

Commission services non-paper on possible simplification of the rules under the Retail Investment Strategy

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1. Introduction

On 24 May 2023, the Commission adopted a proposal for the Retail Investment Strategy (RIS) consisting of:

- an Omnibus Directive amending MiFID, IDD, UCITS, AIFMD and Solvency II in the area of investor protection
- an amending regulation revising the PRIIPs Regulation.

This package formed part of the broader 2020 CMU action plan and was proposed against the backdrop of low retail investor participation in capital markets. In addition to proposing remedies to the problems identified in the accompanying impact assessment, it also sought to achieve greater coherence with respect to the rules governing the retail investor protection framework.

The Commission's principal objectives were to encourage retail investor participation in capital markets, including by facilitating their access to markets, by ensuring that they are offered products that deliver value for money and by empowering them to make informed investment decisions. Those objectives are even more relevant today in light of the central role of retail investment in the efforts of building the Savings and Investments Union. The achievement of these objectives will further be supported by the simplification and burden reduction efforts, which are at the core of the Commission's mandate.

Both the Parliament and Council negotiation mandates, adopted in the first half of 2024, are diverging from the original RIS proposal in some important aspects. In some parts, they also increase the complexity of the rules.

During the first trilogue, the co-legislators have asked the Commission to assess possibilities for simplification of the RIS, with a particular focus on the areas of Value for Money, investor "journey" and disclosure rules.

The Commission is fully aligned with the co-legislators with respect to the simplification objective. The rules must be as simple as possible and limit administrative burden while still achieving their objective – as efficiently and effectively as possible. Therefore, and in light of concerns about a potentially disruptive impact of a full ban on inducements, the Commission's original proposal included a number of measures to address shortcomings identified in the Commission's Impact Assessment pertaining to the manufacturing and distribution of retail investment products. The negotiating mandates of the co-legislators delete some of these proposals (e.g. a ban on inducements for non-advised services),

amend others (e.g. the client's best interest test) and make some, in particular the value for money assessment, more complex and burdensome for market participants.

This Commission services' non-paper assesses the possibilities for simplification of the proposed legal texts.

This non-paper focuses on three key aspects as agreed in the first political trilogue:

- the value for money rules,
- the rules of the investor' journey/the different tests, and
- disclosure rules.

2. Value for Money

The Commission has proposed strengthening existing product governance rules to prevent products which do not offer Value for Money from being released to the market and sold to retail investors.

As evidenced by ESMA and EIOPA's regular annual cost and performance reports, some products being sold to retail investors offer no or very low Value for Money, in particular due to their excessive costs in relation to performance. Given widespread low financial literacy levels of retail investors and potential conflicts of interest of advisors due to the payment of inducements, such products may be sold to retail investors even if they are not in their best interest, for instance in terms of return on investment. By contrast, if retail investors are able to obtain good returns, they are likely to be incentivised to invest more in capital markets in the future.

Under the Commission's initial proposal, firms would be required to assess the value for money that their investment products would be expected to bring retail investors. In order to specify the value for money assessment and introduce objectivity, that assessment would be made, where available, in comparison to benchmarks on costs and performance as well as other benefits, developed by ESMA/EIOPA, based on a methodology and criteria specified in a Commission Delegated Act. The data required for the development of such benchmarks would mainly be available from existing reporting requirements of the industry. However, limited additional reporting may still be needed.

Both the Parliament and the Council texts considerably amend the Commission's proposed approach and, while differing in certain aspects, broadly speaking suggest a two-pillar approach to ensure value for money:

- The benchmarks developed by ESMA and EIOPA become "supervisory benchmarks" only, which are non-binding and used by supervisors to identify any outliers.
- In addition, firms would be required to assess the value for money of their product against peer groups of similar financial instruments, based on a methodology set out in guidelines or a Delegated Act.

Data reporting by firms (which may be necessary for the peer grouping/benchmarks in addition to existing reporting) would be further limited and framed. Given that a peer grouping exercise requires access to data, the Council's text requires that firms be given access to the data collected by ESMA and EIOPA via an externally accessible database. ESMA and EIOPA could recoup the costs for maintaining the database by charging firms for access.

