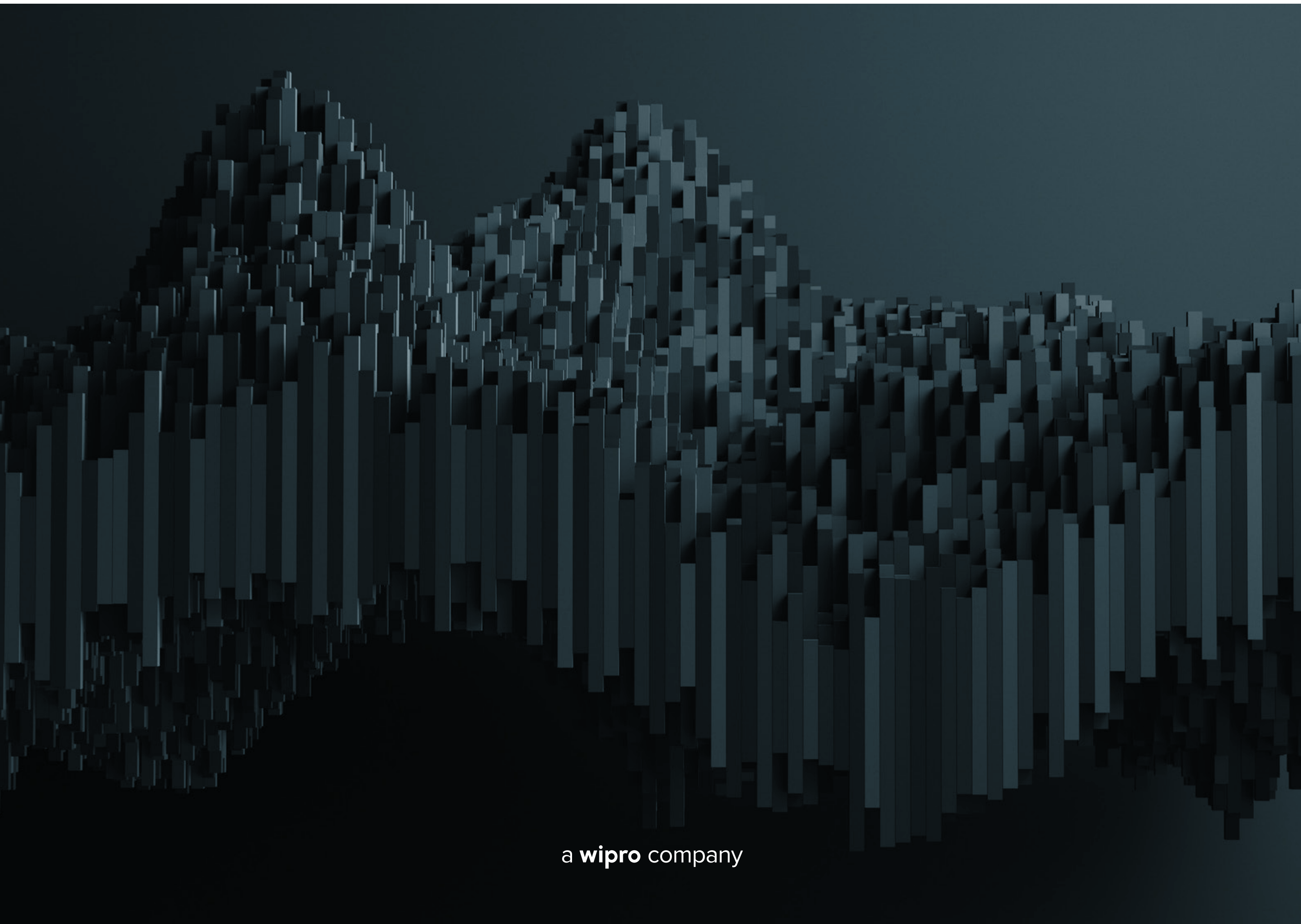
CAPCO

EU RETAIL INVESTMENT STRATEGY

DECEMBER 2024 UPDATE



Set to enhance investor protection and increase retail investors' participation in the capital markets, the EU Retail Investment Strategy (RIS) Directive has entered the key phase of interinstitutional (trilogue) negotiations between the European Parliament, the Council of the European Union, and the European Commission.

