowered and protected retail investors. 53 or 35% were largely of the opposing view, mainly consumer organisations and NGOs, as well as 4 national authorities and some company/business representatives of investment management, banking and market infrastructure. Similarly, when asked whether existing limitations stemming from retail investor protection rules were justified, a majority (89 out of 149, or 60%, mainly company/business representatives of banking, insurance, investment management and market infrastructure), were of the view that limitations were unjustified, whereas 45 or 30%, (including consumer organisations, NGOs, some banking and insurance representatives as well as most public authorities) defended the limitations.

A substantial majority of respondents (95 out of 154, or 62%, mainly company/business representatives of all participating sectors as well as 7 public authorities) were aware of investment products that retail investors were prevented from buying due to constraints imposed by EU regulation, with a number of respondents (predominantly business and company representatives) highlighting areas where they considered that the regulatory framework (or indeed lack of regulation) unnecessarily prevented retail investor participation. Respondents also expressed concerns about perception of risk and lack of understanding as some of the most important factors that might discourage or prevent retail investment. A majority of respondents (78 out of 142, or 55%), including 9 public authorities and company/business representatives of investment management, banking and insurance, agreed that investment products were sufficiently available to retail investors, although that sentiment was less strongly felt among 29 or 37% of respondents, namely consumer organisations, NGOs, and citizens. Business and company respondents from all sectors represented in the consultation also strongly supported the view that products were competitively priced and offered alongside a sufficient range of competitive products, in contrast to the views of consumer organisations, citizens, NGOs and 4 public authorities, who disagreed.

Almost half of respondents (66 out of 138, or 48%)[197] agreed that products were adapted to modern digital channels whereas a lower share of respondents (48 out of 137, or 35%)[198] agreed that retail investment products are sufficiently adapted to ESG criteria. The most supported area where the vast majority of respondents (104 out of 134, or 78%), namely consumer organisations, company/business representatives from all the sectors participating in the consultation and most (i.e. 9) public authorities, saw scope for improvement was financial literacy. Consumer organisations also expressed a preference for improvements to disclosure requirements and inducements as well as quality of advice and complexity of products, whereas public authorities gave the highest priority to inducements and quality of advice, disclosure requirements as well as financial literacy.

Financial literacy

[196] In this and following paragraphs, percentages of respondents are calculated by dividing the number of responding stakeholders expressing a specific view (e.g. agree/disagree) over the total number of respondents to a given question. Blank answers were not taken into account.

[197] Among which company/business representatives of banking, insurance and investment management as well as 5 public authorities.

[198] Including representatives from investment management, banking, insurance and market infrastructure and 3 public authorities.

There was overwhelming consensus that increased financial literacy would be beneficial to retail investors. A majority of respondents affirmed the positive impact of financial literacy, noting that financial literacy helped improve investors' understanding of financial products, helped investors create realistic expectations, and helped them to align investments with their objectives (137 out of 144 or 95%, 139 out of 143 or 97%, and 138 out of 144 or 96% respectively). Stakeholders' views were also sought as to which further measures aimed at increasing financial literacy might be pursued at EU level. Respondents offered various suggestions and comments, including on cooperation and funding, the coordinating role of the Commission, the importance of financial literacy at school, as well as the effectiveness of financial education and the need for other measures in addition to financial literacy to protect retail investors.

Digital innovation

A strong majority of respondents (80%) was positive towards an open finance approach, noting several benefits, while however acknowledging the risks. Machine-readability of key documents was identified as an essential new tool that might be enabled through innovation, as was the development of a digital identity, the latter of which would be very beneficial for consumers and reduce duplicative compliance costs. Artificial intelligence and analytical tools would help service providers create better, customised products. Half of respondents (68 out of 137, 50%) considered that diverging rules on marketing and advertising of investment products constituted an obstacle for retail investments when accessing products in other EU markets, while a smaller group of respondents (33, 24%) disagreed and 36 respondents (26%) expressed no opinion. All stakeholder groups were generally in agreement, with the exception of public authorities whose opinions were split evenly. Views were split as to whether there might be a need for stricter enforcement of rules on online advertising to protect against possible mis-selling of retail investment products, with a slightly larger group of respondents (61 out of 142, 43%), composed of most business organisations and associations, suggesting that the current enforcement regime was adequate, as opposed to those (59, 42%), which included most consumer organisations and public authorities, who saw the need for stricter enforcement.

A majority of respondents (83 out of 144, 58%), which included a majority from all stakeholder groups, expressed support for further coordination and harmonisation of national rules on online advertising and marketing of investment products, whereas 41 respondents (28%) disagreed, and 20 respondents (14%) expressed no opinion. A strong majority (105 out of 137, 77%) agreed that social media platforms played an (either somewhat or very) important role in influencing retail investor behaviour, whereas an even larger majority (111 out of 136, 82%) considered that social media platforms may be used as a vehicle by some users to help disseminate investment related information, and this may pose (either somewhat or very) significant risks for retail investment. Consumer organisations and public authorities were almost unanimous in this view, while a majority of business associations and organisations agreed. In this regard, 50% (amounting to 69 out of 138 respondents) highlighted the need to introduce rules at EU level, whereas 39 respondents (28%) disagreed, and 31 respondents (22%) voiced no opinion. Consumer organisations, NGOs and public authorities were overwhelmingly in favour of this introduction, with a smaller majority of business organisations and associations agreeing. Most respondents (82 out of 141, 58%), mainly from public authorities, business organisations and associations, indicated that adequate protection for online purchases existed, commenting that where problems did occur, they were an enforcement issue. Others (39, 28%), including all consumer organisations, noted that some digital-specific risks existed and should be addressed via EU rules. Finally, views were split as to how important it was that lower risk and non-complex products appeared first on listings when products were offered online, with 39% (52 respondents out of

132), mainly business organisations and associations, indicating it was rather not important or not important at all and 30% (40 respondents), including a majority of public authorities, indicating that it was somewhat or very important. One consumer organisation also suggested that risky and complex products should not be included in the rankings at all.

Disclosure requirements

Industry representatives generally agreed that pre-contractual disclosure documentation for retail investments enabled adequate understanding of the key product features in cases where no KID was provided (52 out of 131, or 40%, mainly representatives of banking, investment management and insurance). On the other hand, 35 respondents (or 27%) including 5 NGOs and all consumer organisations considered these inadequate and public authorities saw room for improvement. A group of respondents was of the view that the information provided to retail investors in the PRIIPs KID was sufficiently understandable (33 out of 128, or 26%) and reliable (37 out of 124, 30%), to help them take investment decisions, including half of consumer organisations, business representatives from all sectors participating in the consultation and a minority of public authorities and NGOs. This was opposed to those who indicated that the information was not sufficiently understandable (42, 33%) or reliable (33, 27%), including consumer organisations, less than half of public authorities as well as representatives of all the sectors participating in the consultation. Moreover, respondents were generally of the view that information about the type, objectives, functioning, risk-profile, and the summary risk indicator of the product was understandable and reliable, while the information about product performance was less so. In addition, the majority (77 out of 134, or 57%) of respondents[199] agreed that pre-contractual disclosure should enable as far as possible a clear comparison between different investment products (e.g. insurance versus investment funds), unlike the 37 (28%) who disagreed[200].

Almost half of respondents (55 out of 126, 44%), including consumer organisations and NGOs as well as 5 public authorities and company/business representatives of banking, investment management and insurance, considered that the amount of information provided in the PRIIPs KID was adequate, however views on information about product performance were split[201]. On the PRIIPs KID, a group of 33 out of 119, or 28% of respondents[202] considered that information on sustainability-aspects of the product was insufficient. A similar share of respondents, 31 or 26%[203], considered that it was adequate, while only 11 or 9% thought it was excessive. The remaining 37% did not express an opinion. In general, respondents expressed support for the current maximum length of the PRIIPs KID or a similar pre-contractual disclosure document, although some consumer organisations and public authorities expressed a preference for shorter

[199] Including all consumer organisations and most NGOs, representatives of the banking, insurance and investment management sectors, 9 national authorities as well citizens.
[200] Mainly investment management representatives, as well as some banking and insurance representatives, 1 public authority and a minority of NGOs.
[201] Opinions included 'insufficient' (29 out of 123, or 24%, including all consumer organisations, citizens, 2 public authorities and representatives of mainly investment management as well as banking and insurance), 'adequate' (38, 31%, mainly NGOs, a few public authorities and representatives of banking, investment management and insurance), and 'excessive' (33, 27%, including representatives of investment management, banking and insurance, as well as 5 public authorities and a consumer organisation).
[202] All consumer organisations and NGOs, 5 public authorities and a few representatives of banking, insurance and investment management.
[203] Including banking, investment management and insurance representatives as well as citizens and a few NGOs.

KIDs, and the investment management industry expressed a preference for more flexibility. There seemed to be general agreement that the PRIIPs KID was overloaded with information.
On the Insurance Information Document, 31 respondents out of 91, or 34%, including one consumer association, 6 public authorities, most NGOs and representatives of the banking, insurance and investment management sectors, said that the amount of information provided was adequate. Only 5 (5%) stated that it was insufficient, while 9 (10%) deemed it excessive, in both cases mainly business representatives of the insurance sector. The remaining 51% did not provide an answer.

Regarding the way product cost information is calculated and presented in the EU disclosure rules (e.g. PRIIPs, MiFID, IDD, PEPP, etc.), a vast majority (80 out of 128, or 63%,[204]) saw overlaps, inconsistencies, redundancies, or gaps. Only a minority (11 or 9%) stated that they were not aware of such characteristics in EU disclosure rules. With respect to how performance information is presented, similarly, a majority of 71 out of 122, or 58%[205], stated that they were aware of overlaps, inconsistencies, redundancies, or gaps. Only a minority (13 or 11%) answered that they were not. Moreover, respondents expressed different views on how disclosure requirements for more complex products and those for simpler products should differ, including *inter alia* that more information on complex products would not necessarily facilitate understanding, that the definition of "complex" products was not always appropriate, that it would be important to ensure that consumers saw less risky and complex products first, or that such products should not be offered without advice (some respondents suggested adding one extra page to the KID for complex products. Many respondents, particularly from the industry, considered that there was no need for additional information).

A vast majority of respondents (108 out of 133, 83%[206]) were in favour of the use of electronic format by default, with (free) paper versions available upon request. A similarly strong majority (110 out of 134, 82%[207]) noted the importance of information documents translated into the official language of the place of distribution. When disclosing information through digital means, a large group of respondents found that it was important that key information was displayed in ways which highlighted the prominence, was appropriately labelled, and that relevant hyperlinks used to provide access to supplementary information. Clear rules to prescribe presentation formats and the adaptation of formats for different kinds of devices were also recommended.

The PRIIPs regulation

Slightly more than a third of respondents who answered (49 out of 129, or 38%) agreed that the PRIIPs KID improved the level of understanding that retail investors have of retail investment products, as opposed to slightly fewer who disagreed (43, 33%), while the remaining respondents (38, 29%) voiced no opinion. While the views of consumer organisations were split, representatives of investment advisors, insurance, and other sectors such as banks generally answered affirmatively. Half of the public authorities who answered (7 out of 14) found that the PRIIPs Regulation had not met this objective, pointing to the PRIIPs KID's complexity, its

[204] Mainly investment management, banking and insurance representatives, as well as 9 public authorities, one consumer organisation and most NGOs.
[205] Representatives from all sectors participating to the consultation, 2 consumer organisations, NGOs and 9 public authorities.
[206] Including most consumer associations and NGOs, most public authorities (12 out of 17) and representatives of all the sectors participating to the consultation.
[207] Namely all consumer organisations, almost all public authorities (14 out of 17) and a vast majority of industry stakeholders comprising all sectors represented in the consultation.

tendency to be overloaded with information, and the fact that cost and performance indicators may in some cases be misleading.

Views were split (49 out of 128, or 38%, disagreed whereas 46, or 36%, agreed and 33, or 26% voiced no opinion) on whether the PRIIPs Regulation improved the ability of retail investors to compare different retail investment products, both within and among different product types. Among those who agreed were 1 consumer organisation, 5 public authorities and representatives mainly from the banking sector, as well as the insurance and the investment management ones. Those who disagreed included 2 consumer organisations, 6 public authorities, as well as NGOs and company/business representatives of mainly investment management, in addition to some from banking and insurance. A fourth of respondents (34 out of 127, 27%), mainly from business associations and companies (overwhelming from the banking and insurance sectors) and a minority of public authorities (2), indicated that the PRIIPs Regulation had reduced the frequency of mis-selling of retail investment products and the number of complaints, while a smaller group (22, 17%) counting 4 public authorities and NGOs disagreed. The remaining 60% expressed no preference. Moreover, 39 respondents out of 128 (30%)[208] agreed that the PRIIPs Regulation had enabled retail investors to correctly identify and choose the investment products that are suitable for them, based on their MiFID and IDD defined individual sustainability preferences, financial situation, investment objectives and needs, and risk tolerance. However, 50 respondents, or 39%, disagreed[209]. Finally, 39, or 30%, voiced no opinion. Almost half of respondents (77 out of 128, or 47%)[210] considered that retail investors were easily able to find and access PRIIPs KIDs, while another group (26, or 20%)[211] were of the opposing view and another 26 respondents (20%) had no opinion. No views were expressed on the rules on access to the PEPP KID.

A majority of respondents (67 out of 119, 56%) preferred requiring that the PRIIPs KIDs and PEPP KIDs be made available in a dedicated section on manufacturer and distributor websites[212]. This was followed by requiring that the KIDs be uploaded onto a searchable EU-wide database (47, 39%,[213]), whereas a larger portion of respondents (60 or 50%,[214]) disagreed. The uploading onto national databases was supported by 40, or 34%[215].

A significant majority of respondents (86 out of 123, or 70%, made up of 1 consumer organisation, 9 public authorities, NGOs, and company/business representatives of all the sectors participating to the consultation) saw merits in simplifying the current PRIIPs KIDs. A group of respondents (49 out of 117, 36%, i.e. 9 public authorities, NGOs and company/business representatives of banking, insurance and investment management) noted the existence of

[208] Predominantly banking and insurance representatives and a minority of public authorities (2).
[209] Including all consumer organisations, NGOs, 7 public authorities and representatives of mainly investment management, and some from banking and insurance.
[210] In particular business associations and companies from the investment management, insurance and banking sectors, as well as 6 public authorities.
[211] Mainly citizens, consumer associations, and NGOs.
[212] This included all consumer organisations, NGOs, 8 public authorities and representatives from investment management, banking and insurance. The minority who disagreed (37, or 31%) comprised representatives of mainly banking and insurance, as well as investment management, and 2 public authorities.
[213] All consumer organisations, NGOs, 4 public authorities and representatives of investment management, banking and insurance.
[214] 6 public authorities and a sizeable number of representatives of banking, insurance and investment management.
[215] Consumer organisations, NGOs, 4 public authorities and representatives of investment management, banking and insurance.

inconsistencies or discrepancies in the actual implementation of the PRIIPs Regulation. Only 16 or 14% disagreed. A small number (18 out of 111, 14%, among which investment management companies, insurance and banking associations, as well as 2 public authorities) noted inconsistencies in the supervision of PRIIPs KIDs. Limited answers were provided, with strong variability between them, on the costs of manufacturing and updating a PRIIPs KID, a PEPP KID and an IPID. A larger group of respondents (44 out of 107, 41%[216]) answered that distributors and/or manufacturers of Multiple Option Products should not be required to provide retail investors with a single tailor-made KID reflecting the preferred underlying portfolio of each investor, as opposed to those who agreed to this (21, 19%,[217]), while 41 (38%) held no opinion. A majority of consumer associations and public authorities which responded expressed their support for a single tailor-made KID.

On the question whether pension products should be included under the scope of the PRIIPs Regulation, a majority of respondents, mainly from business associations and companies from the banking, insurance, and investment management sectors, were generally of the opinion that pension products should remain outside the scope, whereas a minority, mainly NGOs, consumer organisations, and citizens, expressed their support. Half of respondents (70 out of 118, 59%), in particular on the industry side, were generally opposed to allowing access to past versions of PRIIPs KIDs, pointing to the risk of displaying outdated KID versions and subsequent misinterpretation. A smaller group of respondents (20, 17%) were in favour and 28 respondents (24%) voiced no opinion. A strong majority (90 out of 122, or 74%) finally indicated that the review and updating of the PRIIPs KID should not occur more regularly than what was the case at the time of consultation.

Suitability and appropriateness assessment

The results of the consultation on the suitability and appropriateness assessments show a significant contrast in the perception of the effectiveness of those tools between the respondents from industry and those from consumer organisations.

The overall majority of respondents (81 out of 126, 64%), mainly from business organisations (73%), public authorities (54%) and business associations (90%) considered that the suitability assessment served retail investor needs and was effective in ensuring that they are not offered unsuitable products. Public authorities were equally divided about the usefulness of the appropriateness test to serve retail investor needs. Consumer organisations and NGOs, on the other hand, overwhelmingly disagreed on the efficiency of those tools. Nearly 100% of this group and 52% (65) of all respondents identified problems with the suitability assessment and made suggestions for improvement regarding *inter alia* the interplay between the product governance rules and suitability or appropriateness testing, focussing on the overall understanding of investments or portfolio composition, making the rules less burdensome and more useful for the investor and clarifying the interaction between knowledge and experience criteria.

Most stakeholders, constituting majorities from business organisations, business associations, and public authorities, found that the rules on suitability assessments (64 out of 121, 53%) and appropriateness tests (74 out of 122, 61%) were sufficiently adapted to the increasing use of

[216] 3 public authorities, and a large group of investment management, banking and insurance representatives.
[217] 1 consumer organisation, 4 public authorities and investment management, insurance and banking representatives.

online platforms or brokers when providing advice. However, consumer organisations and NGOs largely disagreed or expressed no opinion.

A strong majority (91 out of 123, 74%) of stakeholders from the business groups, considered that providing a warning about the fact that a product was inappropriate was sufficient protection for retail investors, however some respondents of that group expressed concerns, *inter alia* that warnings might not be enough for complex instruments. On the same topic, nearly all of the consumer associations considered that providing a warning was not sufficient in terms of investor protection. The majority of stakeholders (83 out of 123, 67%) from all respondent groups except for consumer organisations (of which only a third agreed) agreed that in case of the execution of orders or transmission and reception of orders of certain non-complex products, at the initiative of the client, no appropriateness test should be required.

39 respondents out of 98, or 40%, mainly business organisations and associations agreed or strongly agreed that the demands and needs test in its current form was effective in avoiding mis-selling of insurance products and in ensuring that products distributed correspond to the individual situation of the customer, opposed to the 9 (9%) that disagreed or strongly disagreed. However, 51% of respondents, in large part consumer organisations and public authorities, indicated that they had no opinion (38) or viewed this as neutral (12). A few (21 out of 100, or 21%), being a minority from all stakeholder groups except consumer organisations, all of which voiced no opinion, identified problems with the demands and needs test, in particular its application in combination with the suitability assessment in the case of insurance-based investment products, including *inter alia* the failure to consider the consumer's global assets and/or possible over-insurance or double insurance and the fact that the line between suitability test and demands and needs test appeared to be blurred. Around one third (33 out of 96, 34%) disagreed that more detailed rules were needed in EU law regarding the demands and needs test to make sure that it was applied consistently throughout the internal market, opposed to roughly 19% of respondents (18) who answered affirmatively. The majority of respondents (45, 47%), representing a majority from all different stakeholder groups, voiced no opinion. About one fourth of respondents (34 out of 93, or 37%), mainly public authorities, business associations and organisations, considered that the demands and needs test was sufficiently adapted to the online distribution of insurance products, while a much smaller group (8, 9%) considered that this was not the case and an absolute majority of 51 respondents (55%) voiced no opinion. Respondents were also divided (out of 94, 20 affirmative (21%) versus 25 negative (27%)) on whether procedural improvements or additional rules or guidance were needed to ensure the correct and efficient application of the test in cases of online distribution. The disagreeing stakeholders were public authorities, business associations and organisations, whereas all consumer organisations voiced no opinion.

Reviewing the framework for investor categorisation

A strong majority (92 out of 137, or 67%), composed of a majority of public authorities, business organisations and associations, found that adjusting the existing definition of professional investors on request would be the most appropriate approach for ensuring more appropriate client categorisation. The introduction of an additional (semi-professional) client category received less support (51 out of 139, or 37%) while the “no changes”/other measures option gathered support from an even smaller group (26 out of 130, 20%). All stakeholder groups presented a majority which disagreed with the latter two options, except consumer organisations which were evenly split among “yes”, “no” and “no opinion”. A significant majority of respondents indicated that changes were necessary to the criteria measuring frequency of transactions over the last four

quarters (95 out of 124, 77%, overwhelmingly from public authorities, business associations and organisations, with consumer organisations disagreeing), the existing wealth criteria (78 out of 126, 62%, mainly from business associations) and the criterion measuring a clients' experience (88 out of 124, or 71%, constituting a majority from all stakeholder groups). A majority of respondents (70 out of 123, or 57%), mainly from business associations and organisations, also supported the introduction of an additional fourth criterion. Regarding the criteria for companies to be classified as professional investors, around half 49% (56 out of 114) expressed support, with most business associations in agreement. 34 respondents (30%), including most business organisations, expressed no view, whereas 26 respondents (23%), including a majority of consumer organisations and public authorities, did not support the introduction.

Inducements and quality of advice

When considering options aimed at protecting retail investors against receiving biased advice due to potential conflict of interests, including regulating inducements, the option of ensuring transparency had the largest support (100 out of 126, or 79%), particularly from business and company representatives of insurance, banking and investment management, as well as 10 public authorities, half of the consumer organisations, and NGOs. Only 9 respondents or 7%, including 1 consumer organisation, considered that transparency had little impact on consumer behaviour.

A strong majority of 93 respondents out of 128, or 73%, in particular business/company representatives from banking, insurance and investment management as well as 8 public authorities, considered that a ban on all forms of inducements for all retail investment products would not be effective. Among those opposing the ban, in total 20 or 17%, concerns were expressed *inter alia* about the quality and availability of advice. Consumer organisations, NGOs and 2 public authorities were instead in favour of a ban. Among those in favour of banning inducements, it was suggested that it might result in distributors proposing a wider range of cost-efficient and less complex products, pointing also to the experience of the Netherlands. A majority of respondents, (74 out of 119, 62%) in particular business/company representatives of banking, insurance and investment management, as well as 6 public authorities and 1 consumer organisation, found that the current rules on advice and inducements under MiFID ensured sufficient protection against poor advice due to potential conflicts of interest. Among the 23 (19%) who disagreed were 3 out of 4 consumer organisations, 2 public authorities and NGOs, while the remaining 19% voiced no opinion. The views in relation to IDD and payments of inducements to providers of online platforms/comparison websites were less clear-cut. 31 respondents out of 114 (or 27%) including 3 out of 4 consumer organisations, NGOs, 3 public authorities and representatives of mainly investment management, found that the current rules did not ensure sufficient protection. The 49 respondents, or 43% that instead agreed that IDD provided sufficient protection included 4 public authorities and a majority of representatives from the insurance and banking sectors. The remaining 30% expressed no preference.

Out of the 114 who answered, a majority of 67 (or 59%) of respondents (among which 3 consumer organisations, 9 public authorities, NGOs and representatives of all sectors participating in the consultation) were in favour of aligning rules related to the payment of inducements across MiFID and IDD. Views were instead split (depending on the sector to which the respondent belonged) over whether IDD should be aligned to MiFID rules or vice versa. 53 respondents out of 128 (41%), mainly businesses and company representatives from the banking and investment management services as well as 4 public authorities, disagreed that legislative changes were needed to address conflicts of interest, receipt of inducements and/or best execution issues surrounding the compensation of brokers based on payment for order flows from third

parties. A third (44, 34%) however took the opposite view and supported the need for legislative change. They included 3 out of 4 consumer organisations, 8 public authorities, NGOs as well as representatives of mainly market infrastructure, in addition to banking, investment management and insurance. The remaining 25% voiced no opinion.

On the question whether there was merit in developing a voluntary pan-EU label for financial advisors to promote high-level common standards across the EU, the views were split (52 out of 121, or 43% of respondents disagreeing, 47, or 39% of respondents seeing such merit, and the remaining 22, or 18% sharing no opinion)[218]. A majority of respondents (61 out of 115, or 53%) were of the view that robo-advisors were regulated in a manner sufficient to protect retail investors[219]. A majority of respondents (66 out of 114, or 58%) also suggested that the use of robo-advisors remained limited in the EU because customers placed greater trust in human advice[220].

Addressing the complexity of products

Among the 130 that replied to the question, half (65 out of 130, or 50%), namely consumer organisations and NGOs, 6 public authorities and company/business representatives of banking, investment management and market infrastructure, considered that further measures should be taken at EU level to facilitate access of retail investors to simpler investment products, whereas a smaller group (52, 40%, including 4 public authorities and company/business representatives of insurance, banking and investment management) disagreed. A majority of respondents were opposed to: (a) measures to reinforce or adapt execution of orders rules to better suit digital and online purchases of complex products; (b) measures to make the rules which prohibit excess complexity of products that are sold to retail investors more explicit; (c) the development of a new label for simple products; (d) developing further rules to define and regulate simple products; and (e) measures to tighten the rules restricting the sale of very complex products to certain categories of investors. Consumer organisations and NGOs however generally supported such measures.

Redress

A significant majority of respondents (78 out of 113, or 69%), including all consumer organisations, NGOs, and public authorities, as well as a majority of business associations and organisations, considered that it was somewhat or very important that retail investors had access to rapid and effective redress, in particular when investing in another Member State. Most respondents (71 out of 106, 67%) were of the view that the MiFID II requirement for investment firms to publish the details of their complaint handling process was sufficient to ensure efficient and timely treatment of client complaints. This view was particularly strong among public authorities, business and company representatives, while the views of consumer organisations and NGOs were split. Most respondents (54 out of 101, or 53%), mainly business associations

[218] Those who saw merit in the initiative included half of the consumer organisations (2), 3 public authorities, NGOs as well as representatives from mainly investment management, but also banking and insurance. Among those who disagreed, instead, there were 6 public authorities, and representatives from banking, insurance and investment management.

[219] These included 6 public authorities, 1 consumer organisation and representatives of banking, investment management and insurance.

[220] These included half of consumer organisations (2), NGOs, representatives of banking, investment management and insurance as well as 4 public authorities.

and organisations, were of the view that retail investors knew where to turn in case they needed to obtain redress through an out-of-court procedure, a view which was not shared by some consumer organisations, NGOs, and public authorities. Most respondents (65 out of 106, 61%), constituting a majority in all stakeholder groups except consumer organisations and NGOs (which expressed split views), also considered existing out-of-court procedures to be (somewhat or very) effective at addressing consumer complaints related to retail investments/insurance-based investments. Consumer organisations, NGOs and some other public authorities expressed however a number of concerns. A group of 46 respondents out of 50 (92%) were of the view that further efforts might be needed to improve redress in a cross-border context, while 27 respondents (54%) shared the view that such efforts might be needed domestically.[221] A sizable minority (49 out of 106, or 46%), mostly consisting of business associations and organisations, considered consumer redress in retail investment products somewhat or very accessible to vulnerable consumers, while a smaller group of 18 respondents (17%) found that redress was rather not accessible or not accessible at all. 53 (50%) respondents, including majorities of consumer organisations and public authorities, were either neutral or voiced no opinion.

Product intervention powers

A majority of respondents (71 out of 112, or 63%) indicated that the ESAs and/or NCAs were making sufficiently effective use of their existing product intervention powers. A clear split was noted between a first group comprising business/company representatives and public authorities, and a second group made of consumer organisations and NGOs. The latter group was indeed of the view that ESAs/NCAs did not use their powers effectively. Views were also split as to whether further convergence of NCA powers was needed (42 out of 108, or 39% in favour, 36, or 33% against, and 30, or 28% voicing no opinion). On the side of industry, a larger group of respondents saw no need for further convergence, whereas a majority of public authorities, consumer organisations, and NGOs saw a need for further convergence. A majority of respondents (60 out of 113, or 53%) saw no need to reinforce the product intervention powers of the ESAs. This view was particularly shared by business associations and company/business organisations, with many respondents arguing that the current framework and powers of the ESAs were sufficient. However, a majority of public authorities considered that it would be necessary to reinforce the product intervention powers of the ESAs, with some arguing that ESA product intervention powers should be made permanent, or alternatively, have a longer duration. All consumer organisations (3, 100%) and most NGOs (4, 80%) were by a large majority in favour of strengthening the product intervention powers of the ESAs.

Sustainable investing

A majority of respondents (44 out of 61, or 72%), constituting the majority of business organisations and associations, indicated that financial returns were the most important element when investing, followed by investments that contributed positively to the environment and society (10 out of 41, or 24%). The views of NGOs and consumer organisations on the ranking of priorities were split, with a majority indicating that the financial returns were least important. The majority of respondents (56 out of 104, or 54%), including all consumer organisations and a

[221] 23 respondents, or 46%, selected noted that further efforts are required in both domestic and cross border contexts, resulting in a total number of responses being higher than the number of respondents.

majority of NGOs and public authorities, considered that the fear of greenwashing represents a very or somewhat important factor preventing more sustainable investment. The 'lack of an EU label on sustainability related information' (50 out of 106, 47%) and 'poor financial advice on sustainable investment opportunities' (48 out of 105, or 46%) were also considered important factors by almost half of the respondents, including a majority of consumer organisations and NGOs. Half of respondents (59 out of 118, or 50%) considered that 'detailed guidance for financial advisers would be useful to ensure simple, adequate and sufficiently granular implementation of sustainable investment measures', while 42 respondents (36%), mainly business organisations and associations, did not. There was clear support from NGOs, consumer organisations, public authorities, and trade unions for the former view, also shared by most citizens. A slightly larger group (45 out of 115, 39%), composed largely of business associations and organisations, considered that the reinforcement of the current research framework to ensure systematic consideration of ESG was not needed, as opposed to a smaller group (40, 35%), composed largely of consumer organisations, NGOs and public authorities, which considered it needed.

Other issues

A number of comments were provided on topics not covered by other chapters of the consultation with relevance to retail investments, including how new regulation may impact the level of direct participation of retail investors in capital markets, the interconnectedness of retail investment and wholesale financial markets, the increase of market data fees, improving participation of retail investors in corporate governance matters, various issues pertaining to sustainability, different aspects pertaining to supervision, in particular when services are provided on a cross-border basis, the prevention of fraud, and taxation issues.

1. 2. Targeted consultation on options to enhance the suitability and appropriateness assessments

On 21 February 2022, the Commission also launched a targeted public consultation on options to enhance the suitability and appropriateness assessments. The deadline to respond was 21 March 2022. The consultation looked into the feasibility of a new retail investor-centric approach to the MiFID II and IDD suitability and appropriateness tests. Such a proposal was the result of stakeholders' suggestions received in the Retail Investment Strategy public consultation, regarding the possibility to simplify, improve, automate, and standardise the way investor profiles are currently assessed. Views were sought on the options proposed to enhance the client assessment regime and introduce a personalized asset allocation strategy.

Overview of respondents

In total, 69 respondents participated to this public consultation. The largest group of respondents came from business associations (36) and company/business organisations (21), representing together 82% of all respondents. There were also 5 public authorities (7%), 1 consumer organisation (1%), 1 NGO, 1 trade union, 1 EU citizen, and 2 others (3%) who participated in the consultation.

The largest group of respondents came from the investment services industry (27, 39%), followed by the insurance industry (16 or 23%). Other respondents came from a group which indicated "other" (16 or 23%), as well as from investment management (15, 22%), new technologies (6,

9%), pension provision (4, 6%), market infrastructure operation (1, 1%) and social entrepreneurship (1, 1%). The respondents that indicated "not applicable" were only 2 (4%)[222].

The majority of respondents came from the EU (98%, 68 respondents) with one response from outside of the EU (United States, 1%). The highest number of respondents came from Belgium (22%, 15 respondents), followed by Italy (16%, 11 respondents) and France (13%, 9 respondents). The above-average response rate from Belgium can be explained by the high number of EU-level organizations and associations who have their seat in Brussels.

An enhanced client assessment regime – General

Most business associations and organisations considered that the current suitability and appropriateness assessments were well-designed and did not require extensive changes, and hence were not in favour of the idea of a standardised retail investor assessment regime. Conversely, only 2 citizens, 1 NGO, and 1 trade union were in favour, while public authorities were split. A principal argument of the supporters of a more client-centric approach was that putting consumer interests at the centre would spur more competition. Some expressed support for a "retail investor passport" which would allow a retail client to easily switch between or using multiple brokers/financial intermediaries. Others noted that a standardised retail investor regime could reduce discretion and improve harmonisation in the application of the assessment process, further enabling national and EU authorities to better supervise these processes and allowing individual investors to enforce their rights, thus making it easier to compare recommendations and assess "value for money". On the NCAs side, several considered that an in-depth analysis of the weakness of the current regimes was needed as a preliminary step, fearing that a new regime could bring additional burdens on investment firms and a probable deathblow to existing execution-only distribution channels.

The majority of respondents were of the opinion that a Personal Investment Plan ("PIP") would not bring specific benefits to retail investors and financial intermediaries, while a sizeable minority expressed a positive view about the PIP's potential. Most respondents believed that there would be certain drawbacks associated with the introduction of the PIP regime, noting large implementation costs requiring significant and complex adaptations of IT systems and internal processes. A few respondents noted that standardisation of the onboarding process would reduce the margin for financial intermediaries to use innovative machine learning tools and behavioural finance methods. They added that such standardisation would also reduce or remove the incentive for intermediaries to compete on improving the quality of assessment processes. Other respondents stressed that standardisation of the PIP questionnaires at EU level would be difficult given the variance in cultures and environments, as well as the bespoke nature of insurance-based investment products and execution-only services. On the latter, several respondents found that requesting a suitability assessment in such cases would contradict the basic approach of financial instrument transactions without advice. The different nature of investment services was viewed as justifying a different degree of information to be obtained and assessed, and consequently the appropriateness and suitability assessments should remain separate. Regarding the concept of a personal asset allocation strategy ("PAAS") in general, several respondents noted that investment intermediaries would be biased towards products that are part of their offering. Therefore, these strategies may differ significantly from one intermediary to another. Some respondents highlighted that clients tend to be secretive about their financial situation, and that for a

[222] Respondents were able to select multiple sectors, therefore resulting in higher total number of responses when compared to the total number of respondents.

successful implementation of the asset allocation approach, it would have to be guaranteed that the client is transparent about their overall financial situation.

Amongst the minority who supported the more client-centric approach, one business association indicated that this initiative could be game-changing when coupled with the upcoming Open Finance strategy, as it would spur more competition, put consumers' wishes and interests at the centre, let clients be the true owners of their personal data, encourage digitalisation, and ultimately empower retail investors to participate more in capital markets. A majority of the respondents were however not in favour of giving retail investors the ability to transfer the results of their assessment together with their PAAS to brokers/financial intermediaries of their choosing, on the grounds of them being confidential know-how. Other respondents stated that the transferability and use of the assessment and PAAS may create liability risks for the intermediary providing the investment advice. Several respondents believed that this portability could lead to standardisation and ultimately to an impoverishment of the product ranges, as well as a general deterioration of the quality of the investment advice given to the client. Regarding the key components of a standardised PIP and the main investment objectives and constraints to be addressed by a PIP, respondents expressed some support to the different suggested elements, with little support for the elements related to the duties and responsibility of the adviser drawing up the PIP and for all rules and guidelines surrounding the drawing-up and review of the PIP. Elements regarding the client's tax situation got little support as well. Respondents mostly agreed that the tax situation must not be included in any appropriate / suitability assessment, because of its complexity.

On the electronic storage and accessibility of the suitability assessment and the asset allocation strategy by all financial intermediaries (subject to client consent), opinions were evenly split. Many respondents expressed concerns about the risk of data profiling and client manipulation as well as liability and remuneration issues. Few responses were recorded about cost estimates for the PIP, with the values provided being varied and of little apparent use. In providing for the breakdown of costs, most warned of significant costs that would arise if firms were to implement a new regime, including related to IT, internal processes, adjustment of policies, products, contracts, product manufacturing and distribution, training of staff/HR, and updates to client profiles. A similar sentiment among respondents was seen with regard to cost savings. Most respondents felt that savings are dependent on the details of the new regime, the set-up costs which should not be underestimated, and the additional costs to a bank's current suitability and appropriateness framework.

A personalised asset allocation strategy (PAAS)

A significant majority of respondents were not supportive of the idea of standardised investor profiles, with some noting that there is currently no standardisation across firms, Member States, and the industry in general on how investors' profiles are classified. Some said that investment service providers already have their own classification system based on the current legislation, their own products, research, and investment strategies. Others added that the use of a personalised asset allocation strategy would not be coherent with standardised investor profiling, and that harmonising risk profiles may hinder competition and reduce choices for the retail client. However, some respondents did contend that standardisation could, for some investors under certain circumstances, provide a meaningful simplification.

Regarding value-for-money when considering asset classes, a few respondents highlighted that value-for-money criteria are already applied at the level of product governance processes. Some

respondents noted that each advisor should assess what products constitute best value in light of the investor's risk appetite. Several respondents remarked that value-for-money screening can effectively be performed only when selecting an individual financial instrument within an asset class, since the earlier stage involving the establishment of the PAAS is too high-level to comprise these criteria. Various respondents stated that a financial intermediary other than the one that drew up the client assessment should be able to propose a different asset allocation strategy (other than the one originally established), given that the investment environment, the investor's financial position as well as their risk appetite are subject to change over time. For this reason, a plan cannot be based on elements which cannot be standardised. Some respondents stated that investors should be given the choice as to whose views they trust and what advice they choose to follow, rather than be stuck with a mandatory asset allocation. Other respondents claimed that in the interest of liability, each ISP should be left with the possibility of adapting the PAAS.

In terms of additional comments, several respondents expressed the need for more time to deliberate for the issues in consideration. Various respondents stated that because the IDD and MiFID II have only relatively recently been established, more data needs to be gathered on the issues that the proposal aims to address. Another point reiterated by respondents was the fear of creating a free-riding system: if the asset allocation strategy was due to be performed without charging, there could be free-riding from other intermediaries

2. 3. Outreach to stakeholders

Stakeholder outreach on suitability and appropriateness tests

The Commission organised and held several rounds of stakeholder outreach, both bilateral and multilateral, building on the feedback obtained from the responses to the above-mentioned consultations on the retail investor strategy and the suitability and appropriateness assessment. The objective of the outreach was to collect targeted data on the possible costs and benefits of option relating to Value for Money as well as the PIP to inform the preparation of the impact assessment.

Summary of outreach to NCAs

The Commission held bilateral calls with six NCAs between 24 and 28 September 2022. NCAs generally did not note any major issue with the current framework, reporting very limited (or even inexistent) client complaints to investment firms, although with some variations across Member States. With respect to the possibility of introducing a list of asset classes and a personalised asset allocation strategy, NCAs generally saw a risk of blurring the line between advised and non-advised services. More specifically, 2 NCAs noted that the definition of asset classes should be granular enough in order to be useful, while another remarked the need to carefully consider the algorithm used. Moreover, NCAs did not see the overall necessity to further standardise the suitability assessment, noting the acceptability of existing industry standards, however 2 NCAs encouraged further simplification of the assessment for retail investors. Finally, 4 NCAs considered that the appropriateness test should be reinforced with questions on the client's financial situation, ability to bear losses, and possibly risk appetite.

Summary of outreach with the industry and consumer associations

Workshop with the industry

The Commission held a workshop with industry stakeholders on 28 September 2022. The general sentiment expressed by participants was that the current suitability and appropriateness assessment regime worked well, and adjustments were therefore seen as costly. Many participants were against having the same assessment for advised and non-advised (execution-only) services, with a large majority also against the standardisation of some elements of the suitability assessment across financial intermediaries. Amongst the participants offering execution-only services, a majority (82%) was against switching from the appropriateness assessment to a suitability assessment. Finally, only 38% of participants noted that they already identified particular asset classes suitable to their client as a result of the existing suitability assessment, whereas the remaining 62% did not.

Workshop with consumer associations

The Commission held a workshop on 28 September 2022 with two consumer associations. The general sentiment was that the most effective remedy to shortcomings in the retail framework would be a ban on inducements, and that any other measures (including the PIP) would fall short of making substantial improvements. The standardisation of certain elements of the suitability assessment was also seen as unlikely to bring additional benefits. Moreover, participants noted differences regarding the level of mis-selling across Member States, underlining that the detriment it caused to retail investors was estimated to exceed that caused by gamification. Finally, Value for Money was considered a more important topic, with the associations recommending that the Commission explored how Value for Money could be linked to the suitability assessment instead of being confined to product governance.

Stakeholder outreach on Value for Money

During the first half of September 2022, the Commission held several discussions with a total of 8 stakeholder organisations on the issue of Value for Money, based around a discussion note and an accompanying short questionnaire. The Commission worked in close coordination with both ESMA and EIOPA, who have already conducted significant work in this field. The discussions took place via dedicated meetings and were complemented by written follow-up of participants'. The latter included 3 consumer organisations as well as representatives from the banking, insurance, financial intermediaries and investment management industries.

Consumer organisations broadly welcomed the idea of a strengthened Value for Money approach as part of the strategy, while industry representatives had more mixed reactions as to whether, and to what extent, the cost effectiveness of investment products was an issue.

Consumer organisations set out clear ideas as to how a Value for Money approach could be framed in legislation. Industry representatives were generally more sceptical, and pointed to a number of practical difficulties, in particular relating to how to capture the concept of value across a broad range of very different products.

Consumer organisations suggested having concrete and granular rules, such as the development of benchmarks against which the Value for Money prospect of proposed products might be compared. Industry representative, on the other hand, were rather favouring high-level principles only. Views also differed as to whether the assessment of Value for Money should be made at the product governance or advice stage, or both.

With respect to whether new rules should apply across the full range of retail investment products or be restricted to products where problems had been identified, diverging opinions were

expressed between keeping the approach broad and straightforward versus having a narrow and targeted approach.

3. 4. Call for evidence

A call for evidence was opened between 3 May 2022 and 31 May 2022[223] to request feedback from stakeholders on the retail investment strategy. Stakeholders were asked to provide views on the Commission's understanding of the problem and possible solutions, as well as provide relevant information, including on the possible impacts of the different options. 43 respondents replied to the call for evidence and presented their views. Out of those 43 respondents, 30[224] had also replied to the public consultation with their views remaining broadly the same as outlined in the paragraphs above.

The views of the 13 other respondents can be summarised as follows:

1. The five EU citizens who responded raised concerns about low returns, fraud, the lack of clear and correct disclosures provided during the advice process (especially on costs) as well as on the differences in disclosure rules.
2. Two financial institutions raised the issue of investor categorisation and recommended the inclusion of a semi-professional category in EU legislation. Two firms stated their support for strong financial literacy.
3. Two representatives of the insurance industry were in favour of relying on existing rules, pointing at recent application of EU legislation for the sector, highlighting the particularities of the insurance industry and the need to properly represent insurance-specific information in the key information documents. A representative of the banking and insurance sectors remarked the need to simplify disclosures, reassess investor categorisation and avoid radical changes that could not fit the characteristics of national markets.
4. A consumer organisation pointed to the complexity of disclosure information, including on costs, conflicts of interests and sustainability. It also highlighted the need to make the suitability and appropriateness assessments more consumer-focused, increase consumer protection in the digital environment and the need to address complexity of products offered to retail investors.

Contribution from the Financial Services User Group (FSUG)

As described in the Call for evidence, the consultation strategy included a thematic discussion with a written contribution from the FSUG which was published on 17 November 2022[225]. In its position paper, the FSUG reviewed the relevant retail issues to be addressed as listed in the Commission's April 2021 roadmap and consultation, assessing whether and how the Retail investment strategy is expected to address the topic and what could be done to further improve the initiative.

4. 5. ESA recommendations

A call for advice was issued by the Commission on 27 July 2021 and addressed to: (i) both ESMA and EIOPA to provide technical advice on a number of specific areas in the field of retail

[223] Retail investment – new package of measures to increase consumer participation in capital markets (europa.eu)

[224] The respondents that had already replied to the public consultation represented: 6 company/business organisation, 18 business association, 1 non-governmental organisation (NGO), 1 trade union, 1 consumer organisation.

[225] FSUG opinions 2022 (europa.eu)

investor protection; and (ii) the Joint Committee of the ESAs regarding the PRIIPs Regulation. The deadline for ESAs to deliver their technical advice was 30 April 2022.

Summary of ESMA's recommendations

The recommendations received from ESMA related to areas concerning disclosures (both digital and non-digital), and the treatment of digital tools and channels in the existing investor protection framework. Among other things, ESMA recommended to develop a standard EU format for the disclosure of costs and charges and identify amongst regulatory disclosure a short subset of "vital information" that should be prominently disclosed in all marketing communications to clients. The inclusion of a definition of marketing communications to capture (online) advertising and messages on social media (including via the use of influencers or other third parties engaging clients) was also recommended, as was the need to clarify the powers of NCAs to intervene in a timely manner in the case of misleading marketing practices and impose the use of risk warnings for specific complex and risky financial instruments. In that context ESMA recommended to include in MIFID II an explicit mandate to ESMA to develop guidelines on the topic of marketing communications and more generally on the use of digital techniques and tools by firms. ESMA also recommended the Commission to complement its legislative proposal on the review of MiFIR through amendments of MiFID II so as to prohibit the receipt of payments for order flow from third parties based on investor protection concerns. Lastly on the topic of open finance, ESMA recommended to the Commission to consider specific potential risks and benefits when developing any legislative proposal.

Summary of EIOPA's recommendations

EIOPA's recommendations also related to digital disclosures and the treatment of digital tools and channels in the existing investor protection framework, however also extended to the issue of damaging conflicts of interest in the sales process and product complexity in the retail investment product market. In particular, EIOPA recommended a shift to simpler disclosures which use digital layering and interactive elements. EIOPA further suggested to address inconsistencies between existing disclosure requirements, specifically between Solvency II and the IDD. To enhance existing period disclosures at EU level, EIOPA recommended the idea of developing an annual statement, similar to existing statements in pensions legislation, providing information on paid premiums, past performance, current value of savings and adjusted individualised projections. Regarding conflicts of interest, EIOPA suggested improvements to existing rules on inducements through a combination of several solutions, ranging from further transparency to an inducement ban. In particular, EIOPA recommended enhancing existing rules on product design, oversight and governance to address value for money, undue costs and risks of misunderstanding of the main features, costs and risks of the product. EIOPA also suggested the promotion of an affordable and efficient sales process by improving the suitability and appropriateness tests. Finally, regarding product complexity, EIOPA recommended the re-evaluation of the concept of complexity in the IDD and the PRIIPs Regulation.

Summary of recommendations of the Joint Committee of the ESAs on PRIIPs

The recommendations of the Joint Committee of the ESAs on PRIIPs focused on making KIDs more consumer friendly. The ESAs recommended targeted changes to the PRIIPs Regulation as part of a review of the PRIIPs framework. In particular, the Joint Committee recommended the following amendments:

1. Improving the presentation of the KID on digital media and providing more flexibility for their digital presentation;
2. More visible presentation of ESG information in the KID through a separate section;
3. Providing more specific cost information for insurance multi-option products;

4. Incorporating more flexibility into the KID, including by allowing different types of performance information depending on the product type;
5. Making KIDs more tailored to specific product types; and
6. Clarifying and tweaking the product scope of the PRIIPs Regulation by making it clear that certain corporate bonds are excluded.

ANNEX 3: WHO IS AFFECTED AND HOW?

1. PRACTICAL IMPLICATIONS OF THE INITIATIVE

The objective of this section is to set out the practical implications for the main stakeholders stemming from the preferred options under this initiative. Those implications are assessed in more detail in the following tables, however in summary:

1. Manufacturers of investment and insurance-based investment products would be required to:
   - update the PRIIPs KIDs to new formats;
   - adapt marketing communications to the new rules
   - provide an annual statement of cost and performance under IDD and use an EU template for the disclosure of costs
   - adapt to the ban on inducements
   - assess value for money on the basis of criteria and benchmarks.
2. Distributors of investment and insurance-based investment products would be required to:
   - adapt business models to the ban on inducements,
   - adapt suitability and appropriateness assessments to new rules;
   - provide an annual statement of cost and performance under MiFID and use an EU template for the disclosure of costs
   - adapt marketing communications to new rules;
   - assess value for money on the basis of information received from product manufacturers, criteria and benchmarks and including distribution costs.
3. National Competent Authorities would be required to:
   - supervise the extended scope of marketing communications and new rules on disclosures;
   - check compliance on the ban on inducements in line with more straightforward rules;
   - check compliance with strengthened value for money rules.
4. European Supervisory Authorities would be required to:
   - develop more specific rules at level 2 for a range of measures stemming from the strategy:
   - develop criteria and benchmarks in the context of Value for Money.

2. SUMMARY OF COSTS AND BENEFITS

I. Overview of Benefits (total for all provisions) – Preferred Option		
Description	***Amount***	***Comments***
Direct benefits		
Improved quality of financial advice: reduction of bias in financial advice for investments, better alignment of interests between intermediaries and investors and improved advisor standards.	This benefit is expected to be significant, given the prominent role of financial advisors in the distribution of investment products and major role of inducements as a factor leading to bias in the provision of investment services. An accurate estimation of the	The ban on inducements would impact the ties between investment product providers and distributors that exist as a result of commission payments. If financial intermediaries (advisors) were paid by their client rather than through commissions, the interests of intermediaries and clients would be better aligned and there would be a stronger incentive to recommend and offer products based on their benefits for the client, rather than based on the relative size of commission income from different products. Overall, a

(main beneficiaries: retail investors)	amount of inducements is difficult to establish, due to strong data limitations regarding the share of inducements in total product costs and the exact number of products in the market that carry inducements. By way of illustration and on the basis of a series of assumptions (presented in Annex 7C), the total annual cost of inducements for one market segment (actively managed UCITS funds which are directly held by retail investors), is estimated to represent EUR 5.13 billion (2019), EUR 5.25 billion (2020) and EUR 6.1 billion (2021). For previous years the calculations would be in a similar order of magnitude.	shift towards independent financial advice (including through portfolio management) and execution-only is expected, as discussed and evidenced in section 6.2 and Annex 7, as well as consumers being offered cheaper and simpler retail. investment products. The quality of advice would also be strengthened due to better alignment of rules on advisors' knowledge and competence.
Greater transparency on costs, performance and the ESG profile of investment products (main beneficiaries: retail investors, potentially also investment products which are cheaper or have better ESG characteristics)	Unquantifiable benefit	The annual cost and performance statement under MiFID and IDD and the EU template on costs, would improve transparency on costs and performance, enabling all retail investors to better consider the impact of all the costs on their investment decisions and to better monitor the net performance of their financial products. Changes to PRIIPs KIDs would give greater visibility to key information about the products in scope including on their costs and ESG profile. Indirectly, both measures could contribute to a consumer shift towards cheaper and more sustainable investment products.
Better understanding of investment products (main beneficiaries: retail investors)	Unquantifiable benefit	Improving the presentation of PRIIPs KIDs would make it easier for retail investors to understand key characteristics of the investment product they are considering. Including vital information in marketing communications would provide important context to marketing messages and would thus also contribute to better understanding of key elements of investment products. The annual cost and performance statement would provide retail clients in one single document with an overview of the performance of their portfolio, together with the total or detailed amount (upon request) of all the costs borne and payments received. This would facilitate the comprehension of the cost impact on the performance. The use of EU templates for costs reports, whether on an ex-ante or ex-post basis, would also facilitate comparison and favour more competition.
Reduced risk of misleading information (main beneficiaries: retail investors)	No estimate available	Inclusion of vital information in marketing communications would ensure that crucial information to help retail investors understand the product are always mentioned and presented in a prominent and balanced way. Changes to the PRIIPs KIDs would also (indirectly) make this document more attractive and help retail investors to pay more attention to it relative to marketing communications. Ensuring that marketing communications (including advertisement and associated persuasive techniques), whether made directly or indirectly by a firm (e.g. through social media), clearly appear as such and are bound by all rules on marketing

		communications, would avoid misleading communication and would help to avoid misinformation of retail investors.
Removal of products which do not deliver or deliver poor value for money due to undue costs (main beneficiaries: retail investors, product manufacturers or distributors with more cost-competitive investment products / distribution systems)	Level of benefits is difficult to quantify as it depends on many factors: invested amount, asset class, performance, etc.	Enhancing VfM within product governance rules, which in practice means adjusting the cost of products to their quality (expected returns, level of risk and value added by additional products features, like biometric risk coverage) would bring benefits to investors, as high costs undermine expected returns.
Broader access to financial instruments (main beneficiaries: more experienced retail investors, product manufacturers)	Unquantifiable benefit	Easing restrictions for certain retail investors to qualify as professional investors: allowing better differentiation between the diverging needs of individuals would help reduce unnecessary information disclosure to those clients who do not need it for their investment decisions, leading to cost savings for those financial operators as well as allow broader access for those clients to financial instruments.
Investors would be exposed to more products which would be better matched to their needs, preferences and investment objectives.	Unquantifiable benefit	Retail investors would benefit from better quality of service leading to more appropriate investment decisions where firms (i) take sufficient time to conduct suitability and appropriateness assessments, ensuring more accurate client profiling, (ii) consider in their screening and assessment for advised services, more client-specific information , with certain key elements made mandatory and standardised, and (iii) include in their screening and assessment for non-advised services, the financial capacity and ability to bear losses of their retail clients. In an advice setting - facilitate, for retail clients, comparability between assessments and recommendations, when approaching different firms. Also, the considerations of the existing client portfolio and the need for portfolio diversification would improve the overall diversification of the client's investments and limit potential losses. In a non-advisory environment, clients would benefit from stronger warnings, allowing them to avoid potentially detrimental investment decisions that would have been taken in disregard of their financial capacity and ability to bear losses
Enhancements to retail investor protection through stronger NCA powers, more effective cross border supervision and improved complaints mechanisms (main beneficiaries: retail investors, supervisory authorities)	Unquantifiable benefits	NCAs would be better equipped to more rapidly detect and address problems and misleading marketing communications, reducing the amount lost by investors to frauds, scams and unsuitable investments. The process and cooperation between home and host NCAs would become more efficient. Supervision of cross-border activities would be enhanced by enabling NCAs to work together and benefit from sharing of supervisory expertise, while at the same time preventing jurisdiction shopping. Retail investors would benefit from clear information and instructions and adequate access to communication channels and complaints mechanisms.
Indirect benefits		
Strengthened market oversight (main beneficiaries: supervisors, retail investors, broader	No estimate available	Some of the measures, notably providing clarity on the scope of the definition of marketing communications as well as the introduction of an EU template for costs, the annual cost and performance statement and the development and use of

society)		benchmarks for assessing value for money, will make it easier for supervisors to fulfil their supervisory mandates. Due to the ban on inducements, supervisors will no longer have to check quality enhancement and detriment tests.
Cheaper and better quality investment products for retail clients, more competition and innovation (main beneficiaries: retail investors, broader society)	The size of the impact of Value for Money and other measures has been quantified through convergence scenarios, suggesting monetary benefits estimated in the range of EUR 4.4 billion to up to EUR 22 billion, depending on the effectiveness of convergence pressure (13.8 billion for fund products, 8.4 billion for insurance products)[226]. However, the ban on inducements is expected to lead to a significant cost reduction, as the UK and NL markets, where bans were first introduced, demonstrate significantly lower (management) fees for retail investment products[227]. Taking into account the dynamic effects of a ban, which would imply that a certain percentage of retail investors would switch to cheaper products (as experiences in the NL and the UK have shown), these effects would be even higher. Assuming that 5% of investments in the EU would shift to low-cost investment products (such as ETFs), this could generate further aggregated cost savings of EUR 0.5 billion (2019), EUR 0.6 billion (2020) and EUR 0.8 billion (2021). The above illustration of the value of inducements is limited to only one market segment and could therefore be considered as a significant underestimation of the overall impact.	Multiple measures included in the preferred option would indirectly contribute to making investment products more affordable for retail investors, fostering competition and innovation in the market. The ban on inducements would contribute to a reduction in costs paid by retail investors and increase in quality of services and products distributed to them: i) by aligning incentives and making financial advisors much more likely to recommend more cost-efficient and higher quality products, and ii) by encouraging more competition in investment product distribution (also across the EU single market). Strengthening product governance requirements for manufacturers and distributors (Value for Money) would help eliminate from the market those products that are likely to present investors with poor value for money (both directly as captured above and indirectly, by fostering more comparison of products and thus stronger competition), while shifting the overall product mix towards cheaper (and likely more simple and higher quality) investment products. Other measures, such as ex-post statements on costs and performance could also contribute to a reduction in costs as they would improve client awareness about the ongoing cost and performance of products.
Digital shift in financial product distribution (main beneficiaries: retail investors, innovative players in the financial sector, and broader	Unquantifiable benefit	The ban on inducements in particular might accelerate an already ongoing trend towards digitalisation and increased innovation of the value chain, in particular at the distribution level.

[226] The results for insurance products are strongly influenced by observations for 2 Member States, for which the data used is based on few observations.

[227] Meanwhile service fees increased to a certain amount, depending on provider and services offered.

society)		
Improved financial literacy (main beneficiaries: retail investors, broader society)	Unquantifiable benefit	By supporting and supplementing the work of EU Member States in promoting financial literacy, financial literacy levels would increase. As established in the main body of this report, this would have further positive consequences for retail investors. i.e. enabling them to better understand investment products.
Possible increase in retail investment participation (main beneficiaries: retail investors, financial sector, non-financial companies and broader society)	Unquantifiable benefit	A combination of the benefits mentioned above (better understanding of products, lower risk of being misled, aligning incentives, cheaper products, strengthened supervisory enforcement, better quality advice) resulting from the different measures in this initiative would likely over time lead to increased trust levels among retail investors and through this, potentially their greater participation in the market for investment products. This benefit could thus also be reflected in greater business volumes for asset managers and other providers of retail investment products in the long run[228] and to some extent in potentially more funding for companies.
More effective accumulation of capital for retirement and other objectives (main beneficiaries: retail investors/households and potentially state budgets)	This benefit would be very difficult to quantify, as it depends strongly on the size of the expected shift towards cheaper products. Given the underlying compound interest mathematics, even small savings on annual costs could translate into a large long-term benefits for retail investors.	Reduced costs of retail investment products discussed above would improve after-fee performance, allowing invested capital to accumulate at a higher rate. Improved financial literacy levels could also stimulate wider retail investor participation in capital markets, leading to more people being able to accumulate more capital for their retirement and other life objectives.
Administrative cost savings related to the 'one in, one out' approach*		
Saving on existing requirements on inducements such as disclosures and quality enhancement / no detriment test (main beneficiaries: financial sector)	No estimate available [229]	Where inducements are applied, this currently has to be appropriately disclosed. Firms also need to comply with other regulatory requirements for the payment of inducements (e.g. ensuring that inducements satisfy the quality enhancement (under MiFID) and no-detriment (under IDD) tests). A ban on inducements implies such requirements would no longer apply, and savings on related administrative burdens.
Investor categorisation (main beneficiaries: retail investors, financial sector)	Benefit expected, but rather small and difficult to quantify	Existing criteria for professional clients on request would be adapted to accommodate those investors with appropriate knowledge, experience and ability to bear losses, who should hence be able to benefit from regulatory alleviations offered to professional investors, reducing information overload for this new investor category. This also implies that after checking who belongs in this category, product manufacturers and distributors would be able to save resources dedicated to assessing clients' needs and objectives and providing information to them.

[228] In the short run, a decline might be seen, in particularly in the advised segment of the market.

[229] In addition to the actual saving compared to the baseline, there is a potentially substantial saving compared to the alternative option considered in this impact assessment, which would require strengthening disclosures on inducements in order to safeguard interests of retail investors. (As regards quantification, it is not possible to determine approximate magnitude of the saving, as the evidence gathered points to potential non-compliance with the existing requirements, which would likely make any estimations unreliable).

II. Overview of costs – Preferred option							
		Consumers (retail investors)		**Businesses (financial product providers and financial advisors)**		**Supervisory authorities**	
		One-off	**Recurrent**	**One-off**	**Recurrent**	**One-off**	**Recurrent**
Disclosures and marketing communic-ations	Direct adjustment costs	None	None	None	None	None	None
	Direct administrative costs[230]	None	None	The costs for adapting/updating existing (automat-ed) systems to provide an annual statement on cost and performance, under MiFID and IDD, the total EU-wide cost could be estimated in a range of EUR €19 – 67.5 million[231]. The costs for adapting existing (automated) tools to incorporate the EU template on cost disclosures under MiFID and IDD and adjust internal policies, would depend on how the format is developed. This will be assessed while developing the relevant level 2 acts. Update of PRIIPs KIDs to comply with the new rules: very limited cost. Adapting marketing communication templates and internal policies and procedures	Investment firms will incur new ongoing costs in relation to the annual statement on costs and performance for clients who currently do not receive annual information on costs (e.g. clients with whom the firm is not considered to have "an ongoing relationship"). The estimate of these costs is EUR 5 per client/per year[232]. It was not possible to quantify the number of "new" clients that would be covered by this[233]. Negligible for PRIIPs[234] and marketing communications.	None	None

[230] Although these costs relate to the substantive requirements of the proposal which are necessary for the fulfilment of the objective of informing retail investors, they are categorised as administrative costs for "one in, one out" purposes.
[231] It should be noted that it was not possible to estimate the number of new clients under MiFID who at present do not receive annual information on costs, nor was it possible to gather data on the number of clients under portfolio management who already receive information on costs and performance, to be able to deduct these costs from the estimated one-off costs (see Annex 4).
[232] Based on the Retail investment study (page 217).
[233] Considering the divergent interpretation and practices of the investment firms and Member States on the qualification of "ongoing relationship" in the context of costs disclosure, it is not possible to estimate the number of new clients under MiFID who at present do not receive annual information on costs (see Annex 4).
[234] Sustainability information in KIDs will also be updated, but this will be done based on information already collected and disclosed under the SFDR. This is not expected to change the frequency of updates. With regard to the annual cost and performance statement under MiFID and IDD, no significant additional costs in cases where clients already receive annual information.

				on marketing communication: likely limited cost, but difficult to quantify.			
	Direct regulatory fees and charges	None	None	None	None	None	None
	Direct enforcement costs	None	None	None	None	None	Enforcement of the obligation to include vital information in marketing documents and providing annual statements: low cost implications expected.
	Indirect costs	None	Possible cost pass-through to clients: likely limited by the small size of the additional cost	Possible costs related to application of digital features in KIDs (voluntary, but companies may face competitive pressure to provide more appealing KIDs)	None	Acquisition or development of supervisory tools and training for staff to control the extended scope of marketing communications (NCAs). Other measures: slightly adapting supervision to the new approach	Further costs to supervise a larger range of marketing techniques under the extended definition. This is difficult to quantify as it would depend on volume of identified issues and intensity of supervision selected by NCAs. Disclosures: negligible supervisory cost impact[235]
Inducements	Direct adjustment costs	None	None	Change in business models of distributors[236] (including changing contracts, new billing systems): not possible to quantify but large impact expected. An extrapolation of the expected costs has been provided on the basis of cost estimates which were performed in the NL	Similar or lower ongoing compliance costs compared to the baseline scenario.	None	None

[235] For PRIIPs KIDs, the scope of supervision does not change significantly (very limited number of datapoints would be added, which are disclosed on websites and other documents under existing legislative frameworks). Similarly, for the annual statement on costs and performance, there is already supervision in place and the number of datapoints will only increase moderately. Where more work would result, this would likely be tackled through slight reprioritisation rather than budget increase.

[236] e.g. more roboadvice solutions, chatbox functions or application of other digital distribution and marketing tools.

				and UK at the time of introduction of the bans on inducement. These illustrations are based on a series of assumptions and caveats as presented in Annex 7C. On the basis the NL estimates, the one-off costs for investment firms and asset managers in the EU would be in the range of EUR 58-69 million[237]. On the basis of the UK estimates, the one-off costs for the sector could amount to a range between EUR 13.91 and 15.03 billion. The impact on different types of stakeholders is presented in Annex 7C.			
	Direct administrative costs	None	None	None	None	None	None
	Direct regulatory fees and charges	None	None	None	None[238]	None	None
	Direct enforcement costs	None	None	None	None	None	Costs of enforcement of the ban (NCAs).
	Indirect costs	None	Retail investors would have to pay upfront for investment services, including financial advice, as these costs would no longer be incorporated in the overall fees. The upfront payment for the	Migration of some asset holdings into inducement-free share classes	The changes to existing market structures and business/ distribution models, may affect the cost and revenue base for financial institutions. Apart from changes in the cost structure, a ban on inducements may imply a loss of revenues, but may also create an opportunity for financial institutions. The exact impact would depend on existing business	None	None

[237] On the basis of the NL estimates it was not possible to perform an extrapolation for other types of affected stakeholders (such as insurance undertakings).

[238] Only sanctions in case of non-compliance to ensure the ban is adequately enforced.

			investment service is however not expected to lead to a cost increase for retail investors compared to the baseline (see indirect benefits).		models, the choices that financial institutions would make in the transition to a new fee model and the duration of any transitional period.		
Value for money	Direct adjustment costs	None	None	Adaptation of existing internal processes and IT systems to assess VfM of investment products against bench-marks	Loss of business from products that do not offer retail investors good value for money and possible pressure on margins (both for product manufacturers and distributors): potentially sizeable, but not possible to estimate. In the long run, may be mitigated (partially or fully) by growth in the retail investment market [239].	None	None
	Direct administrative costs	None	None	Moderate increase in supervisory reporting costs from updating already existing structures (estimated around €60 million (range €13-252 million)	Ongoing supervisory reporting costs estimated to be minor €2.3-22.6 million annually across the EU. These costs would be further assessed and refined by the ESAs when preparing their technical advice on the more detailed rules to be adopted by the Commission at L2. Additional costs for VfM at distribution level could not be reliably estimated.	None	None
	Direct regulatory fees and charges	None	None	None	Fees to cover the cost of supervision may increase, depending on national systems	None	None
	Direct enforcement costs	None	None	None	None	Adjustment of super-vision by the NCAs, including	Enforcement of value for money rules[240] (NCAs and ESAs) and development of

[239] Making costs more effective may attract more investors to capital market increasing the scale of retail participation, thus also profits for financial intermediaries.

[240] Additional costs for NCAs to receive the relevant information from product manufacturers and pass it on to the ESAs are expected to be limited.

						possible changes to IT systems or reporting channels.	VfM benchmarks (ESMA, EIOPA). Final effect not clear as there would be savings on enforcement of product rules that could offset this increase in costs[241].
	Indirect costs	None	Depending on the size of costs to the industry, there may be a cost pass-through to clients.	None	None	None	None

Flanking Measures							
		Consumers (retail investors)		**Businesses (financial product providers and financial advisors)**		**Supervisory authorities**	
		One-off	**Recurrent**	**One-off**	**Recurrent**	**One-off**	**Recurrent**
Client categ-orisation	Direct adjustment costs	None	None	Marginal: related to one-time re-classification of some clients	None	None	None
	Direct administrative costs	None	None	None	None	None	None
	Direct regulatory fees and charges	None	None	None	None	None	None
	Direct enforcement costs	None	None	None	None	None	None
	Indirect costs	None	None	None	None	None	None
Enhanced suitability and appropriateness assess-ments	Direct adjustment costs	None	Retail clients would spend more time filling out suitability and appropriateness	Adjust-ments to IT systems and training of financial advisors: estimated	More time dedi-cated to suitability and appropriateness assessments for exist-ing	None	None

[241] Under the current framework, despite efforts by the ESAs to coordinate, some NCAs have expressed concerns that the rules are difficult to enforce.

			assessments.	approximately in the range of €12.5-48.5 million.[242]	and new clients: estimated approximately in the range of €7.1-19.1 million.[243]		
	Direct administrative costs	None	None	None	None	None	None
	Direct regulatory fees and charges	None	None	None	None	None	None
	Direct enforcement costs	None	None	None	None	None	None
	Indirect costs	None	Possible cost pass-through from the financial sector.	None	None	Possible costs to adapt IT systems to process /verify digitalised information.	More data fields to assess in case of a complaint, but possibly more simple due to standartisation: overall cost impact likely negligible
Supervisory enforcement	Direct adjustment costs	None	None	Adjustment to rules on com-plaints handling	Running reinforced complaints process (not quantified)	Setting up a centralis-ed tool for reporting potential scams and updating reporting tool for data on cross-border activity would imply costs for ESAs (not quantified)	Maintenance costs for the centralised reporting tool and for the tool for reported data on cross-border activity.
	Direct administrative costs	None	None	Adjustment of documents to include risk warnings (negligible)	Ongoing costs of additional reporting of cross-border activities (not quantified)	None	None
	Direct regulatory fees and charges	None	None	None	None	None	None

[242] For breakdown of this figure and estimation details including key assumptions, refer to Annex 8.

[243] For breakdown of this figure and estimation details including key assumptions, refer to Annex 8. This is mostly driven by the enhancement of the suitability assessment.

	Direct enforcement costs	None	None	None	None	Establishing processes for increased enforcement and information exchange between NCAs and ESAs.	Increased enforcement in some Member States and increased information exchange between NCAs and ESAs:
	Indirect costs	None	None	None	Some of the increased enforcement costs for the ESAs and NCAs may be reflected in higher supervisory fees.	None	NCAs may face further costs depending on any increased use of (new) powers.
Qualification of advisors	Direct adjustment costs	None	None	Advisors and their firms may incur additional costs to meet higher professional requirements	Some investment firms and insurance distributors would incur higher costs of continuous training and associated processes, depending on the level of current standards.	None	None
	Direct administrative costs	None	None	None	None	None	None
	Direct regulatory fees and charges	None	None	None	None	None	None
	Direct enforcement costs	None	None	None	None	None	None
	Indirect costs	None	Possible increase in fees charged to customers, correspond-ing to an increased quality of services	None	None	Possible costs linked to adaptation of supervisory practices	None
Costs related to the 'one in, one out' approach							
Total	Direct adjustment costs	None	None	Inducements: large market adjustment impact; could not be quantified	Value for money: loss of revenues for		

				Value for Money: adaptation to revised product governance rules and use of benchmarks; not possible to quantify Flanking measures: adjustment to rules on complaints handling and to meet higher requirements for advisors; one-time reclassificatio n of clients: could not be quantified but expected to be rather low	products that do not offer good VfM, but could not be reliably quantified. [244] Flanking measures: reinforced complaints process and additional training for financial advisors (could not be quantified)		
	Indirect adjustment costs	None	Inducements : direct payment for financial advice and services or alternative ways to obtain information All measures: possible pass through of costs to clients (likely limited by the low expected size of some impacts on the industry) Flanking measures: possible increase in advisory fees charged to customers due to	Inducements: enhancing digital and other alternative distribution models (not possible to quantify; large offsetting factors expected[245]); migration of some asset holdings. Disclosures: voluntary costs for application of digital features	None		

[244] Over time, this is expected to be (partially) mitigated by growing retail investment participation and greater use of payment-based financial advice and alternative distribution models such as roboadvice.

[245] Notably the ongoing savings from not having to pay inducements to financial advisors.

			higher qualification requirements				
	Admin-istrative costs (for offsetting)	None	None	Disclosures and marketing communicat-ions: adaptation for annual statement in approximate range of EUR €19 – 67.5 million, some cost impact of adaptation to EU template on cost disclosures: cost to be assessed at L2. Limited cost impact of marketing communicatio n measures (not quantified)[246]. Value for Money: supervisory reporting costs estimated to amount to between (approximate) EU total €13-€192 million (costs to be further assessed at L2 by the ESAs[247]) Flanking measures: Adjustment of documents to include risk warnings (negligible).	Disclosures and marketing communica t-ions: providing annual statement to new clients: EUR 5 per client/per year (total could not be quantified). Negligible cost impact for PRIIPs and marketing communica tions[248]. Value for Money: supervisory reporting EU total of €2.3-32.2 million per annum (costs to be further assessed at L2 by the ESAs)[249] Flanking measures: Ongoing costs of additional reporting of cross-border activities.		

3. RELEVANT SUSTAINABLE DEVELOPMENT GOALS

[246] Although these costs relate to the substantive requirements of the proposal which are necessary for the fulfilment of the objective of informing retail investors, they are categorised as administrative costs for "one in, one out" purposes.
[247] The supervisory reporting costs for Value for Money do not take into account cost reductions from synergies with the supervisory reporting introduced by the AIFMD review.
[248] Although these costs relate to the substantive requirements of the proposal which are necessary for the fulfilment of the objective of informing retail investors, they are categorised as administrative costs for "one in, one out" purposes.
[249] Additional costs for VfM at distribution level could not be reliably estimated.

III. Overview of relevant Sustainable Development Goals – Preferred Option(s)		
Relevant SDG	**Expected progress towards the Goal**	**Comments**
SDG no. 8 – decent work and economic growth	Indirect impact on target 8.10 "Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance and financial services for all" by encouraging retail investment participation and better investment outcomes for retail investors. Further impact is expected on accumulation of more money to finance retirement and other life needs.	By shifting the incentives for financial advisors towards the interests of retail investors and addressing informational deficiencies that hinder sound decision-making, this initiative can increase trust and participation of citizens in financial markets through retail investment products. Retail investors would be also more likely offered cheaper investment products which translates into being able to accumulate more money over time for their life needs.
Multiple SDGs, notably SDG no. 13 – climate action	The inclusion of an ESG dashboard in PRIIPs KIDs would increase the visibility of environmental and social factors towards retail investors, indirectly contributing to greater emphasis on these factors in the financial markets	More visible presentation of information on the sustainability profile of investment products would contribute to greater use of such information when selecting products and could produce a behavioural nudge towards more sustainable products. The impact would link more with SDG no. 13 as existing sustainability metrics focus more on climate impacts.

ANNEX 4: DISCLOSURES AND MARKETING COMMUNICATIONS

This Annex presents in more detail the measures proposed under Options 2 and 3 of the impact assessment in the area of disclosures and marketing communications, as well as a number of technical measures.

Option 2: Targeted changes to disclosure rules to improve their relevance for retail investors

Measures relating to the PRIIPS Key Information Documents (KIDs)

This part of the annex further elaborates on the measures suggested with regards to PRIIPs KID under the Option 2 for addressing informational deficiencies.

1. Digital KIDs and the inclusion of a dashboard summary

1.1 Problem description

The Joint ESA advice on digital finance and the results of the Retail investment study evidenced that disclosures to retail investors, including those in PRIIPs KIDs, are not sufficiently adapted to the digital age. For instance, there are constraints and inconveniences to the use of KIDs on smartphones and for the use of layering[250], which could help reduce the information overload, that was also well-documented by the Retail investment study. This deprives retail investors from receiving disclosure information in a more engaging way. The evaluation published in parallel to this impact assessment also confirms that this limits the effectiveness and coherence (notably in contrast with PEPP KID) of the framework on disclosure rules for retail investors.

Key information documents can be provided to retail investors on paper, using a durable medium or, under certain conditions[251], by means of a website. When provided through a website, PRIIPs requires that the client can durably download a KID and consult it for a certain period. The current legal text hence does not prevent digital use of KIDs, including possible layering of information, but it also does not encourage it. While it provides some flexibility for supervisors to specify the details of the presentation of a KID when distributed electronically, it prevents changes to the order of the PRIIPS KIDs sections. Under the current legal framework, this would limit layering to presenting the information in a menu to display the headings and hide/unhide the information, which may not be sufficient. Moreover, KIDs are currently not well adapted to be viewed on different electronic devices (such as smartphones or tablets), which are becoming the dominant way in which especially younger generations of investors access information about their accounts and investment products.

