“The EU's Retail Investment Strategy - Everything should be made as simple as possible, but not simpler[1]”

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1. Introduction

On 24 May 2023, the European Commission (EC) proposed its Retail Investment Strategy (RIS) with the aim to empower retail investors to make investment decisions that are aligned with their needs and preferences, ensuring that consumers are treated fairly and that they are duly protected[2].

The package proposed by the EC, which is part of the 2020 Capital Markets Union Action Plan, includes:
- A Proposal for an Omnibus Directive as regards the Union retail investor protection rules[3];
- A Proposal for a Regulation amending the PRIIPS Regulation[4].

A wide range of measures is proposed, which should ultimately enhance the trust and confidence of retail investors. Many of these measures, such as increased transparency, protection against misleading marketing, enhancement of the professional qualifications of financial advisors, adaptation of the disclosure rules to the digital age and empowerment of consumers to make better financial decisions, can be applauded.

Of particular importance is the introduction of the concept of Value for Money, on which both EIOPA and ESMA have been working for some time. It is a further development of the concepts of product oversight and governance (POG) which were introduced in the IDD and follows the recognition that some products offer little value for consumers because of the costs and charges related to these products. It must be stressed however, that Value for Money is not just a question of setting the right benchmarks in terms of costs and charges. In insurance, it is also a question of designing the right products, which offer real protection and can help to reduce the ever-growing insurance protection gap.

The package, which includes proposed solutions for real problems, does however include a proposal for a partial ban on inducements[5], which is questionable from a legal point of view, in terms of its conformity with the principles of subsidiarity and proportionality.

The Retail Investment Strategy is a horizontal strategy. It not only covers the sale and marketing of investment products, but it also applies to areas such as non-life insurance and traditional life insurance. Are the EC's proposals which may be justified for investment products, such as PRIIPs and IBIPs, equally necessary or justified for non-life and traditional life insurance products?

Non-life insurance products are not investment products. They should therefore not be dealt with in a strategy, which is called "retail investment strategy". This is not only an oversimplification that does not take into account the business model of insurance, it is also likely to make matters more complex and is unfair towards the customers and distributors of insurance products.

The impact assessment, which is a very interesting document and is clearly the result of a lot of work, focuses heavily on investment products. It hardly touches insurance and it does not explain why it is necessary to extend the new provisions which aim at improving the sale and marketing of investment products to non-life insurance products and to traditional life insurance products and why it is so urgent to amend so many provisions in the Insurance Distribution Directive (IDD)[6] so soon after its entry into force[7]. There is no impact assessment for these changes.

In describing in the Explanatory Memorandum the contents of Article 2 of the Omnibus Proposal, which deals with the amendments of the IDD, the EC states that these *changes apply to all insurance products and not only to IBIPs, which are specifically within the scope of the EU retail investment strategy, in order to avoid fragmentation in the disclosure rules, which apply to all insurance products and IBIPs alike*[8].

Of particular interest is the way in which the Retail Investment Strategy deals with inducements. A number of questions can be raised in this regard:

- Is interference with the way in which financial and insurance intermediaries are remunerated in line with the principles of subsidiarity and proportionality enshrined in Articles 5(3) and 5(4) TEU? Were these principles, introduced by the Treaty of Maastricht, not specifically aimed at preventing the EU from regulating matters which could be better dealt with by Member States, particularly in areas such as financial and insurance intermediation, where the business reality may be very different from Member State to Member State?

- Is it right for the EU to introduce uniform rules in this area when the impact of the rules can be very different, depending on the remuneration model, which differs between Member States and between categories of intermediaries?

- Why should one depart from the minimum harmonization approach adopted in this area by the IDD, which focussed on transparency of the remuneration and did not interfere with the remuneration model itself, a matter which was left for Member States to regulate?

- Does the partial ban on inducements not constitute an unjustified interference with the principles of freedom of establishment and freedom to provide services?

2. Subsidiarity and proportionality

Any legislative action by the EU legislator is subject to the limits on the exercise of competences, enshrined in the Treaty on European Union (TEU).

Article 5 (1) TEU contains **the principle of conferral**, which states that the Union can only act within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States. When the EU is empowered to act following the principle of conferral, it must act with due respect of the principles of subsidiarity and proportionality.

Under **the principle of subsidiarity**, in areas which do not fall within its exclusive competence, the Union can act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level (Article 5 (3) TEU).

Under **the principle of proportionality**, the content and form of Union action may not exceed what is necessary to achieve the objectives of the Treaties (Article 5 (4) TEU).

