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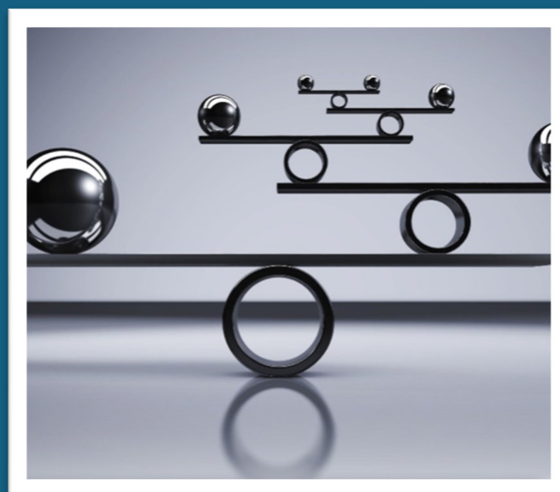
VALUE FOR MONEY

Outline of the sectorial view of the European Structured Products manufacturers at the starting trilogue negotiations on the EU's Retail Investment Strategy with a focus on the VFM topic | October 2024



Positions and suggestions of the Structured Products industry

EXECUTIVE SUMMARY

In the following summary we mark up the **five key positions** of the structured products industry on legislative proposals relating to peer group comparisons, benchmarks, best-interest tests and enhanced suitability as were put forward by the EU Commission, the Council and EU Parliament as part of the Retail Investment Strategy's law-making process. Specific amendments and further background is added in separate sections 2 and 3.

1

Position One (Asset-class specific methodologies)

Value for Money requires the use of asset-specific methodologies.

EUSIPA strongly advocates for any future Value for Money set of rules, in particular but not only those linked to any peer grouping or benchmarking, to be set up in a way that their application in practice allows or even requires using asset-type/class specific quantitative methodologies.

While the details of such adequately adapted methodologies will have to be set out on level 2 legislation, EUSIPA suggests inserting clear rules relating to this issue already on level 1, as part of any future trilogue compromise.

On a more general note, EUSIPA wishes to reiterate that – while supporting the broader idea of a concept of Value for Money – our industry is of the strong conviction that any related methodologies should not result in cost caps, contain specifications of costs nor should the methodologies make other prescriptions regarding costs.

2

Position Two (Yes to outlier identification using a forward-looking approach for a synthetic benchmarking for structured products)

EUSIPA supports the identification of products that are cost and/or performance outliers as part of the issuer distribution governance.

For doing this effectively in the area of Structured Investment Products, EUSIPA recommends allowing for a "synthetic benchmarking" as represented by the "next best alternative" product (NBA), incorporating a peer-conscious approach with industry guidelines.

Following the principle set out before as position 1 (to allow the use of asset specific methodologies), EUSIPA suggests using for the identification of cost/performance outliers in the area of structured investment products **allowing for a "synthetic benchmarking"** called "**Next Best Alternative" (NBA)**.

A **forward-looking approach is necessary for structured products**, as neither past performance, nor cost of previously issued products are representative of market conditions and value at the point of subscription by investors.

Such approach is also "peer conscious" since it would be supported by industry guidelines applied homogenously among peer financial institutions.

The NBA comparison would focus on comparing product's forward-looking return expectation against a **Zero-Coupon-Bond or equivalent**, rendering the exercise primarily benchmark-like, as it evaluates the cost of the structured product relative to the cost of capital protection alone.

Furthermore, a risk premium (for example an "equity risk" premium for products with an equity underlying) is added, making the comparison closer to a peer group-like tool, as it assesses whether the product's market exposure delivers sufficient risk-adjusted returns, which would be similar to comparisons made across products issued by other (peer) institutions, due to the use of industry-wide guidelines on economic assumptions relating to such risk premiums.

3

Position Three (for leverage products, such as warrants and securitised options, only costs)

For leverage products, VFM should be judged by cost, but not by performance.

EUSIPA is convinced that **in the area of leverage products any VFM related quantitative analysis should strictly be limited to** (a comparison of) **costs,** rather than to costs and performance. **Consequently, EUSIPA suggests that the interpretative rule (recital 15 of the RIS-OMNIBUS legal act)** as approved by the Council as the General Approach and suggested for the RIS trilogue negotiation, according to which peer-group comparisons for derivatives and certain securitised derivatives are limited to costs and charges, **should be extended to leverage products** and cover also benchmarks (next to peer groups). **Furthermore, such an amended recital should finally be reflected in Art. 16a itself.**

4

Position Four (No need for new Best-Interest rules)

There is no need to introduce new rules on the Best-Interest-Test, which is already part of MIFID II. The relevant provisions added to article 25a in the RIS amendments by Council and Parliament should hence be deleted.

EUSIPA is of the conviction that under MiFID II, the Best Interest test is already a critical part of investor protection and sufficient in its practical implementation in particular in light of the exhaustive ESMA guidance on how firms should interpret and apply this obligation.

As there is no shortcoming in these rules, neither with regard to **cost-efficiency** (approach of the Council) nor **efficiency** (approach of the European Parliament), EUSIPA is of the opinion that new rules, such as proposed by both institutions on the article 25a under the RIS Omnibus directive in the Commission's initial version, are not necessary.

5

Position Five (No room for enhanced suitability)

EUSIPA strongly advocates not to link suitability with the absence of unnecessary features. The respective amendment should be disregarded.

The MiFID rule linking suitability to the absence of unnecessary features creates **massive legal uncertainty due to the subjective and vague nature of determining what is "not necessary," compounded by the challenge of legally proving a negative condition**.

This requires firms to define necessary features in advance, placing a heavy burden on them to demonstrate the absence of unnecessary elements. It will foreseeably lead to overly cautious advice, reduced product diversity, and complex compliance challenges, as the rule's interpretation can vary across regulators and clients.

PROPOSED AMENDMENTS

The amendments suggested by EUSIPA are set out in the following text below the relevant five positions, recapped again in this section so to make working with this document easier.