This two-pillar approach is intended to give firms some additional discretion when making their assessments, while still equipping NCAs with a tool to ensure that comparative assessments are performed objectively and that outliers are identified. The effectiveness of this approach also depends on ensuring that firms have access to reliable data.

Possible ways forward on simplification:

Any simplification of the value for money approach would need to ensure that the result remains effective for retail investors without imposing excessive administrative burdens for firms.

Being cognisant of the proposal of the Parliament and the Council, it is suggested to base the value for money framework on existing best practices and build on work that has already been carried out.

- For **investment funds and structured products**, the value for money approach would be based on promoting existing best practices around peer grouping, coupled with appropriate safeguards and elements to increase supervisory quality and convergence and ensuring the availability of appropriate data. This approach would ensure that the result remains effective for retail investors while avoiding extra burdens and resources on ESMA/EIOPA.
- For **insurance-based investment products (IBIPS)**, the approach would continue to build on EU supervisory benchmarks, given the lack of publicly available data concerning certain insurance features of the products (including costs and in some cases performance) that would complicate the implementation of a peer grouping approach by insurers. This approach also takes into account the fact that EIOPA has already developed a workable methodology for value for money assessment on the basis of supervisory benchmarks for insurance products.

Under the peer grouping approach for **investment funds and structured products**, manufacturers and distributors would be required to carry out value for money assessments by comparing their products to other comparable products (peers), at the inception/authorisation stage and on an ongoing basis (e.g. periodically or in case of material developments), on the basis of a harmonised and strengthened methodology set out in a new Delegated Act. The methodology in the Delegated Act would include for example the parameters for selection of the peer groups. It would be based on criteria including similar product features, target markets and distribution channels to ensure the accuracy and reliability of peer group comparisons, while also ensuring that the peer

grouping is not subjective (containing for instance only underperforming or very costly products), which would undermine the purpose of the value for money assessment.

Peer group selection should not only comprise key comparable products from the same Member State, but also those from other Member States.

The level 2 act would also help guide firms on how to perform the peer grouping. Consultation with the industry would aim to identify, improve and codify best market practices.

The peer grouping approach would mainly be based on publicly available data. Its effectiveness could be further supported by facilitating access by investment firms and asset managers to relevant data, including through industry-led initiatives and by fully leveraging the potential of the ESAP.

National competent authorities would be responsible for supervising compliance with the peer group methodology at the time of the initial authorisation of the funds or products and on an on-going basis, across their markets. They would carry out random checks, including based on outlier analysis, of peer group samples, among other things to verify whether they have been selected by firms on the basis of objective criteria, and would be able to challenge and possibly sanction any breaches in the selection of those peer groups. NCAs should report the outcomes of their supervision to ESMA and other national competent authorities on an annual basis.

At EU level, ESMA could promote consistent supervision and enhance convergence across Member States, among other things by updating its supervision handbook to outline the best supervisory practices for national competent authorities on the value for money assessments and by engaging in regular supervisory convergence exercises, such as common supervisory actions, peer reviews, coordination groups or other supervisory convergence tools, including the discussion of concrete cases, with the objective of promoting high supervisory standards in the supervision of value for money by all national competent authorities.

In the case of **IBIPs**, manufacturers would be required to do, as part of the product governance process, a documented value for money assessment to ensure that costs and charges are justified and proportionate and do not undermine the value which is expected to be delivered by the product. Supervisory benchmarks would be developed by EIOPA using already existing data reporting under the Solvency II Directive and of PRIIPs KIDs published under the ESAP system. The supervisory benchmarks would be organised in clusters, allowing it for manufacturers to easily identify the relevant supervisory benchmark for their IBIP. The value for money assessment would be reviewed by the manufacturers on a regular basis. National competent authorities would be responsible for supervisory compliance with the rules on value for money assessment. They should in particular identify manufacturers offering products that deviate from the supervisory benchmarks and enforce compliance with the rules on value for money assessment by making use of their powers as required.