As part of the Better Regulation agenda, the EC has committed to include in the Explanatory Memorandum that accompanies its legislative proposals a more thorough explanation of how the initiative meets the twin tests of subsidiarity (why the goal cannot be achieved by the Member States alone) and proportionality (why the measure proposed does not go further than what is needed to meet its goal. This is essential to promote accountability[9].

3. Ban on commissions as violation of the principles of subsidiarity and proportionality

The IDD, like its predecessor, the Insurance Mediation Directive (IMD)[10] is a minimum harmonisation Directive. An important reason for the minimum harmonisation approach is, that distribution channels and remuneration regimes differ considerably between Member States.

As stated in recital 2 to the IDD, the form of a Directive was chosen "*because this type of legal instrument is appropriate in order to enable the implementing provisions in the areas covered by the Directive, when necessary, to be adjusted to any existing specificities of the particular market and legal system in each Member State*".

Recital 3 to the IDD adds that "*this Directive is aimed at minimum harmonisation and should therefore not preclude Member States from maintaining or introducing more stringent provisions in order to protect consumers, provided that such provisions are consistent with Union law, including this Directive*".

The difficulty to draw common conclusions concerning insurance distribution markets in the EU, because of the divergences between Member States, is confirmed by the study carried out by EIOPA on the basis of Article 41 (5) IDD on the structure of insurance intermediaries' markets[11].

As far as remuneration models are concerned, EIOPA observes that "*there are significant varieties and most Member States do not monitor remuneration structures and models on a continuous basis. The most common remuneration models are a commission-based model and a fee-based model. The former is the most prevalent one in several Member States.*[12]"

An important objective of the IDD was to increase the transparency towards the customer about the remuneration attached to the sale of an insurance product. This matter is dealt with in Article 19 IDD. Before the conclusion of an insurance contract, the intermediary must provide the customer with information on whether in relation to the insurance contract, it works:

- on the basis of a fee, that is the remuneration paid directly by the customer;
- on the basis of a commission of any kind, that is the remuneration included in the insurance premium;
- on the basis of any other type of remuneration, including an economic benefit of any kind offered or given in connection with the insurance contract; or
- on the basis of a combination of the aforementioned types of remuneration.

Where the fee is payable directly by the consumer, the insurance intermediary must inform the customer of the amount of the fee, or where that is not possible, of the method for calculating the fee (Article 19 (2) IDD). Member States are free to prohibit the acceptance or receipt of fees, commissions or other monetary or non-monetary benefits paid or provided to insurance distributors by any third party, or a person acting on behalf of a third party, in relation to the distribution of insurance products (Article 22(3) IDD). Under the current IDD, Member States are therefore allowed to implement a partial or complete ban on commissions for all types of insurance distributors. This possibility takes account of the differences in approach between Member States.

Because of the need to protect consumers, the IDD prohibits certain commissions, i.e., those that potentially conflict with the insurance distributor's duty to act in accordance with the best interests of its customers. No arrangement by way of remuneration, sales target or otherwise that could provide an incentive to itself or its employees to recommend a particular insurance product to a customer can be made when the insurance distributor could offer a different insurance product which would better meet the customer's needs (Article 17 (3) IDD).

In addition to these provisions, which apply to all insurance products, the IDD stipulates for insurance-based investment products (IBIPs), that a commission or other type of remuneration is prohibited if it has a detrimental impact on the quality of the relevant service to the customer (Article 29(2)(a) IDD) and impairs compliance with the insurance intermediary's or insurance undertaking's duty to act honestly, fairly and professionally in accordance with the best interests of its customers (Article 29(2)(b) IDD).

Here again, **Member States may impose** stricter requirements, including a prohibition or restriction of certain types of remuneration, including commissions (Article 29 (3) IDD).

The IDD does not by itself impose a partial or total ban on commissions, neither for the sale of insurance products in general, nor for the sale of insurance-based investment products.

Article 29(4) IDD empowers the EC to adopt by way of a Delegated Act the criteria that are relevant for assessing whether inducements paid or received by an insurance intermediary or an insurance undertaking have a detrimental impact on the quality of the relevant service to the customer, as well as the criteria for assessing compliance of insurance intermediaries and insurance undertakings paying or receiving inducements, with the obligation to act honestly, fairly and professionally in accordance with the best interests of the customer. This matter is dealt with in Article 8(2) of the Commission Delegated Regulation of 21 September 2017.[13]

The rules on inducements in the IDD provide the basis for the "commission-based" distribution model of insurance products, including insurance-based investment products, whereby insurance intermediaries are remunerated for their services either directly by the policyholders or by the manufacturers of the insurance products. The rules do not, however, exclude a purely "fee-based" model, whereby insurance intermediaries are only paid directly for their services, including advice, by policyholders.