At the same time, information from PRIIPs KIDs is already set to become easier to be used digitally under the baseline, as the contents of PRIIPs are set to become available through the European Single

[250] Layering is a practice of organizing information into related groupings and then presenting or making available only certain groupings at any one time. In the case of PRIIPs key information documents, this implies breaking down each section of a document into layers in order to allow for a simplified view (first layer) where only several pieces of information are shown, with a possibility to expand the view to see the more details for any section of interest.
[251] Notably, the regulation requires that the retail investor should be given the possibility to choose between information provided on paper and information by electronic distribution (cf. Paragraph 5(b) and in case of electronic distribution a paper copy should be provided upon request (cf. paragraph 3).

Access Point (ESAP) in a data extractable format as of 2026, pending the outcome of the negotiations on Commission's proposal[252]. The targeted changes in PRIIPs discussed in this annex are considered to be coherent and complementary with the inclusion of PRIIPs KIDs in ESAP. While ESAP will improve access to and digital use of information in PRIIPs KIDs by requiring that they are submitted to ESAP in a data extractable format, targeted changes proposed in this impact assessment would make this information more user-friendly for the reader. Easier digital use is unlikely to significantly affect the necessity to read the KID by retail investors and financial advisors, notably when assessing characteristics of a specific investment products. As the KID presents key information about a product in one place and in 3 pages, it is expected to remain a crucial document, hence the need to make the document more user-friendly remains relevant as well.

1.2 Proposed measures

Proposed measure A1: Adapting the PRIIPS KIDs to the digital environment and increasing the usability of its information

The Advice of the ESA joint committee on PRIIPs pointed to the fact that digitization can facilitate a more consumer-centric approach and provide retail investors with interactive tools, which could make information more engaging and easier to understand. This may help overcome the fear/reticence of retail investors to engage with financial information. This option would implement specific recommendations of the ESAs outlined below:

1. Allowing the use of **layered approach**, i.e. interactive web-based formats would allow for the presentation of information in multiple layers, allowing for sequential presentation of product information to investors and minimizing the impression of information overload for retail investors.
2. Allowing more flexibility in the **digital presentation of PRIIPs KIDs** and some degree of personalisation or customisation in the 3-page PDF document:
    1. The inclusion of a menu, contents sidebar or similar feature on a webpage, which the reader can use to immediately go to different sections of the disclosure (for example to information on risks, the costs of the product, or how to complain).
    2. Facilitating greater inclusivity by, for example, adding functionality to make information accessible to visually impaired consumers[253].
    3. Interactivity: marketing staff should be authorised and enabled to present a personalised KID or to compare different products on the same webpage. This would allow retail investors to personalise the information, such as the holding period or investment amount, as well as choose how the information is presented, for example in a graph or a chart.
    4. They should be able to retrieve the KID and the results of this simulation.

ESMA would be mandated to develop more specific rules for layering of information and digital presentation of KIDs (e.g. specifying vital information to appear in the first layer or to ensure that navigation between the layers is straight-forward).

[252] Commission Proposal amending certain Regulations as regards the establishment and functioning of the European single access point, COM/2021/725 final.

[253] This can be achieved through the presentation and format by providing, for example, sufficient contrast between colours, making it possible to enlarge font size and limiting colour in the interface.

Proposed measure A2: summary dashboard

This option would add a short summary dashboard in the PRIIPs KID, based on the example of the PEPP KID, where consumer testing has demonstrated that a dashboard may be an effective way to quickly understand key elements in a static format such as a PDF[254]. While specific contents would be determined at Level 2 PRIIPs to allow for sufficient flexibility, the PRIIPS dashboard would likely include basic elements on the costs, performance, and risks of the product. This dashboard would take some space among the 3-page PRIIPS KID, which may leave less room for other content. As is currently the case, it will be up to the RTS to determine how to distribute the available space among the different types of content required at Level 1 to ensure that the 3-page limit is adhered to.

1.3 Assessment of the proposed measures

Benefits: Improved presentation of the PRIIPs KID by greater use of layering and inclusion of a summary dashboard would make it easier for retail investors to understand key characteristics of the investment product they are considering (e.g. its costs, performance or whether there are guarantees). This would help achieve specific objective 1 "*Improve information provided to investors and their ability to take well-informed investment decisions*" by helping retail investors understand investment products. Through this, it would to some extent contribute to facilitating the choice of a product that matches their needs. It would also bring an opportunity for PRIIPs manufacturers to attract retail investors to their products as consumers are more likely to purchase products they understand.
Costs: This option implies a one-time adjustment of PRIIPs KIDs (and automated tools that the industry typically uses to develop them) to adapt to the new rules.

Affected groups of stakeholders:

1. Industry: This option would enable PRIIPs manufacturers to make greater use of layering and digital formats in KIDs. This could make disclosure documents and potentially also some of their products, more easily understandable and attractive for consumers. At the same time, while the use of layering would remain voluntary, PRIIPs manufacturers may feel competitive pressure to make use of these new possibilities. This option also implies a slight change in the format of PRIIPs KIDs. Where a new summary dashboard would be added, this would imply a one-time change of KIDs and related costs which are expected to be relatively small (as discussed above) and some prioritisation of textual information to fit in the page limit.

2. Consumers: retail investors would clearly benefit from more user-friendly disclosures as they would be able to more effectively search for information they need to make their decision and read it with more convenience on smartphones and tablets. Especially younger consumers would benefit, as they use smartphones more for this purpose. Clear specifications at Level 2 would prevent potential misrepresentation of information when layering is used.

[254] See: https://www.eiopa.europa.eu/sites/default/files/publications/pepp-consumer_testing_final_report.pdf

3. Supervisors: only limited impacts are expected for national supervisory authorities, as they would need to slightly adapt their approach to supervise and enforce rules for digital formats. Supervisors themselves have not voiced any significant concerns in this regard. No significant impact is expected on the resources of ESMA and EIOPA, as their involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

Stakeholder views: This option has strong support of stakeholders. In response to the Call for Evidence, the majority of stakeholders including consumer associations as well as insurers and asset managers also expressed support for being able to present the KID in a layered format.
Overall, these measures are complementary and would both bring additional benefits at little expected cost and would contribute to the objectives of the Retail investment strategy. Hence, based on the assessment above, **both measures A1 and A2 have been selected to be part of the preferred option**.

2. Presentation of Environmental, social and governance (ESG) information in PRIIPs KIDs

2.1 Problem description

Retail investors have a demonstrable need for information on the sustainability performance of the financial products and the companies in which they invest. Recent EU legislative initiatives such as the SFDR, the CSRD, and the provisions on disclosure in the Taxonomy Regulation seek to provide information that can be useful for investors, including retail investors, to understand relevant sustainability aspects. While much of this data has become or is becoming available through websites and documents, these disclosures may be rather complex for retail investors to navigate and may not be sufficiently visible to them.

As the PRIIPs KIDs provide key information on financial products, they should also include information about the sustainability profile of investment products. The PRIIPs Regulation already includes a requirement for ESG information to be included in the KID as part of the product's objectives within the 'What is this product?' section (Article 8(3)(c)(ii)), where this is applicable.

However, despite empowerments in the Regulation that would allow both the Commission and the ESAs to further specify these disclosures, those empowerments were not exercised, partly due to a preference to wait and adapt to the development of other EU legislative initiatives relating to sustainability disclosures. This has included, in particular, the adoption of the SFDR in 2019, followed by the ESAs' draft RTS, specifying the content and presentation of sustainability-related disclosures in the prospectus of investment funds, in the KIDs of PEPPs, and, for IBIPs as part of pre-contractual disclosures to policy holders under Solvency II.

In the responses to the ESAs' call for evidence on PRIIPs in the context of the Joint ESA committee's advice, several respondents raised the issue of the inclusion of ESG information in the PRIIPs KID. In particular, EFAMA indicated that the current format of the PRIIPs KID does not allow inclusion of information on the ESG profile of investment products in a way that would provide sufficient visibility[255]. In addition, the evaluation (Annex 11) confirmed that this poses a challenge with regards to relevance of PRIIPs KIDs.

[255] Excerpt from EFAMA response: "*We consider the current nature of the PRIIP KID to be overly prescriptive in each of the elements to be disclosed, making it impossible to insert the (soon to be needed) ESG information into the PRIIP KID (unless it is squeezed together with 'other information', such as a link to the past performance), which would be unhelpful in providing such new key information elements to investors*.".

2.2 Proposed measures

Proposed measure B: ESG dashboard in PRIIPs KIDs

The proposed measure entails adding an ESG dashboard in PRIIPs KIDs, as a dedicated section that would present key ESG information about the product. A dashboard would draw from available data about investment products that are collected under existing sustainable finance disclosures under the SFDR. It would take into consideration relevant developments in the sustainable finance legislative framework. This information could include the environmental and social objectives that are pursued by the product, and relevant KPIs and infographics on the share of the product that is invested into Taxonomy-aligned activities, information on sustainability risks, the principle adverse impacts of the product, and other types of information included in pre-contractual documentation under SFDR.

Compared to exercising level 2 empowerments, the specification at level 1 would allow:

1. To present ESG information in a separate section in the KID.
2. To specify at level 1, details on the type of ESG information that should go into this section/dashboard, thereby increasing legal certainty.

Discarded option: Exercising the existing empowerments in the PRIIPs Regulation. This option would give further details on how the requirements of Article 8(3)(c)(ii) of the PRIIPs Regulation should be specified, and in particular, in light of the extensive work that has been conducted by the ESAs under the SFDR, which ESG information – and in what format – should be included in the PRIIPs KID, including what is envisaged under SFDR, and/or how the ESG reference included under the SFDR should be referenced in the PRIIPs KID (as suggested by some stakeholders such as EFAMA) and the implications from a consumer perspective.
However, this option would not allow for the creation of a separate or dedicated section of the PRIIPs KID devoted to ESG information, as the name and order of sections are governed by the level 1 Regulation. Hence, this information would be less visible to investors.

2.3 Assessment of the proposed measures

Benefits: With an ESG dashboard, the PRIIPs KID would act as a snapshot on ESG information, with a reference to the pre-contractual disclosure documents where the full set of ESG information is available. It would provide easy access to basic ESG information on an investment product in the PRIIPs KID, such as Taxonomy-alignment and ESG objectives, risks, and impacts. This would allow retail investors to easily compare products with respect to ESG elements, avoiding the need to browse through multiple documents to obtain basic product and ESG information.
Costs: The ESG dashboard would be devised in such a way as to only reuse information, KPIs, and infographics that are already included in other pre-contractual documents, such as on the share of the product that is invested into Taxonomy-aligned activities. In this way, costs for product manufacturers would be minimal, and the information will already be under supervision through the SFDR.

Affected groups of stakeholders:

1. Industry: PRIIPs manufacturers will need to update their KID production processes and ensure that the information from the SFDR product disclosures is included in the ESG dashboard where necessary. When SFDR product disclosures are updated, this will need to be reflected in the PRIIPs KID, but this is not a significant additional burden as there are already requirements to regularly update PRIIPs KIDs and information from SFDR product disclosures is not expected to change with a particularly high frequency.

2. Consumers: Retail investors would have easy access to ESG information and be able to more easily understand and compare products along this dimension.
3. Supervisors: No impact expected, as the information will already be under supervision through the SFDR.

Stakeholder views: The inclusion of ESG information in the KID was requested by several environmental NGOs and also by parts of the fund industry. There are no stakeholders that are specifically opposed to the inclusion of such information in the KID, as far as we are aware.
Based on the assessment above, **measure B has been selected to be part of the preferred option**.

3. Transparency of costs of Multi-Option Products (MOPs) in PRIIPs KIDs

3.1 Problem description

One of the most specific technical issues identified as part of the evaluation activities[256] has been transparency on costs in the case of KIDs for insurance Multi-Option Products ("MOPs"). MOPs are PRIIPs which consist of a wrapper (insurance contract) and an underlying investment where clients choose between multiple options (up to several hundreds). In some countries, they constitute envelopes that enable retail investors to make investments under advantageous tax conditions. The investment options are usually made up of collective investment products that are themselves packaged (e.g. UCITS funds). Therefore, the retail investor bears the costs of two packages: the first is the insurance product itself (the wrapper), the second is a collective investment vehicle (UCITS or other). This double level of fees makes it difficult to understand the total costs borne by the retail investor.

The Advice of the ESA joint committee confirms that it is sometimes difficult for investors to identify the total costs related to a particular investment option and that information on the underlying investment option typically does not include the total costs of investing in that option (because the cost of the wrapper is found in a separate document). This hinders retail investors' ability to comprehend costs related to these products and hence reduces the effectiveness of PRIIPs KIDs for this market segment. This also poses a moderate challenge to the internal coherence of the PRIIPs framework, as the level of transparency of costs of different products is not the same.

Under the PRIIPs Regulation, MOP manufacturers have two options:

1. produce as many KIDs as there are investment options. Each KID shall include both the costs of the wrapper and the costs of the chosen investment options;
2. produce one generic KID for the wrapper and one specific information document for each investment option.

[256] This issue is rather covered here as a more technical issue, with only a short mention in the evaluation annex, to keep the relevant explanations close to the text that assesses the problem and possible solutions.

Since the main purpose of a PRIIP KID is to inform retail investors on the cost of each financial product and to allow them to compare these products, the current situation leads to some concerns which have been also voiced by the ESAs:

1. It is difficult for retail investors to identify the total costs related to a particular option they are considering. The generic KID usually shows only a range of costs (from the most expensive investment option to the least expensive), but does not always identify which costs are specific to the investment option and which costs are related to the insurance contract. This would be necessary, as the costs of the insurance contract are usually not fixed and depend on the investment option selected. The costs may be sufficiently high to significantly affect the performance of this investment option, especially over longer time periods (assuming compound interest). This hinders investors' ability to understand the implications of their choices between different options and hence could make such choices less likely to lead to the right product for them.
2. When investors are provided a specific information document for each investment option, it does not usually include the total costs of investing in that option. This does not allow sufficient transparency on total costs for retail investors. This situation could further affect retail investors' ability to compare different MOPs with each other, especially in situations where two or more MOPs they are choosing from use a different presentation of options in the fund catalogue.
3. Information on the exact costs of the selected combination of underlying options plus package is not explicitly required by the PRIIPs RTSs, and is often not provided within the KID documentation. The provision of this information may require the dynamic calculation of costs, depending on the underlying options chosen in each case, as it is not possible to know in advance which allocation retail investors will choose.

3.2 Proposed measure

Proposed measure C: Adapting PRIIPS KIDS to MOPs

Assessing the current situation regarding MOPs, and taking into account the ESAs recommendations, the following areas for improvement were identified: 1) Improving transparency on the costs of the insurance contract; 2) Demonstrating more clearly the impact of the costs of the insurance contract, for example on the performance of the product; 3) Better facilitating comparison between retail investors' investment options within a MOP and between different MOPs; and 4) Better reflecting how different investment options can be combined within a MOP.

Building on the ESAs' recommendations, this option would require manufacturers to develop and use an online digital tool that would allow retail investors to compare different investment options in order to establish the best combination suited to their needs. This IT tool would give dynamic "real-time" information on costs to retail investors. It should distinguish very clearly between the costs due to the wrapper and the costs due to the selected investment options. After having filtered the investment options that interest them, retail investors could then view the KID or specific information documents related to the more limited set of investment options that interest them. Under this option, the content of this tailored KID would still be derived from the KIDs drawn up by the PRIIP manufacturers, and liability would remain with the PRIIPs manufacturer.

Discarded option: An option was considered, but discarded, to **require KIDs to be produced for all combinations**. This option would not be optimal as it would be costly for PRIIPs manufacturers and

could lead to information overload for retail investors when the number of underlying options is significant. In fact, there are signs that the existing number of KIDs for MOPs already leads to some degree of information overload. To make sound decisions, investors need to have a comprehensive view of the total costs, with both the costs related to the wrapper and those related to the underlying investments.

3.3 Assessment of the proposed measure

Benefits: Improvements to the presentation of cost information in the PRIIPs KID for MOPs are expected to increase transparency on costs for this segment of retail investment products, where total costs are particularly challenging to understand. This would directly benefit retail investors, making it easier for them to understand key features of investment products and contribute to making retail disclosures more fit for purpose. Indirectly, this would also contribute to SO3, "*Ensure that retail investors are offered cost effective products effective*", as making total costs of MOPs more transparent and easier to compare could increase the pressure on costs of these products. It would also contribute to greater coherence of the PRIIPs framework, levelling the field between MOPs and other products within PRIIPs scope on transparency of costs.
Costs: Development of a tool to display total costs of combinations of a wrapper and different options would naturally imply certain one-off costs. These costs would be difficult to estimate and would likely vary between companies, based on the solution selected, their in-house IT resources and other factors. It is likely that such a tool would not need to be very advanced and would likely be similar to other tools that PRIIPs manufacturers already have in place, which would help ensure that costs are reasonable.

Affected groups of stakeholders:

1. Industry: There would be limited one-off costs related to the development of such online tools (as discussed above). Further economic impacts could materialise in the long run, in case the greater transparency on costs of these products leads to product switching, either towards other MOPs or for instance to UCITS.

2. Consumers: This measure would increase transparency towards consumers with respect to total costs they would pay for MOPs (and possibly finding other characteristics about these products more easily through digital means). Indirectly, this could contribute to making these products cheaper in the long run, as it may encourage product switching.

3. Supervisors: Only negligible impact is expected with respect to resources, as supervisors would only need to somewhat adapt enforcement to check whether the adapted rules are followed. Since the information would be presented digitally and more transparently, it would also be likely somewhat easier to check for the supervisor, effectively increasing oversight over this market segment.

Stakeholder views: Stakeholder views differ between groups. While the option would appear to be overall supported and notably by supervisors and consumer associations, stakeholders from the insurance sector are more sceptical. Some indicated a preference to keep the status quo (which however seems suboptimal from other perspectives).

Based on the assessment above, **measure C** would bring useful benefits and increase coherence within PRIIPs. As such, it **has been selected to be part of the preferred option**.

4. Clarification of the scope of PRIIPs regarding corporate bonds and immediate annuities

4.1 Problem description – corporate bonds

Another technical issue that is covered in this annex is the lack of legal clarity over the exclusion of certain types of corporate bond from the scope of PRIIPs, which according to some stakeholders is one of the factors limiting the offer of these instruments towards retail investors.

Plain corporate bonds (i.e. which are not particularly complex) have a number of advantages that would seem to justify their purchase by retail investors. For example, they are relatively easy for investors to understand and, compared to equities, corporate bonds issued by the same issuer are considered a less risky form of investment. From the point of view of the issuer, more retail investor participation in corporate bond markets would benefit companies by giving them a more diversified investor base for their funding needs.

It is therefore unfortunate that there has been a decline in the number of corporate bonds sold to retail investors in the recent years. In a study conducted in 2021 by BaFin, the German national competent supervisor notes an overall decline in the total value of annual corporate bond purchases by retail investors from 4.5 billion Euros in 2016 (which was before the entry into force of PRIIPs on 1 January 2018) to around 2.5 billion Euros in 2019. Other asset classes, such as government bonds or DAX stocks, which are excluded from the application of the PRIIPs Regulation, have not seen such declines.

It would appear that there is a link with the requirements of the PRIIPs Regulation, even as plain corporate bonds do not satisfy requirements to be included in the PRIIPs scope[257]. In 2019 the ESAs observed that: "*Uncertainty over the application of the PRIIPs Regulation to bonds, has led to negative consequences for the functioning of bond markets, and access to these markets by retail investors.*[258]*"*

The uncertainty was especially linked to bonds with so-called "make-whole clauses", which is defined in the supervisory statement as *"a clause that allows the issuer to pay off the remaining debt early using a reference rate to determine the net present value of future coupon payments that will not be paid".* Because the investor is exposed to a reference rate should the issuer call back the bond, some issuers had interpreted the make-whole clause as meaning that the bond was a PRIIPs, according to criteria 1 in recital (6). However, the Supervisory Statement did not settle the matter of whether bonds with make-whole clauses should be categorised as PRIIPs259. Although NCAs were recommended to apply the guidance when supervising these requirements, this still resulted in significant uncertainty remaining on the market. And as illustrated above, the

[257] In the PRIIPs Regulation, recital (6) explains that the scope should include "*all products, regardless of their form or construction, (...) where: i) the amount repayable to the retail investor is subject to fluctuation because of exposure to reference values, ii) or subject to the performance of one or more assets which are not directly purchased by the retail investor*." Plain corporate bonds do not satisfy either of these requirements, as the repayable amount is fixed (= the coupon and the principal) and the asset (the bond) is held directly by the retail investor.

[258] ESAs: Supervisory Statement on the application of the scope of the PRIIPs Regulation to bonds (JC 2019 6497).

[259] It concluded that: "The inclusion of a clause that allows the issuer to pay off the remaining debt early using a reference rate to determine the net present value of future coupon payments that will not be paid (i.e. make whole) is expected to mean that the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values. However, where the mechanism to calculate the discount rate is known in advance to the retail investor, this could be considered as a separate case, which does not satisfy the criteria in Article 4(1). Therefore, not all callable bonds are considered to be in scope, but some are expected to be on the basis of the specific "callable" feature, as well as depending on the other contractual features of the bond."

limited offer of plain corporate bonds to retail investors may be partially explained by this legal clarity issue[260].

In the Call for Evidence, the ESAs asked for views and experiences regarding the Supervisory Statement. The vast majority of respondents expressed support for the Statement while also stating that there remains legal uncertainty on the application of the PRIIPs Regulation to bonds, given that the Statement is a non-binding measure. Some respondents also argued that a number of additional features of bonds, in particular "make-whole" clauses, should not result in a bond being deemed a PRIIP. As a result, plain vanilla corporate bonds are still hard to access for retail investors since it has not been fully clarified that these financial products are not considered as "packaged" retail investment products (PRIIPs). Consequently, these bonds cannot be purchased by retail investors unless the issuer of the bond publishes a KID.

Apart from retail investors, stakeholders particularly affected are:

1. Non-European firms which do not explicitly market their bonds to European retail investors and therefore do not publish a KID in Europe, or
2. European firms that do not want to take the risk associated with the publication of a KID. The industry standard is that issuers sell their bonds to their bank consortium and have no further interest in the reselling of these bonds by the banks, in particular to retail investors. It would therefore seem that the entities most disadvantaged by this situation are the banks that resell the corporate bonds.

4.2 Problem description – immediate annuities

There is also an issue with the legal clarity concerning inclusion or exclusion of immediate annuities in the PRIIPs scope. Annuities are products which pay a monthly income for a certain period of time based on an existing lump sum. Within this product space, immediate annuities are retirement products without a saving or accumulation component which considerably reduces risks to retail investors. There is a problem with inconsistent treatment of these products with regards to PRIIPs scope across the Union, with only several Member States considering them to fall within the scope of the PRIIPs Regulation. The Joint Committee of the ESAs has recommended to explicitly exclude these products from the scope.

4.3. Proposed measure

Proposed measure D: Amending the scope of PRIIPs to explicitly exclude bonds with make-whole clauses and immediate annuities

This option would clarify the scope of PRIIPs at L1 to explicitly exclude bonds with make-whole clauses. Given that make whole clauses are a mechanism that allows the manufacturer to end the product early without detriment to the investor, it may be argued that this is not the type of structure that was originally intended to be captured by the PRIIPs Regulation. The amendment would hence correct this with the aim to increase legal clarity and access of retail investors to corporate bonds.

[260] Other factors are likely involved as well, such as typical higher amounts needed for an investment or low liquidity of such bonds in secondary markets, but these are outside the remit of PRIIPs and the Retail investment strategy more broadly.

In their Supervisory Statement, the ESAs defined such clauses as '*the inclusion of a clause that allows the issuer to pay off the remaining debt early using a reference rate to determine the net present value of future coupon payments that will not be paid'*. A relevant criterion was considered to be whether the mechanism to calculate the discount rate is known in advance to the retail investor. In the meantime, a similar definition of "make-whole clause" has been introduced into MiFID II as follows: *"make-whole clause" means a clause that aims to protect the investor by ensuring 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;'* ESMA also recommended exclusion of immediate annuities from the PRIIPs scope.

This definition could also be used to identify such clauses in the context of PRIIPs.

4.4 Assessment of the proposed measures

Benefits:
Clarifying the product-scope of PRIIPs to exclude certain corporate bonds would potentially encourage more banks to resell corporate bonds to retail investors. This could potentially increase retail investor access to wholesale capital markets and encourage corporate issuers to target retail investors. For corporate bonds for which PRIIPs KIDs are produced today, in certain cases PRIIPs KIDs would no longer have to be produced and updated, which would lead to cost savings. The magnitude of these savings is difficult to assess and is likely relatively small. The exclusion of immediate annuities (without an accumulation phase) would promote a more harmonised treatment of these products across the Union and could also positively impact their offer to retail investors. This, together with possible further smaller clarifications in the legal text, would also improve legal clarity and would imply some savings on legal advice.

Costs:
By explicitly removing corporate bonds with make-whole clauses from the scope of PRIIPs, there may be some cases where retail investors will not properly understand or not be able to properly compare the attributes of one corporate bond with another, because they do not benefit from the short, simple, and standardised disclosures of a PRIIPs KID. This may increase costs for retail investors to locate the best investment proposition for their needs, and in a worst case could lead to instances of mis-selling. But this risk is expected to be proportionately rather small.

Affected groups of stakeholders:

1. Industry: this measure would benefit the banks that resell corporate bonds and to a certain also the issuers of corporate bonds by potentially helping them reach a more diverse set of investors, as detailed above.

2. Consumers; as mentioned above, retail investors may benefit from better access to wholesale capital markets, but would also have less access to useful disclosures.

3. Supervisors: this measure would aim to align supervisory practices across the EU by providing more clarity on how to apply the PRIIPs Regulation in the case of corporate bonds. This could save some work for supervisors in the long run.

Stakeholder views: consumer organisations are not in favour of removing products such as corporate bonds with a make-whole clause (or any other bonds) or immediate annuities from the scope of the PRIIPs Regulation. They tend to support increasing the scope of PRIIPs to include

more products, including pension products. The option is however generally supported by the financial industry and some supervisors.

Based on the assessment above, **measure D has been selected to be part of the preferred option**.

Measures relating to MiFID and IDD

5. Annual statements on costs and performance

5.1 Problem description

Both MiFID II and IDD[261] require that, where applicable, investors shall be provided with information on all costs and charges on a regular basis, at least annually, during the life of the investment.

The requirements under MiFID II are further specified in Delegated Regulation (EU) 2017/565[262] which clarifies that "*investment firms shall provide annual ex-post information about all costs and charges related to both the financial instrument(s) and investment and ancillary service(s) where they have recommended or marketed the financial instrument(s) or where they have provided the client with the KID/KIID in relation to the financial instrument(s) and they have or have had an ongoing relationship with the client during the year. Such information shall be based on costs incurred and shall be provided on a personalised basis*." Specific rules also exist in respect of portfolio management services which include a comprehensive list of information to be provided to all clients periodically[263].

Except in the case of portfolio management services, this means that the annual costs and charges disclosure requirement only applies if several conditions are met and in particular where there is an "on-going relationship" between the investor and the investment firm or the insurance distributor. As the notion of on-going relationship is not defined in the Directives, ESMA clarified this notion by publishing Q&A[264] with a non-exhaustive and non-cumulative list of on-going relationships. Despite such clarifications, the notion of on-going relationship remains subject to interpretation when used in the context of the ex-post annual costs statement. In situations where this condition is considered not to be met, some retail investors are prevented from receiving an annual statement on costs and charges linked to the financial products they hold.

In addition, except in the case of portfolio management services, there is no obligation to provide retail investors with an annual report on the performance of their financial instruments. The obligation under MiFID II that requires investment firms that hold client financial instruments or clients' funds to send them at least on a quarterly basis[265] or in another periodic statement[266], a

[261] Article 24.4, last paragraph MiFID II and Directive 2011/61/EU and article 29(1) 3rd subparagraph IDD.
[262] Article 50.9 of Delegated Regulation (EU) 2017/565.
[263] Articles 60 and 62 of Delegated Regulation (EU) 2017/565.
[264] ESMA Q&A on MIFID II and MIFIR investor protection and intermediaries' topics, section 15, Other issues, Question 1, answer 1.
[265] Article 63.1 of Delegated Regulation (EU) 2017/565.

statement of those financial instruments or funds, but does not include any obligation to include information on performance[267] or on costs and charges. The same is true for the regular cost information under IDD. Even if some distributors nonetheless provide, on a voluntary basis, such information, the lack of legal requirement to do so leaves many retail investors without this very useful information. Without a complete annual report, covering the different elements necessary to assess the effective performance of their financial products, many retail clients do not have a comprehensive view on their portfolio's performance which would enable them to consider the quality of their investments and investment services and to assess any need to adjust in order to achieve a better outcome.

While mandatory annual updates on the development and performance of an investment are only provided for pension products, in the form of the Pension Benefit Statement under the IORP II Directive[268] and the PEPP Benefit Statement under the PEPP Regulation[269], at national level, several Member States have introduced periodic disclosure requirements for life insurance products or insurance-based investment products.[270]

In the EIOPA advice on retail investor protection, EIOPA specifically recommended the development of an annual statement in the IDD that would be similar to the Pension Benefit Statement for IORPs and PEPPs. The introduction of such a statement appears particularly appropriate in the case of IBIPs, as IBIPs are long-term structured products which are very often purchased as an alternative or a complement to pension products. In view of this functional equivalence with pension products, EIOPA recommended that the content of the annual statement should to a large extent be similar to that of the Pension Benefit Statements. It proposed in particular to include adjusted individualised projections as important information for investors to take into account when considering if they are on track to meet their aims for retirement saving or other long-term savings objectives.

5.2 Proposed measures

Proposed measure E: Introduction of annual statements on costs and performance

In order to ensure that **all** retail investors get, at least on an annual basis and regardless of their relationship with their financial intermediary, the necessary information to evaluate the costs and performance of their portfolio, an obligation would be introduced for investment firms and insurance undertakings to present an annual statement on costs and performance to all retail

[266] Article 63.2, last paragraph of Delegated Regulation (EU) 2017/565: there is however not obligation to provide such periodic statement "where the investment firm provides its clients with access to an online system, which qualifies as a durable medium, where up-to-date statements of client's financial instruments or funds can be easily accessed by the client and the firm has evidenced that the client has accessed this statement at least once during the relevant quarter".

[267] Article 63.2 (f) of delegated regulation (EU) 2017/565 requires only to mention in the statement of client assets the "market or estimated value, when the market value is not available, of the financial instruments included in the statement with a clear indication of the fact that the absence of a market price is likely to be indicative of a lack of liquidity. The evaluation of the estimated value shall be performed by the firm on a best effort basis".

[268] Articles 38 to 40 of Directive (EU) 2016/2341 (IORP II Directive).

[269] Articles 35 to 37 of Regulation (EU) 2019/1238 (PEPP Regulation).

[270] See, for example: Germany – § 155 Versicherungsvertragsgesetz, VVG; France – Law No 2019-486 of 22 May 2019, Article L.132-22 Code des assurances; Belgium; Ireland - Consumer Protection Code.

clients in a way which would allow them to easily appreciate the costs and charges paid and the effective performance of their financial products.

This obligation would be introduced at Level 1, requiring investment firms and insurance undertakings to provide all their retail investors who owned financial instruments in a securities account held with such firms or have insurance-based investment products manufactured by them, with an annual statement including a global and detailed view on all elements necessary to appreciate the costs and the performance of their portfolio. The statement should provide in an easy-to-understand format, the below personalized key information:

For investments falling under MiFID II, this annual statement would contain at least the following elements:

1. details of all financial instruments held by the investment firms for the client at the end;
2. the **market or estimated value** (when the market value is not available) of the financial instruments;
3. the **total costs and charges (including tax)** related to both the financial instrument(s) and the associated investment and ancillary services incurred during the reporting period. The total costs and charges would nonetheless itemize separately (i) total costs and charges charged by the investment firm for the investment service(s), (ii) total costs and charges charged for the financial instruments, (iii) total third party remuneration received or paid by the investment firm in connection with the services provided to the retail client and (iv) total taxes withheld by the firm and borne by the retail client. A more detailed breakdown per financial instrument and per service would be provided by the firm upon request of the client;
4. the **total amount of dividends, interest and other payments** received during the reporting period in relation to the client's portfolio. A more detailed breakdown per financial instrument would be provided by the firm upon request of the client; and
5. the **annual performance of each financial instrument** held by the client and the **annual global performance of their portfolio** (at least for the financial instruments purchased through an investment advice service or RTO service or execution of order service of the firm).

For insurance-based investment products falling under the scope of IDD, the annual statement would have to be provided by the insurance undertaking manufacturing the insurance-based investment product. It would contain the following elements:

1. Current value of the investment;
2. Payments made by the retail investor (investments, deposits, contributions, premiums, fees, etc.) over the previous 12 months, deducting any withdrawals made;
3. A breakdown of all costs and charges incurred, directly or indirectly, by the retail investor over the previous 12 months and the amount of any remuneration paid to the distributor on an ongoing basis by the manufacturer or another party except the customer in connection with the distribution of the investment product; comparison of the costs with benchmarks for comparable products (developed in the context of VfM);
4. Past performance of the investment (during the relevant year compared to previous periods);
5. Adjusted individual projections of the expected outcome at the end of the contractual or recommended holding period, based on the current value of the investment and its performance development so far and linked to the pre-contractual performance scenarios

in the PRIIPs KID, and a disclaimer that those projections may differ from the actual final value of the investment;

6. Information on the conditions and financial consequences of an early termination of the investment or switching of providers, including, in the case of an insurance-based investment product, the surrender value and conditions for surrendering the insurance policy;
7. Information on what happens when the insured person dies or another insured event occurs;
8. In the case of unit-linked protection policies for which the policy terms and conditions provide for periodic premium reviews, the projected premiums required to maintain existing protection benefits until the ages of 55, 65, 75 and 85.

5.3 Assessment of the proposed measure

Benefits: The information provided in the annual statement would enable all retail investors to get a comprehensive view of their portfolio's performance and the global costs they bear, without the need to collect all necessary pieces of information or to make calculation by themselves. It would enable them more easily to consider the quality of their investments and investment services and, where needed, to adjust them in order to achieve better outcome. The standardised format of the document would greatly contribute to these benefits and also allow for better comparability. More broadly, this transparency may also lead to increased competition on the supply side, eventually putting downward pressure on prices charged for products and services from which all investors benefit collectively. It could also facilitate cross-border business by ensuring a harmonised standard of investor protection. As regards supervisory authorities, this measure would support their supervisory actions by giving them the possibility to access more and better data on costs and charges and performance, helping them to better compare the effective value for money of the financial products.

Costs: Investment firms and insurance distributors are already subject to annual ex-post disclosures on costs and in some cases, on performance to their clients. The introduction of the ex-post annual statement on costs and performance would deepen the existing disclosure obligations in terms of (i) content, by including the element of performance and payments received (in addition to costs) to all clients under MiFID and IDD and personalized projections in relation to clients under IDD, and (ii) broaden the circle of clients receiving such annual statement under MiFID, since the obligation to provide an ex-post annual information would apply in relation to all clients (and not only to those with whom the investment firm has an ongoing relationship or are under portfolio management)[271].

The introduction of the ex-post annual statement on costs and performance would represent a one-off cost for the industry, which would consist of costs for the adjustment of existing (IT) systems so that the element of performance and payments received (and projections in the case of IDD) could also be provided and that the statements would be extended to all clients. In the Impact Assessment accompanying the Proposal for the IORP II Directive (SWD(2014) 103 final of 27.3.2014), the Commission estimated the one-off cost for the implementation of a short and standardised annual Pension Benefit Statement containing both personalised and generic information about the pension scheme, on average, at around 7 EUR per member (which would

[271] Under IDD, insurance undertakings are already under an obligation to provide information on costs to all clients.

equal EUR 7.7 per member adjusted to 2022 price levels). As investment firms and insurance undertaking are already expected to provide annual information on costs to clients, the calculation of the one-off costs could be based on an assumption that that the changes/updates of existing systems would amount to a range of 5-15% of these costs (per client). For an investor base of between 49-58.5 million retail investors[272] the one-off costs could be estimated to be in the range of EUR 19 – 67.5 million. It should however be noted that, considering the divergent interpretation of investment firms and Member States on the qualification of "ongoing relationship" (see above) and the different practices of investment firms (some providing on a voluntary basis extensive information, beyond the legal requirements), it is not possible to estimate the number of new clients under MiFID who at present do not receive annual information on costs. There is also a substantial percentage of clients under MiFID who already receive information on performance (e.g. clients under portfolio management). For these clients, the systems of the investment firms would already be adjusted to provide such information. It was however not possible to gather data on the number of clients under portfolio management to be able to deduct these costs from the estimated one-off costs.

In relation to ongoing costs, the Retail investment study quantified the existing costs for private pensions and insurance products covering the preparation and update of periodic information at EUR 5 per client per year[273]. It could be assumed that the costs for the ex-post annual statement on costs and performance would be in a similar range (if not lower). The ongoing costs for investment firms and insurance undertakings are not expected to increase in relation to clients who already receive annual information, since after the adjustment of the systems, the information that is already available at the level of the firm (or easily retrievable from trading venues platforms/websites) could be provided to clients without any significant additional costs. As the number of clients under IDD who already receive annual information (on costs) would not increase compared to the baseline, the ongoing costs for insurance undertakings are not expected to increase. For investment firms an increase of ongoing costs is expected in relation to clients who currently do not receive annual information on costs (e.g. clients with whom the firm is not considered to have "an ongoing relationship"). For those clients, investment firms would start to incur ongoing costs of EUR 5 per client/per year. Considering the divergent interpretation and practices of the investment firms and Member States on the qualification of "ongoing relationship" in the context of costs disclosure (see above), it is not possible to estimate the amount of new clients under MiFID who at present do not receive annual information on costs.

No material increase of costs is expected for the NCAs, as such controls already exist and existing IT tools should be able to absorb a bigger amount of data. No significant impact is expected on the resources of ESMA and EIOPA, as their involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

Finally, this option would impose no new direct costs on retail investors, but there is a risk that investment firms and insurance companies may shift the costs they bear to provide such enhanced annual statements onto their retail clients via an increase of their investment and ancillary services costs.

[272] Based on the assumption that about 25-30% of the households hold capital market instruments, which given 195.4 million households in the EU and an average household size of 2.3 individuals results in an absolute number of 49-58.5 million clients. The number of estimated retail investors could vary, although likely not significantly, due to the fact that some investors might have accounts with different intermediaries or due to the fact that some retail investors might be categorized as professional investors in the future (see annex 6).
[273] Retail investment study, page 217.

Affected groups of stakeholders:

Industry: This option would allow investment firms and insurance undertakings to more clearly and in a standardized way communicate with their clients the information relating to their investments. Enhanced transparency may also lead to increased competition on the supply side, eventually putting downward pressure on prices charged for products and services to retail investors. This development could be further stimulated by the appearance of service providers and advisers focusing on switching opportunities for retail investors.

Consumers: As the existing requirement to provide an annual statement on costs and charges to retail investors will be extended to all MiFID II and IDD retail investors, regardless of their relationship with the firm, and would also include additional elements, in particular information on performance, all retail clients would benefit from increased transparency, enabling them to more easily compare different products and consequently take better informed investment decisions. Investors would obtain a more comprehensive view concerning the costs and performance associated with their investments. This information would be backward looking and personalised. It would allow retail investors to get at a glance a global view or a detailed view should they request so, on how their financial instruments have performed over a year time, taking into account all costs and charges and any received payments. As information would be provided on an annual basis, clients could better assess the quality of their investments and decide whether to hold their investments, reinvest or disinvest if deemed appropriate. In the case of insurance-based investment product which are typically bought for retirement or other long-term investment purposes, adjusted individualised projections and additional information on termination and switching options will allow retail investors to check if they are still on track to meet their savings objectives and to take the necessary steps if this is not the case.

Supervisors: The measure is expected to help supervisory authorities in their control processes. Allowing access to more data on costs, charges and performance to supervisors, would help them to better compare the effective value of financial products marketed to retail clients. It is not expected that this measure would lead to any material increase of costs for the NCAs.

Stakeholder views:

In the insurance sector, representatives of insurance intermediaries and consumers are supportive of the annual cost and performance statement which they see as an important improvement of investor information. They in particular call for the inclusion of information about past performance and performance projections. On the other hand, a majority of insurance undertakings expressed criticism, pointing out that the existing information and annual statements, where provided for under national law or voluntarily by firms, are sufficient and also better adapted to the specific features of the different Member States. They were particularly critical of the proposal for personalised performance projections for IBIPs, which they consider overly burdensome and difficult to realise in the case of products which have no clear holding period. Should an annual statement be realised on a European-wide level, it would have to replace existing national solutions to avoid duplication and overlap.
A large majority[274] of distributors of investment products also expressed a strong reluctance to change the current rules on costs and charges disclosure, considering the current regime as strong

[274] Between 65 and 71.9 % of business associations and business organisation.

enough to ensure transparency of costs and cost impacts for retail investors. They expressed concerns that the enhanced annual statements on costs and performance may lead to an information overload. Others (in particular consumer associations) however considered that the current regime is not always efficient, as the information may be too complex and confusing for retail investors. Simplification and standardization appear particularly useful in a digital context.

Based on the assessment above, **measure E** would bring useful benefits and increase coherence between MiFID and IDD. As such, it **has been selected to be part of the preferred option**.

6. A standard EU format for costs disclosure under MiFID and IDD

6.1. Problem description:

The divergent use of the terms to describe and present costs to retail investors has been signalled as an information deficiency. In practice, this results in the use of a plethora of different words (e.g. costs, charges, expenses, fees, commissions etc) to present the same or similar concepts which on the one hand can easily confuse or mislead retail clients, and on the other hand make it difficult to compare the costs across different products. The same applies to the format for the presentation of disclosure of costs and performance: there is currently no standardised format in the EU.

In the ESMA advice on retail investor protection, ESMA highlighted that "*the discretionary powers given to Member States with regards to the format that can be used to disclose relevant information do not appear to be an optimal solution to create a single market of financial products and services*"[275]. A majority of respondents (62.5%) to the public consultation on the Retail investment strategy mentioned that they are aware of overlaps, inconsistencies, redundancies, or gaps in the EU disclosure rules with respect to the way product cost information is calculated and presented. The Retail investment study also concluded that costs disclosure rules and practices were complex and sometimes inconsistent, making comparison and the use of this information challenging for retail investors. In the vast majority of product information documents which were reviewed, retail investors were presented with multiple cost items. To allow investors to clearly identify and compare costs and performance in the disclosure documents, it is important to make such disclosures more standardized and understandable for retail investors. In the context of an increased provision of cross-border services by digital providers, the lack of standard EU format for the disclosure on costs does not facilitate comparability and development of cross-border investments.

6.2 Proposed measures

Proposed measure F: Introduction of a standardized EU format for the disclosure of cost under MiFID and IDD

This measure would imply the introduction of a standardized EU format for disclosures in the area of costs. ESMA and EIOPA would be mandated, after having conducted consumer and industry testing, to develop draft regulatory technical standards to specify i) the standard costs

[275] ESMA advice on retail investors protection, see point 19, page 8.

and charges terminology to be used by the investment firms when delivering statements on costs and charges and ii) the relevant format for the presentation of such statements. This standardization aims to improve understandability and comparability of cost disclosures for retail clients.

The relevant regulatory technical standards would likely need to cover several formats, depending on the category of financial products and whether the information on costs is to be provided before or after a transaction on financial products takes place[276].

6.3 Assessment of proposed measure

Benefits: An EU format for the disclosure of costs provided to retail clients would make it easier for retail investors to understand the impact of the different costs on the performance of their considered or on-going investments. This would help achieve specific objective 1 "*Improve information provided to investors and their ability to take well-informed investment decisions*". This measure could facilitate the choice of a product that matches the retail client's needs.

Costs: This measure implies a one-off cost for the industry to adjust existing systems for the new EU standardised formats for costs disclosure. This will require costs for the automated tools usually developed by the industry for this kind of reporting. It may also require firms to adjust their pricing strategy in view of the cost transparency this new format should bring and the enhanced competition it might create. The exact impact will also depend on how the format is developed, which will be assessed in the context of the development of the relevant Level 2.

Affected groups of stakeholders:

1. Industry

The industry would benefit from an EU template, as firms would no longer need to conceptualize standards in-house. This does not apply to companies that have already established disclosure formats, which would need to be realigned to the new template. Considering that firms already have in place templates for costs disclosure, the implementation of the new standard will lead to one-off compliance costs for investment firms and insurance undertakings.

2. Consumers

An EU standard for the information shown to clients would harmonise existing disclosures on costs across different investment firms and insurance undertakings. Investors would benefit from more and better streamlined transparency and would therefore be able to better compare costs product-by-product.

3. Supervisors

The development of a standardized template would facilitate the work of supervisory authorities as there would be less divergence between the documents they would have to review. It would also provide supervisors with relevant and comparable data for their supervision. Furthermore, it would allow them to check on a bigger scale the costs communicated ex-ante and the costs actually charged to retail investors. No significant impact is expected on the resources of ESMA and EIOPA, as their involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

[276] This would in particular concern the ex-ante costs and charges disclosure and the ex-post annual costs statements.

Based on the assessment above, **measure F** would bring useful benefits and increase coherence within MiFID and IDD. As such, it **has been selected to be part of the preferred option**.

Option 3 – Addressing shortcomings in relation to marketing communications

7. Addressing the relevance of information in marketing communications

7.1 Problem description

Retail investors currently receive abundant information about investment products and services, through multiple sources, including marketing communications. Considering the complexity and abundance of the information provided, retail investors are often inclined to base their decisions on retail-friendly marketing information[277]. Such information can consequently play a key role in investment decisions, particularly if it is the first information that retail investors receive. This is due to the fact that individuals tend to be more influenced by the first piece of information they receive (put more focus on it) in relation to a specific product[278].

[277] ESMA advice on retail investor protection, point 108, and in particular 2021 AMF study into investment scams: "*Considering that social media have therefore become a source for investors to base investment decision upon, it is important that communications on social media platforms are compliant and monitored timely*." Also October 2021 UK FCA press release: "*58% of younger high-risk investors say that both a hype on social media and in the news lies behind their investment decisions*.".

[278] ESMA advice on retail investor protection, point 22: "*ESMA notes the key role that marketing communications can play in determining consumer behaviour and influencing investment decisions, especially considering the phenomenon of 'anchoring bias' that makes people be over reliant on the first piece of information they receive. For many retail investors, decisions about if and how to invest are significantly influenced by information conveyed in marketing communications. Retail investors who are subject to misleading marketing communications are more likely to be mis-sold an unsuitable/inappropriate financial product and service, even where correct information is provided through regulatory disclosures (such as PRIIPs KIDs or UCITS KIIDs).*".

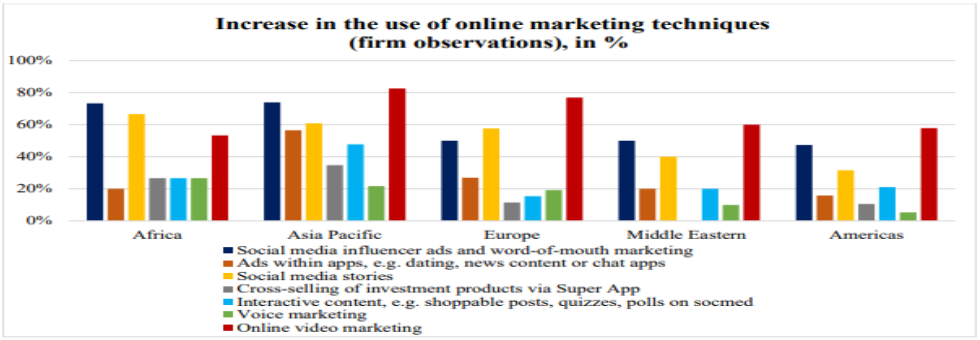


Chart 5

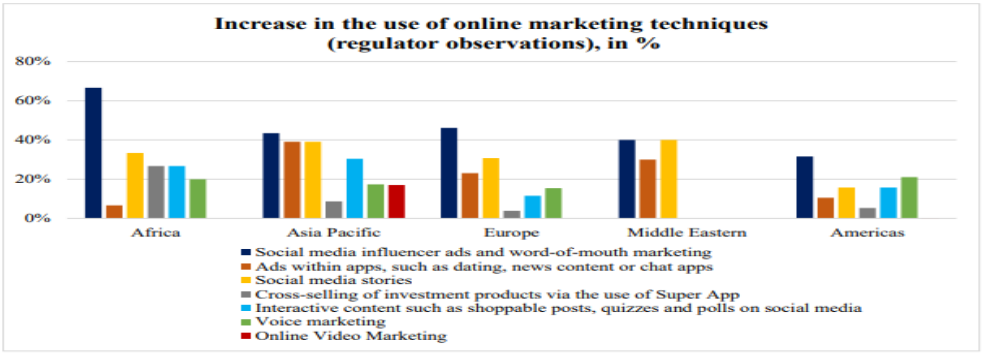


Chart 6

Source: IOSCO report on retail distribution and digitalisation – October 2022
Figure:

Identifying key information in marketing communications can be difficult for retail investors, as some material information (e.g. on the costs or the risks) may be hidden or missing,[279] or the way key information is presented may not be appealing (e.g. presentation of risky or inappropriate elements in particular may be minimised compared to a more prominent presentation of positive and attractive elements)[280]. Unbalanced presentation causes informational deficiencies that hinder the ability of investors to make well-informed decisions and is particularly impactful in the context of an increasing use of digital channels for retail investing.

In a digital context, retail investors are often exposed to influences from social media and online channels (see table above). Online marketing tools in particular present risks, such as the possibility for firms to exploit investors' biases, to target inappropriate market segments, to push unsuitable products[281] or to distort the investor's ability to appreciate risks and costs[282]. Marketing techniques can also use segmentation, personalisation and retargeting methods that exploit investors' biases[283], as well as product placements, enticements and reward schemes via social media and influencers[284]. The use of behavioral biases and the lack of financial education

[279] ESMA advice on retail investor protection: point 37.
[280] ESMA advice on retail investor protection, pages 10 and 14.
[281] IOSCO report on retail distribution and digitalisation, page 6.
[282] ESMA report on the European Commission mandate on certain aspects relating to retail investor protection
[283] IOSCO report on retail distribution and digitalisation "While marketing communications, in particular through digital means, presents certain benefits for retail investors, in particular in terms of flexibility, convenience and ease of access to the information, they also present potential risks such as biasing investors' choice, unsolicited offers, offers targeting an inappropriate segment, pushing towards unsuitable products, increased misconduct, difficulties for competent authorities to control the digital marketing, enforcement challenges, etc".
[284] This is seen especially in relation to the advertisement of more volatile and risky products, such as crypto assets

result in consumers taking ill-informed choices and doing so on the basis of information or advice they might not have consciously perceived. Such digital marketing approaches present particular challenges in regulation, especially where the marketing is carried out by a third party, such as an influencer, and not directly by the firm.

According to the aforementioned IOSCO's study, 10% of surveyed firms already use influencer marketing, and the majority are considering increasing or starting to use influencers as part of their marketing strategy[285]. The growing interest of firms to use influencers is taking place in a context of growing use of social media by retail investors. The December 2021 Dutch AFM's study into financial influencers[286] showed that 15% of execution-only investors with less than two years of investment experience use social media as a source of information. These percentages have likely further increased in the meantime, emphasizing the need for clarification in this area. The French AMF has also been paying specific attention to the growing trend of influencers in the financial products and services sphere, in particular by developing an educational module in partnership with the French ARPP (Advertising Self-regulatory Organisation) on best practices and rules applicable to influencer campaigns and communications on financial products and services. Influencing practices are also being scrutinized in other jurisdictions (e.g. the US, where a recent SEC ruling explicitly required disclosure by influencers of the remuneration they receive for the placement or advertisement of financial services or products[287]). ESMA has also highlighted that finfluencers, which are already required to flag sponsored posts under general advertising rules, should also comply with rules for financial products and services communications and ensure that the information they present is *'fair, clear, and not misleading*'[288].

The use of behavioural biases of consumers, through gamification techniques and techniques that present certain information more prominently, or in other cases 'hidden', is also increasing and becoming a source of concern[289]. Such techniques, when applied to communications by firms, can entice consumers to purchase a product or use a service. This can be achieved through various techniques, such as use of limited offers, reward programs, sign-up bonuses, etc.[290].

In order to the protect retail investors from misleading or harmful marketing practices, it is important that online activities, in particularly through third parties, such as influencers, are covered by the existing rules on marketing and fall under the responsibility of the relevant investment firm or insurance undertaking. However, as indicated in the ESMA advice on retail investor protection, there is confusion in the application of the definition of marketing communications as to whether online advertising and firms' private messages to clients and

[285] IOSCO report on retail distribution and digitalisation – pages 16 and 17.
[286] See: AFM - the pitfalls of finfluencing.
[287] In the US, Section 17(b) of the Securities Act makes it unlawful for any person to: "publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.
[288] ESMA advice on retail investor protection: point 113, page 35.
[289] ESMA advice on retail investors protection: page 27.
[290] The UK FCA for example has also noted that utilisation of techniques such as the offer of sign-up bonuses can induce consumers to invest, UK FCA CP 22/2, page 26

potential clients on social media fall under this definition[291], both when communicated directly by the firm or through third parties' social media (i.e. 'finfluencers' who operate on behalf of financial service providers).

NCAs also face significant challenges in monitoring new forms of marketing communications, for instance as regards the use of finfluencers by firms or other developing means to engage clients via third parties through social media[292]. While it should be clear that the outsourcing of marketing to an influencer is ultimately the responsibility of the (management of the) financial service provider, who should monitor whether the information provided by finfluencers complies with the necessary regulation, ESMA and EIOPA consider that more detailed rules on the control and oversight to be exercised by investment firms and insurance companies on marketing communications is necessary to ensure a consistent approach across all Member States. A majority of respondents in the public consultation considered that there was a need for further EU coordination/harmonisation of national rules on online advertising and marketing of investment products[293].

7.2 Proposed measures

Proposed measure G1: introduction of vital information in marketing communications

Under this measure, the existing requirements on marketing communications would be strengthened by requiring firms (and where relevant third parties) to include all "vital information" in marketing communications relating to financial products and services. Such vital information (i.e. essential characteristics of the product or the service) should appear in a prominent way and be accessible at a glance, in all marketing communications[294]. The Commission would be empowered to adopt a delegated act to specify the essential characteristics of financial instrument(s) or investment and ancillary service(s) to be disclosed in all marketing communications targeting retail clients.

The vital information to be displayed should ensure that retail investors get an easy overview of the key product features of the financial instruments, including the main risks. This necessity of this measure is reflected in the strong growth of the use of online marketing[295] over the past ten years and future trends[296] for the increasing use of such marketing tools[297].

Proposed measure G2: inclusion of a definition of "marketing communication" under MiFID and IDD

[291] ESMA advice on retail investor protection, page 9, point 21.
[292] ESMA advice on retail investor protection, page 11, point 25.
[293] See 2021 Public consultation, Q3.6.
[294] In the ESMA advice on retail investor protection (see point 42, page 15), ESMA considers that vital information should appear in all marketing communication, including where such communication is in the form of extremely brief social media messages.
[295] IOSCO report on retail distribution and digitalisation, page 15.
[296] Idem – see page 18.
[297] It would also reflect, as mentioned by ESMA in its advice on retail investors protection, "*the key role that marketing communications can play in determining consumer behaviour and influencing investment decisions, especially considering the phenomenon of 'anchoring bias' that makes people be over reliant on the first piece of information they receive*". Reason why, according to ESMA, "*vital information should also be disclosed in marketing communications, to avoid that such communications are only highlighting the potential gains and do not mention, or hide, the costs and risks*".

Under this measure, a definition of marketing communication would be introduced in MiFID II and IDD to provide clarity as to the application of the existing rules on activities that are to be considered as marketing communication, in particular as it is used in a digital environment. A definition of marketing communication would ensure better compliance with existing MIFID II and IDD rules and a provide clearer mandate for enforcement.

MiFID II states[298] that "*all information, including marketing communications, addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading. Marketing communications shall be clearly identifiable as such*". However, MiFID II does not provide for a specific definition of "marketing communication" and has no explicit provisions that apply to the digital marketing of financial products and services. Delegated Regulation 2017/565 provides some clarifications and requirements[299] as to the need for the marketing materials to be fair, clear, not misleading and consistent with any information provided by the firm to its clients in the course of providing investment and ancillary services. It also includes precise requirements as to the content of the marketing communication[300]. The same Delegated Regulation also specifies[301] that a recommendation as defined in Article 3.1, point 35, of the Market Abuse Regulation (MAR)[302], not meeting the conditions to be qualified as investment research shall be treated as a marketing communication and clearly identified as such. However, those requirements do not address, or not properly enough, the identified problems, especially in a digital context.

The proposed measure would clarify the concept of marketing communication in MiFID II and IDD to ensure that all marketing communications and advertising (in particular those carried out digitally), made directly or indirectly by an investment firm (including through third parties, such as influencers) in any format and using any marketing techniques, with the aim to offer, market, recommend, suggest or entice any investment in, or promote, in a direct or indirect way, any specific financial products or services under MiFID II and IDD or the activities of firms falling under the scope of MiFID II and IDD would be covered by the rules on marketing communication. The definition of marketing communication would thus also cover advertisement[303] (together with promotions, sales, branding and campaigning), social media messages, the use of third parties, nudging techniques and tools, and surreptitious communication[304].

[298] MIFID II Article 24.4.

[299] Delegated Regulation 2017/565 art 44.2 f) , article 46.5.

[300] See Articles 44, 46(5) and (6) of Delegated Regulation 2017/565.

[301] Delegated regulation 2017/565, articles 36.2 and 37.1.

[302] Regulation (EU) 596/2014 on market abuse – Article 3.1, point 35: 'investment recommendations' means information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public.

[303] See ESMA advice on retail investor protection: point 29, page 12.

[304] The reference to surreptitious communication is inspired from art 9 of DIRECTIVE (EU) 2018/1808 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 November 2018 amending Directive 2010/13/EU on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services (Audiovisual Media Services Directive) in view of changing market realities – art 9 of this directive prohibits the use of surreptitious audiovisual commercial communication.

The definition would also capture all marketing practices aimed at influencing investors' decisions to capture the risks highlighted by IOSCO (i.e. new marketing practices such as for instance influencer marketing (with influencer endorsements) and placements in audio-visual content[305]). The same would also apply to the use of tools and techniques that directly or indirectly entice consumers to purchase products or to use investment services more frequently[306] or in a gamified manner[307].

The definition would also ensure that MiFID II and IDD rules apply to marketing communications that do not target any specific MIFD II, respectively IDD, financial products or services or any specific firm, but rather refer to a broad category of such financial products or services or to broad category of firms, with the ultimate aim of enticing retail investors to invest in those products or to subscribe to those services, or to consider trading with a specific category of those firms. It would also capture marketing communications that do not refer precisely or globally to any MiFID II/IDD financial products, services or firms but nonetheless entice retail investors to consume MIFDI II/IDD services.

The clarification of the notion of marketing communication would be accompanied with measures reinforcing the investment firms' obligations to have internal policies and procedures sufficiently strong to ensure investor protection when it comes to marketing communication. Those policies and procedures will also concern the management's responsibility for the accuracy and non-misleading aspect of the marketing communication, including when provided via social media and other third party channels.

ESMA and EIOPA would be mandated to develop guidelines on marketing communications. This tool would ensure the necessary flexibility to quickly adjust those guidelines to evolving marketing communications and practices. It would also complement the existing supervisory convergence tools that the ESAs and supervisors may use to address the various issues on misleading marketing.

7.3 Assessment of proposed measures

Benefits: Measures G1 and G2 would ensure better protection of retail clients by ensuring: i) more transparency on the nature of the marketing communication made, directly or indirectly, by investment firms, also through digital channels (e.g. social media); ii) reducing the lack of clarity about the scope of the definition of marketing communications and the applicability to influencers and other alternative means of advertisement, iii) reinforced firm's procedures and policies on marketing communication and on management's responsibility, facilitating legal actions in case of misleading marketing communication and iv) the inclusion of key elements related to financial products and investment services, in all marketing communications. These measures would increase the quality of information provided to investors, which would contribute to better understanding of marketed products by retail investors. These measures

[305] IOSCO report on retail distribution and digitalisation,page 16, point 62.
[306] Ibid – point 64.
[307] Idem – page 1, point 2 « Nonetheless, increased digitalisation and cross border offerings bring various new risks for investors, and challenges for IOSCO members. For instance, apparent risks are associated with the accrued complexity of financial products and services, the rapid pace of innovation, the ongoing gamification trends, and increasing levels and volumes of self-directed trading among retail investors, that may have not been accompanied by a proportionate increase in financial consumer education.".

would also facilitate interventions and enforcement on the part of the competent authorities in relation to (misleading) marketing communications.

Costs: For the industry, it is expected that compliance obligations would increase. The requirement to have vital information in all marketing communications and the clarification as to the concept of marketing communication, enhanced with reinforced organisational and responsibility rules would require additional oversight by investment firms, leading to higher regulatory costs. However, the measures would also be expected to provide further clarity on the regime and reduce grey-areas, providing additional certainty for ensuring compliance. This could lead to cost reductions for compliance and legal advice, especially for smaller firms, due to the additional clarity provided by the definition. The measure would not impose direct costs on investors.

Affected groups of stakeholders:

1. Industry

Measure G1 would help the industry to know precisely the essential elements that should always be in a marketing communication and how they should be presented. Measure G2 would facilitate understanding by firms and third parties about with whom they may interact, and about what constitutes a marketing communication under MiFID II and IDD. This would consequently facilitate better compliance with relevant rules on marketing communications.

2. Consumers

The measure would help retail investors more easily identify digital marketing of financial products and would help ensure that such marketing provides them with clear information about the products. This would contribute to specific objective 1 "*Improve information provided to investors and their ability to take well-informed investment decisions*". The proposed measures would also help reduce the lack of clarity as to the applicability of the rules to influencers and other alternative means of advertisement. Clarification as to the responsibility of the firms' management as regards the fair, clear and not misleading aspect of the marketing communication, including when made via a third party, would facilitate legal actions of retail clients and would increase their protection.

In addition, with harmonisation at the EU level, more equal protection for retail investors would be ensured in cases of cross-border activity by firms, regardless of their location: the cross-border nature of digital platforms and channels used for marketing communications pleads for further harmonisation of the marketing communication definition at the EU level. The use of digital communication channels, and especially social media, is not confined to the territory of a specific member state.

3. Supervisors

The requirement for firms to have vital information, presented in an accessible and understandable way, in all their marketing communications, would facilitate the control of those communications by the supervisory authorities and should not trigger any material additional costs. Clarification as to the concept of marketing communication and the responsibility of the firms' management for such communication would allow for easier intervention and enforcement by supervisory authorities. This measure would also provide a basis upon which the

enforcement in relation to novel marketing techniques, such as influencer campaigns, could be applied. While the monitoring role and supervisory power of the competent authorities in the domain of marketing communications would remain the same, to increase efficiency of any supervisory actions there may however be a need for technology-based detection and investigatory techniques and qualified staff, which may involve one-off and further costs, depending on the volume of identified issues and intensity of supervision decided on by NCAs. Nevertheless, No significant impact is expected on the resources of ESMA and EIOPA, as their involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

Stakeholder views:
The public retail consultation showed a majority of respondents (more than half representing the industry) supporting the need for further EU coordination/harmonisation of national rules on online advertising and marketing of investment products. A harmonised definition of "marketing communications" and a single set of requirements for the content of these communications, including those delivered through digital means, was viewed as allowing for more consistent information and a reduction in costs that would benefit all EU investors. They also argued that further harmonisation would ensure the same level of protection for the investors and the same market conditions for the various product and service providers. It was viewed as crucial that new trends such as influencers, personalised targeting and online disclosures (examples mentioned by respondents) were regulated at EU level for investment products. Those respondents who considered that there was no need for further EU coordination on online advertising and marketing of investment products, argued that current rules were sufficient and problems, where they existed, related more to the lack of supervision in certain Member States.

Based on the assessment above, **measure G1 and G2** would bring useful benefits and increase coherence within MiFID II and IDD. As such, they have **been selected to be part of the preferred option**.

ANNEX 5: FINANCIAL LITERACY

1. Introduction

1. Background and problem definition

The level of financial literacy[308] in the EU is low. The most comprehensive exercise measuring financial literacy is the Standard & Poor's Global Financial Literacy Survey conducted in 2014. According to the survey, financial literacy levels in the EU range from as high as 71% for the population in Scandinavian countries to as low as 13% in the Southeast of the EU, demonstrating that there are large differences among Member States. The OECD/INFE 2020 International Survey of Adult Financial Literacy confirmed this. The latest OECD survey of adult financial literacy[309] (2020) showed that the combined financial literacy score in 14 EU Member States varied between 11.1 (Italy) and 14.7 (Slovenia) out of a maximum score of 21[310]. The survey did not ask for expert knowledge, but for a general understanding of key concepts such as inflation, interest rates and risk diversification. The financial knowledge score[311], which is part of the combined financial literacy score together with attitudes and behaviour, was also relatively low: the average score of the EU Member States was 6.1, which is lower than the OECD average of 6.2. Furthermore, five of the 14 participating EU Member States scored lower than the average. Finally, financial literacy and education were identified as an issue in the EBA's Consumer Trends Report (CTR) 2018/19[312], similarly to the issue of insufficient digital financial literacy, raised in EBA's Consumer Trend Report 2020/21.

Low financial literacy has an important impact on retail investment more generally and on the effectiveness of retail investment protection measures laid down in EU law, more specifically. Low financial literacy reduces the effectiveness of disclosure of financial information provided to an investor, as it implies that the average citizen may lack the ability to properly understand the information received. At the same time, it increases reliance on advice, be it good or bad, due to the lack of awareness of the available tools

[308] Financial literacy, according to the 2020 OECD Recommendation on Financial Literacy, refers to a combination of financial awareness, knowledge, skills, attitudes and behaviours necessary to make sound financial decisions and ultimately achieve individual financial well-being.

[309] https://www.oecd.org/financial/education/oecd-infe-2020-international-survey-of-adult-financial-literacy.pdf

[310] Scoring the maximum of 21 effectively means that an individual has acquired a basic level of understanding of financial concepts and applies some prudent principles in their financial dealings. Achieving the maximum thus suggests a basic knowledge of and use of finance.

[311] The financial knowledge score is computed as the number of correct responses to the financial knowledge questions, and it ranges between 0 and 7.

[312] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2551996/75e73a19-d313-44c9-8430-fc6eca025e8b/Consumer%20Trends%20Report%202018-19.pdf

(instead or in addition to professional advice) to form an opinion on financial products. Citizens may also not be aware of the importance of a budget and savings or may not even know where to start or what questions to ask. Finally, many citizens struggle to understand the basic financial concepts of interest, compound interest, and how to calculate them; the relationship between risk and return; the concept of risk diversification and/or the concept of inflation. The uptake of FinTech and digital tools in the area of financial services raises additional challenges for citizens who may not have a sufficient level of digital literacy.[313] Similarly, with the rise in appetite for ESG products, investor education is needed to make sure that on the retail side there is a proper understanding of ESG product offerings and disclosures, as well as of the sustainability impact of different investment strategies[314].

Increasing the level of financial literacy of citizens as retail investors can provide them with a greater understanding of the risks involved when investing money, can help them plan and make better budgetary decisions and participate in capital markets in a way that meets their needs. These skills will be even more important for individuals (and, indirectly, businesses) as the economy gradually recovers from the COVID crisis, as well as in context of the current inflationary trends that can erode the value of consumers' savings.

Financial literacy is a Commission priority[315] aimed at contributing to an EU economy in which retail investors are financially resilient and feel empowered to make decisions that contribute to their financial wellbeing. The Commission has therefore recognised the need to address it as part of its broader Retail Investment Strategy.

A growing body of evidence shows that well-designed financial education programmes have had a positive effect on both financial knowledge and downstream financial behaviours[316]. In this context, the Commission is developing several measures to support Member States in improving the financial literacy levels of their citizens. For instance, in January 2022, the Commission and the OECD-INFE published their financial competence framework for adults in the EU[317]. The framework was developed jointly with EU Member States to create a shared understanding of financial competences for adults across the European Union[318], and defines the competences that individuals need

[313] Financial Education in Europe : Trends and Recent Developments | OECD iLibrary (oecd-ilibrary.org)
[314] This is notably underlined by ESMA: https://www.esma.europa.eu/sites/default/files/library/esma30-379-1051_sustainable_finance_roadmap.pdf
[315] It is worth noting that also the founding Regulations of the ESAs contain a mandate to review and coordinate financial literacy and education initiatives by the competent authorities (article 9(1)(b) of the three founding Regulations.
[316] See e.g. Kaiser, T., Lusardi, A., Menkhoff, L., & Urban, C.J. (2020). Financial education affects financial knowledge and downstream behaviours, Wharton Pension Research Council Working Paper No. 2020-07.
[317] https://ec.europa.eu/info/publications/220111-financial-competence-framework_en
[318] The framework is for adults aged 18 years and over, it defines 564 competences that adults in the EU need to make efficient personal finance decisions and to improve their financial wellbeing. The goal of the

in order to make appropriate decisions in the area of personal finance.[319] The framework was made available for voluntary uptake amongst Member States and stakeholders. However, its adoption is not a silver bullet that could alone solve the problem and, since the latter is likely to persist, additional actions are needed to improve financial literacy in the EU, especially when it comes to investing in capital markets.

In order to address this problem, the High Level Forum on CMU suggested that the co-legislators should build on the principle set out in Article 6(1) of the Mortgage Credit Directive (MCD)[320] and reflect it in other financial sector legislation, with a view to:

1. Requiring Member States to promote formal and informal learning measures that support the financial education of consumers in relation to responsible investing;

2. Requesting the Commission to assess the financial education available to consumers in Member States and to identify best practices. The Commission is also requested to assess which sectoral legislation would be the most appropriate to extend the principle set out in Article 6 MCD (e.g., MiFID, IDD, PEPP, UCITS, PRIIPs, etc.).

For this reason, in Action 7B of the 2020 CMU Action Plan[321] the Commission committed to assess the appropriateness of extending the principle enshrined in Article 6 MCD to relevant sectoral legislation, with the objective of promoting learning measures to support the financial education of consumers in the context of retail investment.

The present Annex to the impact assessment explains why a provision in EU law addressed to Member States to put in place measures supporting the education of consumers in relation to the distribution of investment products would address the identified problem of low levels of financial education in the EU. It considers options of how to address the problem in the most effective and cost-efficient way for stakeholders. In doing so, it is aligned with the aims of the first specific objective (SO1) laid out in chapter 4.2 of the main body of this impact assessment, that is to improve retail investors' ability to take well-informed investment decisions[322]. The measure presented

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framework is that Member States, educational institutions, industry and individuals will use it to develop public policies, financial literacy programmes and educational materials. It will also facilitate the assessment of financial literacy levels and the evaluation of financial literacy initiatives.

[319] Specific attention is given to competences pertaining to digital finance, sustainable finance and financial resilience.

[320] Article 6 (1) MCD: "*Member States shall promote measures that support the education of consumers in relation to **responsible borrowing** and **debt management**, in particular in relation to mortgage credit agreements. **Clear** and **general information** on the credit granting process is necessary in order to guide consumers, especially those who take out a mortgage credit for the first time. Information regarding the guidance that consumer organisations and national authorities may provide to consumers, is also necessary."*

[321] Action 7 - Empowering citizens through financial literacy | European Commission (europa.eu)

[322] SO1, i.e. 'Improve information provided to investors and their ability to take well-informed investment decisions', as described in the main body of this impact assessment, is the relevant specific objective for this Annex. Overall, this financial literacy flanking measure is in line with the general objectives of the

in this Annex, on its own, however, cannot address the identified problem in full and should only be seen as a complementary or flanking measure to other measures assessed in this impact assessment, as well as to other ongoing or future actions taken by the Commission and Member States in the area of financial education (including the ones mentioned above).

1. Effectiveness of Article 6(1) MCD and merit to its extension to other areas

The transposition deadline for the MCD was 21 March 2016. The conformity studies performed during 2016-2017 by an external contractor showed that 7 Member States (CY, ES, PT, MT, LU, IE, RO) literally transposed Article 6(1) MCD and delegated the competence to an NCA. Other Member States (DK, EE, PL, LV), instead, provided for a general obligation to promote financial education or knowledge/awareness on financial products. Overall, the studies identified several initiatives that have been put in place, in particular by NCAs, to promote and support financial education. However, while it is likely that many of these initiatives were triggered (at least in part) by the implementation of the legal provision in MCD (or the corresponding national provision transposing it), it was difficult to establish the exact extent to which they were specifically linked to the MCD's implementation.

Examples of such initiatives (identified in the studies) include:

1. Provision of information about mortgages (e.g. mortgage borrowing process, how to best choose the mortgage credit, responsible borrowing, rules applicable during the credit lifetime, consumers' rights), on consumer financial education websites set up/managed by NCAs or on NCAs' websites (AT, BE, DE, RO, LT, EE).
2. Establishment of platforms to enhance the financial awareness by organising events (NL).
3. Provision of guidance documents containing information about types of home loans, mortgage loan process and access, costs and other expenses, event of default on the mortgage, consumers' rights, management of personal finance, dispute resolution (DK, ES[323], IT[324]), mortgage shopping around checklist (IE). ES and IT published/updated the guidance documents in May 2016.
4. Organisation of seminars for teachers and students concerning credit (AT).

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retail investment strategy, and especially that of strengthening the protection framework for retail investors to empower them when taking investment decisions. To that end, the measure supports the improvement of retail clients' financial literacy, which is relevant when it comes to investors' competences in the area of investing and management of personal finances, more broadly, as well as to investors' understanding of disclosure documents and marketing communications, as laid out in SO1, more specifically.

[323] ES mortgage loan access guide published in May 2016.

[324] IT guide to immovable property loans was updated in May 2016.

5. Establishment of a programme in 2016 to improve consumers' budget management, to prevent over-indebtedness by providing solutions as soon as possible to consumers in financial difficulties (FR).
6. Provision of consumer support by consumer organisations (SE); customer service centre and call centre processing written consumer claims and providing information (HU); free legal advice both online and by phone by some organisations (CZ).

As part of the continuous effort to ensure that rules are fit for purpose, the Commission launched in November 2021 an open public consultation[325] on the MCD review, to gather evidence on the MCD's functioning. The consultation included, among others, a question on Article 6 of the Directive and its effectiveness in increasing the financial education of consumers (Question 10). The results showed that:

1. 35.9% of the respondents considered that Article 6 has been effective in increasing the financial education of consumers. The majority of them were industry representatives (companies/business organisations and associations). Several considered that Article 6 promoted financial literacy and encouraged Member States to be more active in this area. Notably, a few, mentioned that the exact impact of Article 6 would be difficult to assess.

2. 33.3% of the respondents (mixed stakeholders) considered that Article 6 has not been effective in increasing the financial education of consumers. Among them, several stressed that there was no significant evidence of the impact of Article 6 on financial literacy programs/initiatives in Member States and highlighted the general lack of financial education among the population.

