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The application of suitability and appropriateness tests in relation to retail investors under EU capital markets law

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A. The legal framework as in force

I. "MiFID II" as the point of reference legislative act

1. Introductory remarks

(1) Directive 2014/65/EU of the European Parliament and of the Council (hereinafter 'the co-legislators') of 15 May 2014 "on markets in financial instruments (…) (recast)"[1] ('**MiFID II**') governs, *inter alia*, the *stricto sensu* protection of retail investors,[2] some aspects of which are the key issue discussed in this article. This legislative act, which contains 97 Articles and was published before the "Capital Market Union" ('**CMU**') project was launched,[3] was adopted in accordance with the ordinary legislative procedure laid down in **Article 289(1)** of the Treaty on the Functioning of the European Union[4] ('**TFEU**') on the legal basis of **Article 53(1) TFEU** on the coordination of the provisions laid down by law, regulation or administrative action in Member States concerning the taking-up and pursuit of activities as self-employed persons.[5] In accordance with the 3-level so-called "***Lamfalussy* procedure**", this is a "level 1" act.[6] It is in force as amended 11 times,[7] which in the author's view raises *per se* concerns as to legal certainty.[8]

As of 3 January 2018,[9] MiFID II repealed **Directive 2004/39/EC** of the co-legislators of 21 April 2004 on the same aspect ('**MiFID I**'),[10] which in turn had

[1] OJ L 173, 12.6.2014, pp. 349-496.

[2] On this term, see **Gortsos (2018)**.

[3] See however **Section C below, under C.I (2)**.

[4] Consolidated version, OJ C 202, 7.6.2016, pp. 47-200.

[5] On this TFEU Article see, by mere indication, **Schlag (2019)**.

[6] On the *Lamfalussy* procedure and its levels, see **Gortsos (2023a)**, pp. 413-423 (and the literature cited therein).

[7] The most recent consolidated text of this legislative act as of 28 March 2024 is available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02014L0065-20220228&qid=1647607249473>.

[8] See further **Section D below**.

[9] **MiFID II**, Article 94, first sub-paragraph, as amended by **Article 1, point (8) of Directive (EU) 2016/1034** of the co-legislators of 23 June 2016, which amended MiFID II (OJ L 175, 30.6.2016, *pp.* 8-11).

[10] OJ L 145, 30.4.2004, pp. 1-44. On this legal act, see by mere indication the various contributions in **Ferrarini and Wymeersch (2006**, editors**)**, **Moloney (2008)**, pp. 337-571 and the various contributions in **Avgouleas (2008**, general editor**)**.

repealed **Council Directive 93/22/EEC** "on investment services in the securities field" ('**ISD**'),[11] which was the first EU legal act laying down the conditions for the establishment of a single capital market in the European Union ('**EU**').[12] MiFID I was also repealed by **Regulation (EU) No 600/2014** of the co-legislators of 15 May 2014 "on markets in financial instruments (…)"[13] ('**MiFIR**'), which contains 55 Articles. MiFID II and MiFIR are referred to as '**twin legal acts**'.[14]

These legislative acts are sources of EU capital markets law, and their provisions mainly apply to investment firms. However, several of the provisions of MiFID II and the entire MiFIR also apply (*inter alia*) to credit institutions if their license covers the provision of investment services and/or the performance of investment activities.[15] In terms of definitions: '**investment firm**' means – in principle – any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis;[16] '**credit institution**' means[17] **(a)** an undertaking the business of which consists of taking deposits or other repayable funds from the public and granting credits for its own account (according to the traditional definition), *and* **(b)** an undertaking the business of which consists of carrying out any of the activities referred to in points (3) and (6) of Section A of Annex I to **MiFID II** subject to specific conditions (namely, dealing on own account and underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis) subject to specific conditions (*inter alia*, the total value of its consolidated assets exceeds 30 billion euro, the so-called '**Class 1 investment firm**').

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11 OJ L 141, 11.6.1993, pp. 27-46.

12 On the evolution of MiFID II, see **Moloney (2023)**, pp. 354-362.

13 OJ L 173, 12.6.2014, pp. 84-148, as in force.

14 On these twin acts, see by means of mere indication **Moloney (2023)** in various Chapters (on a thematic basis), **Sethe (2014a)** (relating to its impact on Swiss capital markets law) and **(2014b)** (on the third country regime under these twin acts), the contributions in **Busch and Ferrarini (2017**, editors**)**, **Gortsos (2017)** (on public enforcement under MiFID II) and **(2018)** (on investor protection, Articles 24-30 MIFID II), and various contributions (on a thematic basis) in **Veil (2022**, editor**)**. On the regime governing third-country firms thereunder, see **Busch and Louisse (2017)**. On the relation of MiFID II to other investor protection regulations, see **Willemaers (2014)** and **Colaert (2017)**.

15 **MiFID II**, Article 1(3), point (b) and **MiFIR II**, Article 1(2).

16 **MiFID II**, Article 4(1), point (1).

17 Article 4(1), point (1), (a) and (b), respectively, of **Regulation (EU) No 575/2013** (Capital Requirements Regulation, '**CRR**'), OJ L 176, 27/6/2013, pp. 1-337, as in force. The provisions of MiFID II discussed in this study apply to credit institutions in the meaning of the definition under point (a).

(2) One of the key features of MiFID II is that the level of protection provided to investors/clients does not have to be equal but may be differentiated depending on their sophistication.[18] **Recital (86)** makes in this respect the following consideration:

> "*One of the objectives of this Directive is to protect investors. Measures to protect investors should be adapted to the particularities of each category of investors (retail, professional and counterparties). However, in order to enhance the regulatory framework applicable to the provision of services irrespective of the categories of clients concerned, it is appropriate to make it clear that [the] principle to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading apply to the relationship with any clients.*"[19]

In that respect, MiFID II introduced the following provisions on the categorisation of clients: *on the one hand*, with regard to the investment services of receiving, transmitting and executing orders on behalf of clients and dealing on own account,[20] a **"three-tier categorisation"** has been introduced: retail clients,[21] professional clients, meaning clients meeting the criteria laid down in **Annex II to MiFID II**, and eligible counterparties.[22] *On the other hand*, with regard to the other investment services, a **"two-tier categorisation"** has been introduced: retail clients and professional clients.[23]

The practical implication of these categorisations is the level of protection provided to the client or potential client.

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[18] The same also applied under MiFID I; see on this **Gortsos (2008)**, pp. 105-112.

[19] That principle and this obligation are laid down in **Articles 24(1) and (3)**, respectively.

[20] 'Dealing on own account' means trading against proprietary capital resulting in the conclusion of transactions in one or more financial instruments (*ibid.*, Article 4(1), point (6)).

[21] On the specific need to protect retail investors under MiFID I and the limits of that regulatory framework, see **Moloney (2006)**, p. 418-420.

[22] Transactions executed with eligible counterparties are governed by Article 30 MiFID II.

[23] The categorisation of investors into retail and professional clients was, in principle, also provided in **Article 11 ISD**, but no criteria were laid down in order to determine how this categorisation should be effected. Under that Article, Member States should draw up rules of conduct which investment firms should observe at all times. These rules should be applied in such a way as to take into account the "professional nature" of the person to whom investment services were provided. MiFID I introduced objective criteria for the categorisation of clients, while the active involvement of investors themselves has also been provided for, whereby they assume, to a certain extent, responsibility with regard to the level of their protection. This approach has been retained in MiFID II as well.