The new proposed Omnibus Directive goes a step further and aligns the provisions on inducements for insurance-based investment products (IBIPs) in the IDD with those existing or proposed for investments under MiFiD[14].

The new Article 29a(1) IDD, which deals with inducements in the case of the sale of insurance-based investment products (IBIPs), introduces a ban on inducements paid from manufacturers to distributors in relation to non-advised sales (execution-only) of insurance-based investment products (IBIPs). The objective is to remove incentives for firms to give more prominence to certain products in their product offering and should ultimately benefit retail investors that invest via execution-only services, as they would avoid any charges due to the payment of inducements.[15]

The new Article 30(5b) IDD introduces a differentiation between advice given on an independent and non-independent basis, in alignment with MiFiD, if insurance intermediaries

want to present their advice as 'independent'. It does so by making the independent basis category compulsory instead of optional for Member States, and by banning the reception or the provision of inducements in relation to advice given on an independent basis. However, such a ban should not prevent insurance intermediaries from offering advice for which they may receive inducements, provided that the advice is not presented as 'independent', that the reception or payment of inducements does not impair compliance with their duty to act honestly, fairly and professionally in accordance with the best interests of their customers and that their customers are informed of the existence, nature and amount of the inducements (new Article 29a (2) IDD).

As with the present IDD, Member States may impose stricter requirements, including a prohibition or restriction of certain types of remuneration, including commissions (new Article 29a (4) IDD).

The partial ban on commissions in the Omnibus Proposal for execution-only sales and non-independent sales of insurance-based investment products is not extended to the sale of insurance products in general.

If one takes into account the importance which inducements (in particular, commissions) play in the distribution of insurance-based investment products[16], one would expect that a departure in this area from the approach followed in the IDD would be extensively justified by the EC, particularly in the light of the principles of subsidiarity and proportionality which the EU legislator must respect based on the principle of conferral enshrined in the TEU.

The justification of the respect of the principles of subsidiarity and proportionality in the Explanatory Memorandum preceding the EC's proposal for an Omnibus Directive is extremely short.

As far as subsidiarity is concerned, the EC indicates that "*only EU action can set a common regulatory framework that ensures the same level of retail investor protection across Member States, independently of the type of investment products or services offered and in full respect of the freedom of establishment and freedom to provide services. In this regard, this proposal, like the Directives it seeks to amend, is in full compliance with the principle of subsidiarity*".[17]

In the Impact Assessment, the EC explains that "*any EU action for completing the internal market has to be appraised in light of the subsidiarity principle set out in Article 5(3) of the Treaty on European Union (TEU). According to the principle of subsidiarity, action at EU level should be taken only when the objectives of the proposed action cannot be achieved sufficiently by Member States alone and thus mandate action at EU level*".

It is then concluded that "*action is required at EU level as the options considered in this impact assessment necessitate the modification of the existing legal framework, consisting of EU Directives and Regulations. Individual initiatives at Member State level are therefore not suitable, insofar as the proposed amendments will be made to EU Directives and Regulations and consequently beyond the scope of the legislative competence of Member States*"[18].

This can hardly be considered a justification of the respect of the principle of subsidiarity. The mere existence of Directives and Regulations at EU level is not enough to justify modifications of these legal instruments for matters that are not yet dealt with at EU level.

Why are common rules needed? Why is there a need for the same level of protection for all investment products and services in all Member States? Why is there a need to introduce throughout the EU the highest possible standard of consumer protection? Can this matter not better be dealt with by individual Member States, taking account of the different remuneration models that exist at national level? Should it not be enough for the EU to adopt basic principles, such as the principle that the reception or payment of inducements by an intermediary should not impair compliance with its duty to act honestly, fairly and professionally in accordance with the best interests of its customers and that its customers must be informed of the existence, nature and amount of inducements paid or received?

As far as proportionality is concerned, the EC states that "*this proposal aims to amend certain provisions of the Directives, in particular those on information provided to retail clients before and after making investment decisions; requirements on the marketing of investment products to retail clients; product oversight and governance; requirements for the provision of advice and other distribution services of investment products to retail clients; professional qualifications; and cross-border supervision. The amendments are*

necessary and proportionate to strengthen retail investor protection, while considering market participants' interests and cost-efficiency."[19]

In its Impact Assessment, the EC explains that "*ensuring a coherent investor protection framework that empowers consumers to take financial decisions and benefit from the internal market can only be achieved at EU level, in close cooperation with Member States*".