3. 30.8% of the respondents did not know or did not answer.

While a majority of respondents agreed with a positive impact of Article 6 MCD, some respondents struggled with providing a positive response, the main reason being the difficulty to demonstrate causality between this provision and the national financial education measures that were taken as a consequence. This is because some Member States were already rather active in this field and proactively took measures seeking to increase the level of financial education of their citizens. At the same time, financial education has not been (at least originally, i.e. at the time of the adoption of MCD) on the political agenda of all Member States and the explicit provision in MCD could have triggered action from those Member States that were not planning (and hence would not have put forward) any actions on their own. Furthermore, it can be assumed that the specific focus on responsible borrowing ensured that those Member States that were already planning their financial education campaigns, ensured that due attention was paid to this specific aspect of financial education.

On this basis, it can be concluded that the Article 6 MCD has had a positive impact at least in some Member States. It should therefore be considered as a relevant supporting

[325] See at: https://ec.europa.eu/info/files/2021-mortgage-credit-review-consultation-document_en

measure to provide equal incentives for all Member States to work towards promoting initiatives related to the financial literacy of their citizens.

The below assessment is based on the presumption that creating such incentives is better than taking no action at all at EU level, as the latter case would leave taking any action entirely to the choice of Member States, which may have different schedules and objectives in their national financial education strategies. This is without prejudice and fully respecting to the principle that Member States have legal competence in the matters related to financial education and that the European Union (as per Article 165 of the Treaty on the Functioning of the EU) can only contribute to developing quality education by encouraging cooperation between EU countries, and supporting and supplementing their action. Increasing the level of financial literacy can be considered as a key complement to financial consumer protection policy, as enshrined in Article 169 TFEU. [326]

1. **Identification of "other relevant sectoral legislation" and scope**

This section frames the policy options set out in the next section. It discards upfront the solutions that would be too costly and inefficient. It allows to focus then on the options that are credible and most efficient in dealing with the identified problem.

For an effective replication of Article 6 MCD, Member States should focus, in their national transposition, on as wide a universe of investment products as possible. The legislative mapping carried out in the context of this analysis[327] has shown that coverage can be maximised by acting at the level of legislation on distribution of financial products, rather than at the level of individual product legislation. This is because EU product legislation is numerous and broad; and acting on it would imply possible multiple transposition rounds for Member States, risk of further fragmentation and of leaving possible gaps unattended (for example, innovative products not captured in the current legislation could be left out of scope).

[326] According to article 165 TFUE, education policy is a Member State competence that the EU can support and supplement. Nonetheless, increasing the level of financial literacy can be considered as a key complement to financial consumer protection policy, as enshrined in Article 169 TFEU. With this in mind, the co-legislators agreed to have an article requiring Member States to promote financial education initiatives in the context of the sale of mortgage products (Article 6 MCD). The current proposal for a review of the Consumer Credit Directive (CCD) includes an article that widens the scope of Article 6 MCD to the loans covered by the CCD. Article 169 TFEU relates to consumer protection and states that to promote the interests of consumers and ensure a high level of consumer protection, the Union shall contribute to protecting the health, safety and economic interests of consumers, as well as to promoting their right to information, education and to organise themselves in order to safeguard their interests. Article 169(2) TFEU specifies that these objectives can be reached through measures adopted pursuant to Article 114 in the context of internal market completion.

[327] The legislative mapping was carried out in 2022. It analysed the scope of products and/or providers regulated under the UCITS Directive, AIFMD, PRIIPs Regulation, IDD, IORPs Directive, PEPP Regulation and CRD.

Acting at the level of the distribution, instead, would have three main benefits. Firstly, it would compel action in relation to the vast majority of products marketed and distributed in the Union to retail investors (including through digital channels). Secondly, it would streamline the transposition efforts as well as eliminate the need to cater for the specificities (e.g. traditional investment vs insurance) that would arise by acting on individual product rules. Finally, the focus on distribution would put the spotlight on the moment of interaction between the distributor and the client, where the financial literacy of the latter is key.

In this context, it is important to underline that the replication of Article 6 MCD in the distribution rulebook[328] would not impose any direct obligation on financial intermediaries and distributors as the provision would be addressed to the Member States. It would call on them to support and promote financial education for retail investors through the means they see most appropriate.
Since the Markets in Financial Instruments Directive (MiFID) and Insurance Distribution Directive (IDD) are the cornerstones of the EU's distribution rules, the policy options around the replication of Article 6 MCD would focus on them. Additionally, this would build on the already existing principle under these two frameworks that distributors have to know their clients – and in particular the level of their financial knowledge.

The legislative scope would not go beyond MiFID and IDD, as the products distributed outside of these two frameworks generally would not reach the average retail investor. For example, in the case of AIFMD[329] regulated entities, asset managers would rarely distribute products themselves and, if they did, they would require a MIFID license therefore entering the established scope (moreover, they would be focused on distributing units of their own investment funds only). As a result, the replication of Article 6 MCD in AIFMD would not add to achieving better financial literacy level for retail clients as a whole.

2. Necessity and added value of an EU action

The problem as set out above persists despite actions already undertaken at national, international (OECD) and European level in non-binding format[330], including the recently developed EU/OECD financial competence framework for adults[331], which is for voluntary uptake by Member States.

Further EU action is needed at legislative level, as neither national measures nor multilateral soft measures have so far been fully effective to remedy the low level of

[328] MiFID and IDD.
[329] Alternative Investment Fund Managers Directive.
[330] For example, a Council recommendation on "Key competences on lifelong learning" is a soft law tool, however, due to its nature, it would not be feasible to include financial literacy into it (financial skills are only mentioned as an example of mathematical competences).
[331] Financial competence framework for adults in the European Union (europa.eu)

financial literacy across the EU (and in particular in some Member States). Only a combination of measures on financial education can prove to be effective in tackling the problem, creating positive externalities and scale and scope effects. A coherent and comprehensive solution at EU level might be able to lower the cost of fragmentation for national administrations, investors, financial intermediaries, and companies alike. The preferred option must however respect the principle of subsidiarity and proportionality, achieving the objectives yet avoiding excessive, negative consequences on Member States.

Policy Options

3. What are the available policy options?

Option label	Option description
Baseline (Option 1)	**Do nothing to change the current legal framework.** Rely on the existing enforcement mechanisms to ensure that the existing rules (Article 6 of MCD) and proposed rules (article 34 of CDD in case adopted) are correctly applied, however limited to credit agreements for consumers and relating to residential immovable property.
Option 2	**Support and supplement the work of the Member States in this domain, by replicating a similar provision to the Article 6 MCD into the relevant financial legislation on distribution of investment products.** EU law will call upon Member States to promote financial education/digital literacy initiatives, without however specifying further the content of these initiatives (in line with Art. 6(1) MCD and Art. 34 of CCD).
Option 3	**Achieve more harmonisation in financial education matters: replicate similar provisions to Article 6 MCD into the relevant financial legislation (as in Option 3) and, in addition, introduce regular reporting requirements on national educational measures, while establishing a quality control system.**

4. What are the impacts of the options and how do they compare?

1. Baseline (Option 1)

Under the baseline scenario, the schedule of (possible) legislative financial education initiatives remains unaligned being determined entirely by Member States. The currently isolated EU-level provisions in MCD and CCD would be complemented with separate national measures in other areas only according to the needs, timelines and political willingness of national authorities. The EU can continue to foster financial education

through complementary (non-legislative) workstreams, such as the EU/OECD financial competence frameworks.

The baseline would not be effective in addressing the existing problem. It implies a very low level of harmonisation and coordination, leaving policy decisions to Member States. The baseline also creates a high risk of fragmentation between the schedules of initiatives adopted at national level due to non-coordination among Member States. The EU would limit itself to complementary (non-legislative) measures that, while contributing to the objective, would not address fully the identified problem.

2. Option 2

Under this option, the EU would replicate Article 6 of the MCD in other sectoral legislation, therefore increasing the scope of financial products for which Member States would need to promote financial education measures. These financial education measures could potentially build on the deliverables of other initiatives in the area of financial education, such as the EU/OECD financial competence framework for adults, which should facilitate the development of targeted trainings and training material in a harmonised manner across Member States. In such a manner, the timing, intent and, to a certain extent, content of national educational measures could be better aligned across the EU. Under this option, the Commission would, however, neither monitor nor assesses the educations measures put forward by Member States.

Benefits

In terms of consumer protection and integrity of the single market, this option adds to the ongoing work of the Member States by providing a legal commitment to foster action on financial literacy. Nevertheless, Member States would retain control over which measures they should adopt and promote, as they see fit to their national agenda, and would also be able to coordinate their efforts and exchange best practices on implementation, owing to the fact that they would be transposing the same legislative requirement. Under the option, *Member States* may find it easier to put in place educations measures than without coordination/ exchange of best practices with other Member States. *Consumers*, whose level of financial education would (gradually) increase, would be the main beneficiaries under the option (although it would be impossible to quantify the amount of such benefit accruing to consumers). Longer-term benefits would include wider retail investor participation in capital markets (ultimately benefitting *financial intermediaries)*, better saving (pension) opportunities for *consumers* (at the same time reducing the risk of their over-indebtedness) and more available funding for *companies* across Member States.

Costs

This option would only generate limited costs for Member States and very low costs (if any) for other stakeholders. *Public authorities* would be able to save costs due to the possibility to exchange best practices during the implementation of the provisions. Since

no ex-post reporting would be required, costs for public authorities would be rather contained. Financial intermediaries could potentially have to bear some costs depending on the actions taken at national level. There will be no costs for consumers.

Conclusion

This option ensures a sufficient level of policy coordination across the EU while leaving full flexibility on implementation to Member States, allowing for Member States to exchange best practices to increase the level of coherence. While not being sufficient on its own to tackle the identified problem (i.e. to increase the level of financial education across the EU), it has the potential to effectively complement and reinforce the impact of other measures taken by the EU in this area. It thus has a fair level of effectiveness, while being a cost-efficient option.

3. Option 3

This policy option would introduce a higher degree of centralisation, building on but also going beyond option 2. It would aim to achieve a higher level of harmonisation in financial education matters than under option 2. In addition to replicating the provision in Article 6 MCD to promote financial education measures in other sectoral financial legislation (similarly to option 2), it would introduce mandatory regular reporting requirements for NCAs regarding the national financial educational measures taken, as well as a quality control for such measures. NCAs would be required to regularly report such information to both the ESAs and the Commission by means of progress reports. The Commission would then need to adopt a quality control system to ensure that the educational measures are effective. Under this quality control system, the Commission would assess and approve the educational measures based on a system of key performance indicators (KPIs) to be developed by the Commission.

Benefits

As under option 2, benefits would arise for *consumers/citizens*, *Member States* and *financial intermediaries* from the level playing field that would be created by leveraging on the existing mechanisms implementing MCD-related financial literacy programmes. This would in fact empower Member States to use the already existing credit framework as an example of how to promote financial literacy initiatives in the area of investment, and in doing so, to use the same educational channels that both citizens and the industry already have access to. Compared to option 2, however, option 3 would potentially generate higher benefits for *consumers/citizens* who would stand to benefit more from measures whose effectiveness would be vetted by the Commission under the quality control mechanism.

Costs

Option 3 would also lead to higher costs than option 1, in particular for *public authorities* and *Commission/European Supervisory Authorities (ESAs)*:

5. Public authorities would incur higher administrative costs related to regular reporting on educational measures in the form of progress reports.
6. The Commission and/or ESAs would need to pre-approve notified measures in accordance with the quality control mechanism. It would require the development of KPIs.

Financial intermediaries may incur costs due to the need to adapt their existing educational tools to the new (potentially stricter/more far reaching than under option 2) national measures. This option would not generate any costs for *consumers/citizens*.

Conclusion

Option 3 is likely to be more effective in tackling the identified problem than option 2. It could also be a more coherent option since all education measures would be subject to the same quality control put in place by the Commission/ESAs. Nevertheless, option 3 would entail a much higher cost for Member States, the Commission, ESAs and financial intermediaries and therefore would be a much less cost-efficient option than option 2.

Summary

	Effectiveness	Cost efficiency	Coherence
Baseline (Option 1)	+	+	0
Option 2	++	+/-	++
Option 3	+++	---	+++

Legend: +++ = very positive ++ = positive + = slightly positive 0 = no effect
negative -- = negative --- = very negative

4. Preferred option

Option 2 should be considered as the preferred option based on the overall assessment described above.

ANNEX 6: INVESTOR CATEGORISATION

1. Background and problem definition

MiFID II makes a distinction between retail investors, professional investors and eligible counterparties. The distinction is important because different levels of protection and safeguards, including disclosure requirements, are associated with each investor category. In addition, other pieces of financial services legislation like AIFMD, ELTIF or PRIIPS also refer to these types of investors.

MiFID II introduced measures to protect retail investors at a time where access to investments in financial instruments became more commonplace, also for retail investors. These measures have helped safeguard investors, but also restrained access to some financial instruments and introduced a number of additional protective measures, such as substantial disclosure requirements towards clients. Compliance with these requirements helps ensure adequate protection for most retail investors, however it can also represent a burden for or overprotect those with sufficient knowledge and experience and relevant financial capacity (i.e. ability to absorb losses), who, due to these requirements, sometimes cannot easily access certain financial instruments and feel that they are over-loaded with information that they do not deem necessary or useful. This also constrains the ability of experienced investors falling under the retail investor category from better diversifying their portfolios and achieving improved investment-outcomes.

In addition, the existing legal requirements in MiFID II may also create unjustified administrative burden for financial services providers who have to produce and disclose information that more sophisticated investors do not need and do not use in their investment decisions.

Currently, even if some retail clients possess the appropriate knowledge and experience and demonstrate the ability to absorb losses, it is very difficult for them to be re-classified as professional investors. Estimations suggest that currently only 0.09% of existing clients are treated as professional[332]. In order for retail investors to be re-classified as professional investors "upon request", investment firms have to assess whether at least two of the following conditions are satisfied: (a) the client has carried 10 transactions per quarter, (b) the size of the client's financial instrument portfolio (including cash) exceeds EUR 500 000, and (c) the client works or has past professional experience with the

[332] Calculations based on data provided to the commission services by a large bank, indicating the types of services provided and number of clients in each category. In summary, the bank services 5 347 536 clients, out of which only 4 761 are categorised as professional clients.

envisaged transactions or services for at least one year. Furthermore, under the current framework, legal entities are also treated as retail investors, where they are not considered as large undertakings (balance sheet below EUR 20 million, net turnover below EUR 40 million, own funds below EUR 2 million).

The creation of a new client category or the modification of the existing conditions for professional clients on request could give a subset of retail investors with appropriate knowledge, experience and financial capacity broader and more comprehensive access to capital markets. It would also help ensure that the information received by investors is more targeted to their specific needs, contributing towards specific objective 1 (SO1) as described in section 5 of this impact assessment. This would bring additional sources of funding to the EU economy and allow those investors to benefit from better diversification of their portfolios. Any adjustments to the rules have nevertheless to cater for the necessary degree of investor protection for all groups of investors while improving engagement with the capital markets and removing unnecessary (excessive) administrative burden for market operators.

2. What are the available policy options?

The impact assessment considers two options, other than the baseline scenario set out under option 1, to address the identified problem. Both options are assessed against the baseline that would maintain the existing client categorisation framework as it is.

Under **option 2**, a separate new intermediate category of *semi-professional* investors would be created in MiFID II with tailored, more easily fulfillable criteria. The new definition would imply setting out a new list of criteria that semi-professional investors would have to comply with, which would be significantly less restrictive than for professional investors. It would also require a review of the existing investor protection measures for investors currently defined as retail investors with a view to determining which ones would stay relevant for semi-professional clients and which ones would no longer apply. This would apply to MiFID II, however also to all other financial services legislation which refers to these definitions. The result would be 4 distinct categories of investors that would be used in the financial services acquis: retail investors, semi-professional investors, professional investors and eligible counterparties. Financial service providers would have to adjust their IT systems and procedures, in line with the new requirements for the treatment of semi-professional clients.

Under **option 3**, the existing criteria for professional clients on request would be adapted in order to make this category more accommodative for those investors with appropriate knowledge, experience and ability to bear losses, who should be treated as and hence able to benefit from regulatory alleviations offered to professional investors. More concretely, this would involve reviewing the existing thresholds (i.e. 500 000 EUR in financial assets, 10 transactions per quarter), and the definition of what is considered as relevant professional experience. It could also be envisaged to introduce an additional criterion capturing the knowledge of clients (i.e. those having passed acknowledged financial

certifications). Furthermore, it would be envisaged to reduce the existing thresholds to make it easier for legal entities to qualify as professional investors upon request[333].

Option label	Option description
Baseline (Option 1)	**No changes to client categorisation – this is the baseline scenario**
Option 2	**Introduction of an additional client category - semi-professional investors**
Option 3	**Adjusting the current criteria to qualify as a professional client on request**

3. **What are the impacts of the options and how do they compare?**

1. Benefits

Option 2 (introducing an additional category of semi-professional investors) would allow for better differentiation between the diverging needs of individuals within the retail investor category. This would help reduce unnecessary information disclosure to those clients who do not need it for their investment decisions, leading to cost savings for those financial operators as well as allow broader access to financial instruments. *Semi-professional investors* would get better-tailored investor protection, fit for their specific profile and background. This would help avoid them getting overloaded with unnecessary disclosure from financial operators and gain access to some products which may not be suitable for all retail clients, therefore allowing for improved portfolio composition and diversification. Separate safeguards would have to be developed for each segment of investors (retail, semi-professional, professional), therefore potentially helping to better ensure more proportional safeguards for each category.

Under **option 3**, the benefits identified under option 2 and accruing to various groups of stakeholders would be similar. It is possible that under option 2 the group of investors defined as semi-professional would get slightly more tailored and hence potentially better fitted investor protection than under option 3 where no additional stand-alone category would be created and where these investors would rather be treated as professional investors. On the other hand, the increased complexity of the regulatory and supervisory framework due to the creation of an additional category and differentiated safeguards may also undermine consumer protection by increasing the probability that clients may end up inappropriately categorised (i.e. the risk of firms being able to manipulate the categorisation of their clients according to their interests would increase given the

[333] Currently only large undertaking meeting two of the following size requirements on a company basis can request to be treated as professional clients: 1) balance sheet total of EUR 20 000 000; 2) net turnover of EUR 40 000 000; 3) own funds of EUR 2 000 000.

relatively low requirements for the semi-professional category), therefore it is uncertain whether the benefits of option 2 would overall be significantly higher.

2. Costs of option 2

Option 2 would imply high costs for financial service providers and public administrations. It would first of all require a comprehensive review of the current framework for investor protection, determining which protections would remain appropriate for retail investors and which would be appropriate for the newly created category of semi-professional. Definition of the new category (including setting the requirements at an appropriate level across the EU Member States), delineation of all existing investor protection measures and effective supervision/enforcement of the new framework would require significant administrative resources by *public authorities* at EU and national level. It would also be a politically challenging exercise, requiring extensive debates amongst co-legislators given that investor protection is considered a sensitive and important area and a specific threshold would be easier to reach in some Member States than in others (i.e. due to national differences in income thresholds). Furthermore, it would lead to significant costs for *financial service providers* as they would have to review the categorisation of all existing clients, update and adapt their information systems according to the new categorisation framework. The complexity of the internal procedures and processes would also significantly increase as staff would have to be aware of and apply the requirements to different types of clients. Furthermore, given that a high proportion of investors currently classified as retail investors would qualify for the semi-professional category, the re-evaluation of these clients would present a significant cost, taking also into consideration the costs related to document verification and the liability to be undertaken by the firm for incorrect classification. These costs might subsequently be passed on to *investors*.

Option 3 would imply marginal costs to *financial service providers* as it would not require a comprehensive review to possibly re-categorise a very substantive number of clients currently falling under the retail investor category: only a relatively small subset of the existing retail investors would qualify under the new criteria and would only be re-categorised as professional investors on their request. The existing investor protection framework would be maintained, implying no (substantial) additional costs for *public authorities* (unlike under option 2), the focus being to ensure that clients with sufficient knowledge, experience and wealth are adequately categorised using the existing framework (even if based on the adapted criteria). *Financial service providers* would nevertheless have to incur some cost (although much lower than under option 2) as they would have to update their client categorisation processes according to the adjusted criteria and would receive an increased number of re-classification requests.

3. Overall assessment

Option 2 would possibly generate slightly higher potential benefits, than option 3, for *investors* due to the possibility to better differentiate and apply more tailored investor

protection safeguards to each of those groups (although also risking over-exposure to risk if the safeguards are not adequately balanced). This option is however associated with significant costs for *financial services providers* (due to the need to assess and reclassify a very substantial number of clients and to train staff and apply different procedures and safeguards to different categories of retail clients), These costs would likely be passed on to end-customers. *Authorities* would have to deal with additional complexity of the financial services acquis, which could in turn also potentially reduce the overall effectiveness of the framework. The introduction of an additional investor category would require a rather comprehensive review of the existing investor protection measures, creating additional burden for administrations and companies who would have update and apply new and more complex procedures and processes. The overall efficiency of this measure, would therefore likely be negative, given the very substantive costs. Furthermore, the substantive additional complexity of the legal framework due to the additional category and the distinct investor protection rules would not be coherent with the Commission's objective to simplify EU laws and reduce red tape.

In comparison, **option 3** would have a smaller potential positive impact on investors as the fine-tuning of existing criteria would be of a more limited scope than in option 1, although still allowing for clients with sufficient knowledge, wealth and experience to access the professional upon request category. The costs associated with this option would be significantly lower than under option 2 and therefore imply a higher overall efficiency for this policy option.

The policy options were presented in the public consultation on the retail investment strategy. The majority of respondents were most favourable to the option of adjusting the existing definition of professional investors on request (63.5% were in favour with only 18% against). The introduction of an additional client category received considerably less support with the majority of respondents not being in favour (35% in favour and 45% against). The baseline scenario (no changes to status quo) received the least support (18% in favour, 54.5% against).

Looking at the individual respondent groups (business association/companies/public authorities/citizens/etc.), the sentiments for the different options remained largely consistent (identical) across all groups. One exception being for the category of EU citizens, who according to the results of this survey preferred the creation of an additional category of semi-professional investors (68% in favour and 18% against out of 26 respondents) over the adjustment of the existing categories (43% in favour and 32% against). One consumer organisation was in favour of adjusting the existing categories, one was in favour of introducing an additional category and two did not express a specific view.

The respondents who were against any changes to the existing investor categorisation argued that the additional benefit would be small compared to the costs and that overall access to products for retail investors should be improved. The proponents of adjusting

the existing client categorisation, in contrast, argued that there is systematic overprotection of retail investors and that this needs to be addressed. The opponents of the additional category of investors highlighted the complexity that identifying suitable criteria would entail and the legal complications as well as the risk that the remaining retail investors would become further excluded from certain products/services.

4. Preferred option

Option 3 should be considered as the preferred option based on the overall assessment described above.

Summary

	Effectiveness			Efficiency (cost-effectiveness)	Coherence
	Reduced information overload for more sophisticated investors	Better tailored investor protection rules	Reduced administrative burden for financial services providers		
Baseline (Option 1)	0	0	0	0	0
Option 2	++	++	---	--	--
Option 3	+	+	+	+	+

Legend: +++ = Very positive; ++ = Positive; + = Slightly positive; +/- = Mixed effect; 0 = No effect; - = Slightly negative; -- = Negative; --- = Very negative

ANNEX 7: INDUCEMENTS

PART A – Experience with the ban on inducement in the Netherlands

A ban on inducements for advised services in relation to certain retail products (e.g. structured investment products such as IBIPs but also other retail products such as mortgages) was introduced in the Netherlands on 1 January 2013. In December 2013, the Dutch legislator also extended the national ban beyond the MiFID II requirements, applicable as of 1 January 2014. Those two combined rules created a level playing field at national level between all types of investment products.

Transitional period and supervisory actions

The ban on inducements for investment services was accompanied by:

1. a one-year transitional period for units in investments undertakings, provided that any inducements would be passed on to the client, and
2. a grandfathering clause for certain existing contracts.

Impacts on the retail clients

Overall, the ban on inducements made the fees for Dutch retail clients more competitive, and spurred innovation in the distribution models. The popularity of index trackers increased from 8% of retail investors owning an ETF in 2016 to 20% in 2021, while it was 36% for starting (and likely younger) investors[334]. At the same time, there was a decrease in sales of actively managed funds and a significant decline in insurance-based investment products (IBIPs).

[334] Consumermonitor AFM 2021, pages 7, 8, 14, 35, and 36

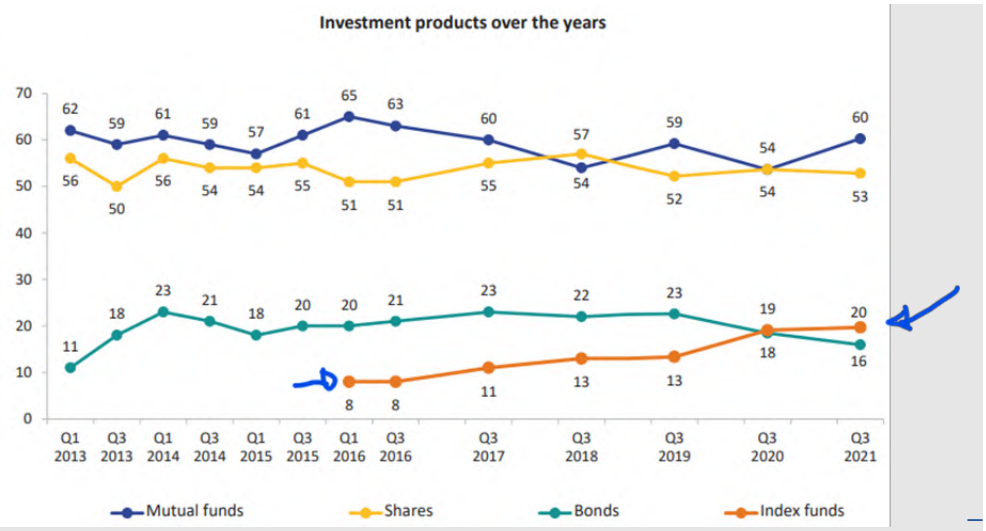


Figure 7.1 Source: Consumermonitor AFM 2021

The following table illustrates the decline in sales of Investment based insurance products (in thousands) [335].

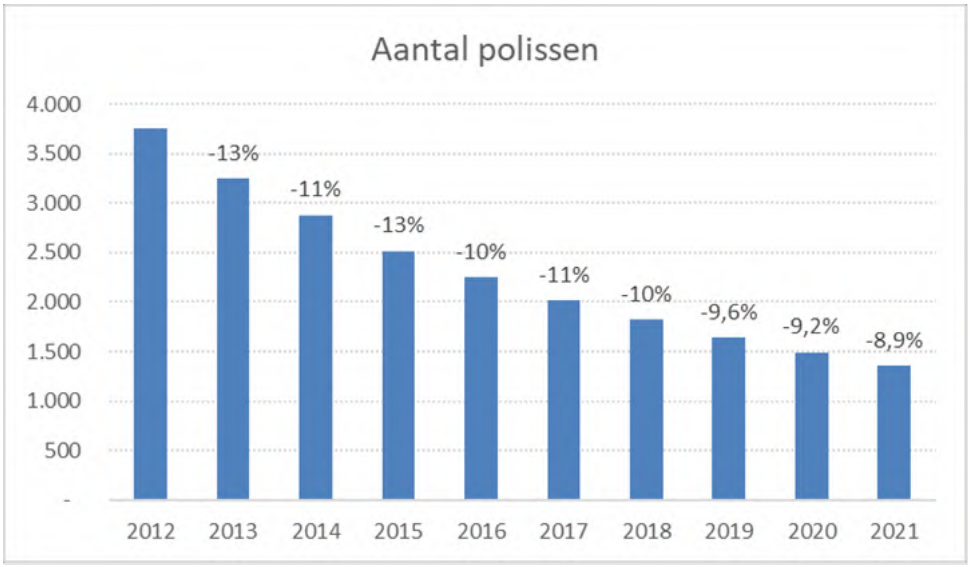


Figure 7.2, Source: DNB[336]

Retail investor participation, on the other hand, slightly increased, as illustrated below[337].

[335] At the same time, self-employed advisors, making up 85% of the Dutch market, indicated that more than 50% of their total turnover came from non-life insurance consultancy and intermediation.
[336] Graph created by DNB on request of the European Commission on October 12, 2022.
[337] It should be noted that this survey does not include investments large parts of the Dutch populations hold through their pension fund. Only direct retail investments are measured, while the total market exposure of the population is higher due to the pension system.

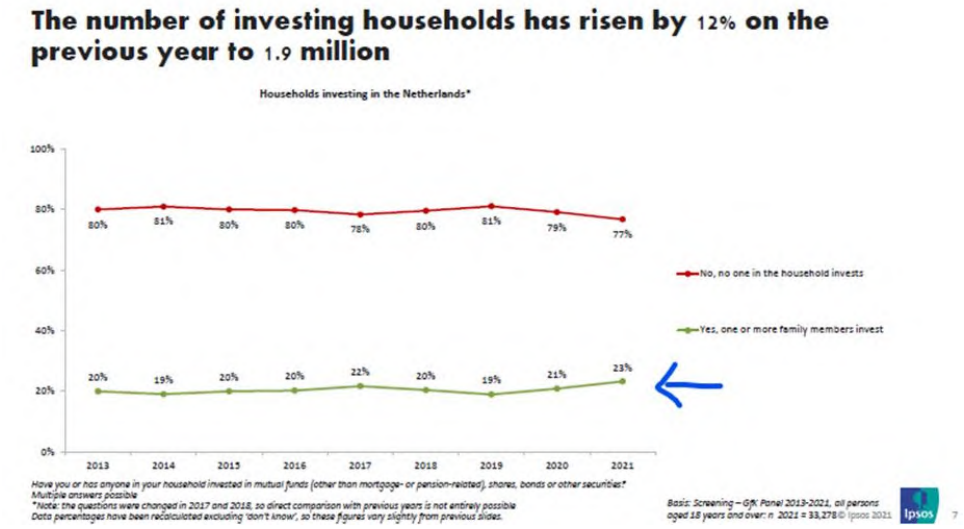


Figure 7.3, Source:Consumermonitor AFM 2021

At the same time, there was a shift from advice to portfolio management, including robo-advice and semi-automated portfolio management, while the levels of execution-only investing remained stable.[338] Within the group of clients requesting the service of execution only, 10% invested making use of a "guided execution only" in 2022. Such possibility allows clients to invest into a pre-determined, cost-efficient and well-diversified but limited range of products. The proportion of execution-only investors (66%) in the group of starting investors rose slightly in 2021.

[338] In this regard, the Retail investment study, page 292, points out that further to a mystery shopping, customers seeking traditional advice were encouraged towards execution only services instead. At the same time the report found that there was a shift from advice to portfolio management services instead, which means that any loss of access to traditional (often physical) advice services for particular client segments was largely compensated by their access to automated portfolio management services. Said report also found in the mystery shopping that following the ban on inducements in the Netherlands, there was no longer availability of advice without charges directly to customers (contrary to other EU Member States). This finding shows that intermediaries complied with the inducement ban by requiring a service fee to cover their costs.

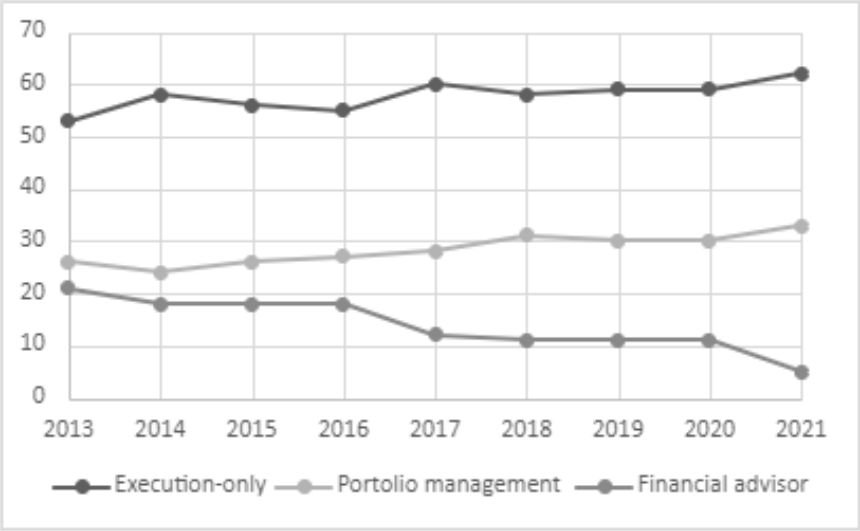


Figure 7.4

A 2021 AFM study looking at finfluencers[339] observed that 9% of execution-only investors use social media or influencers as sources of information. Finfluencers advertise or provide information on a wide range of products, from shares and ETFs to crypto-assets and CfDs, through channels such as YouTube, Twitter, Instagram, Facebook, Spotify and various websites. Whilst finfluencers reflect a growing trend, the AFM observed that their followers are predominantly retail investors that choose to invest without traditional forms of advice.

As finfluencing, depending on the content of the message issued online, can qualify as financial advice or investment recommendations, the AFM has clarified that the activities of finfluencers active in the Dutch market fall under licensed activities. Furthermore, finfluencers, as for any other intermediaries, are in breach of the ban on inducements if they receive referral payments or other forms of monetary benefits from the firms for whom they finfluence[340].

The number of investors investing small amounts annually has also increased over recent years in the Netherlands.

[339] AFM, The Pitfalls of Finfluencing, 2021.

[340] AFM: The Pitfalls of Finfluencing, 2021 page 11: In practice, this applies in any case if an investment firm pays a fee, e.g. to a finfluencer, when the clients referred to the firm: are in the onboarding process for opening an investment account; have opened an account; or have opened an account and have made an initial deposit. Consequently, providing referral fees to any third parties, not exclusively finfluencers, violates the ban on inducements in relation to investment services. If current clients of an investment firm receive a fee for referring friends, acquaintances or other people to the firm, this also qualifies as an inducement. This applies to both cash payments and other forms of remuneration, such as payments in shares.

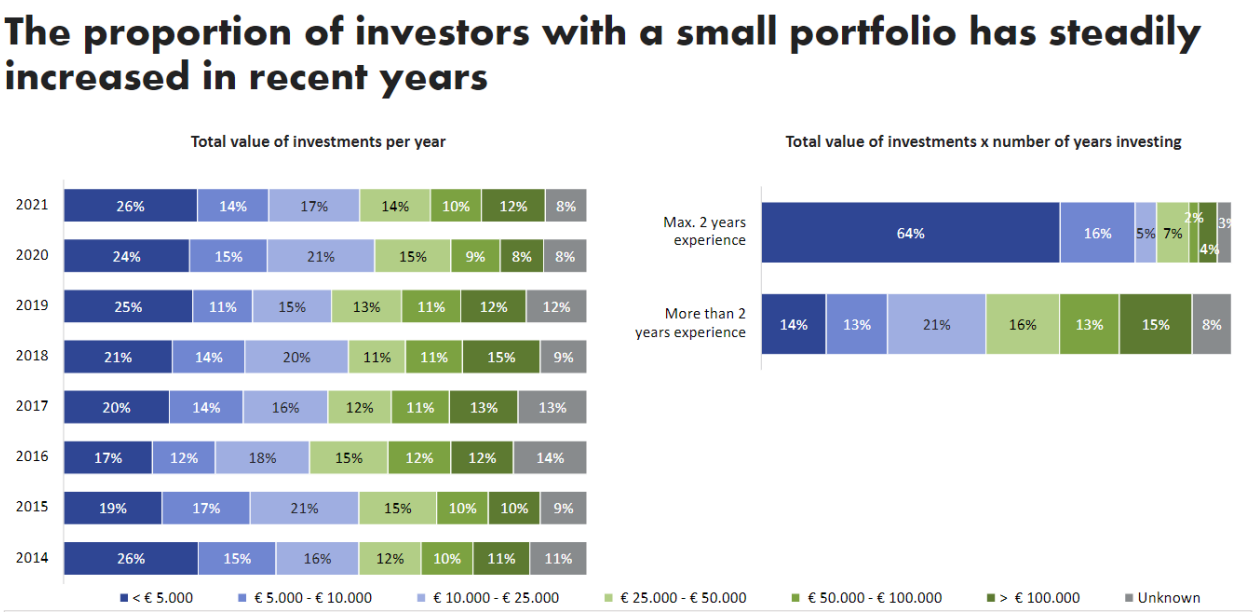


Figure 7.5, Source:Consumermonitor AFM 2021

The level of trust of retail clients in the advice received is high, with 81% at the time the advice is received and at 72% at hindsight[341].

Market consolidation

A general market consolidation began in the Dutch market in 2008, triggered by the global financial crisis. The number of self-employed financial advisors with an AFM license, making up 85% of the Dutch market, was already on the decline before the introduction of the ban on inducements[342], it is therefore not possible to attribute this consolidation entirely to the ban on inducements.

Since 2013, the average total turnover of independent financial advisors has risen by 5% per year and now represent about 50% of the advice market in the Netherlands[343]. The Netherlands now has 5960 licensed independent financial advisors with 7550 offices, compared to 726 bank branches. Advisors adjusted their business models after the ban on inducements was introduced. Different fee models emerged such as a service subscription, hourly fee, fixed rate per service, fixed rates per combined service, basic fee and negotiated fee. Companies able to make economies of scale could profit by the new regime, and the increase of return was higher for the firms with a larger amount of employees. Overall, the average size of employees of firms operating in the financial sector increased as did the investment in IT systems. After the introduction of the ban, advisors worked with different manufacturers, the largest group of advisors (40%)

[341] AFM consumer monitor on financial advice first half of 2022 https://www.afm.nl/nl-nl/professionals/onderwerpen/consumentengedrag-consumentenonderzoek.
[342] http://decisio.nl/wp-content/uploads/Decisio-Periscoop-Evaluatie-Provisieonderzoek-Definitief.pdf
[343] https://www.afm.nl/nl-nl/professionals/doelgroepen/adviseurs-bemiddelaars/thema/marktmonitor

offered products from 4-6 different manufacturers. The turnover development for advisors focussed on professional clients (not concerned by the ban) compared to advisors focussed on retail (concerned by the ban on inducements) did not[344] differ.

The chart below illustrates the reduction in the number of license holders since 2011[345].

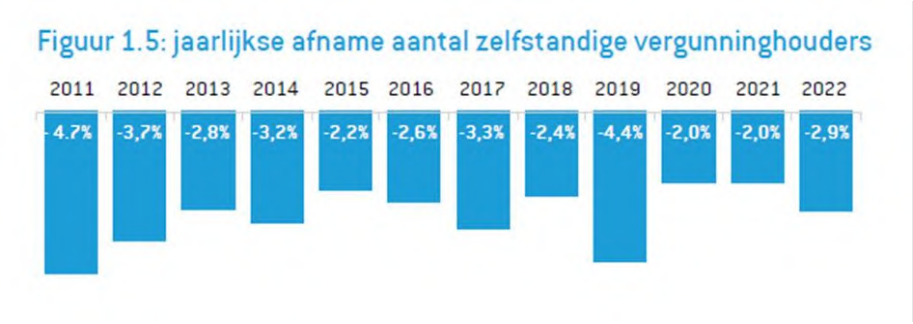


Figure 7.6 Source: Adfiz

Fee structure

As mentioned, new fee models were developed in the Dutch market following the introduction of the inducement ban. Examples include service subscriptions, hourly rates for advice on insurance and risk analysis, lump sum payments and percentages of the assets under management. The table below shows total costs and investment thresholds for both traditional/physical and online advice, for (semi)automated portfolio management/robo-advice and for execution-only services.[346]

In parallel, the inducement ban has seen the emergence of online asset managers, competing on costs by including portfolios of index trackers. The total costs charged automated portfolio management, such as for online robo-advice, including product costs, are between 0.7979 and 1.22%, as shown in the below table. The table also gives an indication of the costs per type of service used and indicates the minimum thresholds of investments per type of advice, if any[347].

Cost overview Dutch	Traditional/ hybrid advice	~Costs	Automated portfolio management	~Costs (incl. product costs)	Guided Execution	~Costs (incl. product costs)

344

https://www.researchgate.net/publication/328754959_Invoering_van_het_provisieverbod_in_de_financiele_dienstverlening Kloostermans/Wagensveld (Radboud Universiteit Nijmegen) in Maandblad voor Accountancy en Bedrijfseconomie

345 Adfiz; Advies in Cijfers, 2022-2023.

346 European Commission desktop research, November 2022.

347 The table does not include pure execution only. The costs for this service strongly depend on the trading behaviour of each client. Guided execution only a pre-determined, cost-efficient and well diversified range of products in offered to the client.

investment firms					only	
Firm A	EUR 50,000	~1.5%	N/A		No minimum	0.94-1.07%
Firm B	EUR 20,000		No minimum, advised minimum is 2,000	Depending on amount invested: at 20,000 it is 0,79%	N/A	N/A
Firm C	EUR 50,000				No minimum	
Firm D			EUR 10,000	0.93-1.22%		
Firm E	N/A	N/A	No minimum.	0.89-0.99%	N/A	N/A

An example for the costs of investment advice in Wealth management in three different categories is provided hereunder. While the example shows the annual fix costs as well as the variable costs per transaction, as well as the VAT, product costs are excluded and come on top [348].

	Beleggingsadvies		Beleggingsadvies Actief		Beleggingsadvies Specifiek	
	Exclusief btw	Inclusief btw	Exclusief btw	Inclusief btw	Exclusief btw	Inclusief btw
Vaste kosten per jaar					0,35%	0,42%*
0 - 500.000	0,50%	0,61%*	0,70%	0,85%*		
500.000 - 1.500.000	0,50%	0,61%*	0,60%	0,73%*		
1.500.000>	0,35%	0,42%*	0,55%	0,67%*		
Minimum bedrag					€ 500	€ 605
Variabele kosten per transactie (vrijgesteld van btw)	0,45%		0,30%		0,45%	

The rising popularity of comparison websites, which in the Netherlands require a licence, was another notable development triggered by the ban on inducements.

Investment Services

Prior to the ban on inducements, banks and brokers mainly offered actively managed investment funds from their in-house manufacturer as part of advisory and asset management portfolio services. Following the inducement ban, banks began to also advise on index trackers. Several large Dutch banks sold or divested their in-house asset

[348] European Commission desktop research, November 2022.

managers (e.g. Robeco, previously owned by Rabobank[349], as well as ING who sold their Investment Management services to Nationale Nederlanden in 2013[350], who sold it on to Goldman Sachs in 2022). In some cases, those asset managers started their own direct distribution models.

Economies of scale have become a more important factor in an increasingly competitive environment, also considering the high cost of investing in digital systems. Market consolidation is ongoing, both through larger, international mergers and at national level for smaller firms.

Evaluation

In an evaluation of the ban on inducement carried out in 2018 the Dutch Ministry of Finance found that a mitigation of the conflicts of interest had taken place. Other findings included: an increase of the quality of advice and a better focus on the objectives of the clients. There were no major constraints to access advice, while at the same time consumers tended to underestimate the costs of advice prior to the reform. Once advisors get the opportunity to explain the value added of their services, the acceptance to pay for such fee-based services increases[351].

Part B : third country jurisdictions

There are also a number of third country jurisdictions that have banned the payment of inducements, either fully or for certain products and services (e.g. India, Canada, South Korea, Taiwan, South Africa, Australia and the UK). This chapter looks at the effects of the bans on inducements in Australia and the UK, as their markets structures can be most easily compared to the EU.

Australia

Commissions and incentives for 'product pushing', (i.e. selling products that offer high commissions often aligned with a certain marketing campaign or product launches), were banned by Australia's Future of Financial Advice reforms in 2012. The reform also imposed a client's best interest duty and mandated annual fee disclosures for investment services providers.

Following the reform, a shift towards new charging models was observed such as pay-for-advice, percentage-based fees and trailer fees (the latter which can no longer be levied since 2013). The Australian Securities and Investments Commission is conducting

[349] https://www.orix.co.jp/grp/en/newsrelease/pdf/130701_ORIXE1.pdf

[350] https://www.ing.com/Newsroom/News/Press-releases/PR/ING-announces-rebranding-of-ING-Insurance-operations-to-NN-testarticle.htm https://www.goldmansachs.com/media-relations/press-releases/2022/announcement-11-apr-2022.html

[351] https://www.researchgate.net/publication/328754959_Invoering_van_het_provisieverbod_in_de_financiele_dienstverlening Wet- en regelgeving financiële markten | Tweede Kamer der Staten-Generaal

an extensive evaluation on the inducement ban and intends to publish its report in December 2022. It will examine a number observed trends, notably that a large number of financial advice firms switched to platform fees following the ban, with a view to assessing whether they could be considered to circumvent the inducement ban. Such fees offer consumers access to a range of different products in one place, with the idea of portfolio simplification.

United Kingdom

In the United Kingdom, the ban on inducements was introduced to address a number of market failures on the market for retail investment products identified by the Retail Distribution Review ("RDR Review") in 2006/2007 (complex charging structures and lack of clarity as to how benefits accrue for retail clients were identified as a driver for a low retail participation). Inducements combined with retail clients' reliance on advisors were seen as a strong conflict of interest and source of consumer detriment. Low consumer trust was seen as an issue to be addressed[352].

The UK's ban on inducements was implemented in two main stages and through two distinguishable frameworks, as part of a comprehensive Retail Distribution Review:

1. A ban on inducements for advised services was effective as of 1 January 2013. Grandfathering for trailing commissions and existing transactions entered into effect prior to 1 January 2013.
2. The ban was extended to non-advised business or direct-to-consumer platforms, effective as of 6 April 2014, with a 2-year transitional period. Legacy rebates were receivable by platforms during the transitional period.

Impacts

The ban was evaluated primarily in the following reports:

1. FCA, Post-implementation Review of the RDR - Phase 1, 2014 - https://www.fca.org.uk/publication/research/post-implementation-review-rdr-phase-1.pdf ("FCA 2014");
2. Europe Economics, RDR Post Implementation Review, 2014 - https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf ("Europe Economics, 2014");
3. FCA, Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review, 2020 - https://www.fca.org.uk/publication/corporate/evaluation-of-the-impact-of-the-rdr-and-famr.pdf ("FCA 2020").

[352] FSA DP 07/1: Retail Distribution Review, pages 16-17.

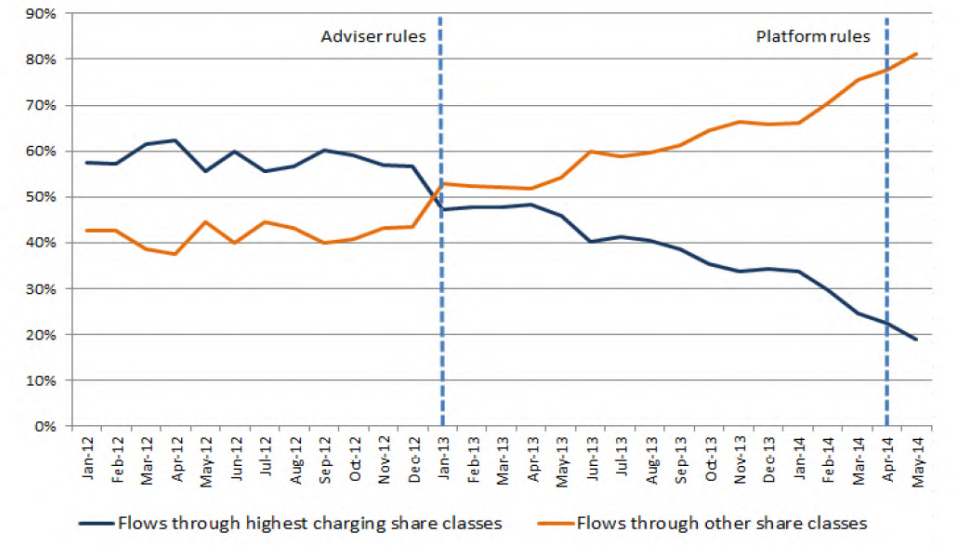
Impact on retail clients

Reduced product bias, and shift toward low-cost investment products and self-directed investments

Evidence from the reviews show that prices of financial products declined following the inducement ban, by at least the amount of commissions previously incurred. The ban on third-party commissions has also reduced product bias. In particular, the sales of high-commission products fell, while the sales of products which had little or no commission pre-ban rose (no data available on overall cost reduction for all products). Although other factors, such as the trend towards increased platform-based sales (online execution only), also have contributed to the change of product mix, that trend does not fully explain the steep changes in the relative size of sales of commission vs. sales of non-commission products just after the reform. The Europe Economics 2014 report concluded that there was a strong correlation between high-commission products and advised sales[353].

The decline in the proportion of investment products sold in the highest charging share classes is shown in the figure below. In January 2012, 60 per cent of all gross retail flows was through the highest charging share classes. As of May 2014, 80 per cent of flows were through shares classes other than the highest-charging classes[354].

Figure 6.2: Gross retail flows through highest-charging class shares and other shares



Source: IMA (2014), "Asset management in the UK 2013 – 2014".

Figure 7.7

[353] Europe Economics 2014, pages 3 and 73 to 76.
[354] Europe Economics 2014, page 74.

A sharp spike in sales of typically low-cost tracker funds was also observed after the ban[355] from 4 percent in 2012 to 12 percent the following year:

Figure 6.3: Tracker fund net sales and percentage of total funds under management

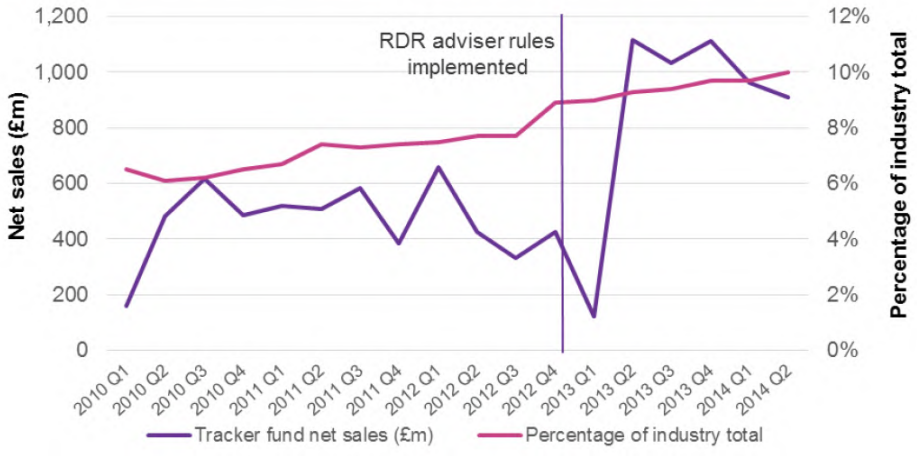


Figure 7.8

Following the ban, there was a significant increase in the proportion of execution-only (non-advised) sales in comparison to advised sales across virtually all investment product segments, and as a consequence, non-advised sales have become the largest portion of total unit sales:

4. PSD RI - Volume of advised and non-advised sales

4.1 Number of advised and non-advised sales by product type

		Reporting Periods (e): 2010	2011	2012	2013	2014	2015	2016
Number of advised and non-advised (j) sales by product type (b)								
Bonds	Advised sale	206.990	195.529	129.598	49.739	44.408	35.438	58.261
	Non-advised sale	15.064	12.103	13.976	21.228	20.955	31.510	28.958
Decumulation Products	Advised sale	217.769	198.943	211.618	150.312	112.624	132.010	139.615
	Non-advised sale	181.596	174.198	195.033	210.812	111.505	67.257	78.436
Endowments (p)	Advised and non-advised sale	73.616	65.658	54.844	49.700	46.079	47.226	42.977
ISA	Advised sale	559.997	406.655	236.934	136.708	131.888	107.788	92.509
	Non-advised sale	77.748	81.274	85.045	121.344	114.095	107.914	98.033
Long-term Care Insurance (k)	Advised & non-advised sales	1.308	1.231	1.329	944	1.119	973	1.051
Occupational Pensions	Advised sale	23.878	44.591	15.367	25.388	24.220	11.456	14.191
	Non-advised sale	108.562	141.293	148.403	307.754	191.607	200.539	139.571
Personal Pensions	Advised sale	618.092	592.618	578.610	624.962	912.503	734.994	780.587
	Non-advised sale	374.918	411.403	500.534	1.228.036	1.507.038	1.200.523	1.280.547
SCARPs	Advised sale	27.314	24.336	21.349	27.376	16.218	12.644	11.820
	Non-advised sale	1.554	1.658	1.808	4.721	3.733	2.473	1.509
Trusts and OEICs	Advised sale	195.076	142.656	71.129	38.668	37.114	34.024	31.692
	Non-advised sale	119.374	115.680	79.657	124.991	143.588	155.004	167.687
Total		**2.802.856**	**2.609.826**	**2.345.234**	**3.122.683**	**3.418.694**	**2.881.773**	**2.967.444**

Source: FCA Product Sales Data, https://www.fca.org.uk/data/product-sales-data/psd-archive

[355] Europe Economics 2014, page 75.

When assessing possible reasons for this shift, the FCA observed that consumers "*who would previously have paid for full regulated advice are increasingly turning to alternatives such as investing on a non-advised basis, e.g. via platforms*". This is because "*consumers have become more confident at directing their own financial affairs. [In fact] 74 per cent thought that it is better to research financial products before considering financial advice, and 44 per cent thought that it is actually better to make the investment decisions without obtaining professional advice*."[356]. More recent FCA consumer surveys have shown that, "*Most respondents [...] hadn't sought out advice because it was not needed, or that they felt they could make these decisions themselves (66%) and 22% had simply not thought about it*."[357]

Constant investment volumes since the ban

Retail sales (volumes) of units of investment products experienced a decline post-2008 and pre-ban, recovered to 2007 levels in 2013, and have since remained stable within the same bandwidth until 2020. Notably, sales volumes do not include transactions concluded via nominee accounts, such as those used in platforms, and as a result actual sales figures would be higher. These sales trends were clearly not only influenced by the ban, but also by other factors such as the global financial crisis.

Year	2007	2008	2009	2010	2011	2012	2013
Total Sales	**3.145.274**	2,963.686	2.641.737	2.802.856	2.609.826	**2.345.234**	**3.122.683**
Year	2014	2015	2016	2017	2018	2019	2020
Total Sales	3.418.694	2.881.773	2.967.444	3.478.903	3.310.966	3.194.029	**2.914.101**

Units sold including Bonds, Decumulation Products, Endowments, Individual Savings Accounts (ISA), Long-term Care Insurance, Occupational Pensions, Personal Pensions, Structured capital-at-risk Products (SCARPs), Trusts and Open-ended Investment Companies (OEICs) Source: FCA Product Sales Data, https://www.fca.org.uk/data/product-sales-data/psd-archive

Developments in the advice market

In 2016, the FCA[358] underlined that the RDR review (which, among other things, introduced the ban on inducements) had resulted in a high-quality financial advice market in the UK and that the ban on inducements had improved transparency and ended conflicts of interest caused by a mainly commission-driven model. However, FCA also expressed concerns about the existence of an "advice gap" in the UK, as advice was not always cost-effective for consumers, particularly those with smaller amounts of money to invest or with simpler needs. When examining the reasons for such a gap, the report identified different underlying issues, both on the supply and demand side (including

[356] Europe Economics 2014, page 42.
[357] FCA 2020, page 35.
[358] FCA, Financial Advice Market Review, Final report, March 2016.

high costs, limited confidence of consumers to engage with financial issues, a lack of trust following past instances of mis-selling, etc.).

Advice services in the UK were already decreasing before introduction of the ban (a decline from 25% of the adult population receiving advice in 2008 to 13 per cent in 2012 just prior to the ban).[359] The more recent reports show a renewed upward trend in the percentage of the population receiving regulated advice. In 2019, 8% of UK adults received regulated advice on investments, a rise of 2% since 2017.[360]

Post RDR research which examined the risk of clients being left without advice, showed that some firms were segmenting clients, and some were specialising in high net-worth clients or introducing minimum investor thresholds.[361] A very small number of investors appeared to have been impacted negatively. Client-uptake by advisors increased shortly after the ban, while the segmentation of customer bases appeared to be aimed at offering more tailored advice for different groups in the long-term.[362]

As regards minimum investment amounts, the evidence is contradictory. Some sources examined in the 2014 Europe Economics report suggested minimum thresholds varied by firm, some firms had moved to accepting minimum wealth levels of between £50,000 and £100,000. However, much of this evidence relates to what firms were planning pre-ban but not corresponding to actual minimum investment limits. In the evaluation that followed the ban, there was no clear conclusion about whether limits apply and if so, what they are.[363]

Eight years after the reform, the FCA observed that only 40% of firms declared having formal minimum thresholds for pensions/investments, but there was no indication that firms without a formal minimum investment size targeted or served less affluent customers.[364]

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[359] Europe Economics 2014, page 41.

[360] Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review, page 34.

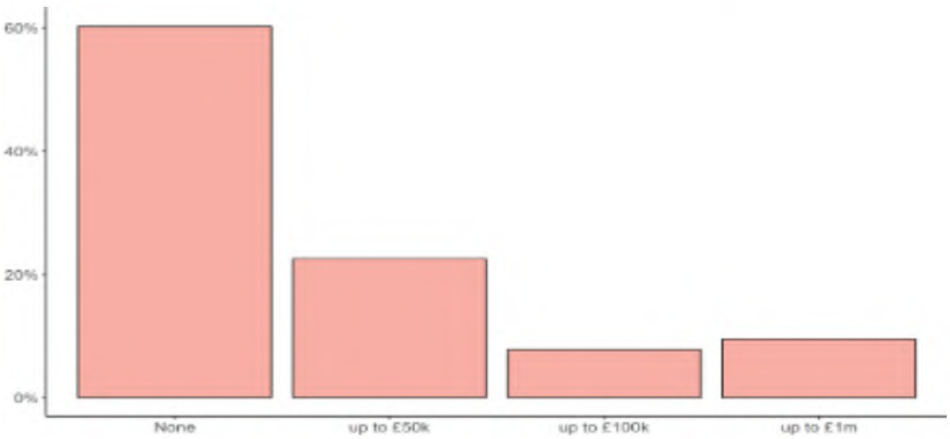
[361] Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review, page 50.

[362] Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review, page 51.

[363] Europe Economics, 2014, page 50 "The research is also varied in its conclusions as to what this level is: a report by Fundscape states that most financial advisers seemed to have settled on a minimum of £100,000 in investable assets, whilst other sources suggest a threshold of £50,000. This contrasts with research from Schroders which shows that for the majority of firms the minimum levels are lower. In their survey 50 per cent of advisers reported that their cut-off level for investment, which was used to determine which clients were asked to leave, was below £25,000, and over 30 per cent saying it was below £50,000. Mintel contends that the availability of advice has declined post-RDR especially for customers with less than £20,000 to invest.".

[364] Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review, (Europe Economics 2014, page 39).

Figure 2.5: Percentage of firms with minimum pot thresholds



Source: RDR and FAMR firm survey 2019

Figure 7.9

The Europe Economics report[365] also analysed a *potential advice gap distinguishing between three groups of consumers* who may have a need for investment advice but who may not be receiving it for different reasons: (a) those not engaged in the investment market; (b) those unwilling to pay for advice at true cost; and (c) those seeking advice but where firms are unable or unwilling to provide them advice. For each of these segments it was concluded that there was no evidence to suggest that the ban had created or enhanced the gap, for the following reasons

1. "*The first group (a), though important, does not constitute an 'advice gap' in that the affected consumers are not actively looking for investment advice (they might, of course, benefit from unregulated, generic advice). [..]*

2. *The second group (b) is driven by consumer choice about value for money and existed to a degree prior to the RDR. To the extent that this is a choice by consumers as to whether they are willing to pay for investment advice, whether this group is a 'gap' is arguable. By revealing the true cost of advice, the RDR is likely to have increased the size of this group, although the evidence suggests the size of this increase has been limited by the move by the majority of firms to adopt contingent charging structures rather than up-front fees. This group includes consumers who would pay for cheaper forms than the full advice model - the absence of these cheaper models therefore creates a forced choice for this group. There are signs that in time the market will adjust to address at least part of this gap by developing cheaper advice offerings that these consumers may consider value for money.*

[365] Europe Economics, 2014, page 3.

3. *The third group (c) is firm-driven. This group of consumers is likely to have increased under the RDR as a result of firms moving to target higher wealth, higher margin consumers. Some firms are segmenting their client books and focusing on wealthier customers. Where this is the case, the evidence suggests the number of consumers affected is generally small and that these consumers are likely to have been picked up by other adviser firms. Advisers have capacity and have been taking on new clients. There is little evidence that consumers perceive themselves to have been abandoned by advisers. As this gap is likely to be small, to the extent there are firms willing to provide advice to lower wealth consumers, the market should be able to resolve this in time.*"

Finally, the reform (including the ban) appears to have contributed to a long-term trend of increased consumer trust. According to the FCA's 2020 research report, the majority (72%) of consumers who had received advice in the past year reported being satisfied with the charges they paid. An increase in the trust in advisors amongst retail clients was observed. 66% of adults in 2020 who had received regulated advice in the past 12 months trusted that advisors were acting in the best interest of their clients, compared to 58% in 2017.[366]

Impacts on industry

Various impacts on industry have been evaluated, in particular:

The initial decline of advisory services following the ban was reversed with the re-entry into the market of retail banks, facilitated by technological developments (digitalisation)

The number of advisors initially declined in the immediate aftermath of the ban. This was attributed to the exit of retail banks, something which was already occurring before the ban.[367] The number of retail advisors increased by 4% between 2012 and 2019[368]. Retail banks re-entered the market through the channel of technology-based advice and guidance.[369] Since 2016, the FCA has also observed an increase in advice firms' revenues, with a 21% growth in per adviser revenue and 37% increase in total revenue per firm.[370].

There has also been a significant shift towards execution-only services over platforms offering execution only services. There has also been significant growth in the direct (i.e. non advised) sales, and specifically via platforms. In a 2017 study the FCA has observed that the investment platforms market has more than doubled between 2013 and 2017, from £250bn to £500bn AUM respectively. Platforms formed a large share of the retail

[366] FCA 2020, page 31.
[367] Europe Economics, 2014, page 54.
[368] FCA 2020, page 37.
[369] FCA 2020, page 41.
[370] FCA 2020, page 31.

equity market, and 20% of AUM on platforms was in directly owned equities. Crucially, the FCA also concluded that the number of consumers using platforms has increased, with about 2.2 million more customer accounts created between 2013 and 2017.[371]

A sustained decline in commission revenues followed by uptake of fee-based remuneration and an overall increase of retail investment business turnover

Research into remuneration structures in the UK in the years shortly after the ban showed a sustained decline in the proportion of revenue stemming from commissions, coupled with an increase in advisor charges.[372] In 2012, advisor charges accounted for less than 20% of revenue and they were around 35% in 2013.[373] In contrast, in 2019 ongoing advice alone represented 70% of firms' revenue.[374] Although not analysed in relation specifically to the impacts of the ban in 2013, total reported annual revenue from retail investment business has increased by approximately 71% between the period 2013 to 2019, with average reported revenues for firms increasing by approximately 54% during the same period.[375]

PART C1 – Cost estimates of a ban on inducements for administration and compliance for firms

This section presents two different inducement ban related cost estimations that were performed in the UK and in the Netherlands between 2010 and 2014. The methodological approaches for assessing compliance costs differ in these two jurisdictions, making it difficult to compare estimates. Furthermore, this section includes an extrapolation on the basis of the two cost estimates to illustrate the possible EU wide impact of an inducement ban.

UK

FCA compliance cost estimates of 2010 for the inducement ban were informed by a multi-stage process, involving surveys, interviews and industry consultations. Compliance cost estimates were separated into one-off and ongoing costs for each of the three firm groups – intermediaries, providers and platforms. Intermediaries included Directly Authorised (DA) and Appointed Representative (AR) firms, banks, stockbrokers, network providers, financial services conglomerates, and insurer and asset manager distribution arms. Providers included conglomerates, insurers and asset managers (excluding their distribution arms).

Additional professional qualification costs formed a significant part of the one-off cost estimate for intermediaries (£115m–£165m), together with the introduction of the

[371] FCA, Investment Platforms Market Study 2019, pages. 4 and 46.
[372] Europe Economics 2014, page 46.
[373] Europe Economics 2014, page 47.
[374] FCA 2020, page 19.
[375] FCA 2020, page 53.

adviser-charging model (£140m–£160m). Disclosure documents and marketing (£20m–£45m), and costs for introducing independence requirements (£5m) were also included. Ongoing intermediary costs are related to up-keeping adviser charging (£40m–£60m), satisfying disclosure requirement (£25m), and additional search costs incurred due to independence requirements (£35m).

In relation to providers, one-off costs mainly consist of those for IT and systems, including the introduction of multiple share classes, product redesign and additional product disclosures (£330m–£385m). Ongoing costs include annual changes to IT systems and the costs of administering additional share classes, or other measures to facilitate adviser charging (£70m–£85m).

The table below summarises the original cost categories as identified by the FSA for intermediaries and provider firms, broken down into one-off and ongoing costs.

Type of firm	One-off incremental costs	Ongoing incremental costs
Intermediaries	**Clarity of service:** cost of updating firm marketing material and updating service and cost disclosure materials.	**Clarity of service**: cost of explaining the firm's status and charging structure to clients.
	Adviser charging: cost of amending or creating a price tariff for services offered, updating systems to deal with Adviser Charging and training advisers on new systems.	**Adviser charging**: costs resulting from updating price tariffs periodically as necessary, administering Adviser Charging and running new IT systems.
	Qualifications: cost of training advisers from their current qualification level to QCF Level 4 (or equivalent), including study time.	**Independence**: ongoing costs associated with the revised definition of independence, e.g. market search costs, product due diligence costs and adviser product training.
	Independence: one-off costs associated with complying with the revised definition of independence, e.g. redrafting investment procedures.	
Providers	**Systems**: systems costs associated with moving to factory gate pricing, including the costs associated with offering a service for collecting and passing on adviser charges.	**Share classes**: costs associated with the ongoing administration of new share classes.
	Product redesign: costs associated with redesigning existing products on a factory gate priced basis, i.e. without commission built in.	**Other measures to facilitate Adviser Charging**: costs associated with other measures to support Adviser Charging, such as cancellation of units.
	Additional share classes: cost associated with creating new share classes to support Adviser Charging where this is felt to be necessary.	**Systems**: incremental costs associated with maintaining new systems on an ongoing basis.
	Disclosure documents: cost of updating disclosure documents.	

Table 1 below provides a detailed breakdown of incremental costs faced by different types of intermediaries and providers according to the FSA estimate of incremental compliance costs for Retail Distribution Review proposals[376]:

Table 1.1 Incremental compliance costs for intermediaries*

ONE-OFF COSTS BY CATEGORY	Clarity of Service	Adviser charging	Qualifications	Independence	TOTAL
DA FINANCIAL ADVISERS	£5 - 10m	£20m	£30 - 40m	£0m	**£50 - 70m**
AR FINANCIAL ADVISERS	£5 - 10m	£15m	£25 - 35m	£0m	**£45 - 60m**
BANKS	£0 - 5m	£55 - 70m	£25 - 35m	£0m	**£80 - 110m**
CONGLOMERATES	£0 - 5m	£15m	£20 - 30m	£0m	**£35 - 45m**
STOCKBROKERS	£5 - 5m	£5m	£5 - 10m	£0m	**£15 - 20m**
INSURER DISTRIBUTION ARMS	£5 - 10m	£25m	£10 - 15m	£0m	**£40 - 50m**
ASSET MANAGER DISTRIBUTION ARMS	£0 - 0m	£0m	£0 - 0m	£0m	**£5 - 5m**
NETWORK PROVIDERS	£0 - 5m	£5m	£0 - 0m	£0m	**£5 - 10m**
TOTAL	**£20 - 45m**	**£140 - 160m**	**£115 - 165m**	**£5m**	**£275 - 370m**

ONGOING COSTS BY CATEGORY	Clarity of Service*	Adviser charging	Independence	TOTAL
DA FINANCIAL ADVISERS	£5m	£15 - 15m	£10m	**£30 - 35m**
AR FINANCIAL ADVISERS	£5m	£10 - 15m	£10m	**£25 - 30m**
BANKS	£0m	£5 - 10m	£0m	**£5 - 10m**
CONGLOMERATES	£5m	£5 - 5m	£0m	**£5 - 5m**
STOCKBROKERS	£0m	£0 - 5m	£10m	**£10 - 10m**
INSURER DISTRIBUTION ARMS	£5m	£5 - 10m	£0m	**£10 - 15m**
ASSET MANAGER DISTRIBUTION ARMS	£0m	£0 - 0m	£0m	**£0 - 0m**
NETWORK PROVIDERS	£0m	£0 - 0m	£5m	**£10 - 10m**
TOTAL	**£25m**	**£40 - 60m**	**£35m**	**£100 - 120m**

Table 1.2 Incremental compliance costs for providers*

ONE-OFF COSTS	Systems	Product redesign	Share classes	Disclosure docs	Other	TOTAL
CONGLOMERATES	£50m	£10 - 15m	£5m	£0 - 5m	£0m	**£65 - 75m**
INSURERS	£130m	£25 - 50m	£10m	£15 - 25m	£5m	**£185 - 225m**
ASSET MANAGERS	£30m	£5 - 5m	£45m	£0 - 5m	£0m	**£80 - 85m**
TOTAL	**£215m**	**£35 - 75m**	**£55m**	**£15 - 35m**	**£10m**	**£330 - 385m**

ONGOING COSTS	Adminstration of extra share classes	Other measures to facilitate Adviser Charging	Systems	Other	TOTAL
CONGLOMERATES	£0m	£0m	£0 - 5m	£0m	**£5 - 5m**
INSURERS	£5m	£5m	£10 - 25m	£0m	**£25 - 40m**
ASSET MANAGERS	£30m	£0m	£5 - 10m	£0m	**£35 - 40m**
TOTAL	**£40m**	**£10m**	**£20 - 35m**	**£0m**	**£70 - 85m**

(1) All figures are rounded to the nearest £5m (e.g. £0m implies a cost between £0m and £2.49m). Figures may not add up due to rounding.

(2) The use of segment medians to derive segment totals reduces the impact of significant outliers, either high or low. Where the impact of this approach is materially different from alterative approaches, we have referred to the sensitivitie in the commentary text.

**source: FSA 03/2010, page 9*

Further to the ex-ante estimation of 2010, Europe Economics performed an ex-post cost analysis of compliance cost in 2014. The following table shows how pre-RDR estimates compared to post-RDR estimated costs, per type of provider, with hindsight that the overall costs were lower than anticipated.

The analysis of Europe Economics indicated an overestimation of compliance costs at the level of intermediaries of 60% and 31% with respect to expected one-off costs and ongoing costs, whereas one-off costs compliance costs of provider firms fell short by 37%, while ongoing costs turned out 30% lower than initially estimates.

[376] FSA estimate of incremental compliance costs for Retail Distribution Review proposals, March 2010

Table 8.3: Comparison of *ex ante* and *ex post* RDR compliance cost estimates

Estimates pre-RDR £m		
	One-off	*Ongoing*
Intermediaries	275 - 370	100 - 120
Providers	330 - 385	70 - 85
Platforms	33 - 67	8 - 15
Total	**638 - 822**	**178 - 220**

Estimates post-RDR £m		
	One-off	*Ongoing*
Intermediaries	109 - 152	71 - 81
Providers	355 - 625	32 - 76
Platforms	32 - 48	11 - 15
Total	**496 - 825**	**114 - 171**

Source: Europe Economics (2014), page 95

Netherlands

The introduction of the inducement ban in the Netherlands was complemented by a cost estimation in 2014.[377] While the ban was presumed not to create any direct administrative costs, the industry was expected to face considerable one-off compliance costs while transitioning to commission-free services and products. These one-off costs were estimated at EUR 3.5 million at that time. At investment firm level, costs associated with communicating the ban towards clients were identified as key cost driver comprising one-off cost of EUR 2.6 million, whereas the costs for the migration of clients' positions to commission-free versions as well as ICT-related changes were estimated at EUR 720,000. Direct billing to customers had to be enabled and the business models of firms, including the fee schedule, had to be adjusted. UCIT management companies and managers of AIFs were expected to face compliance costs stemming from the setup of commission-free units, including the establishment of clean share classes and the migration of client portfolios into those share classes we expected to cost a total of EUR 115,000.

A separate cost estimation was initiated in 2012[378] to support the inducements ban for insurance/complex products in the Dutch market. One-off compliance cost were estimated at EUR 18.7 million in the first seven years, while ongoing compliance costs of EUR 3.4 million per year had been identified. One-off costs were mainly driven by the one-off development of required procedures and the periodic review of new products relating in the initial establishment phase of five years. It was further estimated that the costs associated with business model adaptations would result in EUR 14.9 million in the advisor community over a period of seven years. In terms of ongoing costs, it was observed that insurance undertakings would likely be confronted with EUR 3.4 million annually in structural compliance costs from testing of new products against procedures.

Table 2 summarises the result of the cost estimations carried out in the Netherlands in 2012 and 2014:

[377] https://zoek.officielebekendmakingen.nl/stb-2013-537.pdf
[378] Staatsblad 2012, 695 | Overheid.nl > Officiële bekendmakingen (officielebekendmakingen.nl)

		Comparison NL compliance costs (mm EUR)			
		original prices (2012,2014)		*latest price levels (2021)*	
		ONE-OFF COSTS	ONGONIG COSTS	ONE-OFF COSTS	ONGONIG COSTS
Intermediary	Investment firms	3,38	n/a	3,72	n/a
	Insurance/ complex products	14,88	n/a	16,87	n/a
Provider	Investment	0,11	n/a	0,13	n/a
	Insurance / complex products	3,80	3,39	4,31	3,39

Summary based on cost estimates of the Royal Dutch Decrees 2012 & 2014

The cost estimates in the Royal Dutch Decree were provided on an ex-ante basis. The Commission reached out to different financial institutions in the Netherlands to gather information on the actual (ex-post) level of costs incurred for the implementation of the ban on inducements, however most institutions could not provide such information, mainly due to the fact that the costs were absorbed by the institutions long time ago and factual information was not readily available. One institution was able to collect such information, which is presented in the below case study. The case study is presented for illustration purposes; while rich in details, given the limited sample, it was not considered possible to use this as a reliable basis for extrapolations at the EU level.

Case study

The impact of the ban on inducements in the Netherlands can be showcased through an example of the impact on one Dutch bank which has a significant share of the retail market.

The implementation of the ban on inducements carried certain implementation costs and costs savings for the bank and brought about key changes to the revenue model and the services used by clients.

Costs for implementing the ban

Type of Costs	One-off	Ongoing
Providing information to existing clients on the changes to the model (conversations with clients under advice, explanation of fees, information materials, calls to advised clients, etc.)	ca. EUR 200 per client (costs for providing information per client, including 1h of conversation for clients who needed more information than just a letter).	none
Legal and marketing costs	EUR 1.5-2 million	none
IT Costs – fee model	EUR 1 million	none
Costs for coordination of transition project	EUR 1-2 million (8 FTEs working on the project for 1,5 years)	none
Costs savings		Lower legal costs because of simplified relationship with produ manufacturers (not quantified)

Impact on the revenue model and services used by clients

Prior to the ban, inducements made up 40% of the revenue of the investment arm of the bank, while overall the investment arm of the bank was not profitable. As the bank switched to a fee-based model, the revenues from commissions on investment products declined and needed to be compensated.