Given the 'omnibus' nature of RIS, and its consequent implications for a raft of in-flight and proposed regulations, there is industry demand for simplification of the proposed Directive and a re-evaluation of its impacts in terms of human, operational and consumer testing costs.

In this article, we examine some of the key challenges facing financial services firms and provide a status update on the Directive's progress.

OVERVIEW

A flagship initiative of the Savings and Investments Union (formerly the Capital Markets Union) that supports the European Commission's ambitions to enhance market competition, the Retail Investment Strategy (RIS) looks to ensure a more efficient and investor-friendly retail investment market within the EU. To this end, the proposed Directive focuses on investor protection, market transparency, cross-border investment, financial literacy, innovation, and regulatory harmonization.

As an Omnibus Directive, RIS will incrementally alter current rules enshrined in existing directives, including MiFID II, the Insurance Distribution Directive, UCITS, AIFMD and Solvency II. In addition, RIS will modify regulation relating to packaged retail and insurance-based investment products (PRIIPs), with a particular focus on the key information documents (KIDs).

RIS is expected to be finalized in 2025 and come into force from 2026/2027; despite this long timeframe, financial institutions, including insurers and asset and wealth managers, are nonetheless advised to begin preparing sooner rather than later. However, the trilogue negotiations have highlighted some key disconnects between the European Council and Parliament, and the exact impact of this complex Directive is not yet clear.

PROJECTED RETAIL INVESTMENT STRATEGY TIMELINE

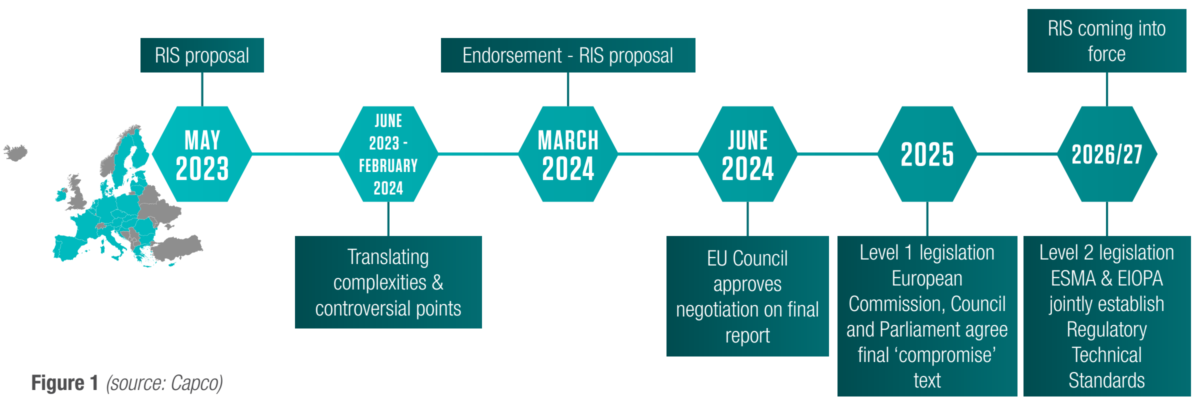


Figure 1 *(source: Capco)*

REGULATORY IMPACT ASSESSMENT

The exact details of RIS are still in a state of some flux but, based on typical aims and measures associated with such initiatives, the potential impact on existing regulatory processes and measures will likely include changes to reporting, transparency, process pricing and data sharing among others.

Given the current uncertainty surrounding the Directive, at this juncture we have chosen to highlight three specific areas of potential impact and their associated challenges as financial firms begin their initial preparations for the changes ahead.

Figure 2 below summarizes how RIS will reshape other regulations.

THE MAIN DIRECTIVES IMPACTED BY THE RETAIL INVESTMENT STRATEGY (RIS)

<table>
<tr><td rowspan="11">RIS
(OMNIBUS)</td><td rowspan="3">MiFID</td><th colspan="2">Investor Customer Protection</th><th colspan="2">Reporting/Transparency</th><th>Additional Information</th></tr>
<tr><td>Product/need fit</td><td>GSP product governance</td><td>Rates/fee information</td><td>Retrocession framework</td><td rowspan="10">• RIS may also impact SFDR (Sustainable Finance Disclosure Regulation) as one of the objectives of RIS is to promote sustainable investment, there could be a strengthening of the requirements for disclosure of information on ESG products/criteria.

