

# The EU Retail Investment Strategy- Position Paper

To European Commission  
From The Dutch Fund and Asset Management Association (DUFAS)

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**DUFAS welcomes the opportunity to provide feedback to the draft proposal of the European Commission of the European Retail Investment Strategy, as published on 24 May 2023.**

## **Executive Summary**

DUFAS welcomes the opportunity to respond to their extensive reform proposal of the EU legislative framework for retail investments, the Retail Investment Strategy ('RIS') as published on 24 May 2023. We strongly support the objective of the RIS to boosting better access of retail participation in the financial markets. We do appreciate the European Commission's comprehensive work in this field. The proposal by the European Commission entails several proposals that should contribute to more retail participation in the capital markets. Some of the proposed measures are however quite far-reaching and could however lead to unintended side-effects especially regarding new and emerging business models. However, some of the elements of the RIS proposal could also cater for improved retail participation. More retail participation should be gained based on (i) transparency and (ii) trust.

## **Value for Money**

Our main concern relate to the Value for Money concept and the benchmarking mechanism set forth in MiFID product governance rules and undue costs rules in AIFMD and UCITS. We believe that the Value for Money concept, the way it is proposed by the European Commission, could effectively be perceived as price interference, even if it has not been intended as such. As a result we are concerned about maintaining a diverse product landscape suited for catering the wide range of possible (retail) investments needs. We are also concerned that the proposals do not sufficiently recognize the significant structural differences between different markets – what may work in the Dutch market may not be applicable in other markets or indeed vice versa.

## **Costs benchmarking for transparency purposes**

We have concerns about the benchmarking included in the European Commission proposal and the potential price interference mechanism that comes along with it. However, if done properly we do see merit in costs benchmarking as a transparency tool for the retail investor. More transparency creates trust. We therefore support any establishment of such benchmarking for this purpose only provided that (i) benchmarking only includes costs, not performance which as a concept should be represented separately, and (ii) establishment of benchmarks is done with utmost due care and with input from and dialogue with the investment industry. We acknowledge the complexity and challenge of creating relevant benchmarks. Benchmarking and maintenance thereof will necessitate a solid governance process including appropriate IT governance. Our experience of establishing a multi-stakeholder, multi-national data delivery mechanisms across multiple third party IT systems such as those run by FinDatEx for MiFID 2 or PRIIPs reporting underlines the importance of allowing sufficient time for design, testing and delivery,

## **Undue costs**

We disagree with the proposed compensation rights granted to retail investors for undue costs. We believe that full transparency via a benchmarking system as proposed is a far better way to deal with retail investors rights rather than such compensation rights.

## **Simplified investment services**

We support any initiative of the European Commission ensuring that suitability and appropriateness tests are better adapted to retail investors. Limiting suitability and appropriateness requirements for certain investment services and financial products could have a positive effect on access of retail clients to capital markets. This could be defined as so-called simplified investment services concept, services that create better and easier for retail clients. For such purpose, we have outlined specific proposals to this effect as elaborated in our position paper.

## Introduction

We strongly support the objective of the RIS for boosting better access of retail participation in the financial markets. We do appreciate the European Commission's work in this field. The comprehensive package entails several proposals that could contribute to more retail participation in the capital markets.

### *Alignment IDD and MiFID*

- We very much support the proposal of the European Commission to align IDD with MiFID, but also to align MiFID with UCITS and AIFMD. We do think that a level playing field amongst sectors is very important to achieve the goals under the RIS, but more importantly, it helps the retail investor to compare financial products and services within the financial sector.

### *PRIIPs improvements*

- We also welcome improvements to the PRIIPs KID where more flexibility is provided to displaying key information to retail investors such as presenting information from PRIIPs key information documents in a layered way and in a personalized manner. As a result of opportunities provided by digitalization, a more customized and flexible approach is needed in order to facilitate retail investors to consume the information contained in the PRIIPs KID rather than consuming information based on a three pager pdf format. There are a number of key operational issues which still need to be addressed:
  - The effective date of implementation and transfer to a new regime by firms needs to occur at the end of a calendar year in terms of implementation feasibility and ensuring consistent data collection and presentation;
  - With regards to the document length, it is likely to be impossible to include additional key elements and keep this to the current 3 page limit (language translations may also affect length). As such when moving from a default pdf format consideration should be given to allow for/accommodate translations differences; and
  - While we are in agreement of reforming to a digital by default format we recommend incorporating recognition of neuro-diversity into document presentations – i.e. do we have to show the info in same format (a chart), or can people switch between different forms of visual information (bar graph, table, chart) providing the underlying source data is the same?