The bank developed and focused on certain services and fee structures: for clients under advice, a (flat) fee of about 1% of assets under management (AUM) was introduced. There was a significant reduction of commissions on investment products held by execution-only clients. The bank developed new services, such as online discretionary portfolio management which made this service also available for small investors. Existing discretionary portfolio management (DPM) clients did not see significant adjustments, as annual fees based on AUM were already a part of the service.

On the client side, at the time of introduction of the ban as well as in subsequent years, the bank observed a large decline in the number of advised clients, with today only approximately 10% of the total number clients still being advice-clients compared to the pre-ban situation. A large number of clients previously receiving advice, switched to DPM and execution-only services. According to the bank, the ban allowed for a cultural shift within the institution to put the clients' needs first as the conflicts of interests were removed.

The new services developed by the bank with asset-based fees, which could be scaled-up easily, in combination with a stronger negotiating power by the bank towards product manufacturers (this was a result of the growth in DPM), resulted in higher levels of revenue, allowing the bank – over a period of several years after the introduction of the ban – to make its investment arm profitable.

The choices that the bank made for its business model resulted also in an internal restructuring, where the bank had to let go 75% of its employed advisors. While this created an estimated one-off cost of, on average, one annual benefit per advisor, it also resulted in an overall structural cost savings of the same amount per year on an on-going basis.

Extrapolation of costs on the basis of Dutch and UK figures

With a view to obtaining orders of magnitudes of the expected compliance costs incurred by the EU industry of investment products, this section provides extrapolations on the basis of the two cost estimations performed in the Netherlands and UK.

The analysis is based on the information and methodological assumptions provided in the Royal Dutch Decree[379] and the FSA estimate of incremental compliance costs for Retail Distribution Review proposals[380]. Original cost estimates have been adjusted to align the analysis closer to the planned policy proposal subject to different assumptions that are further described below. All results are expressed to EUR and reflect latest available price levels.

1. Netherlands

Cost estimates in the Netherlands were calculated per investment firm and investment fund manager based on the estimated workload and costs required to complete different compliance related tasks (a summary of the activities and calculations carried out in the context of the Dutch cost estimation is presented above).

For the purpose of extrapolating, firm level estimates from the Netherlands were applied to firms in the EU-27, excluding the Netherlands (in the following defined as EU-26). The perimeter of relevant EU firms is based on the ESMA's register of investment firms, selecting those firms that are active in the EU-26 and which hold a MiFID license for providing investment advice. The scope of asset managers on the other hand is determined based on the number of UCITS management companies and Alternative Investment Fund Managers. While UCITS typically are generally retail oriented, Alternative Investment Funds are offered primarily to professional clients. To account for this segmentation, a range of 15-25% is applied to determine the number of relevant AIF managers, instead of taking the full population of AIF managers.[381] Concerning UCITS fund managers, the full sample i.e. 100% are taken into account. This is considered to be an overestimation, as not all UCITS fund managers are expected to be equally impacted.

The result of this extrapolation is provided below:

Jurisdiction	**Number of investment firms**	**Number of UCITS management compa**	**Number of AIF managers (100%)**	**Costs faced by investment firms (1,000 EUR)**			**Costs faced by asset managers (1,000 EUR)**	**Sum (1,000 EUR)**	
				Communication	*Client*	*Transitional ICT adjustment*	*Clean share classes*	Min	Max

[379] stb-2013-537.pdf (officielebekendmakingen.nl)

[380] FSA estimate of incremental compliance costs for Retail Distribution Review proposals, March 2010

[381] This assumption is based on the share of 14% of retail investors in AIFs. According to ESMA figures, EUR 700bn of a total of EUR 5tn were held by retail investors in 2022 (cf. ESMA Cost and Performance Report 2022, page 28).

		nies		*costs*	*migration costs*	*costs*					
						Min	*Max*	*Min*	*Max*		
EU-26	4.597	1.318	2.627	47.869 €	5.166 €	2.583 €	12.915 €	2.377 €	2.742 €	**57.995 €**	**68.692 €**

2. United Kingdom

For the purposes of this extrapolation, the UK costs estimates (in the relevant market segments as identified by the FCA) have been applied to licensed investment firms, insurance undertakings and insurance intermediaries in the EU. The over- and under-estimations that were signalled in the post-RDR review undertaken in 2014 by Europe Economics have been taken into account. These extrapolations are provided for illustration purposes and rely on a series of assumptions and caveats (further explained in the paragraphs below). Information and data on the number of firms in the EU were in some cases limited to Euro area firms. In order to extrapolate cost estimates for the rest of the EU (i.e. the EU-26, excluding the Netherlands), results were multiplied by a scale factor of 1.25, which broadly reflects the size of the MiFID retail market in the missing countries.

The ban on inducements in the UK was introduced as part of a broader set of measures prior to the implementation of MiFID II and IDD. The FSA's cost estimates also include other measures which are irrelevant in the context of a ban on inducements (e.g. professional qualifications requirements) or that have in part already been implemented in the EU through previous legislation (e.g. certain disclosure obligations). Considering the broader scope of the RDR and reflecting current conditions, several cost drivers included in the FCA estimates have been discarded or only partially taken into account:

- **Professional qualifications:** the RDR reform set out qualifications requirements which were also part of the cost estimates. These costs are excluded from the extrapolation.

- **ICT costs**: ICT systems costs were estimated to be on the higher end in 2010, however, in today's context those estimates do not necessarily reflect market realities after a decade of digital transformation by the industry. Against this background, a haircut of 50% is applied with respect to all system costs.

- **Ongoing costs**: A fair part of the described ongoing costs would apply equally in environment where inducement would be allowed and can be considered to be part of a firm's overheads in business as usual (e.g. product diligence costs, ongoing client communication and the update of new documents and IT systems). Furthermore, most disclosure related compliance obligations already came into effect with MiFID II and IDD. In consequence, ongoing cost as per the FSA approach are disregarded from the analysis as they are deemed not to represent incremental costs.

The table below summarizes the main results of the extrapolation of cost estimates for the EU-26. The details of the calculations across the various segments are presented in the following parts.

Type	**Segmentation**	**EU-26 costs (million)**	
Intermediaries	Banks	372 €	
	Stockbrokers	48 €	
	Financial advisors	3,231 €	
Providers	Insurance undertakings	2,986 €	
	Asset managers	7,273 €	8,399 €
Total		**13,910 €**	**15,036 €**

EU intermediaries

1) Banks

The population of banks comprises all directly and indirectly supervised entities by the SSM that hold a MiFID license for investment advice. While there are 346 credit institutions offering advice that are deemed significant in terms of their size and risk, the vast majority of credit institutions in the population are so-called less-significant institutions (1,418 firms).

The extrapolation is based on the UK cost estimates of an average bank (arithmetic mean), which is applied over 346 significant institutions in the EU-26. The average costs reflect the post RDR review (i.e. certain under- and over-estimations) and exclude professional qualifications costs as well as certain ICT charges as described further above.

Below table summarizes the cost extrapolation for the euro area (significant banks), excluding the NL, and an estimation of expected costs in the EU-26.

Average cost per bank	**Euro Area, excl. NL**	**EU-26**
EUR 860.000	EUR 298 million = 0.86 million x 346 banks	**EUR 372 million** = EUR 298 million x 1.25 (scale factor)

2) Financial advisors

The segment of companies providing financial advice in the euro area (excl. NL) covers all MiFID firms (2,428 firms) with a license for offering investment advice that are neither banks nor defined as brokers and beyond that includes smaller credit

institutions[382] that were disregarded from the analysis under point 1. (1,418 LSIs). In addition, 815,000 licensed insurance intermediaries in the Union are considered (which is overestimate as the number also would cover intermediaries in the NL).

In terms of firm-level cost estimates, a simple average between the compliance costs of a commission-based directly authorised (DA) financial advisory firm and an appointed representative (AR) financial advisory firm is taken. Firms are categorised into three size bands (small: 1 - 3 advisors, medium: 4 - 19 advisors and large: 20 and more advisors.

	Small	**Medium**	**Large**
DA financial advisors	EUR 4,194	EUR 10,543	EUR 47,125
AR financial advisors	EUR 3,513	EUR 9,378	EUR 47,125
Average	**EUR 3,853**	**EUR 9,961**	**EUR 47,125**

For the purpose of extrapolating the cost estimates to EU-26 level, a scale factor of 1.25 is applied to the number of MiFID investment advisors and smaller credit institutions (LSIs) in the euro area, while selecting respectively the medium category and large category to quantify total costs. Concerning the insurance sector, the smallest cost category is used for reference, acknowledging the circumstance that more than 50% of the IDD universe are one-person businesses.

Type of advisor	**Average cost per firm**	**Costs EU-26**
Firm providing investment advisory	EUR 9,961 (Medium advisory firm)	EUR 24 million = EUR 9,961 x 2,428 firms
Less significant credit institutions	EUR 47,125 (large advisory firm)	EUR 67 million = EUR 47,125 x 1,418 firms
Insurance intermediary	EUR 3,853 (small advisory firm)	EUR 3,140 million = EUR 3,853 x 815,000 firms
TOTAL		**EUR 3,231 million**

3) Stockbrokers

Brokers are defined as MiFID firms with a license for the receipt and transmission of clients' orders or the execution of orders, but who do not offer investment advice to clients. The population in the euro area (excluding NL) is estimated to be 427 firms.

The extrapolation is based on the UK cost estimates of an average stockbroker (arithmetic mean), which is applied over 427 companies that offer brokerage services in the EU-26. The average costs take into account the post RDR review (i.e. certain under-

[382] They are taken into account in the category of financial advisors (rather than in the previous category of banks) because their compliance costs are expected to be closer to those of large financial advisors rather than significant banks

and over-estimations) and exclude professional qualifications costs as well as certain ICT charges as described further above.

Below table summarizes the cost extrapolation for the euro area, excluding the NL and EU-26.

Average cost per brokerage firm	**Euro Area, excl. NL**	**EU-26**
EUR 89,600	EUR 38 million = 89,600 x 427 firms	**EUR 48 million** = EUR 38 million x 1.25 (scale factor)

EU provider firms

4) Insurance companies

The segment of insurance companies consists of insurance undertakings that write unit-linked products, profit participation products or undertakings that sell both types of products. The population of these insurers is comprised of approximately 552 firms in the EU-26.

For the purpose of extrapolating, the median cost estimates for a medium size insurance company is selected, subject to deducting half of ICT related charges and accounting for the post RDR review.

Below table summarizes the cost extrapolation for the EU-26 with regard to insurance undertaking offering IBIPs.

Number of insurance undertakings	**Expected cost for a medium size insurer**	**Costs EU-26**
552	EUR 5.41 million	EUR 2,986 million

5) Asset managers

The segment of asset managers is being defined as UCITS management companies and Alternative Investment Fund Managers. As UCITS typically are retail oriented, we are taking all asset managers into account, therefore overestimating the potential effect. Alternative Investment Funds are offered mainly to professional clients and to account for this segmentation, not the full population but a range of 15-25% is applied to determine the relevant market of AIFs.

In terms of firm level costs, the median cost estimates for a medium size asset manager is selected, subject to deducting half of ICT related charges and accounting for the findings of the post RDR review.

Below table summarizes the cost extrapolation for EU-26 with regard to asset managers.

Number of asset	**Expected cost for a medium**	**Costs EU-26**

management firm	size asset manager	
1,318 UCITS MC	EUR 4.25 million	EUR 5,602 million
394 – 657 AIFs		EUR 1,671 million – 2,797 million
Total		**EUR 7,273 million – 8,399 million**

PART C2 – Quantification of expected benefits of the ban on inducements

This section illustrates in quantitative terms the expected benefits of the ban on inducements, by providing a summary of the benefits calculated by the UK at the time of introduction of the ban, as well as an illustration prepared by the Commission services for the possible benefits in the EU.

UK

The FSA carried out an evaluation of the benefits expected from the ban on inducement. Particular attention was paid to benefits stemming from the potential elimination of consumer detriment as a result of the ban, especially in relation to mis-selling resulting from commission bias. In 2010 the FSA provided an estimate of the detriment to consumers based on a number of mis-selling case examples.

The following estimates were provided:

Example	**Annual Detriment Estimates**	
	mm GBP (2010 prices)	mm EUR (latest price levels)
Pension Switching	£43	60 €
Unit Trust Market	£70	98 €
Investment Bond Market	£92	129 €
Personal Pensions	£18	25 €
Total:	**£223**	**314 €**

(FSA 10/06, A1:10)

Overall, benefits from the reforms for both consumers and the industry appeared to outweigh the costs incurred by the transition.

Expected benefits at an EU level

The expected benefits for consumer of a ban at an EU level can be illustrated by estimating the total value of inducements charged to investors on an annual basis. An accurate estimation of the amount of inducements is difficult to establish, due to strong data limitations regarding the share of inducements in total product costs and the exact number of products in the market that carry inducements.

On the basis of a series of assumptions, the value of inducements can be illustrated for certain products and market segments (e.g. actively managed UCITS funds which are directly held by retail investors).

Data from Eurostat[383] shows that the direct holdings of investment funds by retail investors equalled EUR 2,785 billion in 2019, EUR 2,834 billion in 2020 and EUR 3,357 billion in 2021. The likelihood that a fund will be induced is highest for actively managed UCITS funds. According to ESMA's 2022 Cost and performance report, UCITS funds (at EUR 4 trillion) represent approximately 85% of the EU retail fund holdings. Active UCITS accounted for around 67% of the overall market, from 71% in 2019 (rounded up to 70% for the purposes of this calculation). Applying these percentages to the level of direct holdings of investment funds and taking (i) as an assumption an average of the total annual costs for UCITS fund (equity, bonds and mixed UCITS funds) with a 10-year investment horizon as reported by ESMA[384] (e.g. 1.65% in 2019, 1.61% in 2020 and 1.58% in 2021) and (ii) as a conservative assumption that products carrying inducements are on average 25% more expensive than non-induced products, the total annual costs of inducements at an EU level for these UCITS funds would represent **EUR 5.13 billion** (2019), **EUR 5.25 billion** (2020) and **EUR 6.1 billion** (2021). For previous years the calculations would be in a similar order of magnitude.

As indicated in chapter 3, the conflicts of interest that arise from inducements create product bias and lead to the sale of more expensive products to retail investors. The above estimates do not take into account the dynamic effects of a ban, which would imply that a certain percentage of retail investors would switch to cheaper products (as experiences in the NL and the UK have shown). If these dynamic effects were taken into account, the actual detriment of inducements for investors would be even higher. For example, assuming that 5% of investments in the EU would shift to low-cost investment products (such as ETFs), this could generate further aggregated cost savings of EUR 0.5 billion (2019), EUR 0.6 billion (2020) and EUR 0.8 billion (2021)[385].

The above estimates of the value of inducements are limited to only one market segment and should therefore be seen as a significant underestimation of the overall impact. Insurance based investment products, which have a significant market share and carry high level of inducements, as well as other retail investment products, are not included in this calculation.

As a consequence of a ban on inducements, retail investors would have to pay separately for investment services, including financial advice, as these costs would no longer be incorporated in the overall fees. The costs of such payments could not be quantified, but it is expected that they would be significantly lower than the cost of inducements.

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[383] Financial balance sheets annual data extracted from Eurostat: https://ec.europa.eu/eurostat/databrowser/view/NASA_10_F_BS/default/table?lang=en .

[384] Based on average total costs for the UCITS market published by ESMA in its 2023 Market Report on Costs and Performance of EU Retail Investment Products.

[385] Based on total annual costs of ETF UCITS provided by ESMA: 0.7% in 2019 (2021 costs and performance report), 0.5% in 2020 (2022 costs and performance report) and 0.43% in 2021 (2023 costs and performance report).

Finally, it should be noted that for the calculation, the same proportion of inducements was applied across all Member States, whereas in reality, the average level of inducements charged in each Member State varies. Nevertheless, it is evident that inducements amount to sizeable costs for retail investors in the EU, in the order of billions of Euros. They represent a wealth extraction which lowers market efficiencies. If these cost savings were made available to households, they could contribute to wealth creation for retail investors and be used for further investments in the economy. Furthermore, while these illustrations show the level of inducements charged, the main benefit to retail investors will relate to the removal of conflicts of interest and biased advice. This would make it less likely that retail investors, in particular those that are less financially literate, are recommended products that are overly risky or expensive, considering their needs and objectives.

Illustration of impact on individual investors

The impact of inducements can be illustrated along the return a retail investor can earn on a typical EUR 10,000 investment with different combinations of the size and timing of fees paid to the provider of the financial instrument, when using either a commission-based or a fee-based investment product. This illustration is based on a series of assumptions relating to the gross return on the investment and the magnitude of the fees. The numbers in ESMA's cost and performance reports of EU retail investments provide suitable benchmarks for such assumptions.

The calculations assume a gross annual return would be 5%, which is slightly lower than the average gross performance of EU UCITS funds over an investment horizon of 10 years in 2017-2021[386]. The actual return was somewhat higher (at 9%) for equity UCITS. Second, we assumed a hypothetical level of 1.6% annual costs for the commission-based model. This is in line with the average fee charged on equity UCITS, which was 1.57% annual ongoing charge plus 0.16% subscription and redemption fee in 2021 according to the ESMA report. To remain consistent with the quantification of aggregate benefits, which assumed that ongoing costs of commission-based investment products include a 25% surcharge to pay for inducements, i.e. ongoing costs in the fee-based model are 80% of those in the commission based model (i.e. 1.28%).

Simulations were carried out for two different types of fee-based models. The first model assumes that the investor does not need any advice, while the second assumes that the investor needs an hour of advice and is charged EUR 130. This amount was reported by industry stakeholders as representative. It is higher than the labour costs of 85 EUR that the Kantar study used as benchmark and much higher than the average hourly salary in the financial sector. Hence it includes contributions to the fixed costs and profit margin of the

[386] The average gross performance for equity, bonds and mixed UCITS for a 10-year investment horizon over the period 2017-2021 was 4.92%, calculated based on data in ESMA's 2023 Market Report on Costs and Performance of EU Retail Investment Products.

provider. In these two models, the investor is charged 1.28% in annual costs. The advice fees are paid upfront and are deducted from the investment amount of EUR 10,000. The impact of other entry and exit costs has not been considered in any of the models.

When applying an annual gross return of 5%, the fee-based model without advice immediately outperforms the commission-based model. The fee-based model with advice only does so after five years. In the longer term, however, the commission-based model is evidently lagging behind both of the fee-based models.

After 10 years, the commission-based model is outperformed:

- by EUR 438 (fee-based model without advice);
- by EUR 251 (fee-based model with an upfront advice fee).

These gaps become increasingly wider as time passes. After 25 years, the commission-based model is outperformed:

- by EUR 1,853 (fee-based model without advice);
- by EUR 1,529 (fee-based model with an upfront advice fee).

Year	Commission-based model (1.6% annual costs)	Fee-based model without advice (1.28% annual costs)	Fee-based model (1.28% annual costs, 130 EUR advice fee upfront)
	10000.00	10000.00	9870.00
1	10340.00	10372.00	10237.16
2	10691.56	10757.84	10617.99
3	11055.07	11158.03	11012.98
4	11430.95	11573.11	11422.66
5	11819.60	12003.63	11847.58
6	12221.46	12450.16	12288.31
7	12636.99	12913.31	12745.44
8	13066.65	13393.68	13219.57
9	13510.92	13891.93	13711.33
10	13970.29	14408.71	14221.40
11	14445.28	14944.71	14750.43
12	14936.42	15500.66	15299.15
13	15444.26	16077.28	15868.28
14	15969.36	16675.36	16458.58
15	16512.32	17295.68	17070.84
16	17073.74	17939.08	17705.87
17	17654.25	18606.41	18364.53
18	18254.49	19298.57	19047.69
19	18875.14	20016.48	19756.26

20	19516.90	20761.09	20491.20
21	20180.47	21533.40	21253.47
22	20866.61	22334.45	22044.10
23	21576.07	23165.29	22864.14
24	22309.66	24027.04	23714.68
25	**23068.19**	**24920.84**	**24596.87**

In the example above, the commission-based model is consistently outperformed by the fee-based models in the medium and long term. However, the example is focused on a single type of product, bearing relatively high costs. It is well possible that, if the commission-based model was no longer available consumers would (be advised to) switch to different types of products altogether. Exchange Traded Funds (ETFs) are a close substitute to actively managed UCITS.

ETFs are significantly cheaper than other investment products. Based on data for retail share classes provided by ESMA for the period 2011-2020, ETF ongoing costs were 4 to 6 times lower than ongoing costs for equity UCITS. The calculations below use the historical performance and costs of equity UCITS and equity ETFs of the last 10 years[387], demonstrating the return investors would have accomplished had they invested EUR 10,000 into either of these instruments 10 years ago. The return and cost numbers are those that ESMA reported. Considering the performance of these two categories of products, an investor with a EUR 10,000 investment in 2011 would have earned almost EUR 2,000 more by investing in ETFs after 10 years, compared to equity UCITS (one-off costs have not been taken into consideration in any of the scenarios). This is not because ETFs achieved consistently higher performance over the 10 years, but because of the large differences in costs. As ESMA has concluded in its 2023 Costs and performance report, *'Costs for active equity and bond UCITS were higher than for passive and UCITS exchange traded funds (ETF), leading to net underperformance of active funds compared to passive and UCITS ETFs'*.

	Equity UCITS			**Equity UCITS (no inducements)**			**ETF**		
Year	**Net investment amount (EUR)**	**Gross performance (%)**	**Ongoing costs (%)**	**Net investment amount (EUR)**	**Gross performance (%)**	**Ongoing costs (%)**	**Net investment amount (EUR)**	**Gross performance (%)**	**Ongoing costs (%)**
	10000.00			10000.00			10000.00		
2011	8893.33	-9.33	1.74	8928.07	-9.33	1.39	9067.95	-8.90	0.43
2012	10270.01	17.18	1.70	10340.54	17.18	1.36	10727.05	18.67	0.37
2013	11733.31	15.93	1.68	11848.73	15.93	1.35	12423.19	16.20	0.39
2014	13135.19	13.58	1.64	13303.15	13.58	1.31	13960.28	12.73	0.36

[387] Cost and performance figures from 2011-2020 used for this example were provided by ESMA. They are end-of-year values computed as weighted averages from a sample of retail share classes based on Refinitiv Lipper data.

2015	14310.81	10.57	1.62	14536.91	10.57	1.30	15179.74	9.07	0.34
2016	14946.92	6.02	1.57	15228.76	6.02	1.26	16356.42	8.04	0.29
2017	16513.46	12.01	1.53	16871.46	12.01	1.22	17912.11	9.78	0.27
2018	14882.31	-8.38	1.50	15255.61	-8.38	1.20	16505.45	-7.59	0.26
2019	18715.97	27.22	1.46	19230.00	27.22	1.17	21119.84	28.21	0.26
2020	19901.04	7.76	1.43	20502.47	7.76	1.14	21888.03	3.87	0.24

This simplified analysis comes with some limitations. In particular, performance and cost rates are specific to the time period and might look very different in the future. However, the lower costs provide a useful buffer for investors even when performance is lagging behind. More expensive, actively-managed products are from the start setting the bar higher for their managers, who need to achieve higher returns just to offset the higher costs.

Keeping in mind that equity UCITS share classes sold to retail investors often carry inducements, a further scenario shows the outcome of the investment if the costs of the equity UCITS would have been 25% lower (corresponding to an absence of inducements). This reduction in costs would have improved the investment outcome by around EUR 600 at the end of the investment period relative to an equity UCITS that carried inducements. The investment return would still be almost 1400 EUR below those of the corresponding equity ETF.

PART D – Market Structure Overview

1. Overview Markets in financial instruments

The Markets in Financial Instruments Directive[11] (MiFID) governs securities markets, the provision of investment services in the EU and the authorization of investment firms.

Investment firms

Investment firms are authorized entities that perform various services for investors in financial instruments. These firms operate in a diverse universe in which there are differences in terms of size, business model and complexity. The EU market for investment firms is large with 5,494 registered investment firms, some of them being banks. The chart below provides an overview of the number investment firms in the EU per Member State.

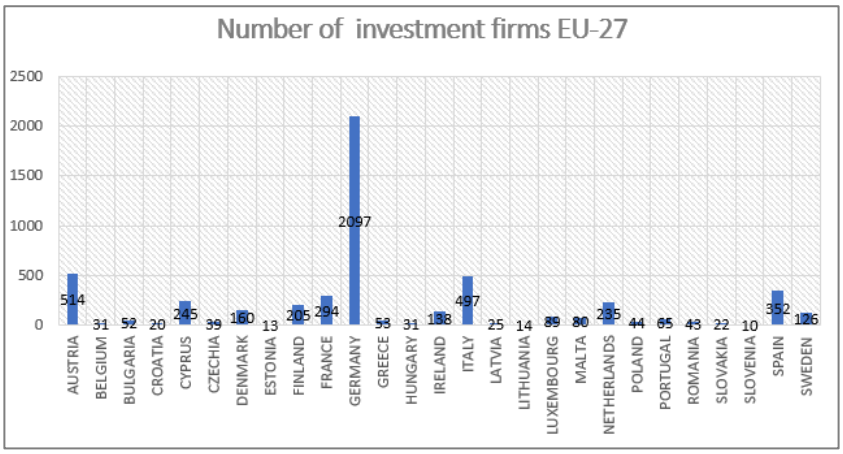


Figure 7.10 Source: ESMA Registers – list auf authorised investment firms

In terms of geographical distribution, the market is asymmetric, with most investment firms concentrated in only a few countries. While over 2,000 firms are registered in Germany, Austria is the second largest host with 514 investment firms, followed by Italy, Spain and France, where 497, 352 and 294 companies are domiciled respectively. The smallest number of authorized investment firms is in Slovenia, Estonia, and Lithuania which count altogether 37 registered companies.

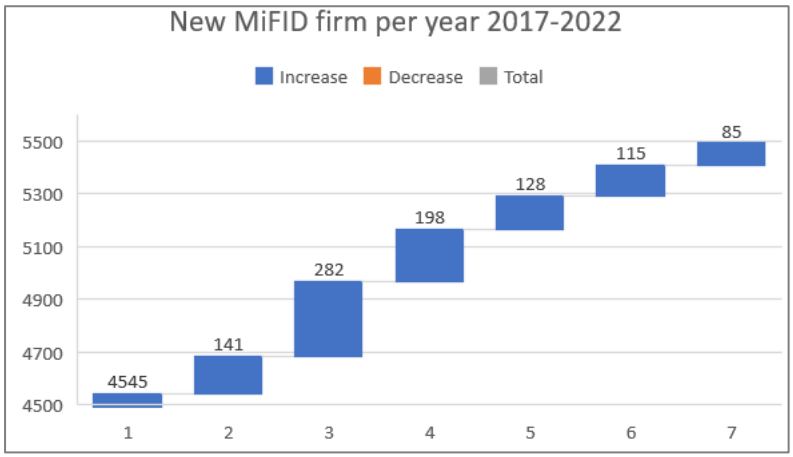


Figure 7.11 Source: ESMA Registers – list auf authorised investment firms

The number of authorized investment firms grew on average by 170 companies per year (Figure 7.11). The highest number of registrations occurred in 2018 and 2019, when 282 and 198 companies respectively applied for a MiFID license.

Investments in MiFID products

MiFID II covers investment services relating to many asset classes, ranging from stocks and bonds to investment funds and derivatives. The chart below shows the size of the MiFID market in the EU 27 by country, including its evolution between 2017-2021.[388] In

[388] X-axis: 1 = year 2016, 7 = year 2021

2021, investments in MiFID products were valued at EUR 54.453 billion in the EU. This number increased by 10% against the previous year, in line with the positive trends in 2020 and 2019 when the stock grew 4% and 12% respectively.

At national level, the largest market by some way is Italy, where EUR 14,734 billion in assets are held. Compared to the rest of the EU, the Italian market accounts for 27% of all MiFID assets. The other major markets are Germany, France, Spain and Sweden, which account for approximately 50% of the EU market. The value of MiFID assets in those countries comprised respectively EUR 9,772 billion EUR 6,539 billion, EUR 6,505 billion and EUR 5,486 billion. The smallest markets in terms of absolute holdings in MiFID assets are Cyprus (EUR 30 billion) and the Malta (EUR 28 billion)[389].

	Financial assets: MiFID products (total economy)				
	2021	**2020**	**2019**	**2018**	**2017**
EU - 27	*54.452.803*	*49.264.054*	*47.245.598*	*41.981.968*	*42.397.940*
IT	14.734.409	13.436.341	12.330.496	10.808.504	10.628.464
DE	9.772.021	8.730.257	8.716.851	8.107.777	8.407.123
FR	6.539.223	6.343.626	6.439.875	5.820.112	5.991.771
ES	6.505.778	5.327.009	4.972.817	3.999.807	3.930.405
SE	5.486.992	5.043.030	4.860.483	4.414.723	4.491.499
BE	2.473.563	2.267.220	2.166.443	1.961.724	1.968.126
DK	1.529.268	1.403.296	1.369.534	1.208.871	1.323.225
NL	1.657.308	1.511.078	1.484.561	1.366.437	1.312.058
AT	1.259.408	1.089.942	1.012.199	877.726	945.246
FI	1.003.122	926.434	832.292	688.163	674.933
PL	605.417	552.068	550.534	498.111	459.431
PT	612.220	549.219	540.101	510.407	553.957
CY	352.826	381.083	422.890	391.861	398.053
EL	287.391	257.395	194.793	136.572	193.957
HU	187.554	173.381	166.983	158.646	153.054
IE	233.937	223.164	218.851	196.324	198.692
BG	189.323	169.139	147.418	128.237	115.767
RO	215.438	165.152	152.511	139.216	129.411
LU	86.551	79.466	80.130	71.149	67.540
EE	181.604	150.063	143.346	134.652	134.333
LT	211.175	182.538	158.768	129.932	128.952
SI	62.306	53.924	47.341	41.377	36.152
SK	31.548	28.253	24.854	22.931	20.175
HR	34.666	32.033	30.141	27.051	26.721
LV	32.176	27.537	21.969	18.561	17.378
CY	29.845	24.997	21.178	19.845	20.774
MT	27.582	26.256	28.089	23.687	21.360

Source: Eurostat, Financial balance sheets – total economy, MiFID assets defined as F3, F5 and F7

Retail investors

Investments in MiFID products by EU households comprised EUR 11,728 billion in 2021. The value expanded steadily during in recent years (EUR 8,719bn in 2018, EUR 9,719bn in 2019, EUR 10,201bn in 2020). The share of retail investors in MiFID assets compared to professional MiFID investors is 21.5%.

As regards the size of domestic markets, the retail sector is equally concentrated, however, the top three markets in Italy, Germany and France are more closely aligned. While Italian retail investors own EUR 2,233bn in MiFID assets, the German market is second largest with EUR 2,011bn. Retail clients in France on the other hand own EUR 1,922bn in MiFID assets.

[389] Data sourced from Eurostat – financial balance sheets.

While these markets are large in absolute terms, they are small in comparison to the domestic market of all MiFID assets. Analysing the level of retail participation[13], the highest retail participation rates are observed in Slovakia, Hungary and Luxembourg. In those countries, the share of households MiFID assets / total economy MiFID assets amounts to 73%, 63% and 53% of MiFID investment are held by the retail sector.

Asset classes

Stocks and shares in investment funds represent the largest asset class among MiFID investors, with a value of EUR 36,656bn or 67% of all investments. Debt securities comprised EUR 15,348bn (26%), whereas financial derivatives, including stock options totalled EUR 2,449bn (5%). The preference for equity and investment funds is even more pronounced for retail investors. This asset classed comprised EUR 11,219bn, or 96% of all retail investments.

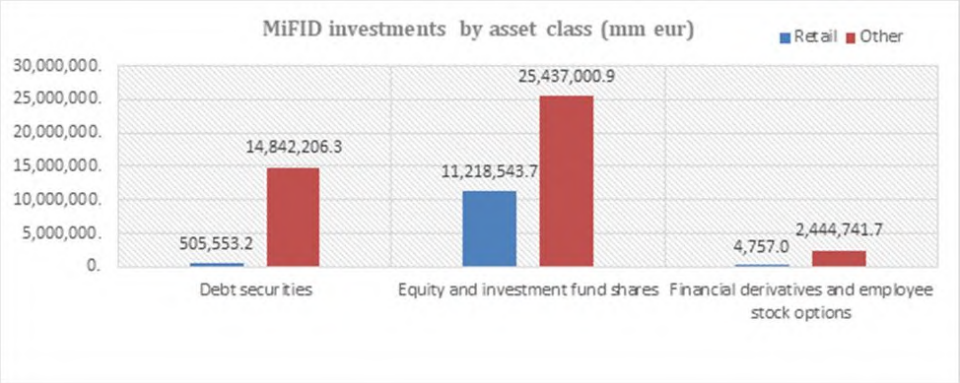


Figure 7.12 – Eurostat data

Figure 7.13 gives a more detailed view on EU retail investors' MiFID holdings and different asset classes, including a country-by-country overview. For the EU as a whole, shares or units in investment funds and unlisted shares represent the two largest asset classes and are of comparable size - EUR 3,357bn and EUR 3,248bn, respectively (> 50%). Other forms of equity are valued at EUR 2,871bn and unlisted shares also take a substantial share (EUR 1,742bn). Long-term debt holdings are comparably low (EUR 479bn), whereas the position of financial derivatives are negligible. The distribution of these asset classes differs considerably across national markets.

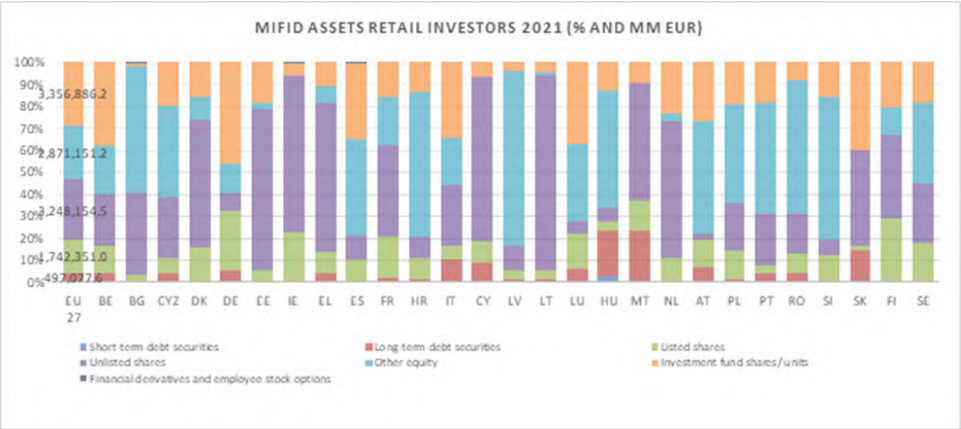


Figure 7.13 - Eurostat data

Comparison of EU retail investors at global level

As described above, the product offering to retail clients in the EU can be broken down in different categories, of which open-ended regulated funds form the largest product group sold to retail clients. The EU is the second largest market globally in terms of open-ended regulated funds, following the United States (US), with, respectively, 30% and 48% of global net assets. At the end of 2021, the EU UCITS segment remained the largest fund investment sector in the EU, with more than EUR 12tn. of which EUR 6tn held by retail investors. At the end of 2021, US households held 88% of the total net assets of US mutual funds. In the EU, this share remains at 60%.

EU UCITS and ETF market

The EU UCITS market is highly concentrated: 90% of retail investment assets were managed by 15% of managers. More than 90% of retail investment centres on equity, bond and mixed assets. The distribution of retail investment across these assets is heterogeneous in the EU. For example, in 2021, the share of investment mainly focusing on equity was 10% in Italy, while it was around 65% in the Netherlands and Sweden.

The EU UCITS ETF segment grew to EUR 1.2tn in 4Q21 from 908bn in 4Q20, or 13% of the total EU UCITS market. At the end of 2021, net annual inflows in equity ETFs were equal to EUR 92bn and to EUR 26bn in the case of ETFs mainly focused on bonds.

Passive equity and bond UCITS non-ETFs accounted for, respectively, EUR 637bn and EUR 198bn, in ESMA's sample, this also includes institutional clients.

Structured retail products

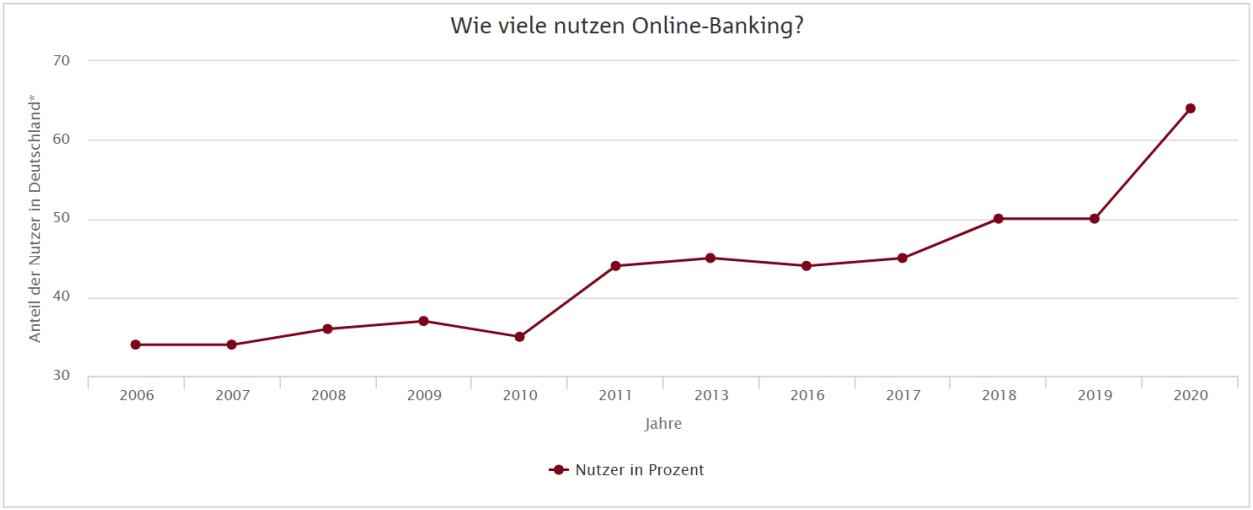
The total outstanding volume of SRPs held by EU retail investors at the end of 2021 was a little over EUR 300bn, making up around 2% of the financial net worth of EU households in 2021.

There has been a continually declining trend in the total value of outstanding SRPs. Recently, the total number of outstanding products has seen a major increase, reaching

over 11million at the end of 2021, up from around 9 million the previous year. Across Member States, considerable heterogeneity in terms of distribution channels, types of products issued and the size of the market persisted. Sales volumes in 2021 were highest in France, followed by Germany and Italy.

Digital distribution

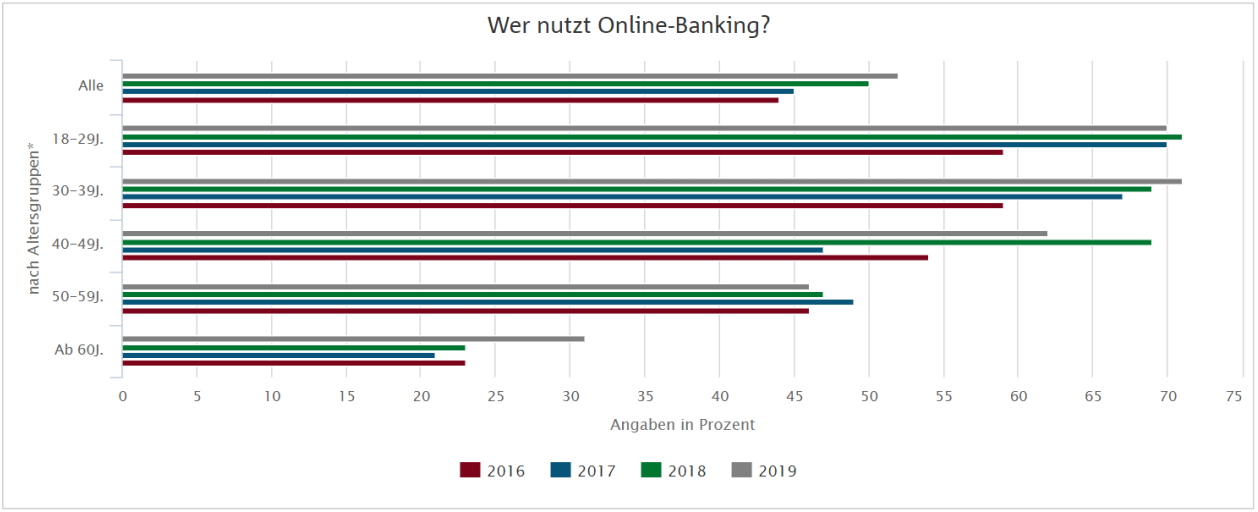
Digitalisation has changed the way financial products and services are accessed by retail clients. There is a strong trend of increased usage of online banking services across all age groups, which was boosted even more by the outbreak of the COVID 19 pandemic. Financial service providers adjusted their business to be able to automate historically personalized interactions with clients and/or introduced software update to enable online and hybrid meeting structures. The below charts illustrate in the case of Germany bank clients how the total usage of online banking has increased (first chart) and for all age groups (second chart, x-axis) although chart two was surveyed prior to outbreak of the COVID 19 pandemic[390].



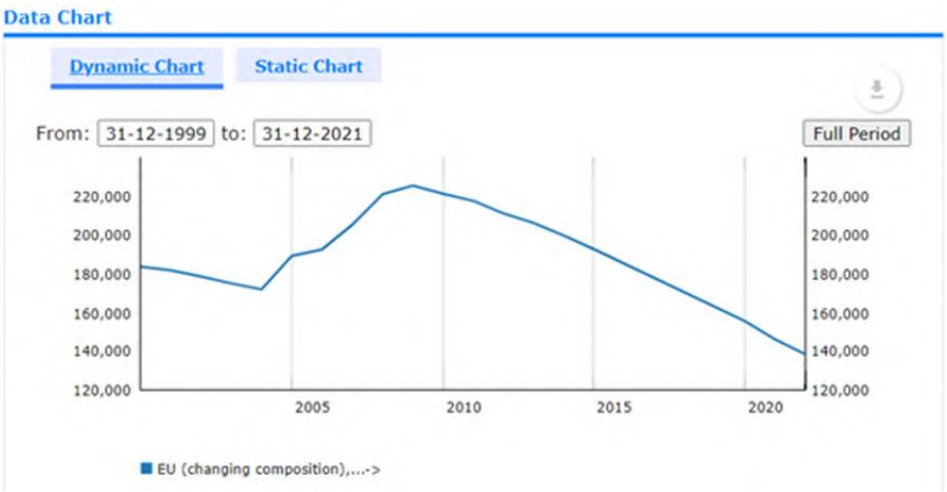
Zur Auswahl einzelner Datenreihen bitte in der Legende klicken.

Quelle: Bankenverband / KANTAR, 2020

[390] BVI, Kantar



This development goes in hand in hand with the decline of physical branches as the below ECB chart shows. The number of physical bank branches in the EU has decreased from about 220,000 in 2008 down to 140,000 in 2022[391]. As banks and other financial intermediaries move more services online, online solutions, such as robo–advice or online portfolio management and the scalability of these services are likely to influences the profitability of the sector going forward compared to traditional face to face advice.



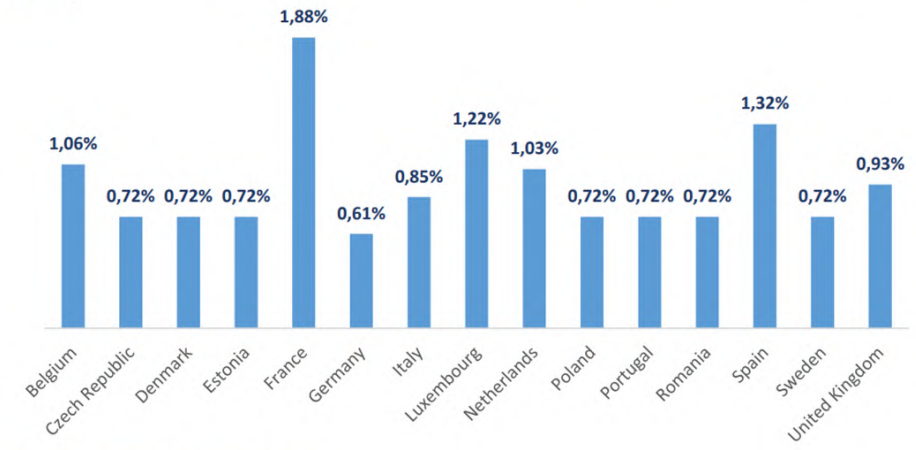
Robo/automated advice

Robo advisors are on-demand technology solutions based on complex algorithms leveraging client data, that provide customised financial plans and asset management. Usually, they cover all parts of the client experience, from onboarding and investor risk profiling to investment allocation. Hybrid and fully automated models can be present, as well as different types of services such as discretionary and advisory-based investment management. There are different levels of automation and complexity of the advice that can be provided by robo-advisors, ranging from questionnaire-based product and portfolio proposals to fully automated investments based on self-improving algorithms.

Across Europe, robo-advisory services have a differing level of uptake by consumers and different offerings. Based on assets under management, the market appears most developed in Germany.

In relation to fees, robo-advisory services usually include an annual portfolio management fee and a fee based on underlying investment funds. Annual management fees vary across countries, as demonstrated in the following graph, which shows the situation in 2017:

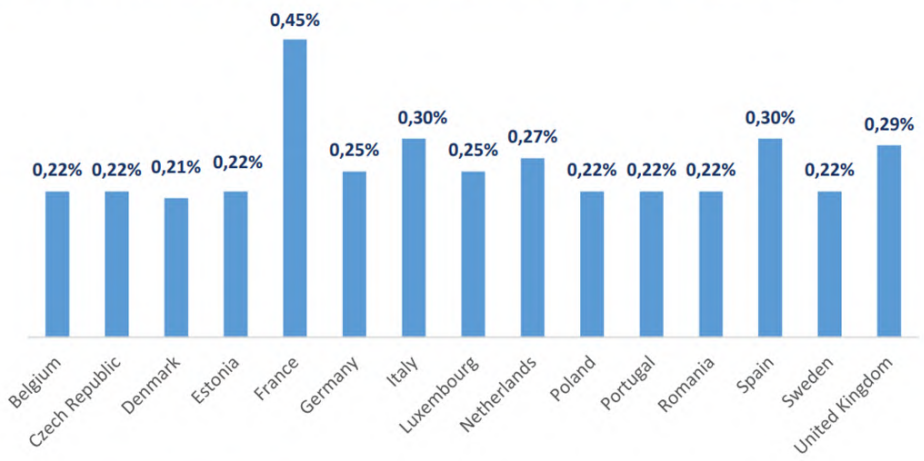
Graph 42: Average management costs of robo-advisors (in %, per Member State)



Source: Deloitte analysis (2017)

Variations of fees charged on the basis of the underlying ETFs or other funds can also be observed across Europe:

Graph 43: Average ETF costs of robo-advisors (in %, per country)



Source: Deloitte analysis (2017)

It can be expected that robo advice or semi-automated portfolio management will continue to increase. Such automated services still only represent a minor portion of total investment services but is increasing and is likely to replace at least partially the traditional physical advice.

As described in the section on the experience with the inducement ban in the Netherlands (7.A), portfolio management through robo-advice/ semi-automated portfolio management is a cost efficient alternative to advice and has strongly increased in the Netherlands and has compensated for the decrease in advice. It will support retail clients and thus retail participation in the case of further reductions in the number of physical branches. In the case of the Netherlands, the decline in advised services should be seen in the context of the increase of (online) portfolio management services through robo-advice.

D.2 Overview Market for IBIPs

Summary overview of markets

IBIPs are exclusively a retail product. They consist of an insurance wrapper with underlying investment assets usually in funds and may also have biometric risk coverage (unit linked, profit participation or hybrid). Sales of IBIPs vary greatly across member states and represent a large portion of retail investments in FR, IT, ES and PT.

In terms of market size, there is no IBIP-specific data, but a relevant proxy is life insurance data. In 2020, the life insurance Gross Written Premium (GWP) was 670.6 bn €, of which 206.1 bn € represent unit-linked type of IBIPs (the rest is profit participation and hybrid products). Within the total financial assets of EU households, insurance and pension products represent around 35%.

Distribution structures also varies greatly among member states. The channels are direct distribution by insurers, banks as intermediaries, brokers and tied agents.

There are about 815000 licensed insurance intermediaries in the Union. Of these about 467,000 are physical one-person businesses, meaning that the split between one-person businesses and legal persons (of varying size) is 80%/20%. There is a significant continuous trend towards consolidation (in 2016 there were about 1 million intermediaries in total 670,000 one-person intermediaries), partially due to ageing structures.

At Union level, credit institutions constitute the largest channel and distribute about 44%, other insurance intermediaries 44% and insurers themselves through direct distribution 16%. As noted, the relative importance of distribution channels vary greatly across the Union but one can distinguish between three categories: Member States with an important "bancassurance model" (i.e. France, Italy, Spain and Portugal) where credit institutions are the major distribution category, Member States with main distribution by intermediaries or tied agents other than banks (e.g. Germany, Poland, Bulgaria, Greece) and a few countries where direct distribution by insurers is the largest or available channel (Estonia, Hungary).

There is no data available on digital direct sales of IBIPs specifically, but the proportion of online sales for insurance products generally in terms of total volume of GWP is still relatively low in many Member States, ranging mostly from 0.2% to 2%. At the same time, in Denmark and Estonia, it is estimated that online sales account for 80% of the total volume of GWP and the proportion of online sales in LV is relatively high as well (70% for life insurance).

Facts and Figures IBIPs EU

This Section sets out the following data and information

- Number of registered insurance intermediaries- Decreasing number of intermediaries registered as natural persons

- Market developments with regard to specific IBIPs

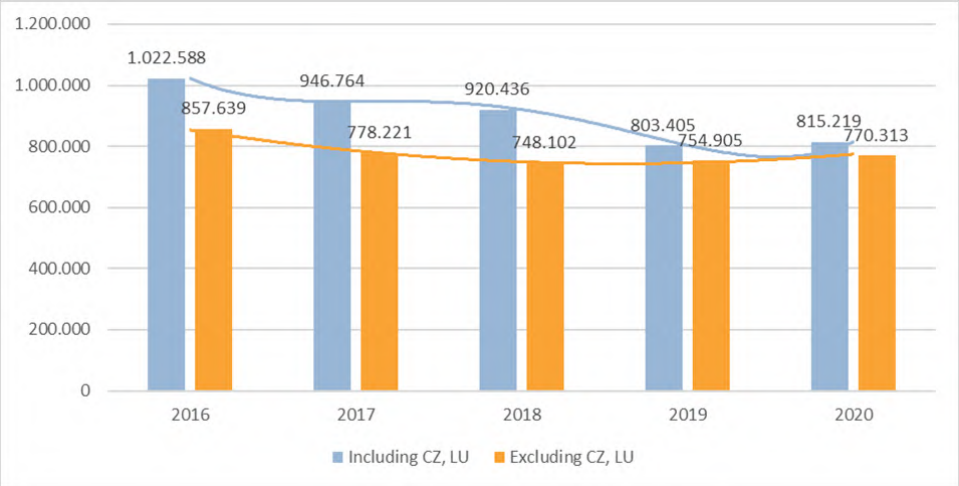
- Costs and charges for the distribution of IBIPs, in particular commission rates

- Growth in the market for online distribution of IBIPs

Number of registered insurance intermediaries

Based on data from 25 NCAs[392] there were 815,219 registered insurance intermediaries[393] in those markets at the end of 2020. In terms of the level of change in the number of registered intermediaries, the blue trend line of Figure 7.14 below shows that the total number of registered insurance intermediaries decreased significantly from 2016 to 2020, a trend which has been going on for several years[394].

Figure 7.14: Total number of registered insurance intermediaries over the period 2016-2020



In order to have a better comparison across Member States of the data over the period from 2016-2020, the amber columns of the figure exclude the number of CZ and LU insurance intermediaries. As illustrated in the chart, there was a significant decrease in the number of registered insurance intermediaries from 2016 to 2018, followed by an increase since 2018[395].

Decreasing number of intermediaries registered as natural persons

24 NCAs[396] provided information on the number of registered insurance intermediaries split between natural persons and legal persons for 2016 and 2020. **Figure 7.15 below shows that, in 2020, insurance intermediaries registered as natural person**

[392] GR, HU, IE and NL have provided information on the number of insurance intermediaries for 2019 and 2020 only. LT has provided only limited information for 2016-201

[393] This includes registered ancillary insurance intermediaries and excludes ancillary insurance intermediaries exempt from the IDD

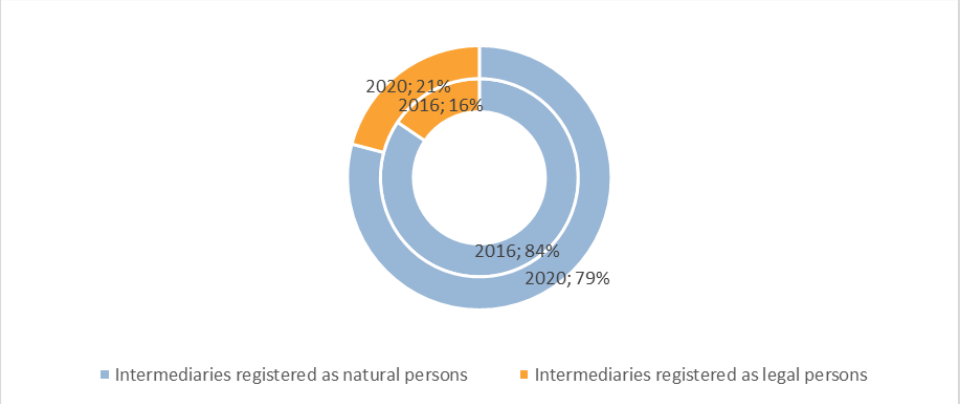
[394] See EIOPA's report on the Structure of Insurance Intermediaries Markets in Europe: https://www.eiopa.europa.eu/media/news/eiopa-evaluates-european-insurance-intermediaries-markets_en. It is important to note that, following the deletion of inactive insurance intermediaries from the national registers, the number of registered insurance intermediaries in CZ decreased sharply from 162,791 to 38,481 in 2018/2019 and in LU from 10,019 to 6,905 in 2019/2020. This has had a significant impact on the overall decrease in the number of insurance intermediaries. It is important that NCAs regularly identify and delete inactive intermediaries from their registers in order to have a correct overview of the number of intermediaries included in their registers

[395] This can be explained by an increase in the number of insurance intermediaries registered in RO from 40,402 to 69,932 over the period from 2018 to 2020

[396] AT, BE, BG, CY, CZ, DK, ES, FI, FR, HR, IS, IT, LI, LT, LU, LV, MT, NO, PL, PT, RO, SE, SI, SK

represented 79% of the total number of insurance intermediaries, hence small intermediaries represent the majority of market participants. However, it should be noted that the number of intermediaries registered as natural persons decreased from 669,670 (2016) to 466,942 (2020). Over the same period, the number of intermediaries registered as legal persons increased from 123,007 (2016) to 123,278 (2020).

Figure 7.15: Intermediaries registered as natural and legal persons in 2016 and 2020



Bancassurers remain dominant in the life sector

For the purpose of developing its IDD application report[397], EIOPA gathered information from NCAs and some industry bodies on the total volume of gross written premiums (GWP) by the following distribution channels, split in life and non-life:

1. Direct business
2. Credit institutions acting as insurance intermediaries
3. Insurance intermediaries other than credit institutions

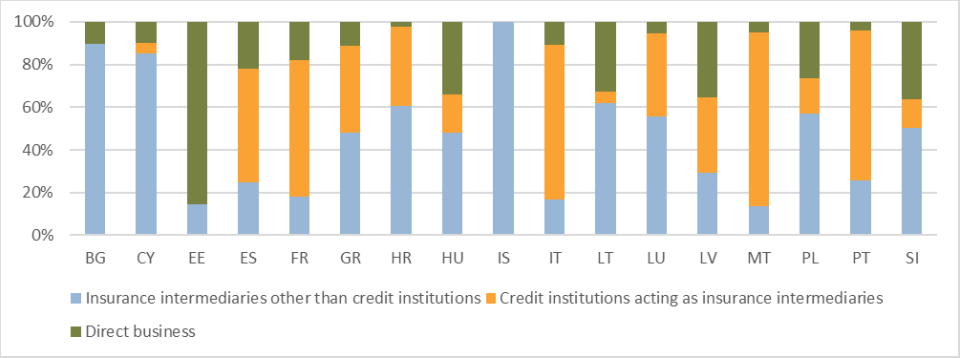
15 NCAs were able to provide data on the total volume of GWP (split in life and non-life) by the three distribution channels indicated above for 2020[398].

Based on the data provided by those 15 NCAs and some industry bodies, Figure 7.16 below indicates that credit institutions acting as insurance intermediaries played a significant role in the distribution of life insurance products in terms of GWP generated (in particular, in ES, FR, GR, HR, IT, LU, LV, MT, PT) during 2020.

Figure 7.16: GWP per distribution channel, Life (2019/2020)

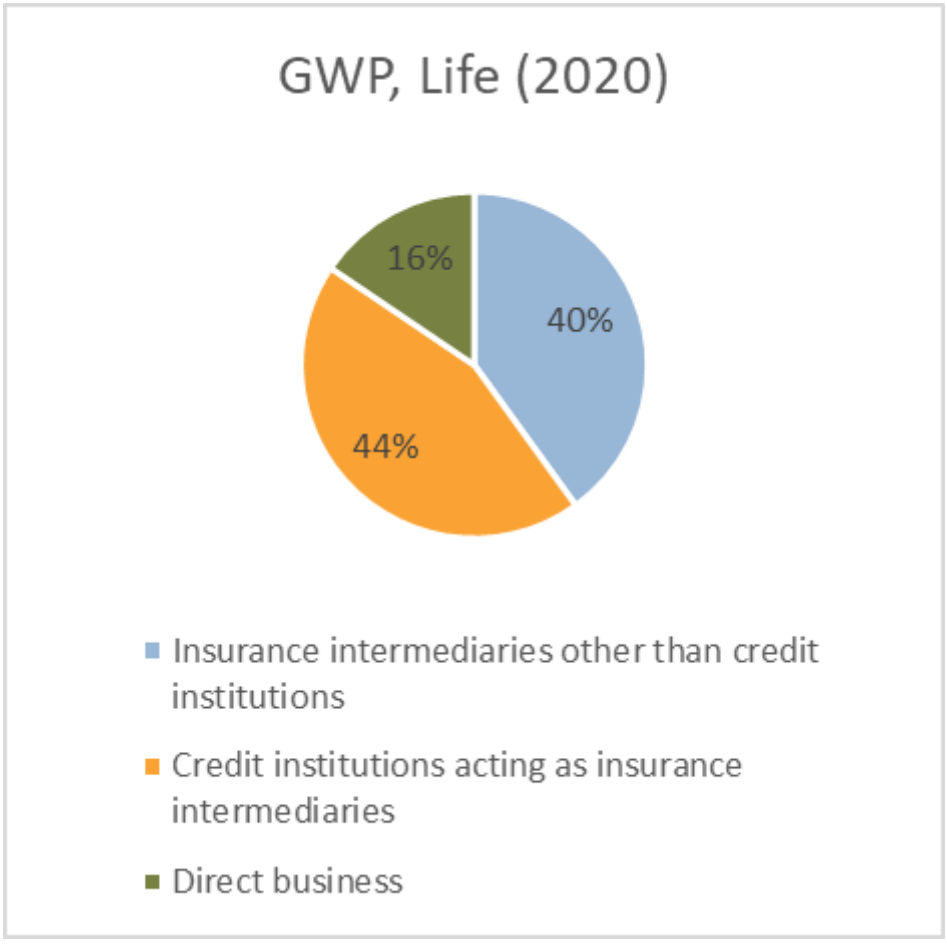
[397] https://www.eiopa.europa.eu/media/news/eiopa-publishes-report-application-of-insurance-distribution-directive_en

[398] 15 NCAs indicated that, for 2020, they are not able to provide data on the GWP by intermediaries other than credit institutions (AT, BE, DE, DK, FI, FR, IE, NL, NO, RO, SE, SK), credit institutions acting as insurance intermediaries (AT, BE, DE, DK, FI, FR, IE, MT, NL, PT, SE) or direct business (AT, BE, DE, DK, FI, FR, IE, LI, NL, RO, SE), split by life and non-life (CZ).



With regard to life insurance, Figure 7.17 below indicates that credit institutions acting as insurance intermediaries generate almost half of the premiums in the area of life insurance in 2020. Direct business accounts for approximately one fifth of the premiums for life insurance.

Figure 7.17: Split of GWP for distribution of life insurance in 2020

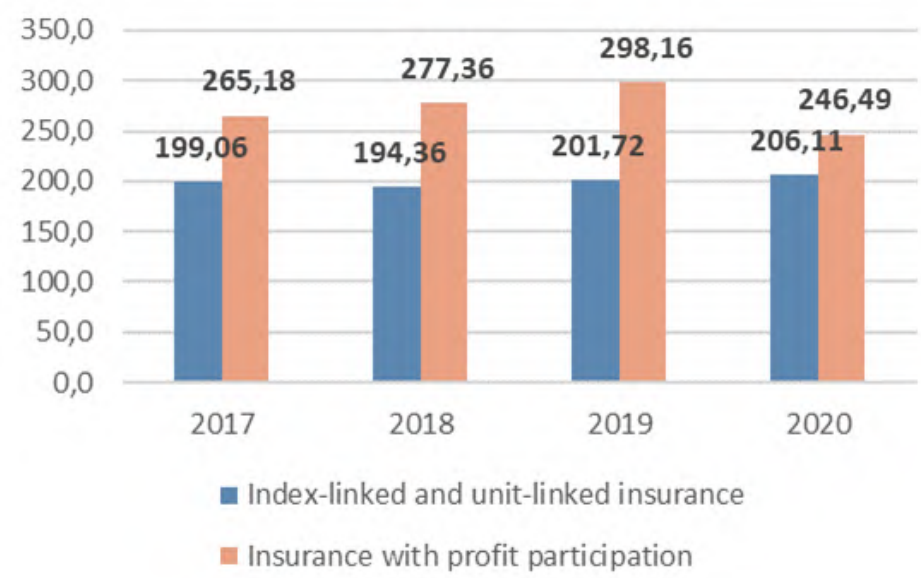


Market developments with regard to specific IBIPs

The shift from insurance with profit participation towards unit-linked life insurance is more and more evidenced throughout the years. In 2017, the GWP reported on profit participation business was around 265 € bn, whereas it was around 247 € bn by the end of 2020. Even though, the GWP related to unit-linked business is around 206 € bn at the end of 2020, the continuous increase is remarkable, especially looking at the starting point in 2017, around 199 € bn (see Figure 7.18 below).

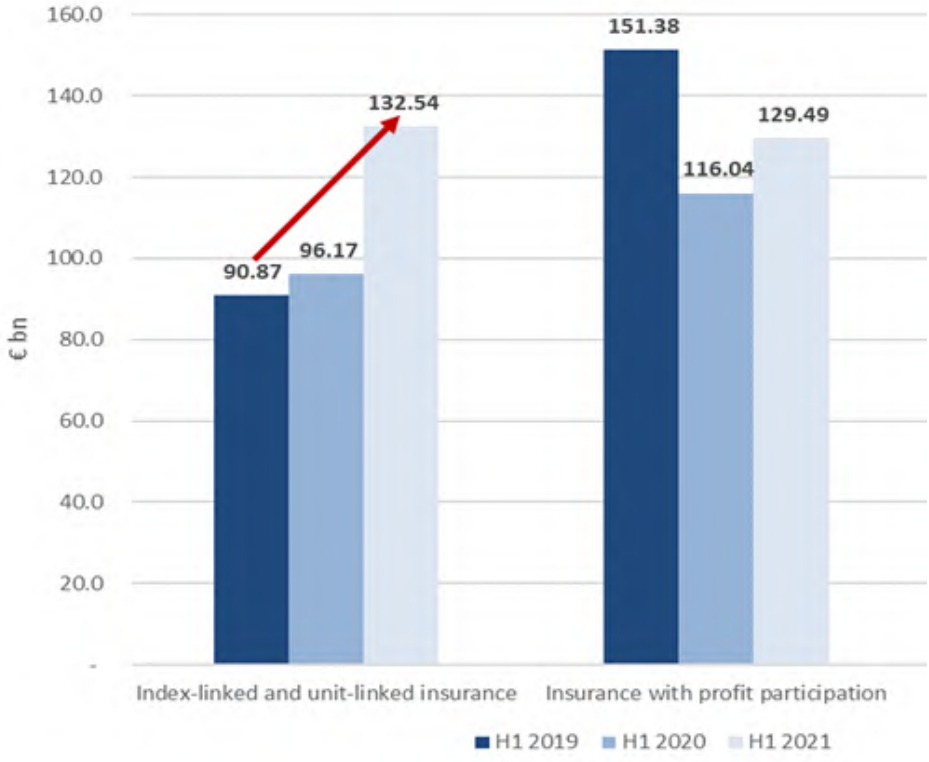
This picture is enhanced when looking at the reported figures throughout the crisis triggered by the COVID-19 outbreak, highlighting the prominence of the unit-linked business at EEA level. The analysis of 2021 quarterly data also reinforces the aforementioned trends as unit-linked GWP registered in H1 2021 a 37.8% growth, being 45.9% higher than pre-crisis level. With profit-participation GWP also recovered by 11.6% in H1 2021, but the aggregated level is 14.5% lower than the pre-crisis point (see Figure 7.19 below).

Figure 7.18 – Annual GWP (€ bn) for unit-linked and profit-participation Lines of Business, 2017-2020



Source: EIOPA Solvency II database

Figure 7.19 - Quarterly GWP (€ bn) for unit-linked and profit-participation, Q1 2019 - Q2 2021

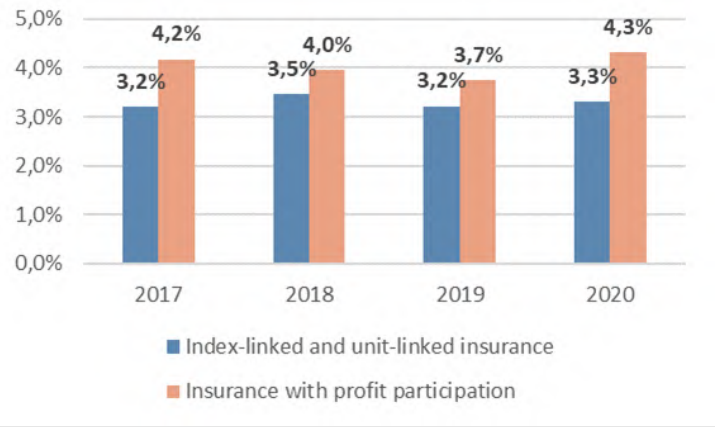


Source: EIOPA Solvency II database

Costs and charges for the distribution of IBIPs, in particular commission rates

At EEA level, commission rates exhibit a stable behaviour, being slightly higher for profit-participation products (see Figure 7.20 below). Nevertheless, differences in practices, remuneration schemes and regulatory terms impact the different level of commission rates across member states. Based on Solvency II data, it is not possible to take into account distribution channels, therefore the aggregate figures must be interpreted with caution.

Figure 7.20 - Commission Rate for UL and PP products, EEA, 2017-2020



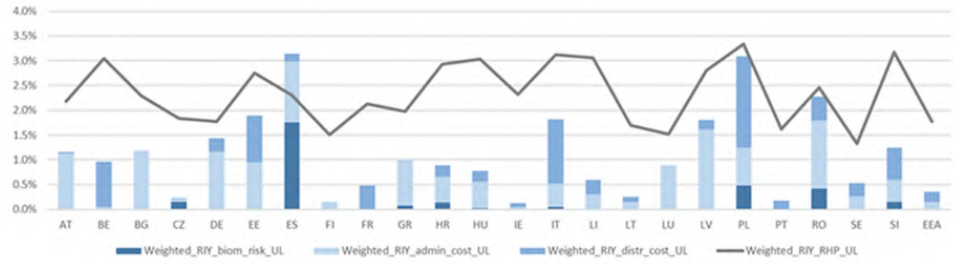
Source: EIOPA Solvency II database

In terms of costs composition, administrative costs continue being the most predominant driver of costs, often representing more than half of the total costs paid by consumers, followed by distribution costs (see Figures 7.21 and 7.22 below). Distribution costs are continuously pointed as a problem across the industry, accounting for, in RIY terms, 0.3% of total unit-linked costs, and 0.5% of total profit participation products. Distribution costs have, on average, an impact between 10% and 30% of the total costs, in both unit-linked and profit-participation products (see Figure 7.23 below). Even though it does not seem to be a recurring practice, some undertakings might also not include these costs in the total costs reported, or disclose these costs jointly with administrative costs due to the lack of requirement to disclose such costs separately. This might be in particular the case of the data collected from Austria, Bulgaria, Greece and Luxembourg. Jurisdictions where intermediaries also provide either financial products services or other goods/services different from insurance/financial products tend to exhibit higher distribution costs[399], in terms of RIY.

Additionally, the reduction in the number of registered intermediaries might have triggered further broker mergers and acquisitions and higher levels of concentration among the largest intermediaries, driving distribution costs higher. Interestingly, LV exhibits some of the lowest distribution costs, and simultaneously reported one of the strongest significance of online sales (around 15% for life insurance), reinforcing the hypothesis that technology will potentially decrease those costs across the industry. As a matter of fact, online insurance aggregators and direct channels are reporting greater volumes, especially following the COVID-19 crisis.

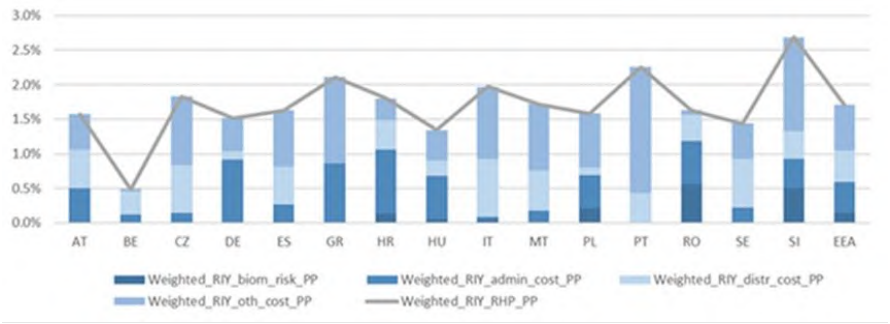
Figure 7.21 - Breakdown of total costs for unit-linked products, across Member States, 2019

[399] See Figure 1.3 of the EIOPA Report on the application of the IDD on page 20 as an illustration of this



Source: EIOPA Cost and Past Performance Survey

Figure 7.22 - Breakdown of total costs for profit-participation products, across Member States, 2019



Source: EIOPA Cost and Past Performance Survey

Figure 7.23 - Proportion of the different costs driver on the total costs for unit-linked products (left) and for profit-participation products (right)

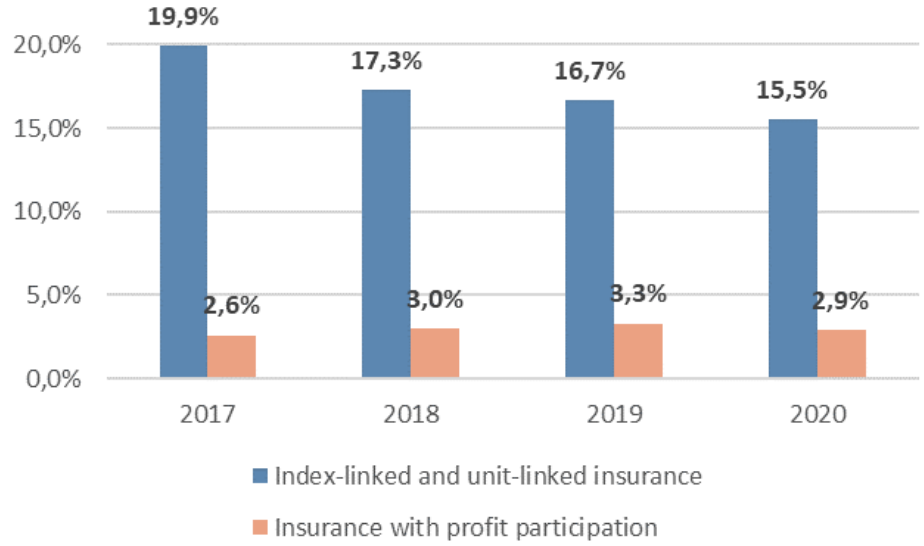


Source: EIOPA Cost and Past Performance Survey

Despite observing a shrinkage in the overall cross-border activity, measured in terms of GWP written under FOS/FOE, the number of registered intermediaries' cross-borders has been steadily increasing (see Figure 7.24 below). Cross-border activity seems to be more significant across the unit-linked market, where the proportion of premiums written abroad ranges from 20% to 15%.

Stricter supervisory actions related to unit-linked products might have impacted the cross-border expansion in the recent years. Nevertheless, the number of insurance intermediaries conducting cross border business has been increasing. Therefore, despite an expansion in the distribution network, the actual amount of business being written on a cross-border basis has decreased, particularly when it comes to unit-linked products.

