

# VALUE FOR MONEY: A CHANGING RETAIL INVESTMENT LANDSCAPE IN THE UK AND THE EU

On 24 May 2023 the European Commission adopted a retail investment package<sup>1</sup> which aims to empower retail investors to make investment decisions that are aligned with their needs and preferences, while ensuring that they are treated fairly and duly protected. Significantly, the package includes a Retail Investment Strategy (RIS) that would require manufacturers and distributors of investment products to ensure that these products bring real “value for money” to retail investors.

To UK regulatory lawyers this language around value for money will feel familiar, and for good reason. On 31 July the Consumer Duty (the **Duty**) will come into effect for new and existing products and services, setting higher and clearer standards of consumer protection across financial services. Spearheaded by a new Consumer Principle that requires firms to act to deliver good outcomes for retail customers, the Duty further comprises a series of complementary cross-cutting rules and expected outcomes, including – crucially – an outcome around price and value.

Both the EU and UK regulators are, therefore, interested in the relationship between the price a consumer pays for a product or service, and the benefits they receive from it. But how do their approaches differ? And what might the EU learn from the UK’s implementation of the Duty?

## Placing value in context

The act of tracing the UK and EU’s respective journeys on fair value betrays key differences in regulatory approach.

<sup>1</sup> [https://finance.ec.europa.eu/publications/retail-investment-package\\_en](https://finance.ec.europa.eu/publications/retail-investment-package_en)

<sup>2</sup> The FCA’s asset management market study, the final report for which was published in June 2017, considered whether products offered appropriate value and noted that “persistently high levels of profit ... suggest that prices lie above competitive levels, which in turn indicates that on average investors may not be achieving value for money” (<https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf>). The FCA subsequently embarked on its Investment Platforms Market Study, which looked at the role of platforms in retail investor access to investment products offering value for money. See also FS 19/4 FS19/4: Fair Pricing in Financial Services: summary of responses and next steps ([fca.org.uk](https://www.fca.org.uk)) and PS 21/5: PS21/5: General insurance pricing practices market study: feedback to CP20/19 and final rules ([fca.org.uk](https://www.fca.org.uk)).

The UK’s proposals on fair value are contextualised by a long-running programme of FCA work on fair pricing, which has most recently been applied in policy interventions in general insurance and funeral plans.<sup>2</sup> The FCA has, moreover, previously shown itself to be muscular on the topic of pricing and value, setting limits on payday loan interest charges and introducing specific measures on overdraft pricing.<sup>3</sup>

Significantly, the FCA’s language around these interventions is couched in terms of consumer harm, language replicated in the context of the price and value outcome of the Duty (“retail customers experience harm where they don’t get value for their money”).<sup>4</sup> This marks a subtle point of difference with the EU’s approach.

Developing long term retail investment in EU capital markets (which has traditionally been lower than in other jurisdictions such as the United States) is one of the main objectives of the EU’s Capital Markets Union (CMU) action plan published in September 2020. The RIS – an earlier form of which was subject to public consultation in 2021<sup>5</sup> – aims to achieve this goal. While seeking to ensure that consumers are treated fairly and duly protected, the EU’s approach to value is also driven by a desire to “enhance retail investors’ trust in capital markets” because this is “essential to make a success of the Capital Markets Union”.<sup>6</sup>

This is not to suggest that consumer harm is unimportant to the EU, as evidenced by previous work on the topic of value for money. Last month, for example, ESMA published an Opinion that made a case for clarifying the concept of “undue costs” in the UCITS Directive

<sup>3</sup> <https://www.fca.org.uk/news/press-releases/fca-confirms-price-cap-rules-payday-lenders> and [FCA gives update on banks’ overdraft pricing decisions and plans to support consumers | FCA](https://www.fca.org.uk/news/press-releases/fca-gives-update-on-banks-overdraft-pricing-decisions-and-plans-to-support-consumers).

<sup>4</sup> FCA, FG22/5 Final non-Handbook Guidance for firms on the Consumer Duty (July 2022), p.56. Available at <https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf>.

<sup>5</sup> [https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12755-EU-strategy-for-retail-investors\\_en](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12755-EU-strategy-for-retail-investors_en).

<sup>6</sup> European Commission, Questions and answers on the Retail Investment Package (24 May 2023). Available at [https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_23\\_2869](https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_2869).

(2009/65/EC) and Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD). This was prompted by one of the findings emerging from ESMA's 2021 Common Supervisory Action on costs and fees, which showed divergent market practices as to what industry reported as "due" or "undue" costs in funds<sup>7</sup>. EIOPA too has underlined the need to put consumer outcomes at the heart of life insurance product design and distribution, following observations that unit-linked products provide average higher returns despite the higher costs, but also expose policyholders to market shocks and volatility.<sup>8</sup>

Rather, it could be said that the UK's approach is driven by the desire to protect the financial health and wellbeing of the individual consumer, where the EU approach focuses more on the financial health and wellbeing of the CMU.