### *Contributions to increased retail participation*

Although the proposal entails several proposals that could contribute to more retail participation in the capital markets, we do believe that certain proposals may need adjusting to reach the goals of the RIS. We do for example think that the proposal should elaborate much more on how to get better access to advisory services, but also to portfolio management services. We do recommend developing so-called 'light' or 'simplified' investment services which are more suitable for mass retail investors, especially where investors are investing on a regular / preprogrammed basis or where they invest relative small amounts.

### *Concerns*

- We do have major concerns about the proposal on the value for money principle in the RIS which may lead to unprecedented impact on the financial sector. Not because of the principle that investment products should offer value for money as such, which we firmly support, but the way the European Commission embeds this principle in the RIS which could effectively entail pricing regulation.
- In addition, throughout the measures included in the proposal, we see an increased focus on performance and costs. With this, we believe that the proposal disregards the broad concept of 'value' that an investment product can offer to an investor. The proposed measures can have as an unintended side-effect that the range of products available for retail investors get reduced significantly or could have a negative impact on innovation.
- As an overall concern, all the measures proposed under the RIS are expected to have a big impact in terms of IT infrastructure for both manufacturers and distributors. Asset managers will need to put

processes and resources in place to comply with all data sharing with distributors, but also with ESMA and EIOPA. Therefore, we stress that the legislator should introduce an implementation period that gives sufficient time to be able to introduce these systems and scale them up. Currently we believe the timeline proposed is not feasible and the impact on *inter alia* IT infrastructure has not been taken into account. The development of the IT infrastructure across a diverse multi-national and multi-stakeholder infrastructure necessary to support the significant increase in data transmission between firms themselves and between regulators is a multi-year process requiring significant IT governance and time for design, testing and rollout. Moreover, we expect that the implementation of these proposed measures will come with significant costs. It is essential that the proposed measures are proportionate, and one has to bear in mind that there is concern that ultimately such costs will also indirectly reflected in the costs and fees charged to clients.

## Value for money

**Draft article 16-a Product Governance requirements MiFID, draft article 12 sub (f) AIFMD, and draft article 14 sub I UCITS**

### *General view-price interference*

- **We believe, and this should go without saying, that financial products and financial services should provide added value and value for money for any clients, whether retail or professional clients. We also support the principle that such value for money concept should be applied throughout the entire chain.** Both the manufacturer and a distributor should take into account both costs and charges of a financial product together with costs and charges of its distribution, in order to assess whether the overall offering has value for money for the end investor. This principle is or should already be embedded in MiFID product governance rules. In The Netherlands, the value for money concept is already a well-embedded concept that applies within the product governance framework of financial undertakings. Although, one has to bear in mind that with the regulatory developments on due- and undue costs within the AIFM and UCITS framework, the question arises how the value of money concept interacts with the due- and undue costs and how this fits within the ‘pricing process’ as proposed by the European Commission.
- We understand that the European Commission envisages embedding the value for money concept in current MiFID product governance rules and similarly by embedding also the undue costs concept in UCITS and AIFMD. Although it seems that the European Commission had intended otherwise, the way this proposal is being perceived is that the ‘pricing process’ as described in the RIS is tantamount to pricing regulation whereby legislators or regulators *de facto* may determine in advance or in hindsight whether certain pricing of financial products or services are legally acceptable or not. **Pricing regulation as set forth in the European Commissions’ proposal imposes legal uncertainties and selling risks for financial market parties that have sold a financial product possibly combined with the investment service above a certain benchmark. Moreover, this legal uncertainty will also be detrimental to the retail investor.** In addition, the same uncertainty may also apply where retail investors should be reimbursed for undue costs which is also part of the proposed measures from the European Commission. The question arises whether situation may occur that certain costs may be due at the moment of manufacturing an investment fund, but becomes an undue cost at later stage. From that perspective, we are disappointed that the European Commission did not reflect the far reaching product and pricing structure set out by ESMA in its May 2022 Recommendations following its CSA on Costs and Charges which we would believe would reinforce the delivery of value for money without the legal uncertainty inherent in the current proposals.

