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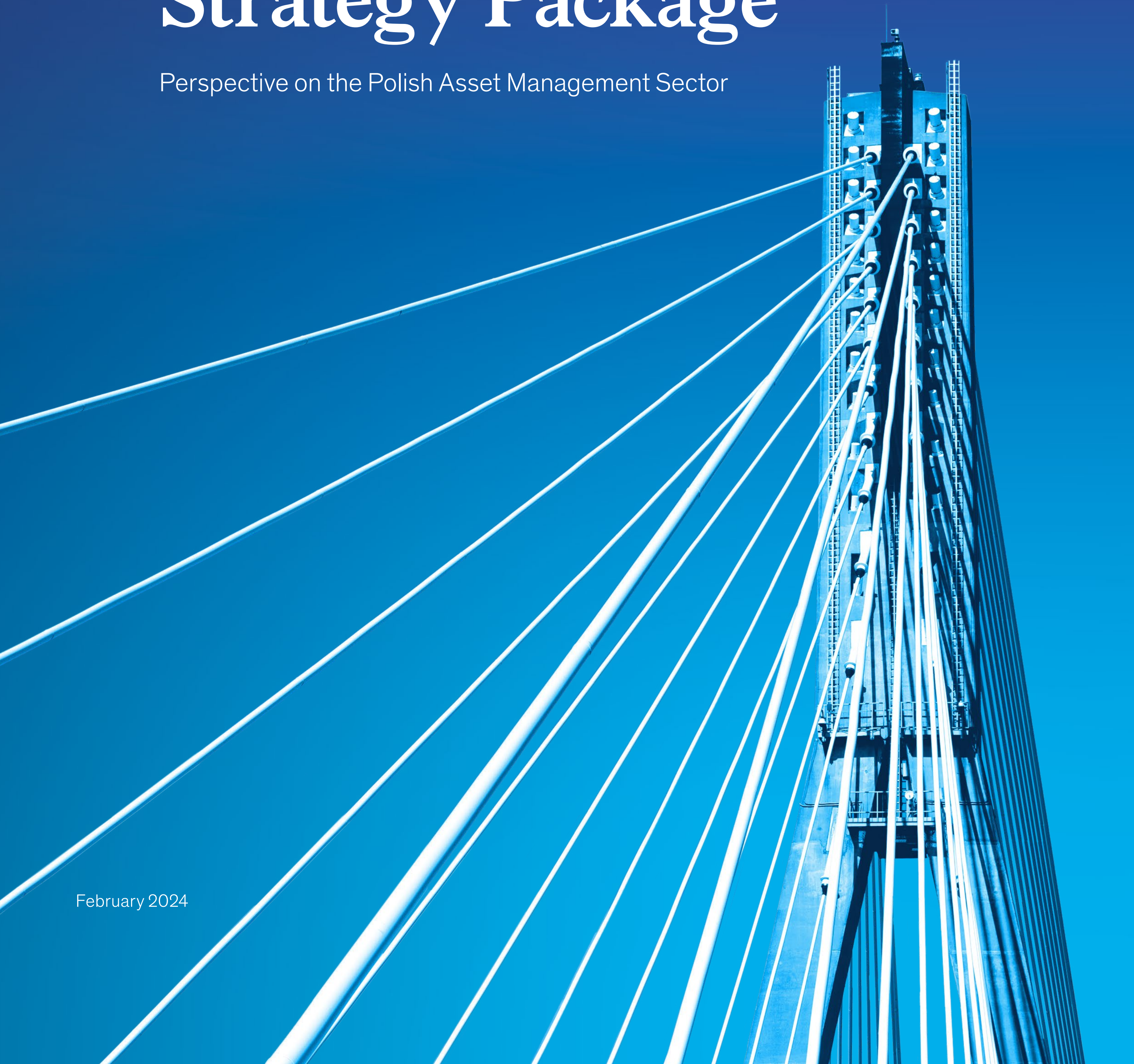
Draft EU Retail Investment Strategy Package

Perspective on the Polish Asset Management Sector



February 2024

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In response to questions raised about the potential effects Retail Investment Strategy Package might have on the Polish asset management sector, this document provides some fact-based analyses for informational purposes in the context of a rapidly evolving and uncertain environment.

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Executive summary

In May 2023, the European Commission proposed its revised Retail Investment Strategy Package, which amends existing regulations and directives, including MiFID II, UCITS, IDD, and PRIIPs.[1]

The proposed legislation aims to cover most investment products,[2] and amendments are currently being discussed by the European Parliament and Council. Once adopted, according to the proposal, Member States will have 18 months from the legislation's introduction to implement the new measures. If the new legislation is adopted, the Commission may revise the regulations and assess their impact on the retail investment market after three years.

The key objectives of the package, which are still under discussion, focus on three main areas: 1) introducing a partial ban on inducements, both monetary and non-monetary compensation from asset management companies to distributors, 2) ensuring financial products offer value for money through price benchmarks, and 3) improving the quality of information available to investors to support informed decision-making.

Individual investor participation in Poland's capital markets is below the European and US averages

The European Commission has stressed that the value of financial assets in EU households is significantly lower than in the US.[3] The Polish investment fund market is less developed than those in other EU countries, particularly in terms of asset volume and structure. Financial assets per capita in Poland are three times lower than the EU average. Polish households primarily invest in low-risk financial assets, such as deposits, which constitute approximately 50 percent of portfolios, compared to approximately 30 percent in Europe. Moreover, pension funds and life insurance products hold a three times smaller share in overall financial assets in Poland than in the EU, and investment funds account for only 4 percent of the Polish market, vs. 10 percent in the EU.[4]

Impact of increased inducements on investment markets in the UK and the Netherlands

Inducement guidelines, which were introduced in a more regulated form than currently proposed in the EC's Retail Investment Strategy Package, were implemented in the UK in 2013[5] and the Netherlands in 2014.[6] Post-implementation, these markets saw no significant changes in the volume or share of investment funds in total financial assets of households. However, there was a notable increase in the share of passive instruments, including ETFs, in investor portfolios, rising from 10 to 28 percent in the UK, and from 9 to 13 percent[7] in the Netherlands.

The measures led to changes in the settlement model between parties, introducing new fees for customers, such as platform access, advisory, and service charges. However, this inducement decreased investment firms' margins.[8]

Subsequently, there was a noticeable shift in retail investors' preferences. In the Netherlands, they turned towards self-managed investments or reliance on banks rather than independent advisors. In private banking, investment advisory gained popularity, increasing by eight percentage points in the Netherlands[9] and ten percentage points in the UK.[10]

New regulatory standards for asset managers and distributors

The new measures aim to protect retail investors while establishing new standards for investment firms and distributors. These regulations are set to increase information transparency for retail investors. The proposed solutions aim to ensure that investors receive investment advice—defined by MiFID II as the provision of personalized recommendations regarding transactions in financial instruments—which is more tailored to their understanding of financial markets, risk preferences, and other aspects of their asset portfolios. Additionally, these measures can restrict the sale of high-cost products by introducing value for money benchmarks, potentially optimizing retail investors' investment portfolios towards more profitable instruments.

These changes may have impact on asset management markets. Inducement restrictions and shifts towards the dividend model could reduce the availability of investment advisory services for retail customers, potentially leading to a rise of robo-advisory services. The regulations emphasize the role of advice as a customer value-add. In order to increase access to advice in a cost-effective way, banks and other institutions may have to turn to algorithmic advisors that can be integrated with existing applications and online portals.[11]

Another potential implication that has been raised is a reduced product offer, shifting towards passive instruments, mainly foreign ETFs.[12] Distributors might also introduce new charges for retail customers, similar to practices observed in the UK and the Netherlands.

