BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Ref: European Commission Consultation on the review of suitability and appropriateness assessment
Date: 21 March 2022
Link: https://ec.europa.eu/info/consultations/finance-2022-suitability-appropriateness-assessments_en

EXECUTIVE SUMMARY

(for BETTER FINANCE readers' benefit, not in the draft replies to the public consultation below)

Explanation	The European Commission proposes to replace the current *suitability-appropriateness* duality in the MiFID II and insurance distribution Directives with a new, unique, and standardised suitability regime for all categories of retail investment products, including "IBIPs" (insurance-based investment products). From what we understand, the structure of this regime will be: • An initial questionnaire will determine the investor profile of the client; • on the basis of the investor profile, a *personalised asset allocation strategy* (PAAS) would be determined, acting as a general framework or guidelines of investment to reach the investor's objectives; • within the confines of the PAAS, a *personal investment plan* – which would be the actual investment recommendation into specific products – would be made. (*this is BETTER FINANCE's understanding of the proposed framework*).
General comments	BETTER FINANCE welcomes the initiative of the European Commission to harmonise and improve the consumer journey towards investing. BETTER FINANCE previously voiced its concerns regarding the detrimental effects of the suitability-appropriateness test duality, pointing to the fact that the *appropriateness* regime brings little added value for retail investor protection. We regret that - although representatives of consumers and individual investors are mentioned as a primary target of this public consultation - this consultation is published only in English - the native language of only one Member State - and in technical terms that are not intelligible for most "retail" investors. In addition, the time to reply is very short (one month). We strongly recommend to merge the two proposed documents (the *personal asset allocation strategy or* PAAS and the *personal investment plan*) to simplify this process for Eu citizens as savers and to make it more intelligible to them.
Limits for intermediaries in determining or assessing the suitability assessment	BETTER FINANCE sees this regime delivering optimal outcomes for consumers if: • the questionnaire and *personal asset allocation strategy* (PAAS) should be drawn up and modified by independent professionals (such as the Certified Financial Planners in the US); • the *personal investment plan* can be proposed, complemented, or modified by any distributor of financial products, except under the execution-only regime; • providers of execution-only services should be allowed to provide a wider palette of instruments (not only "*simple products" in the sense of the MiFID Directive, which does not apply to the vast majority of retail investment products anyway)*) if those fit in the client's PAAS.
Model suitability questionnaire and standardised investor profiles	BETTER FINANCE sees benefits in harmonising the suitability questionnaire and providing standard investor profiles, under certain conditions: first, to adequately define and differentiate the risk-return trade-off, which proved inadequate for long-term investment products; second, the rules behind the standardised asset allocation and the investor profiles must allow the **independent** advisor to accommodate for a wider variety of risk profiles, investment horizons, and objectives. BETTER FINANCE described a methodology proposal on which harmonisation can build on (based on research done by independent experts), but we highlight that sustainability preferences must be taken into account and the European Commission should establish a working group made of consumer representatives and independent academics to develop this methodology fully.

Portability	BETTER FINANCE sees the machine-readability format of the suitability assessment and its portability as key elements to the added value of the regime. However, only consumers should be allowed to transfer the data from one intermediary to another. For clarity and transparency (both for consumers and supervisors), the suitability assessment should be stored in a blockchain-like structure, allowing easy identification and storage of new records.
Elements for the personalised asset allocation strategy (PAAS)	The *personalised asset allocation strategy* (PAAS) should focus on the following elements: • Rules on identifying strategic asset allocation – including the baseline allocation of portfolio assets to asset classes • Time horizon • Return objectives: long-term **real net** returns per year • Constraints: liquidity – expected investor outlays, etc. • Unique investor circumstances, e.g. ethical or environmental preferences
Elements for the personal investment plan	The *personal investment plan* should comprise the following elements: • A description of the investor and its investment objectives • Investment constraints • Technical guidelines specifying technical aspects on how the investment should be carried out; • ESG factors; • Rebalancing – policies on rebalancing asset class weights
Costs and conflicts of interests	This initiative will not solve by itself the current detriment suffered by too many EU citizens as retail investors and pension savers without ensuring: • bias-free advice (one of the four key objectives of the EC's EU Strategy for Retail Investors, • or, at the very least, harmonizing EU rules on "value for money" for all retail investment products and the enforcement of the existing EU rules (such as ensuring "no undue costs" are charged, and cost comparisons with equivalent financial instruments). In a costless environment, asset allocation is indeed the main driver of investment performance over a given time horizon. However, asset allocation per se does not ensure positive outcomes for retail investors, as independent research repeatedly demonstrates that the main drivers for the performance of **retail** investments are: • the level of overall charges, • and the selection bias by commission-based intermediaries. These factors too often lead to the recommendation of high risk / low (or negative) return investments, even when the allocation of underlying capital market assets is adequate. The cost factor - however crucial for the adequacy of retail investments - is a big absentee of this consultation.