1 **Position One** (Asset-class specific methodologies)
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EUSIPA strongly advocates for any future Value for Money set of rules, in particular but not only those linked to any peer grouping or benchmarking, to be set up in a way that their application in practice allows or even requires using asset-type/class specific quantitative methodologies. **While the details of such adequately adapted methodologies will have to be set out on level 2 legislation, EUSIPA suggests inserting clear rules relating to this issue already on level 1, as part of any future trilogue compromise.**

2 **Position Two** (Yes to outlier identification using a forward-looking approach for a synthetic benchmarking for structured products)

EUSIPA supports the identification of products that are cost and/or performance outliers as part of the issuer distribution governance. For doing this effectively in the area of Structured Investment Products, EUSIPA recommends allowing for a "synthetic benchmarking" as represented by the "next best alternative" product (NBA), incorporating a peer-conscious approach with industry guidelines.

Following the principle set out before as position 1 (to allow the use of asset specific methodologies), EUSIPA suggests using for the identification of cost/performance outliers in the area of structured investment products **allowing for a "synthetic benchmarking"** called "**Next Best Alternative" (NBA)**.
A **forward-looking approach is necessary for structured products**, as neither past performance, nor cost of previously issued products are representative of market conditions and value at the point of subscription by investors. **Such approach is also "peer conscious" since it would be supported by industry guidelines applied homogenously among peer financial institutions.** The NBA comparison would focus on comparing product's forward-looking return expectation against a **Zero-Coupon-Bond or equivalent**, rendering the exercise primarily benchmark-like, as it evaluates the cost of the structured product relative to the cost of capital protection alone. **Furthermore, a risk premium (for example an "equity risk" premium for products with an equity underlying) is added,** making the comparison closer to a peer group-like tool, as it assesses whether the product's market exposure delivers sufficient risk-adjusted returns, which would be similar to comparisons made across products issued by other (peer) institutions, due to the use of industry-wide guidelines on economic assumptions relating to such risk premiums.

3 **Position Three (for leverage products, such as warrants and securitised options, only costs)**
For leverage products, VFM should be judged by cost, but not by performance.

EUSIPA is convinced that **in the area of leverage products any VFM related quantitative analysis should strictly be limited to** (a comparison of) **costs,** rather than to costs and performance. **Consequently, EUSIPA suggests that the interpretative rule (recital 15 of the RIS-OMNIBUS legal act)** as approved by the Council as the General Approach and suggested for the RIS trilogue negotiation, according to which peer-group comparisons for derivatives and certain securitised derivatives are limited to costs and charges, **should be extended** to leverage products and cover also benchmarks (next to peer groups). **Furthermore, such an amended recital should finally be reflected in Art. 16a itself.**

On Recital (12a)	Commission	Parliament	Council	EUSIPA proposition
21a			*(12a) Product governance obligations should be strengthened by obliging manufacturers and, where appropriate, distributors to have robust value-for-money assessment processes, where value for money of investment products should be established through appropriate testing and assessments, taking into account the specificities of the investment products. The value-for-money process should include, subject to data availability, a market comparison to similar investment products in the Union, by comparing costs and charges and performance of investment products to costs and charges and performance of a peer group of investment products in the Union with similar characteristics. The peer-group comparison should assess whether the investment product is an outlier compared to the peer group. Outliers should be investment products that are at a*	*Following the left draft text of the Council General Approach, which EUSIPA would support, it should be added:* ***For some products however, for example structured products, being debt instruments embedding a derivative, considering the unavailability of appropriate data, an alternative approach to peer-grouping and benchmark comparison should be adopted. Such alternative approach should be based on products' forward-looking testing and assessments of expected performance compared to their "next best alternative" (e.g., debt instruments with similar credit risk and maturity), potentially in addition to a qualitative assessment.*** ***A value-for-money assessment for derivative instruments or specific types of transferable securities with characteristics that are similar to derivatives,***

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			significant distance from the average of the peer group to the detriment of the client and thereby have an increased risk of poor value for money.	***such as, for example, leverage products in the format of turbos and warrants, should only be made in relation to costs and charges."***

On Recital (15)	Commission	Parliament	Council	EUSIPA proposition
24	(15) To enable ESMA and EIOPA to develop reliable benchmarks, based on reliable data, manufacturers and distributors of investment products should be required to report necessary data to competent authorities, for onward transmission to ESMA and EIOPA. To limit, to the greatest extent possible, costs related to the new reporting obligations and to avoid unnecessary duplication, data sets should as far as possible be based on disclosure and reporting obligations stemming from EU law. ESMA and EIOPA should develop regulatory technical standards to determine the data sets, data standards	(15) To enable ESMA and EIOPA to develop reliable benchmarks, based on reliable data, manufacturers and distributors of investment products should be required to report necessary data to competent authorities, for onward transmission to ESMA and EIOPA. To limit, to the greatest extent possible, costs related to the new reporting obligations and to avoid unnecessary duplication, data sets should as far as possible be based on disclosure and reporting obligations stemming from EU law. ESMA and EIOPA should develop regulatory technical standards to determine the ~~*data sets, data standards and*~~	(15) ~~*To enable ESMA and EIOPA to develop reliable benchmarks, based on reliable data, manufacturers and distributors of investment products*~~***For derivatives and specific types of transferable securities with characteristics that are similar to derivatives, where the performance replicates the performance of the underlying assets or values on the basis of a formula, peer-group comparison*** should be ~~*required to report necessary data to competent authorities, for onward transmission to ESMA and EIOPA. To limit,*~~***performed with respect to costs and charges only. This should also***	***For derivatives, such as options, and specific types of transferable securities with characteristics that are similar to derivatives, such as, for example, leverage products in the format of turbos and warrants, a peer group comparison should be performed with respect to cost and charges only.*** *(re EU benchmarks see the Council GA sentence starting with "This should also apply (...)", which EUSIPA supports.*

	and methods and formats for the information to be reported.	~~methods and~~ formats***, frequency and starting date*** for the information to be reported.	***apply*** to the ~~greatest extent possible, costs related to the new reporting obligations and to avoid unnecessary duplication, data sets~~***Union supervisory benchmarks. The Commission should be empowered to adopt a delegated act to specify for which specific types of transferable securities the peer-group comparison*** should ~~as far as possible be based on disclosure and reporting obligations stemming from EU law~~***only be performed in relation to costs and charges***. ~~ESMA and EIOPA should develop regulatory technical standards to determine the data sets, data standards and methods and formats for the information to be reported.~~	

