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WORKING DOCUMENT

From: Presidency

To: Working Party on Financial Services and the Banking Union (Retail Investment)
Financial Services Attachés

Subject: Retail Investment Strategy - Presidency non-paper on marketing practices, disclosure information, client categorisation and promotion of financial literacy for discussion at the 4 and 5 September 2023 meeting

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RETAIL INVESTMENT STRATEGY

Presidency non-paper on marketing practices, disclosure information, client categorisation and promotion of financial literacy for discussion at the 4 and 5 September 2023 meeting

1. Introduction

This paper is based on Member States' written comments. It aims to guide the discussions on the Commission's proposal for amendments to the Markets in financial instruments Directive (MiFID), the Insurance Distribution Directive (IDD) and Solvency II. Member States are invited to present their views on this non-paper.

2. Marketing practices

The Commission's proposal aims at addressing the risk of misleading marketing communications and clarifying the responsibilities of the entities, including when using digital channels and when relying on third parties. Member States generally support the goal of introducing requirements for marketing communications and practices.

2.1. Definitions

Marketing Communications

Some Member States support the definition proposed by the Commission. Others have suggested:

- Clarifying the notions of “promoting”, “enticing” and “third party” to ensure a consistent approach between IDD and MiFID II. Some delegations have pointed out that promotion already encompasses enticing.
- Clarifying specifically in the articles that “marketing advertising” is a subtype of marketing communications.
- Narrowing the scope of the definition of marketing communication so that the record-keeping and reporting requirements do not become an excessive burden.
- Applying new requirements to all marketing activities, and not just marketing communications, to ensure the applicable regulation is this Directive and not Unfair Commercial Practices Directive (which applies to financial services) or any other Union or national law.
- Excluding unique, personalized marketing communications addressed to specific individual clients from the definition of marketing communication.

Marketing Practices

Some delegations have proposed:

- Clarifying the conditions that need to be met by a strategy, use of a tool or technique to be considered as a marketing practice.
- Clarifying the definitions of “reach” and “effectiveness” (acquiring new clients, increasing the number of transactions, etc.).
- Including “online interfaces” within the list of marketing practices.
- Narrowing the scope of the definition, otherwise some activities such as enhancing distribution channels or improving data analysis techniques might be categorised as marketing practices.
- Introducing this definition in the UCITS and AIFM Directives and the CBDF Regulation, as well: AIFMD defines “marketing” (art. 4.1.x), UCITS Directive refers incidentally to “marketing communications” (e. g. art. 63.4) and CBDF Regulation regulates the “requirements for marketing communications” (art. 4). These already have definitions of “marketing”; but expanding the proposed definition would ensure coherence across these EU pieces of legislation.

Other definitions

1) Amendments to MiFID

A few delegations have proposed including mobile applications within the definition of online interface, as under art. 3(m) of Regulation (EU) 2022/2065 on a Single Market For Digital Services.

2) Amendments to IDD

Some Member States have suggested clarifying the definition of electronic format.

Member States are invited to present their views on:

- a) whether they agree with the Commission’s definition of marketing communications,
- b) whether (and why) they would propose to restrict/adjust or enlarge the definition of marketing communications,
- c) whether they agree with the Commission’s definition of marketing practices; and
- d) whether (and why) they would propose to restrict/adjust the definition of marketing practices.

2.2. Marketing communications and practices requirements

1) Amendments to MiFID

(I) Strategy for the distribution of financial instruments

Several Member States have suggested clarifying the difference between “target market” and “target audience” in case there is such a difference.

(II) Presentation of marketing communications

Some Member States have warned about the impossibility for short marketing communication (such as social media or Google Adds) to meet the requirement to include all the essential information presented in a balanced manner.

(III) Other comments

Some delegations have proposed:

- Harmonizing these requirements with the marketing communication provisions under UCITS Directive, AIFMD and CDBF Regulation.
- Clarifying that the proposed requirements within Art. 24c are of “minimum harmonisation” and Member States could go beyond these provisions if they wish.
- Adding a provision on the use of dark patterns in online sales.

2) Amendments to IDD

(I) Division of responsibility between manufacturers and distributors

Some Member States have proposed broadening the scope of liability to manufacturers when the investment firm or the insurance intermediary uses information from the manufacturers for the advertising material or when the manufacturer and the distributor jointly draw up the marketing communication.

(II) Annual reports

Some Member States have pointed out the need to lower the burden of this obligation, especially for small players.

