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INDUCEMENTS BAN KEEPS THE EC RETAIL INVESTMENT STRATEGY HOSTAGE

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The European Commission is expected to unveil its plans for the European retail investment strategy (RIS) at the end of May. The discussion about the RIS has recently been dominated, or perhaps been held hostage, by the question of whether the European Commission will dare to push through its intention to impose a total inducements ban under the Markets of Financial Instruments Directive (MiFID). According to **Randy Pattiselanno, Manager Strategy & Regulatory Affairs at the Dutch Fund & Asset Management Association (DUFAS)**.

The EU Commissioner responsible, Mairead McGuinness originally declared herself to be in favour of the introduction of a full inducements ban, comparable to the UK and the Netherlands. However, during her speech on 27 April at the Eurofi High-Level Seminar in Stockholm she announced that a full ban of inducements for all investment services may not be included in the RIS.

The background of RIS

The European Commission has been busy developing the RIS for some time: a full consultation was already published back in May 2021. The idea behind the RIS is to improve retail investor access to the European capital markets. This is certainly in reaction to the reality that European citizens increasingly have to take care of building up their own pension. That is the main driver behind the RIS. As was said as part of the review, the European Commission was considering the introduction of a full inducements ban for all investment services under MiFID, following the example of the UK and the Netherlands. The reason being is that it expected that the introduction of a full ban would significantly reduce costs for the retail investor, something that is backed up by research. Reduction of costs may be an important factor in increasing access to the capital markets for the mass retail investor. A proposal for a full ban of inducements has led to a lot of resistance from the market, but also from various large member states and members of the European Parliament. The pressure is obviously the reason why the EC is not intending to pursue with the full ban of inducements, but may propose a targeted ban on inducements for execution-only transactions only.

What is left for the RIS?

It seems that the entire RIS has been held hostage by the inducements ban discussions. The question arises if not a full inducements ban, what will the strategy for retail investors entail? We have seen some ideas launched by the European Commission. One of them related to the (Personalized Strategy Asset Allocation Strategy (PAAS) or Personalized Investment Plan (PIP), published by the European Commission almost a year ago. It related to the concept of introducing a portable retail investor passport which may also include features and data of the investor, investor objectives, investor constraints, risk appetite, knowledge and experience, possible preferences etc., but also preferred a personalized asset allocation strategy. This idea of a retail investment passport seems definitely to have some merits, as it may facilitate the client onboarding process when offering advisory services of individual portfolio management services. However, the entire concept did not seem to really be welcomed by the market, so it is quite doubtful this will be part of the final RIS package.

Value for money?

Another concept which has been discussed with various stakeholders in the market is the value for money concept (VfM). The idea from the European Commission is a strengthened approach as part of the RIS aimed to prevent financial products that offer little or no prospect of positive net returns for retail investors, because of excessive costs being offered to retail clients. The VfM concept should raise the overall level of cost efficiency. Apparently more prescriptive quantitative and qualitative assessments of cost and charges may be part of such VfM assessment, which could be applied at the product governance process and at the distribution chain level. As a concept, VfM cannot be argued against. Financial products and services should always have to have value for money. In a certain way current MiFID product governance rules already cover the VfM concept, as costs and charges are features that already should be taken into account within the product governance process. The only thing that may be added, are more prescriptive rules which forces financial market parties to justify their costs and charges.

In any event, the VfM may be perceived as an alternative for a full inducements ban. The VfM concept is aimed at justifying costs and should ensure that the financial market party can demonstrate that its investment product really has added value. The questions arise however whether this also will lead to lower costs products.

Alternative RIS strategies?

In case a full inducements ban will not be introduced, the European Commission is likely to announce additional measures, such as the VfM concept or any other measures as a tradeoff. The question arises whether it makes sense to exempt those financial market parties or effectively financial market parties established in jurisdictions where a full ban already exists, such as in The Netherlands, from such extra obligations. Investment firms under MiFID can be given an incentive to choose not to receive any inducements anymore., if they will be exempted from various obligations under e.g. a VfM concept. This may also reduce any regulatory risks.

Furthermore, and more importantly, the main driver of the RIS should be increasing access of the mass retail investor to the capital markets. Dutch experience have shown that the introduction of a full inducements ban nevertheless has led to an advisory gap for the mass retail investors. For example, most large banks in the Netherlands only offer nowadays investment advisory services to clients that have a total of assets over 500.000 euro. Hardly, considered to be mass retail. Although in the Dutch market concepts such as guided execution-only have emerged, there is still need for advisory services. Moreover, apart from inducements, the main obstacles for better access to advisory services are rooted in the rules for the onboarding of clients, and various other rules attached to such services such as the issuance of a suitability statement.

Simplified advice or advisory light?

Costs of financial products play an important role, but it is also essential that the RIS offers solutions to enable access to advisory services for the lower end of the market. This is true for the Netherlands where an advisory gap has emerged, but the same applies for all mass retail investors in the rest of Europe. It is important to look at the obstacles that investment firms encounter when obtaining extensive client information, when giving investment advice or offering individual portfolio management. As said, although alternative forms have been found in the Dutch market in the form of guided execution, there is still a need to fill this gap.

As part of the RIS, the European Commission could consider for example the introduction of a light investment advisory service where a mass retail investor invests with (i) relatively small amounts in (ii) well-diversified investment products, such as investment funds, for (iii) long term goals such as building your pension, against (iv) efficient costs. Inspiration can be gained from the Financial Conduct Authority in the UK, which published a consultation on core investment advice last November. Such 'light' advisory service should also be made available for investment firms only that choose not to receive inducements, also in order to warrant low-cost efficient investment products and service. Investment firms will be given a choice between offering advisory services without the burden of a number of regulatory obligations in return of giving up their inducements. Needless to say, such simplified advisory service would help the advisory gap in the Dutch market and would stimulate new online offerings whilst it also adds a new extra flavour to the investment services already included in MiFID.