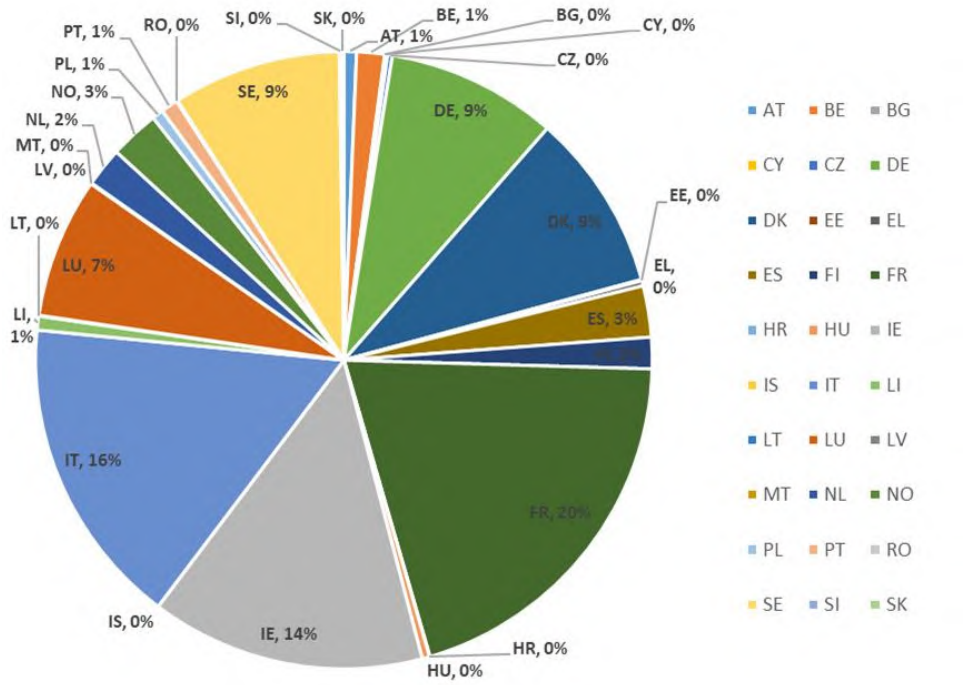
Figure 7.24 - Proportion of GWP under FOS/FOE over total GWP, EEA, 2017-2020



Source: EIOPA Solvency II database

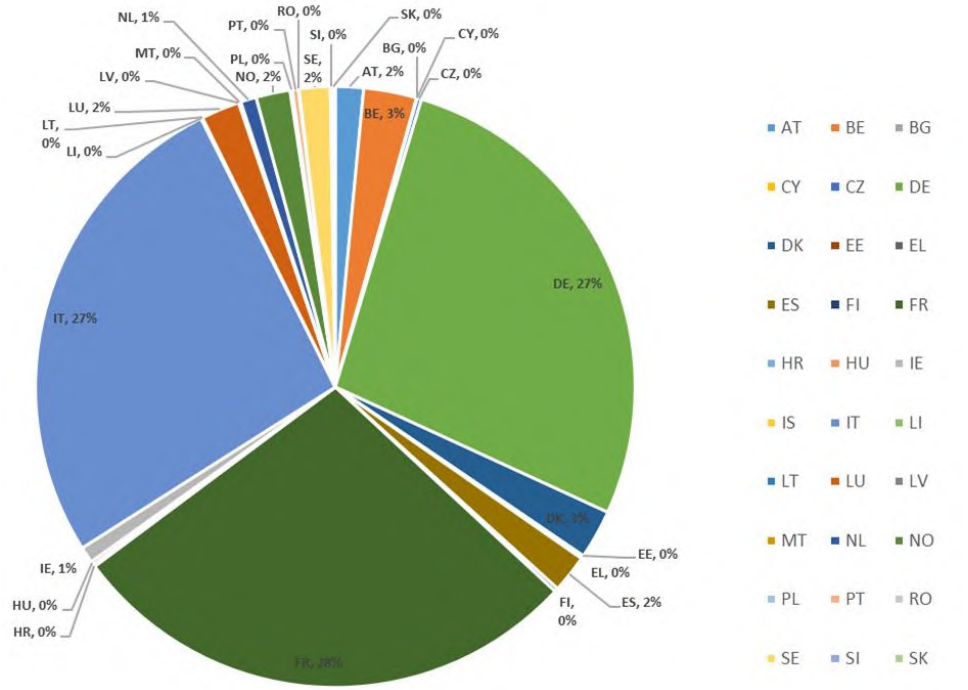
Despite the different size of each line of business and structural heterogeneity across countries (Figure 7.25), the trend of a shift from insurance with profit participation towards unit-linked life insurance is verified across 21 Member States. For some of them, namely BE, EE, FR, HU and LV, the decrease in the overall significance of profit participation decrease by over 5%. In an extreme case, PT observed a decrease of 21% in the weight of the profit participation GWP compared to the total life GWP (Figure 7.27).

Figure 7.25 - % GWP UL LoB across Member States, 2020



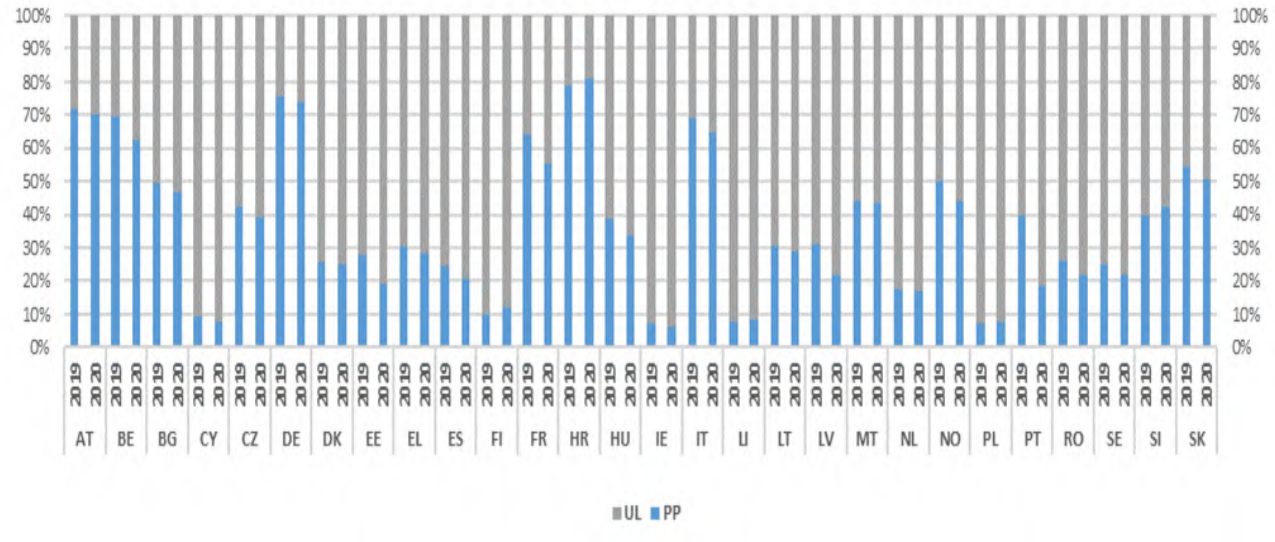
Source: EIOPA Solvency II database

Figure 7.26 - % GWP PP LoB across Member States, 2020



Source: EIOPA Solvency II database

Figure 7.27 - GWP distribution between UL and PP lines of business per Member State, 2019-2020

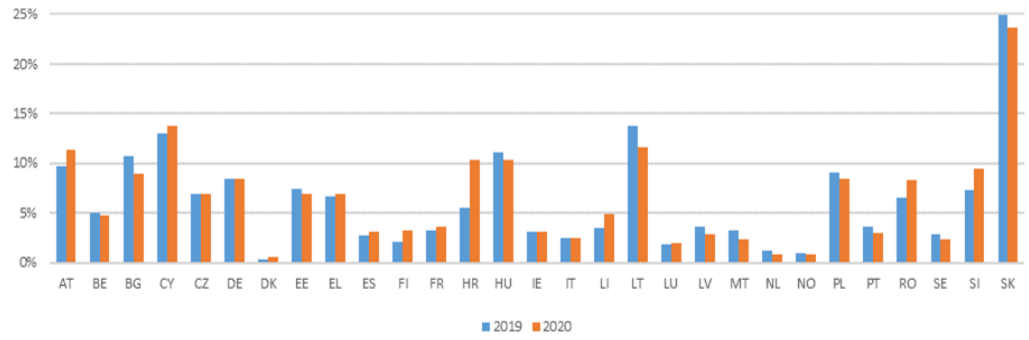


Source: EIOPA Solvency II database

Costs and charges for the distribution of IBIPs, in particular commission rates

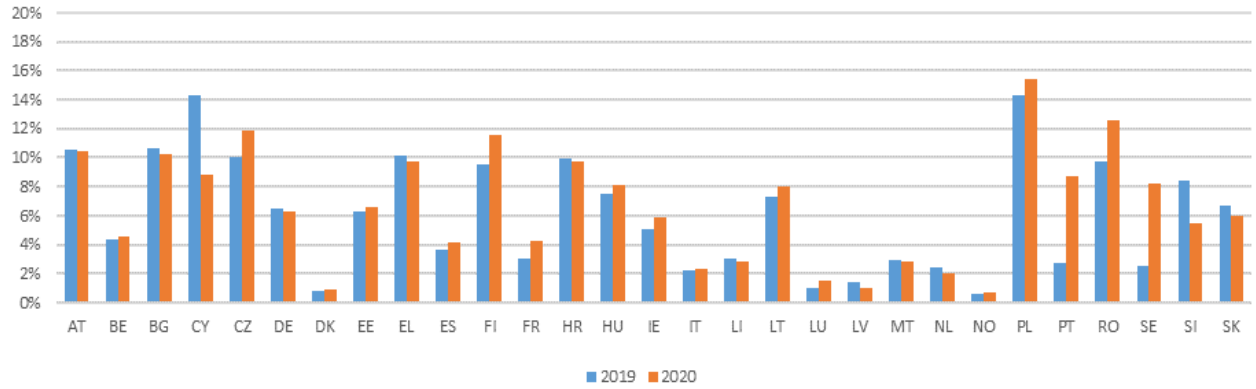
Considering the overall distribution strategies reported by each country (Figures 1.2, 1.3, 1.4 from EIOPA's IDD application report), it seems that markets where the majority of insurance intermediaries acted on behalf of one or more insurance undertakings, also tend to charge higher commission rates, especially for UL products (Figure 15).

Figure 7.28 - Commission Rates for UL products, by Member State, 2019-2020



Source: Solvency II database

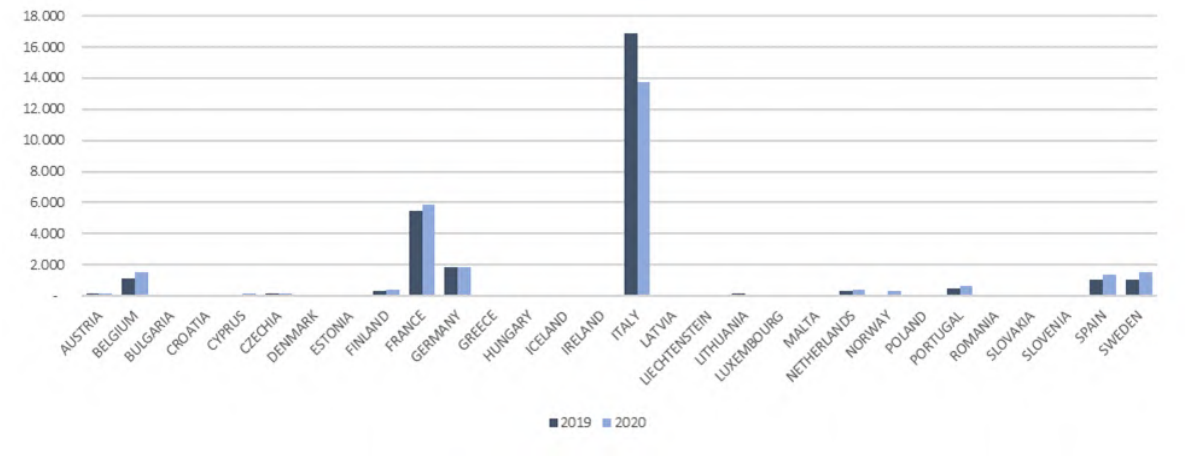
Figure 7.29 - Commission Rates for PP products, by Member State, 2019-2020



Source: EIOPA Solvency II database

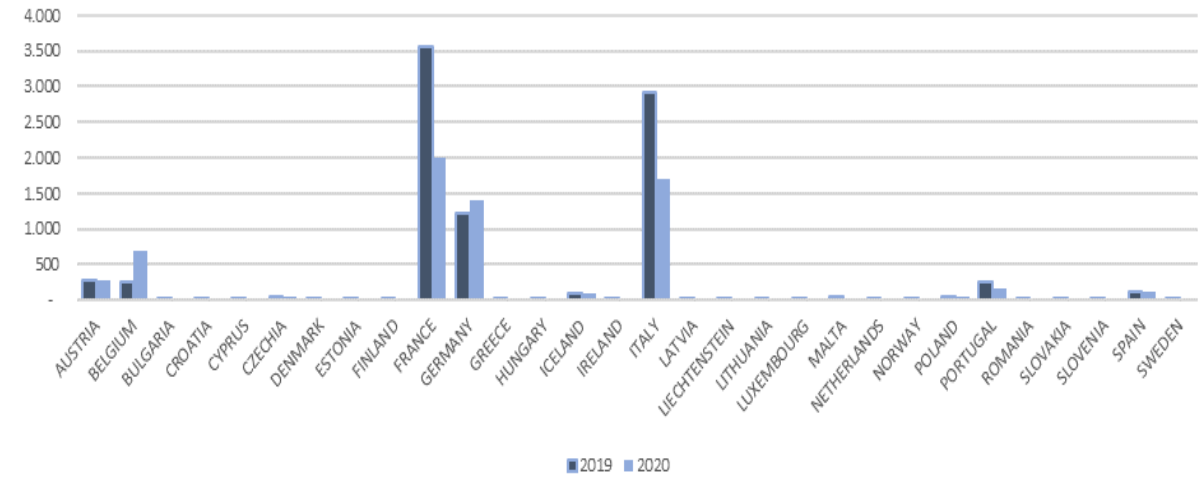
Regarding cross-border activities, Italy, France and Germany emerge as the largest markets reporting cross border activities, even though there are interesting dynamics across the Baltics and Nordics. The picture at country level reinforces the snapshot at EEA level regarding the decrease in amount of cross border activity in the past years (Figures 7.30 and 7.31).

Figure 7.30 - GWP exported on cross border by LOB for UL products, 2019-2020



Source: EIOPA Solvency II database

Figure 7.31- GWP exported on cross border by LOB for PP products, 2019-2020



Source: EIOPA Solvency II database

Growth in the market for online distribution of IBIPs

Given the ongoing digital transformation occurring in the EU distribution market, EIOPA has also looked at whether there has been any specific growth in the online distribution of IBIPs. EIOPA is not in a position, based on limited data provided by NCAs, to provide a detailed picture of the growth in the market for online sales of IBIPs. (As noted in the section of this Call for Advice related to digital tools and channels, the existence of online platforms selling IBIPs seems to be particularly low at present).

Generally speaking, EIOPA has noted in its IDD application report[400] that online sales for insurance products seem to be increasing on a yearly basis and it is likely that this trend will continue as this trend is being further enhanced by the COVID-19 pandemic and social distancing measures. Based on data for 13 Member States provided by NCAs and some trade associations, the proportion of online sales for insurance products in terms of total volume of GWP remains relatively low in many Member States, ranging mostly from 0.2% to 2%. It is interesting to note that for DK and EE, it is estimated that online sales account for 80% of the total volume of GWP and the proportion of online sales in LV is relatively high as well (70% for life insurance).

The aforementioned Commission Report on "Distribution systems of retail investment products across the European Union"[401] indicates that *"for life insurance products (both with guaranteed capital and without guaranteed capital), these make up for 4% of the total number of products identified on distributors' websites in the Member States observed"*.

It is, however, emphasised in the report that *"the sample of distributors did not include brokers"* and *"the products availability depends largely on the market analysed"*. The report goes on to indicate that *"in France, Italy, Czech Republic, Belgium and Portugal, a relatively wide variety of life insurance policies are offered. However, in Denmark, Estonia, Germany, Spain, Sweden, and the UK, no such products were identified with their associated costs disclosed. In the cases of Denmark and Germany, the lack of information on life insurance costs and charges, although well known, is all the more remarkable, since life insurance and annuity entitlements represent a very significant share of households' financial asset portfolio. It must be noted however that there is no obligation for distributors to disclose fees for life insurance products on their webpages"*.

[400] https://www.eiopa.europa.eu/media/news/eiopa-publishes-report-application-of-insurance-distribution-directive_en

[401] https://ec.europa.eu/info/sites/default/files/180425-retail-investment-products-distribution-systems_en.pdf - see page 20

ANNEX 8: ENHANCED SUITABILITY AND APPROPRIATENESS ASSESSMENTS

1. Problem definition

The suitability and appropriateness assessment regimes are designed to ensure that financial instruments recommended to or bought by investors are coherent with, respectively, i) the client's investment objectives, risk tolerance, knowledge and experience and ability to financially bear any investment risks related to such instruments[402] and ii) the necessary experience and knowledge relating to the risks of a particular product[403]. Correspondingly, the retail investment study[404] highlights that "*the assessment of suitability and appropriateness is one of the most relevant regulatory obligations for consumer protection. The suitability assessments are performed to ensure that retail investors who generally do not have the necessary financial knowledge to make investment decisions by themselves do not face mis-buying or mis-selling risks by being offered products that are not adequate to their profile*".[405]

The purpose of the **suitability assessment** is to ensure that financial intermediaries know their clients and their needs and objectives prior to offering financial products to them. The purpose of the **appropriateness assessment** is to ensure that financial intermediaries know whether the products that their clients want to buy fit the risk they can bear. The appropriateness test reduces overconfidence, confirmation bias and familiarity bias in investment decisions, which have been identified as important behaviours that may lead to disappointing investment experiences.[406]

Both instruments aim to frame retail investors' decision-making processes without exerting paternalistic constraints on them. They reduce the information disadvantage of retail investors, increase transparency in the relationship with distributors of financial products and help prevent behavioural biases in investment decisions. The use of those assessments should minimise mis-selling of financial products to retail investors and ultimately the risk of disappointing investment experiences that would weigh on retail investors' trust and participation.

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[402] Article 54(2) of Commission Delegated Regulation (EU)2017/565.
[403] Idem, Article 56(1).
[404] Retail investment study.
[405] Idem, page 320.
[406] See Baisch, R. and R. Weber (2015), 'Investment Suitability Requirements in the Light of Behavioural Findings', in *European Perspectives on Behavioural Law and Economics*, Mathis, K. (editor), Springer, pages 159-192.

1.1. What are the problems?

Persistent concerns about mis-selling[407], a continuously high number of complaints by retail investors to financial supervisors, and mixed survey responses about consumers' perception of the usefulness of these instruments suggest the two instruments are not sufficiently fulfilling their purpose.

The Retail investment study pointed to challenges regarding inadequate advice to retail investors and listed a number of studies which evidenced the selling of investment products to clients that were not suitable for their profile[408]. In 2018 the European Parliament commissioned a study which analysed cases of mis-selling of complex products to retail investors[409] and EIOPA has also expressed concerns relating to the possible mis-selling of unit-linked products to consumers featuring high costs and commissions as well as complex structures[410]. A consumer interest organisation compiled a list of 43 mis-selling scandals in EU Member States between 2005 and 2021[411]. While many of these cases cover instruments that banks issued during the financial and sovereign debt crisis, especially consumer organisations cautioned that mis-selling practices still remain an issue.[412] In a study[413] elaborated by Deloitte for the Commission in 2018, more than half of the surveyed consumer protection bodies reported they received frequent complaints about unsuitable products and inappropriate advice, i.e. complaints that should not occur if suitability assessments are done properly. The considerable number of complaints that national competent authorities still receive about investment advice and, in particular, about the sale of structured and complex financial products (see chart below) illustrates that the issue of mis-selling remains important, requiring urgent action.

The Retail investment study underlined the fact that retail investors tend to trust advisors and follow their advice, although the behavioural experiment conducted as part of the study suggest that advice may be inadequate.[414] Complaints about inappropriate advice and mis-selling of products negatively affect retail investors' trust in financial markets

[407] See Retail investment study – pages 22, 26, 29" The overall intention of the policy framework (i.e. reducing mis-selling) remains highly relevant.", also page 302 in section 7 suitability assessments and needs and demands test.

[408] Retail investment study, pages 242 and 243.

[409] Conac, P..H. (2018), 'Mis-selling of Financial Products: Subordinated Debt and Self-placement', Study for ECON, European Parliament, IP/A/ECON/2016-17IP/A/ECON/2016-17.

[410] EIOPA, consumer trend report 2021, page 6.

[411] https://www.thepriceofbadadvice.eu/ by BEUC. The website was created in 2018, but lists scandals prior to that year, recognising that mis-selling is often detected with a considerable delay.

[412] Today no statistics on mis-selling exist. As mentioned under footnote 9, this is partly due to the broad nature of the concept. It is also due to the fact that mis-selling typically take years to manifest itself - that is until the damage materialises or until the efforts to receive compensation come to fruition (or fail).

[413] Deloitte (2018), Distribution systems of retail investment products across the European Union, page 106. 8 consumer protection agencies and 15 alternative dispute resolution agencies participated in the survey.

[414] Retail investment study, pages 278 to 291.

and may lead to their permanent withdrawal. The latter goes contrary to the key objective of the CMU of increasing the scale of the EU capital markets through enhanced retail investors' participation. The participation of retail investors in capital markets is, in turn, important to also allow retail investors to benefit from investment opportunities offered by capital markets – ever more important in a high-inflation environment.

While on the one hand investors that do get advice tend to rely on such advice (see above), amongst those respondents to the Eurobarometer survey (2022), who say they have sufficient money to invest, but do not do so, 12% and 21% indicated that they had no trust in financial advice and that they are concerned about the risks, respectively. These findings suggest that the client profiling process and the suitability or appropriateness assessments, as applied today by financial intermediaries to offer advice or execute the sale of a financial product, are not sufficient to foster trust in financial markets.

Suitability assessment

For advised services (requiring a suitability assessment), the retail investment study identifies deficiencies in the screening process related to the coverage, depth and timing of the suitability assessment. It also demonstrates a great variation in application across the Union. *"The information obtained from the client needs to be correctly interpreted and transformed into an investor profile that is indeed useful in selecting suitable investment products. The mystery shopping exercise suggests however that this is often not the case*".[415]

These findings are consistent with issues identified by national competent authorities in Germany, Ireland and France with how suitability assessments are conducted.[416] ESMA also reported that national competent authorities receive about a dozen of consumer complaints about the quality of investment advice and a similar number of complaints specifically about suitability assessments each year (see chart below). Whereas it is difficult to establish whether truly unsuitable products were sold, suitability assessments, if conducted properly, should have reduced the scope for financial advisors to misguide retail investors with incorrect information and hence should have limited the number of complaints about advice.

[415] Retail investment study, page 326: "*We asked all those who had an investment product or who were exploring making an investment and had received advice whether they recalled being asked questions about their financial situation, past experience with investments, attitude towards risk, etc. While the majority of respondents said "yes", 21% said "no" and another 14% did not know. The number of respondents who recall undergoing this process varies between countries. The country with the lowest share of respondents who recall undergoing this process is Poland. In the traditional distribution channels mystery shopping exercise this is also the country where many screening conversations were very short and superficial in terms of items covered. A similar situation can be observed in Romania, where a high number of mystery shoppers received product suggestions after a very short conversation covering few aspects of their profile*". See also page 339.

[416] Retail investment study, page 337.

Figure 1: Complaints received by national competent authorities related to investment advice and appropriateness/suitability assessments

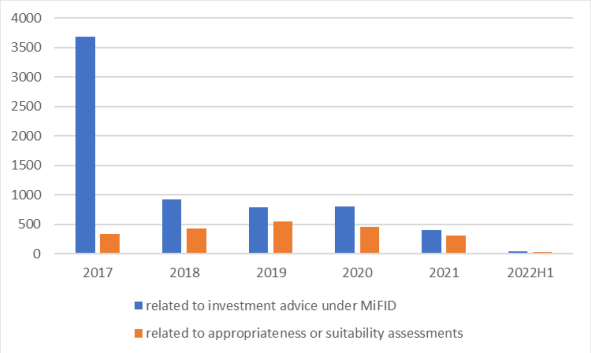
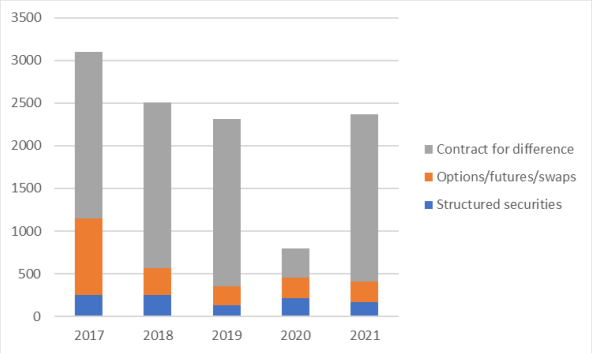


Figure 2: Complaints received by national competent authorities related to different complex financial instruments



Note: Reporting may be incomplete and procedures, methodologies and categories different across Member States. Specific events distort the interpretation of time trends. For a detailed analysis of specific events and how they impact complaints data, see ESMA, 'Monitoring retail markets via complaints data' Trends, Risks and Vulnerabilities, 1/2017 pp. 37-43.
Source: ESMA.

The consumers' appreciation of the usefulness of the suitability assessment and benefits hereof seem to differ across Member States. For example, surveys in Germany and Finland revealed mixed perceptions of retail investors about the usefulness of suitability assessments. The majority of customers of German banks surveyed in Paul et al (2019) found them disruptive and not providing net benefits.[417] However, in Finland only a small minority of consumers of financial services voiced a critical view about the benefits of suitability assessments in Cronstedt (2021).[418]Both surveys, however, have a small sample and seem to be biased towards views of sophisticated investors. The retail investment study asked more than 3000 customers in 10 EU Member States how useful they find the screening progress for investment. 64% found it useful, 18% very useful while 16% responded it was not.[419] The public consultation yielded views about the usefulness of the screening instruments similar to the retail investment study.[420] The still significant share of consumers that expressed dissatisfaction together with about 20% of respondents who did not recall being subject to an investment screening suggest the suitability assessment is not as effective as intended.[421]

Figure 3: Share of respondents that recalled having been subject to investment screening and their experience

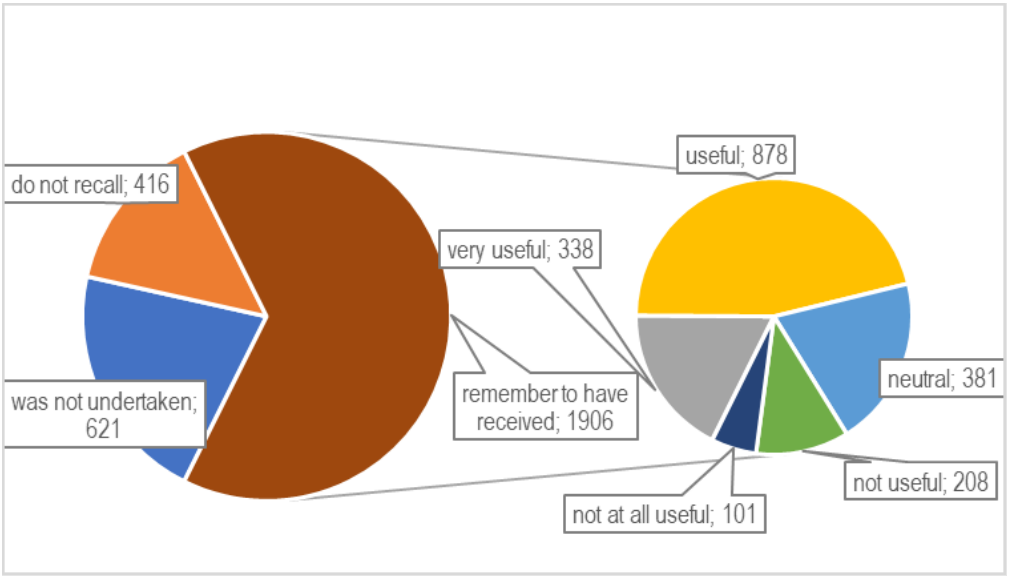
[417] Paul, St., Schroeder, N. and Schumacher S. (2019), 'Auswirkungsstudie MiFIDII/MiFIR and PRIIPs-VO: Effektivitaet und Effizienz der Neuregelungen vor dem Hintergrund des Anleger- und Verbraucherschutzes', *Study on behalf of the Deutsche Kreditwirtschaft*, University of Bochum.

[418] Cronsedt, C.-W. (2021), 'MiFID II and IDD and their effect on customer experience', *Hanken School of Economics,* Helsinki.

[419] The sample consisted of those respondents that had purchased financial products in the last 3 years and remembered having been subject of an investment screening.

[420] 10.3% (n=13) disagreed with the statement that current suitability assessments are effective in ensuring that retail investors are not offered unsuitable products, 6.3% (8) - strongly disagreed. The similarity of the distribution in the retail investment study and the public consultation is remarkable, given little overlap in the respective populations of respondents: while the study surveyed retail investors, the majority of respondents to the public consultation were business associations and companies (in addition to consumer associations, representing the views of retail investors).

[421] The exact share is 22.6% if the 47% of respondents who said they did not invest because they had no money to invest are excluded.



Source: Retail investment study, Annex 10, T.35 and T36

Appropriateness assessment

For non-advised services, the appropriateness test, focused on testing the clients' knowledge and experience only, is viewed by many NCAs as largely insufficient to provide any useful assessment as to the capacity of investors to understand and bear the financial risks of certain types of investments. A large majority of respondents[422] to the public consultation, however, said that appropriateness assessment is effective in ensuring that clients do not purchase products they are not able to understand or that are too risky. The share of respondents who disagreed was slightly smaller than that for the comparable question on the suitability assessment.[423] While the appropriateness test is not designed to prohibit the purchase of risky and complex products by clients, it aims to dissuade clients from purchasing products when they do not understand the risk they are taking. More recently, the adequacy of the appropriateness tests has been challenged in the context of the "GameStop case".[424]

[422] To the question " to what extent do you agree that the appropriateness test serves retail investor needs and is effective in ensuring that they do not purchase products they are not able to understand or that are too risky for their client profile?" 34% of respondents strongly agreed (34 answers), 37.1% agreed (46 answers), 8.9% disagreed (11 answers), 4.8% strongly disagreed (6 answers) and the rest did not know (6.5%) (8 answers) or were neutral (15.3%) (19 answers).

[423] 8.9% (n=11) disagreed and 4.8% (6) strongly disagreed. Some stakeholders stated that even when having passed an appropriateness test, (experienced) retail investors could repeatedly buy unsuitable or harmful products through a poorly designed (online) choice environment. Therefore, appropriateness tests should be viewed as one component of a wider framework for investor protection.

[424] ECON Committee (2021). GameStop and similar recent market events: Exchange of views with representatives of the European Commission and the European Securities and Markets Authority, 23 February 23.

In non-advised services, retail investors decide to invest, sometimes without a proper evaluation of the instrument and the related risk, making them potentially vulnerable to questionable information and tips disseminated via social media and by influencers. ESMA consultation on the appropriateness test and execution-only services in the context of MiFID II[425] revealed that there is insufficient convergence in the understanding and application of several areas of the appropriateness and execution-only requirements by firms in different Member States, and often within Member States themselves, creating problems for achieving a consistent level of investor protection in the EU.

1.2 What are the problem drivers?

1.2.1 Diverging and partly insufficient depth of client profiling

The retail investment study shows that in practice the method used for performing suitability assessments, the quality of investor screening, questionnaires and associated results vary greatly in the EU and do not always ensure that the advice is based on individual needs and circumstances of the clients nor it prioritises positive outcomes for them. Amongst others, the retail investment study identifies problems of "late phasing" where advice was given before carrying out the suitability assessment, only shortly before contract signature. Furthermore, in some mystery shopping cases, investment recommendations were even given without performing any or only very limited profile screening.[426] It was also shown that the depth of information covered varies greatly and that an important share of conversations which resulted in product recommendations took into account only minimal or hardly any client information (see chart below). It is evident that practices differ considerably regarding whether and how the suitability assessment is actually linked to the provision of advice and investment recommendations.[427] There were significant differences even in relation to essential parameters and in 28% of observations the profiling quality was judged as insufficient.[428] Disparities were also found between Member States with regard to the length of the screening questionnaire before a product was recommended.[429] Issues with the implementation of existing provisions about suitability assessments were also found in the research of several National Competent Authorities, albeit to varying degrees.[430]

Figure 4: Results of the mystery shopping, number of items covered by human advisors during the screening (out of 16 items identified as relevant) and experiences of the mystery shoppers in % (170 visits)

[425] https://www.esma.europa.eu/press-news/esma-news/esma-consults-appropriateness-and-execution-only-under-mifid-ii

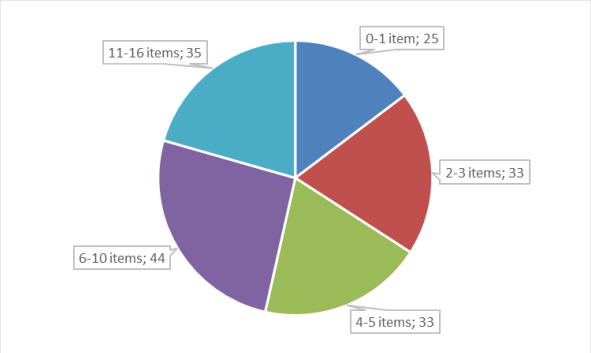
[426] Retail investment study, pages 325-326.

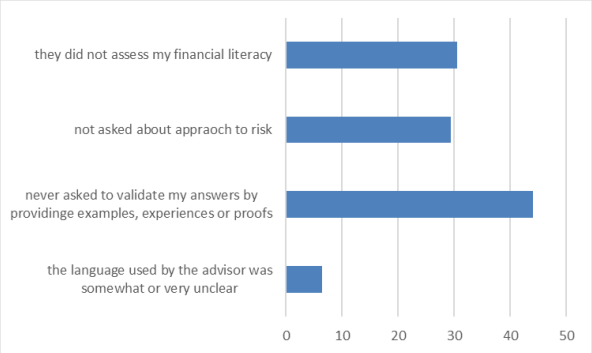
[427] Idem, page 325.

[428] Idem, pages 329-330

[429] Idem, page 331.

[430] Idem, page 337.





Source: Retail Investment Study.

1.2.2 Product-centric assessment and lack of portfolio approach in the provision of retail investment services

Currently, client-profile assessments, be it suitability assessment preceding investment advice, or the appropriateness assessment required for the provision of non-advised investment services, focus on identifying whether a specific product in the investment intermediary's offering should be sold to the investor in view of a certain set of information gathered about the investor. That information is more (suitability assessment) or less (appropriateness assessment) extensive, depending on the type of assessment carried out.

The current approach helps ensure that the client is offered products that match certain personal circumstances, such as prior investment experience, financial situation and investment objectives. However, it does not require the financial intermediary to consider, as part of the assessment, the client's overall holding of investment products, and how the recommended product fits into its overall portfolio. The retail investment study highlights that the portfolio composition is not sufficiently considered and clients are not invited to adopt a mixed portfolio approach and count too much on a small number of volatile assets.[431]. The retail investment study reports other findings from the literature that "*the most important concerns involve underestimating risk and having suboptimal portfolios due to a lack of diversification*".[432] Those findings evidence that the client profiling process that leads to the suitability assessment and which is based on the existing legal requirements under MiFID II is not sufficient to prevent disappointing investment experience. Some algorithms automatically restrict the possible range of products. In other cases, financial intermediaries advising certain model portfolios,[433] may not necessarily take into account the existing composition of the client's portfolio, thus failing to diversify across the full spectrum of clients' assets, running the risk of asset concentration or overexposure to some assets/asset classes.

[431] Idem, page 349.
[432] Idem, page 313.
[433] Idem, page 343.

The same applies to the appropriateness assessment that only focuses on the knowledge and experience in the (relevant) investment field but does not consider whether the client has the capacity to bear losses or to face any urgent financial liquidity needs.

The current product-centric approach to client assessment may therefore lead to suboptimal outcomes for the client. While the investment intermediary may be able to claim that the product sold can individually be deemed suitable, it may fit poorly into the existing portfolio of products or assets already held by the client, exacerbating certain types of exposure, while ignoring other forms of exposure that could contribute towards a diversified portfolio with a superior risk-return profile.

1.2.3 Investment influencing techniques and gamification of the investment process

Retail investing has experienced a shift towards greater reliance on digital platforms to place investments on the market. While the increased use of digital platforms has certainly facilitated access to investing, it has not come without risks. The ease of access to non-advised investments via digital means poses the risks that retail investors decide to invest, sometimes without a proper evaluation of the instrument and its related risk and that the current appropriateness assessment test may not be enough. A recent report by international financial supervisors on the impact of digitalisation on retail distribution identified benefits for financial consumers related to online marketing from (1) increased access to financial services and products; (2) reduction in search cost; and (3) flexibility, convenience, price and quality comparison.[434] A survey among 90 financial firms revealed that the industry is relying increasingly on online marketing, especially on the use of social media influencer ads, social media stories and online video marketing.

[434] IOSCO report on retail distribution and digitalisation.

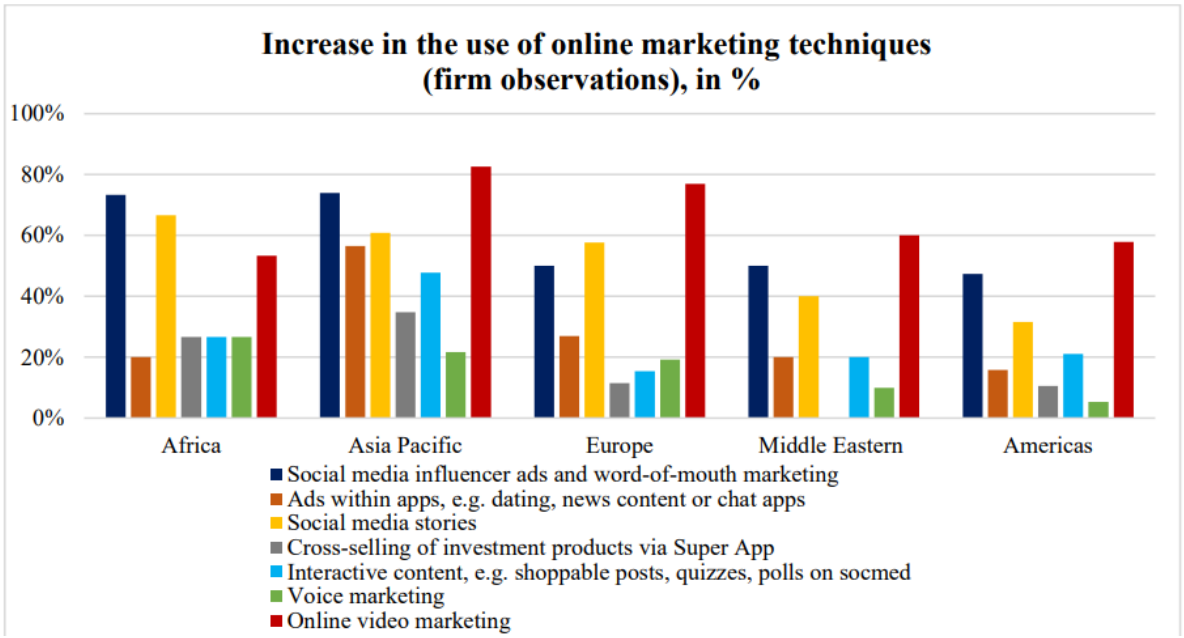


Figure 5 Source: IOSCO (2022).

Nevertheless, the report also identifies important risks stemming from online marketing related *inter alia* to: *"(1) possibility for firms to track, experiment with and thus exploit investor biases; (2) unsolicited online offerings and/or offers targeting an inappropriate market segment [including rerouting to products or services]; (3) push towards unsuitable products or strategies through online marketing methods"*. The report also lists certain types of inappropriate behaviour observed by IOSCO members such as:

- impersonation (e.g. pretending to be a credible source to extract information);
- sending junk e-mails that overpromise returns;
- bulk targeting;
- hacking and other cyber security violations;
- including fake success stories by using influencers.

There is hence a risk that investing platforms may steer investors into making decisions that benefit intermediaries but can be detrimental to the client. As more investors have moved to digital platforms, financial intermediaries have increasingly been relying on behavioural nudges or biases in order to steer clients towards certain actions. This includes phenomena such as 'gamification' of investing as well as designing the platform to 'nudge' clients to change their behaviour in predictable ways, resulting in inappropriate investment decisions. Highlighting the phenomenon, ESMA notes that the 'use of gamification techniques that are intended to nudge (retail) clients to undue risk taking and that lead to addictive behaviour are never in the best interest of the investor'. This can divert retail investors from making investment decisions catering for their needs and amplifies investment patterns, which do not focus on portfolio-wide considerations.

1.2.4 How likely are the problems to persist?

If no amendment is introduced to the legislative framework governing the suitability and appropriateness assessments, the current framework would continue to produce inefficient results, unable to support investments that are in the best interest of the client. Without more consideration for a correct client's profiling focussed on key elements, a portfolio diversification and an adequate timeframe to perform the suitability or appropriateness assessments, the suitability and appropriateness assessments would continue to be perceived by many retail clients as a pointless exercise. The framework, therefore, would continue to present inefficiencies in the investment process, which would lead to sub-optimal outcomes for retail investors, including in the balance of risks incurred and rewards that can be expected from an investment. Consequently, the overall attractiveness of capital market investments is reduced for retail investors and they may miss out on opportunities to cater for their long-term needs. This adverse effect on retail investors' willingness to invest in capital markets also runs counter to the European Commission's plan to create a single market for capital (the Capital Markets Union), in which investments and savings flow to all Member States, benefiting consumers, investors and businesses wherever they are based in the European Union.

2. What are the proposed options

Option label	Option description
Baseline	**Do nothing to change the legal framework**
Option 1	Enhancing of the existing framework for suitability and appropriateness assessment
Option 2 - Discarded at an earlier stage	Introducing in the current suitability and appropriateness assessment regime the requirement for firms to provide to each retail client, as a result of the assessment, an asset allocation strategy, under the name of a Personal Investment Plan. An opt-out option for retail clients using non-advisory services for simple products would be maintained.

Two possible options were considered at the outset of this assessment: (1) enhancing of the existing framework for suitability and appropriateness assessment; and (2) introducing in the current suitability and appropriateness assessment regime the requirement for firms to provide to each retail client, as a result of the assessment, an asset allocation strategy, under the name of a Personal Investment Plan. An opt-out option for retail clients using non-advisory services for simple products would be maintained.

Multiple stakeholder consultations showed that the new requirement (under option 2) could result in substantial costs, in particular for the non–advisory segment of the industry that could be passed on to the retail investors, with potential detrimental impact on the accessibility and costs

of investment services. Also, it is anticipated that the package of other measures (including in particular the ban on inducement) set up to improve the investor protection and boost the investor's trust in investing, would avoid the necessity to change more substantially the current set-up of the suitability and appropriateness assessments rules. This package should ensure (with the removal of a material source of conflicts of interest) that those assessments are performed in line with the existing requirements and in particular in the best interest of the clients. This proportionate approach would avoid unnecessary changes and burden for the investment firm while ensuring nonetheless a material improvement in the investor protection. **Option 2 was therefore discarded at this stage but could be reconsidered in the future if progress in terms of retail investor protection does not appear sufficiently strong.**

In the public consultation, some NCAs supported the idea of reinforcing the quality of the suitability and appropriateness questionnaires to achieve better assessments, enabling better investment decisions. Such qualitative improvements, in line with option 1, could also contribute to raising the understanding and financial literacy of retail investors.

The modalities of **option 1** would involve a combination of several measures:

Measure 1): an enhanced suitability test for the **advised services**; together with an enhanced suitability assessment report
Measure 2): an enhanced appropriateness test for the **non-advised services**;

For **all services**. clarification as to the relevant timing for the performance of those assessments, to ensure that the distributors reflect the results of the screening in either their product recommendation or the warning they may need to deliver to their clients when receiving from them an order of execution.

For advised services, it is proposed to strengthen the suitability assessment under MiFID II and IDD by enhancing the client profiling/screening test, that is necessary to produce a suitability assessment, with more precise and standardised elements. This would ensure that all firms systematically get the essential facts about their clients. It would avoid situations identified in the retail investment study where the client profiling questionnaire is so limited or performed in such a limited period of time that it cannot deliver on its primary objective of accurately identifying the client's profile and needs. This would also avoid that certain firms keep on performing this assessment as a 'box-ticking' exercise where no or insufficient relevant information for a proper suitability evaluation is collected. The current requirements on the suitability assessment would be enhanced through the introduction of a mandatory list of key information, to be defined by the ESAs, that a firm would be required to obtain from all its retail clients. This information would need to be presented in a standardised way in order to facilitate its possible portability to other firms, with the client's consent. Next to this key information to be collected in a standardised way, the firm would also have to collect any additional information that might be relevant to better capture the specific situation of their clients.
The introduction of this mandatory list of key information to be obtained from the retail client and to be collected in a standardised way aims at ensuring more alignment in the

implementation of the screening processes by firms, better identification of clients' profiles and ultimately better suitability assessments.

In designing its suitability assessment, firms would have to obtain information on and take into account the composition of its clients' overall securities portfolio and the need for diversification. The securities making up the portfolio should include any financial instruments as defined under MiFID II. Similarly, intermediaries of IBIPs would need to better take into account the overall portfolio when advising on particular IBIPs.[435] Where the client's securities portfolio is held in custody with the firm in charge of the suitability assessment, the firm would automatically have to consider such portfolio composition when preparing the suitability assessment. Where the client holds a securities portfolio with another firm but declines to provides information on that portfolio, the firm preparing the suitability assessment would not be obliged to take into account such information, provided that it has warned the client that the absence of such information may impact the quality of the suitability assessment and of the investment recommendation based on it, and provided the client has acknowledged such warning.

In case of advised services, it would also be clarified that the suitability assessment has to be performed before the advice is provided to the retail client[436] (and not only, as required today, before the transaction).

For non-advised services, it is proposed to strengthen the appropriateness assessment under MiFID II and IDD by enhancing the client profiling/screening test, that is necessary to produce an appropriateness assessment, with questions on the client financial capacity and financial ability to bear losses. Today the obligation related to the appropriateness assessment only requires firms to determine whether the retail client has the necessary knowledge and experience to understand the risks involved in the product or investment service offered or demanded. Such requirement does not apply to services relating to the execution of or reception and transmission of client orders for non-complex products.

The very limited scope of information that is taken into account during the current appropriateness test raises questions as to its effectiveness and was the subject of criticism in the public consultation[437]. The need for an adequate appropriateness

[435] Noting that an intermediary under IDD cannot advise on investment products other than IBIPs (and vice versa for MIFID firms). However, both distribution channels should take into account holdings/assets also outside the regulatory scope in a more holistic way to ensure a better investment outcome.
[436] The retail investment study mentioned that in France, advisors only performed the suitability assessment after having already provided advice in one third of the cases [see page 337) and also that "there is evidence both from the mystery shopping as well as from existing research that in a non-negligible minority of cases full suitability assessments are only carried out at the end of the advice process (see 7.2.4), shortly before the contract signature. Therefore, the suitability assessment does not feed into the process of informing the advice and supporting the client's choice (see page 340).
[437] 31.7% of the answers to the retail public consultation indicated problems with the appropriateness test: some stakeholders stated that even when having passed an appropriateness test, (experienced)

assessment has further increased over the years due to a rapid growth of investment products accessed through digital platforms in an execution-only format, where the online environment may also influence the investor's choice. As it could be expected that self-directed investments (execution-only sales) would increase following the introduction of a ban on inducements, the need for adequate safeguards is further reinforced. In their responses to the public consultation and subsequent bilateral exchanges, in particular NCAs call for the enhancement of the appropriateness test to include more elements on the financial capacity of clients in case of unexpected events in their personal situation or their ability to bear losses. NCAs believe that this enhancement could also contribute to raising the financial literacy of retail investors.

A flanking measure to the enhanced appropriateness test would also include a stronger standardised warning to clients when the investment appears not appropriate. The firm would not be authorised to proceed without getting from the client an acknowledgment of receipt of the warning and a confirmation that the client still wishes to proceed with the order.

For all services, it would be important that the suitability and appropriateness assessments were fully linked to the screening exercise, which should not be undertaken as a stand-alone exercise. In the case of investment advice, firms would disclose in a standardised way how the recommendation matches the retail client profile, as determined following the screening process and the assessment made by firms.

3. Assessment of the proposed measures

Effectiveness in meeting the specific objectives

Measure 1 under option 1 is considered to be effective in meeting the specific objective of addressing poor client-profiling leading to poor suitability assessment. Ensuring that

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retail investors could repeatedly buy unsuitable or harmful products through a poorly designed (online) choice environment. Some stakeholders considers that the current appropriateness test has little added value, creates burdensome procedures for retail clients, and thus should be eliminated – in certain cases – or replaced by the suitability assessment. Additionally, some respondents noted that the appropriateness test only requires the client to disclose information about their knowledge and experience in the field relevant to the product in question. There is no explicit reference to environmental objectives (or similar concepts). Some respondents directly pointed that the appropriateness test (performed for "non-advised services", except execution-only) which only requires the client to disclose information about their knowledge and experience should be changed to include sustainability preferences.

When it comes to the insurance sector, some stakeholders stated that the appropriateness test reduced to experience and knowledge, while necessary, is not enough protective and could result in inappropriate selling. Life insurance has specific features that require certain precautions in its marketing. They are products offering multiple investment choices, some of which present a form of complexity or risk. In this sense, life insurance products are not comparable to simple financial instruments, which may be distributed by only execution of orders.

key information about clients is systematically and in a standardised way tested by all firms would improve the suitability assessment across the EU. Furthermore, when combined with the requirement for firms to take into account the client's existing securities portfolio in their suitability assessment, the measure would tackle the problem of a product-centric approach in advice, avoiding over-concentration in similar financial instruments and supporting portfolio diversification. A more solid suitability assessment, following a portfolio approach, would result in more suitable investment recommendations for clients, instilling higher retail investors' trust in investment and gradually raising the level of clients' awareness and understanding of capital markets.

The standardisation of key elements of the client profiling would favour common assessment practices amongst EU firms, eliminating practices of poor/non-informative suitability assessments that carry a high risk of mis-selling.

Measure 2 under option 1 would make the appropriateness assessment more informative and better tailored to the client's needs, as financial capacity and ability to bear losses are fundamental characteristics of an investor's profile Investors would be pro-actively encouraged to reconsider their investment decision through warnings, in case of an inappropriate investment. A well-performed and more complete assessment for execution-only services would act as a counterweight to the influence that other sources (family, peers, social media etc) or information asymmetry may have on the client's choice, and consequently would avoid (or considerably limit) biased investment decision. Combined with the obligation to act in the best interest of the client together with the other measures put forward in the retail investment strategy, the measures contribute to limiting mis-selling by firms or mis-buying by retail clients. Taken, measure 2, however, would be unlikely to significantly improve the current situation.

Costs-benefits[438]

i. *Costs and benefits for investors*

Retail investors would in general **benefit** from receiving a better quality of service and are likely to make a more appropriate investment decisions where firms (i) take sufficient time to conduct suitability and appropriateness assessments,[439] ensuring more accurate client profiling, (ii) consider in their screening and assessment for advised services, more client-specific information, with certain key elements made mandatory and standardised, and (iii) include in their screening and assessment for non-advised services, the financial capacity and ability to bear losses of their retail clients.
In an **advice** setting, making mandatory to test and assess certain key (standardised) elements would facilitate, for retail clients, comparability between assessments and recommendations, when approaching different firms. Also, the considerations of the

[438] A detailed analysis of costs is included in the appendix to Annex 8 (see below).

[439] See Retail investment study– page 315: Figure 7.10 - Duration of the screening questionnaire prior to product specific conversation for traditional distribution channels (n=170).

existing client portfolio and the need for portfolio diversification would improve the overall diversification of the client's investments and limit potential losses.
In a **non-advisory** environment, clients, which are typically more prone to manipulation of investment choice and gamification, would benefit from stronger warnings[440], allowing them to avoid potentially detrimental investment decisions that would have been taken in disregard of their financial capacity and ability to bear losses.

It cannot be excluded, however, that investment firms may increase the **costs** of their advised and non-advised services to cover the costs associated with the preparation of enhanced suitability and appropriateness assessments. These costs might then be passed on to investors. Nevertheless, these extra costs are likely to be of a one-off nature and hence would be limited.

ii. *Costs and benefits for investment firms*

With an enhanced suitability assessment, investment firms would be able to better know their clients and to further adjust their investment advice to the needs and objectives of those clients (including financial liquidity needs). Clients' satisfaction in their investments and trust in their financial intermediaries would increase, triggering potentially more retail investments in the capital markets and more revenues for the firms. A similar outcome can be expected for the enhanced appropriateness assessment, where investment firms would also be able to offer a higher quality of service to their clients, better adapted to their financial situation, thus strengthening trust of these investors in capital markets, fostering investor participation and increasing future revenue potential for these firms. In both cases, firms are likely to see a decrease in the commercialisation of risky and/or complex products in favour of simpler and less risky investments. If the volume of simple investments increases sufficiently (due to higher trust and investor participation), it could however compensate for the loss of revenues from risky or complex products.

While the compliance with an enhanced suitability assessment will lead to higher costs for firms, it is unlikely to represent a substantial additional cost for the firms already compliant with the ESMA MiFID II guidelines. Firms providing non-advised services would need to set up the necessary IT infrastructure and train staff to be able to conduct a more extensive appropriateness assessment. The incremental cost is, however, likely to be more important for firms offering only non-advised services and not used to collecting information on the financial situation of their clients and their ability to bear losses.

The enhanced suitability assessment would include the coding of standard key information to enable its portability to, and use by, other distributors, as well as additional processing of clients' information on its securities portfolio. The main cost

[440] Retail investment study indicates however that in a context of suitability advice, the potential gains from changing disclosure warnings are likely to be minimal (page 25). In a non-advised context, warnings may however be more effective.

element would be identifiable in the additional time necessary to assess products not only against the personal client's profile, but also against the already existing client's portfolio. This also means some distributors' staff, used to perform very limited suitability assessment would need more time to obtain the necessary information and discuss with clients. Distributors that offer portfolio management services and other investment services, would potentially incur a lower cost, given that they already have the experience of acquiring such information from clients.

Considering that most of the process for the client profiling/screening and provision of advice will remain unchanged, an increase of the duration by 10% might be considered as a conservative estimate for the impact of the integration of portfolio views in the suitability assessment. This aspect will come on top of the requirements to know the client, his/her objectives, time horizon and capacities, to match the client's profile to risks, returns, fees and liquidity profile of financial products, and to explain the advice. The 10% increase would be applied to new clients, as well as the existing customers seeking advice.

Similar to the enhancement of the suitability assessment, the change to the appropriateness test (i.e. its enhancement) is likely to lead to a longer duration of the process. Incorporating additional elements, such as the clients' financial capacity and ability to bear losses into the screening process would increase the list of questions to be asked. The relative increase in length would depend on how many questions the distributors already ask about knowledge and experience. Since the MiFID II requirements for the appropriateness tests are much lighter than suitability tests, the additional elements may carry a larger relative weight than in the case of a suitability assessment. Therefore, under a conservative estimate, a 20-30 % increment to the duration of the appropriateness test (as conducted today) could be considered.

For the **enhanced suitability assessment**, assuming that: (i) half of the existing customers of investment firms would transact per year and that 70% to 80% of them would seek advice and 20% of them being subject to an enhanced suitability test each year, and that (ii) the average duration of the suitability test is 20-30 minutes and that this test would get by 10% longer, and finally that (iii) the labour cost per hour of EUR 50.7, **annual incremental costs due to the enhancement would be EUR 5.7 million to EUR 11.9 million.**[441]

For the **enhanced appropriateness assessment**, under the assumption that: (i) between 2% and 5% of all households hold complex products,[442] (ii) that half of the existing

[441] The share of 15% was chosen because 15% of the respondents to the survey conducted in the framework of the Retail investment survey indicated they had invested based on advice in the last 12 months.

[442] Under MiFID II, a strict requirement to conduct an appropriateness assessment in an execution-only setting applies only to complex products (for non-complex products Member States can exempt investments firms from an obligation to conduct an appropriateness assessment).

customers would transact per year with 20% to 30% of them transacting without advice and thus undergoing an appropriateness test, (iii) that the average duration of the appropriateness test is 5-10 minutes and that this test would get by 20% to 30% longer, and finally that (iii) the labour cost per hour of EUR 50.7, the **annual costs associated with the enhanced appropriateness tests could increase by about EUR 83 thousand and EUR 1.2 million**. [443]

The large ranges of both estimates stem from the variation in underlying assumptions about the share of households and the time needed for the screening.

Moreover, onboarding (for advised and non-advised services) of new customers would become slightly more expensive. If the 11% of respondents in the Retail investment survey that stated to look for investment is taken as a lower range for the rise in demand and the 14% that claimed to have an interest to invest added to this for a higher range of 25%, the envisaged measures would entail additional costs related to the enhanced suitability assessment between EUR 1.2 million and EUR 5.9 million per year and those related to enhanced appropriateness tests between EUR 41 thousand and EUR 124 thousand per year. These costs were initially calculated as cumulative and were annualised using an assumption that such clients would be onboarded over 5 years. Such an assumption is only illustrative and it is more likely closer to a higher bound.

Distributors would also need to amend their IT infrastructure to conduct the required assessments or tests efficiently. IT tools contribute inter alia to accelerating the provision of targeted information and guidance to staff dealing with retail investors, to documenting the results of the tests and communicating the results to internal control and compliance departments. Although online interfaces with customers are used by a small share of clients, as confirmed in follow-up exchanges with distributors, all of them seem to have IT systems in place. Hence, none of the options would require the development of new IT systems from scratch. Additional costs would thus relate only to the adaptation of the existing systems and potentially adding new modules to these existing systems.

Amendments to IT systems would result from the enhancement of (1) suitability assessments modules a) to codify standardised basic (key) information about clients suitable for portability and b) to process additional information about clients' wealth portfolio; (2) appropriateness tests module to cover additional elements of profiling/screening related to the client's financial capacity and ability to bear losses.

[443] See the appendix for more details about the calculations and motivation of the assumptions. Assumptions for the baseline are the following, with sources for the upper and lower range in brackets: 25-30% of households hold financial securities (Retail investment study, Eurobarometer, ECB Household and Consumer Finance Survey); 2-3% hold complex financial instruments (Retail investment study, Eurobarometer); 70-80% invest using financial advice (Retail investment study, Eurobarometer, industry information) and 20-30% - without; 20-30 minutes duration of suitability assessment (rounded up from the Retail Investment study and rounded down from industry information); and 5-10 minutes for an appropriateness test (Retail investment study, supplemented by industry information), EUR 50.7 per hour as labour costs in the financial sector (Eurostat Structure of Earnings Survey).

While all distributors would need to use such modules, many, although not all, distributors seem to already have IT systems in place that would allow to easily accommodate the required changes. Reports from the industry suggest that many firms have the required IT tools already in place to consider the clients portfolio for suitability or appropriateness assessments.[444] Moreover, not every distributor would need to develop such modules. A possible scenario would be that larger banks and asset managers develop their own systems, while smaller distributors purchase them from IT specialist firms. Using certain realistic assumptions about the costs of the required modules,[445] IT costs could amount to EUR 5.6 million to EUR 9 million. These numbers are considerably lower than the estimates in the 2011 impact assessment that accompanied the MiFID II proposal.[446] At that time, one-off costs were estimated at EUR 75 million – EUR 132 million, broken down into EUR 50 million – EUR 87 million for the development of risk profiles and EUR 25 million – EUR 45 million for the production and printing of supporting documentation. The costs for the development of additional modules appear to be lower, albeit commensurate with the historical estimate. This could be due to learning costs and as such IT systems have become part of business as usual. More detail on the assumptions and calculations is provided in the Appendix to this Annex.

The need to train staff will lead to further one-off costs. These costs depend on the number of staff members that will need this training. Industry sources suggest that an advisor caters for between 150 to 360 clients, which would imply 135 to 390 thousand staff[447] with customer relationships and in need of training. Considering the compensation of financial advisors of 50.7 EUR per hour as opportunity costs[448] to approximate the costs of 1 to 2 hours training would lead to aggregate training costs in the range EUR 6.9 million to EUR 39.5 million.[449]

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[444] In a targeted survey of the industry, 38% of the respondents claimed to have already identified asset classes suitable for the client as part of the suitability assessment, 43% of the respondents even said they identify a suitable asset allocation.

[445] EUR 50,000-75,000 per module (source: industry information) plus profit margins for the 50% share not developed in-house. More detail on the assumptions and calculations is provided in the Appendix to this Annex.

[446] Commission staff working paper, 'Impact assessment accompanying the document Proposal for a Directive on Markets in financial instruments [Recast] and the Proposal for a regulation on Markets in financial instruments, SEC(2011) 1226 final.

[447] This is derived from the range of 150-360 customers per advisor and 49-58.5 million households investing.

[448] It is assumed that the advisor could have earned EUR 50.7 for providing advice in the hour that he/she spends on following a training. While this is not a perfect estimate for the cost of training, this is used as a plausible proxy. This is further explained in the appendix to this annex.

[449] An alternative approach starts from a share of 10% of employees in the US financial sector providing financial advice to customers. More than 500,000 staff in the financial and insurance sector would be in the field of financial advice in the EU 27, if the 10% ratio observed in the US applied also to the EU27.

Table: Cost estimates in million EUR			
	Lower range	**Higher range**	**Memo: Estimates in retail investment study**
Ongoing costs for existing clients (per annum)			
Additional time for suitability assessment	5.7	11.9	15* (or 8.7 with labour costs recalculated) ***
Additional time for appropriateness tests	0.08	1.2	
Ongoing costs for new clients (per annum)			
Additional time for suitability assessment	1.3	5.9	
Additional time for appropriateness tests	0.004	0.12	
Total ongoing costs estimate	**7.1**	**19.1**	
One-off costs			
Additional IT modules for suitability assessment	2.6	4.5	
Additional IT modules for appropriateness tests	3.0	4.5	Max 1**
Training for advisors	6.9	39.5	45.2 (or 26.3 with labour costs recalculated) ***
Total one-off cost estimate	**12.5**	**48.5**	

*) for collecting statements, once per year at 20 minutes per advisor and hourly labour costs of EUR 87. Includes also regular statements from advisors on conflicts of interests and inducements to supervisors; **) for keeping robo-advisors compliant; ***) recalculated to 50.68 EUR per hour sourced from Eurostat due to possible geographical and seniority biases in the survey (detailed below), other assumptions held constant

iii. *Costs and benefits for NCAs*

NCAs do not check how distributors conduct suitability and appropriateness assessment on a regular basis but may do so sporadically or to follow on a complaint. The standardisation of certain elements of the profiling/screening would reduce time dedicated by NCAs to checking compliance with the suitability requirements as with the standardisation, it would be easier to spot missing key elements. Controlling whether the client portfolio and the need for diversification have been sufficiently considered may, however, represent limited additional work and costs for the NCAs, as it would be also the case with the new requirements under the appropriateness assessment (for the financial capacity and ability to bear losses). This may involve costs to adapt IT systems to process/verify digitalised information from distributors received in a standardised form and some, albeit limited, training for staff to efficiently monitor the new regulatory environment. The adaptation costs for NCAs are likely to be minimal though and might even be overweighed by newly gained efficiencies from more standardised information. No significant impact is expected on the resources of ESMA and EIOPA, as their

involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

4. Overall assessment

The measures on the enhancement of the suitability and appropriateness assessment would help the firms better know their clients and, when they provide advised services, to better tailor their recommendations to the needs and objectives of their clients, or, when they provide non-advised services, to better appreciate when to warn their clients if the investment is not appropriate for the client. The measures should thus curtail the risk of mis-selling to clients and promote trust of retail investors in investment and, more generally, in capital markets. The measures would also contribute to the standardisation of the client profiling information in the EU, allowing potentially for easier portability of this information, more competition among distributors and wider choice of investment options for retail clients. Standardisation of clients' key profiling information would also facilitate supervision and enforcement by NCAs who would find it easier to compare investment recommendations based on similar clients' profiles across distributors. While the measures would lead to additional costs for distributors and NCAs, those are likely to be limited and, it can be reasonably assumed, that they would be outweighed by the benefits generated by the proposed measures.

Appendix to Annex 8: Benchmark for the cost estimates and assumptions

Baseline for ongoing costs

The baseline puts costs in perspective and serves to discuss the assumptions behind some of the coefficients used to assess the costs of the preferred option. About 25-30% of the households hold capital market instruments, which given 195.4 million households in the EU and an average household size 2.3 means an absolute number of 49-58.5 million clients.

Distributors are obliged to conduct assessment tests for all clients that seek advice. While national competent authorities do not report numbers on the number of advices and indications from the industry vary strongly and depend on their business model, a benchmark number would be that up to 70-80% of clients are likely to search for advice. This number is consistent with 23% that claimed not having received advice in the retail investment study. It is also consistent with a share of 18-25% that a financial association and a bank reported as execution-only clients, i.e. not wanting to be helped. The number of investors covered by advice would then be 29-47 million. About 10 million households would invest without professional advice and therewith relying on execution only purchases.

The retail investment study counts that a one-hour long suitability assessment would cost EUR 87. This seems like a high estimate based on numbers from rich Member States in the EU and assuming that high-ranking managers are providing the advice, as this figure is considerably higher than labour cost for managers in the EU financial sector published in Eurostat's Structure of Earnings Survey, that would imply hourly costs close to EUR 50.68. Given this likely bias, we have used the Eurostat figure, which is still significantly higher than the figures used for total compensation of professionals across the EU, including overheads.

The duration of the assessments is a crucial determinant of their costs. A length of 1 hour for the suitability test is consistent with information from a national competent authority. One financial institution even considered this as the bottom of the range whereas another one reported a time needed for first time clients of 10-20 minutes. The results of the mystery shopping exercise presented in the retail investment study points to an average time of 16 minutes. Only 3% of the visits lasted longer than 45 minutes. The retail investment study suggested to calculate with an average timing of 20 minutes, which consists of 15 minutes for the interview with the client and 5 minutes for the decoding.

The broad range is unsatisfying and there is indeed reason to believe that both indications may be biased. Some of the mystery shop visits were to robo-advisors, which may be accounted for the 50% share of visits that lasted 5-10 minutes and reduced the average. Moreover, the mystery shoppers cannot know the time it takes for the advisor to document the test. The short time is also consistent with evidence in the retail investment study and other studies that many distributors fail to provide good and comprehensive advice. On the other hand, distributors seem to report the total time needed, which underestimates that they would need to spend some time and information for a successful advice. This means, not all the time spent on a suitability assessment is due to compliance costs.

For the benchmark scenario, the average duration of a suitability assessment is assumed to last 20 to 30 minutes. If 70-80% investors that seek advice were subject to a 20-30 minutes suitability test, aggregate costs would be EUR 574 million to EUR 1186 million. This compares to EUR 350 billion gross value added per annum in the financial sector in the EU-27[450] and EUR 4,800 billion held by EU-27 households in financial securities[451].

Among the investors that do not seek advice, those that aim to invest into a complex product need to be subject to an appropriateness test, which asks for their knowledge and experience (i.e. ability to understand the risks) regarding the specific type of investment product or service. Since the appropriateness tests covers a subset of the suitability assessment, it is much shorter. An online broker reported an average duration of 6-8 minutes, a traditional bank indicated 5-10 minutes, depending on whether the test is done in person or online.

Eurostat numbers show that EU households hold less than 0.015% of their financial assets in financial derivatives and employee stock options[452]. The ECB's Household and consumer finance survey does not provide information about the share of households that hold derivatives or other complex products. In the absence of statistics about the number of retail investors that hold complex financial products, the surveys by the retail investment study and Eurobarometer (2022) provide the best basis for estimates. According to the survey in the retail investment study, 1.1% hold structured products[453].

Under the assumption that between 2 and 5% of all households hold complex products, that 20 to 30% of them transact without advice and would undergo an appropriateness test, which lasts 5-10 minutes at hourly labour costs 50.7 EUR as above, the baseline for appropriateness test yields aggregated costs of EUR 828 thousand to 7.4 million.

These costs for suitability assessments and appropriateness tests accrue when relationships with new clients are formed, the "on-boarding". The numbers above can therefore be understood as cumulative of historical costs. Distributors update these tools regularly, but the frequency seems to vary across distributors and the costs of an update are a small part of the initial costs.

Higher costs during the on-boarding phase should be balanced against the possibility of distributors to attract more clients and expand the business with them. The cost calculations below assume that the upgrade of support does not create higher revenue per client, which would need to be balanced against the additional costs. Provided the consumers consent, they would not need to redo the suitability test if they see a different distributor since the portability of the tests would allow that parts would need to be done once for each new client when they onboard, followed by periodic updates.

[450] Most recent data for 2019 and sector K64, i.e. excluding insurance and pension and auxiliary activities to financial intermediation.
[451] Data for 2021. Sum of debt securities, listed shares, investment funds and financial derivatives.
[452] Eurostat, financial accounts.
[453] To read the number from the report, note that only those 28% that said they hold financial assets were asked, i.e. the 4% of those holding assets that said they held structural products translated into 1.1%.

Impact on ongoing costs

The suitability assessment would be enhanced by coding standard information so that it can be used by other distributors and by processing additional information about clients' wealth portfolio. The main cost element would be additional time to assess products not only against the personal profile of the client, but also against the existing portfolio. This also means the distributors' staff would need more time to explain and discuss with the retail clients. Distributors that offer portfolio management services would already have done so. Sophisticated financial advisors will consider knowledge about their client's portfolio an essential ingredient of their client's profile.[454]

Considering that the bulk of the financial advice will remain unchanged, an increase of the duration of suitability assessments by 10% might be a conservative estimate for the impact of the integration of portfolio views. They come on top of tasks to know the customer, his objectives, time horizons and capacities, to match the client's profile to risks, returns, fees and liquidity profile of financial products, and to explain the advice to him. The 10% increase would be applied to new customers and to those existing customers that turn up for advice at the distributor. Appropriateness tests are much lighter than suitability tests and the additional elements carry a larger relative weight.

The retail investment study documents that 50% of the survey respondents that had financial investment said they had invested in the last 12 months. The share of existing customers that seeks advice is likely to be lower than that of new customers and only a part would ask to repeat the suitability test. If their wish to seek advice is the same as for the historical customer base and 20% of those would be subject to a suitability test, annual costs could increase by EUR 5.7 to 11.9 million. If the new elements in the appropriateness test increase the costs by 20 to 33%, annual costs could increase between EUR 82 thousand and 1.2 million.

A further critical cost component common to all options is that onboarding of new customers will become slightly more expensive. The market potential is sizeable. 11% of the respondents to Kantar (2022) said they are looking for investments and a further 14% replies it had the savings and the interest to invest. 53% of the non-invested households or 38% of all households form a potential retail investor base.[455]
If the 11% of respondents in Kantar (2022) that stated to look for investment is taken as lower range and the 14% that claimed to have an interest to invest added to this for a higher range of 25%, costs for the additional enhanced suitability assessments could amount to between EUR 1.3 million and 5.9 million per year and that for enhanced appropriateness tests between EUR 4 thousand and 112 thousand per year. These costs were derived as the total cost that would materialise over time as the new customers request advice or buy those complex financial securities that require an appropriateness test. It was assumed that these costs would hence be

[454] Distributors that are already providing portfolio views to their clients did not disclose how much more costly and time consuming such expansion is for them.
[455] This is derived from a share of 47% of those that 72% of the total respondents who responded to Eurobarometer (2022) that they did not invest said they had not the means to do so.

spread out across at least 5 years as a conservative assumption (this could be even more gradual, which suggests that the overall cost impact of this policy initiative through onboarding of new customers is low).

Impact on one-off costs

Distributors will need to amend their IT infrastructure to conduct the required assessments or tests efficiently. IT tools contribute inter alia to accelerate the provision of targeted information and guidance to staff dealing with retail investors, to document the results of the tests and communication of the results to internal control and compliance departments. Changing requirements lead to one-off costs for amending the IT systems. Although online interfaces with customers are used by a small share of clients, all distributors seem to have IT systems in place. Hence, none of the options will require the development of new IT systems, costs will be caused by adapting the systems and adding new modules to existing systems.

Relevant amendments to IT systems will result from the enhancement of (1) suitability assessments towards modules to a) decode standardised basic information about clients suitable for passporting and b) the processing of additional information about clients' wealth portfolio, (2) appropriateness tests towards additional elements covering profiling screening, the client financial capacity and ability to bear losses.

While all distributors will need to use such modules, many distributors seem to already have IT systems in place that would accommodate the required changes, but not all. Reports from the industry suggest that a many firms have the required IT tools already in place to consider the clients portfolio for suitability or appropriateness assessments. The market sounding for this impact assessment may not be representative. Yet, 38% of the respondents have already identified asset classes suitable for the client as part of the suitability assessment, 43% of the respondents even said they identify a suitable asset allocation. Since the number of respondents is only half of that that replied to the question on the suitability assessment, it appears conservatively realistic to assume that the share of firms that need to set in place such a module would be around 80%, with a lower bound at 62% and an upper bound at 100%. The lower bound is motivated by the observation that 38% of the firms FISMA consulted said they had a system in place that offers portfolio views.

Not every distributor will need to develop such modules. A possible scenario would be that the 10 largest banks and asset managers develop their own systems and all other distributors purchase them from a range of 10 products in both sectors that are developed from IT specialist firms. This scenario would mean that 40 IT modules are developed for enhanced suitability assessments (ESA) and enhanced appropriateness tests (EAT). While the presence of competing products from IT specialist firms will reduce average costs, it seems not plausible to assume that the price will decline to the average development costs. For simplicity, it is assumed that the IT specialist firms charge a price that will secure them profits equal to the development costs.

Adaptation costs to the IT systems would be proportional to the complexity of the new IT modules. The cost of developing the required modules is difficult to estimate and is likely to be very different across entities depending on their existing IT infrastructure, strategic orientation, business and needs and client base. The cost of development of apps depends very much on the

degree of complexity, ranging from EUR 50,000 - 75,000 for simple apps up to EUR 140,000 – 250,000 for developing sophisticated robo-advice tools. This impact assessment connects the development costs for modules need for ESA and EAT to those of a simple app.

Table: Parameters to estimate one-off IT and training costs for financial advisors in banks and asset managers, in million EUR.						
	Estimate		Assumptions			
			Banks		Asset managers	
	Lower range	Higher range	Own development	purchase	Own development	purchase
Suitability assessment	2.6	4.5	[6.2, 10]*[50k, 75k]	10*[50k, 75k]*2	[6.2, 10]*[50k, 75k]	10*[50k, 75k]*2
Appropriateness test	3.0	4.5	10*[50k, 75k]	10*[50k, 75k]*2	10*[50k, 75k]	10*[50k, 75k]*2
Training for advisors	6.9	39.5	[135k,390k] staff trained for [1,2] hours at labour costs EUR [50.68]			

6.2 := minimum number of big entities that will need to develop such module, 10 = maximum number of modules to be developed, k:= thousands, 2 to account for profit margin of IT specialist firms.

The table below combines the parameters into a lower and higher range for the estimate adding banks and asset managers. These numbers compare favourably to the estimates in the 2011 impact assessment that accompanied the initial MiFID II. At that time, one-off costs were estimated at EUR 75-132 million, broken down into EUR 50-87 million the development of risk profiles and 25-45m accounted to the production and printing of supporting documentation. The costs for the development of additional modules appear to be proportionate to the historical estimate.

The need to train staff will lead to further one-off costs. These costs depend on the number of staff members that will need this training. While 1 to 2 hours of training per advisor could be sufficient, there is no good estimate of the number of employees in financial services entrusted with doing these assessments and therefore requiring additional training. One estimate is that advisors cater for between 150 to 360 clients. Hence, the number can be derived from the total of retail investors served. With 195 million households in the EU-27 of which 25-30% are holding financial assets, there could be demand for 135 to 390 thousand staff with customer relationships and in need of training. An alternative approach starts from a share of 10% of employees in the US financial sector providing financial advice to customers.[456] More than 500,000 staff in the financial and insurance sector would be in the field of financial advice in the EU 27, if the 10% ratio observed in the US applied also to the EU27. Since the financial sector is larger in the US

[456] Egan, M. et al. (2017), 'The Market for Financial Adviser Misconduct', NBER Working Paper No 22050, September 2017. The study reported that 650,000 financial advisors are active in the US. Employment in finance and industry was 6.2 million in 2021 according to US Bureau of Labour Statistics.

than in the EU, the numbers above look reasonable. Taking the pay in the financial sector of 50.68 per hour as opportunity costs to approximate the costs of 1 to 2 hours training times 135,000-390,000 persons being involved in such assessment work would lead to aggregate training costs in the range EUR 6.9 to 39.5 million.