The development of benchmarks for financial products focused mainly on the value for money principle could impact the profit margins for asset management companies (known in Poland as Towarzystwa Funduszy Inwestycyjnych or TFIs).

In its proposal, the European Commission plans to assess the potential impact of new measures on individual countries within three years of their introduction. If the main objective is not met, the EC has stated it will propose further revisions.

Proposed regulatory package will have diverse impacts on retail customers, asset management companies, and distributors

	Partial inducement restrictions	Value for money principle
Asset managers (TFIs)	Currently—limited implications for fund managers Further inducement reduction—potentially accelerated market concentration (banks may prefer their own AMs) In groups where an asset manager is a subsidiary, of the distributor changes to cost structures are likely (potential shift towards dividend payments) Changes in offers are anticipated, due to growing importance of ETFs There may be further specialization of smaller AMs	Increased pressure on opex reduction due to lower revenues and potential EU-wide cost convergence Risk of reduced product innovation Potential challenges in generating profits from low-margin products Possible exit of smaller investment firms from the market Growth in development of cheaper financial products like ETFs
Distributors	Changes in the operating models of distributors Potential limitations in the provision of financial advisory services Reduced pressure on selling higher-cost products Increasing importance of robo-advisory services Decreased profitability for distributors	Need for revision of investment product offers to include low-cost products Reduced profitability following the introduction of low-cost products Introduction of alternative revenue streams, such as fees for services that were previously free
Retail customers	Enhanced transparency of information Value addition through investment advice, incl. a recommendation of at least 1 basic and 1 low-cost product Potential limitation in product offerings	Optimization of investment portfolio by eliminating products with no value added and unjustifiably high costs Potential risk of limited investment offering due to market consolidation and the displacement of independent asset managers

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New measures as an extension of current regulations

In its proposal, the European Commission has identified several key reasons for the limited participation of retail investors in financial markets:

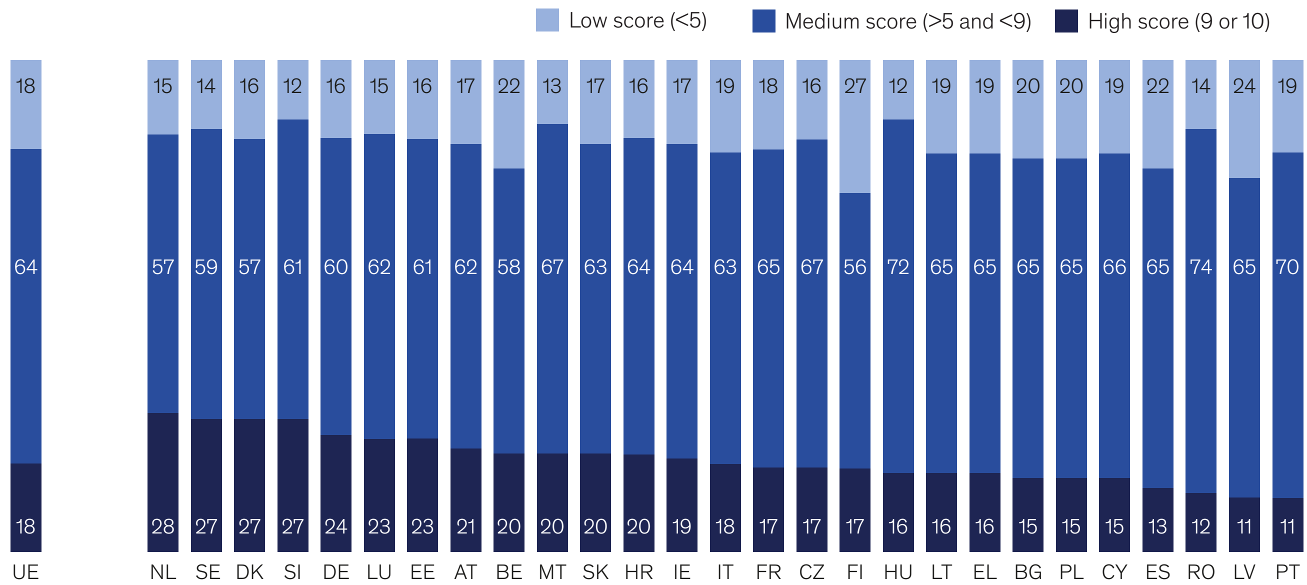
— **Low financial literacy, an issue observed across all EU countries.** Only 18 percent of EU citizens possess a high level of financial literacy (Exhibit 1).[13]

— **Low level of trust in financial advisory services across the EU.** Despite the definitions and standards set by MiFID II,[14] only about 6 percent of EU citizens show a high level of trust in services received from banks, insurers, or financial advisors. 70 percent of the EU's population have only limited trust in investment professionals (Exhibit 2).[15]

Exhibit 1

Only 18 percent of EU citizens achieved top scores in the financial literacy and behavior survey

Total scores in the financial literacy and behavior survey (equal weights for each score)

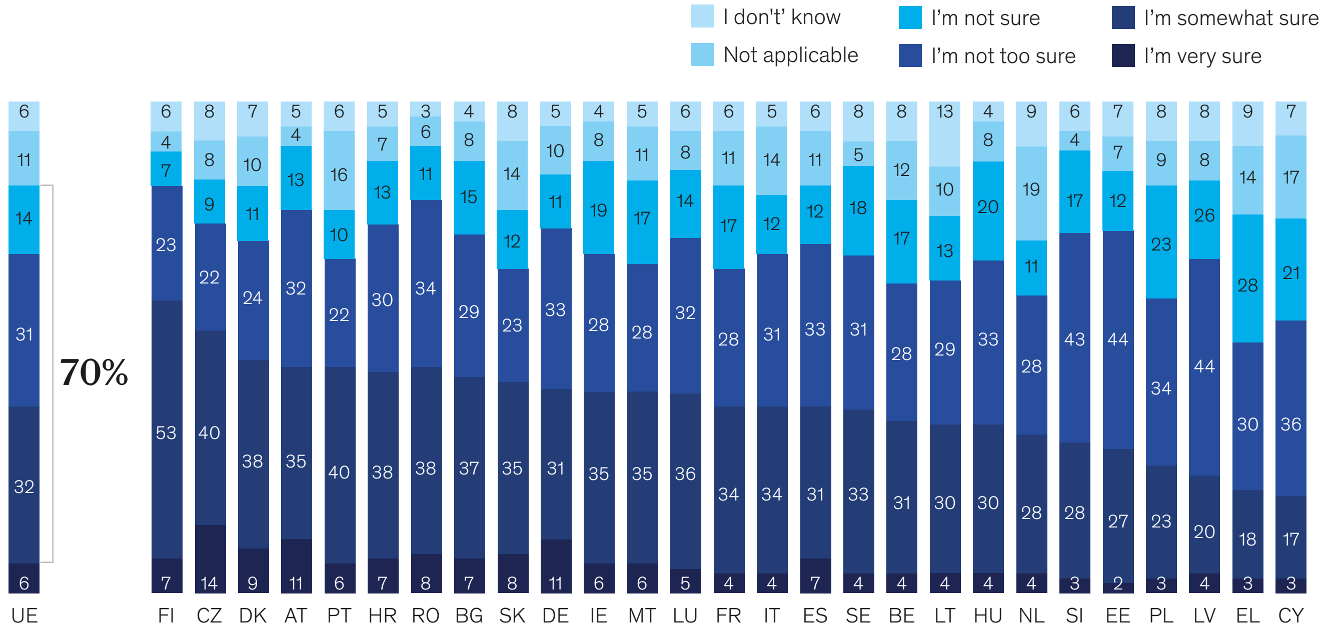


Source: Eurobarometer 2023: Monitoring the level of financial literacy in the EU

Exhibit 2

Seventy percent of EU citizens have at least some level of trust in investment advisors, but only 6 percent express a high degree of trust

Question: To what extent are you sure that investment advice you receive from your bank/insurer/financial advisor is provided in your best interest?, percent



Source: Eurobarometer 2023: Monitoring the level of financial literacy in the EU

- **Significant differences in fees for retail and institutional investors.** In 2021, charges for individual investors in the EU were, on average, 40 percent higher, than those for institutions.[16]

- **Potential conflict of interest.** The existing distribution model for retail investment products is based on a commission system. Such inducements might incentivize distributors to recommend products that are suboptimal for customers but lead to higher compensation.