3. Amendments covering the investors journey

The investor's journey, after an initial contact with an investment firm, insurance intermediary or insurance undertaking, usually starts with a client screening. Depending on the distribution channels through which products are distributed (i.e. with advice or through execution-only scenario), the sale of an investment product would be preceded by certain assessments. Different rules exist for professional and retail clients. For retail clients, the framework, as amended by RIS, could include the following assessments:

- in the advice scenario: the suitability assessment and the client's best interest test,
- in the execution-only scenario (without advice): the appropriateness assessment (only for the purchase of complex investment products), and
- in the case of insurance-based investment products, the demands-and-needs test (independently from the specific way of purchasing).

Independently from the specific way of purchasing, an inducement test has been proposed under the Council's negotiating mandate.

3.1. Simplification of client categorisation as professional client

Currently, retail clients (notion that includes individual investors but also non large legal entities (e.g. SMEs), public sector bodies, local public authorities and municipalities) can request to be treated as professional investors when they fulfil two out of three criteria (relating to relevant transaction frequency, size of financial portfolio and work experience in the financial sector). In addition to these conditions, the firm is also required to further assess the client's expertise, experience and knowledge, in order to get reasonable assurance that, in light of the nature of transactions or services envisaged, the client is capable of making investment decisions and has an understanding of the risks involved.

While this client categorisation framework is set out in MiFID, it is applicable across the financial services acquis given that other pieces of legislation (e.g. AIFMD) cross-refer to it. Firms that transact with clients that are not categorised as professionals have to respect a number of additional requirements (for example, the need to produce a PRIIPs KID). While these requirements are important safeguards for retail investors, they may be considered burdensome under certain scenarios, in particular within the venture capital and private equity field, f. ex. where not all investors within a narrow group of interested individuals manage to qualify as professionals, hence requiring the fund to be structured as a retail product or preventing individuals that did not qualify as professional from accessing it.

Simplifying the MIFID requirements for the reclassification of a retail client into professional client upon demand would lower the burden for more sophisticated clients. The Commission's proposal has already sought to address some of the issues by widening the existing criteria for client categorisation. It sought to take a balanced approach by fine-

tuning the existing framework in a targeted manner. The Parliament and Council have largely supported this approach, with each proposing certain amendments, some of which are more permissive whilst others are more restrictive.

Possible ways forward on simplification

Based on a preliminary analysis and the current context of the RIS negotiations, the co-legislators could consider introducing further flexibility in the MiFID client categorisation framework:

- Broadening and further fine-tuning the existing criteria, entailing amendments to the transaction frequency criteria, which would distinguish between and cater for different investor groups (e.g. by introducing a lower transaction frequency criterion specifically for large investments). Furthermore, the criterion for work experience could be further broadened, taking into account not just financial, but also entrepreneurial expertise or the general management experience (for example fundraising activities).
- Creating more targeted exemptions for certain investor groups and/or transactions to include a broader possibility for an (one-off) opt-out of the MiFID protection framework for some sophisticated transactions (e.g. for a single transaction that is above the value of EUR 500.000). The opt-out would allow a client to be considered as a professional for that specific transaction, without the need for the client to comply with other eligibility criteria (subject to a client's request and his explicit written consent).

3.2. In the advice scenario: the suitability assessment and the client's best interest test

The objective of the suitability assessment is to allow the advisor to identify financial products which are suitable to the client, on the basis of information that the advisor will obtain from the client regarding their personal and financial situation. The suitability assessment already exists in the current MiFID and IDD frameworks and is an essential element in the context of advice.

The objective of the client's best interest test, as proposed by the Commission in the RIS, is to help the advisor identify, from the range of suitable products, the product which best meets the client's interests. The client's best interest test would thus frame the discretion of the advisor. While the specific client's best interest principle included in the Commission proposal as such is a new test, it only substantiates/ clarifies the already existing obligation of advisors to act in the best interest of the client. Both tests would constitute two different but complementary steps in the advice process.

The Commission proposed enhancing the **suitability assessment** so that advisors recommend investment products that contribute to the diversification of the investor's portfolio, where needed. In principle, given that the advisor is obliged to act in the best

interest of client, the need for portfolio diversification should in any case be taken into account.