Contact:
Guillaume Prache, Managing Director, prache@betterfinance.eu
Stefan Voicu, Research & Policy Officer, voicu@betterfinance.eu

About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and *retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.*

Contents

INTRODUCTORY EXPLANATIONS (for non-professional readers)

European Union (EU) authorities aim to improve the conditions of saving and investing in capital markets for EU households through several regulatory and supervisory actions. Currently, many of these initiatives stem from the recommendations of the High-Level Forum on the Future of the Capital Markets Union.[1] The European Commission (EC) will follow-up with the *EU Strategy for Retail Investors*,[2] planned for the second half of 2022. This strategy aims to provide individual investors with adequate protection, bias-free advice, and transparent, comparable and understandable product information.

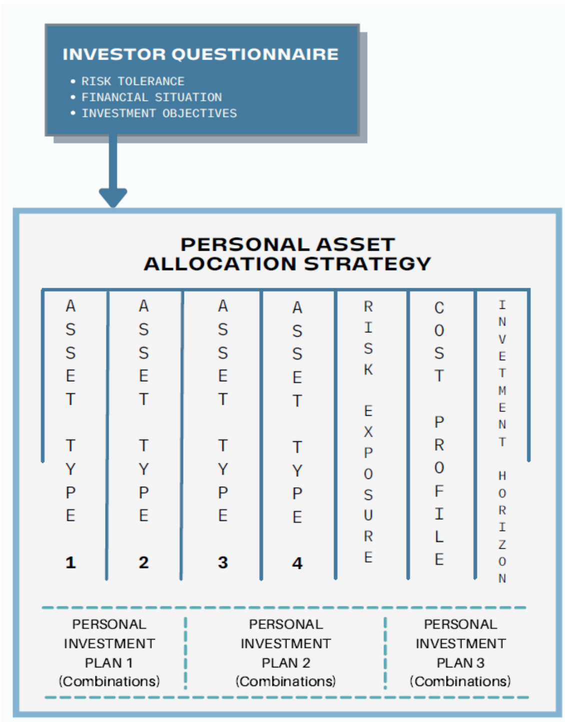
In preparation of its proposals, the EC is exploring different avenues to improve the consumer journey towards investing. One of the proposals is to unify the suitability and appropriateness regulatory frameworks into a single regime for all retail investment products that provides better support on achieving investment objectives and enhances participation in capital markets.

> **The *suitability assessment* is a legal obligation of financial "advisors" (mostly sellers) to evaluate which financial instruments and services would be aligned (*suitable*) with the prospective client; similarly, the *appropriateness assessment* applies for "non-advised" services, but it holds a lower standard of protection compared to the *suitability* rules.**

In short, the EC proposes to require finance professionals advising or selling financial instruments (such as shares, bonds, life insurances, mutual funds etc) to develop a *personalised asset allocation strategy* (PAAS) based on a standardised questionnaire about the client's investment objectives, risk tolerance, and personal constraints. Based on the personal asset allocation strategy, the actual financial recommendation would be a *personal investment plan*.

How we understand the interplay between the three concepts (questionnaire – personal asset allocation strategy – personal investment plan) is as follows:

Graphical representation of how we understand the EC's proposal; BETTER FINANCE, 2022



The questionnaire is used to identify the investor profile (risk tolerance, objectives, financial situation etc). On the basis of the investor profile, the personal asset allocation plan provides a general framework (the limits, such as minimum and maximum) within which a concrete, on point investment recommendation (the personal investment plan) can be recommended.

***Note**: It is unclear, from the explanations provided in the public consultation, for which services this regime would apply (only advised services or not).*

The EC proposes that the result of the new *suitability assessment* would be recorded in a machine-readable format and could be transferred/passported by clients to other, subsequent financial services providers.

[1] Final Report of the High-Level Forum on the Future of the Capital Markets Union (10 May 2020) available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf.

[2] European Commission's announced EU Strategy for Retail Investors, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12755-Retail-Investment-Strategy/public-consultation_en.

From what the BETTER FINANCE team gathers, the *transferability* of the new suitability assessment is built on the example of the portability of historical records of medical examinations, meaning that one health professional can read what the previous diagnosed and recommended.

The EC did not provide ample details on this new suitability regime, nor on the *personalised asset allocation strategy* (PAAS), but is seeking opinions from stakeholders on this proposal and recommendations on how to fine-tune it.

An enhanced client assessment regime – general

Question 1. Do you consider that a unique and standardised retail investors' assessment regime, as described above, applicable to all investment services and enhanced with the provision of a personal asset allocation strategy, could address the weaknesses of the current suitability and appropriateness regimes?