• Tighter controls on distributors of investment products could lead to additional obligations in terms of customer knowledge (KYC, AML/CFT) in order to protect investors against possible fraudulent or non-compliant products.

• To a lesser extent RIS could encourage the distribution of products such as PEPP (Pan-European Product designed with a desire to standardize its rules in terms of distribution/transparency).</td></tr>
<tr><td>Advice & professional requirements</td><td>Conflicts of interests</td><td colspan="2">Terms of remuneration</td></tr>
<tr><td rowspan="2">IDD</td><td rowspan="2">Unique information document</td><td rowspan="2">Fees</td><th colspan="2">Transparency</th></tr>
<tr><td colspan="2">Information methods</td></tr>
<tr><td>UCITS</td><td colspan="4" rowspan="2">Process pricing</td></tr>
<tr><td>AIFMD</td></tr>
<tr><td>Solvency II</td><td colspan="4">Information procedures for investors</td></tr>
<tr><td>RGPD</td><td colspan="4" rowspan="2">Alignment with GDPR objectives and DSP2 data sharing</td></tr>
<tr><td>DSP2</td></tr>
<tr><td>PRIIPs</td><td colspan="2">Format of key information documents</td><td colspan="2">Provision of key information documents</td></tr>
</table>

Figure 2 *(source: Capco)*

1. VALUE FOR MONEY (VFM) FRAMEWORK

The VFM framework is a critical component of RIS, focusing on ensuring that financial products provide fair returns relative to their costs. This framework has three aims:

Establish cost benchmarks. The European Securities and Markets Authority (ESMA) will develop benchmarks for assessing the cost-effectiveness of financial products. These benchmarks will serve as supervisory tools rather than binding requirements, allowing flexibility for product manufacturers while encouraging competitive pricing.

Enhance product governance. Financial institutions will be required to implement rigorous product governance processes to justify the costs associated with their offerings. This includes ensuring that product pricing aligns with investor expectations regarding performance and risk.

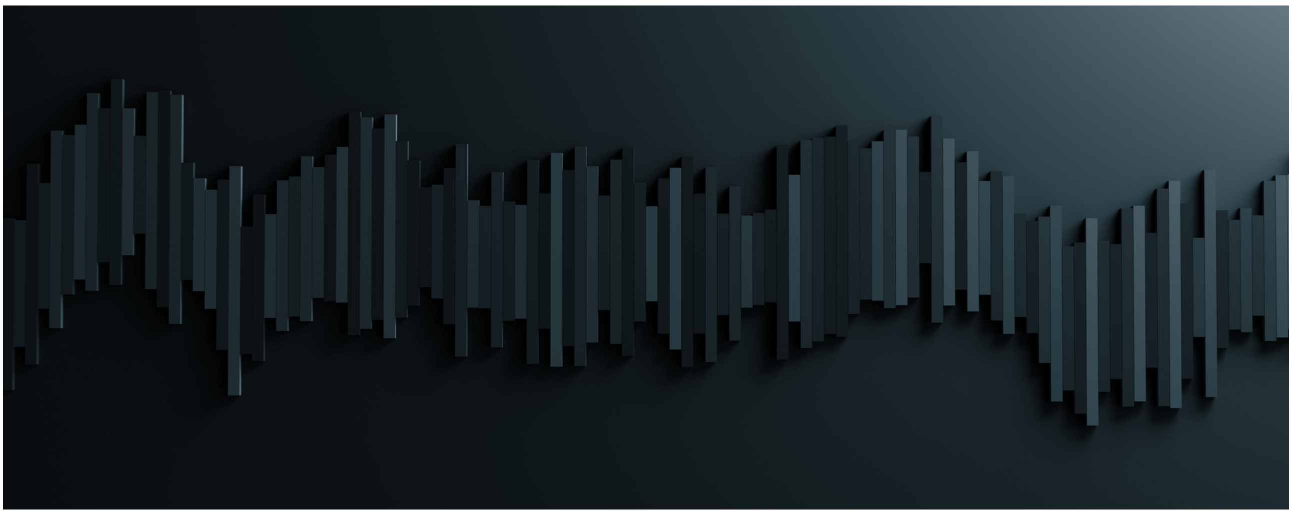
Encourage tailored solutions. The emphasis on VFM may lead to a shift in focus from merely offering the cheapest products to providing those that best meet individual investor needs, balancing cost with quality and enhanced customer service.