On article 16a (e)	Commission	Parliament	Council	EUSIPA proposition
109	(e) in relation to financial instruments falling under the definition of packaged retail investment products in accordance with Article 4(1) of Regulation (EU) No 1286/2014 of the European Parliament and of the Council*, a clear identification and quantification of all costs and charges related to the financial instrument and an assessment of whether those costs and charges are justified and proportionate, having regard to the characteristics, objectives and, if relevant, strategy of the financial instrument, and its performance (‘pricing process’).	(e) in relation to financial instruments falling under the definition of packaged retail investment products in accordance with Article 4(1) of Regulation (EU) No 1286/2014 of the European Parliament and of the Council*, ***and which are made available to retail clients,*** a clear ~~identification and quantification of all costs and charges related to the financial instrument and an~~ assessment ***and description of both quantitative and qualitative features***~~of whether those costs and charges are justified and proportionate, having regard to the characteristics, objectives and, if relevant, strategy~~ of the financial ~~instrument, and its performance (‘pricing process’).~~ ***product, including:***	(e) in relation to financial instruments falling under the definition of packaged retail investment products in accordance with Article 4(1) of Regulation (EU) No 1286/2014 of the European Parliament and of the Council***(*)***, a clear identification and quantification of all costs and charges ***and the performance*** related to the financial instrument***, a clear identification of their other benefits*** and an assessment of ***whether the financial instrument offers value for money, by evaluating*** whether those costs and charges are justified and proportionate, having regard to the ***performance, the other benefits and the*** characteristics, objectives and, if relevant, strategy of the financial instrument~~, and its performance~~	

			~~(‘pricing~~ ***(‘value-for-money assessment*** process’). ***________*** **** Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (OJ L 352, 9.12.2014, p. 1).***	
110			The ~~pricing process~~***assessment that the financial instrument can be expected to offer value for money*** referred to in point (e) shall ~~include a~~***be established through appropriate product testing and assessments, taking into account the specificities of the financial instrument including a market*** comparison with ***similar financial instruments in the Union, subject to data availability, by comparing the***~~the relevant benchmark, where available, on~~ costs and ***charges as well as the*** performance ~~published by ESMA in accordance with~~***of the financial instrument to the***	The assessment that the financial instrument can be expected to offer value for money referred to in point (e) shall be established through appropriate product testing and assessments, taking into account the specificities of the financial instrument including, ***where relevant***, a market comparison with similar financial instruments in the Union, subject to data availability, by comparing the costs and charges as well as the performance of the financial instrument to the costs and charges and the performance of (i) a peer group consisting of other financial instruments with similar characteristics including,

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			costs and charges and the performance of a peer group consisting of other financial instruments with similar characteristics including, where relevant, the product type, similar levels of risk, strategy, objectives, range of recommended holding periods and sustainability features. ***The peer-group comparison shall only be made in relation to costs and charges for each of the following types of financial instruments:***	where relevant, the product type, similar levels of risk, strategy, objectives, range of recommended holding periods and sustainability features; ***or (ii) the "next best alternative" in terms of costs and performance***.
110a			***(a) financial instruments that fall within one of the categories referred to in points 4 to 10 of Section C of Annex I; and*** ***(b) specific types of transferable securities designated by the Commission by delegated act in accordance with Article 89.***	

4

Position Four (No need for new Best-Interest rules)

There is no need to introduce new rules on the Best-Interest-Test, which is already part of MIFID II. The relevant provisions added to article 25a in the RIS amendments by Council and Parliament should hence be deleted.

EUSIPA is of the conviction that under MiFID II, the Best Interest test is already a critical part of investor protection and sufficient in its practical implementation in particular in light of the exhaustive ESMA guidance on how firms should interpret and apply this obligation.
As there is no shortcoming in these rules, neither with regard to **cost-efficiency** (approach of the Council) nor **efficiency** (approach of the European Parliament) EUSIPA is of the opinion that new rules, such as proposed by both institutions on the article 25a under the Omnibus directive in the Commission's initial version, are not necessary.

On article 25a (1) amended	Commission	Parliament	Council	EUSIPA proposition
161	(b) the following paragraph 1a is inserted:	(b) the following paragraph 1a is inserted:	(b) the following paragraph 1a is inserted:	***DELETE***
162	1a. Member States shall ensure that, in order to act in the best interest of the client, when providing investment advice to retail clients, investment firms are under the obligation of the following:	1a. Member States shall ensure that, in order to act in the best interest of the client, when providing investment advice to retail clients, investment firms are under ~~the~~**an** obligation ~~of the following:~~**:**	1a. Member States shall ensure that, in order to act in the best interest of the client, when providing investment advice to retail clients, investment firms ~~are under the obligation of~~**comply with** the following **requirements**:	***DELETE***

163	(a) to provide advice on the basis of an assessment of an appropriate range of financial instruments;	(a) ***to inform the client of the range of financial instruments assessed by the investment firm, and*** to provide advice on the basis of an assessment of an appropriate range of financial instruments ***suited to the clients's needs, whereby the range of financial instruments is adapted to the business model of the investment firm***;	(a) to provide advice on the basis of an assessment of an appropriate range of financial instruments ***identified as suitable for the client pursuant to Article 25(2), from one or more manufacturers which must be sufficiently diversified with regard to their type, characteristics and underlying investment assets to ensure that the client's investment objectives can be met***;	***DELETE***
164	(b) to recommend the most cost-efficient financial instruments among financial instruments identified as suitable to the client pursuant to Article 25(2) and offering similar features;	(b) to recommend the most ~~cost-efficient~~***efficient*** financial instruments among financial instruments identified as suitable to the client pursuant to Article 25(2) and offering similar features***, taking into consideration its performance, level of risk, qualitative elements, costs and charges reported pursuant to Article 16-a, and, if an equivalent product with higher costs is recommended, to justify this on objective grounds and keep records of that justification***;	(b) to recommend the most **cost-efficient** financial instruments among financial instruments identified as suitable to the client pursuant to Article 25(2) and offering similar features~~;~~***. The assessment of cost-efficiency shall take into accounts the costs and associated charges of these products as well as other factors of the financial instruments relevant to the client, such as the performance and the expected return.***'	***DELETE***

5

Position Five (No room for enhanced suitability)

EUSIPA strongly advocates not to link suitability with the absence of unnecessary features. The respective amendment should be disregarded.