☐ **Yes**

☒ **No**

☐ **Don't know / no opinion / not applicable**

Please provide a detailed answer to your question 1:

We agree with the proposed approach of the European Commission for a unique suitability assessment regime only under certain conditions, detailed below. To begin with, BETTER FINANCE believes that the appropriateness test is not fit for purpose and falls short of delivering an adequate standard of investor protection. The current provisions are a middle ground between the suitability assessment and the *simple product thresholds* (for execution-only services) – both in MiFID II and IDD - creating a regulatory and bureaucratic burden with limited effects for non-professional investors.

To ensure that clients are recommended or sold investment products that match their investor profile, the information requirements under the appropriateness regime are insufficient as these concern only the knowledge and experience of the client concerning the respective product. Thus, in our view, an assessment based only on such information will fall short of preventing mis-selling of financial products.

However, we disagree with the European Commission's assessment that the current approach under the *suitability* and *appropriateness* regimes is product focused, meaning that the advisor or seller must consider only one instrument as part of the process. The reading of the applicable frameworks does not oblige the intermediary to consider **just one** financial instrument, but in fact an investment recommendation, concerning one or more financial instruments, that must be aligned with the client's situation globally. BETTER FINANCE is stressing this point so that, in case the current proposal will not be taken on board, the European Commission provides the necessary guidance under the applicable sectoral legislation so there will no longer be a confusion with regarding the suitability obligations of intermediaries.

An element of considerable added value in the European Commission's proposal is the aspect of machine-readability and portability. Recording the recommendation, and subsequent alterations or modifications, will enable better supervision of the distribution process and private enforcement of consumer rights. At the same time, BETTER FINANCE assumes that the idea behind these two elements builds on the example of historical medical records, where health care professionals can evaluate a patient based on the previous diagnosis prescribed. As such, BETTER FINANCE agrees with the proposal and its justification, with the sole exception of integrating in in the *open finance* proposal. In this sense, BETTER FINANCE draws the attention that the suitability assessments should remain the sole propriety of the client and should not be shared, or subject to processing, with any other intermediary except those intermediaries which the client expressly chooses to.

BETTER FINANCE highlighted the importance of this *free choice* in other contexts as well: given that financial services are becoming a necessity (so that there is no longer a demand-offer trade-off), their socio-economic role mandates further limitations regarding data processing. For example, if sharing the data is subject to becoming a client of the financial services provider (given the standardisation of contracts), the client's choice (to agree or not) is no longer free, but coerced.

Regarding the potential benefits of this approach, we believe that it will improve both the consumer journey and the investor protection regime, provided the crucial caveat mentioned in "General comment" is taken into account.

Concerning the investor protection regime, a simplified and standardised (across the various categories of retail investment products) suitability assessment will eliminate the arbitrary in the distribution process and significantly reduce mis-selling. It would also help both the consumer and distributors better understand what portfolio, are suitable given that the *personalised asset allocation strategy* would provide the general limits and investment universe from which concrete investment plans can be built. Moreover, it would enable national and EU authorities to better supervise these processes (also due to the recording in a machine-readable medium) and individual investors to enforce their rights.

Regarding the consumer journey, it would first make it easier to compare the recommendation and evaluate "value for money" (see the EIOPA's framework for value for money for unit-linked insurance for example – see the EIOPA Consultation on value for money in the unit-linked insurance market here https://www.eiopa.europa.eu/content/eiopa-sets-out-framework-delivering-better-value-money-consumer-centric-way_en). This latter aspect is key to ensure better outcomes for non-professional clients.

Second, a standardised and unique suitability regime would provide more clarity for distributors and, thus, diversify the offering of financial instruments. Evidence from BETTER FINANCE members underlines the refusal of many distributors to grant access to "retail" clients to simple products due to "MiFID II requirements", for instance. Lastly, the portability of the suitability assessment will make it easier for clients to both monitor their investment strategy and to switch providers in a manner that remains consistent with their investor profile.

Also, we strongly recommend to merge the two proposed documents (the *personal asset allocation strategy or* PAAS and the *personal investment plan*) to simplify this process for Eu citizens as savers and to make it more intelligible to them.

Question 2. Do you think a new retail client assessment (enhanced with a personalised asset allocation strategy) and its transferability could bring benefits and opportunities to retail investors and financial intermediaries?

☐ **Yes, it could bring them benefits and opportunities**
☒ **No, it would not bring them any specific benefit**
☐ **Don't know / no opinion / not applicable**

Please explain your answers to question 2:

BETTER FINANCE would agree with the proposal only if cost and selection bias factors are addressed. BETTER FINANCE included its explanation in its answers to Q1 above, and mostly to

Q18 below..

Question 3. Should retail investors be able to transfer the results of their assessment together with their personalised asset allocation strategy to brokers/financial intermediaries of their choosing in order to facilitate switching between or using multiple brokers/financial intermediaries and generally enhance the investor experience?