### Regulating value - the regulatory mechanics

As the UK and EU differ in their ends, so they differ in their means; where the UK takes an agile, outcomes-based approach, the EU is more prescriptive when it comes to what represents value for money. A closer look at each approach is potentially valuable here.

#### The UK

The FCA defines "value" as the relationship between the amount paid by a retail customer for the product and the benefits they can reasonably expect to get from the product. A product is deemed to provide fair value where the amount paid for the product is reasonable relative to the benefits of the product.<sup>9</sup> This does not, however, directly translate to lower prices meaning fair value, and the FCA has made it clear that price is only one aspect of value.

Instead, the FCA's approach to fair value is flexible and context specific. The FCA has set out factors that must be taken into account as part of a value assessment, which go beyond price and include the nature of the

<sup>7</sup> Verena Ross, Chair of ESMA, said: "If we want to enhance retail investors' participation in capital markets, we should ensure that the expected return of investment products isn't impacted by undue costs. That investors get value for their money is even more important in the current market situation, with heightened inflation and tightening of financial conditions" (<https://www.esma.europa.eu/press-news/esma-news/esma-calls-legislative-amendments-prevent-undue-costs-funds>).

<sup>8</sup> [https://www.eiopa.europa.eu/eiopa-issues-its-methodology-assessing-value-money-unit-linked-market-2022-10-31\\_en](https://www.eiopa.europa.eu/eiopa-issues-its-methodology-assessing-value-money-unit-linked-market-2022-10-31_en)

<sup>9</sup> PRIN 2A.4.1R.

<sup>10</sup> PRIN 2A.4.8R.

<sup>11</sup> PRIN 2A.4.9G.

<sup>12</sup> See comments on p.8 : <https://www.fca.org.uk/publication/transcripts/inside-fca-transcript-ed-smith-what-is-price-value-outcome.pdf> .

product, any limitations that are part of the product and any characteristics of vulnerability displayed by retail customers in the target market.<sup>10</sup> Firms may also look to the costs incurred in manufacturing and/or distributing the product and the market rates and charges for comparable products.<sup>11</sup> Benchmarking is an important, but not the only, part of a value assessment: firms need to satisfy themselves that a product in and of itself provides fair value.<sup>12</sup>

Both manufacturers and distributors are responsible for the value assessment, which (for the manufacturers) must be conducted at every stage of the product approval process, and (for the distributors) must be considered when determining the distribution strategy for the products. The distribution strategy must be regularly reviewed.<sup>13</sup> If a product is not providing fair value, remedial action may need to be taken and the product may need to be withdrawn.

The elasticity of this approach to value reflects the FCA's aversion to setting prices for firms (at least for the foreseeable future).<sup>14</sup> Nonetheless, the FCA expects firms to consider whether products with a high profit margin are delivering good value for customers, and firms should consider using their value assessments as a prompt for "taking an honest and critical approach" about the value proposition offered by their most profitable products<sup>15</sup>. To minimise the risk of breach, firms should have developed and recorded a clear articulation of their "value" assessments and update them regularly.

#### The EU

The Commission's legislative proposal on the RIS includes an Omnibus Directive amending EU MiFID II, the Insurance Distribution Directive (IDD), the UCITS Directive, AIFMD and Solvency II to address a variety of issues along the retail investor journey (the **Amending Directive**)<sup>16</sup>.

The Amending Directive would revise existing product governance rules in sectoral legislation to "fully tackle the

<sup>13</sup> PRIN 2A.4.19R, PRIN 2A.4.24R.

<sup>14</sup> See the FCA's 2019 Feedback Statement on Fair Pricing in Financial Services, in which the FCA noted the difficulty of making prescriptive rules around fair pricing: "Assessing whether a particular pricing practice is unfair can be complex and the issues can vary from market to market. So, there is no simple formula that determines whether a practice is unfair, and we will use our judgment to balance the considerations in specific context. This implies that prescriptive rules are unlikely to be sufficient to incorporate our thinking into a regulatory approach. We consider at this stage that a principles-based approach may be more effective in driving appropriate outcomes..."

<sup>15</sup> [Countdown to the Consumer Duty | FCA and https://www.fca.org.uk/publications/good-and-poor-practice/consumer-duty-findings-our-review-fair-value-frameworks](https://www.fca.org.uk/publications/good-and-poor-practice/consumer-duty-findings-our-review-fair-value-frameworks)

<sup>16</sup> The package also includes separate targeted proposals to amend the Level 1 PRIIPs Regulation which would affect the contents of the PRIIPs Key Information Document.

issue of product cost-effectiveness<sup>17</sup> and ensure that products that are offered to retail clients offer good value for money. Existing product governance rules in MiFID II and the IDD will be complemented by new requirements on manufacturers to set out a “pricing process” allowing for the identification and quantification of all product costs and charges and an assessment of whether such costs and charges undermine the value which is expected to be brought by the product. If a manufacturer or distributor assesses that the product will not deliver value, they should not approve the product for distribution.