Challenges for financial institutions:

- **Impact on existing product offerings** – Product lines will need to be reassessed to ensure they meet the new VFM standards, which may involve redesigning products to justify their costs against performance benchmarks. This may lead to increased operations costs.

- **Challenges in compliance** – Implementing a new VFM framework will require significant changes in internal governance and compliance structures.

- **Concerns regarding market competition** – The focus on VFM may inadvertently lead to a market offering very similar products, reducing competition, as financial institutions may prefer to ensure they are meeting the VFM framework rather than potentially evolving new financial products.



2. POTENTIAL RESTRICTIONS ON INDUCEMENTS

One of the most significant changes proposed under RIS involves restrictions on inducements. Potential impacts include:

Banning retrocessions. The proposal aims to eliminate retrocessions (commissions paid by product manufacturers) for investment services without advice. This could limit conflicts of interest and promote unbiased recommendations from financial advisors.

Increased transparency requirements. Firms will be mandated to disclose any third-party payments related to investment advice, ensuring that investors are fully aware of potential biases in recommendations.

Best interest tests. Financial advisors will need to conduct best-interest assessments for clients receiving non-independent advice, ensuring that recommendations align with client needs rather than simply being based on cost.

Challenges for financial institutions:

- **Impact on existing revenue models** – Restrictions on inducements could significantly affect the revenue streams of clients that rely on commissions from product providers.
- **Challenges in client acquisition** – With potential restrictions on inducements, firms may find it more challenging to attract and retain clients. The cost of providing investment advice could increase, leading to fewer clients being able or willing to pay upfront fees for services.
- **Concerns about conflict of interest** – Whilst the aim is to reduce potential conflicts of interest, clients may struggle with perceptions that advisors are incentivized to recommend certain products over others.

3. BENCHMARKING

RIS includes proposals for a benchmarking exercise, which will involve the following:

Development of performance benchmarks. ESMA and EIOPA (European Insurance and Occupation Pensions Authority) will create benchmarks for comparing costs and performance across various investment products. This will help ensure that retail investors can make informed comparisons when selecting financial products.

Regular updates and public access. These benchmarks will be publicly available and regularly updated, enhancing transparency in the investment landscape and enabling better decision making by retail investors.

Impact on product offerings. Financial institutions will need to align their products with these benchmarks, potentially leading to a re-evaluation of existing offerings and products provided to retail investors.

Challenges for financial institutions:

- **Impact on performance assessment** – The introduction of benchmarking will require clients to rigorously evaluate their product performance against these metrics. This could lead to significant scrutiny as to how their products are performing against competitors.
- **Challenges with implementation** – Clients may face difficulty in adapting their reporting and compliance internal systems to align with the proposed benchmarking requirements. This may include developing processes for ongoing monitoring of products and ensuring these are constantly aligned to the benchmarking proposals.

RIS: LATEST STATUS UPDATE

At the European Fund and Asset Management Association's 2024 Investment Management Forum, which took place in late November, clear concerns were voiced over the Retail Investment Strategy proposal text.[1] Below we capture the perspectives of the key stakeholder groups.

Industry associations viewpoint

In a joint letter to the EU RIS interinstitutional (trilogue) representatives dated November 13 2024, ESMA and EIOPA note that RIS "rightly aims to mobilize capital held by European citizens into investment and pension products offering value for money, and thereby enhance consumers' financial health and contribute to deepening European capital markets".[2]

However, both parties go on to state that "the financial statement attached to the Omnibus Directive significantly underestimated the resource needs of both ESAs [European Supervisory Agencies]". As a result, they argue, there is a clear need and demand for simplification in line with the EU competitiveness agenda, rather than complexity, if the EU wants to increase interest in investment, insurance and pension products within the CMU.