- It is evident that fees and costs are an important element for retail investors. Full transparency of total costs and fees for both financial product and investment services are essential for retail investors. However, we believe that price regulation is not the appropriate tool to achieve the goals of the RIS. **We do not believe that regulators should intervene in the pricing of financial products or financial services, particularly as this may have unprecedented effects for pricing of financial services and products.** Moreover, the mechanism as proposed by the European Commission would at the end of the day be tantamount to ESMA fixing the price of products and services by creating the benchmark which goes beyond their competence and may potentially even impose certain risk for the supervisory authorities.
- Furthermore, as said the proposal includes that market parties must compare the performance and costs of the products marketed by them against a benchmark developed by ESMA and that product manufactures must assess whether costs are due. We appreciate that the ultimate effect of this measure will depend on (i) whether ESMA will develop a sufficient number of benchmarks to ensure that a relevant benchmark is available for all products, (ii) whether ESMA will apply a sufficiently broad range of costs and performance in their benchmarks, (iii) what is expected in terms of additional effort that would be required to justify any level of costs higher than the benchmark; and (for undue costs) what costs are considered as 'due'. However, the proposed measures could have the effect that products that have (for whichever reason) higher costs – even if they are able to differentiate themselves in terms of offering value for money – will disappear from the market. As the proposal prescribes that ESMA should use data on performance and pricing of existing products as input for its benchmarks in T+1, the proposed measures could trigger a spiral of ever decreasing prices.
- Moreover, it is fair to say that even in the Netherlands where costs of financial products and services are lower in comparison to other EU Member States, also due to the full inducements ban, retail clients still struggle to find their way to the capital markets. **Hence, even in a market where costs are relatively low, and where a full inducements ban is in place, you could question whether this has led to significantly more retail participation. Although over the years retail participation has increased in the Netherlands, the AFM in their report of March 2022 indicated that still more than half of Dutch households have enough financial capacity to invest and should invest, but have chosen to keep their money into savings instead.**<sup>1</sup> This shows that where the aim of the Retail Investment Strategy is to increase retail participation, the solution should primarily be sought in other ways and other tools other than price regulation. In other words by focusing on pricing regulation only, the aims of the Retail Investment Strategy will not be achieved.

#### *Potential negative effects on the range of available investment products*

- As indicated above we fully appreciate how retail investors can benefit from low costs investment products. However, costs are just one feature, out of many possible product attributes. It benefits retail investors if a sufficient range of high-quality investment products is available to ensure availability of financial products that meet all thinkable current and future investment needs. The current European Commission's proposal includes a number of measures of which we believe that these combined can nudge distributors -to save themselves the hassle- to limit their advice/ range of products with a sole focus on having low costs:
  - i) The requirement for distributors to provide additional justification for products having costs higher than a (cost/performance) benchmark;

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<sup>1</sup> See published report by the Authority for the Financial Markets (AFM) Comparing Wealth Effects of Saving and Index Investment, March 2022, published on 24 March 2022. The report did not address why Dutch household did not invest, despite having large or sufficient balances in savings accounts. In the report, AFM noted that the amount of capital invested as a percentage of total household assets remains below the European average (source: EFAMA, 2020). According to AFM this was partly due to the fact that Dutch households already accumulate assets through pension schemes (an institutionalized form of investment), which means there is less need for them to invest privately.

- ii) The requirement for distributors to also include low-cost products in their investment advice and portfolio management;
- iii) Distributors not being able to accept inducement payments,

While low-costs products (e.g. passively managed ETFs/trackers) may provide for a good investment solution for some retail investors, active investment management strategies that take into account wider investment perspectives may be better suited to serve the particular needs/objectives of others. Consequently, in many situations actively managed (in some cases: higher-cost) products may actually prove to be a better fit. For example:

- o as part of the sustainable finance framework that is a priority for both the European Commission and investors, where sustainability preferences were recently recognized as an integral part of clients' investment objectives; and
- o In addition, alternative investment strategies may provide particular added value to a portfolio by offering diversification or hedging benefits. A sole focus on costs and performance will not identify this added value.

