ABBL position on the EU Commission 2023 - Retail Investor Strategy

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Executive Summary

The ABBL welcomes the underlying objectives of the Commission's proposal to reinforce investor protection within the European Union (EU), to foster trust in the financial sector and to promote participation in capital markets.

We are seeing some clear and conclusive developments such as:

- **Cross sectoral alignment** of business requirements
  We are in favour of a cross sectoral alignment of the investment business to see all market participants be treated the same way.
- **Supervisory enforcement**, by preventing the offering of unauthorised investment services and activities which would be detrimental for the end client.
- **Unification and digital by default for disclosure** is very much appreciated by all the market participants.
- **Modernisation of MIFID marketing** requirements.
- Stating **training requirements** for financial advisors.

However, we have identified several aspects where we do not find ourselves in agreement. As a result, we would like to see the following propositions amended:

- Imposing a **product benchmarking** only based on costs with the **Value for Money principle** by which market competition and product development will be hindered.

- **Easing the conditions to qualify as professional clients**
  We are delighted of the proposed changes and have the feeling that the industry has been heard. Additionally, we would like to see the transactions threshold reduced and the addition of the purpose of legal entity representative clearly stated.

- **Ban of inducement in respect of portfolio management**
  We are in favour of maintaining the current wording in Art. 24 para 8 MiFID in respect of inducements.

- **Partial ban on RTO and execution**
  - We are welcoming the fact that no full ban on inducements was imposed.
  - However, in **combination** with the "**best interest test**", we might face the introduction of a superintendence which would drastically reduce the investment products available and compel the sale of investment products which are 'just' cheap.
  - Lastly, we are not endorsing the review clause proposing to revisit the possibility of a full ban in 3 years. In 3 years time, the full ban on inducements will be as disruptive as it would be today.

- **The best interest test**
  - Change in the suitability assessment based on all client's portfolios goes against portfolio diversification principle and would create implementation costs for investment firms that are not counterbalanced by an increased value for the clients.
  - Introducing a "Suitability light" regime for independent advisors will create an uneven level playing field among the advisory service.

Detailed Comments

1. Supervisory enforcement in the cross-border context (referring to article 35.a, 69.2, 86.1 and 87a MiFID)

We welcome the proposal to create an exchange platform between National Competent Authorities (NCAs) and the precautionary measures that can be taken by the host NCAs; both proposals are considered **reasonable and fair**. Enhanced supervisory cooperation will make it easier for NCAs and European Supervisory Authorities to ensure that rules are properly and effectively applied in a coherent manner across Europe.

From a cross border distribution perspectives, the implementation of a reporting requirement for investment firms and insurance distributors on their cross-border activities will create a level playing field where all products can be sold under the same set of rules.

2. One disclosure for all (referring to article 24b. 1-5 MiFID)

Leaving aside the costs of modifying existing disclosure documents, we are supportive of standardising forms and content of cost and charges disclosure across the whole financial industry.

We are optimistic that this will have **positive repercussions** and make comparison between products and market participants easier.

3. Marketing (referring to article 4a and 24c MiFID)

The proposal to better regulate and to protect the retail investors from misleading marketing information broadcasted via social media, influencers, or any other platform, is an **appreciated progress**.

The fact that financial market participants bear the full responsibility for the use and misuse of their marketing communication is an important step to frame and mitigate the negative impacts, which marketing strategies could do to the retail client of today and tomorrow.

4. Training (referring to article 24d MiFID)

We are welcoming the intend to preserve **high standards** of professional qualifications for financial advisors.

Our members reported us that a certain minimum of hours training per year to keep their financial advisors up to date and compliant with KYC requirements and regulatory changes, is already in place for their client facing staff.

5. Value for Money or a price intervention (referring to article 16a MiFID)

The **benchmarking exercise** as presented in the package is a clear **"No Go"** for market participants in Luxembourg. The presented framework is only based on costs and performances and doesn't integrate other dimensions such as the sustainability perspective neither on product nor on the client's investment desire and would therefore distort the product selection in a way that would not be in the clients' best interest.

We are of the opinion that price regulation generated by the introduction of these cost-related benchmarks to be developed by ESMA could bring about some disruptive elements for both Manufacturers and Distributors, as the economic fundamentals on which they would be established could be a concern. As of today, it remains unclear what would be the level of flexibility left to define relevant benchmarks for funds where higher costs could be justified (for example, in case of innovative, alternative, or sustainable products, products carrying higher research and development, data or due diligence costs).

This could potentially reinforce the trend to passive investment strategies while adding pressure on actively managed investments, or also represent an impediment to the democratization of private markets.
Also, the comparability of a product cannot be achieved solely on the cost and performance component, as the latter may evolve due to market fluctuations and investment strategies (i.e., passive versus active strategies).

Besides, the benchmarking on distributor side will reduce drastically the investment products available on the market. Also, many uncertainties are linked to the introduction of a product benchmarking:

- How strict are benchmarks going to be when it comes to product parameters?
- How can it be ensured that the provided data to establish benchmarks will be accurate?
- How many benchmarks are going to be available?