In addition, with a view to simplification, the Commission also proposed:

- the provision of a standardized report containing the client's information, so that this information can be used by the client with subsequent financial intermediaries to facilitate the client on-boarding process.
- a simplification of the suitability assessment for independent advice relating to non-complex (as currently defined under MiFID), well-diversified and cost-efficient products, with the objective to encourage the uptake of independent investment advice.

As regards the **client's best interest test**, the Commission proposed to clarify the obligation to act in the client's best interest with a number of concrete requirements, i.e. to assess an appropriate range of products, to recommend the most cost-efficient of similar (suitable) products and to also recommend a simple product, if additional features are not needed for the achievement of the client's investment objectives. The background of this proposal is that evidence has shown that while firms may carry out the suitability assessment, advisors do not always recommend products which are in the best interest of the client.

Both the Parliament and the Council have proposed amendments to the suitability assessment and the client's best interest test.

In the area of the suitability assessment, the Parliament's and the Council' texts agree with the need to assess the suitability in view of the portfolio diversification in MiFID, but the Parliament's text limits this in IDD. In addition, while the Council accepts the proposal to reduce the requirements of the suitability assessment for independent advisors that provide simple advice only, the Parliament suggests deleting them. By contrast, the Parliament text agrees with the proposed standardization of the report on information collected by intermediaries, whereas the Council rejects this.

As regards the client's best interest test, the Council's and Parliament's texts both clarify the first two criteria of the client's best interest test. For instance, the Parliament makes the first criterion subject to the business model of the advisor and broadens the second criterion to cover the efficiency of the product, rather than focusing on the cost-efficiency of the product. The Council clarifies the cost-efficiency and includes certain wording which may make the application of this criterion less clear. While the Parliament text deletes the third criterion, the Council's text integrates this criterion as a clarification of the articles on the suitability assessment. Finally, the Parliament adds a number of additional criteria.

Possible ways forward on simplification

The suitability assessment and the client's best interest test help ensure that retail investors are recommended products which best suit their investment needs, objectives and preferences.

Evidence has shown¹ that relying solely on the suitability assessment in its current form is not sufficient. In fact, in many cases, retail investors are recommended products which may be considered suitable, but may be too expensive compared to other products on the market or products offered by the same advisors which may better meet the needs of the retail investor. It is thus important to further frame this discretion and clarify what “acting in the best interest of the client” means.

While the existing and newly proposed elements of the suitability assessment and client’s best interest test both contribute to improving the quality of advice, there are ways to ensure that the process is simpler:

- Create an integrated test that focuses on the key elements of both the suitability assessment and the client’s best interest test. This test could include:
 - the requirements on the type of information necessary for assessing the suitability of products for the client,
 - the obligation to identify products which would be suitable for the client’s situation, and
 - from the range of suitable products, recommend the product which best meets the client’s interest, based on the criteria proposed by the Commission.

Such integration would simplify the approach and help clarify the sequencing of the different steps in the advice process, while at the same time improving the quality of advice.

As regards the simplification of the substance of these tests the co-legislator could consider for the suitability assessment:

- Not adding the **standardized report**. This would avoid adding a further L2 act to the developed, which also seems less relevant given that normally any new advisor would wish to have new updated information on their client and will not be able to rely on information that was submitted previously.
- To clarify, if needed, that **suitability questions can be filled online**, even if the advice itself will be provided in person. The suitability assessment could then be done online before the meeting with the advisor, which would ensure efficiency, save time and contribute to digitalisation
- In line with the Commission’s proposal **the suitability test could be partially disapplied in case of independent advice**, and focus solely on the client’s financial situation, its ability to bear losses, investment needs and objectives including sustainability preferences and not on their experiences and knowledge.

¹ Commission staff working document Impact Assessment report accompanying the 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, pages 16 and further and Annex 8.

As regards the simplification of the proposed client's best interest test the co-legislator could consider:

- To exclude from the best interest test all independent advisors as this simplifies burdens in a situation where this is possible
- To focus the test solely on the most cost-efficient financial instruments among the financial instruments identified as suitable to the client. The other criteria are implicitly embedded in this test and would not need to be tested explicitly anymore.