2. In particular: on retail clients

Retail clients deserve the highest level of investor protection according to MiFID II and are defined (in a deductive way and following an "one-size-fits-all approach"[24]) as clients who are not professional ones.[25] In some cases, reference is also made in this legislative act to **'consumers'** (see, e.g., **recital (77)** and **Articles 74(2)** and **75(1)**). Retail investors are also referred to as **"consumer" investors**. This may be confusing, especially if read as leading to the unjustified conclusion that the policy objectives of investor and consumer protection are identical (although they share in common the rationale for eliminating/mitigating information asymmetries). In this respect, it is beyond any doubt that the investor as a shareholder or a bondholder is not a consumer whatsoever and cannot, by definition, be treated/protected as such. On the other hand, the investor as a counterparty to an institution providing investment services is *lato sensu* indeed a consumer of financial services. However, he/she will be protected as a consumer if he/she fulfils the conditions required by the relevant EU legislation (namely, a natural person who, in contracts covered by the relevant legal act, is acting for purposes which are outside his/her trade, business or profession).[26]

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24 It is interesting to note though that MiFID II does not – and correctly so – refer to the notion of the "average" investor. In contrast, as regards consumers, the Court of Justice of the EU has emphasised the need to consider the impact on a hypothetical, typical consumer when adjudicating advertising cases since the adoption of **Council Directive 84/450/EEC** of 10 September 1984 "relating to the approximation of the laws, regulations and administrative provisions of the Member States concerning misleading advertising" (OJ L 250, 19.9.1984, pp. 17-20, as in force). In line with the principle of proportionality and in order to ensure the effective implementation of protection, in **Directive 2005/29/EC** of the co-legislators of 11 May 2005 "concerning unfair business-to-consumer commercial practices in the internal market (…)" ('Unfair Commercial Practices Directive', OJ L 149, 11.6.2005, pp. 22-39, as in force) the "average consumer" is used as the benchmark. This refers to a consumer who is "*reasonably well-informed and reasonably observant and circumspect, taking into account social, cultural, and linguistic factors as interpreted by the Court* (…)" (*ibid.*, recital (18)).

25 **MiFID II**, Article 4(1), point (11); 'professional client' means a client meeting the criteria laid down in Annex II (*ibid.*, Article 4(1), point (10)). The term **'client'** is defined (*ibid.*, Article 4(1), point (9)) to mean any natural or legal person to whom an investment firm provides investment or ancillary services (as et out in Section B of Annex I). According to **recital (26)**, the term 'person' should be understood as including both natural and legal persons. The terms **'investor'** (not defined) and **'client'** (defined) are used in MiFID II as synonymous.

26 For example, a retail investor is entitled to protection under **Council Directive 93/13/EEC** of 5 April 1993 "on unfair terms in consumer contracts" (OJ L 95, 21.4.1993, pp. 29-34) if their investment services contract with an investment firm contains unfair contractual terms, provided the investor is a natural person acting for purposes unrelated to their trade, business, or profession. However, if the retail investor is a legal entity, they will not qualify as a consumer under this definition and will not receive the same protection.

Furthermore, the objectives of the legal acts governing investor protection, on the one hand, and consumer protection, on the other, are largely different.[27] Accordingly, it is this author's opinion that the use of the term 'consumer' in MiFID II is not fully justified, unless it is used for reference to consumer protection legal acts (see, e.g., **Articles 24(6)** and **25(7)**) and the retail investor fulfils the legislative requirements to be regarded as a consumer.[28]

II. Assessment of suitability and appropriateness of investment services and financial instruments provided to clients: the provisions of Article 25(1)-(4) MiFID II – in brief

(1) Under the current legislative framework and namely, **Article 25 MiFID II**, investment firms (and credit institutions)[29] must ensure and demonstrate to their (national) competent authorities ('**NCAs**') on request that natural persons giving investment advice or information about financial instruments,[30] investment services or ancillary services to clients on behalf of the investment firm possess "*the necessary knowledge and competence*" to fulfil their obliga-

It is noted that services to retail customers may fall under consumer contracts within the meaning of Article 15 of the **"Lugano Convention II"** of 30 October 2007 (Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L 339, 21.12.2007, pp. 3-41) and Article 6 of the **"Rome I Regulation"** (Regulation (EC) No 593/2008 of the co-legislators of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ L 177, 4.7.2008, pp. 6-16). See on this **Sethe (2024)**.

27 See on this also **Thiele (2014)**, p. 103, arguing that this is a development which is not solely observed after the recent international financial crisis. On the consumer of financial services and the rationale of its protection, see **Kingsdorf Smith and Dixon (2015)** (making use of the term 'financial citizen').

28 Pursuant to **Article 25(7) MiFID II**, if a credit agreement relating to residential immovable property has as a prerequisite the provision to a consumer of an investment service in relation to mortgage bonds specifically issued to secure the financing of and having identical terms as the credit agreement relating to residential immovable property, in order for the loan to be payable, refinanced or redeemed, that investment service is not subject to the obligations of **Article 25**.

29 Article 25 belongs to those which apply to credit institutions by virtue of Article 1(3), point (b). With one sole exception (and the conclusions), in the rest of this study reference will only be made to investment firms.

30 'Financial instrument' means those instruments specified in Section C of Annex I, including such instruments issued by means of distributed ledger technology (*ibid.*, Article 4(1), point (15)).

tions under Articles 24-25.[31] This same Article governs the assessment of suitability and appropriateness of clients.

(2) Suitability and appropriateness assessments differ significantly in terms of the information collected from retail clients: *on the one hand*, the **"suitability" test** applies in relation to the investment advice and portfolio management investment services (**Article 25(2)**);[32] and *on the other hand*, the **"appropriateness" test** applies in relation to other investment services (**Article 25(3)**), except for such services only consisting of execution or reception and transmission of client orders (**Article 25(4)**, hereinafter the '**execution-only regime**').[33] In particular:

First, to enable it to recommend to a client or potential client the investment services and financial instruments that are **"suitable"** for that client and, in particular, are in accordance with its risk tolerance and ability to bear losses, when providing investment advice or portfolio management, the investment firm must obtain the necessary information regarding that client's: (a) knowledge and experience in the investment field relevant to the specific type of product or service, including risk awareness; (b) financial situation including that client's ability to bear losses; and (c) investment objectives including their risk tolerance.[34] When the switching of financial instruments is involved in

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[31] *Ibid.*, Article 25(1), first sentence. This provision, which does not apply to eligible counterparties (*ibid.*, Article 30(1), first sub-paragraph), was based on the considerations set out in **recital (79)**: "*Given the complexity of investment products and the continuous innovation in their design, it is also important to ensure that staff who advise on or sell investment products to retail clients possess an appropriate level of knowledge and competence in relation to the products offered. Investment firms should allow their staff sufficient time and resources to achieve that knowledge and competence and to apply it in providing services to clients.*"

[32] 'Investment advice' means the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments; 'portfolio management' means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments (*ibid.*, Article 4(1), points (4) and (8), respectively).