ESMA and EIOPA close their comments with a call to the European Commission and the co-legislators to "duly evaluate the impact these new elements would have in terms of human, operational and consumer testing costs".

Finance sector viewpoint

Following recent discussions and exchanges within the EU finance sector on the impacts of RIS, at the very end of November, representatives of Europe's asset management, insurance and banking industries published a joint statement that underlined the importance of simplifying the regulatory administrative burden created by the draft RIS proposal as currently written.[3]

While these institutions reiterated their support for the goals of RIS, they called for a simplification of the proposed rules for firms and retail investors as well as a streamlining of sales processes, and a reduction of perceived information overload, administrative burden, and related costs.[4]

CONCLUSION

Financial institutions should already be assessing RIS – and the broader implications it might have on their business operations – as part of their long-term strategic roadmap. Whatever its final shape, implementing the Directive will inevitably necessitate significant updates to current regulatory and compliance frameworks, as well as impacting costs, product governance, data and other areas.

Financial institutions, advisors, and regulators will need to collaborate closely to integrate these changes effectively. Maintaining a proactive stance and staying close to the topic will be crucial to effective RIS preparations. Given its wide impact on various existing directives, rigorous planning will allow organizations to remain compliant whilst avoiding the troublesome last-minute dash to the finish line too often associated with major regulatory change. By kickstarting a change program today, firms will have adequate time to plan and implement the necessary transformations to ensure full RIS readiness.

HOW CAPCO CAN HELP

With our 25-year heritage supporting the world's largest financial institutions in navigating regulatory change, Capco is ideally positioned as a trusted advisor who can guide you through the complexities and challenges associated with RIS.

Our expertise in regulation, compliance, and business model transformation, combined with our delivery excellence and a global partnership ecosystem, means we can support you in preparing proactively for RIS compliance while maintaining competitiveness and strategic alignment with the Directive's objectives.

We can provide the necessary support and expertise in project and change management, from building awareness within your organization through to impact assessment, gap analysis and implementation.

Contact us to find out how we can help you create solutions that give you the agility and competitive edge to succeed in today's constantly evolving regulatory landscape.

REFERENCES

1. Efama.eu
2. Esma.europa.eu
3. Statement co-signed by the European Banking Federation, EFAMA, Insurance Europe, AMICE Mutuals, BIPAR, the Conference of EU Bancassureurs CEB, European Association of Co-operative Banks, European Association of Public Banks (EAPB), European Forum of Securities Associations, WSBI-ESBG and the EUSIPA - European Structured Investment Products Association.
4. Efama.org

AUTHORS

Maud Hugele, Managing Principal

Philippe Sidler, Associate Partner

Jeannot Zorn, Principal Consultant

Oliver Christie, Senior Consultant

Furkan Demirci, Consultant

CONTACTS

Philippe Sidler, Partner, Capco Switzerland
philippe.sidler@capco.com

Dr. Christoph Ruth, Executive Director,
Capco Germany, Austria & Slovakia
christoph.ruth@capco.com

Jeroen Dossche, Partner, Capco Belgium
jeroen.dossche@capco.com

Julien Kokocinski, Partner, Capco Euronext
julien.kokocinski@capco.com

ABOUT CAPCO

Capco, a Wipro company, is a global management and technology consultancy specializing in driving transformation in the energy and financial services industries. Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its award-winning Be Yourself At Work culture and diverse talent.

To learn more, visit www.capco.com or follow us on LinkedIn, Instagram, Facebook, and YouTube.

WORLDWIDE OFFICES

APAC
Bengaluru – Electronic City
Bengaluru – Sarjapur Road
Bangkok
Chennai
Gurugram
Hong Kong
Hyderabad
Kuala Lumpur
Mumbai
Pune
Singapore

MIDDLE EAST
Dubai

EUROPE
Berlin
Bratislava
Brussels
Dusseldorf
Edinburgh
Frankfurt
Geneva
Glasgow
London
Milan
Paris
Vienna
Warsaw
Zurich

NORTH AMERICA
Charlotte
Chicago
Dallas
Houston
New York
Orlando
Toronto

SOUTH AMERICA
São Paulo

WWW.CAPCO.COM

CAPCO
a wipro company

JN_6495