- **Growing emphasis on sustainable investing.** This type of investment is particularly noticeable among retail investors, who seek to use their capital to combat climate change and supporting biodiversity. The rise in ESG funds requires a corresponding improvement in the knowledge, capabilities, and professional qualifications of financial advisors.

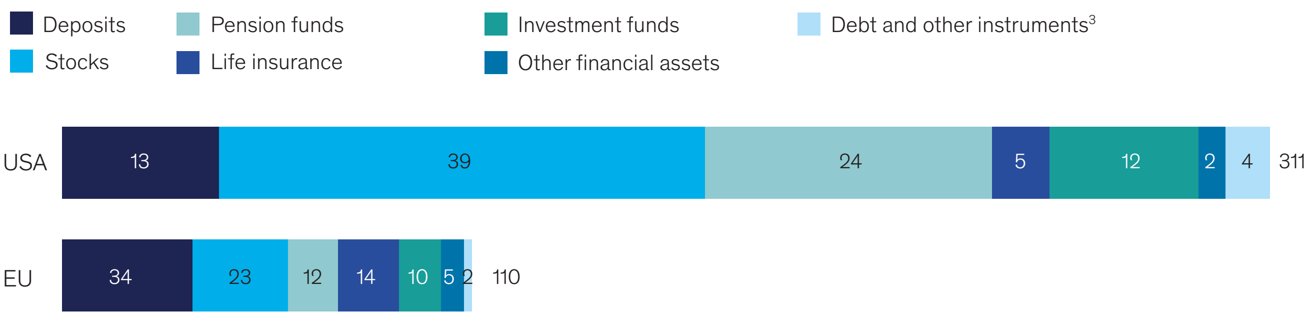
Investment fund markets in the European Union and the US

The EC's rationale for the revised draft legislation highlights a disparity in the value of financial assets held by households in the European Union and the US.[17] In the EU, the value is three times lower than in the US, with the asset structure predominantly composed of deposits, pension funds, and life insurance (Exhibit 3).[18] In the US, stocks (39 percent) and pension funds (24 percent) are the dominant asset types. The retail customers' assets of US investment funds exceed those in the European Union by more than three times (Exhibit 4).

Exhibit 3

In the US, households primarily invest in stocks and pension funds, allocating on average 5.2 times more than households in the EU

Household financial assets per capita in the EU[1] and USA
End of 2022, asset value in thousand euro per capita,[2] asset structure in percent per capita



[1] Excluding data for Bulgaria, Romania, Cyprus and Malta
[2] Assuming USD/EUR as of 31.12.2022 1 USD = 0.9376 EUR
[3] OECD category of „securities other than shares" mainly consisting of debt instruments
Source: OECD

Exhibit 4

Retail investment funds in Europe manage assets 5.7x lower in value than those in the US

Source: EFAMA, ICI

Proposed measures

The EC's Retail Investment Strategy Package focuses on three key areas and a set of measures to enhance the trust of retail investors in capital markets.[19] It includes:

A. Regulated inducements from asset management firms to distributors. Inducements must be fully transparent and will only be allowed if the customer receives investment advice. The EC proposes:

— Banning inducements paid to distributors if the retail customer purchases a financial instrument without accompanying advice. Where inducements are allowed and paid, they should be fully transparent to the customer.

— Changes in advisory services. Advice[20] should consider not only the product in question, but also its impact on the customer's total assets. Intermediaries will have to recommend at least one basic product, and one product offering with the best value for money.[21]

B. Improving the value for money of financial products. Investment product managers will be required to evaluate whether all costs and charges to the customer are justified and proportionate. This includes benchmarking with reference rates of total costs and performance, that will be published by the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).

C. Improving the quality and accountability of investment products' information marketing. Information provided to retail customers should be more transparent, easier to understand, and digitally enabled. According to the EC, this objective can be achieved by:

— Standardizing information provided to investors, ensuring transparency of total costs and their impact on investment returns.

— Implementing marketing regulations, establishing standards for transparent and balanced communication, including the presentation of product risks and key features.

D. Additional measures such as commitments from member states to support financial education on investing and insurance, higher knowledge requirements for investment advisors, and easing the qualification criteria for professional investors.

Impact of inducement restrictions in the UK and the Netherlands

Inducement restrictions or bans were introduced in the United Kingdom in 2013 and the Netherlands in 2014.

Exhibit 5

Logic of newly proposed regulatory measures

	1		2	
Current situation	**Management and distribution process for investment products**		**Retail investors knowledge**	
	Conflict of interests caused by inducements that negatively impacts the quality of products and investment advice provided to customers	Some investment products carry high costs and offer little-to-no value for retail investors	The information given to investors sometimes lacks usefulness or relevance to their decision-making	Investors risk receiving oversimplified or misleading information through marketing communications and digital channels
Proposed scope of solutions	Regulated inducements (A)	Better value for money (B)	Improved provision of information and accountability in investment products marketing (C)	
	Additional measures (D)			

Source: EC Proposal

The UK applied restrictions only to new investment flows, regardless of the financial product,[22] while the Netherlands implemented a total ban on inducements for most financial products, both new and existing.[23]

Impact on investment funds value and share in total financial household assets

After the introduction of these regulations, it is cited that there was no significant change in the value or share of investment funds in the total financial assets of households in either the UK or the Netherlands.[24] However, other factors might have influenced retail investors' propensity to choose investment funds.

Changes in fee structure

In both countries, the settlement model between parties has changed, adjusting fees to the new regulations. New charges, such as platform access, advice, and service fees, were introduced and covered by customers, making fee structures more transparent.[25]

Changes in product portfolio structures

In the UK and the Netherlands, the regulations impacted the product portfolio structures and service choices of retail investors. The share of passive instruments, including ETFs, increased significantly—in the UK from 10 to 28 percent between 2013–2022, and in the Netherlands from 9 to 13 percent between 2014–2022.[26] This trend contrasted with other European countries where passive products remained stable or grew slightly.