[33] 'Execution of orders on behalf of clients' means acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients, including the conclusion of agreements to sell financial instruments issued by an investment firm or a credit institution at the moment of their issuance (*ibid.*, Article 4(1), point (5)). The provisions of Article 25(2)-(3) are almost identical with those of **Article 19(4)-(5) MiFID I**; Article 25(4) is based with some extensions on **Article 19(6) MiFID I**.

[34] National law must ensure that where investment advice is provided recommending a package of services or products bundled pursuant to **Article 24(11)**, the overall bundled package is suitable (*ibid.*, Article 25(2), first and second sub-paragraphs). Under

the provision of such investment services, the investment firm must obtain the necessary information on the client's investment and analyse the costs and benefits of switching; in the case – in particular – of investment advice provision, the investment firm must inform the client about this cost-benefit analysis.[35]

Second, when providing investment services other than those referred to above, investment firms must ask the client or potential client to provide information regarding (only) that client's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded. This should enable the investment firm to assess whether the investment service or product envisaged is **"appropriate"** for that client.[36] If the investment firm considers, on the basis of the information received, that the product or service is not appropriate to that client, it shall warn that client. If the latter does not provide the information referred to above, or the information regarding its knowledge and experience is insufficient, the investment firm shall warn that person that it is not in a position to determine whether the service or product envisaged is appropriate for it.[37]

Third, by means of exception under the execution-only regime, investment firms are allowed not to obtain the information or make the "appropriateness" determination when providing to a client investment services only consisting of execution or reception and transmission of client orders with or without ancillary services, excluding the granting of credits or loans as specified in Section B.1 of

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Article 24(11), which governs the "general principles and information to clients", when an investment service is offered together with another service or product as part of a package or as a condition for the same agreement or package, the investment firm shall inform the client whether it is possible to buy the different components separately and shall provide for separate evidence of the costs and charges of each component. If the risks resulting from such an agreement or package offered to a retail client are likely to be different from those associated with the components taken separately, the investment firm shall provide an adequate description of the different components of the agreement or package and the way in which its interaction modifies the risks.

35 *Ibid.*, Article 25(2), third sub-paragraph, inserted by Article 1, point (5) of **Directive (EU) 2021/338** of the co-legislators of 16 February 2021, which amended MiFID II (OJ L 68, 26.2.2021, *pp.* 14-28). 'Switching of financial instruments' means selling a financial instrument and buying another one or exercising a right to make a change with regard to an existing one (**MiFID II**, Article 4(1), point (8a)). On investment suitability requirements in general (under behavioural economics), see **Baisch and Weber (2015)**.

36 If a bundle of services or products is envisaged pursuant to Article 24(11), the assessment shall consider the appropriateness of the overall bundled package.

37 Both warnings may be provided in a standardised format; *ibid.*, Article 25(3), first – third sub-paragraphs.

Annex I that do not comprise of existing credit limits of loans, current accounts and overdraft facilities of clients, if the conditions set out in **Article 25(4)** are met.[38]

(3) Accordingly, during an appropriateness assessment, less information is gathered compared to that of a suitability assessment. This difference is reasonable since the provision of effective advice or portfolio management services requires a thorough understanding of the client's entire profile (and, thus, a suitable investment strategy should be recommended). In contrast, appropriateness assessment gathers minimal information, focusing on the client's knowledge and experience (in this case, a warning is sufficient).

III. Commission delegated acts

1. Introductory remarks: the two categories of delegated acts

MIFID II empowers in several Articles the Commission to adopt delegated acts in the meaning of **Article 290 TFEU**, as follows:

First, several delegated acts have been adopted in accordance with **Article 89 MiFID II**.[39] This is the case, *inter alia*, in Article 25. In particular, by virtue of **Article 25(8)**, the Commission has been empowered to adopt delegated acts in accordance with **Article 89** to ensure that investment firms comply with the principles set out in **Article 25(2)-(6)** when providing investment or ancillary services to their clients. These delegated acts should take into account (*inter alia*): "*(c) the* ***retail or professional nature of the client*** *or potential clients (…)*".[40]

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[38] On this provision, see also **recital (80) MiFID II**.

[39] Under this Article, the delegation has been conferred on the Commission for an indeterminate period of time from **2 July 2014** and may be revoked at any time by the co-legislators. A revocation decision will put an end to the delegation of power specified in that decision, will take effect the day following the publication of the decision in the OJ or at a later date specified therein, but not affect the validity of any delegated acts already in force (**MiFID II**, Article 89(1)-(3)).

[40] In addition, by virtue of **Article 25(4), point (a)**, the Commission adopted on 13 December 2017 in accordance with the examination procedure referred to in **Article 89a(2)** its **Implementing Decisions (EU) 2017/2318**, **2017/2319** and **2017/2320** on the equivalence of the legal and supervisory framework in, respectively, Australia (applicable to financial markets), Hong Kong Special Administrative Region (applicable to recognised exchange companies) and the USA (for national securities exchanges and alternative trading systems) (OJ L 331, 14.12.2017, *pp.* 81-86, 87-93 and 94-101, *respectively*). *The power to adopt these* "equivalence decisions" was conferred upon the Commission by the amendment of MiFID II by Article 1, point (2) of (the above-mentioned) **Directive (EU) 2016/1034**. On the examination procedure, which is provided for in **Regulation (EU) No 182/2011** of the co-legislators of 16 February 2011 "laying down the rules and general principles concerning

Second, on the basis of other MiFID II Articles (but not – yet – of Article 25[41]), the Commission has been empowered to adopt delegated and implementing acts in the meaning of **Articles 290-291 TFEU**, which are based, respectively, on draft regulatory technical standards ('**RTSs**') and draft implementing technical standards ('**ITSs**') of the European Securities and Markets Authority ('**ESMA**'), in accordance (respectively) with **Articles 10-14** and **15** of its founding Regulation[42] ('**ESMAR**'). These delegated and implementing acts constitute the "level 2" of the above-mentioned *Lamfalussy* procedure.[43]

2. The Commission Delegated Regulation (EU) 2017/565 of 25 April 2016

In accordance with **Article 89 MiFID II**, the Commission adopted on 25 April 2016 its **Delegated Regulation (EU) 2017/565** supplementing MiFID II "as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive"[44] (hereinafter '**DR 2017/565**'). This is an "omnibus delegated act" based on a total of 19 empowerments by several Articles of MiFID II.[45] In relation to Article 25 in general, directly related are **Articles 54-63** of the delegated act; as concerns the subject of this study (i.e., suitability and appropriateness assessments), of interest are its **Articles 54-57**, on which the following is briefly noted:

First, commencing with the recitals, apart from their differences in scope, the two assessments also have different functions and characteristics.[46]

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mechanisms for control by Member States of the Commission's exercise of implementing powers" (OJ L 55, 28.2.2011, pp. 13-20), adopted on the basis of **Article 291(3) TFEU**, see **Gortsos (2023a)**, pp. 423-431.

41 See on this, however, also **Section C** **below, under** **C.II.4 (1)**.

42 **Regulation (EU) No 1095/2010** of the co-legislators of 24 November 2010, OJ L 331, 15.12.2010, pp. 84-119, as in force.