It is then concluded that "*as the current retail investor protection framework largely consists of different EU legal instruments, in order to address the problems identified in this impact assessment and to facilitate cross-border retail investor participation in the EU, this framework may only be amended at EU level to update investor protection rules. Acting at the EU level and harmonising the operational requirements of service providers as well as the disclosure requirements imposed reduces the complexity and administrative burdens for stakeholders and promotes financial stability*"[20].

Here again, the justification is extremely weak. In fact, it is more a statement of fact than a justification. There is no explanation why the amendments are necessary to achieve the objectives of the Treaties.

The EC has apparently realised that its proposal – as far as the partial ban on commissions is concerned - is not entirely based on solid grounds. In recital 3 to the Omnibus Proposal it is stated: "*In light of the potential disruptive impact caused by the introduction of a full prohibition of inducements, it is appropriate to have a staged approach and first strengthen the requirements around the payment and receipt of inducements to address the potential conflicts of interest and ensure better protection of retail investors and, at a second stage, to review the effectiveness of the framework, and propose alternative measures in line with Better Regulation rules, including a potential ban on inducements, if appropriate*."

In its estimation of the financial impact of the proposed partial ban on commissions on the industry, the EC refers to the impact of the introduction of the "fee-based" model in the Netherlands and in the UK and extrapolates the impact to the EU 26. Considering the many differences in remuneration regime in Member States, it is doubtful that such an extrapolation is really meaningful. It is unfair to treat different situations as if they were the same.

It would, of course, have been better to introduce and/or clarify the principles concerning conflicts of interests in the existing Directives, leave some scope to Member States for further elaboration of these principles and come back, after a review of the effectiveness of that framework, with alternative measures, if necessary.

This is also the view of the Rapporteur, Stéphanie Yon-Courtin, who opposes the ban on commissions and proposed in her draft report to the Committee on Economic and Monetary Affairs the following redraft of recital 3:

"*It is appropriate to introduce rules that better frame the current advice environment, by ensuring that financial intermediaries provide more transparent, understandable and tailored advice to consumers. This should ensure that consumers are offered products suitable to their needs and should enable them to better understand the advice that they receive. A review, five years after the end of the transposition period of this Directive, should assess the effects of the measures on the advice environment in the Union. That assessment should be based on the potential conflict of interest associated with inducements, the evolution of costs, the overall level of retail investment in capital markets, consumer protection and the relevance of distribution rules."*[21]

4. Impact on freedom of establishment and freedom to provide services

The question can be raised whether the partial ban on inducements interferes with one of the fundamental freedoms in the TFEU, i.e. the freedom of establishment (Article 49 TFEU) and the freedom to provide services (Article 56 TFEU).

The impact assessment accompanying the EC's proposals is fairly general. There is no distinction between the different types of intermediaries, i.e. brokers and agents. There is no examination of the potential impact which a partial ban on inducements might have on these different types of insurance intermediaries and on the business model in which they are implicated.

As indicated by Thomas Jaeger and Corinna Potocnik-Manzouri[22], a partial ban on inducements might make it less attractive for insurance undertakings to engage in the cross-border sale of insurance products through freedom of establishment. In the exercise of freedom of establishment, for instance through the creation of a branch, insurance undertakings often make use of independent brokers. As it is likely that a partial ban on inducements will lead to a reduction in the number of brokers, insurance undertakings will find it harder to rely on this form of distribution.

If it is more difficult to enter a foreign market – as the number of brokers diminishes – it is also economically less attractive for an insurance undertaking to set up an establishment abroad as the fixed costs of such an establishment would increase in the absence of the possibility to use independent brokers in that foreign market. It is therefore more difficult for the insurance undertaking to compete with insurance undertakings in the foreign market. As a result, insurance undertakings would not exercise their freedom of establishment as this would not be economically viable. A partial ban on inducements can therefore have a negative impact on freedom of establishment. In the same way, a partial ban on inducements will also make freedom to provide cross-border services more difficult. For reasons of cost efficiency, insurance undertakings will often use the services of independent brokers in a foreign market. The reduction in the number of brokers will make it more difficult for an insurance undertaking to exercise the freedom to provide services. Without recourse to insurance brokers, undertakings will face higher costs that will make it difficult for them to compete with other insurance undertakings in a foreign market. A partial ban on inducements can therefore also have a negative impact on freedom of services[23].