Considering the overall focus on costs and performance, we believe this is insufficiently reflected in the current proposal.

- Furthermore, from the perspective of efficiently functioning capital markets, we stress that actively managed investments play an important role. Where an investment manager bases its investment decisions (transactions) on a substantiated view of the value of an asset, it contributes to the price forming process. Where transactions are on a large scale conducted based on rebalancing of benchmarks, with investment managers being willing to buy or sell at any price as long as the tracking error is as small as it can be, financial markets get distorted. Active investment managers also play an important role in feeding information into financial markets, which is essential for the price forming process to function efficiently. A steer towards passive portfolio management can cause undesirable side-effects for price forming.

Amendments to the EC proposal in order to diminish price regulation effects

- As said we are of the opinion that benchmarking should not lead to price regulation. Therefore, we propose to remove at least certain elements of the draft article 16-a Product Governance requirements MiFID, draft article 12 sub (f) AIFMD and draft article 14 sub (e) UCITS.

**Our recommendation**

- *As we do not wish to have a regulator to assess whether costs above a benchmark are being justified or not. We therefore propose to delete the following phrases in MiFID, AIFMD and UCITS:*

*"If justification and proportionality of costs and charges cannot be demonstrated, the financial instrument shall not be approved by the investment firm"*

*'If justification and proportionality of costs and charges cannot be demonstrated, the financial instrument shall not be offered or recommended by the investment firm'*

*"If justification and proportionality of costs and charges cannot be demonstrated or if the [UCITS/AIF] or its share classes do not comply with other criteria set out by the management company in the pricing process that [AIF/UCITS] or its share classes shall not be marketed to retail investors by the management company"*

- *The intention of removing this justification and prohibition clause is that it should prevent that at hindsight investment firms and UCITS or AIFMD managers cannot not be accused by regulators or*

*retail investors that they should not have approved, offered, recommended or marketed the product of services just because of their pricing above the benchmark.*

### Costs and performances

- More important, the proposal entails that for AIFs and UCITS the benchmarking of their funds includes both costs and performance, which are, while there may be interlinkage, in essence two very different concepts. Effectively, by including both costs and performance, performance becomes part of the assessment whether certain costs are proportionate and justified. As a result, performance becomes subject to supervisory scrutiny. We are of the opinion this is not the best way forward. Based upon the current proposal, investors could, with hindsight, expect and perhaps even based on civil law considerations receive indirectly compensation because of bad performance of financial products within certain periods of time, because performance is in the proposal part of the pricing process. In addition, including performance into the benchmarking brings about the practical question how frequent such benchmarking should take place, as performance varies from day to day, whilst costs are normally fixed on an annual basis only. Performance of financial products is obviously key for investors, and plays an important role but should not be part of the pricing process for the reasons mentioned above.

In addition besides performance any other services and aspects that adds value, e.g. downside protection, offering hedged share classes, offering funds with exposure to non-financial criteria such as impact investment are important and, therefore, help justify the costs.

#### **Our recommendation**

*We therefore propose to delete the performance in the benchmarking test:*

*AIFMD: Article 12 (f)(1e): (...) The assessment shall take into account the criteria set out in the pricing process and, for AIFs marketed to retail investors, include a comparison with the relevant benchmark on costs ~~and performance~~ published by ESMA in accordance with paragraph 1f.*

*UCITS: Article 14 (1e): (...) The assessment shall take into account the criteria set out in the pricing process and include a comparison with the relevant benchmark on costs ~~and performance~~ published by ESMA in accordance with paragraph 1f.*

### Costs benchmarking for transparency purposes

- Specifically with respect to benchmarking, apart from the concerns on price regulation and the unintended effects it can have on the range of available products, we have several concerns:
  - The plurality of investment products, each having their own specific features would require a large number of benchmarks to ensure that products having additional features (which add value to the investor) can actually charge a higher fee. It would be challenging to come up with as many benchmarks to accurately represent as many strategies and underlying mix of assets. It worries us that much room seems to be left to ESMA to determine what features can actually justify a higher fee to be charged;
  - It is important that the establishment of benchmarks should be done with utmost due care and input from and dialogue with the industry will be essential. Alternatively, it would be left up to the manufacturer/distributor to assess whether a benchmark is 'relevant (16a(1) and (4));

