EUROPEAN COMMISSION ADOPTS RETAIL INVESTMENT STRATEGY PACKAGE WITH THE AIM TO ENHANCE INVESTOR PROTECTION

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On 24 May 2023, the European Commission (Commission) adopted the Retail Investment Strategy as part of its 2020 capital markets union action plan. The primary objective is to reinforce investor protection within the European Union (EU), foster trust in the financial sector and promote participation in capital markets.

Investor protection rules are currently established across various pieces of EU legislation. Accordingly, the Commission has put forth an Omnibus Directive, proposing amendments to the provisions of the following sectors:

- Investment services, governed by the Markets in Financial Instruments Directive (MiFID II) (Directive 2014/65/EU);
- Insurance or reinsurance distribution services to third parties, regulated by the Insurance Distribution Directive (IDD) (Directive 2016/97);
- The take-up and pursuit of insurance business within the European Union, outlined in the Solvency II Directive (Directive 2009/138/EC);
- The coordination of laws, regulations and administrative provisions relating to undertaking for collective investment in transferable securities (UCITS), as addressed in the UCITS Directive (Directive 2009/65/EC);
- The alternative investment fund managers (AIFM), covered by the AIFM Directive (AIFMD, Directive 2011/61/EU).

The package also encompasses a proposal to amend the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs) (Regulation (EU) No 1286/2014).

The Omnibus amending directive (Amending Directive) is organised into five main sections, each corresponding to one of the amended directives. The amending regulation for PRIIPs (Amending Regulation) focuses on revisions to the general product disclosure rules.

OMNIBUS AMENDING DIRECTIVE (MIFID II, IDD, SOLVENCY II, UCITS AND AIFMD)

The Amending Directive aims to:

1. Streamline and simplify the information presented to retail investors;
2. Amend the rules on product oversight and governance, safeguarding investors against deceptive marketing communications and practices;
3. Protect retail investors from excessive costs and ensure they receive value-for-money investments (i.e. efficient and effective financing);
4. Take into account the discrepancies regarding inducement prohibitions under MiFID II and IDD; and
5. Considering the evolution of digital channels, promote more robust supervisory and enforcement practices.

Ensuring Transparency on the Information Provided to Investors

The Amending Directive introduces a standardised format for advising investors, particularly under MiFID II and IDD. In order to enhance the transparency of financial instruments, the Commission mandates national competent authorities (NCAs) to enforce the utilisation of 'risk warnings' for high-risk products. The European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA), the two relevant competent agencies within the EU, will further define the concept of 'particularly risky products' in forthcoming guidelines.

The proposal also includes amendments to investment firms' regulatory disclosure on costs, charges and associated payments. Undertakings will be required to provide this information in an electronic format using a standardised structure. Additionally, investment firms will have to set out annual statements with information on costs and charges, as well as products' performance.

Adapting Marketing Communications to Investors' Needs

The Commission also emphasises the need for clear communications employed by financial and insurance undertakings to promote their products. Investment firms will need to adopt sound and effective internal policies on marketing communications and practices, which are defined, approved and supervised by their management bodies. Insurance intermediaries are not subject to the same level of organisational requirements, as the IDD does not provide for them.

Marketing communications from both investment firms and insurance intermediaries will need to provide essential product characteristics in a clear, fair and straightforward manner. The Commission will adopt a delegated act to specify the definition and design of an essential product characteristic.

Promoting a Comprehensive Assessment of Costs

According to the Commission's proposal, investment firms, insurance undertakings, alternative investment funds and UCITS management companies will need to establish an integrated pricing process disclosing costs and charges to investors. These requirements apply to both the manufacturer and the distributor levels.

Businesses and NCAs will have to report to ESMA and EIOPA the data on costs, charges and performance of PRIIPs. Building on this reporting obligation, the Commission mandates the two authorities to develop benchmarks for cost and performance. The overall aim of these amendments is to clarify the costs borne by investors and ensure the acquisition of value-for-money investments.

Aligning Conflicts of Interest Requirements

The current rules addressing conflicts of interests differ under MiFID II and IDD. The Commission introduces new provisions under both frameworks, in particular regarding the payment of commissions (Inducements). The proposal will extend the existing ban on Inducements under MiFID II to insurance-based products in IDD, and will continue to prohibit Inducements for non-advised sales.

Nevertheless, where investment firms or insurance undertakings provide advice to clients, the Commission proposes to apply a new test that replaces the 'quality enhancement' test under MiFID II and the 'no detriment' test under IDD. Advisors will need to (i) recommend an appropriate range of financial products; (ii) recommend the most cost-efficient investment; and (iii) offer at least one alternative financial product not necessary to the achievement of the client's investment objectives, allowing the comparison with other potential options.

Enforcement in a Cross-Border Digital Environment

The Commission's proposal also amends MiFID II and IDD to reinforce supervision and enforcement in financial markets. Considering the significant expansion of digital channels and the cross-border provision of services, the Commission aims to ensure that NCAs can cooperate and coordinate their enforcement actions effectively.

The objective is to enhance supervisory efficiency between IDD and MiFID II, while fostering the protection of consumers and retail investors across the EU digital capital market. The Commission aims to expedite cooperation among competent authorities, facilitating communication during supervision and easing the conditions under which they can take action (e.g. restricting access to websites that pose a threat to investor protection).

AMENDING REGULATION (PRIIPS)

The Amending Regulation proposes changes to the PRIIPs regulation. It introduces several amendments to the requirements of the key information document (KID), an information file that provides investors with a concise overview of crucial elements of each investment product (e.g. costs, risks, potential returns).

It also establishes a summary dashboard ('product at a glance'), providing more visibility to key elements on costs and risks of investment products. The presentation of multi-option products is also adapted to include key information, facilitating the research and comparison among the different investment options.

The Amending Regulation aims to modernise the provisions in relation to the KIDs' design, specifying the conditions for the use of layering (i.e. expanding the text of the investment sections of interest) under an electronic format. More substantially, KIDs will include an assessment of the sustainability level of the investment; this section will be structured on the basis of existing sustainability disclosures.

CONSULTATION AND NEXT STEPS

The Commission invited stakeholders and interested parties to submit their feedback on the proposals until 31 July 2023.

The Commission's proposals will now need to go through the European Parliament and the Council of the European Union (the Co-Legislators) for approval. The imminent European Parliament elections in June 2024 may incentivise EU Co-Legislators to rapidly engage on the files or, on the contrary, significantly delay the finalisation and the implementation of the strategy.

The Economic and Financial Affairs Council will discuss the strategy at the next Council of the EU meeting on 16 June 2023. Economic and financial ministers will have the opportunity to express their views and provide their initial reaction to the package.

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