43 In the course of adopting draft RTSs and ITSs, the ESMA may request the opinion of the Securities and Markets Stakeholder Group established in accordance with Article 37 ESMAR. On legislative, delegated and implementing acts in general, see **Craig and de Búrca (2020)**, pp. 157-175.

44 OJ L 87, 31.3.2017, pp. 1-83. This is in force as amended 5 times. Under the fourth amendment by **Commission Delegated Regulation (EU) 2021/1253** of 21 April 2021 (OJ L 277, 2.8.2021, pp. 1-5), sustainability factors, risks and preferences were integrated into certain organisational requirements and operating conditions for investment firms (and credit institutions).

45 Namely, Articles 4(1)-(2), 16(12), 23(4), 24(13), 25(8), 27(9), 28(3), 30(5), 31(4), 32(4), 33(8), 52(4), 54(4), 58(6), 64(7), 65(7) and 79(8) MiFID II.

46 **DR 2017/565**, recital (84).

Furthermore, for the purposes of applying **Article 25(2) MiFID II** of importance are the following considerations:[47]

(i) A transaction may be unsuitable for the client or potential client due to the risks of the associated financial instruments, the type of transaction, the characteristics of the order or the frequency of the trading. A series of transactions, each of which are suitable when viewed in isolation may be unsuitable if the recommendation or the decisions to trade are made with a frequency that is not in the best interests of the client. In the case of portfolio management, a transaction might also be unsuitable if it would result in an unsuitable portfolio.

(ii) Investment firms should undertake a suitability assessment not only in relation to recommendations to buy a financial instrument but for all decisions on whether to trade, including whether or not to buy, hold or sell an investment.

(iii) A recommendation or request made, or advice given, by a portfolio manager to a client to the effect that the latter should give or alter a mandate to the portfolio manager defining the limits its discretion is covered by **Article 25(2)**.

Second, **Article 55** contains specific provisions, which are common to the assessment of suitability or appropriateness (Article 25(2) and (3) MiFID II):

(a) To the extent appropriate to the client's nature, the nature and extent of the services to be provided to it and the type of product or transaction envisaged, including their complexity and the risks involved, investment firms must ensure that the information regarding a client's or potential client's knowledge and experience in the investment field includes the types of service, transaction and financial instrument with which it is familiar, the nature, volume, and frequency of its transactions in financial instruments and the period over which they have been carried out, and the level of its education and profession or relevant former profession.[48]

(b) In addition, investment firms are not allowed to discourage a client or potential client from providing information required for the purposes of **Article 25(2)-(3) MiFID II** and are entitled to rely on the information provided by their clients or potential clients, unless they are or ought to be aware that the information is manifestly outdated, inaccurate or incomplete.[49]

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47 *Ibid.*, recitals (87)-(89).

48 *Ibid.*, Article 55(1).

49 *Ibid.*, Article 55(2)-(3).

Third, **Article 54** imposes the following (detailed and extensive) requirements with regard to the assessment of suitability on investment firms:[50]

(a) They are not allowed to create any ambiguity or confusion about their responsibilities in the process when assessing the suitability of investment services or financial instruments under **Article 25(2) MiFID II**. When undertaking the suitability assessment, they must inform clients or potential clients, clearly and simply, that the reason for assessing suitability is to enable them to act in the best interest of their clients. In order to take market developments into account and ensure the same level of investor protection, when investment advice or portfolio management services are provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment lies with the institution providing the service and may not be reduced by the use of an electronic system in making the personal recommendation or decision to trade.

(b) They must determine the extent of the information to be collected from their client in light of all the features of the investment advice or portfolio management services to be provided and obtain from the client or potential client all necessary information in order to understand the essential facts about it and have a reasonable basis for determining (on the basis of the nature and extent of the service provided) that the specific transaction to be recommended (or entered into in the course of providing a portfolio management service), satisfies the following criteria: it meets the client's investment objectives *and* is such that the client is able financially to bear any related investment risks consistent with his/her investment objectives *and* has the necessary experience and knowledge in order to understand the risks involved.

(c) The information regarding the client's **financial situation** must include, if relevant, information on the source and extent of its regular income, assets (including liquid ones), investments and real property, and regular financial commitments.

(d) The information regarding the client's **investment objectives** must include, if relevant, information on the length of time for which it wishes to hold the investment, its preferences regarding risk taking, its risk profile and the purpose of the investment.

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50 *Ibid.*, Article 54(1)-(2) and (4)-(11), respectively. Article 54(3) refers to the provision of investment services to **professional clients.** This Article also contains provisions on suitability reports under MiFID II.

(e) If a client is a legal person or a group of two or more natural persons or if one or more natural persons are represented by another natural person, investment firms must **establish, implement and record a policy** as to the person to be subject to the suitability assessment and how this will be conducted (including from which person will be collected information about knowledge and experience, financial situation and investment objectives).

(f) Investment firms must take reasonable steps to ensure the **reliability of the information** collected about their clients or potential clients. If they have an on-going relationship with the client, such as by providing an ongoing advice or portfolio management service, they must have in place, and be able to demonstrate, appropriate policies and procedures to maintain adequate and up-to-date information about clients to the extent necessary to fulfil the requirements under **Article 54(2)**.

(g) Investment firms providing investment advice or portfolio management services and not obtaining the information required under **Article 25(2) MiFID II** are not allowed to recommend investment services or financial instruments to the client or potential client.

(h) Investment firms must have in place and be able to demonstrate adequate policies and procedures in place to ensure that they understand the nature, features, including costs and risks of investment services and financial instruments selected for their clients and that they assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their clients' profile.

(i) Investment firms providing **investment advice or portfolio management services** are not allowed to recommend or decide to trade if no service or instrument is suitable for the client.

(j) In terms of cost-benefit analysis, investment firms providing such services that involve switching investments – either by selling an instrument and buying another or by exercising a right to make a change in regard to an existing instrument – must collect the necessary information on the client's existing investments and the recommended new investments and undertake an analysis of the costs and benefits of the switch.[51]

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[51] Article 54(12)-(13) govern, respectively, investment firms' obligation to provide a suitability report to retail clients and periodic suitability assessments.

Third, **Article 56** (“Assessment of appropriateness and related record-keeping obligations”, Article 25(3) and (5) MiFID II) reinforces the rule laid down in **Article 25(3) MiFID II**.[52]

Finally, **Article 57** (“Provision of services in non-complex instruments”, Article 25(4)) specifies that any financial instrument not explicitly specified in **Article 25(4), point (a) MiFID II** must be considered as **‘non-complex’** for the purposes of **point (a)(vi)** if 6 criteria are cumulatively satisfied.