☐ **Yes**
☒ **No**
☐ **Don't know / no opinion / not applicable**
Please explain your answer to question 3:

As explained in the answer to Q1 above, the portability of the suitability assessment is one of the key elements in providing better outcomes for consumers and preventing mis-selling. However, we highlight the same concerns about data processing: the intermediaries should not be allowed to process the data of the consumer, but instead report it to supervisory authorities (for supervisory purposes) and not transfer it to other financial services providers. It should be the express choice of the consumer to transfer the data from one provider to another.

Question 4. Would you see any drawbacks that could emerge from the creation and use of such a new suitability assessment applicable to all investment services (including its sharing/portability if any) for retail investors and financial intermediaries?

☒ **Yes**
☐ **No**
☐ **Don't know / no opinion / not applicable**
Please provide an explanation to question 4:

Yes, BETTER FINANCE highlighted in the answer to Question 1 above certain significant drawbacks of this proposal. If not designed properly, most importantly to take cost - the number one retail investment performance factor – and to ensure the elimination of bias and conflicts of interests, the new suitability regime would backfire both against retail investors and the CMU. In addition, we reiterate the drawbacks highlighted in the general comment (Q18) and in the response to Question 1 ("no undue costs" (current UCITS and AIFMD rules) and selection bias (conflicts of interest) factors, access to data – open finance part).

Question 5. Who should prepare the clients' assessment and their asset allocation strategy?

☐ **Any financial intermediary selected by the retail investor**
☐ **Any independent function within the financial intermediary selected by the retail investor**
☒ **Any independent financial intermediary selected by the retail investor**
☐ **Other (e.g. public entity)**
Please explain your answer to question 5:

As highlighted in the general comment and in the response to Q1, the different parts of the suitability regime should have bespoke rules in terms of the intermediaries that can create or modify it. In our view, the questionnaire and the personalised asset allocation strategy (PAAS) should only be created by an independent investment advisor (the initial intermediary) and then be modified or altered, based on changes in the investor profile of the client or other reasonable considerations, by the same type of intermediary, i.e. an independent advisor.

Given the importance of the questionnaire and the PAAS in guiding the actual investment plan of the client, we believe there is no room for conflicts of interests and biased assessments, thus EU law should prohibit non-independent advisors or sellers (non-advised services) from undertaking such assessments.

The same, and even more crucial – applies to the initial implementing proposal of the PAAS – meaning, the *personal investment plan*. Assuming that – save where errors are committed – the PAAS loyally reflects the investor profile of the client, the choice of instruments or assets to implement the PAAS could be provided by non-independent distributors as well, case in which the risk of mis-selling would be significantly reduced. Independent evidence shows that the selection of specific products with the same asset allocation as a huge impact on outcomes. For example, in the French unit-linked insurance markets (two thirds of the French retail fund market), almost no clean share class or ETF funds are offered, and when ETFs are, they cost more than double the market average.

For personal pensions, the annual cost can vary from 1% (the "basic" PEPP cap) to more than 3%. The outcome will be dramatically different, as - other things being equal – a 2% per annum cost increase cuts your pension savings in half after 35 years. For long term retail products, COST MATTERS EVEN MORE THAN ASSET ALLOCATION.

BETTER FINANCE also sees room for implementing principles of digital innovation in this process given the portability and machine-readability features proposed by the European Commission. In particular, BETTER FINANCE sees similarities with the blockchain process for the suitability regime. Our proposal is based on the following example: assume an inactive EU saver decides to invest and asks the advice of an independent advisor.

The latter determined the investor profile, draws the PAAS and makes (or not, if applicable) a concrete investment recommendation (personal investment plan) that is stored in a machine-readable manner and can be passported by the client to other intermediaries. This creates a ledger-like chain, where the first independent advisor creates an initial record, and all subsequent intermediaries can complement or alter it. This system could enable subsequent intermediaries assess the previous investments of the client and also would allow the client to monitor its investment strategy and path towards achieving the investment objectives. Last, it would bring a significant amount of clarity and transparency in the distribution process of each individual investor.

Question 6. What should be the key components of a standardised personal investment plan?

☒ A description of the investor

☐ A description of duties and responsibilities of the investment adviser drawing up the personal investment plan, custody arrangements and the duties of the client to signal changes in her personal circumstances

☐ Procedures and reviews that are necessary to keep the IPS topical and up-to-date

☒ Investment objectives

☒ **Investment constraints**

☒ **Technical guidelines specifying technical aspects on how the investment should be carried out, such as permissible use of leverage or derivatives; exclusion of specific types of assets from investment, if any**

☒ **ESG factors, such as specific types of assets to be excluded from investments**

☐ **Evaluation and review**

☒ **Rules on identifying strategic asset allocation – including the baseline allocation of portfolio assets to asset classes**

☒ **Rebalancing – policies on rebalancing asset class weights**

Please explain your answers to question 6:

To begin with, BETTER FINANCE is confused with the two new concepts that occur the first time in question 6: the *standardised* personal investment plan and the ***IPS***, which we don't know what it stands for. As mentioned many times, if such public consultations are really aimed at representatives of "retail" investors, they should be written in plain language, which means also not only in English.