The MiFID rule linking suitability to the absence of unnecessary features creates **massive legal uncertainty due to the subjective and vague nature of determining what is "not necessary," compounded by the challenge of legally proving a negative condition**.
This requires firms to define necessary features in advance, placing a heavy burden on them to demonstrate the absence of unnecessary elements. It will foreseeably lead to
overly cautious advice, reduced product diversity, and complex compliance challenges, as the rule's interpretation can vary across regulators and clients.

On Article 25a (2) amended	Commission	Parliament	Council	EUSIPA proposition
304			***Member States shall ensure that investment firms cannot consider a product to be suitable where it contains features which are not necessary to the achievement of the client's investment objectives and that give rise to higher costs.***	***DELETE***

BACKGROUND AND DETAILS

1	**Position 1** (Asset-class specific methodologies) **Value for Money requires the use of asset-specific methodologies.**

EUSIPA strongly advocates for any future Value for Money set of rules, in particular but not only those linked to any peer grouping or benchmarking, to be set up in a way that their application in practice allows or even requires using asset-type/class specific quantitative methodologies.

While the details of such adequately adapted methodologies will have to be set out on level 2 legislation, EUSIPA suggests inserting clear rules relating to this issue already on level 1, as part of any future trilogue compromise.

Explanation and reasoning

Financial products have always been manufactured in order to cover specific commercial needs of investors and thus have distinguishing features that are meant to cater for these purposes. Examples are products insuring against specific life or commercial risks, products aiming to protect capital with limiting the underlying investment risks, products which leverage any such exposure or others that allow an issuer to terminate them early. Financial products relate to different commercial contexts and thus come along with diverging features can mostly not compared against each other across a certain level of distinction.

While using asset class-specific methodologies may even be intuitive at the level of most technical experts, the ambition to create a level playing field, which EUSIPA fully supports, is sometimes wrongly understood in a way that asset-class specific features should not count as relevant under a “value” or “consumer/investment”-focused evaluation approach. This is wrong. Asset specific approaches are needed for the following reasons.

a) Different cost structures and pricing mechanisms:

- **Argument:** Each asset class has unique cost structures and pricing mechanisms that impact the overall cost to the investor. Applying a one-size-fits-all VFM rule would not accurately reflect these differences, potentially leading to unfair comparisons and misleading conclusions.
- **Example:**
    - **UCITS funds:** These funds often involve ongoing charges, management fees, and performance fees. Costs are typically transparent and are usually expressed as a percentage of assets under management (AUM).
    - **Structured products in note-based format:** These products have costs embedded in the product's pricing, such as structuring fees, derivative costs, and distribution fees. Although transparency is provided as well, their disclosure may often not match that of UCITS, making direct cost comparisons with UCITS funds challenging.

- **Banking and insurance products:** These may include costs like premium charges, surrender fees, or embedded administrative fees, which differ significantly from investment products.

– **Implication:** Asset class-specific VFM rules would allow for more accurate comparisons within each category, reflecting the true cost-efficiency and value provided to investors.

b) Distinct risk profiles and return characteristics:

– **Argument:** Different asset classes carry distinct risk and return profiles, which should be taken into account when assessing Value-for-Money. A uniform VFM approach could overlook these differences, leading to inappropriate product selections or, at the advisory end, to inappropriate recommendations.

– **Example:**

  - **UCITS Funds:** Generally, these funds are diversified, regulated for risk, and suitable for long-term investors with varying risk appetites.
  - **Structured products:** These are often designed for specific market views or conditions, with varying levels of capital protection or exposure, making them suitable for more specific needs of a broader retail investor audience.
  - **Banking and insurance products:** These typically focus in a one-sided manner on capital preservation, income generation, or protection, offering lower risk and return profiles compared to pure investment products.

– **Implication:** By tailoring VFM rules to each asset class, regulations can better reflect the suitability of products for different investor needs and risk tolerances, enhancing investor protection and satisfaction

c) Diverging regulatory frameworks and investor protection rules:

– **Argument:** Different asset classes are governed by distinct regulatory frameworks that define disclosure, transparency, and investor protections. Applying generic VFM rules could undermine the specific regulatory intents of these frameworks.

– **Example:**

  - **UCITS funds:** Subject to strict regulatory oversight, including liquidity, diversification, and transparency requirements, which aim to protect investors and ensure fair treatment.
  - **Structured products:** Typically governed by prospectus and standard disclosure rules with a focus on disclosure and transparency, but with fewer constraints on product design and risk.
  - **Insurance products:** Regulated under Solvency II and other specific directives that prioritize solvency, policyholder protection, and capital adequacy over investment returns.

- **Implication:** Asset class-specific VFM rules can harmonize with existing regulatory protections, ensuring that investors receive value in line with the intended regulatory outcomes of each product type.

d) Varied investor objectives and use cases:

- **Argument:** Investors use different asset classes to meet varied financial objectives, such as growth, income, protection, or speculation. A uniform approach to VFM could fail to account for these different use cases and objectives.
- **Example:**
    - **UCITS Funds:** Typically used for diversified, long-term growth or income generation, catering to broad investor segments with varying time horizons and financial goals.
    - **Structured products:** Often targeted at investors seeking specific exposures, yield enhancement, or hedging strategies, with more sophisticated payoff structures and risk profiles.
    - **Banking and insurance products:** Generally used for capital protection, regular income, or life and health (risk) coverage, aligning more closely with safety and security rather than high returns.
- **Implication:** Asset class-specific VFM rules would allow for more nuanced assessments that reflect the intended use and benefits of each product type, ensuring investors receive appropriate value for their specific financial goals.

Conclusion

By implementing asset class-specific VFM rules under the MiFID review, regulators can ensure that assessments are fair, transparent, and reflective of the unique characteristics, costs, risks, and investor needs associated with each asset class.