B. In particular: relevant ESMA Guidelines

I. Guidelines adopted by virtue of Article 25 MiFID II

(1) At “level 3” of the *Lamfalussy* procedure, the (“level 1”) legislative acts may impose on the ESMA or confer upon it the power to issue “soft law” instruments, namely, Guidelines and Recommendations (adopted in accordance with **Article 16 ESMAR**), which specify the rules adopted at levels 1 and 2.[53] In accordance with **Article 25(9)-(10) MiFID II**, the ESMA should adopt by 3 January 2016 **Guidelines** specifying criteria for the assessment of knowledge and competence required under Article 25(1) and by 3 January 2016, and periodically update, **Guidelines** for the assessment of financial instruments incorporating a structure which makes it difficult for the client to understand the risk involved in accordance with Article 25(4), points (a)(ii)-(iii), as well as structured deposits[54] incorporating a structure which makes it difficult for the client to understand the risk of return or the cost of exiting the product before term, in accordance with Article 25(4), point (a)(v).

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52 It also provides that investment firms are entitled to assume that a **professional client** has the necessary experience and knowledge to understand the risks involved in relation to the particular investment services or transactions for which it is classified as a professional client (**DR 2017/565**, Article 56(1), second sub-paragraph). Article 56(2) stipulates that investment firms must maintain records of the appropriateness assessments undertaken and specifies their content.

53 It may also issue Opinions, in accordance with **Article 16a ESMAR**. Delegated and implementing acts, as well as ESMA Guidelines, include quite detailed provisions in relation to the implementation of the level 1 rules. In that sense, the numerous level 2 and 3 measures adopted in the context of MiFID II accentuate its rules-based approach.

54 ‘Structured deposit’ means a deposit as defined in Article 2(1), point (3) of Directive 2014/49/EU of the co-legislators of 16 April 2014 “on deposit guarantee schemes (recast)” (OJ L 173, 12.6.2014, pp. 149-178, ‘**DGSD**’), which is fully repayable at maturity on terms under which interest or a premium will be paid or is at risk, according to a formula involving various factors (**MiFID II**, Article 4(1), point (43)).

Furthermore, pursuant to **Article 25(11)**, the ESMA was empowered to develop and periodically update **Guidelines** for the assessment of financial instruments being classified as non-complex for the purpose of Article 25(4), point (a)(vi) taking into account the Commission's delegated acts adopted under Article 25(8).[55]

(2) The **ESMA Guidelines** "on complex debt instruments and structured deposits" (**ESMA/2015/1787**) were adopted on 4 February 2016 on the basis of Article 25(4), points (a)(ii)-(iii) and (a)(v) MiFID II.[56] Their purpose is to specify the criteria for the assessment of debt instruments incorporating a structure which makes it difficult for the client to understand the risk involved, and structured deposits incorporating a structure which makes it difficult for the client to understand the risk of return or the cost of exiting the product before term, *and* clarify the concept of **'embedded derivatives'** in order to provide an overall framework for the application of **Article 25(4), point (a) MiFID II** in relation to debt instruments. The ESMA expects that these Guidelines will strengthen investor protection and promote greater convergence in the classification of 'complex' or 'non-complex' financial instruments or structured deposits for the purposes of the appropriateness test for execution-only investment services in accordance with **Article 25(3)-(4)**.[57]

(3) The recently issued ESMA Guidelines on suitability and appropriateness assessments (**Guidelines** of 3 January 2022 "on certain aspects of the MiFID II appropriateness and execution-only requirements" (**ESMA35-43-2938**), and of 3 April 2023 "on certain aspects of the MiFID II suitability requirements" (**ESMA35-43-3172**)), contain highly detailed implementation (level 1 *and* level 2) provisions. Having gained substantial experience during the initial adoption of MiFID II, the ESMA provides now more targeted guidance to investment firms on how to comply with the regulatory framework by pursuing the objective of ensuring a consistent and harmonised application of the relevant require-

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55 See **Section A above, under A.III.1**.

56 At: <https://www.esma.europa.eu/sites/default/files/library/2015-1787_-_guidelines_on_complex_debt_instruments_and_structured_deposits.pdf>.

57 **ESMA Guidelines (2016)**, Section III, paras. 5-7. As to the structure, the Guidelines themselves are laid down in **Section V** as follows: **(i)** For the purpose of **Article 25(4), points (a)(ii)-(iii) MiFID II**, the Guidelines on debt instruments embedding a derivative are laid down in **Section I (para. 12)** and those on debt instruments incorporating a structure making it difficult for the client to understand the risk in **Section II (para. 13)**. **(ii)** For the purpose of **Article 25(4), point (a)(v) MiFID II**, the Guidelines on structured deposits incorporating a structure making it difficult for the client to understand the risk of return are laid down in **Section III (para. 14)**, and those on structured deposits incorporating a structure making it difficult for the client to understand the cost of exiting before term in **Section IV (para. 15)**.

ments. Notably, the Guidelines emphasise the importance of how questions are framed, as the way a question is asked can significantly influence the response.

For instance, regarding client self-assessments, the ESMA highlights the following:[58]

> *"Self-assessment should be counterbalanced by objective criteria. For example:*
>
> *– instead of asking whether a client understands the notions of risk-return trade off and risk diversification, the firm should present some practical examples of situations that may occur in practice, for example by means of graphs or through positive and negative scenarios which are based on reasonable assumptions;*
>
> *– instead of asking whether a client has sufficient knowledge about the main characteristics and risks of specific types of investment products, the firm should for instance ask questions aimed at assessing the client's real knowledge about the specific types of investment products, for example by asking the client multiple choice questions to which the client should provide the right answer."*

(3) Of relevance are also the **ESMA Guidelines** of 3 January 2017 "for the assessment of knowledge and competence" (**ESMA71-1154262120-153 EN (rev)**) adopted on the basis of Article 25(9) MiFID II.[59] These Guidelines set standards for the assessment of knowledge and competence for staff providing relevant services in order to assist with institutions and other firms in meeting their obligations to act in the best interest of their clients and to assist with NCAs to adequately assess how they meet these obligations, is to specify the criteria for the assessment of knowledge and competence required under Article 25(1).

II. The Guidelines of 3 August 2023 on MiFID II product governance requirements on the interaction between the target market requirements and the appropriateness assessment

(1) In accordance with **Articles 16(3)** and **24(2) MiFID II**, firms manufacturing financial instruments and structured deposits (hereinafter '**products**') for sale to clients or distributing products to clients must maintain, operate and review adequate product governance arrangements. As part of these arrangements, a target market of end clients must be identified and periodically reviewed for each product, and a distribution strategy must also be consistent

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58 See **ESMA35-43-3172**, para. 46. See also **ESMA35-43-2938**, para. 25.

