

***How will the incentives for financial advisors change with the Retail
Investment Strategy (RIS)? (*)***

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In the framework of the Retail Investment Strategy (RIS), the European Parliament is currently working on an omnibus directive amending the MiFID system and extending it to insurance distribution. The [compromise](#), set out in Stéphanie Yon-Courtin's report of 10 January 2024, will be voted on in the Economic and Monetary Affairs Committee on 20 March, for possible ratification at the plenary session of European Parliament on 22 April. The paper rejects the two most controversial measures of RIS: the total commission ban and the publication of *Benchmarks* by ESMA and EIOPA based on the costs and returns of financial products. This follows claims by EFPA and other representatives of financial intermediaries that warned of the undesirable effects of these measures, including the reduction of choice for retail investors and the *advice gap* they could cause.

The paper also removes the commission ban in the reception and transmission of orders (RTO). It is true that, as EFPA stated in its submissions, in the absence of the added value of advice, it would not be justified to allow commissions in mere reception and transmission of orders. At the same time, however, it must be recognized that the assessment of suitability in non-advised sales has a cost that must be compensated. In addition, a clearer distinction should be made beforehand between sales and advice, and we should stop talking about "advised sales". No one can serve two masters. Indeed, the rapporteur acknowledges in her amendment that "in the absence of a clear and precise definition of RTO, the actual scope of the prohibition remains unclear".

At the same time, the paper maintains the reinforcement of transparency on risks and costs and the prevention of conflicts of interest. We will now explain what the incentive regime will look like.

The reform maintains the differentiation between independent and non-independent advice and the prohibition of accepting inducements from independents, excluding minor

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non-monetary benefits that may improve the quality of the service and do not undermine the duty to act in the best interest of the client, admitting that those of less than 100 euros fulfill this requirement. Before offering the service, the client must be informed of the independent nature of the advice and whether or not the range of financial instruments recommended is limited to well-diversified, non-complex, and profitable financial instruments. For advice limited to these instruments, it is permitted to simplify the suitability test by excluding from the assessment the client's knowledge and experience as well as the composition of his portfolio.

The main novelty of the reform is the so-called "best interest test", which replaces the "quality improvement" test of MiFID II and the "no impairment" test of the Insurance Distribution Directive (IDD). This measure aims to bring consistency to regulation and ensure harmonized application to develop the Capital Markets Union.

In Spain, according to the CNMV's current criteria, to pass the *quality enhancement test* and make way for inducements in non-independent advice, one of the following three requirements must be met: 1) Enhance the quality of service by providing advice on a wide range of financial instruments with an appropriate number of instruments that lack close links to the distributor; 2) Conduct an ongoing assessment of suitability; or 3) Provide access to a wide range of financial instruments, together with a tool that brings added value to the investor such as information tools that help the client to make investment decisions or empower the client to monitor them. To determine the appropriate number of instruments without close links to the distributor, the CNMV requires at least two alternatives to be offered in each category of funds marketed and representing at least 25% of the total products offered. This is a peculiar non-harmonized system.

Under the new regime, everything hinges on the duty to act in the best interests of the client which applies to both independent and non-independent advice. To pass the best interest test advisors "must not put financial or other interests" ahead of the client's interest and must assess "an appropriate range of financial instruments suitable for the client's needs". In addition, among the appropriate instruments, they must recommend the most cost-effective ones based on the "expected net return" of the instrument, considering all costs and expenses, both implicit and explicit. In addition, the duty to inform the client is reinforced in the permitted incentives, adding their cost and impact on profitability.

The compromise has removed an additional requirement that was difficult to understand, according to which advisors had to offer "a product or products without additional features which are not necessary for the achievement of the client's investment objectives and which give rise to additional costs", originally intended to provide retail investors with possibly cheaper alternative options.

Under the new system, it is for ESMA to formulate the standards against which the assessment should be conducted for approval by the European Commission in the form of RTS. These standards will include the criteria for the assessment of an appropriate range of financial instruments, and how these criteria are to be met where advice is provided on a non-independent basis and only financial instruments manufactured within the group of the investment firm providing advice are assessed. It is also for ESMA to clarify what is meant by "performance expectations" and where "past performance or simulated future performance" may be used in the assessment.

The new rule makes it clear that where none of the instruments offered is in the client's best interest, the advisor "shall refrain from making any advice or recommendation".

This "best interest" test also applies to insurance-based investment products, replacing the existing "no impairment" test of the IDD. In this case, it is up to EIOPA to formulate the standards. This brings consistency to the incentive regime by applying the new "best interest" test to both MiFID instruments and insurance-based investment products. The aim is to improve the quality of advice without sectoral differences. Until now, the debate on the prohibition of inducements has overshadowed what is important: that the client is aware of the nature and quality of the service received. According to the Kantar Report on which the reform was based, clients do not understand the concept of "inducement". What they want to know is the service they receive and its cost.

Given the novelty and scope of the reform of the inducement's regime, it is expected that five years after the deadline for the transposition of the Omnibus Directive, the European Commission will assess its impact and may revert to the initial idea of a total ban on inducements.