ANNEX 9: SUPERVISORY ENFORCEMENT

1. Background and problem definition

The retail investor protection framework, in particular in MiFID and IDD, set out the main requirements regarding supervisory powers for the application of the EU rules. An effective and efficient supervision over the EU financial system and enforcement of existing consumer protection rules is crucial to ensure that retail investors are protected and that financial markets in the EU function properly.

This annex aims to address specific problems hindering supervisory enforcement of EU retail investor protection rules, both within Member States (1.1), and with respect to cross-border provision of services (1.2).

1.1 Supervisory enforcement issues related to consumer protection

Incoherent or indeed absence of enforcement in different Member States is a problem in many parts of the EU framework. A number of workstreams have been addressing such issues[457] and efforts have also been made to improve the European supervisory enforcement framework, recently in the context of the review of the European Supervisory Authorities (ESAs)[458] founding regulations.

However, as evidenced in the Evaluation[459] and in the Retail investment study, problems persist and rules are not always applied correctly nor in similar ways. There are particular difficulties with respect to the application of the rules on disclosure of key information[460] and conflicts of interest[461]. Reporting to the ESAs by NCAs about their enforcement actions concerning sanctions

[457] See e.g. the work on sanctions, ESMA's Report Sanctions and measures imposed under MiFID II in 2021 point 8 page 6 '*The adoption of the Inventory of Enforcement Measures and Sanctions by the ESMA Board of Supervisors in September 2021 assisted in developing a common understanding of enforcement and sanctioning powers amongst the NCAs. This common understanding forms the basis of the sanctions reported in this 2021 annual MiFID II sanction report. Terms covered by the inventory include sanctions such as administrative fines, public statements, temporary or permanent bans, suspensions or withdrawals of an authorisation, disgorgements of profits gained or losses avoided, gain-based pecuniary sanctions and orders to cease and desist. This common understanding allows better comparison of the sanctions reported by different NCAs in the EU and EEA*.'

[458] The Regulations founding the European Supervisory Authorities (ESAs), were amended and the new regulations became applicable as of 1 January 2020. The review introduced additional mandates for the ESAs regarding investor protection, including the co-ordination of mystery shopping, the development of retail risk indicators, and the collection, analysis and reporting on consumer trends.

[459] See Annex 11.

[460] Page 350 of the Retail investment study.

[461] Point 6 page 350 of the Retail investment study.
The study found that, even though the rules under MiFID II only allow inducements if a quality enhancement test is passed and hence aim to make inducements the exception, an important share of

and penalties has shown[462] that the sanctioning powers are not equally used among NCAs and that a number issue either few or no sanctions at all, despite supervising a large number of firms. In its the report on Administrative sanctions on IDD[463], EIOPA arrived at similar conclusions regarding the difficulty to compare data across Member States and stressed that the use of sanctions is just one element out of a broader toolbox available to NCAs carrying out supervisory activities.

With increased digitalisation, investment fraud through digital means is becoming more common across the EU[464]. Examples include **fake websites** offering bogus investment opportunities, seeking out victims via social media platforms and inviting potential investors (through online advertisements) to invest online and enticing them with initial benefits. Based on data from the Europol's 2021 Serious and Organised Crime Threat Assessment (SOCTA)[465], investment fraud schemes can result in substantial financial damage to private individuals and companies[466]. While the prosecution of fraud is an issue under the responsibility of the criminal authorities and national courts,[467] NCAs have an important role in ensuring that any investment fraud is detected quickly and stopped, in dealing with fake websites, helping consumers recognise potential scams[468], facilitating access to information and, when necessary, restricting access to these websites. While many NCAs provide information on their websites to consumers about fraudulent or unauthorised activities, the situation differs across Member States[469].

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investment funds analysed clearly applied inducements while for many other products the information was not clearly disclosed so it possible that the use of inducements is even higher than mentioned in the study.

[462] See for instance the 2021 ESMA Report Penalties and measures imposed under the UCITS Directive in 2021 and
ESMA Report Sanctions and measures imposed under MiFID II in 2021.

[463] EIOPA 2nd Annual Report on administrative sanctions and other measures under the Insurance Distribution Directive (IDD) (2020) (europa.eu).

[464] Investment Fraud on Page 60 of Europol (2021), European Union serious and organised crime threat assessment, A corrupting influence: the infiltration and undermining of Europe's economy and society by organised crime, Publications Office of the European Union, Luxembourg.

[465] Ibid.

[466] Europol sources refer to individual cases of millions of euros:
- Fake investors busted in Belgium and France | Europol (europa.eu) - EUR 6 million scam
- report_socta2017_1.pdf (europa.eu) - "one investigation revealed estimated profits of up to EUR 3 billon generated"

[467] The European Union Agency for Criminal Justice Cooperation (EUROJUST) has issued Guidelines on How to Prosecute Investment Fraud Eurojust Guidelines on How to Prosecute Investment Fraud - July 2021 (europa.eu) The guidelines provide an overview of the legal and operational issues that prosecutors may come across and explain how Eurojust and the European Union Agency for Law Enforcement Cooperation (Europol) can help to bring investment fraud prosecutions to a successful end.

[468] Fraudulent schemes that attempt to take money from people.

[469] Other sources of information on scams include for example the IOSCO. The IOSCO publishes a list of alerts and warnings sent by its members on a voluntary basis, with firms' names that are **not authorised** to provide investment services in the jurisdiction which issued the alert or warning. Some unauthorised firms use names similar to those of authorised firms or about unauthorised firms falsely claiming to be associated with authorised firms. Investor Alerts Portal (iosco.org). However, such sources of information are not coordinated, and investors need to look at different places to find what they need.

Furthermore, the existing powers of NCAs to tackle aggressive online marketing practices may not be sufficient to allow them to intervene in a timely manner[470]. As digital marketing content may only be accessible for a brief period of time, NCAs need to be able to effectively and rapidly intervene on "temporary" content, which may play on behavioural biases of retail investors (such as the "fear of missing out"). Under existing powers[471], NCAs can suspend the marketing or sale of certain investment products, provided that the specific conditions[472] for the use of product intervention powers have been fulfilled. However, in practice, the procedure is too lengthy to allow effective and timely intervention.

NCAs and ESMA[473] have also observed (**aggressive**) online **marketing** and advertising campaigns for financial instruments or services that reach many people, but which contain no specific risk warnings about the risky nature of some financial products. The interaction with (potential) clients is often done via online tools (i.e. videos, or even targeted messages or chats), increasing the risk that clients are not adequately informed of the risks and costs of the advertised products. Under the current legal framework, the process for NCAs to impose risk warnings for particular risky financial instruments is lengthy and subject to heavy legal requirements, which undermines the effectiveness of the regime.

While the three European Supervisory Authorities have the power to coordinate **mystery shopping** activities of competent authorities on the basis of Article 9(1f), not all Member States have such powers. NCA's powers vary significantly across Member States[474]. In the exercises coordinated by the ESAs[475], those NCAs that have undertaken mystery shopping activities confirm that they are effective in allowing NCAs to obtain better insight into the conduct of financial institutions and may encourage them to take enforcement action to strengthen the protection of consumers. Coordination of mystery shopping exercises at EU level allows participating Member States to obtain faster results, improve the level of compliance and profit from the exchange of good practices with other NCAs.

In the area of **complaints handling**, the majority of citizens do not resort to complaints to help them resolve issues they face in financial services[476]. Citizens do not receive the same level of

[470] ESMA advice, page 12, point 27.
[471] Article 69(2)(k) MiFID, for IBIPs: Articles 16 to 18 PRIIPs Regulation.
[472] The conditions are described under MIFIR Articles 42(2) to 42(7).
[473] ESMA advice, page 37, point 120.
[474] EBA Report on the mystery shopping activities of NCAs (europa.eu).
[475] EBA Report on the mystery shopping activities of NCAs (europa.eu)
Mystery shopping as a tool for conduct supervision | Eiopa (europa.eu)
Mystery shopping: Compliance, culture and consumer outcomes | Eiopa (europa.eu)
Inclusion of mystery shopping review as part of the ESMA 2022 work programme: esma71-99-1735_esma_work_programme_2022.pdf
[476] According to the Eurobarometer[476] (no. 509) on retail financial services and products published in October 2022 retail clients often (42% on EU average) do not complain if they feel that their rights were breached.

protection across the EU and across sectors due to differences in the rules and procedures, which may in some cases be more detailed and consumer-oriented[477]. Retail investors also face challenges to understand with which provider they are contracting or to whom they should address complaints or seek redress, especially in the increasingly digital environment[478] of financial services.

1.2 Cross border supervision

The development of the single market and the digitalisation of the financial services has led to an increase in the cross-border provision of services. This has benefits for consumers, as it fosters competition, however it also poses challenges to the supervision of cross-border activities and financial institutions.

The **respective responsibilities of the home and host NCAs** for enforcement in cross-border cases are shared according to the home-host principle. The main responsibility remains with the home NCA, even if the supervised entity provides services in other Member States via passporting. In case of non-compliance with relevant rules, procedures ensuring cooperation between the home and the host NCA are in place to ensure proper supervision and avoid consumer detriment.

Nevertheless, as set out in several reports from the ESAs[479], a number of difficulties relating to cross-border enforcement exist which in particular relate to institutional and organisational issues of supervision:

- NCAs responsible for the supervision of the firms authorised in their jurisdiction (home), may face difficulties[480] when supervising their cross-border activities, which may be more easily handled by host NCAs that monitor their own market. The efficiency of the cooperation mechanisms to address such situations is therefore instrumental to ensure proper functioning of the single market. **Cooperation procedures have sometimes been perceived as too burdensome and lengthy** and not effective in protecting consumers quickly and efficiently. This is the case in particular for MiFID firms, where a high burden of proof is needed for the host NCAs to demonstrate they have "clear and demonstrable grounds" to request the application of Article 86 and take precautionary measures[481]. National authorities that have used (partly or in full) the provisions under Article 86 of MiFID believe that the stringent nature of the current rules causes delays in the finalisation of the procedure.
- MiFID and IDD currently include legal provisions to ensure efficient **cooperation between home and host NCAs for cross-border activities**. However, unlike

[477] Point 219 page 64 Joint ESAs Report on digital finance.pdf - EN (1).pdf.

[478] Ibid. Joint ESAs Report on digital finance

[479] ESAs Joint Committee report on cross-border supervision of retail financial services, July 2019
ESMA Technical Advice to the Commission on the application of administrative and criminal sanctions under MiFID II/MiFIR, March 2021
ESMA peer review on supervision of cross-border activities of investment firms

[480] Points 113, 114 of Final Report on cross-border supervision for retail financial services.

[481] ESMA's 2021 Technical Advice on sanctions under MiFID/MiFIR indicates that there is a high burden of proof for the host NCAs to demonstrate they have "clear and demonstrable grounds.

Solvency II, the ESAs do not have a clear legal mandate where there is a significant risk of consumer detriment, to make use of collaboration platforms in cross-border cases to resolve such issues[482].

- Furthermore, under MiFID and IDD there is currently no streamlined yearly **requirement for entities operating via a passport to report on their cross-border activities**. Lack of such data makes it difficult for ESMA and NCAs to gain an overview of the activity of firms passporting into the market: that restricts the efficiency and effectiveness of their supervisory activities and their ability to detect problems.
- There is evidence that some firms have chosen to obtain authorisation in a Member State even though they are not planning to carry out any, or at least not a considerable part, of their activities in that Member State. This could be related to **jurisdiction shopping**, and the intention to benefit from the passport without being subject to a stricter application of supervision rules.

These difficulties indicate that improvements are needed in the way investor protection rules are applied in practice, and that they are potentially affecting clients' trust in the single market. Maintaining the current situation is therefore likely to pose a threat to consumer welfare and the further development of the CMU.

In order to tackle the above problems, options to strengthen supervision and improve consumer protection in the areas of a) general enforcement (including strengthening the framework for the fight against fraud and scams) and b) cross-border supervision have been assessed.

What are the available policy options?

5. 2.1 Aspects of general supervisory enforcement related to consumer protection

Option label	Option description
Option 1 - Baseline	**Do nothing to change the legal framework – rely on existing enforcement mechanisms to ensure that the existing rules are correctly applied**
Option 2 **Targeted measures to strengthen aspects of supervisory enforcement related to consumer protection**	Measure 1 - Provide an obligation for Member States to give powers to NCAs to perform mystery shopping activities. Measure 2 - Address scams in the context of new digital channels Measure 3 – Empower NCAs, ESMA and EIOPA to take timely and effective actions against misleading marketing practices Measure 4 - Empower ESMA, EIOPA and NCAs to impose on firms the systematic use of risk warnings for specific financial instruments Measure 5 - Impose specific requirements to facilitate access to complaints handling for consumers

[482] See Article 152b Solvency II.

2.1.1 What are the impacts of the options?

Option 2 – Targeted measures to strengthen aspects of supervisory enforcement related to consumer protection

The modalities of option 2 would involve a combination of several measures.

Measure 1: Provide an obligation for Member States to give powers to NCAs to perform mystery shopping activities.

Not all NCAs have explicit competence or a legal mandate to carry out **mystery shopping** in their jurisdiction and they consequently do not perform any such activities. Introducing such a power would mean that all NCAs could use this additional tool to help them identify problems, understand how markets operate in practice, whether firms are complying with conduct of business obligations and whether they are delivering customer service in compliance with the applicable rules. Mystery shopping is an additional tool to gather information and detect problems in the market. It complements other supervisory tools and can be used, for example, to follow up complaints received or investigate infringements and unfair commercial practices. Mystery shopping would allow NCAs to obtain faster results and encourage financial institutions to take corrective actions where regulatory shortcomings have been identified and to improve their level of compliance with the applicable regulatory standards, to the benefit of consumers' protection.
The mere possibility that NCAs may undertake mystery shopping may create an incentive for firms to comply with the application of requirements under EU and national law, thus enhancing consumer protection.

In addition, when ESAs are coordinating mystery shopping exercises, ensuring that all NCAs have similar powers will provide a more complete picture of the situation in the whole EU market.

Benefits and costs

As the measures would enable NCAs to detect problems better and quicker, it should help enhance protection, thus benefitting consumers. The measure would not create any costs for the industry.

In order to be able to carry out mystery shopping exercises alongside other supervisory work, national authorities would need to contribute sufficient human and/or financial resources, e.g. for training staff or outsourcing the exercise to external providers.

Overall assessment

The option would strengthen NCAs' supervisory toolbox and better protect retail investors, while the costs would likely remain reasonable in view of the expected benefits.

Measure 2: Address scams in the context of new digital channels

While retail investors may not always be in a position to challenge false claims, NCAs are well placed to understand whether an offer is inappropriately made to retail investors, or whether an offer might in fact be a potential scam, which may include *inter alia* offers based on false/inappropriate/unrealistic claims, products that simply do not exist and are made up, false

claims about whether a provider is regulated, etc. Websites and social media have accelerated the dissemination of such fraudulent offers.

Under this measure, NCAs would first be tasked to **set up the necessary tools for citizens to report potential scams**. NCAs should collect alerts from retail investors or stakeholders (in particular consumer associations) via a standardised reporting procedure via the NCAs' websites. NCAs should then be required to **promptly analyse** (including by engaging with) the website/seller to better understand whether the offer is in fact a scam. If the products/services are not discontinued, and if the NCA investigation concludes that they should be considered **scams**, NCAs should warn consumers by entering such cases into a dedicated section/blacklist.

In order to clarify the powers of NCAs that are already provided in MiFID, and to reinforce their role in tackling scams from non-supervised entities, Member States should empower NCAs, directly or via other national authorities (or legal channels), to **limit access to the websites** or engage in legal procedures to this end, and, where appropriate, undertake other actions (request a cease-and-desist order, request that the assets be frozen etc.)[483]. To the extent possible, NCAs should be granted the following powers:

- To directly remove content or to restrict access to an online interface or to order the explicit display of a warning to retail investors when they access an online interface;
- To order a hosting service provider to remove, disable or restrict access to an online interface;
- Where appropriate, to order domain registries or registrars to delete a fully qualified domain name and to allow the competent authority concerned to record such deletion.

To ensure that retail investors have access to clear and easily understandable information on investment fraud, information provided by NCAs, including the above-mentioned blacklists, would be **centralised on an EU-wide website**. The EU-wide website, operated jointly by the ESAs, would include information regarding warnings and information on scams, as well as relevant links to national websites where consumers may turn in case of problems. Responsibility for the information provided would remain with the NCAs that issue the warnings.

Benefits and costs

By preventing or quickly tackling investment frauds, this measure would benefit retail investors as well as the overall economy. Investment fraud schemes result in substantial financial damage to private individuals and companies. Even though no consolidated data is available on

[483] According to IOSCO " The power to shut down or otherwise block illegal websites promptly, either directly or via petition to a court, may prove to be an effective means of halting ongoing misconduct." See also FCA 2017 Consumer investments data review 2020 | FCA "We decide whether to take enforcement action based on whether we believe there has been serious misconduct. We consider factors such as the severity of the harm arising from the suspected misconduct, whether the suspected misconduct has wider implications, the extent to which it may have involved lack of fitness and the public interest in investigating the matter. This action includes issuing warning notices, publishing consumer alerts, taking down websites, taking civil court action to stop activity and freeze assets, insolvency proceedings and, for the most serious cases, criminal prosecution."

investment fraud, Europol has dealt with cases amounting to millions of Euros[484]. These amounts represent not only a loss for consumers and entities, but also cannot be invested in regulated financial markets and support the CMU. Tackling scams and ensuring easier access to information for retail investors would increase confidence in the financial system as a whole.

This measure would not entail costs for the financial services industry, as no further requirements would be imposed on undertakings. Industry would in fact benefit from investments being directed towards legitimate channels. For NCAs, the costs incurred would not be expected to be disproportionate, given that they already address such issues and inform/warn consumers. Centralising the information on an EU website would imply an initial set up cost for the ESAs for the development of the website and certain fixed maintenance costs, which could however build on similar tasks already performed by the ESAs. The cost would also be proportionate to the benefits to the retail investors at EU level and would rely on information that is already known by NCAs.

Overall assessment

Overall, the measure can be expected to improve efficiency and effectiveness in addressing fraudulent schemes and scams and preventing investment fraud by enabling NCAs to take swift action. Consumers, industry, and capital markets in general will benefit, as NCA's enforcement actions will help increase trust in the financial system.

Measure 3: Empower NCAs, ESMA and EIOPA to take timely and effective actions against misleading marketing practices

In order to be able to fight potential misleading marketing practices, NCAs were empowered by MIFD II to suspend the marketing or sale of financial instruments or structured deposits[485], in or from their Member State, when certain conditions are met[486]. NCAs were also granted the power to take similar action on a precautionary basis before a financial instrument or structured deposit has been marketed, distributed or sold to clients[487]. The exercise of such power was, however, subject to strict conditions[488]. In addition, the current MIFIR regime allows ESMA, under certain conditions[489] to exercise temporary intervention powers, in situations where one or several NCAs fail to appropriately address a given investor protection issue (for instance in case of cross-border marketing communication).

The tight current legal framework is not sufficiently effective to allow NCAs to promptly take action to prevent detrimental impacts for retail investors, in light of the rapid and continued development and propagation of digital marketing communication and the significantly rising

[484] Europol sources refer to individual cases of millions of euros:
- Fake investors busted in Belgium and France | Europol (europa.eu) - EUR 6 million scam
- report_socta2017_1.pdf (europa.eu) - "one investigation revealed estimated profits of up to EUR 3 billon generated"

[485] See Article 69(2)(s) of MIFID II.

[486] See Article 42(2) of MIFIR and Article 21 of delegated regulation (EU) 2017/567.

[487] See Article 42(2), penultimate paragraph - MIFIR.

[488] See Article 42(3) MIFIR.

[489] See Articles 40(2) to 40(5) of MIFIR.

phenomenon of aggressive marketing of complex/risky financial instruments and investment services to retail clients[490]. The current complicated and time-consuming process does not allow, for instance, to catch ephemeral (or short-lived) digital marketing content, accessible for an extremely brief period (sometimes less than 24 hours) and designed to attract an immediate answer from the user[491]. The current rules under MIFIR are also rather constraining and do not allow ESMA to intervene promptly when one or more NCAs fail to appropriately address[492] consumer protection issues.

In order to facilitate coordinated and consistent actions against aggressive marketing practices across the EU, and especially to tackle aggressive marketing practices in a timely manner, the proposed measure would:

- amend the conditions for intervention by NCAs[493] to ensure that they can take timely and effective action against misleading marketing practices (more swiftly than is currently possible under the product intervention measures).
- implement a clear notification system among NCAs that enables sharing of information when one individual NCA has taken action in connection with misleading or aggressive marketing communication or practices. This would include publishing all adopted measures on a single page on ESMA's website dedicated to NCAs, with links to the individual NCA's website. A simplified version of the information could be shared with consumers on the EU-wide website, as mentioned in measure 2 above.
- mandate ESMA to coordinate actions related to misleading or aggressive marketing communications and practices across Member States, where needed.
- amend the existing ESMA intervention power under MIFIR[494] to allow for a more streamlined and faster procedure for ESMA/EIOPA to intervene in cases of problematic cross-border marketing, in particular where an NCA fails to take appropriate actions. This would require the review of the conditions under which ESMA may use such powers, especially to ensure a more rapid intervention[495].

Benefits and costs

This measure would benefit relevant competent authorities in their supervision activities and ultimately investors, as they would be better protected by the strengthened capacity of the relevant competent authorities to react in a timely manner in case of a misleading or an aggressive marketing communication or practices in circumstances when timing is of the essence. Both NCAs and investors would become better aware of such actions, also in cross-border

[490] See ESMA advice to European Commission – point 27, page 12.

[491] See ESMA advice to European Commission – point 27, page 12 "Ephemeral (or short-lived) digital marketing content is only accessible for an extremely brief period (sometimes less than 24 hours). Supervisors need, especially in these types of cases, to be able to effectively and rapidly intervene on "temporary" content that, for example, takes advantage of the fear of missing out (FOMO) and is designed to elicit an immediate response from the user."

[492] See ESMA advice to European Commission – points 27 and 28, page 12.

[493] Under MiFIR (Article.42).

[494] See Article 40 of MIFIR

[495] As currently provided to NCAs under Article 69(2)(k) of MiFID II.

situations. The coordination and intervention of ESMA would ultimately also be beneficial by helping harmonise actions on marketing communications and practices across Member States and thus ensuring that bad practices can be better and more rapidly tackled by NCAs or ESMA.

The measure would not create any costs for the industry but might negatively impact profits for some financial intermediaries that rely on this form of communication with potential investors.

The obligation for NCAs to intervene in cases of aggressive marketing practices already exists in the current rules, however, with the proposed amendments, NCAs are allowed to act in a more timely and efficient manner. As a result, the requirement itself does not impose additional burden to the NCAs per se, and NCAs can decide how they will apply their powers to intervene against misleading marketing practices. In order to ensure more efficiency, technology-based detection, investigatory techniques and qualified staff may be considered. NCAs may have to incur one-off and further ongoing costs depending on the volume of identified issues and the level of intensity of supervision[496]. In particular, access to social media posts is currently challenging, due to their high number and constant change, but also because they are not always accessible by regulators[497], as they are targeted to specific audiences and not visible publicly.

The coordination powers for the ESAs would imply a potential reallocation of priorities to perform the relevant tasks. Depending on the volume and frequency of the coordinated actions, some additional costs related to additional resources may be required. The intervention power granted to ESMA would be limited to extraordinary cross-border cases, when coordination among NCAs is deemed not effective; this should not require more tools and human resources, given the resources already dedicated to NCA cooperation. Some potential re-allocation of resources may be needed in extraordinary cases.

Overall assessment

This measure would help retail investors to access more reliable marketing communication throughout the EU by avoiding, or at least limiting, the spread of misleading marketing

[496] According to IOSCO report on retail distribution and digitalisation, this is a problem that most regulators currently face: while over 60% of firms active in online distribution and marketing plan to increase they activities, less than 25% of the regulators worldwide planned to increase headcount for the supervision in this area based on end 2019/early 2020 survey numbers.

[497] IOSCO Report on Retail Distribution and Digitalisation highlights on pages 22 and 23 that it is particularly difficult to catch misleading or at times illegal recommendations or promotions through digital means, especially via closed channel in social media …. Detecting the existence of the activity in an online environment is the greatest regulatory challenge. Many online marketing initiatives are targeted towards specific audiences and therefore, not visible to every user and regulator, making it possible for misleading information to spread out of regulatory sight. There is an overload of information and information is continuously changing Members surveyed mostly rely on consumer complaints for investigation and enforcement purposes for misleading and illegal promotions [which according to some IOSCO members are relatively low]. In addition, when an individual has signed up to a particular firm or platform, the ability for direct communication can include unsolicited messaging beyond what the individual has signed up to receive. This may be difficult for IOSCO members to monitor as the platforms often have embedded social media aspects such as chat functions. IOSCO also points on the cross-border challenges as online marketing enables unlicensed firms to enter the market relatively easily with minimal or no physical presence.

information which might result in them taking inappropriate investment decisions, in particular for investors investing on their own. This measure should also help to address regulatory and supervisory arbitrage and facilitate enforcement cooperation amongst EU competent authorities and ESMA and should enhance overall investor protection across the EU. The efficiency of this measure may however depend on the technology-based detection and investigatory techniques used by competent authorities and on the expertise of their staff. There may be one-off costs for NCAs and extra costs, depending on the volume of identified issues and the intensity of supervision decided by the national competent authorities.

Measure 4: Empower ESMA, EIOPA and NCAs to impose on firms the systematic use of risk warnings for specific financial instruments

Digital marketing of investment products and services is growing throughout the EU. Such techniques can reach many potential investors, especially via social media[498]. The use of such techniques may help provide information about investment opportunities across a wide range of financial products[499], however it may also expose inexperienced and vulnerable investors to products that are not aligned to their risk profile and personal circumstances[500]. In its advice to the Commission, ESMA observed that social media campaigns very often promote riskier products. ESMA also highlighted that, in the case of the product intervention measures addressing contracts for difference (CFDs), there is an obligation to include a risk warning (also on social media). Under the current rules, however, no such risk warning is imposed for other risky financial services or instruments at EU level. As not all NCAs have a mandate to impose a risk warning for risky financial products, there is a patchwork of different approaches across the EU.

In order to raise retail investors' awareness about risky products that may be referred to or recommended in marketing communications, and to help them make better and informed choices, this measure proposes to:

- mandate NCAs to impose on firms, on the basis of ESMA's guidelines, the systematic use of risk warnings for specific risky financial products in their social media messages and other marketing communications and disclosure documents related to such financial instruments.

[498] ESMA advice on retail investor protection page 37.

[499] See IOSCO report on retail distribution and digitalisation, page 1.

[500] This is further evidenced in a study by the Dutch AFM and further supported by a study conducted on behalf of the UK's FCA suggesting that newer investors might not be matching their investments' risk level to their risk appetite. Extract from the AFM study:
(AFM 2021 Annual Report: a strong year with a market record, rapid increase in number of retail investors and shift of trading to Amsterdam | April | AFM: pg. 64) "one in three independent investors are taking unnecessary risks. Their trading behaviour is suboptimal. Some of the investors have a tendency to trade often, incurring unnecessary costs. In addition, a lack of diversification across instruments and regions results in portfolios with a poor risk-return ratio, as does trading in high-risk products. Around 12% could find themselves in financial difficulties".

- mandate ESMA and EIOPA to issue guidelines on risk warnings to be used in the context of marketing of risky financial products, to further harmonise the content and format of the risk warnings;
- empower ESMA and EIOPA to ensure risk warnings are implemented consistently, especially in cases of cross-border marketing communications. ESMA/EIOPA should be able to intervene if NCAs fail to implement those risk warnings consistently;
- mandate ESMA and EIOPA to provide guidelines on risky financial products.

Benefits and costs

This measure would benefit investors as it would raise retail investors' risk awareness in relation to risky products, in all disclosure documents, including in marketing communications and practices which are often the first information to reach investors. A harmonised approach, via ESA involvement, would ensure this measure is applied consistently, and would ease the compliance burden for firms, thus improving overall efficiency. This measure would also serve as a further deterrent against inappropriately offering excessively risky products to retail clients with the wrong profile.

This measure would not generate any material costs for the industry, as it would only require financial intermediaries to adjust their disclosures, including in marketing communications, to the new risk warnings imposed by the NCAs or ESMA/EIOPA.

Costs for NCAs are expected to be limited, especially if risk warnings are further standardised. No significant impact is expected on the resources of ESMA and EIOPA, as their involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

Overall assessment

This measure would increase the effectiveness of retail investor protection by ensuring warnings are visible and accessible for risky products across all types of communication material. In addition, the exchange of information between Member States through EU-wide coordination would ensure the same level of retail investor protection where services are provided cross-border.

Measure 5: Impose specific requirements to facilitate access to complaints handling for consumers

Eurobarometer no. 509 [501] on retail financial services and products indicated that retail clients (42% on EU average) often do not complain if they feel that their rights were breached; the survey findings indicate that complaint possibilities may not be sufficiently known or easily accessible to clients.

As set out in the Joint ESAs report on digital finance[502], only some EU directives include specific requirements for complaints handling and redress[503] mechanisms, leaving scope for different

[501] Retail Financial Services and Products - October 2022 - - Eurobarometer survey (europa.eu)
[502] Joint ESAs Report on digital finance.pdf - EN (1).pdf

approaches at national level. There is thus a risk that retail investors will not receive the same protection across sectors and across different Member States.

The Joint ESAs report on cross-border supervision[504] also alerted the Commission to the risks of confusion, depending on whether cross-border services are offered directly by a firm (free provision of services – FPS) or via a branch (freedom of establishment – FOE). This may confuse end-investors as to whom they should address their complaints in case of problems.

This measure proposes to:

- require firms wishing to contract with retail clients in another Member State to establish appropriate procedures and arrangements, including digital communication channels, to ensure that they deal properly with clients' complaints. Those measures should allow investors to file complaints in the same language in which the communication material and services were provided[505].
- require firms to specify and clearly disclose to the customer the relevant contact information of the firm or branch responsible for providing the services, as well as the relevant competent authority.

Benefits and Costs

The proposed measures would benefit retail investors by ensuring they have clear information and instructions and adequate access to communication channels and complaints mechanisms. Establishing appropriate procedures and arrangements, including digital communication channels, to ensure that they deal properly with clients' complaints, will help retail investors access firms and allow them to communicate in their own language, both during the provision of services and also in case they encounter issues.

In terms of costs, it is expected that firms will incur costs to put the necessary resources in place. However, the costs of the specific requirements would not be significant compared to the costs that firms already have incurred to set-up mechanisms for complaints handling and those they

[503] Considerations relating to redress mechanisms and facilitation of access to alternative dispute resolution mechanisms by consumers, were not addressed in this strategy. The issue of improving redress procedures will be subject to the review of the Alternative Dispute Resolution Directive to be carried out in the course of 2023.

[504] Final Report on cross-border supervision for retail financial services

[505] A similar provision exists under UCITS Article 15, which requires measures to be in place that allow investors to file complaints in the official language or one of the official languages of their Member State. Article 15: '*Management companies or, where relevant, investment companies shall take measures in accordance with Article 92 and establish appropriate procedures and arrangements to ensure that they deal properly with investor complaints and that there are no restrictions on investors exercising their rights in the event that the management company is authorised in a Member State other than the UCITS home Member State. Those measures shall allow investors to file complaints in the official language or one of the official languages of their Member State. Management companies shall also establish appropriate procedures and arrangements to make information available at the request of the public or the competent authorities of the UCITS home Member State.*'.

anticipated as part of their strategic plans when considering whether to provide cross-border services.

Overall assessment

The proposed measure would seek to ensure easy access of retail investors to complaints handling mechanisms and strengthen consumer protection. It should increase confidence in the EU market for retail investment services and consequently strengthen the CMU.

Summary

All the measures under Option 2 are complementary and together would contribute to strengthening supervisory enforcement in the EU. Stronger supervision addressing scams and aggressive marketing practices would ensure that informed investors can better make decisions that should benefit them. At the same time, strengthening the supervisory toolbox of NCAs and better informing consumers in ways that enable them to act when they encounter issues would help align the interests of consumers and firms, ensuring high quality services and products.
The measures proposed would be in line with the Commission's overarching goal of promoting an economy that works for people.

	Effectiveness			Efficiency	Coherence
	S01 Increased ability of investors to take well-informed investment decisions	SO2 Alignment of interests between retail investor and firms	SO3 Offer of cost-effective products		
Baseline (Option 1)	0	0	0	0	0
Option 2	++	+	+	+-	++

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect
0 = no effect - = Slightly negative -- = Negative --- = very negative

6. 2.2 Cross-border supervision

Option label	Option description
Option 1 - Baseline	Do nothing to change the legal framework – rely on existing enforcement mechanisms to ensure that the existing rules are correctly applied
Option 2	**Improve home/host relationships and protect consumers in situations of cross-border provision of services** Measure 1 – Enhance and accelerate the process of cooperation of home and host NCAs to ensure effective supervision of cross-border service providers Measure 2 – Improve safeguards in cross-border supervision of services to avoid jurisdiction shopping

2.1.1 What are the impacts of the options?

Option 2: Improve home/host relationships and protect consumers in situations of cross-border provision of services

The modalities of option 2 would involve a combination of several measures.

Measure 1: Enhance and accelerate the process of cooperation of home and host NCA to ensure effective supervision of cross border service providers

Under this measure, the Commission would propose a series of actions to ease cooperation between NCAs in cases of cross-border provision of investment services, notably to enhance supervision. Ultimately, those actions would seek to foster confidence in the single market and strengthen the Capital Markets Union.

Article 86 MiFID provides a key tool for coordination of action in cases of alleged cross-border breaches of Union law. However, evidence collected from **ESMA's 2021 Technical Advice on sanctions under MiFID/MiFIR[506],** as well as supervisory experience have shown that a high burden of proof is needed for host NCAs to demonstrate they have "clear and demonstrable grounds" for believing there is an infringement of MiFID II, before they can take the measures. There are often lengthy interactions between host and home NCAs and the process is made more complex by the fact that host NCAs have no supervisory powers nor access to records and information to allow them to assess firms' compliance with the relevant requirements.

According to a survey[507] conducted among national authorities that have used (partly or in full) the provisions under Article 86 of MiFID, the strict rules lengthen the time necessary to finalise the procedure; softening the conditions to trigger an Article 86 procedure would help shorten the process and significantly reduce the harm to end-investors caused by potentially unlawful activities. All NCAs refer to ESMA's March 2021 technical advice on sanctions under MiFID II/MiFIR, which proposes to facilitate the conditions for host NCAs to trigger Article 86 of MiFID given that the current procedure is considered too burdensome and ineffective[508].

The following amendments to MiFID Article 86 should allow to accelerate and facilitate cooperation between NCAs, if a host NCA suspects a firm active on its territory via passporting may be breaching Union Law:

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[506] ESMA Advice on sanctions under MiFID/MiFIR

[507] Snap survey conducted with the 5 national authorities that have started or completed an Article 86 procedure.

[508] Resources: 3 respondents replied that significant resources are required without specifying the number of working days required (they estimated the involvement between 2 to 5 FTEs per proceeding), 2 respondents replied respectively 43 and 150 man-days per proceeding,

Timing: 4 of the 5 respondents stated that the process takes **from six months to over one year** not taking into account the time required for accumulating findings and to qualify clear and demonstrable reasons. Taking into consideration this time can increase significantly the duration of the process. Finally, 1 respondent could not estimate a duration for the process as it had not gone through a complete article 86 procedure but stater that **part of the reason for this is the prohibitive investment in time and resources that was anticipated**.

1. Easing the conditions under which the mechanism can be triggered, by shifting away from 'clear and demonstrable grounds' to 'reasonable grounds'[509], e.g. linked to complaints, or detrimental behaviour, and streamlining the procedure by setting firm and tight deadlines for the NCAs to react.
2. Requiring that the triggering of Article 86 is transmitted to the NCAs of all host Member States where the firm operates, so that they are informed in time where the relevant firm is passporting into their jurisdiction. This would allow NCAs to monitor and anticipate the existence in their market of breaches found by other host NCAs.
3. Introducing an opt-in mechanism through which host NCAs that observe similar issues from the same firm can refer to an already launched Article 86 procedure, without having to go through the whole process, and leverage on demonstrations made by the first NCA to take action.
4. Clarify that, beyond transmitting information about potential wrongdoings of a firm to home NCAs, host NCAs can request home NCAs to formally look into a firm they suspect, based on reasonable grounds, to be acting in breach of Union law.
5. Linking Article 86 to the setting up of an ESMA collaboration platform.

Considering that the IDD provides for less strict and more flexible cooperation mechanisms compared to those of MIFID, alleviating the grounds for intervention by the host authority (proposal 1 above) would effectively mean an alignment of MiFID to IDD's less restrictive test. The remaining measures (immediate circulation to EIOPA and other MS, deadlines for reaction, coordination group and opt-in mechanisms, inspections) might also be included in IDD to facilitate the cooperation and ensure regulatory alignment.

In order to further strengthen the cooperation between home and host NCAs, and building on proposals already made by the Commission in the context of MiCA with regard to the authorisation of crypto-asset service providers(CASPs)[510], host NCAs and the ESAs, in situations when more host Member States are involved, would have the possibility to require the home NCA to review whether the conditions under which a firm has been authorised are still met (e.g. adequate level of resources, consistency of the operations with the initially declared target market, ability to handle complaints from countries where the firm's products are distributed, etc.). The home NCA would then be required to provide evidence of the checks performed and of potential action taken in light of the assessment.

Where cooperation between home and host NCAs remains difficult and does not allow resolution of particular cross-border cases affecting retail investors, NCAs should be able to count on the ESAs to provide for adequate mediation and solution. Article 152b of Solvency II provides for a

[509] A similar amendment was introduced in the AIFMD review proposal from the Commission, in Article 50(5): 5. *Where the competent authorities of one Member State have reasonable grounds to suspect that acts contrary to this Directive are being or have been carried out by an AIFM not subject to supervision of those competent authorities, they shall notify ESMA and the competent authorities of the home and host Member States of the AIFM concerned thereof in as specific a manner as possible (…)*

[510] Article 56(6) of MiCA proposal:
'The EBA, ESMA and any competent authority of a host Member State may at any time request that the competent authority of the home Member State examines whether the crypto-asset service provider still complies with the conditions under which the authorisation was granted.'

collaboration platform between NCAs and EIOPA. Under Solvency II, a platform is set up when EIOPA and relevant national supervisory authorities see merit in strengthening cooperation in view of issues with a specific undertaking. Once a cooperation platform has been established and is organised by EIOPA, the home supervisor and the relevant host supervisory authorities in which the insurance undertaking concerned offers insurance products under FPS and FOE, would cooperate in order to resolve potential issues. The Commission proposal amending the Solvency II Directive (Solvency II Review) gives EIOPA additional powers to settle disagreements between the supervisory authorities involved in a collaboration platform via binding mediation, in accordance with Article 19 of Regulation (EU) No 1094/2010 (EIOPA-Regulation), and to initiate and coordinate on-site inspections. The concept of a collaboration platform does not yet exist under IDD or MiFID.

It is proposed that collaboration platforms would be introduced into MiFID and IDD to better steer cooperation between national supervisors and support the national assessment of cross-border impacts. This would fit within the coordination function of ESMA and EIOPA, as defined under Article 31 of the ESMA and EIOPA Regulations. Setting up such collaboration platforms should be facilitated in particular where NCAs do not swiftly abide by their obligations under Article 86 MiFID[511]. The platform would be able to issue proposals for further supervisory actions (opinions, recommendations etc.), and ESMA and EIOPA, at the request of any of the authorities involved, would assist in settling the disagreements through binding mediation, in accordance with Article 19 of the ESAs founding Regulation[512] . It would also be able to initiate joint on-site inspections with the supervisory authorities concerned, similar to the proposed amendment for collaboration platforms under Solvency II. Subject to the appropriate assessment of confidential information, publicity of the outcomes of the platform for specific undertakings would also ensure that the wider public is informed of the state of play around certain firms or products and help improve accountability and investor protection. The collaboration platform should facilitate the prompt monitoring of the follow-up action by the NCAs concerned.

Finally, ESMA and the NCAs have been performing fact-finding exercises on cross-border activities in recent years[513] showing the need to roll out this type of light data collection exercise on an annual basis going forward. Based on evidence from the **ESMA peer review** report on cross-border activities of investment firms[514], NCAs concurred that the exercise significantly helped them understand better the situation in their own markets and whether firms holding a passport were actually active and to what extent, as some NCAs only started collecting this information in the context of the ESMA exercise. It is proposed to require the mandatory reporting of firms' cross-border activity to NCAs, which would then report consolidated data to ESMA. ESMA would be mandated to develop guidance for a limited but insightful and harmonised reporting of cross border activities, which could help NCAs and ESMA to gain an aggregated view of cross-border services, products, activities or firms which would then enable it to carry out its role more effectively.

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[511] See also 'Measure 1 - Allow host NCAs to act swiftly and efficiently when firms operating on their territory are doing so in breach of law and posing a serious threat to local investors.'

[512] (EU) No 1094/2010 (EIOPA-Regulation) and (EU) No 1095/2010 (ESMA-Regulation)

[513] ESMA has coordinated a data collection exercise that took place in 2020 and 2021, with voluntary participation by NCAs.

[514] Peer review on cross border activities of investment firms

Costs and Benefits

By removing the administrative burden of proof needed for host NCAs to trigger Article 86, the process and cooperation between home and host NCAs will speed up. Enabling host Member States to notify issues to the home Member State and request that the firm's authorisation is assessed will strengthen cross-border supervision and may prove especially beneficial where the size of the activities in the home Member State may not be significant enough trigger the detection of issues, but where the firm does have significant operations in the host Member State.

The establishment of cooperation platforms to address cross-border issues would benefit investors and strengthen investor protection in the Union while fostering confidence in cross-border investment services. The measure would enhance supervision of cross-border activities by enabling NCAs to work together and benefit from sharing of supervisory expertise.

A requirement for light yearly reporting to NCAs and onto ESMA by entities operating via a passport would increase the quality, consistency and efficiency of supervision. It would provide supervisors with more regular and comparable data which could be assessed and analysed to identify trends in the EU market and allow supervisors to potentially re-allocate supervisory efforts towards identified areas of risk.

The majority of the proposed actions under this measure would not incur additional costs for firms nor for NCAs, beyond the work that is already required to perform their supervisory role. On the contrary, the reduction of the burden of proof, as well as the exchange of practices envisaged through strengthened cooperation, may even facilitate and streamline the work performed and bring efficiency gains.

The requirement for a light yearly reporting by entities operating via a passport is expected to follow the established workflows and reporting lines of the undertakings to their NCAs and ESMA. ESMA would be expected to further assess the costs relating to new reporting obligations as part of their mandate to develop relevant guidance/standards. In order to manage the data and make best use of it among the NCAs, there could be a need for the development of an associated IT system by ESMA to receive, analyse and disseminate the data. That would require a one-off cost in addition to resources to develop and maintain the tool.

Overall assessment

Measures that facilitate the cooperation between national authorities are essential. As an internal market measure, it would ensure that retail investors are equally protected across the EU.

This measure would reinforce confidence in the provision of cross-border investment services in the EU and contribute to a more integrated Capital Markets Union.

Measure 2: Improve safeguards in cross-border supervision of services to avoid jurisdiction shopping

The recent peer review exercise on the supervision of cross-border activities by investment firms indicated that supervision of cross-border activities has not reached satisfactory levels in all

Member States[515], and evidenced the increased risk associated with allowing firms to choose to establish in a Member State for the sole purpose of exploiting relaxed supervisory practices or regulatory standards.

While Article 9(2) IDD contains a clear safeguard provision against the abuse of the freedom to provide services or the freedom of establishment, Article 5(4) MiFID reflects this safeguard less explicitly. Recital 46 MiFID[516] nonetheless already clearly mentions the need to prevent cases of circumvention of the rules and jurisdiction shopping, where investment firms choose to obtain authorisation/registration in one Member State with the purpose of avoiding stricter standards enforced in the Member State where the firm intends to carry out the greater part of their activities. For the purpose of ensuring maximum legal certainty, the principle mentioned under Recital 46 should be more explicitly clarified and included in an Article.

The report on cross-border supervision of retail financial services of the Joint Committee of the ESAs[517] called for alignment across sectoral legislation in order to address situations in which providers leverage on the freedom to provide services (FPS) to ask for authorisation/registration in a home Member State where they intend to carry very little, in any, activity. To implement this alignment, the report suggested to align to the wording included in Article 5(4)(a) with Article 11(3) PSD2[518], which requires that a legal person carry out at least part of its business in the Member State where it is registered. Such amendments would empower supervisors to refuse (and, by consequence, if necessary, withdraw) authorisation on the basis of potential abuses of the FPS, and work as a deterrent against such practices.

As a complement to the above, NCAs should be able to provide information in case they have refused to grant a licence. During the application process, NCAs collect important information which may provide evidence of potential mis-selling or risk of scams. This information may be very valuable for other NCAs that may also receive an application, thus fostering regulatory convergence and reducing risks of jurisdiction shopping. A confidential, non-public database/list of denial of licenses, managed by the ESAs, facilitate the exchange of confidential supervisory information between NCAs. The measure would require NCAs to report to ESMA and EIOPA whenever a license application was not granted. Should another NCA receive a licence

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[515] ESMA peer review report on cross-border activities of investment firms

[516] "*The principles of mutual recognition and of home Member State supervision require that the Member States' competent authorities should not grant or should withdraw authorisation where factors such as the content of programmes of operations, the geographical distribution or the activities actually carried on indicate clearly that* ***an investment firm has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within the territory of which it intends to carry out or does carry out the greater part of its activities****. An investment firm which is a legal person should be authorised in the Member State in which it has its registered office. An investment firm which is not a legal person should be authorised in the Member State in which it has its head office.* ***In addition, Member States should require that an investment firm's head office is always situated in its home Member State and that it actually operates there***."

[517] Final Report on cross-border supervision for retail financial services.

[518] Article 11(3) of PSD2: *'A payment institution which, under the national law of its home Member State is required to have a registered office, shall have its head office in the same Member State as its registered office and shall carry out at least part of its payment service business there'.*

application from the same firm, ESMA/EIOPA should put the two NCAs in touch so they can exchange knowledge acquired in the license application process.

Benefits and costs

The proposed measure would prevent jurisdiction shopping, while preserving the home-host principle. In addition, the exchange of information between NCAs on licences not granted and the reasons for not granting them could foster convergence and potentially alleviate the workload for NCAs in the evidence-gathering process. As the ESAs would manage a confidential non-public database and steer the exchange of information, the measure would lead to improved cooperation between NCAs while respecting confidentiality of information. This would also result in better protection for retail investors at EU level.

In terms of costs, no significant impact is expected on the resources of ESMA and EIOPA, as their involvement and roles under this option can be performed as part of their existing regulatory and supervisory work.

For firms, considering that this measure would be introduced as part of the authorisation procedure, it could be expected to have little impact on costs related to authorisation of the firms. However, for the companies that need to adapt to the new requirements, it may imply adjusting their business model either by increasing their presence in the Member State where they are registered or by moving their activities to another Member State where they carry out part of their business.

Overall assessment

The measure would be expected to protect consumers by helping avoid cases of abuse by firms of the freedom to provide services through jurisdiction shopping. It would address the risk that investment firms opt for the legal system of one Member State in order to evade stricter standards in force in another Member State which they intend to carry out or actually carry out the greater part of their activities. In addition, the measure would improve the effectiveness of supervision by facilitating supervisory convergence and exchange of knowledge and experience among NCAs in their efforts to ensure retail investor protection.

Summary

As part of the retail investment strategy, the aim is to address specific issues in cross-border supervision that have been identified by various sources. Option 2 on cross border supervision would ensure that retail investors are better protected by making it easier for NCAs to monitor and supervise the cross-border provision of services and thus aligning the interests of firms to those of EU citizens.

All the options presented are complementary and would together contribute to the achievement of the objectives set for EU action. The proposed measures are in line with the Commission's overarching goal of promoting an economy that works for people.

	Effectiveness			Efficiency	Coherence
	S01 Investors are able take	SO2 Alignment of	SO3 Offer of cost-		

	well-informed investment decisions	interests between retail investor and industry	effective products		
Baseline (Option 1)	0	0	0	0	0
Option 2	+	++	+	+-	++

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect
0 = no effect - = Slightly negative -- = Negative --- = very negative

ANNEX 10: PROFESSIONAL QUALIFICATION OF FINANCIAL ADVISORS

1.1 Background and problem definition

Financial advisors play a key role as gatekeepers to the financial system. Stronger participation of retail investors is likely to increase demand for financial planning and advice. While new investors may fuel demand for financial advice given their need for support in their financial planning and investment, surveys suggest that also incumbent investors value the role of advisors.[519] Better access to financial advice can therefore be instrumental in triggering retail participation by helping overcome the distrust, which households frequently quote as one of the main reasons why they abstain from investing on capital markets and keep their financial wealth in the form of bank deposits. Access to financial advice is thereby not a substitute for financial literacy.[520] While the empirical evidence whether more literate investors seek more advice is mixed, more literate investors appear to be less trustful to advisors[521], but receive higher quality of advice.[522]

Actual statistics about the number and activity of financial advisors are scarce. Official statistics are not sufficiently granular, many financial advisors are employed by financial intermediaries or are closely linked to them[523], and not all financial advisors or consultants specialise in advice to retail clients. This leads to a lack of data about the number of advisors at EU level and statistics

[519] For example, in an international survey of young investors, 16% considered information from independent financial advisors as most important source (49% internet, 47% banks, 43% family). Among those that had invested, the share was higher at 20% (compared to parents (21%), banks (18), internet (14)). See Calstone (2019), 'Millenials and investing: a detailed look at approaches and attitudes across the globe', Research Report.

[520] The relationship between financial advice and financial literacy has been debated in the literature. For an overview, see Kramer, M. (2016), Financial literacy, confidence and financial advice seeking, Journal of Economic Behavior & Organization, Volume 131, Part A, November 2016, Pages 198-217.

[521] Retail investment study; Paul, St. et al. (2019), Auswirkungsstudie MiFID II/MiFIR und PRIIPs-VO: Effektivität und Effizienz der Neuregelungen vor dem Hintergrund des Anleger- und Verbraucherschutzes - Eine qualitativ-empirische Analyse, Study commissioned by the German credit industry, final report; Fazli Sabi, M. and Aw, E. (2019), 'financial literacy and related outcomes: the role of financial information sources, International Journal of Business and Society, Vol. 20, No. 1, pp. 286-298.

[522] For an overview of the empirical research, see Kramer, (2016). See also Kim, H. (2021), 'How financial literacy shapes the demand for financial advice at older ages', Journal of the Economics of Ageing, Volume 20, October 2021.

[523] For example, EIOPA reported about 800,000 insurance intermediaries in the EU, but only a minority acts on behalf of a customer, while a large majority on behalf of insurance undertakings or intermediaries. See EIOPA (2022), Report on the application of the Insurance Distribution Directive (IDD), EIOPA-BoS-21/581.

about firms in this area in Member States.[524] Regarding advice to retail investors, the retail investment study found that advice from distributors is dominant and independent advice is close to insignificant in the EU. While the study does not report statistics on the number of advisors, it notes that 117 independent brokers compare to 7,000 dependent agents in Luxembourg.[525] The German register covers 17 firms that offer independent investment advice.

Detailed information about financial advisors exist for the US and the UK, i.e. markets with high retail participation and regulation of financial advisors: More than 5,500 advisors are registered in the UK.[526] The US SEC register includes more than 14,000 registered advisors and above 5,000 exempted advisors at federal level.[527] Adding advisors at state level, a study reported that 650,000 financial advisors are active in the US, representing 10% of employment in the US financial and insurance industry.[528] Independent advisors in the central registers amount to 0.44% of financial sector employment in the UK and 0.29% in the US. Applying these ratios on the EU27 financial sector employment suggests a market potential for independent financial advisors of 19,000 to 24,000 if retail investment participation and therefore demand for their services were also comparable. More than 500,000 staff in the financial and insurance sector would carry out activities in the field of financial advice in the EU 27, if the 10% ratio observed in the US applied also to the EU27.

Most available data stem from surveys about the use of financial advice, which rely on respondents' own assessment. Since national surveys use different questions and panels, they tend to be non-comparable. The 2012 Eurobarometer and the consumer survey undertaken in 10 Member States as part of the 2022 retail investment study[529] are therefore particularly valuable. The 2012 Eurobarometer asked how consumers bought selected financial products and whether they received recommendations. While it asks for the role of intermediaries and advisors, it did not distinguish between intermediary and advisor nor whether they are linked to the product producer. It portrayed a central role for the product producer and a more limited one for advisors in the recommendation than in the sales process (Table 1).

Table 1: share of respondents in % that used an intermediary or advisor to purchase a financial product, EU aggregate

	Purchased from		Received recommendation	
	Product provider	Intermediary or advisor		none*

[524] A German newspaper reported a ratio of 6 financial advisor and intermediaries per 1000 inhabitants in Germany in 2010, 2.0 in the Netherlands, 2.7 in the UK and 2.5 in the USA.

[525] Similarly, a 2015 market study bases its analysis of the European Union and on numbers about the use of financial advice from a Eurobarometer survey and does neither report the number of advisors in the EU nor Germany. See retail investment study (2022); Burke, Jeremy and Hung, Angela, (2015), 'Financial Advice markets' a cross-country comparison, Rand paper 2015. The study covers the US, UK, Germany, Singapore, and the European Union.

[526] Broken down into 4723 independent advisors, 733 restricted advisors, and 87 restricted independent advisors in 2021. See Financial Conduct Authority (2022), Retail Mediation Activities Return.

[527] Further financial advisors are registers at state level.

[528] Egan, M. et al. (2017), 'The Market for Financial Adviser Misconduct', NBER Working Paper No 22050, September 2017. Employment in finance and industry was 6.2 million in 2021 according to US Bureau of Labour Statistics.

[529] Retail investment study.

Life insurance	65	35	26	34
Other insurance	78	22	16	32
Investment funds	67	33	28	13
Shares or bonds	68	32	18	39

* neither from product provider, intermediary, advisor, consumer organisation, friends or family.
Source: Eurobarometer (2012).

A more recent survey done for the retail investment study yielded comparable numbers: 28% reported the use of independent advisors (Table 2), 45% the advice from the distributor of the financial product. 23% of consumers invested without advice. Although the share of those that claim having received advice from an independent advisor is far from negligible, it is not higher in those Member States where more respondents said they received professional advice, which confirms the importance of advice from producers of financial products.[530] This compares to 56% of households that used business professionals in US surveys[531] and 70% that leave their investment entirely to an expert or seek their advice in the UK.[532]

Table 2: Share of respondents that received advice in %

	Total	DE	ES	FI	FR	EL	IT	NL	PL	RO
No, I have never received any kind of advice	30	28	33	27	29	30	23	44	37	27
Yes, I received professional advice	38	41	43	42	39	36	53	29	27	33
from an independent advisor*	28	26	25	21	25	36	31	29	34	32
robo-advisor, web comparator**	12	12	11	10	11	9	7	11	22	19

*a broker that sells a range of financial products but does not assemble/ manufacture any of them, ** or equivalent.
Source: Retail investment study (2022).

Issues around the quality of financial advice debated in the economic literature relate to frequent reports of misconduct of advisors and the underlying problem that many consumers follow their

[530] The correlation is even negative, though not significant at 10% level given the low number of 10 observations.
[531] US Federal Reserve Board (2020), 'Changes in U.S. Family Finances from 2016 to 2019: Evidence from the Survey of Consumer Finances', Federal Reserve Bulletin, Vol. 106, No. 5, September 2020.
[532] Europe Economics, Retail Distribution Review, Post Implementation Review, December 2014. 33% left their investment to experts, 37% said to ask for advice and help.

recommendations blindly.[533] The consumer survey performed for the retail investment study showed that 24% indicated they follow the recommendation of financial advisors (Table 3); 23% said that banks' or brokers' recommendations triggered their investment decision. About a third of the respondents indicated problems finding a financial advisor and a quarter expressed mistrust in financial advisors. A German survey indicated that 73% of the respondents had full trust in their advisor, a French study reported 20%.[534]

Table 3: Reaction to and assessment of financial advice, share of respondents in %											
	Total	DE	ES	FI	FR	EL	IT	NL	PL	RO	SE
Did you follow the advice?											
Yes, in all cases	24	27	29	19	26	19	30	29	21	18	26
Yes, in some cases	67	64	66	74	64	71	62	59	69	68	69
No, never	9	8	5	7	10	10	8	11	10	13	5
When it comes to advice on financial products, I don't know where to start to look for an adviser											
I agree *	32	36	26	51	28	23	34	36	31	27	33
I trust financial advisers to act in the best interests of their clients											
I agree *, **	36	34	43	42	32	32	33	40	29	43	33
I disagree*	26	34	21	26	27	22	25	22	25	21	35

* sum of slightly and strongly agree/disagree, ** residual of agree and disagree are those that are neutral or did not reply. Source: Retail investment study (2022).

A US study provides numbers on advisors' behaviour: 7% of advisors have a misconduct record, one third of them are repeated offenders; about half of the advisors lose their job after misconduct.[535] They tend to find new jobs in firms that have a reputation for conducting misconduct. Another US study identified that a crucial determinant of the incentive to misconduct

[533] See the overview in Kramer, M. (2016), Financial literacy, confidence and financial advice seeking, Journal of Economic Behavior & Organization, Volume 131, Part A, November 2016, Pages 198-217.
[534] See for Germany, respectively France: Paul, St. et al. (2019), ‚Auswirkungsstudie MiFID II/MiFIR und PRIIPs-VO: Effektivität und Effizienz der Neuregelungen vor dem Hintergrund des Anleger- und Verbraucherschutzes - Eine qualitativ-empirische Analyse, Study commissioned by the German credit industry, final report, AMF (2020), ‚Investisseurs particuliers: leurs motivations et leurs pratiques d'investissement', Etude AMF, October 2020.
[535] See Egan, M. et al. (2017), The Market for Financial Adviser Misconduct, NBER Working Paper No 22050, September 2017.

is whether the ownership of the customer relationship is with the advisors or the firm they work for. Advisors' ownership of the relationship, measured in this study as the right to keep the relationship when changing the employer, led to fewer complaints.[536]

Since advice is a credence good, the low number of independent financial advisors, the difficulties in finding advisors and the distrust in financial advisors bode ill for the desired increase in retail investor participation. New unexperienced investors are in particular need to receive quality advice tailored to their situation whereas financially literate investors have a higher level of mistrust and are particularly demanding. According to a recent paper, trust in the quality of advice appears to be crucial for those that are risk averse.[537] The authors identify two factors important to build trust: competence and caring. Certification of qualifications of advisors cater for the former, standards that align incentives for advisors with those of their clients for the latter.

The qualification and competence of financial advisors are regulated in the EU by MiFID II and IDD. Both MiFID II and IDD contain generic safeguards requiring staff advising on or selling investment products to retail clients, to possess an appropriate level of knowledge and competence in relation to the products offered. Nevertheless, a recent analysis of the current framework[538] highlights that competences and standards vary significantly across the EU because the relevant national requirements are very diverse. Besides national differences, there are also considerable differences across sectoral legislations. Requirements for advisors operating under the MiFID II and the IDD frameworks differ. In addition, differences with advisors operating only under national rules, because they are exempted from the EU legislation, are even larger.

This creates fragmentation within the EU market and may put at risk retail investors who may receive inadequate advice from poorly qualified financial advisors. The low level of retail participation in many EU Member States indicates a certain level of mistrust in capital markets and the low level of trust in financial advisors may contribute to it. The existing rules have not dismissed the distrust.

Furthermore, requirements with regard to the assessment of clients' sustainability preferences will increasingly make the provision of investment advice more complex due to the necessity to go beyond purely financial considerations. This reinforces the role of financial advisors and the need for them to hold the necessary knowledge in this regard as well.

The High Level Forum on Capital Markets Union ('HLF') highlighted that existing rules on qualification requirements for investment advisors are deemed insufficient and can lead to clients

[536] Clifford, Ch. and Gerken, W. (2021), 'Property Rights to Client Relationships and Financial Advisor Incentives', Journal of Finance 2021.

[537] A Polish study asked consumers to rate their experience with financial advisors. It concluded that judgements were predominantly about difference in risk attitudes between advisor and customer by customers with low tolerance for risk. See Barnaba, D. et al. (2020), 'Expertise is in the eye of the beholder: financial advisor evaluations and client satisfaction as a result of advisor recommendations', Polish Psychological Bulletin, Vol. 51, No. 1.

[538] Report on the current framework for qualification of financial advisors in the EU and assessment of possible ways forward, SWD(2022) 184 final.

receiving inappropriate advice and being victims of mis-selling.[539] A relative majority of stakeholders consulted by the Commission on the HLF's recommendations in the form of a feedback process (39% of those taking a position) agreed that the qualification of advisors was a very important or rather important issue to tackle (37% thought it was rather not important or not important at all, 25% neutral). Support for this view was greatest amongst companies and business organisations (66%), but less pronounced amongst business associations (33%) and public authorities (17%). Consumer associations, which were represented amongst the experts of the HLF and took part in preparing the HLF report, did not provide additional feedback.

The existence of issues was also confirmed by respondents to the 2020 consultation on the *'Review of the regulatory framework for investment firms and market operators',* which sought evidence from stakeholders on areas that would merit targeted adjustments to MiFID II and MiFIR, which started to apply in January 2018. A substantial part (39%) of all respondents that took a position on this question agreed that there would be merit in setting up a certification requirement for staff providing investment advice and other relevant information. Amongst others, proponents of a certification requirement pointed out the need for harmonisation and for having a minimum standard for all advisors, the high impact investment advice can have on the overall economic situation of European citizens and the high influence the quality of investment advice can have on a financial institution's reputation.

1.2 What are the available policy options?

In addition to the baseline scenario, the impact assessment identifies two policy options to address the identified problem. Both options aim at improving investor protection and addressing market fragmentation. They are linked, in particular, to SO2, i.e. better aligning interests between intermediaries and investors, to ensure that the advice is of better quality and can therefore better identify and address the needs, preferences and objectives of investors. In addition, such better alignment might also lead to more cost-effective products offered to investors (SO3). Finally, the options might support SO1, improving the information provided to investors, as more qualified advisors should be capable to better tailor the information provided to the clients' needs. The measures considered can, however, not address the identified underlying problems in full and should be seen as complementary to other measures assessed in this impact assessment.

Under the baseline (**option 1)**, no action would be taken and hence the existing requirements set out in MiFID II and IDD would be maintained. With regard to MiFID, current non-binding ESMA guidelines would continue to apply, but fail to achieve convergence across Member States. Qualification requirements and modalities around examination and verification of qualifications would continue to be largely determined by Member States. Some principles would continue to be set out under the relevant provisions in MiFID II and IDD and Member States would maintain the possibility to exempt advisors from these rules under certain conditions[540], as is currently the case. As a result, the level of qualification of advisors would continue to diverge amongst Member States and amongst advisors operating under different legal frameworks.

[539] See: 'A new Vision for Europe's capital markets – Final Report of the High Level Forum on the Capital Markets Union', June 2020.

[540] i.e. where advice is provided outside the MiFID II framework, based on the Article 3 exemption.

Investors would therefore continue to be distrustful of advice and this would continue to have an impact on retail investor participation in capital markets.

Option 2 would seek to strengthen the existing standards and further harmonise requirements set out in MiFID II/IDD. Under this scenario, the requirements for necessary knowledge and competence of financial advisors currently set out in MiFID II/IDD could be further strengthened and some elements around the evaluation of competences of advisors could be further specified. This would involve the transfer of some high level principles and other elements from the existing non-binding ESMA guidelines into the level 1 and possibly level 2 legislative framework of MiFID II to ensure a more harmonised application in the Member States and its extension to the IDD framework. Furthermore, the IDD requirements on continuous training could be further detailed and extended to MiFID II. Inclusion of certain knowledge of sustainability as part of the training of financial advisors could be included as well. Strengthening the existing standards could also include the introduction of additional conditions for the Member States applying the Article 3 exemption under MiFID II (e.g. requiring the Member States to ensure that equivalent standards as regards knowledge and competence are applicable to the advisors operating outside the MiFID II framework).

Option 3 would seek to create and completely harmonise detailed qualification requirements for all financial advisors – whether operating under MiFID II or IDD or under the existing exemptions. This would entail a detailed assessment of the necessary skills, knowledge and competences and their establishment through primary and secondary legislation whilst leaving little discretion at national level. It would also require the development of a regulatory mechanism to ensure that these requirements are updated on a sufficiently frequent basis to take into account developments in the area of finance, i.e. digitalisation, sustainability, new economic and financial concepts and models.

Option label	Option description
Baseline (Option 1)	**No changes to the legal frameworks**
Option 2	**Strengthening of the existing standards and further harmonising some of the requirements set out in MiFID II and IDD**
Option 3	**Maximum harmonisation of the requirements related to qualification under MiFID II and IDD.**

1.3 What are the impacts of the options and how do they compare?

1.3.1 Benefits

The baseline (Option 1) would maintain the status quo. Some principles regarding the qualification requirements would continue to be set out in MiFID II and IDD, however they would likely continue to diverge between Member States and between the legislative frameworks. Retail investors will continue to obtain a largely divergent quality of advice across

the EU, mistrust towards advisors and advice would continue to persist and would influence the decision of a large number of retail investors to refrain from engaging with capital markets.

Under **option 2** some additional qualification requirements would be introduced and further harmonised at EU level, hence contributing to a better alignment of rules on advisors' knowledge and competence both across Member States and across different types of providers of advice (e.g. advisors on regular investment products and insurance-based investment products). Certain equivalent requirements would also become mandatory for advisors falling under the MiFID II Article 3 exemption. This would raise the standards for individuals carrying out activities as advisors where these are currently lower and, as a result, help reduce instances of unsuitable products recommended to clients where this is related to an advisor's deficiencies of knowledge and competence. It would also improve the level playing-field amongst advisors operating from different Member States and make it easier for them to offer their services cross-border.

This would primarily benefit retail investors that would receive better advice. The resulting increase of trust in financial advice would allow retail investors to make better use of the opportunities offered by capital markets to help them cater for their long-term needs.

Option 3 would help raise standards even further by establishing a high and homogenous standard for knowledge and competence of financial advisors operating in the EU. This could significantly raise the standards and level of investor protection in some Member States, however a rigid framework set out at European level could also risk reducing the standards in the Member States with well-developed national frameworks, which are adapted to the specific national context. The benefits to *retail investors* under option 3 would therefore likely be only marginally higher overall than the benefits to them under option 2 (please see more on this in section 1.3.3).

1.3.2 Costs

The costs related to **option 2** would depend on the current situation in the Member State concerned. In some Member States the adjustment to meet the new requirements may be very small, in others (notably where the standards are currently lower) more significant changes might be necessary. The costs for *investment firms* and *insurance distributors* could increase where bigger adjustments to the framework are necessary, as hiring well-qualified advisors and continuing training may become more expensive

Advisors may incur additional costs to meet the potentially higher requirements linked to accessing the profession and for continuous training.

Some *public authorities* may have to incur costs related to the testing and certification procedures and, where relevant, adapting supervisory practices under the new legislative setting.

The overall administrative burden should however remain similar as the new requirements introduced at EU level would largely replace existing diverging requirements at national level. For companies and advisors operating in several legal jurisdictions, the administrative burden would likely be somewhat reduced given that there would be fever divergences in standards and requirements.

Option 3 would imply significantly higher costs than option 2. Setting out fully harmonised requirements at EU level would necessitate a lot of adjustments by *market participants (investment firms and insurance distributor*s) and *advisors/experts* across the majority of Member

States to a likely quite different – compared to the status quo - set of new rules and processes. This would be due to the fact that requirements would be completely harmonised at EU level and therefore even Member States with a comparable level of requirements would have to adjust their national systems. This option would also present more significant on-going administrative costs for public authorities related to the certification system and for European authorities as well as costs related to the review and updating of the pan-European requirements which would be more rigid and less able to adapt to market developments in a timely manner given the nature of the European Union's legislative procedures.

1.3.3 Overall assessment

When considering both benefits and costs, as set out above, option 3 may be a marginally more effective measure to increase the level of knowledge and competence of advisors across the EU (and consequentially of the quality of advice provided to retail investors in all Member States) than option 2. It would ensure the widest possible coverage, benefitting clients of insurance intermediaries and investment firms, and the highest level of professional competence from which no Member State would be allowed to depart. Nevertheless, option 3 is likely to be a very intrusive option that, given its maximum harmonisation nature, would also not allow catering for national specificities, hence potentially representing downsides attributable to any one-size-fits-all approach. This appears more relevant in the area of professional qualifications, where national specificities (for example related to features of the existing education system in a given Member State) can be relevant. Furthermore, option 3 may not allow for the set-up of a certification system adequately fitting the national capital market context, e.g. adjusting it to financial products and services exclusively offered or more popular in a given Member State. This could represent a further shortcoming of option 3, keeping in mind that some respondents to the public consultation also consider that the mechanisms to control and assess knowledge and competence should rather be organised by local regulators who know their ecosystems.

In addition, option 3 would likely entail significantly higher costs than option 2, rendering it less cost efficient. As outlined in the sections above, both options would present comparable added value to retail investors, whilst the costs of option 3 which would require a complete harmonisation of measures at EU level would be significantly higher – both one-off costs, due to the need to initiate more substantive changes to the existing requirements in order to harmonise them, and on-going costs for firms, due to the rigidity of the one-size-fits-all framework and difficulty to adapt the requirements as necessary in a timely manner. Option 2 is thus on balance more cost efficient, while not necessarily less effective in addressing the problem, and for those reasons should be preferred to option 3.

Under both measures, the on-going administrative burden would be likely neutral as the newly introduced pan-European requirements would replace the diverging national requirements currently in place.

Option 2 would effectively reduce the currently existing significant variations of competence of advisors across the EU and between advisors captured under MiFID II and IDD (without, however, fully eliminating them). Option 2 would also lower the risk of investment products being sold to retail investors across the whole EU that are poorly aligned with their needs, preferences and objectives, to the extent that this results from insufficient knowledge and competence of advisors. Including sustainability aspects in the competence requirements set out

at EU level would help ensure that advisors are well placed to carry out the necessary assessment of clients' sustainability preferences in line with the key objective of the EU in the area of sustainability and green transition.

The overall cost-effectiveness of option 2 would be positive due to the low associated costs. Whereas option 3 would have lower cost-efficiency, albeit still positive, depending however on the extent of changes to the existing national requirements arising due to a complete harmonisation exercise which is difficult to quantify.

Based on the overall assessment described above, option 2 is the preferred option.

1.3.4 Summary

	Effectiveness			Efficiency (cost-effectiveness)	Coherence
	Improved investor protection	Reduced market fragmentation	Increased burden for advisors and firms		
Baseline (Option 1)	0	0	0	0	0
Option 2	+	+	-	++	+
Option 3	+	++	--	0/+	+

ANNEX 11: EVALUATION OF THE RETAIL INVESTOR PROTECTION FRAMEWORK

1. INTRODUCTION

7. 1.1 Purpose and scope of the evaluation

As set out in the September 2020 Capital Markets Union (CMU) Action Plan, the CMU aims to put capital markets at the service of people, offering them both sustainable investment opportunities and strong investor protection. Investor protection rules are currently set out in a number of sector specific legislative instruments, including Markets in Financial Instruments Directive (MiFID II)[541], Insurance Distribution Directive (IDD)[542], Packaged Retail and Insurance-Based Investment Products Regulation (PRIIPs)[543], Undertakings for the Collective Investment in Transferable Securities Directive (UCITS)[544], Solvency II Directive[545], Alternative Investment Fund Managers Directive (AIFMD)[546] and Pan-European Personal Pension Product Regulation (PEPP)[547]. The scope of the evaluation, which is targeted and deals exclusively with retail investor protection aspects, focuses in particular on MiFID, IDD, PRIIPs, UCITS with regard to product governance and oversight and Solvency II with regard to disclosures[548] rules, however, AIFMD[549] and PEPP[550] are not assessed.

[541] Directive (EU) 2014/65 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments.

[542] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution.

[543] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

[544] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

[545] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

[546] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD).

[547] Regulation 2019/1238 of the European Parliament and of the Council of 20 June 2019 on a pan-European Personal Pension Product (PEPP).

[548] Solvency II recently had a separate review process focusing on prudential aspects (Solvency II review - Have your say). The framework does not include many aspects related to investor protection. However, the rules on disclosures, are assessed as they concern investor protection aspects.

[549] AIFMD recently had a separate review process (AIFMD review - Have your say) which looked more broadly at the areas covered by the Directives and are currently under negotiations. The review has been

The Commission is preparing this evaluation of the current investor protection rules in order to assess whether the original objectives of the legislative acts have been sufficiently achieved, and whether the current rules are able to sufficiently address new developments. This evaluation also fulfils the legal mandates set out in the different legislative acts requiring the Commission to review legislation[551].

The evaluation focusses on aspects of the framework which are directly related to retail investor protection, namely:

- How the rules on disclosures have achieved their objective to improve transparency and fairness of information and assist retail investors in making optimal investment decisions.
- How the rules on "inducements" (i.e. the payment or receipt of fees, commissions and monetary or non-monetary benefits by third parties in relation to the provision of financial services to retail investors) have impacted the distribution of retail investment products across the Union, and the extent to which they have improved the quality and impartiality of advice to retail investors.
- How the rules on suitability and appropriateness assessments have fulfilled their intended objectives of ensuring that advisers recommend financial products that are suitable for retail investors or, when acting without advice, retail investors invest in financial products that are appropriate for them.
- How product oversight and governance rules have fulfilled their intended objectives of ensuring that the products that are offered target the appropriate market, i.e. features of products are aligned with needs of groups of clients reached by those products.

The evaluation is based on several sources of information, in particular:

➔ A comprehensive study[552] which was designed to capture the whole process of retail investor decision-making, from searching for information, reviewing information documents, to undergoing a suitability assessment/ demands and need test, and receiving advice. The methodology used for the study included legal research which covered a detailed review and assessment of the legal framework at EU and national levels, 149 in depth interviews[553] covering national regulators, consumer protection bodies, industry associations, distributors and manufacturers across 15 Member States, interviews, reviewing and scoring information documents for a sample of 560 investment products in 15 Member States, mystery shopping that concluded in 240 observations for traditional distribution channels in 8 Member States and 13 observations for

comprehensive and covered investor protection aspects; hence it would not be appropriate to review the rules in parallel or before they start to apply and sufficient experience with their functioning is gathered.

[550] The PEPP Regulation started to apply on 22.03.2022. It is therefore premature to evaluate this framework as we do not intend to review it at this stage.

[551] PRIIPs Article 33, IDD Article 41, and MiFID II Article 90.

[552] Retail investment study.

[553] 249 respondents participated in those interviews.

robo-advisors, a consumer survey with an integrated behavioural experiment with 11497 respondents across 10 Member States. This evaluation is largely based on the study which has assessed the rules applying the five evaluation criteria.

- ➔ A public consultation that gathered views from a broad group of stakeholders on how the current framework for retail investments is functioning and how it could possibly be improved. A total of 186 respondents responded to the public consultation (the results are presented in Annex 2).
- ➔ ESA's recommendations as a reply to the call for evidence issued by Commission in 2021 (the results are presented in Annex 2).
- ➔ Reviews and reports published by the ESAs[554].
- ➔ The results of specific consultation processes with various stakeholders (the results are presented in Annex 2).
- ➔ The IOSCO report[555] on retail distribution and digitalisation which looked at the rapid growth in digitalisation and use of social media in the marketing and distribution of financial products.