3.3. The sale of investment products without advice: the appropriateness test

The appropriateness assessment already exists in the current framework and applies to the sale of complex investment products without advice. Distributors are required to assess whether a certain investment product is appropriate for the retail investor in view of his knowledge and experience and, if this is not the case, warn him about this. Despite the warning, the retail investor can still buy the desired product. The appropriateness assessment is normally based on a limited number of questions, often through an online questionnaire. Under MiFID, this appropriateness assessment only applies to the sale of complex products, but not to the sale of simpler products (such as shares, bonds, funds, etc.).

Due to the increased digitalization of financial services, it has become very easy to buy investment products online, including very complex ones that could lead to losses higher than the initial investment. While retail clients should make their own risk assessment, the Commission considers it necessary to provide certain safeguards for retail investors who may easily purchase complex financial products without fully understanding the financial consequences. For this reason, the Commission proposed an obligation for distributors to consider the appropriateness of a product in view of the risk tolerance and ability of the retail client to bear losses.

While the Council's text maintains the proposed requirements of the Commission's proposal, the Parliament's amendments envisage deleting this part of the proposal and keeping the status quo. The Commission would propose to the co-legislators to keep the elements of the appropriateness test as proposed by the Commission, while, with the objective of simplification, to consider deleting the standardisation of the warning which distributors need to give to the retail investors when products are not considered appropriate. This would avoid the need for the development of an ESMA and EIOPA RTS and thus limit administrative burden related to their implementation.

3.4. The inducements test

Unlike the Commission proposal and the Parliament's text, the Council text introduces an inducements test, consisting of certain overarching principles and specific criteria that

firms would need to comply with when paying or receiving inducements. These specific criteria are largely based on existing level 2 requirements. The inducements test could help limit the conflict of interest and help retail investors, e.g. to reclaim the inducement in case relevant consumer protection rules have been infringed and the interests of the clients have been harmed.

Some stakeholders, in particular market representatives, have expressed concerns that this test may increase burden and may lengthen the advice or sales process.

In the Commission's understanding, the inducements test as suggested by Council is envisaged as a back-office assessment, that would need to be undertaken before the financial service providers include products in their offering or provide (investment) services for which they pay or receive inducements. The inducements test is not intended as a consumer facing test that would need to be performed by the financial service provider in advance of every individual product recommendation or transaction, nor that it would be required to share the outcome of the inducements test with retail investors. The inducements test would thus not prolong the investors' journey of an individual investor.

Possible ways forward on simplification

The Commission would not object to the deletion or a significant streamlining of the inducements test, provided that this does not lead to a lowering of the existing standards in the area of inducements. If the co-legislators decide to keep the inducements test, they could clarify more explicitly that the inducements test is *not* a consumer facing, but a back-office assessment, to be carried out possibly as part of the product approval process, and that it would thus not need to be performed by the financial service provider in advance of every individual product recommendation or transaction.

The Commission would in any case not support an outcome that lowers the existing standards in the area of inducements or introduce additional fragmentation in the internal market.

4. Amendments covering disclosures requirements

In order to improve the simplicity and quality of disclosures to retail investors, the RIS proposed a number of targeted improvements, including:

- a standardization of the cost disclosures,
- better disclosure as regards third-party payments/inducements,
- a provision of an annual statement to provide retail investors with information on costs and the performance of their investments,
- adapting disclosures so that they are fit for digital use,
- removing certain duplications and inconsistencies (between Solvency II and IDD),
- requiring the use of risk warnings for particularly risky products, and
- reinforcing the requirements in relation to marketing communications.

The RIS also proposed targeted amendments to the PRIIPs Regulation with a view to improving certain aspects of the pre-contractual product information documents (Key Information Document (KID)), including:

- a summary dashboard providing the main features of the product at a glance on the top of the document,
- facilitating the provision of the KIDs through digital means, including the possibility of layering information,
- improving the sustainability disclosures,
- improving the disclosure regime for multi-option products.

While the co-legislators have included various amendments regarding these provisions in their negotiating mandates, they have in principle largely expressed support for the objectives of these proposals.