(III) Extension of the existing record keeping obligation to all marketing communications

Some delegations suggest establishing an identical time limit to the record keeping period for pursuing claims against insurance undertakings or insurance intermediaries (which depends on each national legislation).

Member States are invited to present their views on:

- a) whether they support the Commission’s proposal for requirements on marketing practices and communications,
- b) whether (and why) they would propose to clarify/adjust the proposed requirements

2.3. National Competent Authorities’ powers to supervise and intervene

Many Member States support the new rules that harmonise National Competent Authorities (NCA’s) administrative and sanctioning powers to enforce the application of marketing requirements. A few delegations suggest adding that host Member States must authorise marketing communications to ensure that they comply with national law before they are launched. This would be in line with existing UCITS regulation.

Member States are invited to present their views on:

- a) whether they support the Commission’s proposal for enhanced NCA powers to supervise and intervene,
- b) whether they would propose to clarify/adjust the proposed requirements in line with comments made by some MS.

3. Disclosure information

The aim of this provision is to simplify and reduce the information presented to retail investors. The Commissions' proposal contains several changes to the regulatory disclosures framework to ensure transparency for retail investors and enable them to take informed decisions.

3.1. Risk warnings

Many Member States have expressed support for the requirement for investment firms to include risk warnings in the information they provide to retail clients when a product is particularly risky. Various delegations have specific suggestions:

- Clarifying what is considered a “particularly risky product.” Although the proposal already empowers ESMA to provide appropriate guidelines on what constitutes a particularly risky product (new art. 24.5c), some delegations suggest adding some indicators in Level 1 (e.g., volatility, complexity, cost/yield relationship or PRIIPs categories); and a few others suggest further alignment with MiFIR to ensure the definition is not too open-ended.
- Addressing additional issues such as what happens with risk warnings when an investor already owns the product, or the possibility that investors perceive products not labelled with this warning as risk-free products.

On the other hand, a few delegations do not support risk warnings as they perceive they might become an important administrative burden for firms. Other arguments against risk warnings include the belief that there is insufficient convergence amongst Member States (guidelines cannot be flexible enough to take this into account). Finally, some delegations have pointed out that it is inconsistent to introduce these warnings in the IDD considering that the Commission's proposal to amend the PRIIP Regulation removed the comprehension alert for complex PRIIPs on the ground that it did not work because of its misleading use.

Moreover, some delegations have expressed reluctance to granting ESMA and EIOPA the supervision and enforcement of imposing risk warnings pointing out that NCA's supervision has been effective and that ESMA and EIOPA would need additional information from firms and NCA. Some delegations do support European Supervision Authorities monitoring the application of risk warnings but believe enforcement is not within their competences.

Member States are invited to present their views on:

- a) whether they support the Commission's proposal for the inclusion of risk warnings in information provided to clients,
- b) whether they would propose to clarify/adjust the proposed approach.

3.2. Digital-by default provisions (IDD)

Several Member States are doubtful about the compatibility of digitization and electronic format with the concept of "durable medium". Other Member States have pointed out that the proposed system may turn out to be very expensive, resulting in additional costs, especially for small intermediaries.

Member States are invited to present their views on

- a) whether they support the Commission's proposal on digital-by-default provisions
- b) whether they would propose to clarify/adjust the proposed approach.

3.3. Disclosures of costs, associated charges, and third-party payments

1) Amendments to MiFID

(I) Standardization of disclosures

Member States have expressed, in general terms, their support to the standardization of disclosures of costs, associated charges and third-party payments. Some delegations have specific comments on certain aspects such as:

- The need to clarify the definition to ensure consistent application across Member States.
- The need to ensure there is no differentiation in disclosure requirements for services provided on a cross-border basis.
- The need to clarify the meaning of “explicit and implicit costs and associated charges”.
- Regarding the time envisaged within the Commission’s proposal for ESMA to draft RTS (18 months after the date of entry into force), they flag that it might not be sufficient, neither for consumer and industry testing, nor for ESMA to conduct an analysis.

Member States are invited to present their views on

- a) whether they support the Commission’s proposal on standardized cost disclosures,
- b) whether they would propose to clarify/adjust the proposed approach.

(II) Format employed for providing information on costs

A few Member States proposed adding an obligation for investment firms to inform clients that they can demand an itemised breakdown of costs, or at least making this right more explicit. Others suggest clearer drafting to better understand what costs need to be aggregated (for example by including third-party payments or making explicit that costs caused by the occurrence of underlying market risk shall not be aggregated).

Member States are invited to present their views on:

- a) whether they support the Commission’s proposal on the format for providing information on costs,
- b) whether they would propose to clarify/adjust the proposed approach.