59 At: <https://www.esma.europa.eu/sites/default/files/library/esma71-1154262120-153_guidelines_for_the_assessment_of_knowledge_and_competence_corrigendum.pdf>. For details, see further **Gortsos (2018)**, pp. 128-134.

with the identified target market.[60] By virtue of **Articles 16(12) and 24(13) MiFID II**, the Commission adopted on 7 April 2016 **Commission Delegated Directive (EU) 2017/593** of supplementing MiFID II "with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits".[61] Of relevance in this context are Articles 9-10 whose aim is to ensure that firms manufacturing and distributing financial instruments should avoid and reduce, from an early stage, potential risks of failure to comply with investor protection rules.[62]

(2) On 3 August 2023, the ESMA issued its **Guidelines** "on MiFID II product governance requirements" (**ESMA35-43-3448**),[63] which are applicable from 3 October of that year and repealed its Guidelines of 2 June 2017 on the same issue (**ESMA35-43-620**),[64] These guidelines apply in relation to the manufacturing or distribution of financial instruments and structured deposits and in particular, in relation to the requirements set out in Articles 9(3), 16(3) and (6) and 24(1)-(2) MiFID II and (the just above-mentioned) Articles 9-10 of **Commission Delegated Directive (EU) 2017/593**. In recognising the problematic interaction between the target market requirements and the appropriateness assessment, making it difficult to effectively match the information, these Guidelines offer investment firms two options to address the issue:

> *on the one hand*, the *ex-ante* assessment of the actual target market is influenced by the services provided, since it can be conducted more or less thoroughly depending on the level of client information available, which in turn depends on the type of

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60 In particular, **Article 16(3)** refers to "organisational requirements". **Article 24(2)** imposes on investment firms specific obligations regarding the distribution of financial instruments: ensure that the distribution strategy is compatible with the identified target market of end clients and that they themselves take reasonable steps to ensure that the financial instruments are distributed to that identified target market; understand the financial instruments they offer or recommend; assess the compatibility of such financial instruments with the clients' needs, taking also account of the identified target market of end clients; and ensure that such financial instruments are offered or recommended *only* when this is in the client's interest (Article 24(2), first and second sub-paragraphs, and recital (71), second and third sentences). In order to meet the last obligation, institutions offering or recommending products manufactured by firms, which are not subject to the product governance requirements of MiFID II or manufactured by third-country firms, should also have appropriate arrangements to obtain sufficient information about the financial instruments (*ibid.*, recital (71), last sentence).

61 OJ L 87, 31.3.2017, pp. 500-517.

62 **Commission Delegated Directive (EU) 2017/593**, recital (15), first sentence.

63 At: <https://www.esma.europa.eu/sites/default/files/2023-08/ESMA35-43-3448_Guidelines_on_product_governance.pdf>.

64 At: <https://www.esma.europa.eu/sites/default/files/library/esma35-43-620_report_on_guidelines_on_product_governance.pdf>.

services provided and the conduct of rules attached to their provision (in particular, investment advice and portfolio management allow for the acquisition of a wider set of information on clients compared to the other services);

on the other hand, the target market assessment influences the decision on the type of services that are going to be provided in relation to the nature of the product and the circumstances and needs of the identified target clients, considering that the level of investor protection varies for different investment services, depending on the rules that apply at the point of sale; in particular, investment advice and portfolio management services allow for a higher degree of investor protection, compared to other services provided under the appropriateness regime or under execution-only.[65]

Furthermore, the ESMA Guidelines provide the following in respect to this issue:

First, when defining their product assortment, distributors should pay particular attention to situations where they might not be able to conduct a thorough target market assessment by virtue of the type of services they provide. In particular, where they only carry out execution services with the assessment of appropriateness (e.g., through a brokerage platform), they should consider that they will usually be able to conduct an assessment of the actual target market which is limited to the sole categories of clients' knowledge and experience; where they only conduct execution services under the execution-only regime, not even the assessment of clients' knowledge and experience will usually be possible.

In this respect, firms should pay particular attention to the distribution strategy suggested by the manufacturer.[66] This is especially relevant for products characterised by complexity/risk features, as well as for situations where there might be significant conflicts of interest (such as in relation to products issued by entities within the firm's group or when distributors receive inducements from third parties), being also mindful of the limited level of protection afforded to clients at the point of sale by the appropriateness test, or no protection at all, in the case of execution-only. In such circumstances, distributors should duly consider all relevant information provided by the product manufacturer, both in terms of potential target market and distribution strategy.[67]

Second, since the client's protection decreases when information available is not sufficient to ensure a full target market assessment, distributors may also decide to let clients operate on a non-advised basis after warning them

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65 **ESMA Guidelines (2023)**, para. 53.

66 *Ibid.*, para. 54 with reference to paras. 19, point (b), 33 and 59-61.

67 *Ibid.*, para. 55.

that the firm is not in the position to assess their full compatibility with such products. In any case, this decision should always be based on the consideration of the product's features (e.g., in terms of costs/complexity), as well as on other relevant situations (e.g., conflicts of interest in case of self-placement or inducements). Therefore, products should not be distributed under non-advised sales if the distributor cannot reasonably expect (i.e., *ex-ante*) that the distribution strategy for the product (including its marketing and information strategy) will generally enable the product to reach the identified target market. Likewise, providing a warning that the firm is not in the position to assess a client's full compatibility with a product does not exempt the firm from the obligation to review products, also taking into consideration any sales outside of the target market.[68]

A point of concern is whether these two options ensure the same level of investor protection. Although the investment firm bears responsibility for its actions, the ESMA highlights the importance of ensuring that, in cases of non-advised sales, the distributor can reasonably expect the product distribution strategy to effectively reach the identified target market. *On the contrary*, if distributors intend to approach clients or prospective clients to recommend or actively market or consider a product for the provision of portfolio management, a thorough assessment of the target market should always be conducted. However, the issue remains problematic if the investment firm decides to warn the client, especially considering the firm's potential lack of authorisation to provide investment advice or the client's refusal to accept the advice.[69]

C. The legislative proposal for an "omnibus" Directive as regards EU retail investor protection rules

I. Introductory remarks

(1) As noted,[70] under the current legislative framework, suitability and appropriateness assessments differ significantly in terms of the information collected from clients. Specifically, less information is gathered during an appropriateness assessment compared to that of suitability. This difference is logical, as providing effective advice or portfolio management requires a thorough understanding of the client's profile. In contrast, the appropriate-

68 *Ibid.*, para. 56 with reference to paras. 60 and 72.

69 *Ibid.*, para. 57.

70 See **Section A** **above, under** **A.II**.

ness assessment gathers minimal information, focusing mainly on the client's knowledge and experience. The differing approach can be attributed to the nature of the investor's involvement in each scenario. In the case of order reception, transmission and execution, the investor independently takes the initiative to make a specific investment. Conversely, in investment advice, the investor seeks expert guidance to inform their decisions, and in portfolio management, the investor entrusts an expert with the management of their portfolio. Consequently, in the latter two cases, the investment firm must gather detailed information to ensure that the service aligns with the investor's needs and profile.

However, a critical issue in the current regulatory framework is that, during an appropriateness assessment, aligning the investor's order with the target market is not feasible unless the investment firm possesses information on criteria beyond the investor's knowledge and experience, which are also used to define the target market.

(2) On 24 May 2023, the Commission submitted a proposal for a Directive of the co-legislators "amending Directives (…), 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules"[71] (hereinafter the '**legislative proposal**'). This is a key element of its "retail investment strategy", launched on that same day, which aims to empower retail investors to make investment decisions that are aligned with their needs and preferences, ensuring that they are treated fairly and duly protected and is linked to its objectives under the 2020 CMU Action Plan: "A capital markets union for people and businesses".[72]

Once this legislative proposal, which (*inter alia*) will also amend Article 30 of the **Insurance Distribution Directive**[73] ('**IDD**'),[74] is finalised,[75] significant changes are anticipated in Article 25 MiFID II,[76] particularly in enhancing the information collected from retail clients. A key objective (as far as MiFID II is concerned) is ensuring that suitability and appropriateness tests are

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71 COM/2023/279 final.