This approach would help protect investors and improve the quality of financial advice, fostering a more effective and investor-centric market environment.

2

Position Two (Yes to outlier identification using a forward-looking approach for a synthetic benchmarking for structured products)

EUSIPA supports the identification of products that are cost and/or performance outliers as part of the issuer distribution governance.

For doing this effectively in the area of Structured Investment Products, EUSIPA recommends allowing for a "synthetic benchmarking" as represented by the "next best alternative" product (NBA), incorporating a peer-conscious approach with industry guidelines.

Following the principle set out before as position 1 (to allow the use of asset specific methodologies), EUSIPA suggests using for the identification of cost/performance outliers in the area of structured investment products **allowing for a "synthetic benchmarking"** called "**Next Best Alternative" (NBA)**.

A **forward-looking approach is necessary for structured products**, as neither past performance, nor cost of previously issued products are representative of market conditions and value at the point of subscription by investors. **Such approach is also "peer conscious" since it would be supported by industry guidelines applied homogenously among peer financial institutions.**

The NBA comparison would focus on comparing product's forward-looking return expectation against a **Zero-Coupon-Bond or equivalent**, rendering the exercise primarily benchmark-like, as it evaluates the cost of the structured product relative to the cost of capital protection alone.

Furthermore, a risk premium (for example an "equity risk" premium for products with an equity underlying) **is added,** making the comparison closer to a peer group-like tool, as it assesses whether the product's market exposure delivers sufficient risk-adjusted returns, which would be similar to comparisons made across products issued by other (peer) institutions, due to the use of industry-wide guidelines on economic assumptions relating to such risk premiums.

The reasons for EUSIPA to suggest using for the identification of cost/performance outliers in the area of structured investment products a synthetic approach called **"Next Best Alternative"** are the following:

A classical approach (read an approach that implies using products issued by third party providers) to benchmarking (or peer grouping) would not work for SPs as diverging funding cost (that depend on ratings and business model in particular with the used hedging model), make **structured products of different issuers incomparable**. This is a **differentiator to UCITS funds which do not have this divergence in funding costs**. SPs are always issued under certain market condition that set the framework for the pricing (with the main reference to but not only the issuers funding costs) which cannot be compared against a product even one having identical pay-off features, issued at a later point it time.

A number of, though not all, structured products lack the open-ended character if they run until a prefixed maturity date, **preventing these SPs from embedding in any comparative methodology a historic performance reference**. Such references (to historical prices) would however be necessary under a classical approach to creating a benchmark or run a peer group comparison.

The **Next Best Alternative approach however delivers the closest possible proximity** to the outlier identification by way of a comparison against a benchmark or peer grouping as using a harmonised methodology under the NBA approach being applied across issuers (as peers) would guarantee for reasonable results (with regard to identifying outliers).

As this methodology would be jointly defined and applied among the peers of any relevant manufacturer of structured products active in the EU it de facto incorporates the essence of the peer approach taken under the value-for-money framework.

The practical implementation could, and ideally should, be handled in close liaison with relevant NCAs allowing the latter to efficiently exercise their market supervision mandate. Consequently, all information about the methodology, its implementation and value for money tests performed accordingly would be formalised, the methodology published and relevant records kept that could be made available to NCAs, further supporting any monitoring of the VFM approach for structured products in its practical implementation.

We briefly summarise below how comparing a structured product (capital-protected and non-capital protected) against a zero-coupon bond (with or without an equity risk premium) can be qualified as a benchmark-like or peer group comparison-like tool.

In both capital-protected and non-capital protected products, the comparison with a zero-coupon bond from the same issuer ensures internal consistency in terms of funding cost and credit risk.

> The zero-coupon bond provides a natural baseline for comparing capital-protected structured products as both carry the same issuer credit risk and the zero-coupon bond represents the cost of capital protection.
>
> The zero-coupon bond from the same issuer reflects the same credit risk, allowing a clean comparison of the product's cost-efficiency for capital protection.
>
> It serves as a "next best alternative" by showing the cost of achieving capital protection alone, without market exposure.
>
> By way of a conclusion, this comparison can be considered benchmark-like because it offers a consistent internal standard to evaluate how much extra cost the structured product charges for additional features (e.g., market exposure or optionality) versus a simple zero-coupon bond.

For products with an equity underlying, a comparison with the zero-coupon bond must further incorporate an **E**quity **R**isk **P**remium (**ERP**) to account for the additional market risk the investor takes on**. (A similar logic applies to underlyings other than equity with regard to their specific risk profile.)**

The ERP adjusts for the expected return above the risk-free rate, making the comparison more meaningful.

The zero-coupon bond yield serves as the risk-free rate baseline, and the ERP captures the expected premium for taking on equity (or other market) risk.

The ERP methodology is generally consistent across issuers, ensuring that comparisons reflect a standardized approach to estimating market risk-adjusted returns.

The structured product's payoff structure is adjusted for factors like participation rate, barriers, or optionality to ensure a like-for-like comparison of risk and return expectations.

By way of a conclusion, this comparison is peer-group-like because the ERP allows for a fair evaluation of whether the structured product's additional risk exposure justifies its return compared to a risk-free alternative. Since most issuers use a similar ERP methodology, this approach can approximate a peer-group evaluation, particularly in terms of risk-adjusted return comparisons.

Summarizing, the zero-coupon bond serves as a baseline to isolate the cost of protection or participation features in the structured product, providing transparency for evaluating whether the extra features justify the cost. Adding the ERP accounts for market risk, providing an additional layer of transparency for non-capital protected products by adjusting for expected returns above the risk-free rate.

3

Position Three (for leverage products, such as warrants and securitised options, only costs)

For leverage products, VFM should be judged by cost, but not by performance.

EUSIPA is convinced that **in the area of leverage products any VFM related quantitative analysis should strictly be limited to** (a comparison of) **costs,** rather than to costs and performance.