If the European Commission considers standardising the personal investment plan (that we support), then we see redundancies with the personal asset allocation strategy; it would also create bureaucratic burdens and increase the costs for retail clients.

From the way question 6 is framed, it seems that the investment plan would – like the PAAS - also be more general and principle-based, with no concrete investment recommendations; therefore, we believe that the elements chosen above should be part of the PAAS.

BETTER FINANCE considers that a few of the elements identified in Question 6 are administrative or procedural information that concern only those intermediaries that can access the personalised plan and are not relevant for the client and subsequent intermediaries. For example, the evaluation and review of the personalised plan can be described in the regulatory framework, which can be accessed by any person, and not be included in the plan per se, for reasons of simplicity and conciseness.

Therefore, BETTER FINANCE chose all other elements provided in the list as being relevant, i.e. those that amount to an actual investment recommendation.

Question 7. What are the main investment objectives and constraints that should be addressed in a personal investment plan?

☒ **Return objectives: Long-term investment return per year, in nominal terms, net of fees**

☒ **Constraints: Liquidity – expected investor outlays, etc.**

☒ **Time horizon**

☒ **Tax situation**

☐ **Legal and regulatory factors, if any**

☒ **Unique investor circumstances, e.g. ethical or environmental preferences**

Please explain your answer to question 7:

The only comment we wish to provide here is for the first element, i.e. that long-term investment returns should be in **real** terms, net of fees and inflation, instead of exploiting the cognitive bias known as "monetary illusion" by providing only "nominal" long term returns which are largely fictitious.

Question 8. Storage and accessibility of the new suitability assessment, including the asset allocation strategy.
Do you agree with the following statement?

All data in the suitability assessment and the personalised asset allocation strategy (the personal investment plan) should be stored electronically and, subject to the client's consent, the investment plan personal should be accessible to all financial intermediaries that the client employs ("open finance").

☒ Yes
☐ No
☐ Don't know / no opinion / not applicable

Please explain your answer to question 8:

See answer to Questions 1 and 4.

Question 9. How often should the client's assessment and asset allocation strategy be updated?

A personal investment plan should be reviewed regularly in order to ensure that it remains consistent with the client's investment objectives and constraints. A personal investment plan should also be reviewed as soon as a financial intermediary becomes aware of a material change in the client's circumstances. A client may request an update of her personal investment plan when her objectives, time horizon, personal circumstances of liquidity needs change.

Question 9.1 When the investor is NOT under advice:

☒ a. once per year
☒ b. upon significant changes in the retail investor's personal circumstances or objectives, communicated by the investor to its financial intermediary
☐ c. upon suggestion of the financial intermediary selected by the investor, subject to providing the investor with any necessary written justification evidencing the need for an update, and subject to the investor's agreement + duly stored
☐ d. other

Please explain your answer to question 9.1

BETTER FINANCE believes that, by default, the personal investment plan should be assessed regularly in light of the performance of the instruments/portfolio recommended, to ensure that it is still on track to reaching the objectives. As such, the personal investment plan should have ranges or performance indica and every 2 years for the PAAS.

Question 9.2. When the investor is under advice/portfolio management:

☐ a. once per year
☒ b. upon significant changes in the retail investor's personal circumstances or objectives, communicated by the investor to its financial intermediary
☐ c. at the initiative of the financial intermediary providing the advice and subject to written justifications evidencing the improvement, communicated to the investor and duly stored
☐ d. other

Please explain your answer to question 9.2:

The PAAS (personalised asset allocation strategy) should be updated as many times as the client considers necessary – either due to changes in its personal circumstances (the type of changes that would determine a different assessment of the questionnaire) or if the client changes the intermediary, depending on the case.

Question 10. Please provide us with an estimate of the necessary costs to set-up and update this possible new client assessment (including the personalised asset allocation strategy) in a structured and machine-readable format as well as for its storage in a way accessible for future reference by the retail investor and competent authorities:

Not applicable for BETTER FINANCE.

Question 11. Please provide us with a cost comparison between the costs associated to this possible new client assessment regime (including the personalised asset allocation strategy) in and your current costs associated to compliance with the current suitability and appropriateness regimes?

Not applicable for BETTER FINANCE.

Question 12. Do you consider that the new client assessment regime would allow material cost savings for financial intermediaries taking into account the standardised and single nature of the possible assessment regime, once the initial sunk costs are absorbed?