In conclusion, we are strongly against introducing a benchmark based on costs and performance as it would be the open door to an exclusively "quantitative" assessment. In the case where the product value does not align with its benchmark it cannot be marketed at all.
We see this as an **intervention** in the free competition of business and an aggressive step towards **regulated price intervention**, with a significant risk that the range of products to consider by retail investors drastically reduced.
The objective of improving value for money for investors should still be exploited but various components of the perceived value should be considered to ensure a fair comparison with costs.

6. Expanding the scope to become a professional client (referring Annex II, section II.1 MiFID)

a. Opt-up criterion based on trading frequency

We at the ABBL have been advocating for a certain time on making the conditions for a retail client to become a professional client more proportionate.

We are welcoming the proposal to reduce the administrative burden and to improve the accessibility of products and services for a more sophisticated retail investor.
The proposed amendments to Annex II.1 of MiFID II notably include:

- Reducing the wealth threshold from €500,000 to €250,000 in the second opt-up criterion.
- Adding a fourth criterion relating to education or training.

However, we note that the **first criterion** based on trading frequency has not been amended:

- The client has carried out more than 10 investments in Financial Instruments each quarter over the previous four quarters each one of significant size.

It has been identified that opt-up criteria based on trading frequency **do not work in practice**, as all instruments are treated in the same way and there are situations where the criteria cannot be applied. To this end, we propose to amend this first criterion by making the shift from retail to professional client category more objective and practice oriented. Therefore, the first criterion would be **replaced** by the following:

"The client has carried out on a regular basis investment in Financial Instruments, each one of significant size, over the last 3 years."

The above proposal will allow the actual experienced clients to justify more easily their investment behaviour and proficiency acquired. Additionally, it will allow to consider **market fluctuations** that can make the 40 transactions justification in a year difficult to reach.

b. Criteria for legal entities

We welcome the Commission's amendment enabling legal entities to qualify as professional if they meet two out of three quantitative requirements, i.e., €10 million balance sheet, €20 million net turnover, and €1 million own funds.
Nevertheless, **we would not support** the proposed new condition for testing the understanding of transactions by the legal representative or the person responsible:

"*The investment firm shall assess that the legal representative of that legal entity or the person responsible for the investment transactions on behalf of that legal entity, understands the relevant transactions or services envisaged, is capable of making investment decisions in line with the legal entity's objectives, needs and financial capacity and is able to evaluate adequately the risks."*,

We are of the opinion that this requirement **should be removed**. We see it both as **overlapping** and **conflicting** with the existing framework to continue testing a representative of an entity that has been reclassified as a professional.
Indeed, the following existing provisions **already address** this point and are stating where the level of knowledge and experience is located and must be tested:

- Guidelines ESMA MiFID II suitability requirements/ Client information for legal entities or groups/Relevant legislation: Article 25(2) of MiFID II and Article 54(6) of the MiFID II Delegated Regulation/General guideline 6 already states that, where a legal person having requested treatment as professional client is to be considered for the suitability assessment, the financial situation and investment objectives shall be those of the legal person.

The introduction of an additional assessment of the capability of the legal representative and/or order giver to make suitable investment decisions on behalf of that legal entity is practically difficult and redundant, as the suitability test is carried out by the investment firm in the case of advice.
No additional suitability testing should be introduced beside the assessment performed by the investment firm when providing investment services.

- Article 25(2) of MiFID II and Article 54(3) of the MiFID II Delegated Regulation "*Where an investment firm provides an investment service to a professional client it shall be entitled to assume that in relation to the products, transactions and services for which it is so classified, the client has the necessary level of experience and knowledge for the purposes of point (c) of paragraph 2.*"

We suggest **replacing** this requirement with the following text on the **corporate purpose of the legal entity**, which seems to us more relevant and responding to the market needs:
"The corporate purpose of the legal entity: the date of constitution of the legal entity is above 1 year and the corporate purpose in the articles of incorporation includes the activity of "buying, holding and selling financial instruments."

7. Ban on inducements regarding portfolio management (referring to article 24a and 24b, 25a MiFID)

According to the current wording of Art. 24 para 8 MiFID member states shall ensure that investment firms do not accept and retain any third-party inducements. Further to the explanatory notes of the retail investor strategy (cf. p. 16) the existing ban on inducements shall be maintained. Contrary to the explanatory notes the proposed Art. 24a para 1 seems to establish a stronger ban on inducements as it states that "*Member States shall ensure that investment firms, when providing portfolio management do not pay or receive any fee or commission [...]".*

It is current market practice that investment firms, when providing portfolio management, forward any received third-party inducements to their clients and it is our understanding that this should be also possible under the proposed regime on inducements. We are of the opinion that a ban on inducements **would limit any kind of cooperation model between investment firms providing portfolio management with credit institutions,** which may be responsible for

the account keeping and client management, although said model would not be disadvantageous for the client.