Impact on margins of investment firms and distributors

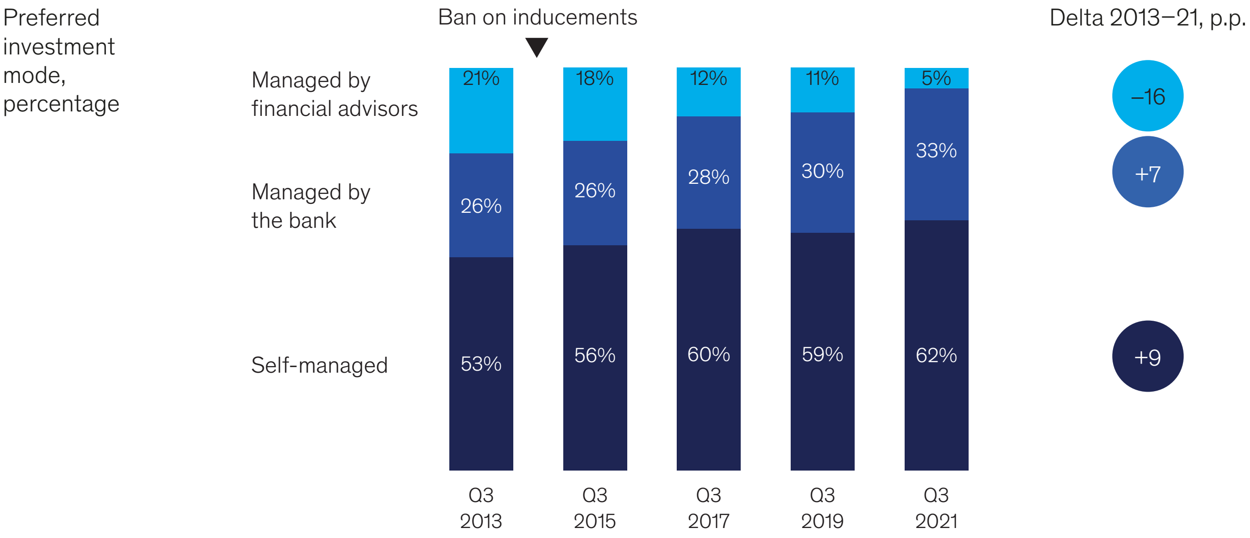
Opponents of inducement restrictions claim they negatively affected the margins of investment firms, particularly in the UK, where the total margin fell by 20 basis points in 2014–2016 (compared to a 9 bps fall in the EU).[27] This was mainly due to reduced management fees (by 22 bps), partly offset by increases in other fees (+2 bps in 2014–2016).[28] Distributor margins also decreased, as seen across Western Europe.

Impact on retail investor behavior

There are indications that the restrictions influenced retail investors' preferences. In the Netherlands, investors increasingly chose self-managed investments or opted for banks over independent advisors. Between 2013–2021, the share of independent advisors in investing modes fell from 21 to 5 percent, while self-managed investors increased from 53 to 62 percent and customers delegating decision-making to banks rose from 26 to 33 percent (Exhibit 6). However, managed investment portfolios gained popularity in private banking, growing by eight percentage points in the Netherlands[29] and ten percentage points in the UK.[30]

Exhibit 6

In the Netherlands, the ban on inducements resulted in financial advisors losing their share in preferred investment modes



Note: 1.104 respondents
Source: AFM Consumentenmonitor najaar 2021

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Potential impact on the Polish market

Background on the Polish investment product market

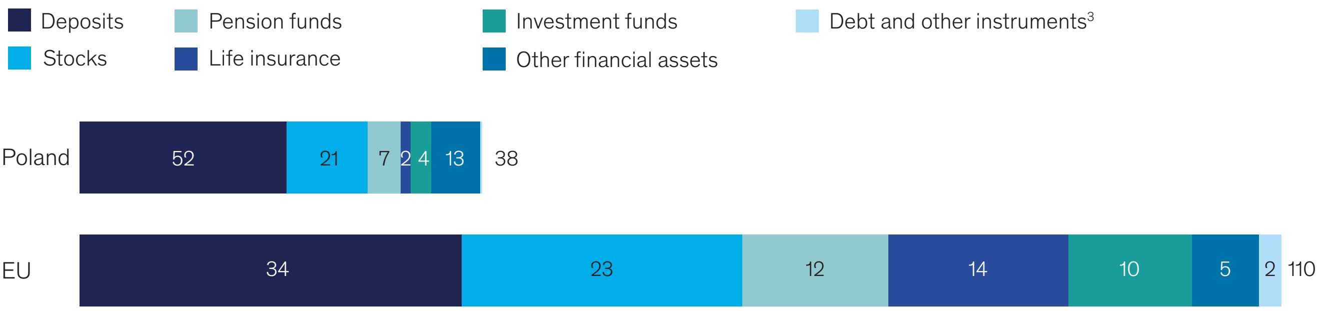
Poland's investment product landscape

Compared to Western European markets, Poland's investment fund market is in an early stage of development and has significant differences in financial asset volumes and structures per capita. On average, Polish households hold financial assets totaling EUR 38,000, which is nearly three times less than the EU average (Exhibit 7). The composition of these assets is predominantly defensive, with deposits accounting for approximately 50 percent, in contrast to approximately 30 percent across Europe. Pension funds and life insurance represent a much smaller portion of total financial assets, over three times lower than the EU average, while investment funds comprise only 4 percent compared to 10 percent in the EU.

Exhibit 7

On average, EU households invest five percentage points more assets in investment funds than Polish ones

Financial assets of households in Poland and the EU[1]
End of 2022, assets in thousands euro per capita[2], asset structure in percentage per capita



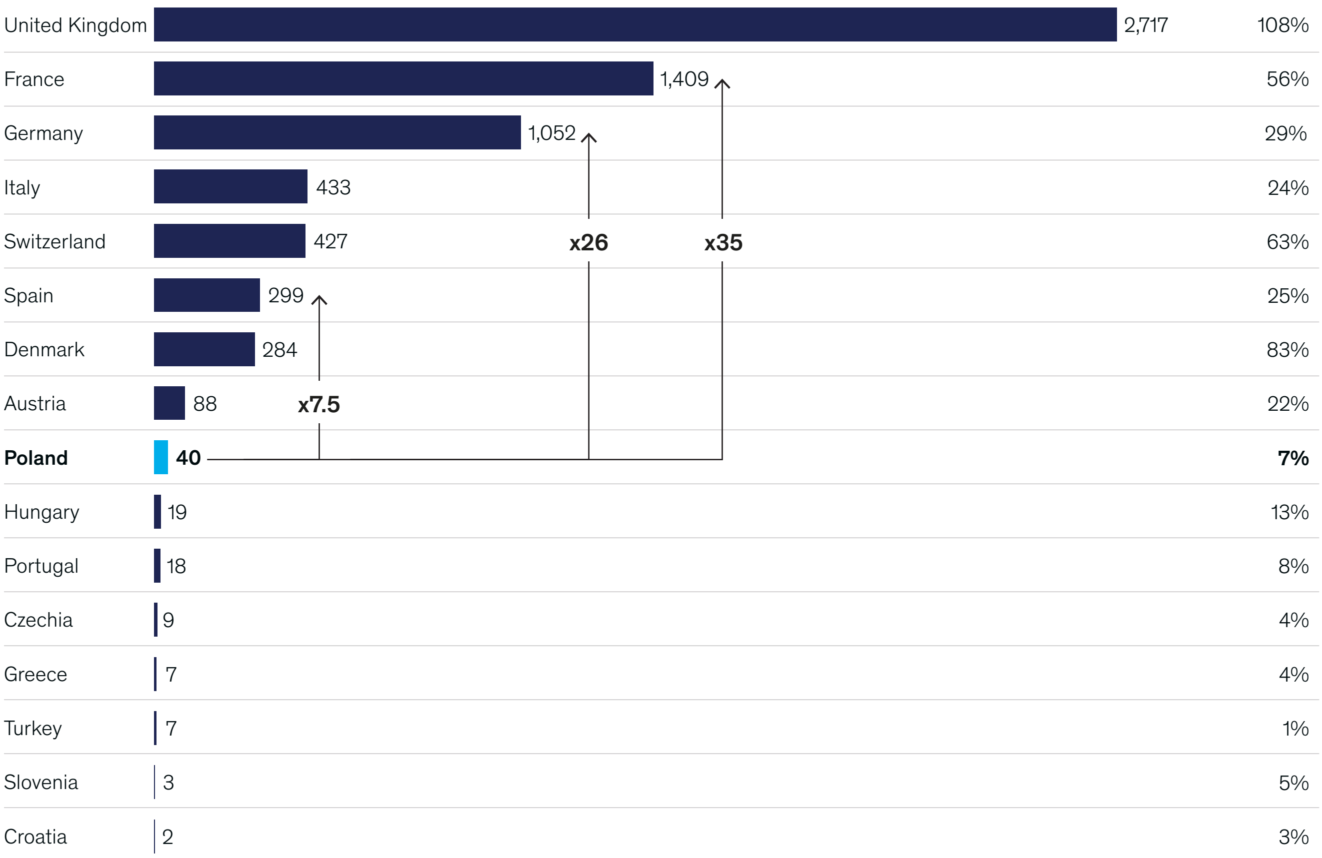
[1] Excluding data for Bulgaria. Romania. Cyprus and Malta
[2] Assuming USD/EUR as of 31.12.2021 1 USD = 0.9376 EUR
[3] In OECD. the „securities other than shares" category consisting mainly of debt instruments
Source: OECD