Possible ways forward on simplification as regards MiFID and IDD disclosures

- Make IDD and MiFID disclosures maximum harmonisation: In order to avoid further gold-plating of disclosure rules in IDD and MiFID, the co-legislators could introduce the principle in both IDD and MiFID that rules on disclosures are based on the principle of maximum harmonisation and that Member States should refrain from including additional disclosure requirements, including by means of guidance. Currently, IDD rules are minimum harmonisation (thus allowing for gold-plating), while MiFID rules are maximum harmonisation, but they still allow the possibility for Member States to impose additional requirements under specific circumstances. Such a step would be also very welcome from an SIU perspective and it will remove barriers for the cross-border distribution of investment services.
- Ensuring full alignment of disclosures on cost and performance between MiFID, IDD and the PRIIPS Regulation: the co-legislators could further align the ESMA/EIOPA mandate to ensure a full alignment between MiFID, IDD and PRIIPS on (the presentation of) costs and performance scenarios in all pre- and post-contractual documents provided to retail clients. The alignment should concern all financial instruments covered by MiFID, IDD and PRIIPS and would seek to harmonise the format, explanations and standard terminology on costs, also including the calculation method (developed at L2), with those under the PRIIPs Regulation. A reciprocal provision should also be included in the PRIIPs Regulation. This would allow for a coherent approach on disclosures between the three frameworks, which would help avoid inconsistencies for retail investors and could help simplify the framework for the industry.
- Furthermore, it could be reflected upon whether and how quantitative information could be presented in a form that is more palatable to an average investor, such as through the use of graphical representation.

Possible ways forward on simplification as regards the PRIIPs KID

The PRIIPs Regulation sets out high-level rules, with most of the details on the content of the Key Information Document (KID) developed at Level 2. Therefore, the simplification

proposals focus mainly on the content added to the PRIIPs KID and the clarification of the ESAs' Level 2 mandate, since the current RTSs require complex disclosures.

- Removing the proposed sustainability section: Given that the Commission has announced a review of the SFDR in Q4 2025 and the importance of ensuring consistency between the information required in the PRIIPs KID and any possible changes under the SFDR, the co-legislators could envisage removing the proposed sustainability section in PRIIPs KID. The presentation of sustainability information in the PRIIPs KID can be updated in the context of the SFDR review. This would ensure consistency in approaches, while at the same time avoiding complex or duplicative disclosures and minimizing administrative burdens.
 - Maintain the maximum page length of 3 pages: In order to avoid additional burdens and keep the PRIIPs KID a simple, concise and understandable document, it would be important to maintain the max. page length of 3 pages. Maintaining the 3 pages limit should be possible taking into consideration the suggested deletions as well as the further simplifications and standardisations proposed (see below).
 - Further streamlining of PRIIPS KID content for a better understanding by retail investors: The Council's text suggests in the recitals that the content of the PRIIPs KID should be further streamlined. The Commission would suggest further developing the Council's suggestion into a clearer level 2 mandate for the ESAs to further review and amend and simplify the content and presentation of the PRIIPs KID, so that it remains an easy-to-read document which does not contain non-essential or difficult to understand information. This would in particular relate to the presentation of costs and information on performance which are currently shown in lengthy tables followed by technical explanations of the methodology. While this information may be useful for supervisors, retail investors may benefit more from short/standardised sentences and concise tables or graphs where needed. As suggested in the Council approach, performance scenarios and information on past performance could be presented in a simple and easily understandable way that would allow investors to get a clear understanding of this important element. Standardising the format would avoid long texts and inconsistent presentations across multiple KIDs. It would also facilitate usability under ESAP and other databases. For example, the ESAs could suggest using a common fund classification, such as the one developed by EFAMA, which is freely available.
- Streamlining the preparation and review of the PRIIPs KID to reduce the burden on PRIIPs manufacturers: the ESAs' Level 2 mandate should ensure that the burden on manufacturers when drawing up PRIIPs KIDs is limited as much as possible. The rules should be easy to implement, adapted to each type of products and reflect real, measurable indicators.