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UNVEILING THE EU COMMISSION'S NEW PROPOSAL FOR FINANCIAL TRUST AND TRANSPARENCY

Digital Finance Team | October 2023

The EU Commission recently published a draft proposal for a new omnibus directive, aiming at reinforcing and harmonising retail investor protection across the entire spectrum of financial services.

SCOPE OF APPLICATION - WHO'S AFFECTED?

As an "omnibus directive", the proposal is intended to affect several key pieces of EU legislation such as MiFID II, IDD, Solvency II, UCITS directive, and AIFMD.

Accordingly, a great variety of actors will be affected including banks, investment firms, insurance companies, funds and their managers, but also investment and insurance intermediaries.

KEY CHANGES - WHAT'S AHEAD?

The draft directive includes multiple changes, big and small. The following key elements are worth noting.

1. Improved transparency

Transparency takes a central place in the proposal, with a focus on enabling retail investors to make enlightened decisions.

Regulated entities will be required to display improved risk warnings in all their marketing and informative materials, ensuring that investors are fully aware of the potential risks and implications of their investment decisions.

Furthermore, the proposal aims at increasing standardisation and the disclosure of critical information on costs, charges, and inducements.

2. New rules on marketing and communications

Acknowledging the significance of unbiased and accurate communication, the proposal introduces new provisions to address potential biases in marketing communications.

All marketing communications on investment services will need to be recognisable as such, identifying the responsible issuer. They will also need to prominently and concisely present the key characteristics and risks associated with the product they advertise.

Investment firms will be responsible for the content and updates of the marketing communications they provide to distributors or disseminate using digital channels or third-party marketing communications, including marketing done through traditional media but also social media, third-party influencers (sometimes called "finfluencers"), etc.

Investment firms will need to submit internal annual reports to the firm's management on marketing communications and strategies, including any identified irregularities and the proposed solutions to tackle them. Investment firms will also be required to maintain records of all marketing communications for a period of five to seven years, including the content, medium used, duration, targeted client segments, locations of availability, and any third parties involved in the dissemination of the materials.

Finally, investment firms will be required to develop and adopt a specific policy on marketing communications and practices to ensure compliance with the new requirements.

3. Confronting conflicts of interests

Conflicts of interests can erode investors' trust and hinder fair treatment. To combat these issues, the proposal reinforces rules on conflicts of interest, and in particular those concerning inducements.

Amongst key changes, the proposal imposes a ban on inducements paid from manufacturers to distributors for execution-only sales, eliminating incentives for firms to favour specific products.

Moreover, safeguards are bolstered for advised sales, ensuring that the payment or receipt of inducements never compromises the duty to act in the client's best interest.

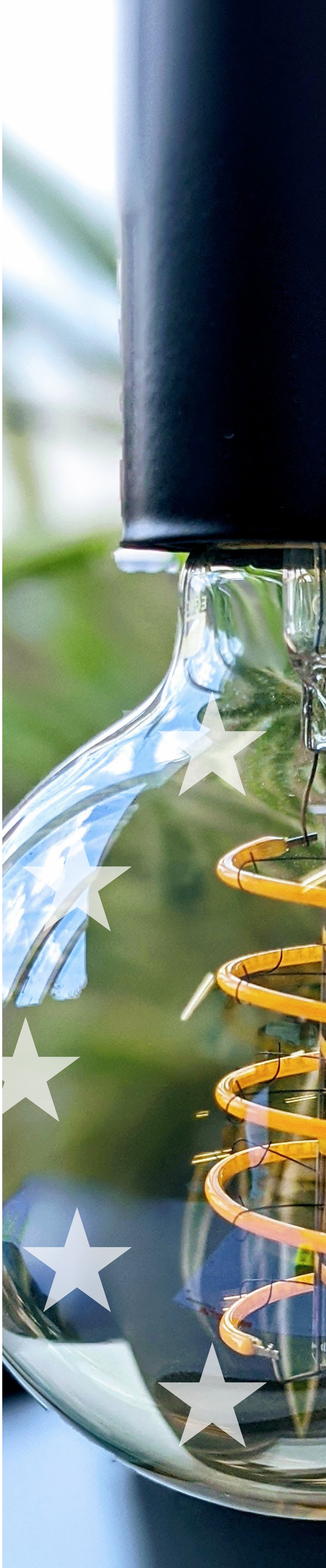
The proposal introduces a new 'best interest' test with clear criteria replacing the 'quality enhancement test' and 'no detriment test' existing respectively in the MiFID and IDD frameworks. Under this new 'best interest' test, regulated entities will need to assess a suitable range of financial instruments, recommend the most cost-efficient options that fulfil the client's investment objectives, and avoid recommending products with unnecessary additional features that carry extra costs.

By strengthening the existing framework prioritising impartiality, the proposal aims to restore investor confidence and create a level playing field over all actors in the European single market.

4. Product oversight

The proposal seeks to enhance product governance rules and pricing processes, aiming to protect retail investors from exaggerated costs.

Manufacturers and distributors will be required to establish a process for the approval of each financial instrument before they are marketed or distributed to clients. This process should lead to the identification of the target market, a clear identification of the objectives and needs of this market, and an assessment of the appropriateness of the financial instrument to meet these objectives and needs. Firms will also be expected to assess all relevant risks and ensure that the intended distribution strategy aligns with the identified target market. Moreover, firms will need to conduct assessments of costs, charges, and performance benchmarks before bringing products to market and assess whether costs and charges are justified and proportionate.



This product oversight requirement will have an ongoing nature, in the sense that investment firms will be required to review their financial instruments regularly to assess consistency with the target market's objectives and needs.

5. Extension of the notion of 'professional client'

The proposal is meant to ease restrictions for investors seeking professional client status. If adopted, this change will most likely be welcomed by the industry.

Administrative burdens will be alleviated through new criteria, including a lower wealth threshold (lowered from EUR 500,000 to EUR 250,000) and the recognition of relevant education and training as an additional qualifying factor.

TIMELINE – WHEN SHOULD YOU START PREPARING?

As with any regulatory proposal, the implementation timeline is subject to review and potential adjustments.

The proposal was published by the EU Commission on 24 May 2023 and is yet at an early stage of the legislative process.

Its adoption should not be expected before the beginning of 2025. The exact timeline may however vary and it is advisable for regulated entities to monitor this proposal closely to implement the expected new requirements in due time.

For any questions or assistance, please reach out to our Digital Finance Team

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