Exhibit 8

Local retail investment funds in Poland have significantly lower assets compared to Western European countries

Value of retail investment fund assets in a country, as of the end of 2021, value of net assets in EUR billion

In relation to GDP, percent



Source: EFAMA, Eurostat

Poland's investment product market from the asset managers' perspective
From the perspective of Western European standards, even the largest investment firms in Poland are considered minor asset managers (Exhibit 8), mainly due to:

— relatively low affluence of the society—according to Eurostat, Poland's GDP per capita was approx. EUR 14,600 in 2022, compared to the EU's average of approx. EUR 28,900,

— lower financial knowledge—self-reported subjective low financial literacy suggests a lower risk appetite and loss aversion among Poles, major inhibitors to investment activity,[31]

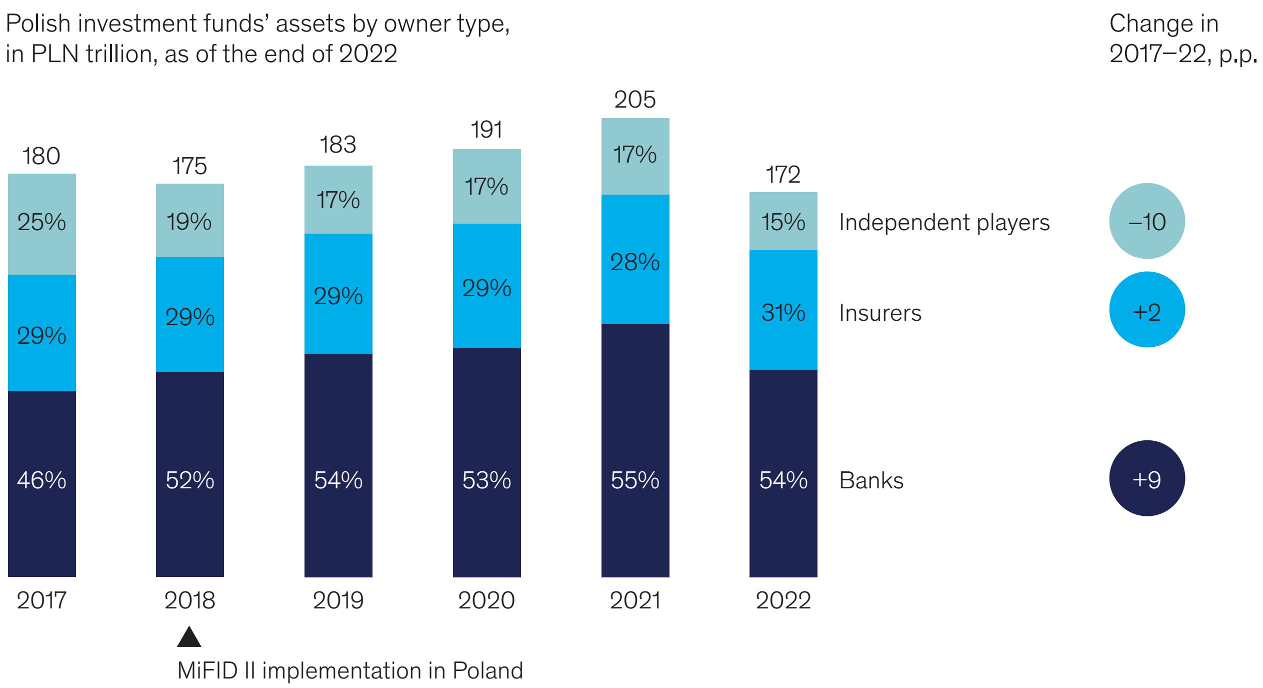
— early-stage investment market, which only began operating in the 1990s.

Impact of precursory legislation on asset managers in Poland

The EU introduced MiFID II regulation in 2018 as a set of amendments to original MiFID from 2007, primarily to enhance investor protection and boost trust in financial markets. This objective was pursued by curbing conflicts of interest in the distribution of financial products and preventing mis-selling of financial instruments. Several measures were introduced, including: 1) limits on inducements paid to distributors, 2) changes to distributor compensation policies, and 3) monitoring the suitability of offered financial products.[32] Following MiFID II adoption in Poland in 2018, the market share of non-bank asset managers declined from 54 percent to 46 percent (Exhibit 9). While other factors may have affected the standing of individual non-bank AMs, the limitations on inducements likely contributed to changes in the investment fund structure. The new conditions seem to favor investment firms with own distribution networks (Exhibit 9).[33]

Exhibit 9

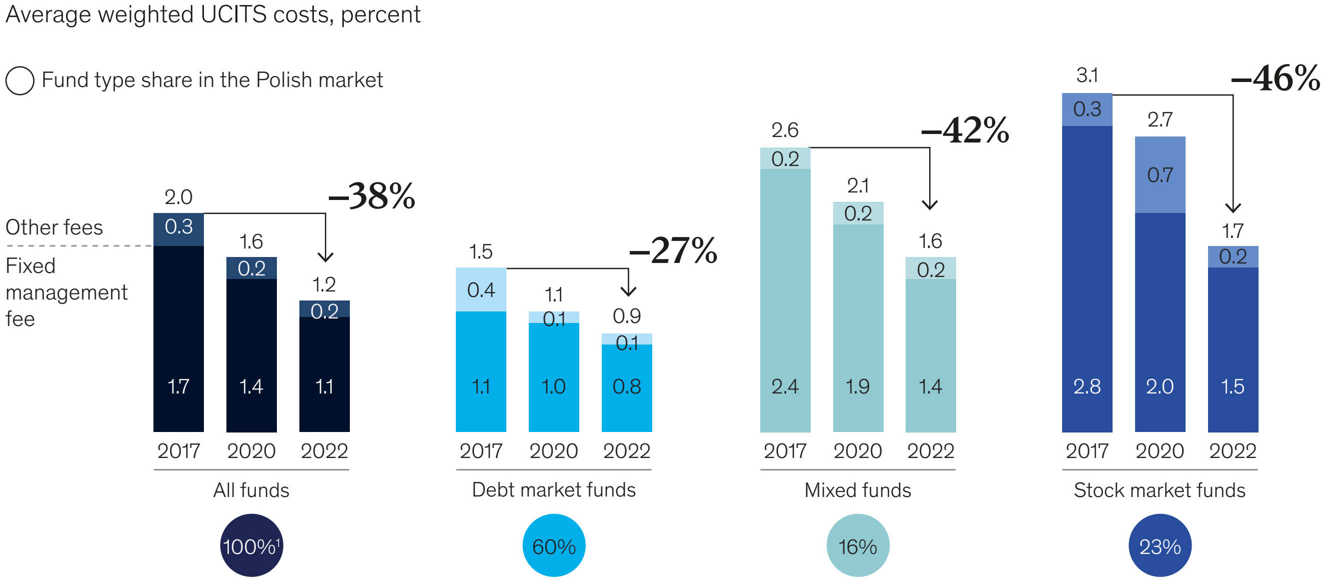
Poland's asset management market consolidation favors banks over independent TFIs