Consequently, EUSIPA suggests that the interpretative rule (recital 15 of the RIS-OMNIBUS legal act) as approved by the Council as the General Approach and suggested for the RIS trilogue negotiation, according to which peer-group comparisons for derivatives and certain securitised derivatives are limited to costs and charges, should be extended to leverage products and cover also benchmarks (next to peer groups). **Furthermore, such an amended recital should finally be reflected in Art. 16a itself.**

Explanation and reasoning

Leveraged products, such as warrants, turbos, and knock-out products, are financial instruments that allow investors to gain amplified exposure to the price movements of an underlying asset (like stocks, indices, or commodities) with a relatively small initial investment. These products use leverage (also called gearing) to magnify both potential gains and losses, making them suitable for short-term trading or as hedging strategy. These products are designed for and used by experienced retail investors who understand the risk nature of leverage, as their value can fluctuate significantly and, in some cases, lead to the total loss of the invested capital.

Regarding retail investors proactively investing in leverage products, comparing the potential performance of these products as a measure of "Value for Money" can be misleading for several reasons, the main ones of which are listed below:

a) Inherent uncertainty of performance

- Leveraged products are designed to amplify the movements of the underlying asset, which introduces significant volatility and uncertainty. The potential performance is highly dependent on market conditions, making it difficult to predict accurately.
- The volatile nature of these products, which allows both hedging and speculative investments, means that performance can vary widely, even over very short periods. Relying on potential performance as a measure of value can lead to unrealistic expectations and does not reflect the product's true cost-efficiency (a hedging instrument for example can have the commercial function of an insurance contract).

b) Misleading comparisons

- Comparing potential performance could mislead investors into focusing on best-case scenarios rather than understanding the risk-adjusted returns. This approach might encourage excessive risk-taking based on high but unlikely returns.

- Performance-based comparisons do not account for the asymmetrical risk profile of leveraged products, where the downside can be substantial.

c) Costs as "certainty"

- Costs associated with leveraged products, such as transaction fees, financing costs, and bid-ask spreads, are known and quantifiable. These costs directly impact the net returns of an investment, regardless of market movements.
- Focusing on costs allows investors to understand the efficiency and transparency of a product. Lower costs generally improve the probability of achieving better net returns, regardless of market performance.

d) Focus on risk-adjusted metrics

- Leveraged products inherently carry a higher level of risk due to their structure. Value for Money should incorporate a risk-adjusted view, **emphasizing the cost of taking on such risks rather than speculative performance**.
- Cost comparisons allow investors to assess which products provide similar exposures at lower costs, thus improving the overall efficiency of their investment strategy.

e) Consistency and comparability

- Costs provide a consistent metric that can be compared across different products and providers. This allows for a standardized comparison, which is not possible when considering performance, given the high variability in any leverage products' potentially different "response" to similar market conditions (e.g. by varying leverage factors that also can be static or dynamic during the lifetime of a product).
- Comparing costs simplifies the comparative process by narrowing the focus to tangible and "alike" elements, avoiding the confusion resulting from considering all or even only some speculative potential performance outcomes.

f) Alignment with investor objectives

- Most investors in leveraged products are looking to capitalize on short-term movements or specific market views (the latter often for hedging purposes). Evaluating products based on costs aligns with the objective of minimizing friction in achieving those goals.
- Especially with leverage products, Value for Money from an investor's perspective is often about the efficiency of their exposure relative to the costs incurred, rather than hypothetical performance, which may not align with their time horizons or risk appetite.

By focusing on the costs of leveraged products rather than their potential performance, investors can make more informed, rational decisions that are aligned with their risk tolerance and investment objectives. This approach encourages transparency and reduces the emphasis on speculative outcomes, promoting a more responsible investment landscape.

4

Position 4 (No need for new Best-Interest rules)

There is no need to introduce new rules on the Best-Interest-Test, which is already part of MIFID II. The relevant provisions added to article 25a in the RIS amendments by Council and Parliament should hence be deleted.

EUSIPA is of the conviction that under MiFID II, the Best Interest test is already a critical part of investor protection and sufficient in its practical implementation in particular in light of the exhaustive ESMA guidance on how firms should interpret and apply this obligation.

As there is no shortcoming in these rules, neither with regard to **cost-efficiency** (approach of the Council) nor **efficiency** (approach of the European Parliament) EUSIPA is of the opinion that new rules, such as proposed by both institutions on the article 25a under the Omnibus directive in the Commission's initial version, are not necessary.

The negative stance taken by EUSIPA towards the insertion of new rules dealing with the application of the already existing Best-Interest principle under a focus on efficiency or cost-efficiency, is rooted in the following arguments.

a) Redundancy with existing MiFID II provisions

Article 25(2) of MiFID II already requires firms to assess suitability based on the client's investment objectives, risk tolerance, and financial situation. This suitability assessment inherently considers elements like costs, performance, and risk, which the new provision seeks to reintroduce.

ESMA's existing guidance (see annex to this chapter for detailed references) already stresses the importance of cost transparency and aligning products with client needs. The requirement to recommend the "most cost-efficient" product would duplicate existing standards without materially improving investor outcomes, as firms already need to justify their recommendations and ensure cost-effectiveness is part of the suitability analysis.

b) Costs should not be the primary criterion for investment products

Insofar as the new Best-Interest rules emphasize cost efficiency (Council General Approach), it should be noted that costs alone are not necessarily the most important factor for ensuring the best outcome for the client. Factors like performance consistency, risk exposure, product design, and client-specific preferences (e.g., ethical considerations or liquidity needs) can be equally or more important.

Forcing investment firms to prioritize cost efficiency might result in lower-cost products being recommended that do not necessarily provide the best overall value or meet the long-term investment goals of the client, particularly when products with higher costs may offer more sophisticated features or better performance alignment with the client's risk and return expectations.

c) "Objective grounds justification" adds bureaucracy without investor benefit

Requiring firms to justify on "objective grounds" why a higher-cost product is recommended and to document that justification adds an administrative burden without significant benefit to the client. This type of justification process already exists in practice, as firms must explain their rationale for product recommendations under existing MiFID II rules. This additional layer of documentation creates operational inefficiencies for firms, increasing costs for them, which might ultimately lead to higher client fees without improving the quality of investment advice. The focus should remain on advising clients based on their holistic needs rather than creating another compliance check that could divert attention from client-focused advisory work.

d) Proposals on new Best-Interest rules could overemphasise standardized products.