Finally, a ban on inducements regarding investment firms providing portfolio management would be an unjustified **disadvantage** compared to firms providing investment advice. As such firms may receive payments from product providers when cooperating regarding client relationship management and provision of investment advice.

The proposed ban on inducements regarding portfolio management seems improper following the high standard on investor protection which is a result of the periodic suitability assessment and periodic reporting.

The proposed wording may further be problematic as it may be understood that investment firms providing portfolio management may not pay any fees and that the firm may not even pay for any third-party services (i.e., research or IT services necessary for the portfolio management).

We are of the opinion to maintain the current wording of Art. 24 para 8 MiFID.

8. Ban on inducements in the context of Execution and RTO coupled with the best interest principle (referring to article 24a and 24b, 25a MiFID)

The impact of the ban on inducements on the Execution only and RTO (Reception and Transmission of Orders) business highly depends on the service and product model implemented post MIFID II. The RTO service covers only order receipt and transmission; as such, the client does not receive any advice and no investment recommendations is made.

While we do understand that in case of active distribution and marketing, a certain level of residual conflict may still exist (i.e., marketing or pushing the products where the inducements may be higher), we are convinced the application of the ban to all cases of transmission of orders or execution of orders goes far beyond the situation where an entity only processes the clients' orders coming purely from the clients' sole decisions.

As a consequence, however, the application of the ban on inducements for the RTO and execution only business, ultimately is going to lead to a **reduction of the open investment architecture** banks are rendering and ultimately limit the offering.

Against this background, we are in opposition to the application of a ban on inducements for the Execution only and RTO business.

On the second point, replacing the quality enhancement test by the **best interest** principle, at first lecture, seems a relief from an administrative burden. We concede that advice requires consideration of an appropriate range of financial products and even the most cost-effective financial product.

However, recommending to "*Offer at least one financial product without additional features which are not necessary to the achievement of the client's investment objectives and that give rise to additional costs"* is **not acceptable.**

Practically speaking this means presenting the client with a product that matches his investment wishes and possibilities, but also recommending the cheapest financial product, even if this product does not match the client's investment strategy.

We don't see the added value of proposing an only "cheap" product to compare to the others.

It also remains unclear how the alternative product to be offered without "additional features that give rise to additional costs" should be understood. For instance, this could mean that due to the additional cost of active management, that passive funds should be included in the offer even if when an active fund is advised (provided the clients' investment objectives can also be met with such an alternative).

Both propositions disclosed above are in contradiction and not linked with the main objective of the CMU action plan which is protecting the retail investor from harmful behaviour and misleading information.

Banks are firmly opposed to an economy under administration where financial market participant must lower their product and service quality level.

9. Change in the suitability assessment based on portfolio diversification (referring to article 25.1-3 MiFID)

The proposed amendments to the suitability assessment aiming to ensure that investment advisors or portfolio managers will also need take into consideration information on any existing portfolios when assessing to assess portfolio diversification on the entire portfolio is a non-sense. The purpose of portfolio diversification is the diversification by assets to reduce a specific portfolio's volatility over time, which is key element for clients.

In addition, MiFID2 was so far leaving an option for the banks to consider applying the suitability test based on all the client's assets held or at the level of each portfolio individually, based on their operation model and if all the suitability elements are duly taken into consideration. This change would lead to additional implementation costs for investment firms having chosen to perform the suitability test at individual portfolio level, without being counterbalanced by an increased value for the client.

Beyond the additional burden that would be introduced by this provision, it remains also to be seen how this will be articulated where the advised products are funds which are already subject to diversification such as UCITS or ELTIFs. Besides, in the Wealth Management industry where it is a common practice for clients to hold several portfolios with various investment strategies, horizons, and risk profiles, and sometimes held in different financial institutions, the consideration of "information on any existing portfolios" seems unachievable.

Therefore**, we are against the introduction of a suitability test based on the entire client assets held with the bank**.

10. A lighter suitability process for independent market advisors (referring to article 25.2 MiFID)

The proposal explicitly **favours** the **independent market advisors** and their business, by reducing the number of data to collect to proceed to a suitability assessment when proposing an advice service.
In particular, the independent advisor will be under no obligation to obtain information on the retail client or potential retail client's knowledge and experience about the considered financial instruments or investment services or on the retail client's existing portfolio composition.

The introduction of this so called "suitability light" regime is not acceptable from our perspective as it will foster uneven treatment among market participants proposing advisory services.

As for the exemptions proposed:

- We agree that the testing of the knowledge & experience of the client is bringing limited value in relation to non-complex products, as it is already acknowledged in relation to RTO services: an extension of this exemption is supported but should be applied to all advisory services in general.
- The exemption from taking into consideration the client's portfolio (i.e., overall portfolio's risk, minimum ESG proportions, diversification, concentration risk) is however not in the client's best interest, regardless of whether the product advised is issued from a well-diversified universe or is low-cost.