Note: Banks and insurers classified as a public market. irrespective of their strategy
Source: NBP

Exhibit 10

Regulations consistently lowered management fees in Polish UCITS



Note: Market average calculated as average Total Expense Ratio for a given strategy. weighted with net asset value as of 2022
[1] Includes ~1% of other funds
Source: analizy.pl. based on open investment fund reports

Management fees in Poland
On January 1, 2022, an ordinance from the Ministry of Finance was implemented, capping the maximum fund management fee at 2 percent per annum and effectively aligning Poland's fee structure to the median of the EU (Exhibit 10).[34] Despite this, the total expense ratios for both the stock market and mixed funds in Poland remain slightly higher than the EU averages (Exhibit 11).[35] This is notable considering that Polish investment funds manage considerably lower assets compared to their Western European counterparts.

The total nominal costs associated with the management and distribution of funds in Poland are lower than in Western Europe. However, due to the smaller value of assets under management (AUM), their relative share expressed as a percentage of assets is higher, and consequently, the margin of investment firms is lower.

Potential impact on the Polish investment product market

Implementation of the proposed Retail Investment Strategy Package may have various implications on the Polish market and the entities operating within it. Looking at 1) the impact of precursory regulations in Poland, such as MiFID II, 2) drawing on the international examples of similar regulations, such as the inducement bans in the UK and Netherlands, and 3) academic research on retail investments, several preliminary observations on possible market developments in Poland may be inferred. However, it may be noted that investment fund markets vary greatly across the EU due to differences in market size,

Exhibit 11

Total costs of investment funds in Poland are at EU's median level

Total Expense Ratio, total fees as % of managed assets

Note: Total Expense Ratio includes management fees and other opex of investment funds. Operating costs of TFIs are another matter.
Source: Performance and costs of EU retail investment products—annual statistics of ESMA; analizy.pl

the balance of retail and institutional investors, and the role of pension funds. These unique local factors could significantly influence how the benchmarks and regulations might impact different markets.

Selective limits on inducements
The proposed selective limits on inducements paid by investment firms to distributors could potentially lead to the following implications:

1. Implications for investment firms[36]

— Continued market consolidation

Increased limits on inducements for distributors might accelerate the ongoing concentration of the asset managers' landscape in Poland, which was observed after MiFID II implementation (Exhibit 9). Independent asset managers that lack distribution platforms could find it challenging to compete. Distributors may prefer offering products from their own investment firms, such as insurance-based investment products like Insurance Capital Funds (Ubezpieczeniowe Fundusze Kapitałowe or UFK). In addition, it has been seen in other countries, such as Switzerland, that limits on inducements can increase the share of bank-owned investment products,[37] which could impact Poland, where most of the largest banks have their own AM entities (TFI).

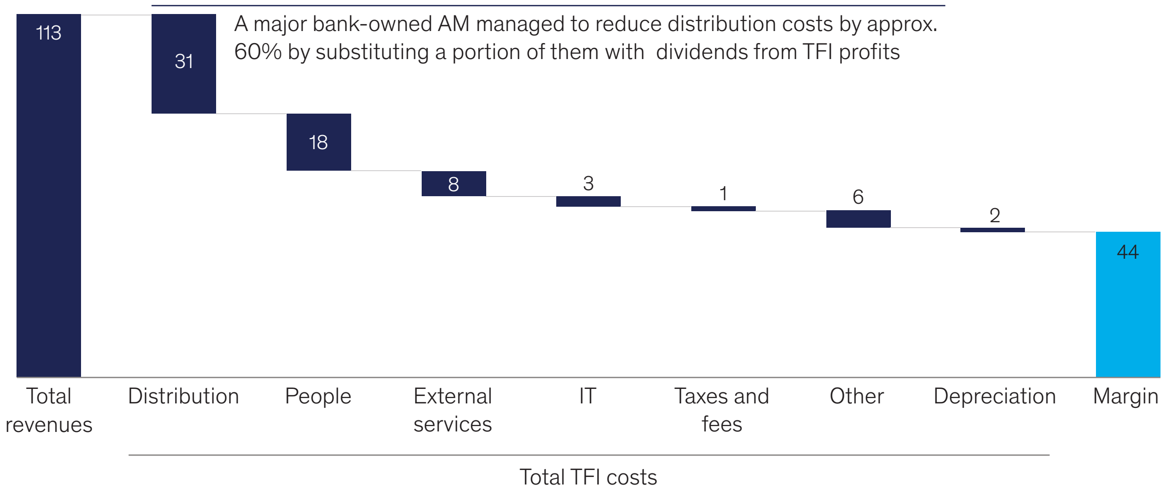
— Changes to cost structure

Limits on inducements could lead to changes in cost structures, particularly among asset managers that are a part of larger distributor groups, such as bank owned TFIs. For integrated players, it has been observed in the market (Exhibit 12) that inducement payouts may be substituted with investment firm dividends.

Exhibit 12

Distribution costs, accounting for approximately 45 percent of Polish AMs' total expenses, can be replaced by dividends

Revenue and cost structure of Polish TFIs1 in 2022, as percent of AuM, bps



[1] Data for Top 9 AMs in Poland (PKO TFI. NN Investment Partners TFI. Pekao TFI. Santander TFI. Generali Investments TFI. Millenium TFI. BNP Paribas TFI. QUERCUS TFI. Skarbiec TFI)
Source: TFI financial reports. McKinsey Performance Lens Asset Management Survey

— Changes to investment portfolio mix

Further inducement limits and incentives to recommend cost-effective products could favor ETF market growth in Poland. This trend, mirroring post-regulation developments in the Netherlands,[38] may impact domestic capital flow, transferring savings towards large international investment firms, that have larger scale to offer ETF products compared to Polish players.

— Specialization of smaller asset managers

As the market consolidates and investment firms specialize, small- and medium-sized investment firms may consider pursuing niche areas in sustainability by developing green funds or in growing in specific customer demographics, such as High-Net-Worth Individuals (HNWI).[39] Nonetheless, these strategies may be challenging and costly for smaller asset managers, given the modest size of the Polish investment fund market and the inherent complexities of niche specialization.

2. Implications for distributors

— Changes in operating model

Inducement restrictions could reshape distributor operating models. In other markets, such as in the Netherlands, inducements are tied to the provision of investment advice.[40] This could improve retail customers' access to investment advisory services. However, a shift to dividend payments, regardless of advice provision, could limit to advisory services to wealthier private banking clients.