The emphasis on cost-efficiency could unintentionally drive firms toward recommending lower-cost, standardized products (like index funds or plain vanilla bonds), which might not always meet the complex, diverse needs of certain investors. More sophisticated investors or clients with unique financial goals (e.g., seeking specific structured products or alternatives with customized features) might receive poorer advice as advisors may hesitate to recommend higher-cost, bespoke products for fear of the extra compliance and documentation burden. This undermines the personalization of investment strategies, which is at the core of MiFID II's objectives.

e) Increased compliance burden without clear client benefit

Requiring firms to "keep records of that justification" for recommending higher-cost products introduces another layer of bureaucracy. Firms already maintain comprehensive records on suitability assessments, risk profiling, and justification of recommendations. Adding another explicit documentation requirement adds administrative weight without necessarily increasing the quality of advice or better protecting clients. This increase in compliance could lead to longer advice processes, higher costs for clients, and possibly lower availability of tailored, client-specific investment solutions.

f) Focus on long-term outcomes, not short-term cost comparisons

The provision (introduced by the Council) emphasizing cost efficiency places too much weight on immediate cost comparisons, whereas the focus should remain on long-term investment outcomes and the holistic alignment of products with the client's financial objectives. A lower-cost product may not necessarily deliver better long-term results for the client, and the additional justification process may inadvertently shift focus away from other important elements like market conditions, portfolio fit, or diversification strategies.

The proposed new Best-Interest provision whether in the format of a focus on efficiency or cost-efficiency does not add value as it largely duplicates existing requirements, introduces unnecessary compliance burdens, and could lead to an overemphasis on cost-efficiency at the expense of more meaningful considerations such as long-term performance, risk management, and client-specific needs.

EUSIPA therefore strongly advocates deleting this provision.

ANNEX to point 5 (details of the existing Best Interest principles / requirements under MIFID 2)

The **Best Interest obligation under MiFID II** is primarily outlined in Article 24(1) of MiFID II Directive 2014/65/EU. This article requires that investment firms "act honestly, fairly, and professionally in accordance with the best interests of their clients." Article 24(1) sets the foundation for ensuring that firms provide services and products that meet the needs of their clients, aligning the interests of the client above the firm's own.

With regard to suitability and appropriateness as **part of a broader "best interest"** embedded in MiFID II, specific obligations are placed on firms in relation to product suitability and appropriateness through article 25 of MiFID II Directive 2014/65/EU as this article requires firms providing investment advice or portfolio management to obtain the necessary information regarding a client's knowledge, financial situation, and investment objectives, to ensure the suitability of the product or service provided. As is commonly known, article 25(3) provides the **best interest principle for non-advised services** (execution-only), firms must assess the appropriateness of complex financial instruments by evaluating whether the client has the knowledge and experience to understand the risks involved.

These provisions clarify the process of assessing whether a product or service is suitable and appropriate for the client, forming a key part of the already existing best interest test. Last not least conflicts of interest are covered under article 23 of MiFID II Directive 2014/65/EU which stipulates the obligations of investment firms to take all reasonable steps to identify, prevent, or manage conflicts of interest, and disclose them to clients where necessary. This requirement ensures that firms prioritize client interests over their own, an essential component of acting in the client's best interest.

ESMA has provided substantial guidance on the MiFID II Best Interest requirement further clarifying its application. One key reference are the ESMA Guidelines on MiFID II Suitability Requirements (ESMA35-43-869, 2018) which elaborate on before mentioned obligations under Article 25 of MiFID II to ensure that investment advice and portfolio management services meet the suitability requirements. The guidelines focus on collecting client information, assessing suitability, and reporting to clients, all of which are essential for ensuring that firms act in the best interest of their clients.

A second if not the main reference is the ESMA Guidelines on MiFID II Product Governance Requirements (ESMA35-43-620, issued in 2017) emphasizing the need for firms to ensure that the design and distribution of financial instruments are in the best interest of clients. The focus here is on the target market identification and ensuring that products are appropriate for the intended audience. A further set of interpretative guidance is contained in the ESMA Q&A on Investor Protection (ESMA35-43-349, which is updated regularly and which provides further clarifications on various aspects of investor protection under MiFID II, including suitability, appropriateness, conflicts of interest, and cost transparency. ESMA regularly updates this document to address evolving regulatory interpretations and market practices.

With specific regard to cost transparency and related communication, article 24(4) of MiFID II Directive 2014/65/EU requires firms to provide clients with information on costs and charges, enabling them to understand the overall cost of the services and how it will impact their returns.

ESMA Q&A on costs and charges under MiFID II finally provide further clarifications (ESMA35-43-349).

5

Position 5 (no room for enhanced suitability)

EUSIPA strongly advocates not to link suitability with the absence of unnecessary features. The respective amendment should be disregarded.

The MiFID rule linking suitability to the absence of unnecessary features creates **massive legal uncertainty due to the subjective and vague nature of determining what is "not necessary," compounded by the challenge of legally proving a negative condition**.

This requires firms to define necessary features in advance, placing a heavy burden on them to demonstrate the absence of unnecessary elements. It will foreseeably lead to overly cautious advice, reduced product diversity, and complex compliance challenges, as the rule's interpretation can vary across regulators and clients.