Similar value for money rules will be incorporated into the existing pricing process under the UCITS Directive and AIFMD. Where costs are considered to be undue, AIFMs and UCITS management companies will be required to compensate investors.

Unlike the UK’s outcome focused rules, the EU is looking to introduce an “objective” value assessment whereby product manufacturers and distributors will have to assess value by comparing the performance and costs of their products against certain cost and performance benchmarks set by ESMA and EIOPA. A deviation from the relevant benchmark would introduce a presumption that costs and charges are too high, and that the product will not deliver value for money (unless it can be demonstrated otherwise). Additional underlying legislation will provide further detail on this process.

In a further reinforcement of their data-centric approach to supervisory harmonisation, ESMA and EIOPA will need to rely on various new reporting requirements in MiFID II, the IDD, the UCITS Directive and AIFMD for manufacturers, distributors and national competent authorities, to facilitate the development of these benchmarks. They will also have a mandate to develop regulatory technical standards that define the parameters of those requirements.

### **Other points of interest**

Two other immediate points of interest emerge upon comparison of the EU and UK’s initiatives: that of the treatment of distribution chains, and the availability of customer compensation.

#### *Distribution chains*

In its review of fair value assessment frameworks, the FCA called for firms to consider the supply chain as a whole, particularly the impact successive distributors and their commission models can have on value.<sup>18</sup> The FCA encourages firms to query those in their distribution chains who ask for information which they feel goes

further than the relevant rules here. It has stressed that it does not want firms to create “overly burdensome processes going above and beyond what is required” and has been working with industry bodies to clarify expectations.<sup>19</sup>

In a similar vein, the EU requirements generally apply to both manufacturers and distributors of retail investment products. Distributors would be required to identify and quantify any costs that have not already been taken into account by the manufacturer, and to assess whether they are justified and proportionate to the needs and objectives of their clients.

#### *Customer claims*

In the UK the Duty paves the way for a potentially tougher regulatory enforcement environment for retail financial services firms and an accompanying increase in complaints and claims for compensation. For now, the FCA is not proposing to introduce a private right of action for breach of the Duty. The Duty could, however, be relevant to the interpretation of any civil claims brought under existing FCA rules.

The FCA has made it clear that it will be working closely with the Financial Ombudsman Service (FOS) during the implementation period for the Duty and beyond, through the Wider Implications Framework.<sup>20</sup> This is both to ensure that there is a consistent interpretation of the Duty and to monitor any decisions relating to customer complaints about fees, charges, and inappropriate sales.

At present, the enforcement processes for the EU proposals under the RIS are less developed, although as noted above the RIS does include a proposed requirement for AIFMs and UCITS management companies to compensate investors where undue costs have been charged, including where costs have been miscalculated to the detriment of investors. Further underlying legislation will be needed to provide the detail on this.

#### **What is the timing?**

In the UK, firms were required to complete fair value assessments for all their existing ‘open’ products by 30 April 2023. That milestone is also when the FCA expects manufacturers to have told distributors about the outcomes of their value assessments.

The regulatory journey for the EU’s proposals is really only just beginning. Finalisation of the Amending Directive (and related regulations) under the RIS might well become a task of the 2024 incoming European Parliament and Commission. Much of the final impact of RIS will also depend on the underlying Level 2 delegated

[frameworks#:~:text=Firms%20must%20undertake%20fair%20value,they%20can%20expect%20to%20receive.](#)

<sup>19</sup> <https://www.fca.org.uk/news/speeches/countdown-consumer-duty>.

<sup>20</sup> <https://www.financial-ombudsman.org.uk/who-we-are/work-other-organisations/wider-implications-framework>.

<sup>17</sup> See Impact Assessment Report accompanying the legislative proposal.

<sup>18</sup> FCA, Consumer Duty: Findings from our review of fair value frameworks (10 May 2023). Available at <https://www.fca.org.uk/publications/good-and-poor-practice/consumer-duty-findings-our-review-fair-value>

acts and technical standards which are foreseen under Level 1. The political and rule-making process, which will start in the autumn after conclusion of the public comment period in August 2023, is likely to reshape the current form of the RIS quite significantly.

It has never been more important for the financial services industry to seize the opportunity to provide practical and evidence-based input on the EU's proposals to help achieve the 'Better Regulation' result that is now at the heart of EU rulemaking.

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