The purpose of this evaluation is to assess to what extent the existing EU rules on disclosures, inducements, suitability and appropriateness assessments and product governance have met their objectives in relation to investor protection and whether they have been efficient, coherent, relevant and have provided EU added value.

2. WHAT WAS THE EXPECTED OUTCOME OF THE INTERVENTION?

8. 2.1 Description of the intervention and its objectives

Given the focus of this evaluation is on how the current legal framework is addressing problems related to investor protection in retail financial services, and more specifically in the areas of disclosures, inducements, suitability and product oversight and governance, this section examines how the rules in each area apply across the sectoral legislation and how the intervention logic works for each topic.

2.1.a Disclosures

Disclosures aim to promote informed and effective decision-making by providing retail investors with information that is fair, easy to read, understandable, comparable and not misleading. The rules are intended to improve transparency and engage consumers and to encourage them to inform themselves about relevant product features. This is in line with the broader aim of reducing information asymmetries between retail investors and financial service providers, which should, in turn, promote more competitive and efficient markets, i.e. on the basis of more informed investment decisions.

[554] Reports and reviews published by the ESAs are sources for this evaluation and are referenced in detail at the corresponding section throughout the document.
[555] IOSCO report on retail distribution and digitalisation.

After the global financial crisis, an important focus was placed on information disclosure[556] as a way of limiting market failures arising from information asymmetries and driving better retail investor outcomes[557], thus improving investor protection.

Relevant legal provisions

Disclosure requirements are covered in a large and multi-layered set of rules at EU level. Retail investor disclosures include the provision of information to clients at pre-contractual (generic information on the products), contractual and post-contractual stages (targeted information to the consumer's situation), to ensure that at all stages of the consumer journey, clients receive the information they need for well-informed investment decisions and to ensure their protection.

Product disclosures are provided in the **PRIIPs KID**[558] (Key Information Document) and the **UCITS KIID**[559] (Key Investor Information Document) at a pre-contractual stage.

The **PRIIPs regulation** introduced uniform rules on transparency for retail investment products that their manufacturers and distributors must abide by. Specifically, it requires providers of financial products to produce a KID, capturing the key information about an investment product and to make it available to retail investors. The regulation sets out rules on the contents of the KIDs and their presentation. It also covers updating of the information included in KIDs and supervision. One article also requires that marketing communication should not contradict the contents of the KIDs. The specification of relevant rules, notably on the content, presentation and timing of delivery of the KIDs, have been further developed through regulatory technical standards.

PRIIPs applies to all products manufactured by the financial services sector which provide an investment opportunity to retail investors and where (irrespective of the investment's legal form) the product's return is subject to the performance of assets which are not directly purchased by the retail investor or subject to fluctuation because of exposure to reference values. Therefore, the PRIIPs KID is required for structured banking products, investment-based insurance products (IBIPs) and packaged retail investment products available to retail clients.[560]

Product manufacturers of **UCITS** funds had to produce and make available a similar document, the UCITS KIID. As of January 2023, the UCITS KIID has been replaced by

[556] Seira, Elizondo, & Laguna-Müggenburg, 2017

[557] Australian Securities and Investments Commission (ASIC) & Dutch Authority for Financial Markets (AFM), 2019).

[558] Chapter II PRIIPs.

[559] Chapter IX, Section 3 UCITS.

[560] The PRIIPs applies to product information across different sectors: The same key information document applies for structured deposits (banking product), insurance-based investment products (insurance product) and packaged financial instruments (investment product). This means that AIFs which are marketed to retail investors under Article 43 of the AIFMD are also captured by PRIIPs obligations.

the PRIIPs KID[561]. The disclosure rules of the new Regulatory Technical Standards are designed to make the PRIIPs KIDs for UCITS fully applicable[562]. In light of the date of application, the impact of this change cannot be assessed in this evaluation but is part of the baseline in the impact assessment.

MiFID II considers the provision of information at all stages of the consumer journey and requires that all information, including marketing communications, addressed by the investment firm to clients is fair, clear and not misleading[563]. It also specifies that appropriate information about the investment firm and its services, the financial instruments and proposed investment strategies, execution venues and all costs and related charges must be provided in good time to the client[564]. In particular, MiFID II requires that information on all costs and charges in connection with the investment services and the financial instruments are aggregated to allow the client to understand the overall cost, as well as the cumulative effect on return of the investment[565]. Where applicable, such information must also be provided to the client on a regular basis, at least annually, during the life of the investment.

The MiFID rules require that the above-mentioned information is provided in a comprehensible form but do not establish an information template or document. Member States may however require that information is provided in a standardised format[566]. MiFID II Delegated Regulation (EU) 2017/565 lays down further requirements on information to be provided to retail clients, including on marketing communications[567].

IDD obliges insurance distributors to provide, in good time before the conclusion of an insurance contract, information about their identity and registration data, any group relationships with insurance companies and the form of advice they provide and they nature (but not the amount) of their remuneration[568] as well as specific information

[561] Regulation (EU) 2021/2259 of the European Parliament and of the Council of 15 December 2021 amending Regulation (EU) No 1286/2014 as regards the extension of the transitional arrangement for management companies, investment companies and persons advising on, or selling, units of undertakings for collective investment in transferable securities (UCITS) and non-UCITS, OJ L 455, 20.12.2021, pages 1–3.

[562] Commission Delegated Regulation (EU) 2021/2268 of 6 September 2021 amending the regulatory technical standards laid down in Commission Delegated Regulation (EU) 2017/653 as regards the underpinning methodology and presentation of performance scenarios, the presentation of costs and the methodology for the calculation of summary cost indicators, the presentation and content of information on past performance and the presentation of costs by packaged retail and insurance-based investment products (PRIIPs) offering a range of options for investment and alignment of the transitional arrangement for PRIIP manufacturers offering units of funds referred to in Article 32 of Regulation (EU) No 1286/2014 of the European Parliament and of the Council as underlying investment options with the prolonged transitional arrangement laid down in that Article, OJ L 455I , 20.12.2021, pages 1–55.

[563] Article 24(3) MIFID II.

[564] Idem Article 24(4).

[565] Ibid.

[566] Idem, Article 24(5).

[567] Chapter II of delegated regulation 2017/565.

[568] Article 18 IDD.

requirements, in particular information about the risks and all costs and charges, in relation to the distribution of IBIPs[569].

Finally, **Solvency II** lays down some general information requirements, to be disclosed before a life insurance contract is concluded[570].

Pre-contractual information requirements stemming from multiple Directives and Regulations need to be respected, depending on the investment product or service to be sold. Nevertheless, the role of pre-contractual (product level) disclosures and disclosures at distributor level is different and generally complementary. Product-level disclosures, besides providing information directly for those retail clients that actively search for them, are also intended to provide distributors with the elements they need to feed into their own obligation to provide risk and cost information on products they sell.

Intervention logic of disclosure rules

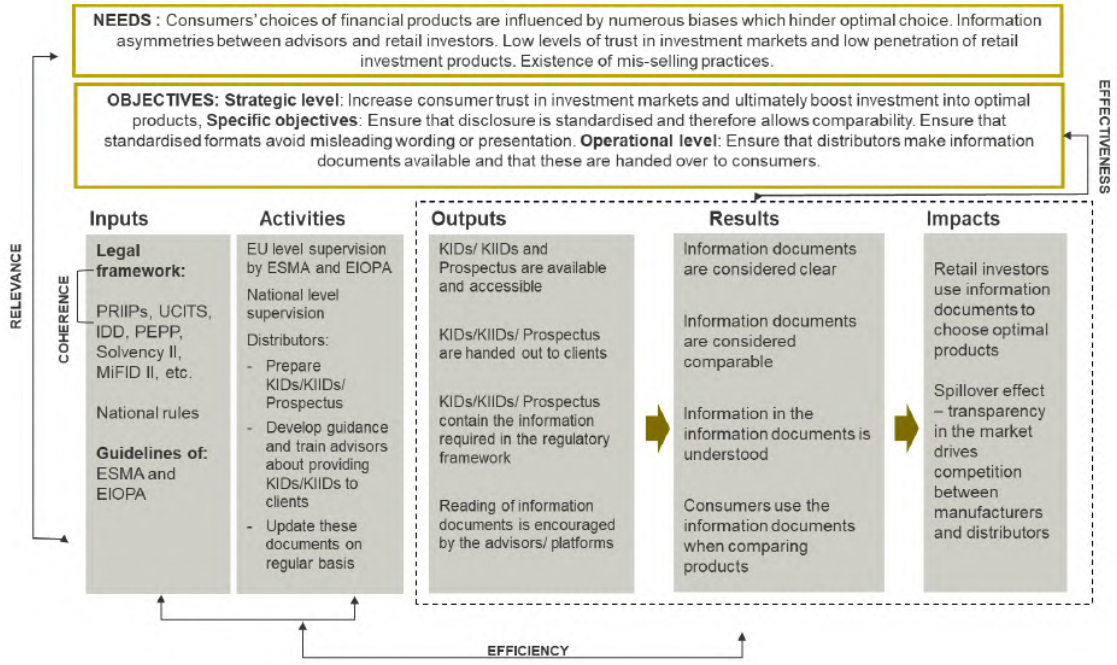
The legal provisions governing disclosure are spread across multiple legal frameworks. The following intervention logic has been reconstructed focusing on disclosures, to present the logical links between the different legal instruments, policy objectives and expected outputs, results, and impacts.

EU action on information disclosure regimes for retail investments was considered necessary to address market failures due to informational asymmetries between retail investors and advisors and prevent retail investors from making uninformed or biased choices when making investment decisions. Specific disclosure requirements were introduced as part of PRIIPs, UCITS, IDD, MiFID II and Solvency II, with the objective of improving clarity, transparency and comparability of information in order to guide investors to choose optimal products.

The rules overall require that certain information on the firm and the services is provided to the potential client and that distributors prepare and regularly review key information documents and provide guidance and training to advisors. The information to be provided is defined by the regulation and needs to be accessible by the retail investors at all times. The desired impact is so that investors have access to information that is clear, comparable, not misleading and understood and that ultimately, they are able to make informed and optimal decisions when choosing investment products. The transparency and comparability of information would also help increase competition in the market.

Figure.1 - Reconstructed intervention logic[571]

[569] Idem, Article 29.
[570] Article 185, Solvency II
[571] As presented in the Retail investment study for the disclosure rules of information documents.

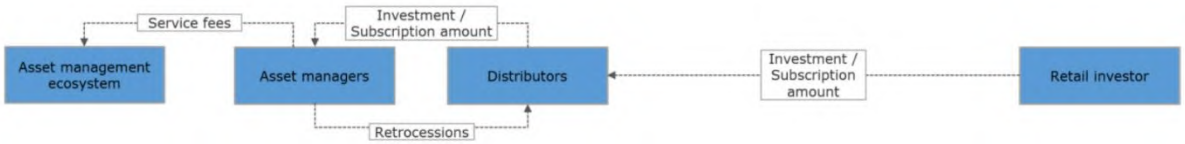


Source: Consortium.

2.1.b Inducements and advice

Professional advice assists retail investors in decision-making when choosing investment products. However, the advice process is affected by strong information asymmetries between the advisor and the potential investor. Informational asymmetries can play an even greater role where inducements are paid by product manufacturers to advisors, which can potentially result in biased advice.

In general, inducements are payments that distributors/intermediaries receive by means of retrocessions from the product manufacturers (e.g. the asset managers). They represent a portion of the total costs that are paid by the retail investor. The following example illustrates in general terms the fee flows and the payment of inducements between different parties in the distribution of an investment fund[572].



Source: Study on distribution systems of retail investment products, 2018

The EU legal framework aims to improve investor protection by imposing rules governing the payment of inducements.

[572] Note: the distribution of retail investment products may vary per product category, distribution channel and jurisdiction.

The rules on inducements aim to:

- minimise conflicts of interest so as to ensure that advice and other services that are delivered to prospective investors are in their best interest;
- inform prospective investors whether the advice given is independent or non-independent and whether the investment firm or insurance distributor receives an inducement for the sale of a given product, so that retail investors are aware of their relationship with the product manufacturer and take it into account when making their investment decision;
- more generally, improve the quality of advice and reinforce the duty of care of retail financial product distributors, as well as to make sure that prospective investors are well informed and understand the advice.

Summary of the relevant legal provisions and the scope of their application

Depending on the type of distributor and investment product, different rules may apply under the current framework. The main legal texts concerned are MiFID II and IDD, which contain specific rules on inducements. Furthermore, both MiFID II and IDD set out the duty of care obligation and contain rules to avoid conflicts of interest, such as continuous organisational rules and remuneration policies.

The MiFID II inducement regime applies to investment firms and the IDD inducement regime applies to insurance intermediaries or undertakings distributing insurance-based investment products (IBIPs). The application of inducement regimes to the different types of products is summarised below:

Table.1 - Inducement regime per product

Products		MiFID II	IDD
Securities	Listed shares	✓	
	Bonds	✓	
Investment funds	Retail UCITS	✓	
	Retail AIFs	✓	
Insurance & pension products	Insurance-based investment products (IBIPs)		✓
	Personal pension products	IDD or MiFID II	
Other products	Structured products	✓	
	Derivatives	✓	

Source: Consortium, based on the legal research.

While MiFID II and IDD rules on inducements aim to achieve the same objective, they differ as regards the specific conditions:

- Under MiFID II, inducements (i.e. fees, commissions or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to clients) are prohibited for portfolio management and independent advice. Where inducements remain possible, the MiFID II framework only allows them if they are designed to enhance

the quality of the relevant service to the client; nor should they impair compliance with the investment firm's duty to act honestly, fairly and professionally.

- Under the IDD framework, inducements (similarly defined as fees or commissions, or any non-monetary benefits in connection with the distribution of an insurance-based investment product or an ancillary service, provided to or by any party except the customer or a person on behalf of the customer only) are generally allowed, provided that they do not have a detrimental impact on the quality of the relevant service to the customer and do not impair compliance with the distributor's duty to act honestly, fairly and professionally.

Quality enhancement test (MiFID II) and Detrimental impact test (IDD)

The nature as well as the conditions of the quality enhancement test under MiFID II and the detrimental impact test pursuant to IDD are different.

On the basis of Article 11(2) of the MiFID II Delegated Directive[573], an inducement shall be considered to enhance the quality of the relevant service to the client if:

- the inducement is justified by the provision of an additional (or higher) level of service to the client;
- the inducement does not directly benefit the recipient firm (its shareholders or employees included) without tangible benefit to the relevant client and;
- the inducement is justified by the provision of an on-going benefit to the client

The MiFID II Delegated Directive also establishes a number of conditions requiring justification of the provision of an additional or higher-level service to the relevant client[574]:

- provision of non-independent investment advice, access to a wide range of suitable financial instruments including instruments from a third party;
- provision of non-independent investment advice combined with either: (a) an offer to the client to assess the continuing suitability of the financial instruments; or (b) with another on-going service about the optimal asset allocation of the client; or
- provision of access to a wide range of financial instruments that are likely to meet the needs of the client, including instruments from third-party product providers.

For the detrimental impact test, pursuant to the IDD regime, the following criteria are relevant[575]:

- whether the inducement could provide an incentive to the insurance intermediary/undertaking to offer/recommend an insurance product/service to the

[573] Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.
[574] Idem, Article 11(2).
[575] Article 8(2), second subparagraph of IDD Delegated Regulation.

client despite the fact that another insurance product or service would better meet the client's needs;

- whether the inducement is mainly based on quantitative commercial criteria/ whether it takes into account appropriate qualitative criteria (such as compliance with applicable regulations, the quality of services provided, client satisfaction);
- the value of the inducement paid in relation to the value of the product/service;
- whether the inducement is paid at the conclusion of the contract or is extended for the whole term of that contract;
- the existence of a mechanism for reclaiming the inducement;
- the existence of any form of contingent threshold unlocked by "attaining a target based on volume or value of sales".

All the relevant legal frameworks (IDD[576], MiFID II[577], UCITS[578]) contain provisions on the **principle of duty of care**. These provisions are set out in the conduct of business rules applicable when services are provided to the client. They apply to all aspects of business and not only to advice while receiving inducements.

Furthermore, Solvency II, IDD, MiFID II, UCITS and AIFMD also contain other **rules on avoiding or mitigating conflicts of interest**, such as continuous organisational rules and remuneration policies.

Continuous organisational rules and administrative arrangements:

Under the MiFID II and IDD regimes, there is an obligation to **identify conflicts of interest** in the course of the service provision. The MiFID II regime[579] makes it mandatory to identify conflicts of interest between investment firms, and their clients, or a conflict between one client and another, including those caused by the receipt of inducements from third parties, or by the investment firm's own remuneration and other incentive structures. The IDD regime makes it mandatory to identify conflicts of interest between insurance intermediaries and insurance undertakings, including their managers and employees, or any person directly or indirectly linked to them by control and their clients, or between one client and another.

The MiFID II and IDD regimes also contain continuous organisational rules obliging service providers to take all appropriate steps to prevent or manage conflicts of interest between a client and themselves (including service providers' managers, employees, tied agents, or any other person linked directly or not directly by control). Overall, the MiFID II and IDD regimes are consistent in applying comparable regimes to prevent conflicts of interest in the context of continuous organisational rules and administrative arrangements. In cases where organisational or administrative arrangements for preventing conflicts of interest are not sufficient to ensure that risks of damage to client interests are prevented, such conflicts of interest should be clearly disclosed to the client.

Disclosure of conflicts of interest:

[576] Please refer to Article 17(1) IDD.
[577] Please refer to Article 24(1) MiFID II.
[578] Please refer to Article 29 UCITS Implementing Directive.
[579] Article 16(3) and Article 23 MiFID II.

The rules on the disclosure of conflicts of interest under MiFID II and IDD are consistent and contain an obligation to disclose conflicts of interest under a condition of last resort[580], the rules on how disclosure should be made (e.g. on a durable medium) and the rules covering the content of such disclosure[581].

Remuneration policies and disclosure of remuneration

Remuneration policies aim to reduce the risk that a financial service provider's remuneration and incentive practices could give rise to conflicts of interest with its clients. The MiFID II delegated regulation provides that a firm's remuneration policy, as approved by the managing body, ensures that the interests of the firm's clients are treated fairly and are not impaired by the remuneration practices adopted by the firm in the short, medium or long term. More specifically, the policy should be designed in a way that firm members are not incentivised to favour the firm's or their own interest, to the detriment of its clients'. Under IDD, remuneration policies should not conflict with the duty to act in the best interest of the client. Such policies should prevent sales targets or other arrangements that could provide an incentive to recommend a particular financial instrument when the financial services provider could otherwise offer another financial instrument more appropriate to the client's needs.

Intervention logic of the measures concerning inducements and advice

Rules on inducements are covered under MiFID II and IDD. In order to facilitate the presentation of why an intervention was required on the rules on inducements at a European level, an intervention logic has been reconstructed presenting the logical links between the different legal instruments, policy objectives and expected outputs, results and impacts.

The introduction of rules on inducements and advice was considered necessary due to the existence of informational asymmetries and the risk of product bias in the distribution process and mis-selling practices that hindered trust in investment markets. Specific requirements for investment advice and inducements were introduced in IDD and MiFID II with the objective of ensuring that the payment of inducements is transparent and does not have a detrimental impact on retail investors (IDD) or improves the quality of the advice (MiFID II).

Under the MiFID rules, inducements can only be put in place where they are justified by an enhancement of the service provided to end-investors. Distributors are required to review existing practices and apply quality enhancement and detrimental tests respectively to justify the presence of inducements. Distributors must also inform retail investors about the key features of the products offered and disclose information about

[580] To be used only where the organisational and administrative arrangements established by an investment firm are "not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented".

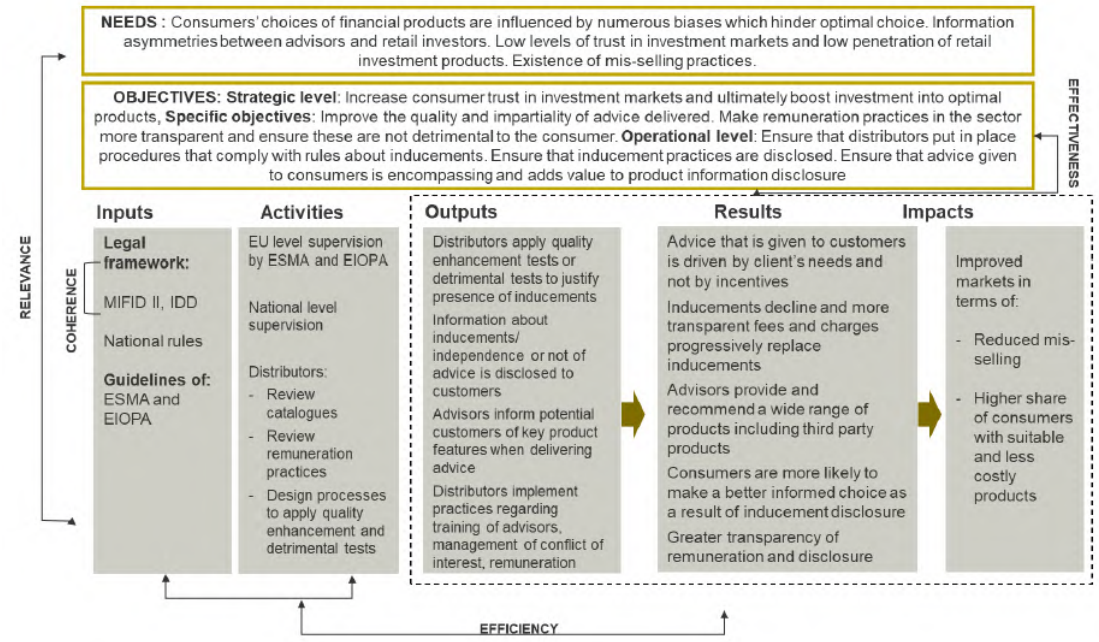
[581] Content such as: sufficient details, consideration of the nature of the client allowing the client to take an informed decision in the context of which the conflict of interest arises, description of the conflict of interest, organisational and administrative arrangements established to prevent or manage conflicts of interest, as well as a specific description of the conflict of interest, the general nature and sources of conflicts of interest, the risks to the client that arise as a result of the conflicts of interest, the steps undertaken to mitigate these risks, and the level of detail to enable that the client would take an informed decision.

the type of advice provided (e.g. independent or non-independent), as well as on the existence of any inducements. Lastly, the rules require distributors to implement practices around the training of advisors, management of conflict of interest and remuneration.

Under the IDD rules, inducements are only allowed if it can be demonstrated that they do not have a detrimental impact on the quality of the relevant service to the customer and do not impair compliance with the distributor's duty to act honestly, fairly and professionally, in accordance with the best interests of their customers. Similar to the MiFID rules, distributors have to inform retail investors about the key features of the product offered and about the type of advice provided and the form of the remuneration received. However, they are not required to disclose the amount of inducement received. The concept of independent advice does not exist under the IDD framework.

The desired impact is that retail investors receive unbiased advice, better and wider offer of products which allows them to make better choices. Greater transparency of remuneration would lead to a decline in inducements. As a result, the rules would improve the market as mis-selling would be reduced and there would be a higher share of consumers offered suitable products.

Figure.2 - Reconstructed intervention logic[582]



Source: Consortium.

2.1.c Suitability/Appropriateness

Depending on the financial services offered to their clients, firms must perform a know-your-client assessment in order to ensure that the products that may be purchased are suitable or appropriate. Retail investors without professional experience are prone to making investment decisions that may not be optimal or they may even be the target of mis-selling practices. Assessing the profile of retail investors is an important component of the investor protection framework. The suitability assessment aims to ensure retail investors are not recommended financial products or services that are not suitable for them. The appropriateness assessment (when the client makes a decision without advice) aims to ensure that the client is warned in case the financial product is not appropriate.

Relevant legal provisions and the scope of their application

The rules on suitability assessments generally cover the same principles under MiFID II and IDD:

- Under **MiFID II** rules, investment firms must conduct a suitability assessment when providing investment advice or portfolio management[583]. The assessment covers the client's (i) level of knowledge and experience in the relevant financial instrument or investment service field, (ii) financial situation and ability to bear

[582] As presented in the Retail investment study.
[583] Article 25(2) MiFID II and Articles 54 and 55 of MiFID II Delegated Regulation.

losses, and (iii) investment objectives, including risk tolerance. The result of this procedure is that firms providing investment advice or performing portfolio management must ensure that they understand the essential facts about the client and have a reasonable basis for determining that the transaction to be recommended or to be made in the course of the advice/portfolio management meets the investment objectives and risk tolerance of the client and that the client is able financially to bear the investment risks consistent with their investment objectives.

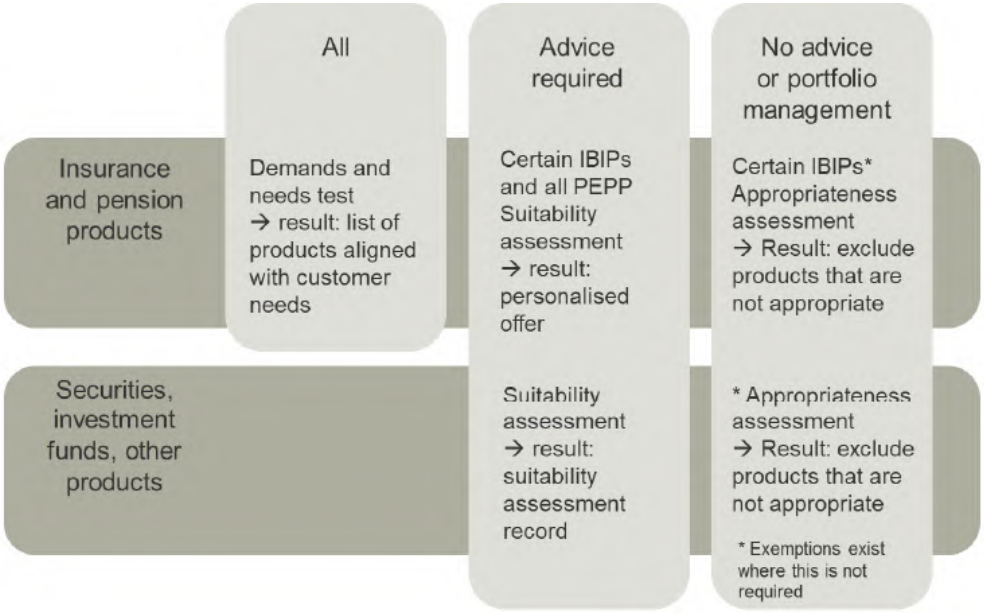
- Under **IDD**[584] a 'demands and needs' test needs to be performed by the distributor before the establishment of a contract. This test is mandatory for all insurance products, including IBIPs[585]. In the case of advised sales of IBIPs, a suitability assessment must be conducted under basically the same rules as under MiFID II. The output of the requirement is a list of products in line with the client's demands and needs, and in the case of advised sales of IBIPs, products that are considered suitable.
- In the case of non-advised services (under MiFID II and under IDD for non-advised sale of IBIPs), firms must undertake an appropriateness assessment is to ensure that retail investors have the necessary experience and knowledge to understand the risks of the financial products they are considering purchasing.

Both MiFID II and IDD allow for exemptions from performing the appropriateness test under certain circumstances (e.g. where the service only consists of executing a client's order on – non-complex products).

Table 2 - The scope of application of suitability and appropriateness assessments (and demands and needs test)

[584] Article 20(1) IDD.

[585] Additional provisions exist for IBIPs and PEPP Article 30(1) IDD; EIOPA Q&A - QUESTION 1638 on IDD available from: https://www.eiopa.europa.eu/content/1638_en and Article 23(1)(a) PEPP Regulation.



Source: Consortium.

Intervention logic of the measures concerning suitability and appropriateness assessments and demands and needs test

The legal provisions governing the suitability assessments and demands and needs tests are set out across several legislative texts. In order to facilitate the presentation of why an intervention was required at a European level, an intervention logic has been reconstructed which presents the logical links between the different legal instruments, policy objectives and expected outputs, results and impacts.

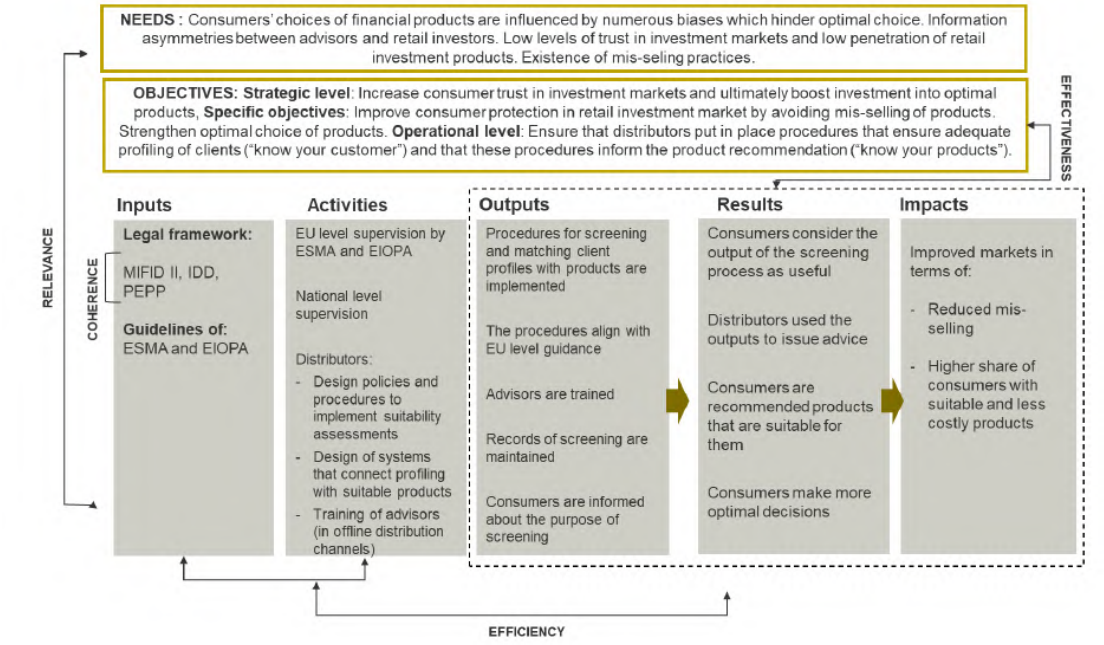
The suitability and demands and needs assessments were introduced in legislation in order to ensure retail investors do not invest in financial products that are too risky for them or do not meet their investment objectives, and more generally to assist retail investors to make optimal choices. The requirements were introduced into IDD and MiFID II with the objective of preventing mis-selling of products and strengthening the decision-making abilities of retail investors, in order to allow them to make optimal choices, thus increasing consumer trust in the market.

The rules require that distributors have policies and procedures in place that allow them to perform suitability assessments and demands and needs tests, further clarified through EU guidance[586]. The results of these tests must be documented and communicated to consumers, and advisors must be trained to perform them. The desired impact is twofold: to ensure that i) distributors consider the outcome of the screening when providing advice and ii) retail investors are recommended products that are suitable for them. As a

[586] ESMA Guidelines on MIFID II Suitability requirements 2018 and 2022, EIOPA Q&A on demands and needs test, EIOPA guidance on integrating the customer's sustainability preferences in the suitability assessment under the IDD | Eiopa (europa.eu).

result, the rules should improve the market by reducing mis-selling and increasing the share of retail investors with suitable financial products.

Figure.3 - Intervention logic for the suitability assessment and demands and needs test [587]



Source: Consortium.

As regards the appropriateness assessment, the intervention logic follows a similar rationale. The appropriateness assessment was introduced in order to ensure retail investors do not invest in financial products (in particular the too risky ones) or services that are not appropriate for them and to assist the retail investors in making optimal choices. The rules require that investors, when investing on their own, need to undergo an appropriateness assessment. If the result of the appropriateness assessment is negative, the firm must warn the client that the product is not appropriate. The desired impact is that retail investors are warned if they want to invest in a complex financial product, that is not appropriate for them.

2.1.d - Product oversight and governance

Relevant legal provisions and the scope of their application

Product oversight and governance (POG) requirements aim at ensuring that the interests of customers take prime importance during product design and throughout the lifecycle of a financial instrument/product, including the arrangements for its distribution.

The POG requirements apply to investment firms and insurance undertakings which create, develop, issue and/or design financial instruments or insurance products (manufacturing stage). POG rules also apply to investment firms and insurance distributors which distribute financial products and investment services to clients (distribution stage). An investment firm or an

[587] As presented in the Retail investment study.

insurance undertaking involved in both the manufacture and distribution of the relevant financial instruments or insurance products will need to apply both sets of requirements. As with other financial instruments, UCITS products are captured by MIFID and IDD POG rules, where distributed by MIFID and IDD firms or by asset managers providing investment services under MIFID. This applies also to compliance with relevant rules for product manufacturers.

The POG requirements under **MIFID and IDD** have the following main features in common: an obligation for firms to define target markets for the financial products, to have a product approval process, a regular review, a distribution strategy, and to exchange information between manufacturers and distributors. These requirements can be summarised as follows:

- A manufacturer of financial instruments/products or insurance products for sale to end-clients/customers shall maintain, operate and review a process for the approval of each financial instrument or insurance product and significant adaptations of existing financial instruments or insurance products before they are marketed or distributed to clients.
- The product approval process shall specify an identified target market of end-clients within the relevant category of clients/customers for each financial instrument or insurance product and shall ensure that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market.
- A manufacturer shall also regularly review financial instruments or insurance products it offers or markets, taking into account any event that could materially affect the potential risk to the identified target market, to assess at least whether the financial instrument or insurance product remains consistent with the needs of the identified target market and whether the intended distribution strategy remains appropriate.
- A manufacturer shall make available to any distributor all appropriate information on the financial instrument or insurance product and the product approval process, including the identified target market of the financial instrument/product.
- The product distribution arrangements shall aim to prevent and mitigate customer detriment and ensure that the objectives, interests and characteristics of customers are duly taken into account.

While these main requirements are almost identical across MIFID and IDD, there are different levels of granularity as regards the specific obligations that need to be fulfilled for each of them. In particular, under MIFID there are explicit obligations for manufacturers to assess financial instruments' risk and reward profile and costs vs performance of products[588], whereas in IDD there are no specific provisions covering charging structures. MiFID II in particular requires from the manufacturers of financial instruments that the design of those instruments is driven by

[588] See Article 9(12) of Delegated Directive (EU) 2017/593: Obligation to consider the charging structure proposed for the financial instrument, including by examining whether the financial instrument's costs and charges are compatible with the needs, objectives and characteristics of the target market, that charges do not undermine the return expectations and that the charging structure is appropriately transparent for the target market.

features that benefit the client and not by a business model that relies on poor client outcomes to be profitable[589]. Distributors, on their side, have to obtain from the manufacturers information to gain the necessary understanding and knowledge of the products they intend to recommend or sell in order to ensure that these products will be distributed in accordance with the needs, characteristics and objectives of the identified target market[590].

In addition to the MIFID/IDD rules, the **UCITS directive** sets out POG requirements for product manufacturers of UCITS funds. These requirements are implemented at different levels.

Firstly, UCITS funds are subject to authorisation by NCAs on the basis of several requirements, including a clear strategy and an investment objective of the product. Before UCITS are authorised, NCAs are provided with information on fee structures and have the powers to assess whether these fee structures are suitable for the UCITS to meet its investment objective. NCAs make active use of these powers including for ongoing supervision.

Secondly, UCITS management companies are subject to different product governance-type rules, notably the obligation to act in the best interests of investors. This includes ensuring that investors in UCITS are not charged undue costs[591]. They are subject to rules designed to minimise the transaction costs charged to the UCITS in implementing their investment decision[592]. UCITS management companies are also subject to rules on conflict of interests. These rules are enforced through ongoing supervision.

Thirdly, the UCITS framework requires that investment products are subject to several levels of oversight, the first being that of senior management which is responsible for checking the adequacy of internal procedures[593], including the process for charging costs and fees and best execution/best selection rules. The second and third layers of control are the permanent compliance function and the permanent internal audit function. The UCITS framework also relies on a strong depositary function, entrusted with various tasks[594], including oversight that applies, among others, to checking whether POG rules are respected. Depositaries are also subject to authorisation and supervision. Finally, UCITS framework requires appointment of financial auditors at the level of the UCITS and of the management company.

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[589] Idem, Article 9(11)(b).

[590] Idem, Article 10(2).

[591] Based on Article 14(1)(a) and (b) of the UCITS, the management company shall: (a) act honestly and fairly in conducting its business activities in the best interests of the UCITS it manages and the integrity of the market; (b) act with due skill, care and diligence, in the best interests of the UCITS it manages and the integrity of the market. Article 22(4) of the Commission Directive 2010/43/EU (UCITS Level 2 Directive) provides that Member States shall require management companies to act in such a way as to prevent undue costs being charged to the UCITS and its unitholders. These are further specified through ESMA supervisory briefing.

[592] Articles 26 and 27 of Commission Directive 2010/43/EU, similar to MIFID II best execution and best selection rules.

[593] Idem, Article 9.

[594] These obligations are set out mainly in Articles 22 to 26 of the UCITS.

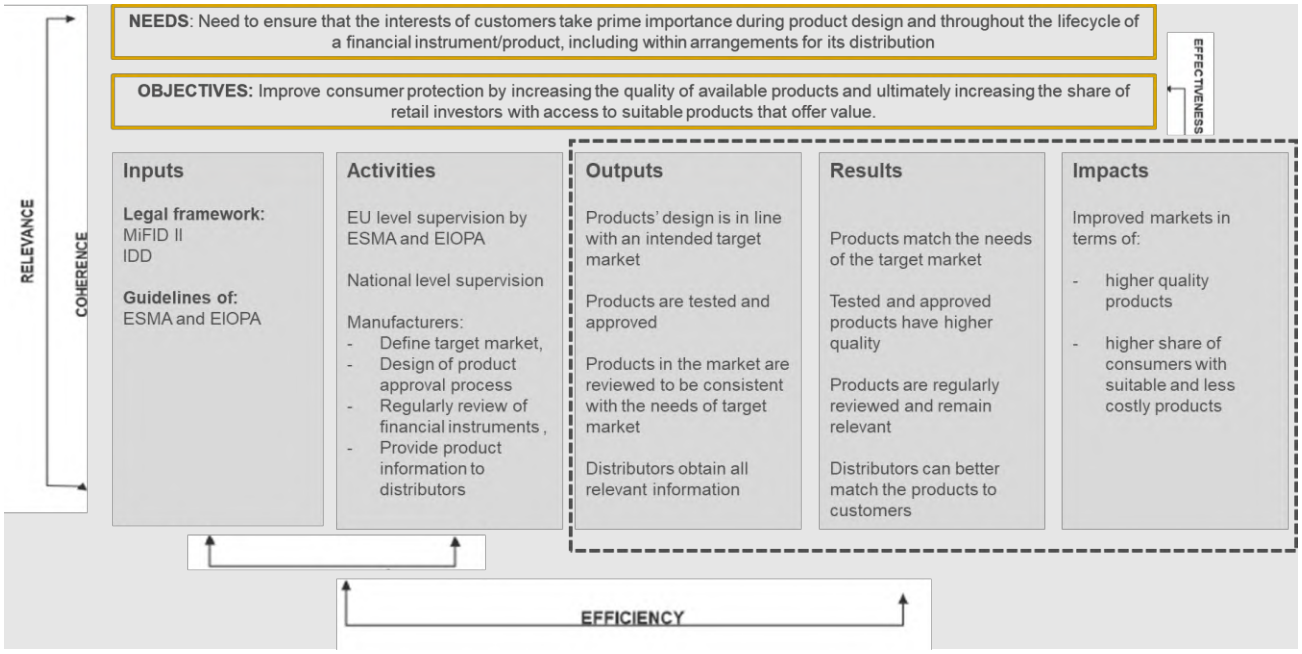
Intervention logic of the measures concerning product oversight and governance

The legal provisions governing POG are set out across multiple legislative instruments. In order to facilitate the presentation of why an intervention was required on POG rules at European level, an intervention logic has been reconstructed, presenting the logical links between the different legal instruments, policy objectives and expected outputs, results and impacts.

POG requirements were introduced to ensure that the needs and interests of retail investors are always at the centre of the lifecycle of a financial instrument/product. Specific POG requirements were introduced under MIFID and IDD to ensure that the products that enter the market are appropriate for the types of investors to whom they are intended to be distributed, thereby ensuring that retail investors have access to good quality investment products.

The rules require that manufacturers have policies and procedures in place for the approval of each product and the defined target market and distribution strategy. Manufacturers must regularly review the financial instruments offered to the market to ensure they continue to be suitable for the target market and that all necessary information on the products is made available to the distributors that will sell the product. The desired impact is that manufacturers test and approve their products before they enter the market, and that the products are designed in a way that meets the needs of the intended market. As a result, the quality of the products distributed to retail investors should improve and products can better meet retail investors' needs in terms of desired results.

Figure.4 - Reconstructed intervention logic



Source: Commission services

9. 2.2 Point(s) of comparison

The starting point to assess the effectiveness of the investor protection rules is the period 2014-2016[595], before the adoption of the legislation that now sets out the current framework of retail investor protection rules across the different sectors. While all legislative instruments aim to protect investors, they were not conceived as a common overarching framework and were subject to sectoral differences. It is therefore more efficient to assess the points of comparison of the rules separately.

Prior to the introduction of MiFID II, rules on disclosure of important information to clients were in place (e.g. on conflicts of interest), however they were more general and did not define in detail the type of information that should be disclosed to clients.

In the area of inducements, the concept of independent advice, did not exist in the legal framework under MiFID. Inducements were allowed for all types of services.

As regards suitability and appropriateness assessments, rules were already in place prior to the introduction of MiFID II to ensure that products offered to clients were suitable or appropriate (depending on the service). The MiFID I regime was only marginally modified by MiFID II, and the overall philosophy and functioning of the framework was maintained.

Prior to the introduction of MiFID II, product manufacturers were not required to define a target market for the products they conceived, and there were no requirements to ensure that product manufacturing undergoes an approval process or that it is reviewed on a regular basis. This made it difficult for supervisors to ensure the quality of the products that enter the market.

Prior to the introduction of the IDD, there were no specific information and conduct of business rules for the distribution of IBIPs. The general rules on disclosure of important information to customers (such as on conflicts of interest or costs) were not sufficiently detailed to ensure retail investors could make a fully informed decision. There was no obligation to disclose the amount of commission or other inducements an intermediary received for the conclusion of an insurance contract. Furthermore, the legal framework before the introduction of the IDD did not provide for a general duty to act in customers' best interests, or rules on investment advice such as the suitability and appropriateness assessment, nor did it regulate in any way the product approval process.

As a consequence, there was a significant regulatory difference between investment products covered by MiFID and investment products with insurance elements that were subject to a more rudimentary legal discipline. This was seen as a serious gap in investor protection and an incentive to regulatory arbitrage.

Prior to the introduction of the PRIIPs KID, disclosures on packaged retail investment products were uncoordinated and often did not help retail investors compare different products or understand their features. This problem was especially pronounced for more complex products,

[595] Markets in Financial Instruments Directive (MiFID II) - 2014/65/EU replaced the previous framework defined by MiFID I, adopted in 2004; Insurance Distribution Directive (IDD) (EU) 2016/97 replaced the previous framework defined by the Insurance Mediation Directive (IMD), adopted in 2002; PRIIPs Regulation No 1286/2014 was introduced in 2014.

that are difficult to understand. Consequently, retail investors have often made investments without understanding the associated risks and costs and have, on occasion, suffered unforeseen losses. They may also have lacked confidence and refrained from investing. Divergent rules on disclosures, governed by different product-specific and national frameworks, led to an unlevel playing field between different products and distribution channels, and posed barriers to an internal market in financial services and products. They also left unmitigated powerful asymmetries of information between retail customers and the industry.

More specifically[596], product disclosures for UCITS funds were provided under the Key Investor Information (KII) of UCITS Directive, while other open-ended funds were only covered by high-level product disclosure requirements for sale of financial instruments under MiFID (which also applied to UCITS, structured securities and closed-end funds). Unit-linked life insurance products were covered by Solvency II (CLD rules) and the Insurance Mediation Directive for some product disclosure requirements. Finally, there were no rules at EU level capturing structured term deposits. Most disclosure regimes were relatively high-level and did not set out in detail the form and content, with the exception of the UCITS KIID regime. Moreover, there was substantial variation in product disclosures across EU Member States.

The **UCITS** directive, including the current product oversight and governance rules has been unchanged since approximately the start of the reference period for the points of comparison of this evaluation (2014-2016). The most recent review of UCITS directive[597] took effect in 2014 ("UCITS V") and brought harmonisation and strengthening of some legal provisions related to retail investor protection, such as the function of the depositary, remuneration policies of UCITS asset management companies, and relevant sanctions. Prior to the introduction of UCITS V, the rules under the UCITS framework did not provide sufficient protection of investors vis-à-vis managers of UCITS funds and their depositaries and offences by UCITS managers were not always adequately sanctioned.

3 HOW HAS THE SITUATION EVOLVED OVER THE EVALUATION PERIOD?

10. Current state of play

The investor protection rules are currently set out in a number of sector-specific legislative instruments. For the analysis of how the situation has evolved during the period, we present below the state of play of these instruments and how they have been implemented:

MiFID II

Member States had to transpose Directive 2014/65/EU into national law by 3 July 2016 (extended to 3 July 2017). Under MiFID II, Member States are required to provide notifications in case of additional requirements that they may decide to impose on investment firms beyond those provided by Directive 2014/65/EU. Additional requirements are only permitted in two areas a) the safeguarding of client assets (as referred to in article 16(11) of the directive) and b) the

[596] See the Impact assessment on PRIIPs, notably the text on problem drivers and table 2.
[597] Directive 2014/91/EU

general principles of investor protection and the information to clients (as referred to in article 24(12)).

All Member States have communicated their full transposition of Directive 2014/65/EU. Following internal assessment and review of the completeness assessments provided by an external contractor, the state of completeness of the transposition is considered sufficient. DG FISMA is currently in the process of carrying out a conformity assessment of key provisions of MiFID II. There are no outstanding infringement cases or completeness examinations related to MiFID II itself[598].

IDD

EU Member States had to transpose Directive (EU) 2016/97 into national law by 23 February 2018 (extended to 1 October 2018). All Member States have communicated their full transposition of Directive (EU) 2016/97. Following internal assessment and review of the completeness assessments provided by an external contractor, the state of completeness of the transposition is considered sufficient for all but one Member State. DG FISMA is currently in the process of carrying out a conformity assessment of the Directive.

The IDD is a minimum harmonisation directive, allowing Member States to introduce additional provisions or to bring additional activities into the scope of the legislation. The IDD does not prevent Member States from keeping or introducing more stringent provisions, as long as they are consistent with the directive. This is explicitly confirmed by specific provisions covering stricter requirements on inducements (including a ban) and rules on mandatory advice. The Directive also states explicitly that where a Member State has decided to impose stricter provisions in its national transposition, these requirements have to be complied with by all distributors selling products to customers residing in the relevant Member State, including distributors from other Member States operating under the freedom to provide services or the freedom of establishment. EIOPA has also issued guidance on transposition and compliance in the form of Q&As.

PRIIPs

The PRIIPs Regulation ((EU) No 1286/2014) aims to improve the transparency and comparability of investment products across the EU through key information documents (KIDs). PRIIPs is a regulation, hence the rules did not need to be transposed. The contents and presentation of the KIDs have been further developed through secondary legislation and ESA guidance.

After consulting with the European Commission and European Parliament, the rules on KIDs were published as Commission Delegated Regulation (EU) 2017/653 and came into force on 1 January 2018. Since then, KIDs must be provided by those producing or selling investment products to retail investors.

[598] However, MiFID II has been amended and supplemented on a number of occasions. More recently introduced directives part of the MiFID package, such as the Capital Market Recovery Directive and the Delegated Regulation and Directive relating to the integration of sustainability factors are in the early stages of transposition assessment. In relation to others, namely Directive (EU) 2019/2177 and Directive (EU) 2020/1504, there are ongoing infringement cases for non-transposition against a small number of Member States.

Important changes to PRIIPs secondary legislation have very recently taken effect (1 January 2023), through an amended RTS. The disclosure rules of the new Regulatory Technical Standards are designed to make the PRIIPs KIDs fully applicable for UCITS. Due to the very recent entry into application of the RTS, there is not yet sufficient experience with their application of the changes[599] it introduced that would allow to assess their effectiveness, efficiency and coherence hence, they are excluded from this review.

UCITS

The most recent review of UCITS directive took effect in 2014 ("UCITS V")[600] with a deadline for the transposition in national legal systems of 18 March 2016. All Member States have communicated the national provisions transposing UCITS V by now. Following internal assessment and review of the completeness assessments provided by an external contractor, the state of completeness of the transposition is considered sufficient. With regards to conformity checks, the outstanding issues have been assessed based on the clarifications from the national authorities. In few cases, the informal exchanges concluded that minor amendments to the national laws were required in order to ensure conformity with UCITS V Directive. UCITS V is now considered fully transposed and implemented across EU Member States. Amendments to UCITS since then include changes on cross-border distribution rules[601], where transposition checks are still ongoing. Finally, some amendments are currently under negotiation as part of the AIFMD review[602] to ensure that the same MIFID product governance rules would apply when investment funds are distributed directly by asset managers providing investment services.

[599] The amended RTS notably has brought the following changes:

- new methodologies for calculating appropriate performance scenarios and a revised presentation of the scenarios, with a view to ensuring that retail investors are not provided with inappropriate expectations as to possible returns;
- revised summary cost indicators and changes to the content and presentation of information on the costs of PRIIPs, to allow retail investors to better understand the different types of cost structure and to facilitate the use of this information by persons advising on or selling PRIIPs;
- a modified methodology for calculating transaction costs, to address practical challenges that have arisen when applying the existing rules, and issues regarding their application to certain types of investment;
- provisions in respect of past-performance information for certain types of UCITS, retail AIFs and insurance-based investment products.

[600] Directive 2014/91/EU amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

[601] Directive 2019/1160/EU amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings.

[602] Information about the 2021 AIFMD review is available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12648-Financial-services-review-of-EU-rules-on-alternative-investment-fund-managers_en.

4 EVALUATION FINDINGS (ANALYTICAL PART)

4.1 To what extent was the intervention successful and why?

Has the retail investment framework been overall successful in improving investor protection?

Overall, the EU legal framework was designed to ensure investor protection. The EU legislative actions over the period 2014-2016 across the different financial services (see table 2.2.1) introduced changes that included new elements and aimed to move towards a more integrated EU market and increased investor protection.

The framework has to a certain extent achieved its objectives to increase investor protection. The details of the analysis are presented in the sections below per area of focus (disclosures, inducements, suitability and product oversight and governance). In addition, according to the public consultation[603], slightly more than half of the respondents (52%), were of the view that the current framework sufficiently empowered and protected retail investors.

However, when looking at where there might be scope for improvements to the framework, the areas identified in the public consultation by the respondents were:

- financial literacy (supported by all groups),
- improvements to the disclosure requirements, clear preference of consumer organisations and NGOs, also priority area according to respondents from public authorities,
- the suitability and appropriateness assessment, clear preference of consumer organisations and NGOs, and
- inducements and quality of advice, clear preference of consumer organisations and NGOs, also priority area according to respondents from public authorities.

To further determine whether the intervention has been successful, we have assessed the effectiveness, efficiency and coherence of the four areas that are captured below, and how the rules in these areas contributed to improving the investor protection with the aim of identifying potential areas of improvement.

4.1.1 More specifically, have the disclosure rules been successful in improving information for retail investors?

Effectiveness

The key elements identified in the retail study for the assessment of the **effectiveness** of the framework on disclosures rules are the following:

Availability and accessibility: Information documents are generally available and accessible when a consumer searches for them. However, the use of information documents when firms/advisors give information to retail investors varies. Under the current legal requirements,

[603] See Annex 2 for the summary of the results on stakeholder consultations.

pre-contractual information should be disclosed "in good time" before the retail investor is bound by any contract or offer relating to the product or service[604]. However, in practice, the documents are not systematically provided to potential clients at a very early stage of their investor journey. Only 54% of mystery shoppers received a key information document or were referred to one online when they were simulating the first contact with an advisor. It is possible that these advisors might have provided the document at a later stage, which would however be too late to inform the decision-making. Even when provided with the document, mystery shoppers were only very rarely given time to read it. While all these practices may comply with the general requirement of "in good time", in practice, if disclosure information is provided at the end of the process or at the time of the contract signature, it is likely that it will not allow retail investors to make informed decisions. There is therefore a certain ambiguity in the definition of "in good time" which is intended to ensure that KIDs and KIIDs are used as the main resource for the consumer's decision-making. This is also highlighted in recent case law (Judgment of 24 February 2022 in Joined Cases C-143/20 and C-213/20, A and others ('Unit-linked' Assurance Contracts), ECLI:EU:C:2022:118, point 116). Furthermore, a substantial proportion of shoppers were provided with multiple documents, thus contributing to information overload. Furthermore, as indicated by the Joint Committee of the ESAs, the PRIIPs KID is not always easy to find on the PRIIP manufacturers' website[605].

While many regulatory disclosures focus on the pre-contractual stage, periodic ex post disclosures to retail investors, focusing on the costs and performance of the products in their portfolio, are more limited. As identified in EIOPA's advice on retail investor protection, in the area of IDD, some Member States have developed national practices beyond the outdated rules in Solvency II, but there is currently no common standard for ex post periodic disclosure in EU legislation which might improve the comparability of different IBIPs and help inform investors about the costs and performance of their portfolio. Both the MiFID and IDD rules[606] require investment firms and insurance distributors to provide investors with annual information on costs and charges related to financial instrument(s), investment and ancillary services and IBIPs. However, as regards investment services, this requirement only applies to situations where there is an ongoing relationship between the client and the investment firm. The same report does not cover the performance of the investor's portfolio, taking into account the performance of the financial products and the costs and fees borne by the investor.

As a result, a significant number of investors do not receive appropriate ex-post information in an easily accessible and comprehensible way, which limits their possibilities to effectively monitor the developments of the investment product purchased, including performance and costs paid.

Completeness and complexity of information: According to the retail study, disclosure documents such as the PRIIPs KID capture relevant information that retail clients need to understand investment products and that allows them to choose between products. When a sample of disclosure documents was checked, the majority were compliant, complete in terms of items covered and, in most cases, up-to-date. Where disclosure frameworks such as PRIIPs have

[604] PEPP, MiFID II and PRIIPs further specify at which point in the retail investor journey this disclosure occurs.
[605] Page 32 of Advice of the ESA joint committee on PRIIPs.
[606] Delegated Regulation (EU) 2017/565 Article 50.9, Article 29(1).

standardised the information to be provided to investors, such as in case of IBIPs, profit participation products or structured products, the study noted a higher degree of completeness than for those products that are not subject to PRIIPs, such as securities, traditional life insurance products and pension funds. Hence from the perspective of completeness, PRIIPs and other disclosure frameworks have contributed to improving information for retail investors. A list of items that need to be included in KIDs (or KIIDs) has also contributed to this. Although standardisation (using common reference points for comparison such as standardised risk indicators) covers some items that improve understanding, it does not overcome the complexity of the terminology nor that of costs. This complexity, even when presented in a standardised manner, inhibits understanding. There is limited focus on situations in which the disclosure document is to be used and which might help retail investors in their decisions.

Readability and user-friendly presentation: In order improve understanding of investment products, disclosure documents also need to present information in a user-friendly manner that is engaging and captures their attention. However, only around half of the information documents reviewed as part of the study contained nudges for reading, and only around half of the mystery shoppers who received an information document were verbally encouraged to read it. **The review of information documents shows that they are rarely engaging, and that their layout is frequently very dense and therefore not reader-friendly**. Furthermore, presentation of the contents of disclosure documents, notably the PRIIPs KIDs is static, presented in a single document and does not allow layering of information or interactivity to enable users to engage with them according to their needs. This may imply missed opportunities to present the document in more user-friendly ways.

Retail study: behavioural experiment on perception of simplified information documents by consumers

During the behavioural experiment conducted as part of the retail study, retail investors were exposed to a simplified one-page information document and asked to give feedback on the documents reviewed on the basis of four criteria (ease of understanding; volume of numbers and figures (proxy for complexity); overall layout and presentation (proxy for engagement); usefulness of information). The simplified document that was assessed is much shorter than the documents that are actually observed in the market, which are in practice much longer than one page.

The **ease of understanding** of the documents shown was rated the least favourably of the four criteria. On a ten-point scale whereby 1 is very bad and 10 is very good, the average score was slightly above the mid-point – 6.1. Some differences in the rating of these mock-up documents by subgroups were noted:

1. people with savings, no investments but looking to invest rated the ease of understanding most positively, even though it was still below 7 – average score 6.65; but
2. people with savings, but not interested in investing rated the ease of understanding the worst – average score 5.68 (i.e. 1 point below the segment of people searching to invest);
3. people with high trust in banking rated the ease of understanding relatively high (7.59) compared with those whose trust rating of banking is low (5.09);
4. older age groups considered the documents to be less clear than younger age groups;
5. risk-averse individuals rated the documents as more understandable than those seeking risk exposure (6.4 versus 5.54);
6. the differences according to level of education or financial literacy scores were much narrower, with the trust and interest in investing variables recording the greatest differences.

The **complexity** of the documents, as measured by the perception of respondents of the volume of numbers and figures, was also rated as middling – 6.51 on a scale of 1 (very bad) to 10 (very good). The documents were already simplified. With regard to differences among subgroups the following were observed:

7. people seeking to invest considered the volume of numbers and figures more positively (6.9) than those who were not interested in investing (6.14), while the other segments were in-between;
8. those with trust in banking considered complexity most positively (7.78 versus 5.74 for those with low levels of trust).

The **layout and presentation** of the documents were used as a proxy for the engaging character of the documents. Engagement is a precondition for people to actually read the disclosure documents. This in turn is a prerequisite of effectiveness. The score for the layout of the documents was also

Clarity of information: According to the retail study, information in the documents is clearly presented, accurately labelled and correctly structured. There were notable differences between

products, with information on UCITS funds and IBIPs, which corresponded to a majority of products covered by KIIDs or KIDs, being generally clearer, and information on traditional life insurance and pension funds, which are not subject to a PRIIPs KID, being significantly less clear. It can be deduced that the specifications for the titles and content of different sections that must be completed by the product manufacturer in KIID and KID templates have contributed to greater clarity. Comparative to other elements of disclosure, the study concluded that information on costs was complex and sometimes inconsistent, making comparison and use challenging for retail investors. A specific issue was identified, notably in case of KIDs for Multi-Option Products ("MOPs"), which consist of a wrapper (insurance contract) and an underlying investment, where clients choose between multiple options (e.g. whether returns are linked to S&P500 index, Stoxx Europe 600 or several specific shares). The Advice of the ESA joint committee on PRIIPs confirms that it is difficult for the investor to identify the total costs related to a particular investment option and information on the underlying investment option typically does not include the total costs of investing in that option. This hinders retail investors' ability to understand costs related to these products and hence reduces the effectiveness of PRIIPs KIDs for this market segment.

Comparability of information: Even though according to the Retail investment study the comparability of information documents was generally rated lower than the clarity of the information provided, notably across product categories, it is evident that the application of the regime around disclosures has improved comparability and understandability of products through information documents. Comparability is relevant to the market, as the consumer survey conducted as part of the retail investment study showed that 76% of those who hold at least one investment product do make comparisons before making their choice: 40% compared products of the same type, while another 36% compared different types of products. The type of information included in the information documents (products description, risk, past and expected future performance, costs, holding period) contribute to consumer understanding and are relevant in driving consumer choices, as confirmed by the results of a questionnaire in the retail study. The transparency of information provides evidence that can be used in the event of any litigation.

Decision-making: The behavioural experiment conducted as part of the study, using already simplified versions of the product information documents, demonstrated the limits of the effectiveness of disclosure when it comes to supporting retail investors' decision making. Simplified information documents, for certain products such as UCITS and insurance products, were effective in supporting optimal choice, similar to the status quo. Such documents were however not as effective where more complex products were involved, and with which people were not familiar. Financial literacy also plays a role in this regard.

Overall, disclosure rules have led to improved and more comparable documents for retail investors. However, weaknesses were identified with respect to accessibility of the documents during the advice process and with their readability and lack of user-friendly presentation. The complexity of the information, in particular relating to costs, inhibits understanding. Documents are also rarely engaging, and their layout is frequently very dense and therefore not reader-friendly. While they contain relevant information that can guide investor decisions, these weaknesses hinder, to a certain extent, the actual use of such information by retail investors in their investment journey.

With respect to **marketing communications**, the current rules under the MiFID and IDD frameworks require *inter alia* that marketing communications are clearly identifiable as such and that the information they contain is consistent with any information the distributor provides to investors in the course of providing investment services. However, in terms of the effectiveness of these rules, ESMA[607] has indicated that there may be confusion in how the definition of marketing communications is applied, and whether online advertising and firms' private messages to clients and potential clients on social media fall under this definition[608], both when communicated directly by the firm or through third parties' social media (i.e. finfluencers who operate on behalf of financial service providers). Marketing communications, particularly in the online environment, may also tend to overemphasize the potential benefits of the product and hide information on costs and risks.[609]

The PRIIPs regulation requires marketing communications to avoid inconsistencies with KIDs or prohibit them from reducing its significance. Limited information is available from supervisors regarding the efficiency of this rule[610]. Nine NCAs do not supervise marketing documents and six NCAs reported no material differences between PRIIPs marketing materials and the KID. Meanwhile, two sources of evidence – responses to the call for evidence and a mystery shopping exercise conducted by one NCA – indicated that distributors tend to focus on marketing documents in the sales process, instead of the KIDs.

Efficiency

According to the study, the **efficiency** (cost-effectiveness) of requirements regarding disclosure through information documents is high, also considering the overall attainment of the objective of increasing retail investor protection that has been described above. The study estimated that total ongoing costs for all three main product categories (investment funds, pension products and insurance products) are approximately 570 million euro per year. When estimating the cost per client, we calculate a unit cost of €3.86. The estimated cost represents approximately 0.0017% of the net asset value. In addition, there are several lesser issues with regard to legal clarity, such as whether PRIIPs applies to certain types of corporate bonds, which could be addressed to further improve efficiency.

Coherence

Overall, the requirements for format, readability, clarity, conciseness, language use and comprehensive coverage are **coherent** across the different legislative texts. The key elements relating to disclosures that have been identified in the retail study for the assessment of the coherence of the framework are:

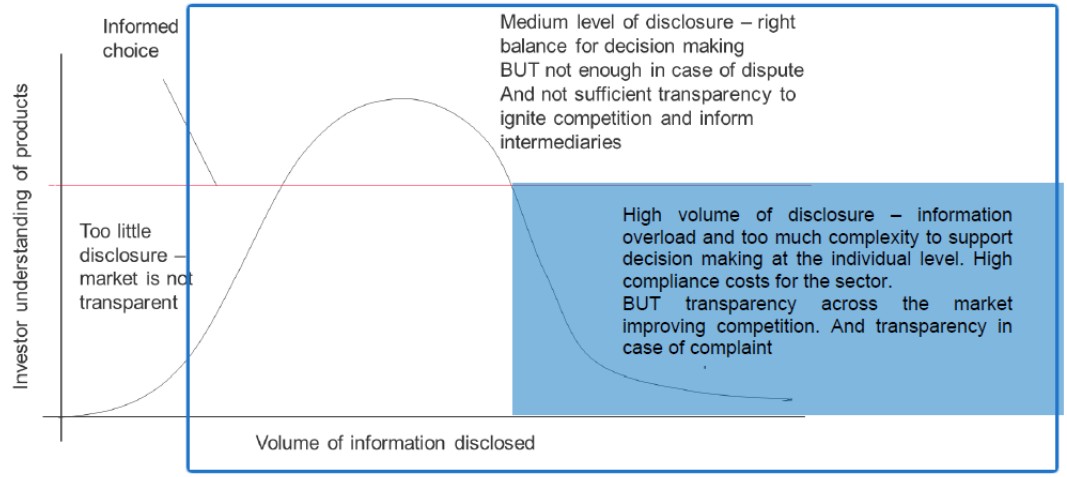
Means of information communication: All EU legislative texts include the option to communicate the pre-contractual information through various means, i.e. on paper, on a durable medium other than paper under certain conditions, and on a website under certain conditions. The

[607] ESMA advice on retail investor protection, page 9.
[608] ESMA advice on retail investor protection, page 9, point 21.
[609] ESMA advice on retail investor protection, pages 10 and 14.
[610] Advice of the ESA joint committee on PRIIPs.

different requirements across the legislative framework created inconsistencies and impracticalities, such as when one information document is provided to the retail investor in paper format, while another is available only online. This provides evidence of the need to make changes to the regulatory framework to increase coherence across the different legislative texts. It is also linked to the increased need for digitalisation of financial services disclosures. The ESAs have also concluded that digitalization trends are not adequately captured and that although the current framework is "*supposed to be technology-neutral, it was mainly designed without considering digital distribution, and certainly before the "app-revolution*[611]". Likewise, the Retail investment study also suggested the need for greater emphasis on the digital environment[612]. Disclosures that would be digitally adapted would allow for minimisation of information overload (through layering of information) and for greater accessibility in the growing digital distribution channels. But disclosure rules currently differ in this aspect - while some more recent legal frameworks such as the PEPP cater greater digital use of key information documents, PRIIPS has not been similarly adjusted yet.

The figure below (presented in the retail investment study) shows the relationship between the volume of disclosure and retail investor understanding of the products.

Figure 5: relationship between the volume of disclosure and retail investor understanding of the products



Source: Consortium.

Informational requirements and methodology: the requirements regarding the introductory section of pre-contractual disclosure documents are broadly coherent. Some overlapping information requirements are present in EU legislation related to the sale of IBIPs (also underlined by EIOPA). EIOPA made specific recommendations for addressing duplication (overlapping information requirements) by targeted interventions in Solvency II, IDD and the DMFSD (Distance Marketing for Financial Services Directive). With regard to the methodologies for calculating risks, some concerns were expressed, during the interviews conducted as part of

[611] Advice of the ESA joint committee on PRIIPs, page 43, para 3.5.1 and EIOPA advice on retail investor protection, page 36.
[612] Retail investment study, pages 15 and 106.

the study, regarding the comparability of performance disclosure in the PRIIPs KID for its application in the insurance sector. However, elements of PRIIPs KIDs related to presentation of cost and performance have been recently amended through secondary legislation, applicable from January 2023, so it will take several years before sufficient experience is accumulated to properly assess whether these changes have been effective. Interviewees expressed concern that the KID requirements were developed for investment funds and were ill-adapted to insurance products. Some interviewees mentioned certain elements specific to insurance-based investment products (biometric risk coverage) that do not find an appropriate placeholder in the KID.

Comparability of costs: The study shows that the comparability of costs across products has not (yet) been achieved and that retail investors face uncertainties. The differences relate mainly to technical aspects, such as the reference period, methodologies, etc. and to reconciling the overall costs with the breakdown of the costs. Another example (as a challenge to internal coherence of the PRIIPs framework) are the difficulties for retail investors to compare total costs of MOPs, which is described under effectiveness. Practical incoherence has also been mentioned in ESMA's Technical Advice. The incoherent practices in the application of the current framework largely diminish the usefulness of disclosures on their investor journey.

4.1.2: More specifically, have the rules on inducements and advice been successful in reducing conflict of interest problems?

Effectiveness

Rules on inducements were introduced in order to tackle the problem of conflicts of interest at the level of the intermediary, which are inherent in the "commissions-based" distribution model. Financial intermediaries receive remuneration from persons other than retail investors for the products they are recommending and selling to them. These conflicts of interest can be significant since remuneration through inducements can represent an important portion of the incomes of intermediaries.

The key elements related to rules on inducements and advice that have been identified, *inter alia* in the Retail investment study, for the assessment of the **effectiveness** of the framework are:

- the legal provisions regarding the **disclosure of inducements are not being fully implemented and reduce the usefulness for investors' decision-making**:
    - The information documents analysed rarely contain explicit information about inducements[613]. In order to identify information about inducements, it is necessary to search in other types of documents, and even there this information is not provided in a clear and direct manner.
    - Costs disclosed by product manufacturers do not specify the share of the costs that are linked to the payment of inducement to distributors. Therefore, when considering disclosure from product manufacturers, end-investors are not in a position to quantify the extra cost linked to the fact that the product they buy is subject to inducements.

[613] The references to inducements are often implicit. In most product information sheets only one line is included in the costs disclosure along the lines of: "This also includes the costs of selling and marketing the product" or "This includes the cost of distributing your product".

    - As the amount of inducements is directly decided and paid by product manufacturers, distributors are usually only in a position to disclose the general conditions surrounding inducements to end-investors.
    - Inducements are also frequently not disclosed during client conversations as observed during the mystery shopping.
- The rules on **disclosure of inducements** aimed at ensuring retail investors would be made aware of the advisor's potential gains from the sale of a given product and thus contribute to better-informed choices. However, according to the survey conducted as part of the study, most retail investors do not understand the concept of inducements (only 36% of respondents chose the correct statement about the meaning of inducements). Retail investors are also primarily concerned with the overall product costs, and not the costs of selling the product (inducements) that are being passed on to them. Such disclosures can still be important, as they can increase competition between manufacturers and distributors and lead to lower prices and allow retail investors to seek redress if they feel that the advice they received was inappropriate. However, disclosure of inducements does not appear to make substantial difference to a consumer's informed choice as it does not sufficiently address the inherent conflict of interest.

Professional advice as part of the consumer journey

As part of the retail study, a segmentation of consumers surveyed in 10 countries was performed, according to a number of characteristics which are likely to make them more or less vulnerable when faced with inadequate advice. Five consumer segments were identified, two of which relate to consumers not able or disinterested in investing[1] The other three segments of consumers who are considering investing or have made investments are shown in the figure below.



Source: Consortium based on the consumer survey analysis.

These segments show that the consumer needs and expectations vis-à-vis professional advisors differ. Experienced and confident investors are much more likely to make their own decisions, possibly using digital tools allowing comparison or robo-advisors. In contrast, vulnerable potential investors are likely to seek and follow advice as they do not trust their own decision-making capacity. This further reinforces the need to ensure that the quality of advice is adequate and can help boost the trust of retail investor in the financial markets.

- In terms of the impact of the rules on consumer behaviour and choice, the **behavioural experiment,** conducted as part of the Retail investment study, found that:
  - The inclusion of a statement about inducements in financial advice is only marginally likely to influence the consideration paid by retail investors to the products and their information documents. In the experiment, when consumers received advice (good or bad) which included a product recommendation and a warning about inducements, they were in fact slightly less likely to go back and review the product information documents than they were in the other scenarios tested. The mention of inducements did not appear to make consumers more cautious about the advice received.
  - People tend to follow the advice they receive, even when the advice is bad. They do so despite the different types of warnings tested.

- When comparing different forms of disclosure about inducements, it was observed that the effects of the different forms on consumer choice are not very significant.

- The introduction of **MiFID II rules on advice does not appear to have triggered a shift towards more independent advice** nor increased the market share of independent advice. Except in the Netherlands where independent advice has a strong market share, in other countries the trend remains towards largely non-independent advice. In other countries independent advice remains relatively limited and tends to focus on private or high net worth individuals. Non-independent advice remains the prevalent model for distributors of retail investment products in the EU[614] among banks, asset/fund managers and insurance companies active in the EU and is more commonly used than independent advice to distribute products. While in the US and the UK, there has been an organic development and growth of disintermediated advice, in countries such as Germany, Spain, Italy, the Netherlands, where their capacity to penetrate well-established markets is lower there is only a small share of independent financial advisors (IFAs).
- Regarding the significance and volume of inducements, the Retail investment study showed, on the basis of those documents that actually contained information on inducements, that inducements have a significant value. On average, for the products in the sample, inducements were equivalent to about 40% of the total product costs charged to the retail investor. The application of inducements is reflected in higher costs for retail investors. The cost of the inducements seems to be passed almost entirely on to retail investors, with the products on which inducements are paid being – on average - about 24-26% more expensive than those investment products on which no inducements are paid[615]. A study conducted by EFAMA[616] showing that distributors receive around 38% of the costs paid by retail investors through retrocessions (both for actively and passively managed funds), would appear to confirm those figures. ESMA has also indicated in its 2019 Cost and performance report[617], that for UCITS funds, the total costs present a significant drain on the fund performance, impacting retail investors to a much higher extent than institutional investors (as retail clients on average pay twice as much as institutional clients), with costs on average accounting for 25% of gross returns in the period from 2015 to 2017. It is clear that the current rules have not (yet) resulted in a market where retail investors receive better value for money, thanks to lower inducements.
- As part of the Retail investment study, the rules on inducements and advice were further assessed by reviewing whether advisors act in retail investor's best interest through a mystery shopping exercise. The exercise assessed **the information provided during conversations when informing or advising about a**

[614] Retail investment study, page 232.
[615] Retail investment study, page 263.
[616] European Fund and Asset Management Association, EFAMA Market insight, September 2021.
[617] ESMA Cost and Performance Report 2019.

product(s), including providing them with product recommendations that match their profile and with the information they need so as to make the optimal decision about product in which to invest. The exercise concluded that the most important product features were not systematically covered when providing information during the advice sessions (whether in the case of traditional channels or robo-advisors). The results are summarised in the table below:

Figure.6 - Summary overview of items covered by advisors during first conversations about products and robo-advisors

Traditional distribution channels*	Items covered by advice	Robo-advisors
54% of advisors discussed past performance	Product past performance	Nearly all provided information
Of those who discussed past performance 77% made a warning	Warning that past performance does not guarantee future performance	None
63% discussed potential returns	Potential returns (forecasts of scenarios)	Nearly all
Not covered in mystery shopping	Warning about the fact that future forecasts are not guaranteed returns	None
74% of advisors discussed it	Risk level	Nearly all
60% of advisors explained	Explanation how product matches objectives	Most robo-advisors presented an explanation
30% of advisors discussed this	Explanation how it matches past experience	n/a
41% of advisors provided KIDs during the 1st conversation	Key information document was provided	Only a small minority of robo-advisors contained links
Of those who provided KIDs, 67% took action to encourage reading them	Encourage KIDs are read	n/a
67% provided other material in addition to KID	Other material	n/a
56% advisors provided information on costs (though only 32% actually explained)	Presentation of costs	Most had clear costs breakdown

Note: The % shows the share of conversations during which the items were discussed. This does not take into account disclosure in information documents.

Source: Traditional mystery shopping (n=240 visits of which 158 led to product suggestions) and robo-advisors mystery shopping

A similar study was carried out in 2018 by Deloitte on request of the European Commission, which also featured a large mystery shopping data collection exercise. The 2018 study analysed only the provision of information about risks and costs and presented a more positive picture[618] of the situation than the findings presented in the retail investment study. However, the 2018 Deloitte study also found notable gaps with respect to costs and charges that were not discussed in a significant minority of cases and, in some cases, risks were also not covered.

[618] As part of the exercise performed in the Deloitte study, information about past experience with investments was asked about in a much higher number of cases (between 77% and 100% of observations reported being asked about this). However, some of the differences could be due to the mode of mystery shopping conversations which included exclusively face-to-face mystery shopping visits while for the retail investment study a mixed model was used intended to reflect the fact that consumers are searching for advice and information about products from home and are not necessarily making physical appointments during the product "shopping around" phase.