72 COM/2020/590 final. See on this (by means of indication) **Gortsos (2022)**, pp. 14-18.

73 **Directive (EU) 2016/97** of 20 January 2016 "on insurance distribution (recast)", OJ L 26, 2.2.2016, pp. 19-59, as in force.

74 **Legislative proposal**, Article 2, point (22).

75 **The European Parliament agreed on its negotiating mandate on the legislative proposal on 23 April 2024. This followed, o**n 12 June 2024, by the agreement reached by the Council on strengthening the EU's rules on retail investor protection (see at: <https://www.consilium.europa.eu/en/press/press-releases/2024/06/12/retail-investment-package-council-agrees-on-its-position>).

76 **Legislative proposal**, Article 1, point (14).

better adapted to retail investors' needs, as well as to clarify and strengthen the requirements that distributors need to comply with when assessing the suitability of a recommendation or the appropriateness of a financial product for the retail investor.[77] In meeting this objective, Article 25(1)-(3), as well as 25(4) and (8) would be amended as discussed just below.

II. Proposed amendments

1. Proposed amendments to Article 25(1)

Suitability and appropriateness assessments need to be conducted by investment firms in good time before the provision of investment advice or portfolio management or the execution or reception and transmission of an order and be determined on the basis of information about the client or potential client as obtained by the investment firm. Furthermore, investment firms shall:

> *first*, ensure that the purpose of the assessment is explained (in a standardised format) to the client or potential client before any information is requested from them;
>
> *second*, inform retail investors, through standardised (as well) warnings, about the negative consequences on the quality of the assessment if they do not provide accurate and complete information, as well of the fact that the absence of information shall prevent the financial firm to determine whether the service or financial instrument envisaged is suitable or appropriate for them and to proceed with the recommendation or the execution of an order; and
>
> *third*, upon request of the retail client, provide them with a report on the information collected for the purpose of the suitability or appropriateness assessment (also in a standardised format).[78]

2. Proposed amendments to Article 25(2)

In respect of this Article, the following amendments are proposed:

> *first*, portfolio diversification will be also added to the elements that distributors need to assess when considering the suitability of a specific product or service on the basis of information obtained from the client or customer, including information on any existing portfolios.

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77 *Ibid.*, Explanatory memorandum, p. 19.

78 The ESMA is required to develop draft RTS to determine the above explanation and warning, as well as the format and content of the above report (and submit them to the Commission 18 months after the date of entry into force of the new Directive); power is conferred upon the Commission to adopt these RTSs in accordance with Articles 10-14 ESMAR. It is noted that this the first time that Article 25 MiFID will/would provide for RTSs in the adoption of delegated acts.

second, in order to encourage the provision of independent advice, the proposal introduces the possibility for independent advisors to provide advice limited to a range of diversified, non-complex and cost-efficient financial instruments; for these products, distributors will be able to perform a suitability assessment on the basis of more limited information about the client; and

third, given that investment advice is limited to well-diversified and non-complex products, an assessment of the knowledge and experience of clients, together with their portfolio diversification, will not be required.

3. Proposed amendments to Article 25(3)

To increase the relevance of the appropriateness assessment and strengthen the safeguards protecting retail investors from inappropriate investments, the scope of client' information that financial firms need to obtain and assess is expanded to also encompass the capacity to bear full or partial losses and risk tolerance. This amendment would significantly improve the alignment between appropriateness assessments and the target market. In case of a negative appropriateness assessment on the basis of the information received, the investment firm shall warn the client or potential client; that warning shall be provided in a standardised format and shall be recorded. In this case, it shall only proceed with a transaction subject to a warning indicating that the product of service is not appropriate at the client's explicit request. Both demand of the client and acceptance of the firm shall be recorded.[79]

4. Proposed amendments to Article 25(4) and (8)

(1) It is proposed to add in **Article 25(4)** a requirement on the ESMA to develop draft RTSs (and submit them to the Commission with the same above-mentioned 18-months period) to determine the format and content of warning referred to in the **first sub-paragraph, point (c)**.[80] The Commission is empowered to adopt them in accordance with Articles 10-14 ESMAR.

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[79] The ESMA is required in this case as well to develop draft RTS to determine the format and content of the above warning (and submit them to the Commission within the same above-mentioned 18-months period); power is conferred upon the Commission to adopt these RTSs in accordance with Articles 10-14 ESMAR.

[80] This is the third condition under the execution-only regime, in accordance to which investment firms may not need to obtain the information or make the appropriateness determination when "*the client or potential client has been clearly informed that in the provision of that service the investment firm is not required to assess the appropriateness of the financial instrument or service provided or offered and that therefore he does not benefit from the corresponding protection of the relevant conduct of business rules. Such a warning may be provided in a standardised format*".

(2) It is also proposed to further enhance **Article 25(8)**[81] to the effect that power should be conferred upon the Commission to supplement MiFID II by adopting delegated acts in accordance with Article 89 to ensure that investment firms comply with the principles set out **Article 25(1)-(6)** when providing investment or ancillary services to their clients, including information to obtain when assessing the suitability or appropriateness of the services and financial instruments for their clients, criteria to assess non-complex financial instruments for the purposes of **Article 25(4), point (a)(vi)**, the content and the format of records and agreements for the provision of services to clients and of periodic reports to clients on the services provided.[82]

D. Concluding remarks and a brief assessment

(1) The legislative proposal on amending MiFID II further enhances investor protection in relation to the suitability and appropriateness assessments. As noted,[83] the key objective is to ensure that suitability and appropriateness tests are better adapted to retail investors' needs, and to clarify and strengthen the requirements that distributors need to comply with when assessing the suitability of a recommendation or the appropriateness of a financial product for the retail investor. This is mainly pursued by enhancing the information collected from retail clients. In that respect, the legislative proposal addresses (to a certain extent at least) the inherent issue of information asymmetry in capital markets by highlighting the significance of accurate and appropriate information.

(2) Notwithstanding the above, the question remains open whether there is a need to further review the existing classification of investors in EU law (in terms of their protection) taking into consideration that all retail investors may not merit the same of level of protection. In addition, a point of concern is whether the objective of preventing mis-selling is effectively achieved through the regulatory framework governing suitability and appropriateness assessments. Other related aspects are also of primary importance: the aging population issue; financial literacy/education and inclusion; the role of social

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81 See **Section A above, under A.III.1**.

82 The delegated acts will have to take into account: (a) the nature of the services offered or provided to the client or potential client, having regard to the type, object, size, costs, risks, complexity, price and frequency of the transactions; (b) the nature of the products being offered or considered, including different types of financial instruments; and (c) the retail or professional nature of the client or potential clients (or, in the case of Article 25(6), their classification as eligible counterparties).