☒ Yes
☐ No
☐ Don’t know / no opinion / not applicable

Please explain your answer to question 12:

Due to the standardisation and streamlining of both the product oversight and governance process and the suitability assessment, BETTER FINANCE believes it would lead to cost efficiency gains. In addition, the initial financial health check at least should be partially funded by Public Authorities, like the physical health checks.

A personalised asset allocation strategy

Question 13. Should the rules on personalised asset allocation strategy foresee standardised investor profiles based on retail investors' personal constraints, risk/return appetite and objectives?

☒ Yes
☐ No
☐ Don’t know / no opinion / not applicable

With a caveat on what is really meant behind the “risk/return terminology. Too often “risk/return” is used as if there is always a trade-off between the two. There is not. Example: money market funds are rated very low risk (and they are low cost usually) in the current EU legal framework. However, they are a very high risk investment option in pension products as both the probability and magnitude of the risk of losing a lot of money in real terms over the pension product's time horizon are extremely high. This risk/return trade-off approach is therefore very inadequate for long term and pension products.

Also, high risk long term retail investment products can be also low return ones such as French unit-linked insurance over the last 20 years as independent research shows (see BETTER FINANCE 2021 edition of the report on *Long-Term and Pension Savings*: https://betterfinance.eu/wp-content/uploads/The-Real-Return-Long-Term-Pension-Savings-Report-2021-Edition.pdf).

Standardisation can be, in many instances, beneficial as it reduces the reliance on the intermediary's competencies, alleviates the risk of mis-selling, and provides comparability across services providers. In our view, a certain degree of standardisation of investor profiles and general asset allocation (as a framework) is a good step in the right direction, but it will not solve the issue of biased advice and mis-selling all by itself. Notwithstanding the proposal below, the main aspect that needs to be tackled in the distribution systems of retail investment products is that of conflicts of interests and acting in the best interest of the client.

However, BETTER FINANCE has previously used a model investor questionnaire (suitability assessment) and general investor profiles in conducting the mystery shopping exercise for its annual Robo-advice report. We believe that a framework of asset classes and target allocations (in % of the total financial savings) could be helpful to guide both intermediaries and investors towards adequate recommendations.

The standard questionnaire and target asset allocations used by BETTER FINANCE were based on a proprietary model researched and developed by a team of academics for the Orange envelope[1]. The questionnaire is composed of eleven single-choice questions under the form of a structured investment test, simply worded, on the basis of which five potential investor profile categories can be achieved: conservative, balanced, dynamic, aggressive, speculative. For each investor category, a range (or target) asset allocation is foreseen based on a risk-return class (on a scale from 1 to 7):

1. Conservative: 1-3 (risk-return profile); equity allocation: 0-20%;
2. Balanced: 2-4 (risk-return profile); equity allocation: 10-45%;
3. Dynamic: 3-5 (risk-return profile); equity allocation: 35-75%;
4. Aggressive: 4-6 (risk-return profile); equity allocation: 60-100%;
5. Speculative: 5-7 (risk-return profile); equity allocation: 85-100%.

That assumes of course that the risk scale of asset classes is adjusted to the time horizon of the investor, as - for example – money market funds can be a risk 1 for a short time horizon, but certainly are much riskier for a long term horizon (5 or 6), like for pension needs (as both the probability and the magnitude of the risk of investment loss in real terms is very high then). BETTER FINANCE already pointed out several times (for example for the PEPP that the 1-7 risk scale could be almost reversed for long term and pension horizons.

On this basis, BETTER FINANCE proposes to further elaborate the methodology to accommodate for a wider variety of asset classes (equity-like instruments, debt securities, commodities, packaged products) and for a wider variety of investment horizons; this is because the abovementioned methodology was designed for long-term and pension savings. However, the new suitability regime should be able to define a PAAS for any investment horizon. Moreover, this methodology does not accommodate for sustainability preferences either, which is a key necessity for retail investors nowadays.

BETTER FINANCE cannot describe the proposed methodology fully under this consultation. We recommend the European Commission to establish an expert group made of consumer representatives and independent academics to develop and fine tune such methodology.

Question 14. Which elements should form the basis for distinguishing between asset classes within the asset allocation strategy? Please select as many answers as you like

☒ **Risk**
☒ **Return**
☒ **Paired correlation with other asset classes**
☒ **Additional criteria**

Please explain your answer to question 14 and provide details on the additional criteria, if any:

The main performance factor for long term retail investment products is missing: cost (see previous replies) and ignores current rules for UCITS and AIF funds as mentioned previously: again, with exactly the same asset allocation some highly packaged retail products will perform much worse than some others.

And again, for returns of long term investments, real ones must be taken into account alongside nominal ones (that foe example excludes any significant allocation to money market funds for pension goals).