- Apart from this also features such as active portfolio management, diversification vs. other (mainstream) asset classes or investment styles and active shareholder ship (engagement) or sustainability more generally should be taken into account as features that could justify higher fees;
  - More importantly, benchmarking should particularly not have the effect that innovation and diversification are being jeopardized. Particularly investment products with investment strategies and asset classes that require specialist knowledge and more active engagement, inter alia investments products with sustainability as objective, should not be hindered by benchmarking;
  - Furthermore, we stress that any cost assessment for the purposes of benchmarking, cannot be done at the fund level only, but it would need to be done at the share class level. Asset managers have different pricing points for clients depending on whether they are institutional or retail, whether they have retrocessions or not. This means dozens of pricing point on a fund level may emerge; and. Performing an assessment at the fund level could end up leading to only being able to offer the cheapest share class and won't reflect the different costs of distribution.
- We could however see some merit in creating benchmarks – if well calibrated – and to the extent the above concerns are appropriately mitigated –for retail investment products **for the purpose of transparency only.**
  - **Transparency provided to the retail investor whether certain costs of a financial product or investment services, are below, equal or above the benchmark of similar products or services, makes it easier for retail clients to assess costs and charges.** Hence, as such we could support the introduction of creating a benchmark for PRIIPs financial products and investment services. Additional disclosure obligations into MiFID and PRIIPs should be added to increase transparency on an individual financial product or investment service level. More in particular, the PRIIPs KID would be the ideal and relevant information document for the retail investor where costs benchmarking can be embedded.
  - Where a public benchmark will be established by ESMA it is essential that the methodology of the creation of benchmarks, the data underneath such creation and of course also the governance must be made transparent. Possibly auditing by an independent third party should also be considered. Financial market parties need to be able to understand the benchmarks and its methodology as the industry will be the one needing to deal with potential claims, and concerns from retail clients.
  - Lastly, where investment firms need to provide data to ESMA and EIOPA for benchmarking purposes it needs to be clear that such data can only be used for the specific purposes and shall not be used for other means.

#### *Costs benchmarking & product governance process*

- Creating a public benchmark may also have another advantages. In the product governance process, investment firms may for the purposes of identifying the target market of financial products use the 'clustering approach'. This means that the investment firm may identify a target market per cluster of a product instead of per individual product. Benchmarks created for the costs, will also necessitate to cluster the right sort of products which are comparable with each other. Such benchmarks may therefore also be useful and ensure more consistency for the clustering approach under the current product governance rules, provided the clustering is clear and in line with market views. We see merit in the use of benchmarking for product governance clustering, but it has to be clear that using the ESMA benchmarking for clustering purposes should be optional, not a regulatory requirement.



## Undue costs

- **We support the principle that UCITS and AIFMD management companies should ensure that the costs borne by retail investors are justified and proportionate**, having regard to the characteristics of the AIF, including its investment objective, strategy, expected returns, level of risks and other relevant characteristics.
- However, as mentioned earlier, we are quite disappointed with the European Commission not taking into account the very detailed ESMA recommendation on running a pricing process that came out as result of the CSA on costs and charges in funds. We believe they provide a lot of rigor in the pricing process.
- Moreover, we struggle to understand the **concept of undue costs**, particularly also in relation to the 'pricing process' as proposed by the European Commission. The concept of undue costs should not be necessary in case a pricing process is being put in place and supervised as any 'undue costs' would be identified in the process. Moreover, if the concept of due or undue costs is envisaged as an essential part of the RIS, the question arises why this concept is embedded in the proposal for investment funds only.
- **We disagree with compensation rights granted to retail investors for undue costs charged in the past. We believe that full transparency via a benchmarking system as proposed is a far better way to deal with retail investors rights rather than such compensation rights.** Moreover, the undue costs concept and the value for money concept whereby any costs for financial products marketed above the benchmark that cannot be justified may even conceptually be tantamount to the same costs. Hence, the proposal of the European Commission does not clarify how these both concepts interact with each other.
- In addition, where compensation right will be granted for undue costs, a process would need to be put in place to facilitate reimbursement to investors, involving costs related to IT for the calculation of amounts involving data as to for example the holding periods of particular investment by a retail investor. It furthermore also needs involvement of distributors. In some cases it may also be practically impossible to identify all past investors for example for ETFs and other products which are traded on the secondary market and where the manager does not know the identity of the investor. We believe that the costs of handling such reimbursement claims may be highly underestimated. Such costs may not outweigh the benefits of investor, particularly where the potential of the amounts that need to be reimbursed are overestimated. In any case, where the European legislator in spite of said arguments wishes to pursue such compensation rights, at least reimbursement thresholds should be considered.