The rule linking suitability under MiFID (Markets in Financial Instruments Directive) with the absence of “unnecessary” features introduces massive legal uncertainty and practical compliance difficulties, the main reasons for which are set out hereunder:

a) Subjectivity of "unnecessary features"

The term "unnecessary features" lacks a clear legal definition. What constitutes "unnecessary" can vary significantly between clients, products, and financial advisors. The subjectivity in interpreting what is "necessary" or "unnecessary" leads to inconsistent application across firms and jurisdictions. What may appear as an unnecessary feature for one client might be essential for another, depending on their investment objectives, risk tolerance, and financial situation. This variance creates challenges in standardizing a compliance approach, in any case.

b) Burdensome suitability process in a heavier client journey

Furthermore, only a distributor, during the suitability process, can assess accurately if the investor deems the feature necessary or not. Such assessment of each feature and per investor as necessary/not necessary, will make **the investor journey on the advisory side more burdensome**, on top of **an already heavy client journey** to investing.

c) Danger of mingling suitability with complexity

Many complex financial products have features that may seem unnecessary but are suitable for certain sophisticated clients or those seeking specific outcomes. The rule risks oversimplifying any suitability assessment by potentially equating complexity with unsuitability, which will limit the range of products advisors can offer and deprive investors of actually matching product and payoff types.

d) Overcompliance risk

Being exposed to a rule which requires a negative screening ((absence of unnecessary features), firms may err on the side of caution, avoiding non-standard, more complex or tailored products altogether to reduce regulatory risk, even if these products are perfectly suitable for certain clients. This reduces product diversity and customization

in the market. Firms would be in any case required to undertake detailed analysis to determine whether all specific features of a product are necessary for a particular client. This adds substantial operational costs, as firms must establish additional compliance procedures, legal reviews, and monitoring mechanisms.

e) Regulatory uncertainty and inconsistent enforcement

There is a big danger that regulators interpret the rule differently across jurisdictions given the unclarity in the used legal term. This not only creates uncertainty for firms that operate in multiple countries, but also would add on to an already highly fragmented regulatory system.

f) Misalignment with client understanding

Clients may not understand the reasoning behind excluding certain features, which would likely follow from a regulatory practice seeking to capture all possible aspect of what may be potentially seen as “unnecessary”, resulting in dissatisfaction or even litigation if they feel deprived of potentially beneficial features. There is also the risk of clients being presented with a narrower range of options than they might want or need. In foreseeably quite some cases, excluding a product due to "unnecessary features" might conflict with the client's best interest or the duty of best execution. For example, a product with complex features might offer better terms, such as lower costs or higher returns, which would actually serve the client better than a simpler alternative.

g) Challenge of judging a negative condition

Firms and advisors are burdened with the responsibility of proving a negative, i.e., that a product does not contain anything unnecessary.

Evaluating whether something lacks unnecessary features is inherently more complex than determining whether a product or service possesses certain characteristics. In the context of MiFID, inserting such a negative condition requires advisors to prove the absence of unnecessary features, which is far more subjective and legally ambiguous than assessing positive qualities such as suitability or risk level.

Legally, proving a negative condition is often more difficult because it requires comprehensive justification as to why a specific feature is necessary in each instance. This creates a high evidentiary burden on firms, potentially requiring extensive documentation and argumentation for each product recommended.

To illustrate the impact of the above, we list below some examples of standard features of structured products that investors are widely using to achieve specific returns (e.g. playing a market scenario which they believe in) .

Examples are:

- Performance-Linked Features or Conditional Returns

  Contingent Coupon Payments: Products offering additional payments based on conditions on the performance of the underling (e.g. above a specific level) might be contested as unnecessary by investors if these conditions are not met, leading to lower-than-expected returns.

Benefit of such feature: It provides a pick-up rate above the risk-free rate.

- Risk Mitigation Mechanisms That Affect Returns

  Capital Protection Caps or Floors: Features intended to protect capital (e.g., principal protection with caps on upside gains) could be questioned as unnecessary by investors who focus on the limited upside when the product underperforms(e.g., return below a direct investment in the underlying).

  Benefit of such feature: It provides a fixed level capital protection at maturity. Cost of opportunity: no risk-free interest rate paid, and more limited upside exposure.

  Downside Barrier protection: these are income product paying usually risk-free rate plus a pickup, which is financed by taking market risk (e.g., if an index is down less than 30%, no capital loss, if more than 30%, the capital repayment is gradually impacted by the drop in the underlying). This could be questioned as unnecessary by investors who focus on the limited upside when the underlying does not go below the barrier (e.g., returns below a direct investment in the underlying).

  Benefit of such feature: It provides a downside protection. Cost of opportunity: more limited upside exposure than a direct investment in the underlying

  Stop-Loss Triggers: Mechanisms that automatically adjust portfolios in response to market conditions may be criticized if they lead to reduced gains in a subsequent market rebound, with investors claiming they weren't needed.

  Benefit of such feature: It is automatically limiting the losses in a fast market drop.

- **Autocallable features**: these allow the investor to get their investment back before the end of the term of a product (e.g., annual early redemption at 100% capital invested and an annual exit rate of 8% per year elapsed if the underlying has positively performed). This could be questioned as unnecessary by investors who could claim that a direct investment in the underlying would have generated higher returns in a situation where the underlying performs more than the product exit rate.
  Benefit: providing a return in a flattish to moderately bullish market. Cost of opportunity: more limited upside exposure than a direct investment in the underlying.

- **Liquidity Constraints**

  Exit Restrictions: Even if a product typically has a defined investment horizon, investors might claim these lockups were unnecessary if they are unhappy with performance and wish they could have exited earlier.

  Benefit of such feature: It makes the hedging possible on illiquid underlyings.

- **Use of Leverage or Gearing**

  Leveraged Products or Funds: Leveraged ETFs, notes, or funds can be attractive in up markets but may also lead to amplified losses. If such products perform poorly, investors

might argue that leverage was an unnecessary feature, especially if they were not fully aware of how it would affect their risk exposure.

Benefit of such feature: It allows an investor to get higher exposure to the underlying (e.g. 2x the performance) while not disbursing (2x) the investment amount. Cost of opportunity : financing of leverage.

- **Interest Rate or Currency Exposure**

  Floating vs. Fixed Interest Rate Exposure: If a product is linked to variable interest rates and rates move unfavourably, investors may argue that a fixed rate would have been more suitable, labelling the floating rate feature as unnecessary.

  Benefit of such feature: It allows an investor to follow a rate scenario (raise/fall/ steepening/flattening of curve)

  Unhedged Foreign Currency Exposure: Products investing internationally without currency hedging may face criticism for currency fluctuations that negatively affect returns, with investors claiming the exposure was unnecessary and added unforeseen risk.

  Benefit of such feature: There are no cost of a currency hedging (mechanism).

In summary, should above and other features, which are often an integral part of many financial products, be allowed to become subject of an ex-post evaluation of their "necessity", to which the recital in question here invites, the distribution of products with a market adequate exposure to capital markets runs the risk to be severely impeded.

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