83 See **Section C above, under C.I (2)**.

media in the dissemination of (accurate) information and the resulting problem of “mis-information”; language barriers for (some segments of) retail investors; as well as digital innovation.[84]

(3) The following should also be noted with a view to the broader picture:

First, based on recent memory from the immense losses in investments in capital markets due the (2007-2009) Global Financial Crisis (‘**GFC**’) and the subsequent euro area fiscal crisis, investors’ risk profile has on average been altered by to risk aversion considerations (lower “risk appetite”). This is a negative sign in view of the role of the EU financial system in filling in investment gaps in the EU economy as recently discussed in the “Draghi Report” of September 2024 on “The future of European competitiveness”,[85] which also advocates for the further Europeanisation of capital markets supervision by enhancing the related powers of the ESMA and introducing a European Security Exchange Commission as a key pillar of the CMU.[86]

Second, the legislative proposal (and the Commission’s “retail investment strategy” overall) fall short in addressing some significant obstacles to furthering capital markets integration in the EU. It is true that some obstacles are due to structural features of the EU financial system (that remains predominantly bank-based) and cannot be addressed by legislative action.[87] On the other hand, the degree of market fragmentation within the EU (albeit higher in the banking system than in – some segments – of capital markets) is also high taking into account the (still) existing differences among Member States.[88] According to the third edition of the ECB biennial Report “Financial Integration and Structure in

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84 On sustainability, financial technology (FinTech) and financial inclusion, see **Zetzsche *et al.* (2021)**. In an effort to address the rise in retail investor fraud and manage the risks posed by technological advancements, the International Organization of Securities Commissions (‘**IOSCO**’) launched on 19 November 2024 a new Roadmap for Retail Investor Online Safety. This strategic initiative aims to safeguard retail investors worldwide from fraud, excessive risk and misinformation as digital trading and social media reshape the retail financial market. IOSCO’s Roadmap addresses these emerging risks by focussing on enhancing investor education and promoting robust regulatory frameworks to better protect retail investors. See at: <https://www.iosco.org/news/pdf/IOSCONEWS749.pdf>.

85 At: <https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en>.

86 **Draghi Report**, Part B: *In-depth analysis and recommendations*, pp. 292-293.

87 See on this by means of indication **Valiante (2018)**.

88 See Commission Staff Working Document “Monitoring progress towards a Capital Markets Union: a toolkit of indicators”, SWD(2021) 544, Overview of CMU Indicators – Update 16 August 2023 (at: <https://finance.ec.europa.eu/system/files/2023-08/230816-capital-markets-union-indicators_en.pdf>).

the Euro Area" (FISEA Report) of 18 June 2024[89] based on a review of the standard set of ECB indicators of financial integration and structure: despite the resilience demonstrated during crises, **progress on financial integration in the euro area has been disappointing overall**; price- and quantity-based financial integration indicators have substantially declined over the past two years, with no sizeable increase since the inception of the EMU; and despite significant legislative efforts over the last decade, cross-border financial market activities and risk sharing have not grown; a "piecemeal approach" seems to have been taken towards many of the reform efforts. In this respect, the FISEA Report proposes three lines of (potentially) mutually reinforcing action for making additional funding capacities available: "unfreezing" a share of the unproductive deposits held by euro area households; developing bond and equity markets to make them more attractive for issuers and investors; and enhancing the attractiveness of euro area financial markets for foreign investors.[90]

Third, and equally important, there is an urgent need – by returning to the "origin" – to overcome national restrictions on capital movements,[91] since the free movement of capital can help gear up financial integration and the CMU.[92]

(4) As **John Berrigan** correctly noted in a speech on 10 April 2024, the CMU is more than ever a "*need to have*" and not just a "*nice to have*". However, taming (very high) expectations on the role of the CMU until the above problems and the "cultural" and informational/educational gaps have been adequately addressed is equally important. Thus, the trade-off is delicate: enhancing the (still) uncompleted and fragmented ("silos") EU regulatory framework, as partially proposed in the Commission's "retail investment strategy", *versus* overcoming inherent problems, the risk of "regulatory overshooting",[93] avoid-

89 At: <https://www.ecb.europa.eu/press/fie/html/ecb.fie202406~c4ca413e65.en.html>.

90 It also advocates for progress in specific policy domains for bolstering financial integration – *inter alia*: harmonising the definition of key concepts in the EU regulatory frameworks; integrating the EU capital market regulatory and supervisory architecture; reviving securitisation for the CMU; increasing standardisation and transparency in the field of structured products; and promoting vibrant EU risk capital and equity markets.

91 These are set out on **Article 65(1), points (a)** (tax differentiation) and **point (b) TFEU** (financial prudential supervision measures; administrative and statistical information; and public policy and security considerations).

92 On the barriers to cross-border funding within the EU by country-specific legislation, action is required including, *inter alia*, a "targeted" update of the Commission's 2017 Report "Accelerating the CMU: addressing national barriers to capital flows" (COM/2017/147 final, 24.3.2017).

93 In this respect, the Draghi Report notes (Part B: *In-depth analysis and recommendations*, p. 310):"*The Commission's legislative activity has been excessively growing, also due to passive scrutiny of the subsidiarity principle, which sets the boundaries of its right of initiative. The*

ing "gold-plating", ensuring "legal certainty" (which is negatively affected by the frequent amendments of EU capital markets law) and the thorny issue – due to diverging priorities of Member States – of (still existing) national barriers in capital movements.

(5) It is reasonably expected that some of the above concerns will be effectively addressed in and tackled by the Savings and Investments Union ('**SIU**') strategy unveiled by the Commission, on 19 March 2025, with the aim to boost the EU economy's competitiveness, by improving the way the EU financial system mobilises savings towards productive investments and enhancing financial opportunities for EU citizens and businesses. This is contained in the Commission's Communication titled: "Savings and Investments Union: A Strategy to Foster Citizens' Wealth and Economic Competitiveness in the EU."[94] *Inter alia*, this strategy should also be viewed as a follow up to the initiatives discussed above on enhancing retail investor protection (albeit with a broader focus). As noted in the preamble:

> *"The [SIU] should encompass all of the EU financial system and be developed at both EU and national levels.* ***The [SIU] should draw on progress already made under the two Capital Markets Union Action Plans and the parallel efforts to develop the Banking Union****.*
>
> *It should be developed further using the most effective measures,* ***both legislative and non-legislative****, factoring in the dual objectives of financial stability and sustainable competitiveness in the EU, while taking into account the EU's strategic goals."*[95]

institution with the main right of initiative, the European Commission, justifies each of its legislative proposals in light of the principle of subsidiarity. However, there is evidence that compliance with the principle of subsidiarity is not always actively scrutinised, for instance by national parliaments".

94 COM/2025/124 final, at: <https://ec.europa.eu/commission/presscorner/detail/en/ip_25_802>. The related Commission's Q&As on that Communication of 19 March as well are available at: <https://ec.europa.eu/commission/presscorner/detail/en/qanda_25_803>. On the remarks by Commissioner Albuquerque, see at: <https://ec.europa.eu/commission/presscorner/detail/en/speech_25_835>. It is noted that, as a key part of further developing the SIU strategy, the Commission launched, on 15 April, a targeted consultation (for two months) to gather stakeholders' feedback on obstacles to financial market integration across the EU (at: <https://finance.ec.europa.eu/regulation-and-supervision/consultations-0/targeted-consultation-integration-eu-capital-markets-2025_en>).

95 **SIU Communication**, p. 4. Thus, the SIU takes a holistic approach, encompassing both the Banking Union and the CMU.

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