- With respect to insurance-based investment products, a report by EIOPA[619] found that monetary incentives from asset managers (managing the assets of unit-linked insurance products) to insurance companies are widespread and significant in the industry, totalling EUR 3.7 billion in 2015. According to EIOPA, monetary incentives and remuneration received represented a median value of 0.56% of assets under management (46% of fund management charges). A large majority of the insurance undertakings did not disclose these monetary incentives and remuneration to the policyholders, nor did they pass these incentives on to their clients. According to EIOPA, these incentives may limit the choice for policyholders and result in poor investment outcomes, in particular for products with long investment horizons, as underlying investment vehicles may be chosen on the basis of the highest level of monetary incentive and remuneration, rather than relevance or competition.
- In addition, consumer and financial user organisations, such as BEUC, Better Finance and Finance Watch[620], have complained that the existing safeguards are not sufficient to prevent mis-selling, as financial incentives lead to the sale of investment products and services to retail investors that are not suited to their needs and/or which are too costly or underperforming, causing significant consumer detriment.
- Evidence suggests that in many jurisdictions certain simple and cheap investment products occupy a limited market share and are seldom offered or recommended to retail investors, compared to more expensive and complex products. Commissions can be an important incentive to offer specific products (so-called "product bias"), for example, where the fund commission can be ten times higher for an actively managed fund as compared to an index fund, generating significant conflicts of interest[621]. The Commission's study on distribution systems of retail investment products[622] found that low-cost ETFs[623] (which typically carry low costs) are among the most commonly available products on websites in many Member States, but in some Member States are almost completely absent from traditional distributors' online offering. Although marketed online, low-cost ETFs were almost never proposed in traditional physical advice distribution channels. The Retail investment study found that low-cost ETFs have gained market share in certain Member States (e.g. Finland, the Netherlands and Poland), but remain marginal in other countries such as France[624], where comparatively more expensive products, such as life insurances, were advised in the majority of cases[625]. While it is clear that these more

[619] EIOPA, Report on Thematic review on monetary incentives and remuneration between providers of asset management services and insurance undertakings, 26 April 2017.
[620] Better Finance Evidence paper on the effects of inducements, BEUC work on the price of bad advice, Consumer organisations' Open Letter on the Retail Financial Services Action Plan.
[621] 2022 Consumer Protection Report, Swedish Finansinspektionen (FI), page 16.
[622] Study on distribution systems of retail investment products, page 33.
[623] Exchange Traded Funds which often provide index tracking or other exposure to markets.
[624] Retail investment study, page 69.
[625] Study on distribution systems of retail investment products, page 22.

expensive products carry different features and benefits which may be suitable for some groups of retail investors, desk research, based on data provided by ESMA and EIOPA, provides an illustration as to how an investor investing EUR 10,000 in a unit-linked insurance product in the period between 2014 and 2020 would have achieved a significantly lower outcome than by investing in ETFs (EUR 2,200 versus EUR 7,600)[626].

- The European Court of Auditors (ECA) concluded in its special report on investment funds[627] that European legislation in relation to (the distribution of) investment funds had not delivered the expected gains for investors, such as lower fees through competition and innovation, or access to more products. Costs continued to be high and investors were still not sufficiently protected against, among other things, biased advice from financial intermediaries incentivised by inducements. The ECA recommended that the European Commission should better protect retail investors, in particular through stricter rules on inducements.

Overall, the rules on inducements and advice and their application have not been effective in addressing issues of conflict of interest, resulting in more expensive products in the market, with inducements representing a large percentage of the total costs. Evidence also shows that in many cases, the advice given omits important information. Finally, the rules on disclosure of information on inducements only have a marginal effect in helping retail investors in their investment decisions.

Efficiency

Regarding the **cost-effectiveness (efficiency)** of rules governing advice, the following issues were observed. According to the retail investment study, the relevant costs to the firms/distributors to implement the regulatory requirements on advice and inducements are approximately €0.68 per client and that they represent 0.0003% of the value of assets managed. The costs mainly relate to the training of advisors, collecting regular statements from advisors, and ensuring that robo-advisors are compliant with regulations.

The costs appear reasonable for the industry when set against the benefits for retail investors from receiving personalised advice. However, the cost-effectiveness of the rules is reduced for the retail investors, as in practice advice does not systematically cover all the essential product features, as evidenced by the results of the mystery shopping exercise, and the cost of inducements is passed on to the client, resulting in higher product costs charged by the product manufacturer compared to products sold without inducements. In other terms, inducements also lead to an inflation of costs charged by product manufacturers.

Coherence

[626]Calculations were based on costs and performance data provided by ESMA and EIOPA. It is important to note that data on unit-linked products may not be fully comparable with data on ETFs, because of slight differences in methodology and sample size. However, it still provides a useful approximation of how both investments would have developed over a 7-year period.

[627] European Court of Auditors, Special report: Investment funds, EU actions have not yet created a true single market benefiting investors, 2022, Special Report 04/2022: Single Market for investment funds (europa.eu)

Overall, with respect to **coherence**, the rules on conflicts of interest under IDD and MiFID II apply a similar approach to prevent such conflicts and define organisational arrangements[628]. However, some differences between the two legal frameworks exist, especially regarding the treatment of inducements:

- With respect to definitions, a clear definition[629] of "inducements" is present in IDD, whereas MiFID II contains only a concept of "inducement"[630]. Nevertheless, pursuant to IDD and MiFID II, inducements are understood in the same manner – as any fee or commission, or any non-monetary benefit. The IDD inducements rules apply only to insurance intermediaries and undertakings in relation to the distribution of insurance-based investment products and not to other life insurance products.
- The MiFID II regime is designed in principle to only allow inducements as an exception: inducements are forbidden under portfolio management, under independent advice, and when the payment of inducements cannot be justified by an enhancement of the service provided to the client. In practice however, the results of the retail investment study showed that inducements were identified in approximately 40% of information documents for investment funds (falling under MiFID II). The regime intended as an exception under MiFID II thus remains relatively widespread in practice.
- The test that requires that an enhancement of service is proven is both challenging to demonstrate for firms and challenging to supervise for competent authorities. This safeguard also appears to lead to different interpretations across Member States and firms, despite convergence efforts by ESMA. A number of studies[631] have also identified shortcomings in how these rules are applied.

[628] Similar definition/concepts, presence of specific tests, conduct of business and conflict of interest rules, disclosure requirements and clear information on inducements.

[629] For the definition of "inducement" under IDD, please refer to Article 2(2) of Commission Delegated Regulation (EU) 2017/2359 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to information requirements and conduct of business rules applicable to the distribution of insurance-based investment products (IBIPs Regulation); For the concept of "inducements" under MiFID II, please refer to Article 24(9) of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU. In 2021, Article 24 of MiFID II was supplemented by Article 24(9a), which was added by Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis (OJ L 68, 26.2.2021, pages 14–28).

[630] The definition of inducements under IDD and the concept of inducements under MiFID II are comparable, but not identical.

[631] Danish Financial Supervisory Authority (2019), Thematic survey of quality improvement services for investment clients: Temaundersøgelse af kvalitetsforbedrende services til investeringskunder (finanstilsynet.dk) and Financial supervisory authority of Norway (2020) Temaundersøkelse om etterlevelsen av reglene for returprovisjon (finanstilsynet.no) Danish Financial Supervisory Authority (2019), Thematic survey of quality improvement services for investment clients: Temaundersøgelse af kvalitetsforbedrende services til investeringskunder (finanstilsynet.dk) and Financial supervisory authority of Norway (2020) Temaundersøkelse om etterlevelsen av reglene for returprovisjon (finanstilsynet.no)

- As a result, the enforceability and the quality of checks surrounding this requirement are not fully satisfactory and the usefulness of this safeguard is thus called into question.
- Under the IDD regime, inducements are allowed as long as they do not interfere with the obligation to act honestly, fairly, and professionally, in accordance with the client's best interests and do not have a detrimental effect on the client. The same difficulty as under MIFID exists with respect to the application of the non-detrimental effects test.
- As IDD is a minimum harmonisation directive, Member States may impose stricter requirements on inducements. The IDD's conduct of business rules have been implemented into national law in different ways, in contrast to MiFID II's conduct of business rules which are based on maximum harmonisation rules and thus there are no such deviations.
- The two regimes impose different rules on the information that must be disclosed to retail investors and the level of detail varies. The retail investment study revealed that no information about inducements was contained in information documents for the insurance and pension products. Such differences may hinder the usefulness of disclosed information in the investor's decision-making.
- The MiFID II framework clearly defines retail and professional investors, while IDD does not.
- Both MiFID II and IDD allow Member States to impose additional requirements[632] . As a consequence, there are differences between the legal frameworks at EU level and those at national level (e.g. an inducement ban in the Netherlands, different interpretations as regards the quality enhancement criteria, different additional requirements under IDD in Member States).
- The possibility of circumvention of the rules[633] arises as a consequence of sectoral divergences with respect to scope of applicability[634]. Under the MiFID II, it is possible to combine an investment product with funds and an insurance element (the so-called "insurance wrapper")[635]. An insurance product can only be

[632] Page 256 of the Retail investment study

[633] For instance, in the "European Commission, 'Open Hearing on Retail Investment Products'" (2008), indicates cases that took place in the Netherlands of companies trying to circumvent the rules. Similar cases are described in "European Commission, Impact Assessment Accompanying the Proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products (SWD (2012)187, 3 July 2012).

[634] The MiFID II inducement regime relates to investment firms in connection with the provision of an investment service or an ancillary service. The IDD inducement regime relates to an insurance intermediary or undertaking.

[635] The scored IBIPs/PPPs rarely disclose separately the KIID of the underlying investment funds (at least on the online search). There is also no cost standardization between KIID and KID or inducements. But from January 2023, also UCITS will have to prepare KID instead of KIIDs. An example concerns the unit linked/hybrid IBIS with multiple options. The practices can range from 3-4 investment scenarios or selection from 10-20 different funds, with different generation of personalized offers, KIDs and KIIDs (common or individual). In particular, costs concerning MOPs may not be precise because sometimes options are UCITS funds investment for which different disclosure requirements under UCITS are in place. In many instances, there is a generic cost information disclosed as a range in the PRIIPs KID while option

distributed by insurance intermediaries or undertakings. That raises the question as to whether all disclosures to retail investors would be respected where UCITS and AIFs have been included into an IBIP – hence following (only) the IDD regime. In theory, the level of investor's protection in such cases might be jeopardised, because the strict MiFID II rules on inducements would not be followed (which would include the payment of inducements). Banks, independent financial advisors or asset managers selling IBIPs are registered as insurance intermediaries and acting as such under the IDD rules.

- Furthermore, stricter national rules could create an unlevel playing field for financial service providers operating cross-border. On the other hand, it may also expose retail investors in host Member States with stricter rules to different, potentially weaker, levels of investor protection.

4.1.3: More specifically, have the rules on suitability/appropriateness assessment been successful in ensuring suitable product purchases?

Effectiveness

According to the retail investment study, the main observations regarding the **effectiveness** of the client profile suitability/appropriateness processes are:

- Suitability assessments are applied and the majority of retail investors who received advice about investment products recall being asked questions about their profile receiving a suitability assessment report.
- There are inconsistent practices in the market with regard to:
  - The **timing of the screening process**. The legal framework only states that the suitability assessment needs to be done "*when providing advice*", while advice needs to be given "*in good time before the provision of services*". There are no legal provisions stipulating that the suitability assessment needs to take place before the advice is given. The mystery shopping exercise, stakeholder interviews and national studies show that there are clear instances where the suitability assessment is carried out at the very last stage, shortly before the contract signature. In the mystery shopping exercise, several clients were explicitly told that this would only be done later, at a contractual stage. Such late performance of the suitability assessment means that in these instances, the objective of using information about the client to provide advice is not fulfilled.
  - The **depth of information covered** before a product is recommended. An important proportion of conversations that resulted in product suggestions covered only minimal or hardly any information about clients (questions such as

level costs are disclosed pursuant UCITS. Even in preparing their own reports, EIOPA has undertaken data quality checks, 'conversions' between UCITS disclosures - KIIDs and equivalent reduction in yields (RIYs) from KID and the explicit data collection of 'wrapper costs' - costs that are not at the option level but are ultimately paid by consumers because part of the insurance product as a whole. These costs, when the information is disclosed as range in the generic KID may not always be easily identifiable. The main objective should be cost standardization and disclosure under MiFID II and IDD for all cost items, and especially inducements - a horizontal regime - for product comparability.

investor knowledge, family status (linked to the client's capacity to bear losses) or the client's wealth and assets, were in many cases not covered). The varied practices are also confirmed by the reports from supervisory authorities. On the other hand, robo-advisors use a range of questions that generally tend to cover all essential areas.

- **Whether and how the suitability assessment is actually linked to the provision of advice and recommendation**. Both good and bad practices co-exist and the quality of the suitability assessment questioning does not as such guarantee good advice. This is particularly evident in cases in which the advice is given before the suitability assessment is done.

The above areas of improvement indicate that the current framework for assessing product suitability and appropriateness does not necessarily ensure that retail investors are recommended financial products or services that are suitable for them and to assist the investors in making optimal choices.

Efficiency

Regarding **efficiency**, the time needed for a face-to-face screening procedure is the most significant cost[636] of the suitability assessment and process. The benefits that the suitability assessments would bring to the retail investor, also considering the overall attainment of the objective of increasing retail investor protection, indicate that overall, the framework is efficient. There are however some issues, identified that hinder the cost-effectiveness of the suitability assessment and where the current framework could be improved:

- The screening process alone is not sufficient to provide good quality advice (as shown under effectiveness).
- If clients do extensive research and undergo assessments with different distributors before choosing the right product, the costs per screening increase. This indicates the possible need for standardisation and portability of elements of the suitability assessments to help minimise the costs.

On the other hand, the use of online processes and the growing trend towards cheaper and often execution-only products can help reduce the cost of the suitability assessment.

Coherence

According to the legal analysis performed as part of the retail investment study, the legal requirements on suitability and appropriateness **are coherent**. The standards set out in IDD and MiFID II on the application of the suitability and the appropriateness assessment are largely

[636] According to the retail investment study, the estimated range of costs for screening processes is between 0.0006% and 0.0015% of the net assets managed by the service provider, therefore between EUR0.7 to EUR 5.4 per client. The maximum cost per screening is around EUR30 on average. In the absence of data about the share of purchases made by robo-advisors and the share of execution-only purchases, the retail investment study assumed that all screenings were carried out using an advisor driven process and that the products sold were accompanied by advice and were not execution-only. Thus, the actual costs per screening are likely to be lower.

identical. Although some minor potential inconsistencies and gaps have been identified through the legal analysis of the EU requirements for the suitability and appropriateness assessment, these mainly relate to reporting obligations (e.g., the suitability statement) and recording obligations, and are therefore unlikely to have impacts on the financial decisions of retail investors.

Additionally, regarding the coherence at national level, **differences exist between the Member States**. IDD is a minimum harmonisation directive which implies that the Member States are given some leeway to implement rules differently, whereas MiFID II aims at maximum harmonisation. However, national-level interviews did not reveal major concerns.

There are some **differences between IDD and MiFID II regarding the treatment of non-complex products**. IDD allows Member States to derogate from the obligations on appropriateness where no advice is given in relation to IBIPs, while under MiFID II, firms are allowed to provide non-advised services with respect to non-complex investment products, without the need to conduct an appropriateness assessment, provided a warning is given.

The option given to Member States to make advice obligatory for certain types of insurance products (under IDD Level 3 rules) could create potential inconsistencies between insurance products across the EU.

4.1.4. More specifically, have the rules on product oversight and governance been successful in ensuring that products entering target markets are suitable, i.e. aligned with needs of those target markets?

Effectiveness

The current product oversight and governance rules have set the foundation to steer the markets towards ensuring that the interests of customers are integral to the product design process and throughout the lifecycle of a financial instrument/product, including distribution arrangements. However, as evidenced by several sources, the rules under MIFID and IDD have not been **effective** in ensuring this objective and offering value to the retail investor. With respect to effectiveness of POG rules under UCITS directive, available evidence suggests that rules are generally quite effective, although with some scope for further improvement.

EIOPA's[637] and ESMA's[638] annual cost and past performance reports indicate that some products[639] offered to retail investors have in recent years offered very low if not negative returns, disproportionate to the risk that is taken by the investor, calling into question their value to the retail investors[640]. In addition, such products are often overly complex and include costs[641] that limit the potential returns and diminish the investment outcome for retail clients[642].

[637] EIOPA Cost and past performance report 2022.

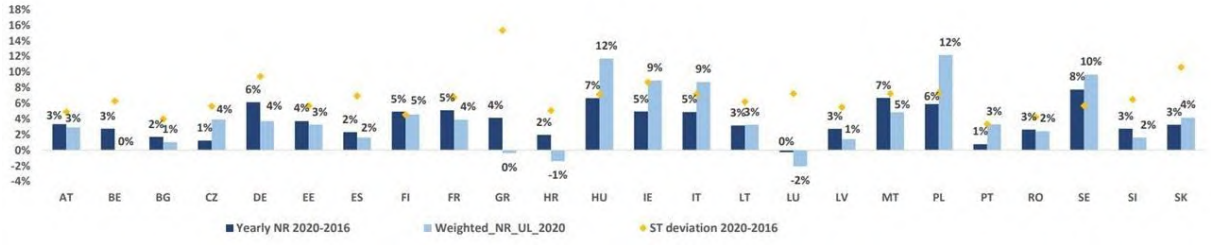
[638] ESMA Performance and Costs of EU Retail Investment Products 2022.

[639] e.g. certain structured investment products or insurance-based investment products.

[640] See page 38 EIOPA's 2022 cost and performance report ("*Products corresponding to lower risk classes had particularly low net returns, at times negative, questioning the value for money offered by these products.*") or page 37 of ESMA's Performance and Costs of EU Retail Investment Products 2022 ("*once costs were taken into account, the simulated returns for a number of SRP's were below zero").*

The figure below shows the weighted average net return of a sample of unit-linked products by Member State commercialised cross-border over the period 2020-2016[643] and the weighted net return in 2020. These net returns do not take into account the effects of inflation during the same period.

Figure.7 - weighted average net return of a sample of unit-linked products by Member State commercialised cross-border



In November 2021 EIOPA issued a supervisory statement on IDD[644] in light of concerns about the significant impact that costs can have on returns of insurance-based investment products, in particular in respect of unit-linked products which may not be designed in a customer-centric manner. Competent authorities have been reporting a number of issues, such as: high complexity, mis-selling, mismatches between actual returns and customers' expectations. The outcome of the Common Supervisory Action (CSA) on product governance requirements under MiFID II[645], coordinated by ESMA in January 2021, indicated that:

- Even though firms generally **define a target market** for the products they manufacture and/or distribute and do so by following the target market categories defined in the ESMA guidelines, such definition is approached as a formalistic exercise, is not sufficiently granular and the terms used are not clearly defined. In addition, the definition of a target market does not always lead to the firms developing a compatible distribution strategy.

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641 Products offered to retail investors frequently incorporate high levels of fees and commissions. In 2021, retail clients were charged on average around 40% more than institutional investors across asset classes.

642 The ESMA report on performance and costs indicates "*In terms of simulated returns and costs, the patterns that were identified in last year's report largely persist. The key findings are as follows: Once costs were taken into account, the simulated returns for a number of SRPs were below zero. This illustrates the benefit of mandating, as done in the PRIIPs KID Delegated Regulation, that performance scenario information provided to investors in the KID be made available net of costs. … There appears to be little correlation between total costs and the underlying asset type, and total costs do not appear to be lower for products that are more popular with retail investors (i.e. economies of scale do not appear to materialise in the market for SRPs).*"

643 Source EIOPA's cost and performance report 2022.

644 Supervisory Statement on "Assessment of value for money of unit-linked insurance products under product oversight and governance".

645 ESMA 2021 CSA on MiFID II product governance requirements.

- Under Article 9(10) of the MiFID II Delegated Directive, firms are required to perform a scenario analysis to assess the risks of poor outcomes for end clients. The CSA showed that the analysis is inconsistently performed among firms and it is not always clear how these scenarios are actually used for the identification of the target market.
- Product manufacturers' procedures insufficiently describe how a product's cost structure[646] is evaluated to ensure compatibility with the product's target market and the application of the product governance requirements does not guarantee that the products that enter the market deliver value to retail investors. The product reviews are not performed with an adequate scope nor frequently enough to verify if the financial instrument remains consistent with the needs, characteristics and objectives of the target market.
- On the **exchange of information between manufacturers and distributors,** the CSA on MIFID rules revealed that a significant number of firms do not provide reports proactively to the product manufacturers, but only upon request.

One notable area of products which may be prone to a higher incidence of poor value for money are structured products (SRPs), which particularly stood out. In its ESMA's Annual Statistical Report 2022 on Performance and Costs of EU Retail Investment Products[647], ESMA highlighted the two key types of costs as those that are embedded in the product when it is issued, and costs involved in distributing the product, such as sales commissions. In its analysis ESMA focused on the former. ESMA indicated that different types of SRPs are offered to retail investors in the EU, many with complex pay-off structures. ESMA's main conclusions are that:

- the total costs do not depend on issuance size or underlying type;
- there does not appear to be any clear correlation between total costs and the Summary Risk Indicators, or between total costs and the recommended holding period for each product - in other words, it is not the case that riskier, or longer-maturity SRPs have higher costs than their less risky or lower-maturity counterparts;
- there is no negative correlation between sales volume and costs (i.e. economies of scale do not appear to materialise in the market for SRPs);
- the existence of a plurality of reference assets does not seem to lead to higher costs per se (SRPs backed by single equities tend to have higher costs than SRPs backed by other underlying assets, including baskets of assets and indices).
- under the moderate performance scenario, approximately one in ten SRPs would offer negative returns, despite this being the second-best scenario out of four. This share increases to one quarter of SRPs when looking at the returns after one year, rather than at a product's maturity.

In light of negative results of this exercise, ESMA suggested that it is rather the 'structured' nature of SRPs' payoff (the most challenging part for investors to assess) that drives costs.

[646] As required under Article 9(12) of the MiFID II Delegated Directive.

[647] SRPs are investments whose return is linked to the performance of one or more reference indices.

This evidence shows that in case of some products, higher costs are embedded irrespective of features which could constitute better product quality but rather relate to complex costs structure. This should not be the case, as complexity of cost structure is justified only when it aims to better align costs to the quality of the product and the returns it generates.

As a result, the current **MiFID and IDD rules**, despite the efforts of ESMA and EIOPA in this area to address the product manufacturing process and rules governing the distribution of retail investment products, do not fully tackle the issue of cost-efficiency of products and are not sufficiently effective to ensure that retail investors are offered products that are cost efficient.

The Common Supervisory Action coordinated by ESMA in January 2021[648] concluded that the supervised entities' compliance with the **UCITS framework**, and in particular the rules detailed in their supervisory briefing, is satisfactory. For example, ESMA has reached the conclusion that "*Very few NCAs reported of regulatory breaches which were already addressed by imposing administrative measures*". In particular, while larger asset managers were found to have good structures in place, small UCITS management companies have less structured pricing processes in place. Subsequent to the CSA, NCAs have engaged in remedial action in cases where deficiencies were identified, in order to obtain the correction of identified deficiencies. Some NCAs have extended the scope of follow-up actions to all UCITS management companies[649].

Beyond these positive results, ESMA identified room for improvement to achieve greater convergence between Member States and is also working on an opinion to further improve the regulatory framework, where necessary. In particular, ESMA's report mentioned the benefit of having a clearer definition of the notion of "undue cost" in the Level 1/Level 2. However, NCAs "*reported that the supervisory briefing on the supervision of costs provided useful indications on the cases where a cost should be considered as due/undue and the categories of costs identified by fund managers largely corresponded to the macro categories included in the supervisory briefing*. "Further assessment by ESMA highlights the key role of supervision in achieving the objectives of POG rules, notably reduction of costs. ESMA's annual statistical report on the costs and performance of retail investment products reports a moderate but broad-based change in costs across investment horizons and reporting periods. For equity, total costs went from 2% at the ten-year investment horizon for the reporting period ending with 2017 to 1.6% at the one-year horizon in the analysis ending in 2019. While more factors contribute to this effect, it is likely that increased supervision has played a role[650].

Nevertheless, there is an important limitation to what POG rules under the UCITS framework can achieve, as the majority of the costs charged to investors do not go to the UCITS management companies, and thus these companies do not have control over them. Indeed, according to a study by EFAMA, "*fund managers only retain 41% of the total cost paid by retail investors*."[651] Most

[648] See ESMA's Final report on the 2021 CSA on costs and fees.

[649] For instance, the CSSF has asked all management companies to conduct, by Q1/2023, a comprehensive assessment with regard to the compliance of their policy, approach and arrangements related to costs, in relation to the observations of ESMA and of the CSSF and to take, if applicable, the necessary corrective measures (CSSF report on the CSA)

[650] There has been an increased focus on costs of investment products notably since 2018.

[651] EFAMA Market insight, September 2021. Indeed, the breakdown of the cost of ownership attributable to the different service providers along the value chain, on average, 41% of the fees charged by UCITS

commonly, distribution and advice costs make up between 30% and 60% of the total cost charged to the UCITS. Costs are also higher for cross-border funds than for domestic funds, mainly due to distribution costs on a cross border basis (translation, etc.)[652]. This conclusion is also consistent with ESMA's report on costs and performance[653]. ESMA also spots that costs are higher for cross-border funds than for domestic funds, mainly due to distribution costs on a cross border basis (translation, etc.)[654]. While it is possible that POG rules under UCITS have contributed to the overall decline in costs that has been evidenced by ESMA[655], this limits the impact that these rules can have on the overall costs paid by retail investors.

Efficiency

The costs related to compliance with product oversight and governance rules are mainly associated with the work performed by the firms to define business models ensuring that products meet the needs of identified target markets and mitigate consumer detriment, e.g. costs for setting up controls and systems that allow for identification of the target market, product testing, defining a distribution strategy and product review.

Anecdotal evidence on the costs of implementation, based on the report on the Guidelines on product governance[656], shows that many respondents identified several one-off and ongoing costs[657] as relevant, but did not provide a quantification. In some cases, respondents noted that costs and resources needed for the implementation of the new framework would be fully compensated by the benefits connected to it. The compliance costs associated with the rules therefore seem reasonable in light of the importance of safeguarding the interests of customers in the product design process and throughout the lifecycle of a financial instrument/product. However, the cost-effectiveness of the rules is significantly reduced in practice for retail investors, as the application of the requirements does not guarantee that the products that enter the market deliver value to retail investors, as shown under the effectiveness assessment of the rules.

Meanwhile, while the UCITS legal obligations also carry a cost, the consultations organised by the ESAs and the Commission on RIS and in the context of the AIFMD review (which partially captured also UCITS in its scope) did not identify any significant issues with the level of costs in stakeholders' answers with regard to UCITS and AIFMD frameworks. Overall, the whole

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cover the expenses incurred by fund management companies in the area of product development and investment management. This means that part of these costs is used to pay providers, for example data and research providers. A slightly lower proportion of the cost of ownership (38%) is paid to distributors in compensation for the provision of advice and for acting as the intermediary for retail investors. The remaining 21% covers administration services, depositary, tax and other expenses

[652] ESMA Annual Statistical Report 2022 on "Performance and Costs of EU Retail Investment Products".

[653] Ibid. For instance, it is well documented that the TER (yearly total expense ratio) over 5 years in the NL where inducements are banned is 0,63% compared to an average of 1,6% for the other countries.

[654] Ibid.

[655] Ibid. There has been a widespread secular decline in costs of UCITS funds which adds up to a non-trivial reduction in cost levels over time. By the end of 2021, investors could on average expect to pay 9% less in terms of ongoing costs for equity UCITS than four years ago.

[656] Page 29, Report on the Guidelines on product governance.

[657] Ibid, Point 64.

ecosystem built on UCITS is considered to work well and the IT systems, resources and procedures involved have over the years became part of business as usual. Combined with the broad effectiveness of UCITS framework (discussed under effectiveness), product oversight and governance rules under the UCITS framework can be considered as broadly cost-effective.

Coherence

The legal requirements on product governance are coherent. The standards are similar across MIFID and IDD, but they are applied with different levels of granularity as regards the specific obligations to be fulfilled for each of these requirements. Explicit obligations to assess the risk and reward profile and cost and performance of financial instruments exist under MIFID at the manufacturing stage. However, such requirements are not specified under IDD, where the rules remain more general and provide an obligation to assess whether the insurance product over its lifetime meets the identified needs, objectives and characteristics of the target market[658]. Based on the analysis performed, the evidence shows that the differences in the specific obligations under the two legal frameworks do not suggest problems arising from the coherence of the rules. Product oversight and governance rules under UCITS can be considered coherent with MIFID rules. They are complementary to the principle-based POG rules under MiFID, which are applicable to most cases of UCITS funds distribution. The only situation where MiFID rules would not apply is the scenario of direct distribution by fund managers (almost negligible), without MIFID intermediation. Some amendments to UCITS and AIFM directives have already been included in the AIFMD review currently under negotiation to ensure that the same MIFID product governance rules would apply when investment funds are distributed directly by asset managers providing investment services. This should hence close such regulatory gap. The more detailed POG rules applicable to UCITS manufacturers (described above) are applied in addition to MIFID product governance rules and there have been no signs of misalignment.

4.2 How did the EU interventions make a difference?

In general, the EU intervention in the area of retail investments (across sectors) has contributed to ensuring investor protection across the EU and a harmonised internal market. Even though a completely integrated internal market for retail investments is still not in place, the steps taken have created common standards and facilitated competition across the EU.

According to the retail investment study, in the area of **product disclosures**, the EU added value stems primarily from the **standardisation of key information documents across all EU countries**. Those key information documents adopt the same content categories across the legal requirements. Harmonisation of the risk indicator, as well as other content categories, makes products more comparable across borders, which could not be achieved through action at the level of individual Member States. This creates transparency on the market and enhances consumer protection through detailed and clear disclosure. Extension of PRIIPs to UCITS funds is expected to further enhance this EU value added.

[658] Article 6 of the IDD Delegated Regulation (EU) 2017/2358 on product oversight and governance requirements for insurance undertakings and insurance distributors.

In the absence of an EU legal framework, it is likely that countries would have adopted diverging disclosure requirements (as also demonstrated by the situation before the introduction of PRIIPs KID and UCITS KIID). The fragmentation of disclosure requirements would lead to differences in the level of consumer protection. It would also imply that manufacturers and distributors operating in multiple countries would have to comply with different sets of rules, which would increase the costs of producing and updating disclosure documentation.

With respect to **advice and inducements**, the EU added value can mainly be found in the **harmonised set of ground rules** for the (i) management of conflicts of interest; (ii) stipulations on which products can be sold through execution-only services and which products have to be accompanied by advice; (iii) rules on when inducements are permitted and when banned, and associated tests; (iv) requirement for the disclosure of the independent or non-independent status of the advice and disclosure of inducements.

If legal provisions at EU level were not in place, national legislation and connected guidance would likely diverge more than is currently the case. Member States choosing to place more emphasis on retail consumer protection would implement stricter rules, while others with a stronger focus on sectoral competitiveness would relax the rules. Regulatory divergence would be unlikely to affect basic principles – such as the duty of care and the obligation to detect and manage conflicts of interest –although the detailed provisions could vary in substantial ways.

In the absence of a European legal framework, rules would not converge solely through the actions of EU Member States. Should national approaches diverge further, leading to different scope of advice subject to the law, fair competition on the **Single Market for retail financial products could be harmed**.

Concerning the impacts on businesses, legal fragmentation would lead, on the one hand to higher transaction costs for businesses conducting cross-border operations and likely non-compliance in some cases with the associated legal risk. On the other hand, more lenient legal requirements in certain Member States could hamper free and fair competition in the Internal Market.

In the area of suitability assessments, the difference made by the EU intervention is mostly visible in the **harmonisation of obligations for investor profile screening and recommending suitable products**. In the absence of EU legislation, national approaches would diverge and consumer protection across the EU would not be achieved at the same level, leading to a weaker functioning of the internal market (notably the cross-border provision of financial services involving investment advice). This would also harm fair competition within the EU.

Lastly, in the absence of a European legal framework, product oversight and governance rules would not converge solely through the actions of individual Member States. Common European rules and the role of ESMA and EIOPA in providing guidance on product oversight and governance facilitate competition in the European market, allow companies to operate cross-border and ensure a retail investor protection of the same level across the EU.

4.3 Is the intervention still relevant?

The retail investment framework and its objectives remain important and correspond to the current needs within the EU. The established framework and the changes it introduced are to a significant extent relevant for retail investors to promote consumer protection.

The priorities of the European Union related to the European Green Deal and sustainability, as well as achieving a Europe fit for the digital age, confirm the need to review the rules on disclosures, inducements and suitability assessments to ensure they remain relevant in view of these priorities and of market developments (*inter alia* increasing digitalisation of financial services, inclusion of sustainability preferences in the suitability assessment or sustainability-relevant information in key disclosure documents).

In addition, the evaluation of the application of the rules under the current framework in the areas of disclosures, inducements, suitability assessments product governance has identified some points where the relevance of the current framework can be improved.

Disclosures

The objectives of the rules on disclosures under the current legal framework remain appropriate. However, as evidenced under effectiveness and coherence, the retail investment study also suggested the need to put greater emphasis on the digital environment[659] with regard to disclosure requirements. The ESAs have also concluded that digitalization trends are not adequately captured, and although the current framework is "*supposed to be technology-neutral, it was mainly designed without considering digital distribution, and certainly before the "app-revolution*[660]".

In addition, the current disclosure framework does not sufficiently take into consideration new market developments, such as the growing sustainability preferences of retail investors. In recent years, there was a significant increase in the market for sustainable investments. Between 2015 and 2020, assets invested in sustainability-focused funds have grown by 173% (37% on a year-on-year basis)[661]. This strong market growth is largely driven by growing preferences for more sustainable investment products. However, preferences for such products and for more sustainability-related information[662] is currently not well reflected in key information documents

[659] Retail investment study, pages 15 and 106.
[660] Advice of the ESA joint committee on PRIIPs, page 43, para 3.5.1 and EIOPA advice on retail investor protection, page 36.
[661] Source: European Financial Stability and Integration Review 2021. The definition of sustainable investment fund sustainable funds used here is based on sustainability criteria set out by Morningstar. This definition includes funds that according to their prospectus: (i) state they use ESG criteria as a key part of their security selection process; and/or (ii) indicate they pursue a sustainability-related theme and/or (iii) seek measurable positive impact alongside financial return. This definition excludes funds that employ only limited exclusionary screens, funds that state they consider ESG factors but do so in a non-definitive way as well as certain types of funds (money market funds, feeder funds, funds of funds).
[662] Indicated notably in the public consultation on renewed sustainable finance strategy. More about this consultation and responses received can be accessed here.

for retail investors, in particular in the KIDs prepared under the PRIIIPs legal framework (and UCITS KIIDs they will replace).

While existing legal provisions allow for inclusion of some information of environmental and social profile of investment products, they do not appear to be provided consistently and in a standardised manner. This could be considered a regulatory gap and potentially as a consequence of original objectives of PRIIPs not having fully anticipated this change in consumer preferences, that has been growing since 2015[663]. PRIIPS KIDs so far make little use of new information that is collected by financial product manufacturers and presented on their websites under the Sustainable Finance Disclosure Regulation (SFDR) and other sustainability-related disclosures. Some funds have referred to SFDR fund categories ("Article 8 and 9 funds"), but such information is not particularly useful and could be misleading, as it was not intended as a fund label. In this regard, relevance of disclosure documents could be improved.

With respect to the rules **on marketing and communications**, in order to remain relevant, they need to be adapted to the increasing **digitalisation** of the industry and able to adapt to new trends. A majority of respondents in the public consultation considered there was a need for further EU coordination/harmonisation of national rules on **online** advertising and marketing of investment products[664]. As stated in ESMA's advice[665], there may be confusion in the application of the definition of marketing communications as to whether online advertising and firms' private messages to clients and potential clients on social media fall under this definition, both when communicated directly by the firm or through third parties **social media** (i.e. 'finfluencers' who operate on behalf of financial service providers). Marketing communications, particularly in the online environment, may also tend to overemphasize the potential benefits of the product and hide information on costs and risks[666].

The existing powers of NCAs to tackle aggressive online marketing practices may not allow sufficiently timely intervention[667], nor the possibility for NCAs and ESMA to impose the use of risk warnings for specific risky financial instruments which may be subject to (aggressive) online marketing and advertising campaigns[668].

Inducements and advice

The objective of the rules on **inducements and advice** under the current legal framework remains relevant to the current needs in the EU. The current rules have set out the framework to ensure advice given and investment services provided to retail investors are in their best interest. However, the current framework does not yet fully address the informational asymmetry and the fact that advice and other services are driven by the financial interests of advisors or other market players.

Suitability

[663] As witnessed notably in the especially large shift towards ESG investment funds, described in European Financial Stability and Integration Review 2021.
[664] See 2021 Public consultation, Q3.6.
[665] ESMA advice on retail investor protection, page 9, point 21.
[666] Idem, pages 10 and 14.
[667] Idem, page 12.
[668] Idem, page 37.

The design of the framework regarding the requirement that the advisor needs to know the client when providing investment advice by conducting the suitability assessment remains relevant for achieving the objective of consumer protection in financial markets.

However, as shown under effectiveness, the application of the rules under the current framework has some limitations with regard to the usefulness of the suitability assessment in ensuring optimal choice of investments: improvements in the consistent use of practices can be considered with respect to on the timeliness and depth of the assessment. For the framework to remain relevant, it should also allow for further development and adaptability to allow for cost efficiencies in the digital environment, only made possible if the use of the rules in the industry is consistent and potentially more standardised.

Product Governance

The objective of the rules on **product oversight and governance** under the current legal framework remains relevant to the current needs in the EU. The current rules set out the basis to ensure at manufacturing stage that the products are **designed** to meet the needs of an identified target market of end-clients, are **distributed** to the identified target market and remain up-to-date and relevant to meet the needs of that market. Current rules apply also to the distribution stage, requiring that distributor understands the features of the financial instruments recommended and establishes and reviews effective arrangements to identify the category of clients to whom products and services are to be provided.

In the current economic environment, this becomes even more relevant, as high inflation, together with costs of products and investment services may completely undermine return expectations for retail investors in the coming years, potentially discouraging them from investing at all. As a result, for the framework to remain relevant, improvements are needed to be in line with the specific issues identified in the previous sections.

5. WHAT ARE THE CONCLUSIONS AND LESSONS LEARNED?

5.1 Conclusions and lessons learned

The different sector specific legislative instruments covered in this evaluation aim at providing a protection to retail investors when buying investment products and services, taking into account their best interest and allowing for their informed and fair participation in the financial markets. Overall, with regard to **effectiveness**, this has been achieved to a certain extent as compared to the previous regimes, however there are still areas where the objectives have not been sufficiently fulfilled. The results of the evaluation show that further action is needed. In respect of the **efficiency**, the evaluation indicates that the costs borne by the industry for the implementation of the rules on investor protection are reasonable when compared to the benefits for retail investors around transparency of information and advice given. In terms of **coherence**, the rules on disclosures, inducements, suitability assessments and product governance are generally aligned across the different legal instruments and set out the same principles for investor protection. There are however elements that indicate a lack of coherence of the current framework. With regard to **EU added value**, the current investment protection framework has provided a basis for consumer protection in the investment financial services across the EU. In the absence of an EU

legal framework, it is likely that countries would have adopted diverging requirements in the areas of disclosures, inducements, suitability assessments and product governance, which would pose additional barriers to cross-border distribution of investment products. The legal framework that covers investor protection rules remains broadly **relevant** for the current needs of EU, with the need to protect the interests of investors that are becoming ever more relevant as use of digital marketing grows and in light of rising inflation. There are, however, areas where the relevance could be increased, in particular considering the need for greater emphasis on the digital environment and sustainability, that have not been fully captured in the original objectives of this legal framework.

In relation to **disclosures**, the framework has been broadly effective, notably in providing information to retail investors that is comparable and useful for their decision-making. Nevertheless, some issues were identified with regard to readability and user-friendliness of presentation of information documents and the timing with which they are made available in the distribution process. Information on costs is also not always clear. With respect to ex-post information (especially on costs and performance), a significant group of investors does not receive documentation in an easily accessible and comprehensible way, which limits their possibilities to effectively monitor the developments of their investment, including performance and costs paid.

The effectiveness of rules on **marketing and communication** is compromised by the confusion in the way the definition of marketing communications is applied, especially in the context of digital media and online advertising and social media, and the fact that key information may not always be presented in a balanced way. However, the retail investment study's behavioural experiment which looked at disclosures shows that there is an inherent difficulty for retail investors to make the optimal choice in respect of which product is best for them. Despite improvements on information disclosures, additional measures should therefore be taken in other areas relating to retail investor protection (e.g. the quality of advice to investors).

In terms of coherence, in the area of **disclosures**, the requirements governing format, readability, clarity, conciseness, language use and comprehensive coverage are coherent between the different pieces of legislation. Some issues were nevertheless identified, such as different level of adaptation to digital or inconsistent application of the requirement to provide disclosure information in 'good time' in the market. In addition, for the insurance industry there are some overlapping information requirements present in EU legislation related to the sale of IBIPs.

The relevance of the current rules on disclosures could be improved, in particular considering the need to place greater emphasis on the digital environment and sustainability. The relevance of the rules on **marketing and communications** could also be improved to better address the challenges that are the result of increased digitalisation of financial services, including the dissemination of marketing communications through digital channels (e.g. social media).

Regarding **inducements,** the current framework has not been **sufficiently effective, notably in the following areas**:

- the requirements on disclosure of inducements are in practice not fully implemented. Information documents rarely contain explicit information on inducements and inducements are frequently not disclosed during client conversations.

- most retail investors do not understand the concept of inducements and are primarily concerned with the overall product costs, and not the costs of selling the product (inducements) that are being passed on to them. Disclosure of inducements does not appear to substantially impact a consumer's informed choice.
- the existence of inducements is reflected in higher costs for retail investors.
- evidence concludes that the most important product features, such as costs and charges, are not systematically covered by advisors when providing information during advice sessions.
- the MiFID II rules (specifying conditions for inducements including the quality enhancement test) have not triggered a shift towards more independent advice or increased the market share of independent advice. Non-independent advice remains the prevalent model for most distributors of retail investment products in the EU[669].
- the existence of inducements may lead to product bias, thus restricting the offer of certain simple and cheap investment products to investors. Existing safeguards are not sufficient to ensure that investors are provided with unbiased advice and offered products which best suit their interests and needs and/or which are not too costly or underperforming.

Even though IDD and MiFID II are largely coherent in their aim to prevent **conflicts of interest** and define organisational arrangements, there are still differences between the two regimes. Under MiFID II, inducements are designed to be the exception, while under IDD inducements are in principle allowed. However, in practice, in the way the rules are applied, inducements are widespread under both regimes. The different safeguards to ensure that inducements 'enhance the quality of service' (under MiFID) or 'are not detrimental for the service' (under IDD), have proven to be challenging for firms to demonstrate and for competent authorities to supervise. In the area of MiFID, this safeguard also leads to different interpretations across Member States and firms, despite convergence efforts by ESMA.

In the area of **suitability assessments**, the main issues affecting the effectiveness of the rules relate to the depth and timing of the screening process, which is in some cases performed at the very last stage, thereby defeating the objective of using the information of the assessments as a basis for the provided advice. There are also different practices regarding the depth of information covered: some advisors cover only minimal or hardly any information about clients, impacting the quality of the assessment and weakening the link to actual advice and recommendations given. With regards to the cost-effectiveness of the assessments, even though overall for the industry the measure is cost-effective there are potential areas of further cost efficiencies, as the costs are increased when clients do extensive research and undergo assessments with different distributors and there is room for cost efficiencies through standardisation and portability of elements of the suitability assessments.

[669] Retail investment study, page 232.

With respect to coherence, there are minor differences between IDD and MiFID II mainly related to reporting obligations, and the application of the frameworks in the Member States[670], although they do not adversely impact the implementation of the framework. Finally, the usefulness and relevance of the suitability assessment is compromised by inconsistent practices and lack of adaptability to the digital environment.

The **product oversight and governance rules** under MIFID and IDD**,** which impose requirements on the definition of the target market, scenario analysis, product review and exchange of information between manufacturers and distributors, are often insufficiently and inconsistently applied. In practice, they are a formalistic exercise and fail to ensure that the products that enter the market deliver value to retail investors. Their role in protecting retail investors is hindered by the ineffective application of the framework leading to the following consequences:

- Some products[671] offered to retail investors have in recent years offered very low if not negative real returns disproportionate to the risk that is taken by the investor. Such products are also often overly complex and include costs that limit the potential returns and diminish the investment outcome for retail clients.
- With respect to structured retail products and the costs of products embedded in their issuance, these costs do not appear to depend on issuance size or underlying type, nor to the risk of the products, while the existence of a plurality of reference assets does not seem to lead to higher costs per se and economies of scale do not appear to materialise in the market for SRPs. There is no correlation between the costs and embedded features that would constitute a justification for better product quality, rather the evidence points to unjustified complex costs structures.

The above issues reduce significantly the cost-effectiveness of the product governance rules for retail investors, as they do not sufficiently prohibit products that deliver little or no value from entering the market.

The economic developments and the shift from low interest rates and inflation to a high inflation, high interest rate environment underlines the urgent necessity for a framework where the products oversight and governance rules remain relevant and are able to ensure that retail investors are adequately protected and are only offered products that deliver them value for money.

With respect to the additional product oversight and governance rules under the UCITS framework, available evidence suggests that rules are generally effective, efficient and coherent, although there is scope for further improvement, such as insufficient clarity of the notion of "undue costs".

Lessons learned

[670] Resulting from the fact that MiFID II aims at maximum harmonisation while IDD (as a minimum harmonisation directive) allows Member States to be more flexible.

[671] e.g. certain structured investment products or insurance-based investment products.

The above conclusions from this targeted evaluation and the lessons learned in terms of the main areas for improvement serve as the basis on which the Commission will aim to provide policy conclusions or follow-up action. These need to be understood within the general conclusion that even though the framework has been broadly acknowledged by most stakeholders as fit for purpose, there are important elements, especially in the area of inducements and advice, that have not sufficiently contributed to the achievement of the intended objectives of the investor protection framework.

In terms of the information disclosed to the retail investor, overall, the requirements are relevant, however there are some targeted areas of improvement; information can still be complex (in particular relating to costs) or not sufficiently useful or relevant to guide their ability to make informed decisions. The rules are not sufficiently adapted to digital channels and disclosures do not sufficiently respond to growing sustainability preferences of consumers. Marketing and communication rules could be improved to better protect investors from the increasing risks linked to oversimplified or misleading guidance from digital channels and marketing practices.

With respect to inducements and advice, the existing safeguards have not sufficiently to limited the product bias and ensured that investors are provided unbiased advice and offered products which may better suit their interests and needs. In addition, understanding the concept of inducements is challenging for retail investors and disclosure of their existence does not appear to make a substantial contribution to a consumer's informed choice nor does it sufficiently address conflicts of interest.

With respect to the current rules on product oversight and governance, while they have set up a framework to promote the offer of products that are tested and address the needs of a target market, the rules do not sufficiently ensure high quality of all the products offered to retail investors: some retail investment products incorporate unjustifiably high levels of costs and/or do not offer value to retail investors.

Finally, the suitability and appropriateness assessment regime, even though generally effective and efficient in ensuring that the needs of the clients are considered in the screening process, can be further improved in certain respects. Evidence has shown that the timing and depth of the assessments is not applied optimally in practice to ensure intermediaries have sufficient knowledge about their clients that would allow them to only recommend suitable products. Improvements could be made in suitability assessment so as to remove inconsistent practices and adapt it to the digital environment.

ANNEX 12: SME TEST

Step 1) Are SMEs likely to be affected?

Although the Retail investment initiative does not specifically target SMEs, its scope will include SMEs and the measures will have some direct and mostly indirect impacts on them. SMEs will be affected in their various roles.

- SMEs as investors will benefit in the same way as any other retail investors, among others, from the improved disclosures, from the better choice of products offering value for their money and from unbiased advice following the removal of conflicts of interest of advisors. We do not have exact information on their number, however, extrapolations suggest that the number of SMEs concerned should be at most 1 million firms[672].
- SMEs will also be affected as providers of financial services, in particular the ban on inducement will oblige SME advisors to change their business models to fee-based systems. Although the precise number of SME financial services providers is not available, official statistics suggest that about 617,000 firms in the financial sector had less than 10 employees in the EU-27 in 2020, representing 97% of all financial firms[673]. There is no statistical information how many of them serve retail customers and services related to investment. To give an indication, of the 815,000 licensed insurance intermediaries in the EU, about 467,000 are physical one-person businesses (see annex 7).
- Listed SMEs as users of funds will also be affected by the initiative. Retail investor participation in capital markets is expected as an indirect positive impact of the measures, which will offer better opportunities also for listed SMEs. There are about 2800 listed SMEs according to ORBIS data. Data from exchanges revealed that 1464 out of 4371 companies on regulated markets were SMEs in 2021, i.e. 33%. Another 1740 firms are listed on SME growth markets, though not all of them would still be SMEs.

Step 2) Consultation of stakeholders

During the public consultation procedure all stakeholders, including SMEs, were consulted and were given the opportunity to contribute with their views to the development of the policy initiative.
The result of all consultation activities is summarised in the synopsis report (annex 2). Stakeholder outreach activities also included discussions with consumer organisations as well as representatives from the banking, insurance, financial intermediaries and investment management industries. The public consultation in particular received input from SMEs, namely medium (50 to 249 employees), small (10 to 49 employees) and micro (1 to 9 employees) companies active in the aforementioned

[672] An extrapolation using German data, based on the number of security accounts held by NFCs, relative to the number of NFCs being 4%, as 99.5% of NFCs are SMEs, this is extrapolated to EU NFCs.
[673] The number of firms come from Eurostat, Business demography by size class [BD_9BD_SZ_CL_R2].

sectors. Notably, among them there were also a few micro and small advisory firms and representatives. Other consulted stakeholders, moreover, involved BIPAR, the European federation, which groups national associations representing insurance as well as financial intermediaries, ranging from multinational companies to SMEs and micro-enterprises. The SME-specific input received mainly focused on the need to ensure proportionality if additional regulatory burden is imposed on smaller businesses, particularly in the insurance sector, which has a higher proportion of SMEs with respect to other financial sectors.

Step 3) Assessment of impact on SMEs

The impacts on SMEs can be threefold: SMEs as users of capital markets, SMEs as investors, and SMEs as providers of retail investment services and products.

SMEs as users of capital markets are expected to benefit from the measures. Given that the ban on inducements can indirectly lead to increased retail participation, SMEs listed on the capital markets could profit from a more diverse and deeper investor base over the longer-term (i.e. by being selected in the assets of small, mid or micro-cap company investment funds).

SMEs as investors will directly benefit from the ban on inducements, including from lower costs of retail investment products. In addition to the removal of conflicts of interest in the advice process, they will also get a better choice of products that offer them value for their money, in the same way as other retail investors. They will also benefit from improved disclosures, in the form of more targeted and more engaging information aimed at facilitating their decision-making, and by better protection against exposure to misleading marketing. Like other retail investors, SMEs will benefit from the impact of Value for Money on the transparency and return of financial products if they intend to invest their financial surpluses in financial assets. The flanking measures will have a positive impact on retail investors, including SMEs, by further improving their protection (e.g. thanks to stronger supervisory enforcement measures) and by empowering them to take better informed investment decisions (e.g. thanks to improving their financial literacy levels).

SMEs, which are providers and distributors of retail financial services (such as smaller advisors), will face, as other market participants, adjustment costs to the transition from a commission-based to a fee-based model. As they will no longer receive commissions from product manufacturers but receive fees from retail investors, they will need to demonstrate the added value of their service to retail investors including through assessments against value for money benchmarks. In the same way as for other market participants, it is difficult to predict the market dynamics for SME financial intermediaries. On the one hand, those smaller businesses, which will not be capable or do not want to take the opportunity offered by the need for a structural transition from an inducement-based to a fee-based system, may exit the market. This might further contribute to the ongoing trend of consolidation in the advice segment as a result of digitalisation of financial services. On the other hand, however, smaller distributors who would like to take advantage from the removal of the barrier that currently exists to their ability to provide independent advice will benefit from a better opportunity to grow their business. This is also shown by the growth of independent advice in the Netherlands (see annex 7). In addition, with the removal of the inducements, the relative bargaining power of distributors against product manufacturers will also increase.

If Member States outsource their financial education efforts to private parties, SMEs active in financial education could benefit from additional revenues. In a similar vein, the qualification of financial advisors could create additional demand for SMEs that provide qualification and training programmes. Financial firms may have to count on a slight increase in their pay for qualified staff. While the investor categorisation would allow more SMEs to qualify as professional investors at request, this effect is likely to be extremely small.

Step 4) Minimising negative impacts on SMEs

The preferred package of options will include a transitional period for the introduction of the ban on inducements. It is necessary to ensure that distributors and manufacturers have time to adjust their business models from a commission-based to a fee-based model, which applies to all sizes of firms, including SMEs. Examples of the steps to be taken are adjustments to the current fee schedule and billing systems, informing clients of the new structures, creating new share classes without inducements in the case of investment funds and upgrading IT systems where necessary. It can also be envisaged that the contribution of financial SMEs to the Value for Money benchmarks will be phased in after a sufficient transition time.

ANNEX 13: GLOSSARY

Term or acronym	Meaning or definition
Advised services	When an intermediary offers or advises a client to perform a certain investment service (e.g. investment advice), or otherwise when the client does not expressly solicit the service.
AIFs	Alternative Investment Funds regulated by Directive 2011/61/EU on Alternative Investment Fund Managers
Best execution	Brokers are obliged (Art. 27 MiFID II) to endeavour to "execute orders on terms most favourable to the client" and "obtain the best possible result".
Biometric risk	All liability risks related to the person's living conditions, including health, longevity, disability, death, etc.
CBDF	Directive (EU) 2019/1160 and Regulation (EU) 2019/1156 on the cross-border distribution of collective investment undertakings
Client	Any natural or legal person to whom an investment or insurance firm provides investment or ancillary services. See 'Retail client'.
Closed architecture	Signifies that a financial institution confines its offering to retail investors to in-house financial products (also called captive products). See opposite, 'open architecture.'
CMU	Capital Markets Union
Commission-based model	Synonymous to 'inducement-based model'. In the commission-based model, distributors and brokers are paid through commissions by product manufacturers or other services providers, which are embedded in the price of the product through annual costs. See 'inducements'.
Distributor	Any investment firm that decides the range of financial instruments or products it intends to offer or recommend to clients, whether they are issued or manufactured by itself or other entities (subject or not to MIFID II)[674].
DMFSD	Directive 2002/65/EC on Distance Marketing of Financial Services
EIOPA	European Insurance and Occupational Pensions Authority
ESAs	European Supervisory Authorities

[674] For the term distributor in the context of insurance see term 'Insurance distributor'.

ESMA	European Securities and Markets Authority
ETF	Exchange-Traded Funds
Execution-only services	When a client expressly instructs a financial intermediary to provide a service (e.g. to execute a trading order) without being proposed or advised beforehand by the intermediary.
Fee-based model	In a fee-based model, the distributor (advisor) is remunerated directly by the client through a fee, generally upfront (see also 'commission-based model', and 'inducements').
Financial instrument	Include a range of instruments that are typically tradeable among market participants and with the purpose of yielding investment return, including notably equity (shares), bonds, derivatives, funds (UCITs and exchange traded funds (ETFs)). Legal definition: Article 4(1)(15) (MiFID II)
Insurance Based Investment Product (IBIP)	Is an investment product consisting of an insurance contract (wrapper) that sets out certain parameters for expected investment performance depending on the performance of the underlying financial assets (typically UCITs) contained in the wrapper. The contract can (but does not have to) cover biometric risk or provide various guarantees (e.g. return of invested capital). IBIPs can be divided into unit linked, profit participation and hybrid products. See also 'Financial instrument' and 'Investment product'. Legal definition: '[A]n insurance product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations.' (PRIIPs)
IDD	Directive 2016/97/EU on insurance distribution
Independent advice	Investment advice qualifies as independent when the advisor is paid only by the client, or another person on behalf of the client. In other words, when the advisor does not receive remunerations from third parties for the service provided to the client.
Inducements	Commissions (monetary or non-monetary, with the exception of minor non-monetary benefits) paid by third parties, not on behalf of the client, to the intermediary for providing a certain service to the client (e.g. recommending a certain product). See also 'commission-based model'
Insurance distribution	The activity of distribution of insurance products and, in particular for the purposes of this impact assessment, insurance-based investment products (IBIPs). Legal definition: 'The activities of advising on, proposing, or carrying out other work preparatory to the conclusion of contracts of insurance, of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim, including the provision of information concerning one or more insurance contracts in accordance with criteria selected by customers through a website or other media and the compilation of an insurance product ranking list, including price and product comparison, or a discount on the price of an insurance contract, when

	the customer is able to directly or indirectly conclude an insurance contract using a website or other media.' (IDD)
Insurance intermediary/distributor	Any person or firm that distributes insurance products and for the purposes of this impact assessment in particular IBIPs. Legal definition: 'Any natural or legal person, other than an insurance or reinsurance undertaking or their employees and other than an ancillary insurance intermediary, who, for remuneration, takes up or pursues the activity of insurance distribution.' (IDD)
Insurance undertaking	Insurance companies that underwrite and cover risks in return for a premium (a fee paid by the client). Insurance can be divided into life insurance (including IBIPs) and non-life insurance. Legal definition: '[A] direct life or non-life insurance undertaking which has received authorisation in accordance with Article 14 [Solvency II].' (Solvency II / IDD)
Investment product	For the purposes of this impact assessment, all products offered to retail investors with the purpose of achieving fully or primarily an investment return, whether financial instruments or investment-based insurance products (IBIPs).
Investment advice	For the purpose of this impact assessment, the provision of personal recommendations to a retail client, either upon its request or at the initiative of the financial provider, in respect investment products. Legal definition: '[T]he provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments' (MiFID II)
Investment firm	Firms that provide investment services to investors. Banks operate as such when providing such services. Legal definition: '[A]ny legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis.' (MiFID II)
Investment service/activity/	For the purposes of this impact assessment, the main investment and ancillary services that are referred to are portfolio management, advice, and execution of orders– only. Legal definition: '[Any of] (1) Reception and transmission of orders in relation to one or more financial instruments; (2) Execution of orders on behalf of clients; (3) Dealing on own account; (4) Portfolio management; (5) Investment advice; (6) Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; (7) Placing of financial instruments without a firm commitment basis; (8) Operation of an MTF; (9) Operation of an OTF.' (MiFID II)
Life insurance	An insurance contract where the benefit is paid out to the beneficiaries when the insured person dies or in respect of incapacity due to injury, sickness or disability
Manufacturer	An insurance undertaking, or intermediary which manufacture any insurance product for sale to customers. An investment firm which manufactures (i.e. creates, develops, issues

	and/or designs) financial instruments for sale to clients. Or any entity that manufactures PRIIPs or makes changes to them.
MiFID	Directive 2014/65/EU on markets in financial instruments
NCAs	National Competent Authorities
Open architecture	A financial institution's ability to offer clients both proprietary (or captive) and external products and services (see opposite, 'closed architecture')
Payment for order flow (PFOF)	Remunerations (inducements) paid by operators of order execution venues (e.g. market makers) to a broker for directing transaction orders to the execution values.
PEPP KID	PEPP Key information document
PEPP	Regulation (EU) 2019/1238 on a pan-European Personal Pension Product
Portfolio management	Often also referred to as 'private banking' where the financial intermediary manages the investment portfolio on behalf of the client on the basis of a general mandate setting out the investment objectives and other parameters. Legal definition: '[M]anaging portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instrument.' (MiFID II)
PRIIPs KID	PRIIPs Key information document
PRIIPs	Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products
Professional client	Refers to clients that invest in a professional capacity such as institutional investors, something legally defined by reference to the type, scope and purpose of the investment activity. Legal definition: Article 4(1)(10) (MiFID II)
Robo-advice/or	Robo-advisors, at times also referred to as (semi) automated portfolio management, are digital platforms that provide automated, algorithm-driven financial planning services with little to no human supervision. A typical robo-advisor asks questions about your financial situation and future goals through an online survey; it then uses the data to offer advice or portfolio management and automatically invest for you. Legally such services fall in the same authorisation and supervision as traditional physical advice or portfolio management.
Remuneration	Any commission, fee, charge or other payment, including an economic benefit of any kind or any other financial or non-financial advantage or incentive offered or given in respect of insurance distribution activities
Retail client	Refers to all investors who do not invest in a professional capacity. Legal definition: '[A] client who is not a professional client.' (MiFID II)

Self-directed investment	Self-directed or do-it-yourself investing is where individual retail investors build and manage their own investment and only use intermediaries for the execution of transactions (contrary to investments built and managed on the basis of advice or portfolio management).
Solvency II	Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance
SRPs/structured products	Structured products are investments whose return is linked to the performance of one or more reference indices, prices or rates (reference values). Such reference values may include stock indices, the prices of individual equities or other assets, and interest rates. The return of a structured product is determined by a prespecified formula, which sets out how the product performs in different scenarios defined with respect to the reference value(s).
Trailing inducements	These are remunerations (commissions, kickbacks, rebates, etc.) paid continuously and as long as the retail client holds the security or investment.
UCITS	Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)
UCITS funds	Units in funds regulated by UCITS Directive
VfM	Value for Money

ANNEX 14: VALUE FOR MONEY - BENEFITS AND COSTS

The policy measure labelled "Value for Money" envisages the introduction of a cost and performance benchmark to help determine that the offer of financial instruments for investment or insurance-based investment products provides value to the market. An obligation to assess value for money of financial instruments against specific criteria and benchmarks would force inferior providers to adjust, either by reducing costs, offering higher returns or exiting the market. This would lift average returns that retail investors can earn and reduce their likelihood of encountering frustrating investment experiences.

To complement the assessment of impacts of this measure, this annex aims to undertake a quantitative assessment of the benefits and costs of the measures. This assessment can provide only a first orientation, since both benefits and costs will ultimately depend on a number of factors, including how granular benchmarks will be (which supervisors will determine in a further step that includes further analysis and consultation with stakeholders) and the extent to which the rules will be adhered to and enforced. There are also certain limitations with respect to the availability of quantitative data, in particular the lack of information on the dispersion of costs across the numerous providers active on EU retail investment markets and the centralisation of data reporting to supervisors within financial firms (i.e. firms are likely to decide on how to organise internally their data compilation and reporting depending on how granular the requirements are, with impacts on their compliance costs).

1. Estimating the benefits

To measure the benefits, it is assumed that the net returns on investments in funds and insurance products that underperformed will improve and converge closer to the EU average. An alternative assumption would be that they converge to the best performers, which would however introduce a risk that the implied target level depends on outliers and specifically favourable framework conditions that cannot be replicated in other Member States or markets. Since there is no basis to determine how fast any such convergence could occur, the calculations below focus on the benefits that accrue once convergence has been achieved. Since full convergence of returns of financial products towards the EU average is unlikely to occur, the calculations assume that only a share of the gap to the EU average will be closed. Calculations are made for scenarios that assume that 10%, 20% or 50% of the gap is closed. This would mean broadly that the 5%, 10% or 25% of the most common investment products would no longer be offered to retail investors and replaced with products that yield the average net return. It implicitly takes into account that some manufacturers and distributors of financial products continue to offer products that underperform in terms of monetary yields, but have other compensating features. Whether the trajectory to convergence will be towards the EU average or the top performers, whether it will stop at the proportions specified above, as assumed in the calculations below, or go further, would ultimately depend on various factors. Chief among them are the design of the benchmarks, their use by firms and supervisors, the increase in competitive pressure they generate and how suppliers react to more intense competition. There is no historical precedent that can provide guidance on this.

It is also assumed that the convergence process neither leads to a change in the benchmark (i.e. that market exit of underperformers increases the average returns used for the calculation of the benchmark), nor that the supply of products declines. This second assumption is made on the basis that operators that offer products above the Value-for-Money benchmark may expand their offer (it may also be assumed that providers that offer underperforming products would prefer to adjust their product offer rather than exit the market altogether, hence not reducing the number of products on offer). Given the limited impact of production constraints in financial services and the possibility to offer products across borders, this assumption may not be unrealistic. The calculations also do not make assumptions on whether higher Value for Money would attract additional retail investors, keeping the amount of investments constant at the current level.

A correct calculation would rely on the benchmarks that the Value-for-Money initiative aims to create. In the absence of such benchmarks, the calculations use data on funds and insurance investments reported by ESMA and EIOPA respectively in their cost and performance reports. For investment funds, the starting point was the net performance indicators for the EU aggregate for equity, bonds and mixed UCITS, weighted by their share in total outstanding assets.[675] Since EIOPA does not publish an EU aggregate, the Member State data was weighted with the share of their households' holdings of investment funds in the EU-27 aggregate. The purpose of the supervisory reports is to compile statistics for comparable asset classes in various Member States. In the absence of suitable data regarding within-country differences, the present calculations were made at the Member State level, assuming that cross-country differences are a good substitute for the within-country differences that the Value-for-Money benchmarks would ultimately address.

The available statistics cover 13 and 24 Member States for different types of UCITS and unit-linked insurance products, respectively. Data are in both cases from 2021. Both ESMA and EIOPA present the detailed methodology behind the calculations in annexes to their reports and caution about the comparability of results across Member States. These underlying methodological differences could not be considered when calculating a convergence scenario.

Despite the methodological caveat, the advantage of the ESMA data is that it provides the best possible comparison of returns on funds currently possible. The report covers data for different products. The net returns used for the calculations are those on bond UCITS, equity UCITS and mixed UCITS, being the most popular asset classes for retail investors, with a holding period of 5 years. UCITS represent 85% of the EU market and it is implicitly assumed that the convergence scenario would occur similarly for the 15% other fund products. The relative share of these three asset classes was derived from the total assets of these types of investment funds in the euro area in 2021, as reported in the ECB Statistical data warehouse. They show a market share of 41% for equity UCITS and 29.5% for both bond and mixed UCITS.

Neither ESMA nor EIOPA data show how much retail investors invested in these products. Information on households' aggregate holdings of funds and insurance products is however available from Eurostat's national accounts. The non-financial sectoral accounts report the investment income of households from collective investment products, i.e. funds, and from insurance policies for 25

[675] Using data from the ECB statistics. This assumes that retail investors and institutional investors hold the same proportion of these three types of UCITS.

Member States[676]. Insurance products cover life-insurance and annuities, which is a broader aggregate than the insurance-based investment products targeted by "Value for Money". EIOPA data on gross premiums is used to calculate the share of unit -linked products, which differ across Member States.[677] This approach excludes the share of investment products that cover profit participations, which seems justifiable as the return on these products is dependent on future economic developments. ESMA's country-specific performance data of investment funds is limited to UCITS investing in bonds, equity or mixed. Retail investors hold investment funds in products for which there is as yet no performance data that could be used for cross-country comparisons, for example AIFs, ETFs or real estate UCITs.[678] The implicit assumption behind the use of supervisory data is that all households would accomplish the yields that were calculated for benchmark products in the asset class. In reality, their actual portfolio may be more biased towards products with a lower return than calculated for the benchmark products.

In practical terms, the first step was to calculate the difference between each Member States' net return of investment funds and insurance products and the EU average. Second, if the return on these investments was lower for a Member State than for the average of available EU Member States, the difference was taken as the extra return to households that convergence to the EU average could generate. Third, to express the assumed increase in the yield in monetary terms, the yield difference was multiplied with households' holdings of investment funds (F.511) and life insurance and annuities (F.62) in 2021[679]. The insurance position was multiplied with the share of the gross written premium of unit linked and index linked insurance products in life insurance premiums.[680]

It is not possible to distinguish, on the basis of the aggregate data, to what extent lower returns in some Member States are due to either fees charged by distributors or those charged by manufacturers. Analysis by ESMA about distribution channels in 2020 showed that the breakdown of costs for manufacturers and distributors is heterogenous across products, providers and Member States. ESMA reported that distribution costs are more than 50 % of costs in several Member States and that they ranged between 50% and 80% for UCITS. EIOPA also highlighted the heterogeneity of distribution costs in its latest report, documenting that the majority of observations are clustered in the range of 10-30% of total costs in the case of unit linked products[681]. It therefore seems a reasonable assumption that convergence will cover fewer financial products if benchmarking applies only to manufacturers. The share of distribution costs above can be used as an indication that, with the more limited option 2, at best half of the convergence for investment funds and at best 90% convergence for insurance products can be accomplished, with both ratios relative to the broader option 3.

Table A8.1 **Increase in households' income in billion EUR in scenarios of yields close 10%, 20% or 50% of the gap to the average of available Member States in those Member States where they were below average in 2021+**

[676] The statistical label for this property income are D.443 for investment funds, and D.441 for insurance policies.

[677] In 2020, the life insurance Gross Written Premium (GWP) was 670.6 bn €, of which 206.1 bn € represent unit-linked type of IBIPs.

[678] ESMA reports in its cost and performance report that the products used in this annex, i.e. equity UCITS, bond UCITS and mixed UCITS, account for more than 90% of the retail market.

[679] Sector S.14, i.e. households without NPISH.

[680] Table 6 of EIOPA's European insurance overview 2022 with data for end-2021.

[681] See EIOPA, 'Cost and past performance report 2022', figure 24.

	investment funds (UCITS)	insurance-based investment products (IBIPs)	total
EU benchmark in %	5.6	3.2	
Option 2			
10% scenario	1.4	1.5	2.9
20% scenario	2.8	3.0	5.8
50% scenario	6.9	7.6	14.5
Option 3			
10% scenario	2.8	1.7	4.4
20% scenario	5.5	3.4	8.9
50% scenario	13.8	8.4	22.2

+ for a 5 year holding period, derived via households' holdings of investment funds in 2021 respectively of life insurance and annuities in 2021 corrected for the share of unit linked products in life insurers' gross written premium in 2021.

The calculations suggest that convergence to the EU average of the net returns of investment funds held by households in those Member States where they were below the EU average in 2021 could generate between 3 and almost EUR 14 billion additional investment income to households per annum, depending on how strong the convergence pressure is, i.e. closing 10 to 50% of the gap to the EU average. The same approach applied on insurance products suggests that households could earn between 1.7 and more than EUR 8 billion more in investment income per annum from a similar convergence of net returns to the EU average. It is not possible to make statements about the strength of the convergence, nor to predict how long it would take. If markets are competitive and well-integrated, however, the convergence could be even stronger and not stop at half of the difference. The other measures discussed in this impact assessment, especially those that improve transparency and address conflicts of interest, are likely to increase convergence pressure on weak performers. The estimate presented here therefore includes sizeable parts of the benefits of other policy measures.

2. Estimating the costs

The IA proposes broad structures for the reporting of VfM data to supervisors and will leave the details on how VfM will be made operational to further analysis by the ESAs. Therefore, any estimate can only produce broad orientations. Well-run financial firms should already have the data they need to demonstrate their compliance with the new rules readily available. They are required to produce such numbers either for their own calculation of the profitability of the products they offer and/or for the production of the Key Information Documents required by PRIIPS.

For a micro approach, one would need to be able to quantify the time required to validate the data for submission to authorities and their actual transmission, the labour costs of the persons involved, IT costs to automate the submission and the number of financial products covered. Such information will only be known once the reporting obligation is in place. Experience with the 2019 compliance cost study shows that, even ex post, it is not straightforward for many firms to provide quantification of their reporting costs.[682]. In the absence of reliable estimates of each of these components, the following text suggests a macro approach that translates the indication of the average cost of supervisory reporting from the 2019 compliance cost study into economy-wide estimates for banks,

[682] ICF/CEPS, 'Study on the cost of compliance for the financial sector', *Final Report*, July 2019, https://op.europa.eu/en/publication-detail/-/publication/4b62e682-4e0f-11ea-aece-01aa75ed71a1/language-en.

asset managers and insurance. This study asked financial firms to report their costs of compliance with different pieces of financial legislation, broken down by type of financial institution and type of cost. Although the reporting firms represented a mere 0.5% of the population of financial firms, they accounted for 10 to 15% of market activity measured by total assets or expenditures in the various market segments, which indicates that large firms were overrepresented in the panel.

Compliance costs with PRIIPS were found to be relatively small compared to other financial legislation and the study documents that the lion's share of compliance costs are one-off, such as for training, consultancy fees, legal advice, adjusting IT development and infrastructure. They amount to up to 0.2% of the reporting firms' operating expenses. Ongoing costs are small relative to both one-off costs and operating expenditures.

Table A8.2: Average compliance costs per firm for compliance with PRIIPS[683]

	banks	investment banks	asset managers	insurers
One-off costs				
average in 1000 EUR	2473	4794	1145	1473
% of operating costs	0.12	0.05	0.18	0.15
Median in 1000 EUR	115	1508	115	1508
% of operating costs	0.05	0.18	0.05	0.18
Ongoing costs				
average in1000 EUR	158	471	123	71
% of operating costs	0.03	0.01	0.14	0.02
Median in 1000 EUR	10	99	10	99
% of operating costs	0.02	0.10%	0.02	0.1

Source: ICF/CEPS, 'Study on the costs of compliance for the financial sector', *Final Report* for the European Commission, DG FISMA, July 2019.

The compliance cost study furthermore detailed that supervisory reporting costs amount to a mere 3% of the costs of compliance with PRIIPS.[684] Translating these reporting costs for PRIIPs into compliance costs for VfM is however not straightforward. One-off costs should be smaller than those in the compliance cost study because firms do not have to create a new reporting infrastructure, but can build on already existing structures. Moreover, the reporting obligations for UCITS and AIF managers proposed under the AIFMD review already cover part of the data that would be required to produce VfM benchmarks[685]. More granular data reporting should thus be implementable through existing reporting systems with only minor administrative costs to add the new data fields. At a later

[683] Table 186, 18, 190 and 192 of the compliance cost study: ICF/CEPS, 'Study on the cost of compliance for the financial sector', *Final Report*, July 2019, https://op.europa.eu/en/publication-detail/-/publication/4b62e682-4e0f-11ea-aece-01aa75ed71a1/language-en .

[684] Figure 56 of the compliance cost study.

[685] Proposal for a directive of the European Parliament and of the Council amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds, COM/2021/721 final

stage, there may be some costs associated with more granularity, but the additional burden should be still minor. It will be for supervisors to weigh the benefits of more granular data for the effectiveness of VfM benchmarks against the costs of higher reporting burden to the industry.

Since central parameters for an estimate of compliance costs are unknown and depend on the specification of reporting, there can only be a rough illustration that uses different assumptions. Scenario analysis suggests that supervisory reporting costs, which are the key component targeted by VfM and at the same time amount to 3% of PRIIPS compliance costs, could be at around EUR 60 million or in a range EUR 13 to 252 million for one-off costs. Ongoing costs could be in a range of EUR 2.3 to 22.6 million per annum.[686] These estimates do not take into account the synergies between the supervisory reporting introduced with the AIFMD review and VfM reporting. The broadness of the range illustrates the uncertainty the estimates are subject to.

[686] The bottom range uses the average of % of operating costs multiplied by aggregate costs in the financial industry, the latter the median absolute costs multiplied by the number of firms.