The revised definition of investment advice under MiFID II now extends beyond assessing the suitability of a financial product for a customer.[41] It also includes evaluating the product's impact on the customer's overall wealth and mandates recommending both the most cost-effective and at least one basic, or plain-vanilla, product. This broader assessment scope may necessitate updates to banks and financial institutions' processes and algorithms to offer more thorough investment product information.

— Changes in product offer

Inducement restrictions could reduce the tendency to sell more expensive products, as recommending cost-effective products would become mandatory.[42] This change may potentially decrease conflicts of interest for distributors who have previously been incentivized to sell more expensive financial products.

A potential decline in third-party product distribution could be another implication, impacting private and affluent banking sectors, which usually provide a wide array of products. Nevertheless, the growing significance of investment advisory in these market segments could offset this impact.

— Rise of robo-advisory

Robo-advisory, offering remote, algorithm-based advice, could become increasingly important, especially for distributors, but also for the investment firms.[43] The new regulations underscore the importance of advisory services as a value-add for customers, which could validate inducement payments. Algorithm-based advisors could be a cost-effective way for banks to expand advisory services and integrate them with their online applications. This technology could improve access to investment advice for digitally savvy Poles, though it may not serve those less familiar or comfortable with digital-only services as effectively.

— Lower profitability

The scope of the inducement ban will determine overall impacts for distributors. It could be applied only to the new products sold post-regulation (as in the UK) or retroactively to selected products (as in the Netherlands) or to all investment products. A comprehensive retroactive ban could significantly impact distributor profitability.[44]

Inducement restrictions might reduce the profitability of distributors, particularly when a retail investor purchases a product without accompanying advice. In such cases, the distributor would not receive any compensation from the investment firm, challenging the viability of smaller distributors.

3. Implications for retail investors[45]

— More information transparency

The move towards more transparent information regarding inducements, especially when linked to investment advice, has the potential to improve the quality of service for retail investors. The EC's package broadens the scope of the appropriateness assessment under MiFID II to include the evaluation of product suitability relative to an investor's total assets and the recommendation of the most profitable and least complex products. This is expected to lead to better consumer decision making and encouragement of investment activity.

The revised definition of investment advice under MiFID II now extends beyond assessing the suitability of a financial product for a customer

— Limited product offer

The new inducement model could lead to distributor reluctance to offer products from external investment firms, potentially narrowing the offer of investment and insurance-based investment products. This might restrict retail customers choices.

— Potentially reduced access to investment advisory

In the Polish market, where asset managers often operate as subsidiaries of distributors, the proposed stricter inducement restrictions could reduce the availability of investment advisory services, making them a privilege for more affluent customers.

Value for money
The development of benchmarks by ESMA and EIOPA to enhance value for money in financial products is still in progress, with specifics yet to be clarified. Key considerations include whether these benchmarks will focus on investment strategy, fund mix, or product type.[46]

The EC has introduced preliminary draft benchmarks that apply to specific clusters of financial products. These clusters will be defined using criteria, such as asset class, investment time horizon, or risk category, following the guidelines set by PRIIPs. The benchmarks are intended to measure performance within a product cluster, considering return on investment and total product costs (including entry and exit costs, transactional costs, management fees, etc. – as described in PRIIPs), and then identify outlying products.

The final methodology for benchmark definition will be key for asset managers. From a local perspective, it is important to establish diverse benchmark indicators that consider fund type, market maturity, cost structure segmented by market and other key parameters, including relevant scopes or calculation methodologies. Benchmarks should also consider different product types, acknowledging that some, like pension funds (particularly the Polish state-supported PPK—Pracownicze Plany Kapitałowe), tend to be less expensive.

1. Implications for asset managers

— Pressure to reduce fees

The introduction of benchmarks may put pressure on the fees of investment firms.[47] In Poland, the potential for reducing fees is limited due to two main factors:

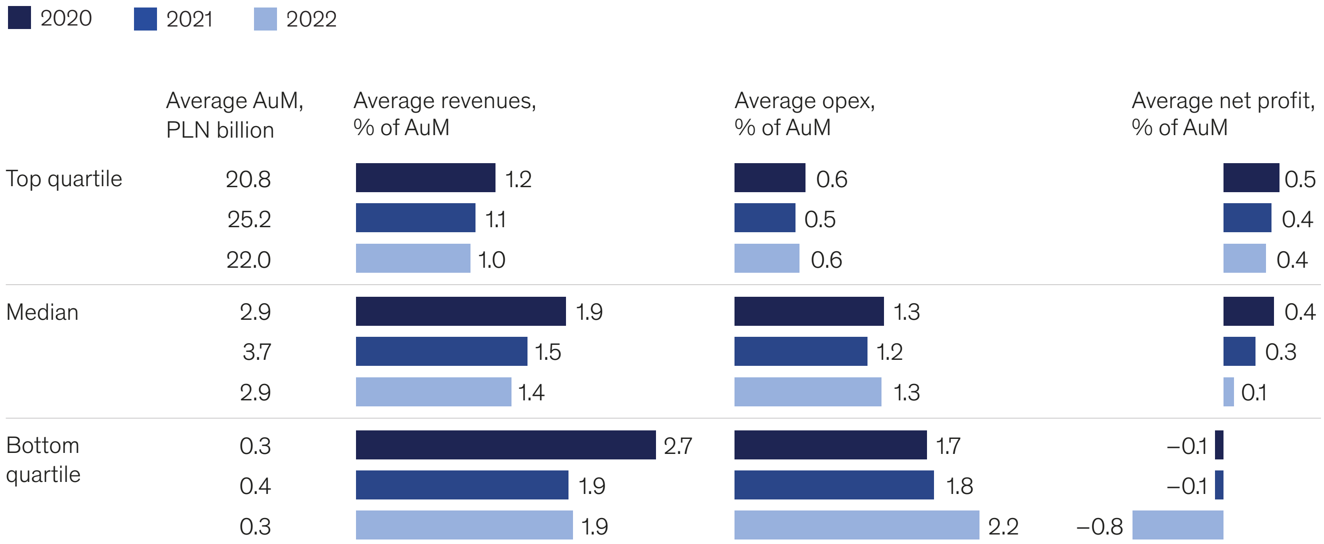
- Margins in Poland are already lower than in Western Europe, due to higher relative operating costs and smaller business scale, resulting in lower profitability.[48]
- Most of the Polish market is comprised of retail investors, compared to Western Europe, where institutional investors dominate. As a result, decline in retail segment profitability is less likely to be compensated by institutional client profitability[49].

The scope of the inducement ban will determine overall impacts for distributors... A comprehensive retroactive ban could significantly impact distributor profitability

Exhibit 13

Over the past three years, the smallest AMs have experienced declining net profits

AM (TFI) performance vs. AuM quartile



Note: Segmentation methodology: data calculated for N = 26 funds allocating over 70% AuM on the public market; top and bottom quartile consisting of top and bottom 11 TFIs in terms of AuM
Source: IZFIA. TFI financial reports

— Cost convergence across EU countries

The Ministry of Finance's ordinance to cap fund management fees suggests that the principle of 'better value for money' for investment products may have limited impact on the profitability of Polish distributors and asset managers[50]. Over time, common European benchmarks could lead to a convergence of customer costs across EU funds.

— Exit of smaller investment firms

Unlike their Western European counterparts, which can remain profitable even with low-margin products due to larger scale operations, Polish investment firms facing a shift towards low-margin products might struggle with profitability issues. This could lead to smaller firms exiting the market, potentially being replaced by larger foreign entities[51].