Question 15. Exposure to assets, as set out in the asset allocation strategy, could be achieved either by investing directly in securities (e.g. shares, bonds), or via investment in potentially complex financial products (e.g. funds, structured products, insurance-based investment products) or a combination thereof.
How should a financial intermediary assess best value-for-money when considering asset classes or sub-asset classes offering the optimal exposure for the retail investor?
The instruments, or combination thereof, that erodes the less the value of the investor in real net terms and that comes closest to achieving the investment objective of the client.

See our previous replies on the "value for money" criteria to be applied by whoever designs the PASS and PIP; already in current EU law, such as, but not limited to:

- no undue costs should be charged" (2010/43/EU art.22)
- investment firms must assess – considering costs and other features - whether equivalent products fulfil the client's objectives and profile (EU 2017/565 art.54.9)

For example; BETTER FINANCE found a unit linked insurance product that offered only one French stock index fund with an overall 2,57 % annual ongoing charge for the client, when the average annual charge for a French stock index ETF is less than 0,25% ,i.e. more than 10 times less. So, this criterion should of course be enforced (not the case unfortunately today) and extended to all categories of retail investment products. These assessments would become even more crucial if the EC eventually gives up its key goal of "ensuring bias-free advice".
Other criteria such as those identified by EIOPA (op.cit.) or by the UK FCA in its annual "value" reviews of investment fund managers, could be used.

Question 16. The rules on the asset allocation strategy should allow for the establishment of asset classes that are fit to achieve the investment objectives of retail investors.

How should those rules take into account situations where the investment intermediary wishes to offer products that do not fit into one of the common asset categories?

☐ Where the intermediary proves that the risk, return and correlation properties of the product are equivalent to those attributed to one of the established asset classes, he/she can consider that instrument as belonging to that asset class
☐ Such products should only be made available to the investor at his or her explicit request, and not as a part of the investable universe determined by the asset allocation strategy
☒ Other solutions

Please explain your answer to question 16:
We are unsure if the question refers to the PAAS or the PIP - It seems the latter as specific products seem to be at stake (see our previous replies on the contents of the PIP).

When it comes to specific products (and not only to asset classes), again the essential factor before risk, return and correlation: cost is missing in the reply options provided.

Besides, we believe that *asset classes* should be understood in principle, comprising both direct and indirect exposure to financial assets (commodities, currency, equities, debt securities, etc.). In this sense, the possibility of proposing a product that does not fit a common asset category would be excluded.

Question 17. Although the form and content of the asset allocation strategy should be prescribed to a certain extent, financial intermediaries will always exercise a degree of discretion when establishing the asset allocation for a given investor. Competition between financial intermediaries in establishing an optimal asset allocation strategy for a given set of client data could yield better quality asset allocation propositions for the client. On the other hand, changing without objective reasons the investment guidance set out by the asset allocation strategy should be avoided in order to ensure that his or her investment goals are attained.

Should a financial intermediary other than the one that drew up the client assessment be able to propose a different asset allocation strategy than the one originally established, where the data required to produce the asset allocation strategy are made available to that financial intermediary?

☒ Yes, but only when there are objective reasons (see notably (b) and (c) in question 9.1 and 9.2 respectively.)
☐ No
☐ Don't know / no opinion / not applicable

Please explain your answer to question 17:
We agree with the identified risks and challenges to changing the PAAS, reason for which we propose that the changes can only be done by independent, fee-based advisors. Besides the objective reasons highlighted in questions 9.1 and 9.2. (upon significant changes in the situation of the client or through a written reasoning of the intermediary), with which we agree, there should remain the degree of competition and added value available between independent advisors, allowing the possibility to disagree with one another. This possibility would create an element for the client to assess value for money.

Question 17.1 Should the investor be required to give explicit consent for the development of a new asset allocation strategy?

☒ **Yes**
☐ **No**
☐ **Don't know / no opinion / not applicable**

Please explain your answer to question 17.1:
Yes, re-evaluating or re-determining the questionnaire and the PAAS should be explicitly requested by the client.

General comment

Question 18. Would you have any general comments on an enhanced client assessment regime and/or personalised asset allocation strategy?

☒ **Yes**
☐ **No**
☐**Don't know / no opinion / not applicable**

Please explain your answer to question 18:
BETTER FINANCE welcomes the initiative of the European Commission to harmonise and improve the consumer journey towards investing in capital markets. BETTER FINANCE has voiced its concerns towards the detrimental effects of the suitability-appropriateness test duality, pointing to the fact that the *appropriateness* regime has very limited added value for the retail investor protection regime, creates bureaucratic burdens, may limit the financial instrument offering to retail investors, and should be, thus, eliminated.

We regret though that - although representatives of consumers and individual investors are mentioned as a primary target of this public consultation - this consultation is published only in English - the native language of only one Member State - and in technical terms that are not intelligible for most "retail" investors. In addition, the time to reply is very short: one month.