(III) Information provided to professional clients

According to the Commission’s proposal, investment firms providing investment services to professional clients shall have the right to agree to a limited application of the information requirements (unless the financial instruments concerned embed a derivative). A few Member States consider that this provision is not necessary, as the Retail Investment Strategy focuses on retail investors and professional clients already have the right to agree to less information due to this categorisation. It has also been argued that having “no application” of the requirements instead of “limited application” could enhance clarity.

Member States are invited to present their views on:

- a) whether they support the Commission’s proposal allowing limited information to be provided to professional clients,
- b) whether they would propose to clarify/adjust the proposed approach.

(IV) Timing to provide information

The proposal refers to the need to provide information to clients in good time prior to the provision of any service or the conclusion of any transaction to clients. Several Member States noted the need to further develop the notion “in good time”, as they believe it is too broad. Some suggestions include:

- Introducing a more precise notion, for example “immediately” or “five days”.
- Defining different timings depending on the type of service. This suggestion is based on ESMA’s 2020 Technical Advice on the impact of disclosure requirements, where it advised transaction-by-transaction disclosures on execution services and no cost disclosure per each investment decision on portfolio management services.

Other Member States have suggested that “the conclusion of any transaction” does not need to be included, as this always goes along with the provision of investment services.

Member States are invited to present their views on:

- a) whether they support the Commission’s proposal on when information is to be provided to clients,
- b) whether they would propose to clarify/adjust the proposed approach.

(V) Calculation of costs

The Commission’s proposal would require expressing costs calculated (i) up to the maturity date of the financial instrument; or (ii) for instruments without a maturity date, the holding period recommended by the investment firm; or (iii) in the absence thereof, holding periods of 1, 3 and 5 years. Some Member States have differing views on the need to calculate costs for the proposed holding periods (e.g., longer holding periods, a smaller number of periods, etc.).

When costs and third-party payments cannot be ascertained, the proposal includes disclosing the method of calculation. A few Member States suggested maintaining the current Level 2 rules (which state that investment firms shall make reasonable estimations of costs with adjustments based on experience).

It has also been suggested that there is a need for more harmonized cost calculation methodologies prior to standardizing the disclosures of costs.

Member States are invited to present their views on

- a) whether they support the Commission’s proposal on how costs should be expressed
- b) whether they would propose to clarify/adjust the proposed approach.

(VI) Other comments

Some Member States had comments on other topics related to the information that should be disclosed, such as:

- The need to take into account the diversification of the client’s portfolio. A few delegations stated that this provision could be clearer by specifying that it is the firm who must consider such diversification, but they should only be responsible for diversification in relation to their services. Other member states suggested that this information might be more useful within the statement of suitability.
- The need to provide information that is comprehensive and follows a standard format. It was suggested that this provision should be more detailed.

2) Amendments to IDD

(I) Interaction between IDD and PRIIPs Regulation:

One Member State has suggested including the impact of fees and costs in an earlier period (e.g. after 5 and 10 years) in addition to for the entire contract period. Such comparison would allow customers to understand what portion of their premium will be absorbed by the fees that are charged during the initial term of the contract if the contract is terminated early.

(II) Concepts of “independent advice”, “retail customer”, “well-diversified” and “portfolio”:

Some Member States have asked for more clarity on the difference between retail customers and consumers. One delegation has suggested that “well-diversified” needs to be specified at level 1. One delegation has proposed adding a clear definition of “independent advice”. Another delegation has commented that the term “portfolio” needs to refer to the “insurance” portfolio and not to the financial portfolio in general.

(III) Third- party payments:

Some delegations have asked if third party payments also encompass commissions that are not included in the premium. They suggest developing technical standards for this procedure.

3.4. Annual statement

Member States have generally expressed support for the requirement for firms to provide an annual statement to their clients to increase transparency. Several delegations have suggested standardizing the format for the provision of the annual statement. Other specific comments are the following:

1) Amendments to MiFID

- Clarifying that ex-post information also needs to be provided in aggregated form. Thus, a few delegations suggest having both aggregate and breakdown information to enhance understanding and comparability. Without aggregate figures on ex-post information, investors would have to calculate total costs by themselves. Aggregate numbers are also needed to include service fees which apply to different instruments (disclosures per instrument would not be able to capture them, but this information is relevant for investors to have information not only on the cost of the financial instrument but also on the cost of the service).
- Defining terms that must be included in the annual statement such as “annual market value” (or replacing it by “market value”) or “net annual performance” (i.e. which costs to deduct).
- Avoiding duplication regarding tax-related costs that need to be included in the annual statement. Thus, these costs are already contained within “costs associated to manufacturing and managing” so they should not have an additional section.
- Making it clear that income taxes will not be disclosed, as they are specific to the client.
- Clarifying the responsibility for the creation of this document (which could generally be the manufacturer unless the intermediary offers this as a specific service) and when market valuations should be provided (that is, if they should be provided when there are management services or also for brokerage only services). In this latter case, such valuations might be too complex so exemptions could be considered to ensure proportionality. For example, valuations could be omitted when it is the client who requests an instrument at its own initiative.
- Eliminating the requirement of providing an overview of the annual performance of the portfolio within the annual statement for services of only safekeeping and administration.

- Eliminating the possibility of not providing the annual statement when investment firms provide retail clients with online up-to-date statements.
- Including a deadline for communicating the annual statement (e.g. 31 March of the following year).

2) Amendments to IDD

Several Member States suggest:

- Adding that the annual paper statement upon request shall be free of charge.
- Including only the cumulative cost and the cumulative effect on the return of the investment in the annual disclosure of the costs for IBIPs.
- Deleting the adjusted individual projections of the expected outcome at the end of the contractual or recommended holding period because they could be misleading to customers as it is not possible to make a reliable performance scenario.
- Deleting the requirement to provide annual information on “payments made” in respect of IBIPs or at least modifying this requirement taking into consideration the specificities of IBIPs.

Member States are invited to present their views on:

- a) whether they support the Commission’s proposals on annual statements in MiFID and IDD
- b) whether they would propose to clarify/adjust the proposed approach.

3.5. Standardised insurance product information document for life insurance products other than insurance-based products.

Member States have diverging views about the appropriateness to include this provision. Some Member States have suggested:

- Clarifying the relation between this document and the PRIIPs KID for insurance-based investment products
- Eliminating the standardised document and only regulating a requirement of minimum harmonisation

Member States are invited to present their views on:

- a) whether they support the Commission’s proposal regarding the standardised IPID for life insurance products other than insurance-based products,
- b) whether they would propose to clarify/adjust the proposed approach.

4. Client categorisation

The Commission’s proposal introduces several modifications to the identification criteria for clients to qualify as professional. Under the IDD, all insurance-based investment products are considered retail products, so no such amendment is introduced.

First, the Commission’s proposal includes a reduction of the size of the financial instrument portfolio from EUR 500 000 to EUR 250 000 but including the condition that this EUR 250 000 threshold has to be met on average during the last 3 years. The proposal emphasizes that switching from retail client to professional upon request category is a very important step in the life of an investor. It opens the door to much more risky investments, with the possibility to lose all its investments and even more. Evidence about the reality and durability of the investor's wealth should be an important point to be checked by the firm. Member States have expressed in general terms their support to this reduction.

Yet, one Member State is concerned about the increased administrative burden because of the need to meet this criterion on average during the last three years.

Second, the Commission's proposal broadens the third criterion on professional experience, to include also relevant experience gathered outside the financial sector (e.g. in the finance department of a large corporation).

Third, the Commission's proposal includes a fourth criterion related to relevant education or training. Consequently, the person subject to the assessment to be treated as professional needs to meet two of the four criteria. Two Member States have proposed to give more weight to the size of the client's portfolio and transaction criteria.

Finally, the Commission's proposal also specifies under what conditions legal entities of a certain size can be treated as professional upon request.

The majority of Member States have expressed support or provided no comments in their written responses to the proposed changes on client categorisation. A few Member States expressed support, requesting however that certain modal modifications are introduced into the text.

Member States are invited to present their views on:

- a) whether they support the Commission's proposal for adjusted rules on client categorisation,
- b) whether they would propose to clarify/adjust the proposed approach.

5. Promotion of financial literacy

The Commission's proposal introduces an article in MIFID and in IDD to ensure that Member States promote financial education measures at national level so that existing and prospective investors can invest responsibly.

Member States generally support the goal of strengthening financial literacy to boost retail investors' participation in capital markets. Several delegations have suggested:

- Implementing different measures for promoting financial education depending on the age group they are addressing.
- Adding that Member States shall designate responsible competent authorities to promote financial education.
- Strengthening the distinction between financial education and marketing communications.

Member States are invited to present their opinion on the promotion of financial literacy, in particular:

- a) Whether they support the Commission's proposal to enhance MS efforts to promote financial literacy with respect to retail investing,
- b) Whether they would propose to clarify/adjust the proposed approach.