## Simplified investment services

- We support the initiative and proposals of the European Commission which ensure that suitability and appropriateness tests are better adapted to retail investors. **Adapting, in the sense of limiting, suitability and appropriateness requirements, is very likely to have a positive effect on access of retail clients to investment services.** We are therefore supportive of an introduction of a so-called simplified investment services concept. Simplified investment services should create better and easier for retail clients, however such services should not be read as cheaper services.
- We do support the introduction of the provision of an advisory service, where advisors provide advice limited to a range of diversified, non-complex financial instruments, although we do think what is considered to be non-complex should be well defined in advance. With regard to non-complex products, a review of this concept or even perhaps amendment of article 57 of the Commission Delegated Regulation (EU) 2017/565 may need to be considered.



- In addition, **we are of the opinion that the same could be developed for portfolio management services**. Such simplified investment services could be introduced next to the current advisory and portfolio management services. Moreover, portfolio management services is even more suited to the simplified investment services concept, particularly as it is the investment firm that makes the investment decisions in the portfolio.
- We understand from the proposal from the European Commission, that for such services, distributors will be able to perform a suitability assessment on the basis of more limited information about the clients and customers. However, the limitation of the intake is restricted to the deletion of knowledge and experience of clients only. We believe that this elevation is not sufficient enough for potential retail clients to get better access.
- Instead, in order to make both investment advice and portfolio management services more accessible for certain mass retail consumers, **we believe that a lengthy intake on, for example, the financial situation of the client as part of the suitability assessment should also not be needed**. Instead, an assessment limited to three or four basic questions may suffice. Even information on the financial position may not be relevant if a retail client invests below a certain specified amount on a monthly or annual basis. In summary, we believe that the suitability requirements should be proportionate and adapted to consumers who have lower sums to invest.
- **Hence, we recommend that an independent advice as envisaged by the European Commission or a similar portfolio management service should be enhanced by adding certain features, about the type of product, amounts invested, online channel, investment objectives, and costs**. For these type/group of mass retail investors not only knowledge and experience should not have to be obtained, but also they should be subject to very limited questions about their financial position or none at all and possibly also risk appetite because of lower investment risks in the portfolio. The typical type of investor targeted are those consumers who may benefit from investing in line with their risk appetite, but who currently hold their savings in cash.

Therefore most of our members advises the European Commission to consider amending the current suitability and appropriateness assessment for a specific group of mass retail investors. This group of retail investors may be defined as investors that wish to

- invest in well-spread and diversified non-complex investment products, such as well spread and diversified investment funds
- periodically with small amounts, say e.g. EUR 50-100, or at a certain maximum on an annual basis, which may possibly even vary depending on the percentage of average national wages in any member state
- in a digital environment, and
- with a long investment horizon, e.g. pension goal, but also possibly without a specific investment objective, other than growth.

- Furthermore, given the group targeted, we also recommend that the suitability report for each and every advice should not be necessary, considering the type of investment products covered by this service, the type of investor and the limited amounts that are invested.

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**DUFAS: Dutch Fund and Asset Management Association**

Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.

**More information**

Would you like to respond, or should you have any questions? We would be pleased to hear from you. Please feel welcome to e-mail Randy Pattiselanno, DUFAS Manager Strategy & Regulatory Affairs, at [rp@dufas.nl](mailto:rp@dufas.nl).