5. Concluding remarks

The proposals in the RIS concerning the nature of the remuneration of financial intermediaries, i.e. partial ban on commissions are difficult to justify in the context of the distribution of competences between the EU and Member States and the requirement for the EU to respect the principles of subsidiarity and proportionality.

It is unfair towards the financial intermediaries concerned to introduce new requirements that go beyond transparency and interfere directly in a remuneration regime that is not common for all Member States. The least thing that one could have expected would have been a thorough analysis of the situation in each Member States with an assessment of the possible impact of the new requirements for each category of intermediary.

The proposals in the RIS show the disadvantage of a horizontal legislative approach which – by giving the same treatment to situations that are really different - looks at the financial sector in the EU as if it were the same, i.e. without giving proper recognition to existing differences in Member States, in types of financial operators and in business models. It might result in a uniform treatment of different realities, which is not what the EU deserves.

To say it with Einstein: "*Everything should be made as simple as possible, but not simpler!*."

[1] Albert Einstein (1950)

[2] European Commission, Press Release "Retail Investment Strategy", 24 May 2023.

[3] European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules, *COM (2023) 279 final*, 24 .5.2023.

[4] European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1286/2014 as regards the modernisation of the key information document, *COM (2023) 278 final*, 24.5.2023.

[5] Also included in the EC's proposal is a possibility for the EC to benchmark certain products, including insurance products, which is contrary to the principle included in Article 181 (1) Solvency II FD for non-life products and in Article 182 (1) Solvency II FD for life products and which prohibits Member States from intervening in he design and the price-setting of insurance products. See, Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) (recast), *OJ* L 335, 17.12.2009, p. 1.

[6] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast), *OJ* L 26, 2.2.2016, p. 19.

[7] Although the IDD was adopted in 2016, the implementation deadline was extended to 1 October 2018 because the implementing measures were adopted late. It can therefore hardly be said that there is much practical experience with the changes introduced by the IDD, particularly in the areas of product oversight and governance.
[8] European Commission, Explanatory Memorandum to the Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules, *COM (2023) 279 final*, 24 .5.2023, p. 13.

[9] European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Better Regulation for better results – An EU Agenda, *COM (2015) 2015 final*, 19.5.2015, p. 5. See also, Commission Staff Working Document, Better Regulation Guidelines, *SWD (2021) 305 final*, 3.11.2021, p. 38.

[10] Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation, *OJ* L 9, 15.1.2003, p. 3.

[11] EIOPA, Insurance Distribution Directive – Evaluation of the structure of insurance intermediaries' markets in Europe, *Publications Office of the European Union*, Luxembourg, 2018, 54 p.

[12] EIOPA, Insurance Distribution Directive*, o.c.,* p. 9.

[13] Commission Delegated Regulation (EU) 2017/2359 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to information requirements and conduct of business rules applicable to the distribution of insurance-based investment products, *OJ* L 2017, 20.12.2017, p. 8.

[14] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, *OJ* L 173, 12.6.2014, 349.

[15] European Commission, Explanatory Memorandum to the Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules, *COM (2023) 279 final*, 24 .5.2023, p. 9.

[16] The EC recognises in its Impact Assessment that accompanies its Omnibus proposal that the "fee-based" model has had limited uptake in the retail segment and that the "commission-based" model is currently predominant for the distribution of retail investment products, including insurance-based investment products in the EU. See, European Commission, Commission Staff working document – Impact assessment report accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules and Regulation (EU) No 1286/2014 as regards the modernisation of the key information document, SWD (2023) 278 final, 24.5.2023, p. 17.

[17] European Commission, Explanatory Memorandum, l.c., p. 5.

[18] European Commission, Commission Staff working document – Impact assessment report accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules and Regulation (EU) No 1286/2014 as regards the modernisation of the key information document, SWD (2023) 278 final, 24.5.2023, p. 16.

[19] European Commission, Explanatory Memorandum, l.c., p. 5.

[20] European Commission, Commission Staff working document – Impact assessment report accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules and Regulation (EU) No 1286/2014 as regards the modernisation of the key information document, SWD (2023) 278 final, 24.5.2023, p. 16.

[21] European Parliament, Draft Report on the proposal for a directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules, 2023/0167 (COD), 2.10.2023, p. 6.

[22] JAEGER, Th. and POTOCNIK-MANZOURI, C., Bans on Commission for Insurance Brokers in the EU Internal Market, Jan Sramek Verlag, Vienna, 2022, p. 43.

[23] JAEGER, Th. and POTOCNIK-MANZOURI, *o.c.*, p. 53.