***Note**: Currently, both MiFID II and IDD require a suitability assessment for "advised" services and the appropriateness assessment for "non-advised" (selling) services; for execution-only services, MiFID II limits the distribution to simple products, whereas IDD also requires a "demands and needs" test.*

In this sense, we agree in principle with the current proposal of the European Commission on the *new suitability regime*, position which we elaborate in the answers to this public consultation, with a crucial caveat that the level of overall costs and the current "value for money" requirements are fully taken into account to build the "*personal investment plan*" , and that it is the result of bias-free advice, one of the four key objectives of the EC "Strategy for Retail Investors".

This initiative will not solve by itself the current detriment suffered by too many EU citizens as retail investors and pension savers without :

- ensuring "bias-free advice", one of the four key objectives of the EC's EU Strategy for Retail Investors, or, at the very least
- taking into account the main driver for retail investments' performance – the overall cost borne by the savers – and harmonizing the EU rules on "value for money" to all retail

investment products and actually enforce the existing EU rules (such as ensuring "no undue costs" are charged, and cost comparisons with equivalent financial instruments).

In a costless environment, asset allocation is indeed the main driver of investment performance over a given time horizon. However, for retail investors, independent research repeatedly demonstrates that the main drivers for the performance of retail investments are:

- **the level of overall charges,**
- **and the selection bias risk generated by the commission-based distribution model;**

before asset allocation.

These factors too often lead to the recommendation of high risk / low (or negative) return investments, even when the allocation of underlying capital market assets is adequate. The cost factor - however crucial for the adequacy of retail investments - is a big absentee of this consultation.

Also, given that there is no specific question in this consultation on the *structure* of this suitability regime, BETTER FINANCE will provide a few remarks under this general comment.

To begin with, it is unclear how the three elements proposed by the European Commission (*questionnaire – personalised asset allocation strategy – personal investment plan*) interplay with one another. BETTER FINANCE assumes the following:

- the questionnaire is the basis to determine the investor profile: it enables the intermediary to understand the investment objectives, horizon, risk profile (tolerance, ability to bear losses) and financial situation of the client;
- the *personalised asset allocation strategy* (PAAS) would be the framework, laying down general limits and guidelines in terms of types of the different categories of underlying assets (such as equities, bonds, money market, real estate, etc), that should be followed by the client to reach its objectives, in alignment with its investor profile;
    - the *personal investment plan* would be one of the multiple possible concrete applications (or materialisation) of the PAAS, pointing to specific investment products that could fulfil the PAAS and PIP.

If we understand the European Commission's proposal as such, including the crucial caveat, we agree with it; if not, we disagree and recommend the European Commission to consider the above.

Second, such an ambitious project could bring alleviations to other sides of the investor protection framework. For instance, in the product oversight and governance process, a step in defining the target market could be eliminated, i.e. the actual target market, determined by the distributor since the initial independent intermediary (see answer to Q5) would already provide the general universe from which instruments can be chosen. Although such approach puts more responsibility on the initial intermediary, it would provide consistency between the theoretical target market (determined by the product manufacturer) and the *personalised asset allocation strategy*, thus reducing the probability of mis-selling.

Third – detailed in Question 5 – a critical element of the new suitability regime is which actors in the distribution process can determine or alter which elements of this assessment. For reasons of simplicity, we highlight here that only independent advisers should be allowed to evaluate the questionnaire and draw the PAAS (or modify it), and non-independent distributors (advisers or sellers) should only be able to propose a new or different personal investment plan. As this looks like a "financial health check" (as promoted by some industry players) , it could also be partially funded by Public Authority, as physical health checks are.

Fourth, BETTER FINANCE sees room for improvement concerning the *execution-only regime*. Under the current rules, distributors of financial instruments (MIFID- regulated ones only) as *execution-only services* are limited to "simple" products and cannot grant access, even at the express request of the client, to other types of products. In this case, considering the fundamental and guiding role of the PAAS, the European Commission could explore ways in which brokers could provide access to a wider palette of products or instruments that fit in the client's PAAS. The execution only regime should also apply to ALL categories of retail investment products, not only the small part of EU households' financial savings products that are in the scope of MiFID.

Finally, if this suitability regime is meant to also embed a form of a *financial health check*, we did not understand how the European Commission expects it to be seen from the private investors' perspective in terms of global savings and investments (financial and non-financial) point of view? Would the saver have to communicate all his or her financial assets and liabilities, as well as real assets, so the financial adviser will have the possibility to make comments on items, although the investor only needs advice in a limited field?

For typically the lower income segment it could provide great benefit, but others might see this as too much interference. Another concern is costs: in one way or another, current players on the retail distribution market (banks, tied agents) will properly try to "share" the costs with the customer and keep the savings for themselves, although the Member States must support financial health checks too, as they do for physical ones. So, the question is, is this too ambitious and should it be implemented stepwise over a longer period?