Over the past three years, the gap between large market players and smaller independent firms in Poland has widened (Exhibit 13), with large companies maintaining stable profits and costs, while smaller firms face higher costs and lower profits relative to assets under management.

— Development of the ETF market

Encouraging the recommendation of low-cost products and limiting inducements could drive the development of Poland's ETF market, presenting opportunities for asset managers[52]. However, this is mostly advantageous for large-scale players, such as international firms, or robo-advisors that sell simple products[53].

The convergence of fees for retail and institutional clients poses a risk for asset managers. While lower fees are sensible for large-scale institutional business, this convergence reduce fund profitability and potentially limit the supply of investment products for retail customers in the Polish market.

2. Implications for distributors[54]

— Product offer adjustment

The changes to inducements and the requirement to offer more profitable products to retail customers may cause distributors to reevaluate and possibly revise their product ranges. This could involve replacing higher-cost products with more cost-effective alternatives to align with the new regulations.

— Lower profitability

The move to low-cost product offerings could influence the profitability and margins of distributors. To counterbalance this, distributors may consider introducing fees for services that were previously offered for free, which was done in the Netherlands and the UK. However, it may be noted that the current investment advisory services are provided free of charge in Poland, so it is unclear how the customers will react.

3. Implications for retail investors

— Product mix optimization

One key example of potential outcomes of the new product benchmarks may be the optimization of retail investors' portfolios. This involves eliminating products that fail to provide sufficient value, particularly those with unjustifiably high costs. The EC would like the mandate to include at least one cost-effective financial product will lead to an increased number of retail investors across the EU[55].

— Limited investment choices

Retail customers might face a reduced selection of investment options. This could result from the withdrawal of independent investment firms or distributors' reluctance to offer products of external asset managers. The potential implications include a limited range of available investment funds and insurance-based investment products, like Unit Linked, a decrease in the drive for innovation, and a reduction in product diversity available to investors.

Other potential outcomes[56]

— Increased public spending on financial education

The impending regulations may require Poland to increase public spending on financial education. This could be essential to make investment funds more appealing to retail customers. Fostering early financial awareness and cultivating investment habits among Poles would be particularly important steps in this process.

The convergence of fees for retail and institutional clients poses a risk for asset managers

— Enhanced knowledge for investment advisors

The proposed regulations demand a broadening of the knowledge base for investment advisors. They will need to be well-informed and up-to-date, especially in promoting investment products that focus on sustainable development. This enhancement in knowledge and information is crucial for advisors to effectively guide their clients in the evolving financial landscape.

— Relaxed qualification criteria for professional investors

By simplifying the process for individuals to qualify as professional investors, more complex and specialized investment products may become more accessible, potentially heightening the interest in investments among higher-income individuals in Poland.

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Proposed legislation—current perspective

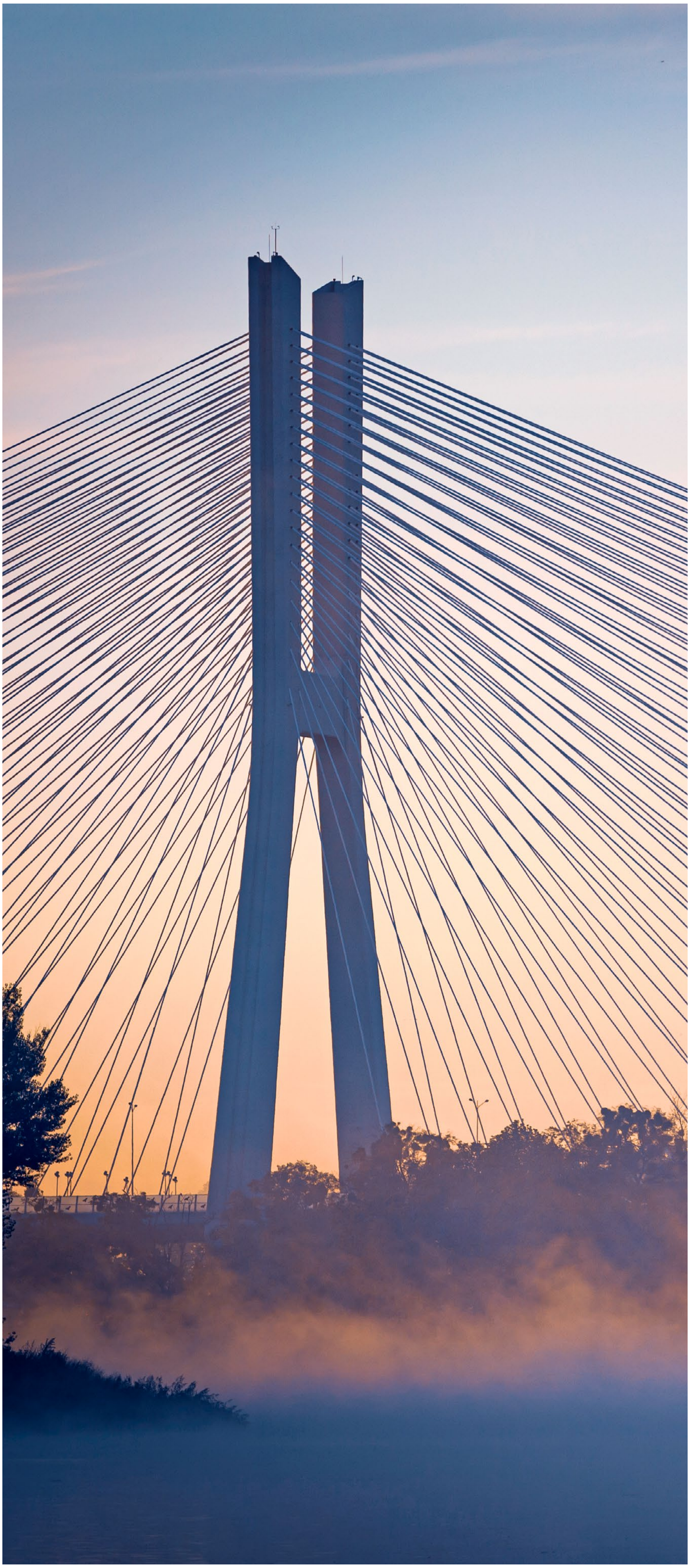
If passed, the proposed legislation could cause a shift in the Polish asset management market, particularly benefitting retail investors, and changing the asset management market. The legislation aims to protect retail investors by providing better information, aligning the interests of intermediaries with investors, and ensuring more suitable investment advice in the long-term.

Asset managers and distributors may be obliged to tailor investment advice to the profile and total assets of retail investors and incorporate more cost-effective products into their offerings. Concurrently, changes in inducement schemes for distributors and the introduction of value-for-money benchmarks could impact investment firms' margins, which might lead smaller Polish investment firms to be challenged by either incumbents that are profitable enough to absorb changes in management fees, or foreign players that can offer products with lower margins.

In the short term, market participants may incur additional costs while adapting to regulatory changes. Legislation may restrict the sale of products that do not offer sufficient value for money compared to other instruments in the same category.

Depending on the final shape of the regulation, a shift could be observed in product offering as some independent asset managers may exit the market, and remaining players might shift portfolios towards passive instruments (predominantly foreign ETFs). Moreover, to ensure profitability, distributors may introduce additional charges for retail customers.

Margin contraction and portfolio shifts towards commoditized cost-effective products may result in further consolidation of the asset management market both at Polish and European level. This process may be further fueled by additional EU measures under the Capital Markets Union initiative, aiming to integrate national capital markets into a single EU capital market.



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