RETAIL INVESTMENT

MARIA LUÍS ALBUQUERQUE

Retail investors and capital markets need each other to succeed

European households have on average high savings rates, and yet too little of those savings produce the best outcomes for both savers and the economy at large. Therefore, the first compelling reason to change the current situation is the need to ensure that savings generate fitting returns to each person's objectives, be it an adequate retirement income or children's education. Long term savings, as in these two examples, should not be put in bank deposits. There, nominal returns are getting ever lower, and real returns are actually negative.

So, the imperative to change comes first and foremost from the need to provide our citizens with the tools to build better financial futures for themselves.

That implies not only designing or adapting legal and regulatory frameworks, but also increasing the level of financial literacy so that each individual is better equipped to understand financial products and make the right choices.

Looking at retail investment as a source of funding for economic activities, there's no dispute that these resources could, and should, be channelled to investments that match the longer-term nature of household's savings. Developing the funds industry, promoting an equity culture, generalising auto-enrolment occupational pension systems, and, most of all, rebuilding people's trust in the financial system, are critical if the EU wants to deliver on its ambitious goals of becoming more competitive and sustainable, while taking full advantage of the benefits of digitalisation. All available resources will have to be pooled to cope with the tremendous investment effort required.

The need to provide our citizens with the tools to build better financial futures for themselves.

In the crisis spurred by the Covid-19 pandemic, the immediate response of support to the economy, though much needed, led to a sharp increase in indebtedness, both for sovereigns and corporates. The banking sector, backed by regulators' flexibility and the monetary policy stance, has contributed significantly to stabilise the economy in this first phase. However, if we are to avoid the risk of an extensive destruction of productive capacity across the EU, debt, and in particular bank debt, is not the answer.

Companies, including small and medium size companies, must have increased access to equity through the capital markets if they are to be effectively supported over the long recovery process ahead. Developing the instruments which promote retail investment engagement, while assuring the necessary investor protection, may actually prove decisive for the survival of many viable businesses. Innovative businesses, growing businesses, in order to be successful in Europe, also depend critically on available funding through capital markets, including that provided by retail investors.

The post-Covid recovery challenge adds to the urgency and relevance of what was already recognised as the necessary way forward. The Commission's new action plan, appropriately called "A Capital Markets Union for people and businesses", sets an ambitious roadmap with targeted and specific measures, taking on board many of the recommendations put forward by the High-Level Forum on CMU.

The actions in the new CMU plan directed at increasing retail investor participation in capital markets, if delivered as intended, do address many of the relevant problems identified, but they are no silver bullet, because there is no such thing in such a complex reality. Culture, namely the lack of a risk culture as seen in other geographies, also plays an important role, and that will take longer to change. Also, powerful instruments in influencing people's decisions, like taxation, are not under the Commission's remit, and therefore could not be considered in the action plan.

For the agreed actions to produce the desired impact, however, more needs to be done. All actors need to take ownership of the plan and do their share. That means swift decision processes through the Council and European Parliament, but also in Member States. Decision makers must recognise the importance of developing integrated and efficient capital markets, and act to put our common goals above protectionist temptations and vested interests. It will not be easy, but it will definitely be worth it.

GUILLAUME PRACHE
Managing Director,
BETTER FINANCE

Addressing conflicts of interest for a CMU that really "works for people"

The recent Capital Markets Union (CMU) Action Plan, sparked by the Covid-19 crisis, aims to put equities back at the heart of the EU economy funding and reduce the reliance on bank funding. In the aftermath of the global health pandemic, the EU economy will be in dire need of new capital financing in order to stimulate a swift recovery as well as innovation, sustainable investments and growth.

As the main source of long-term capital, EU households have a key role to play. But inviting EU savers to participate more directly in capital markets comes with a certain responsibility: investing in the EU's CMU must be safe, fair, and trustworthy.

To achieve this, the EU must first effectively address conflicts of interest in "retail" financial services (distribution and execution) and create a bias-free environment which stimulates competition and upholds clients' best interests.

BETTER FINANCE has long voiced its concerns regarding the misalignment between the interests of financial services providers and those of their individual, non-professional clients. Perhaps the most detrimental practice in this field is that allowed by "non-independent" advice.

Paying commissions or non-monetary benefits to investment advisors for their "advice" (actually for their sales) to "retail" clients has gradually and significantly steered EU households away from direct ownership of the EU economy to packaged, fee-laden financial products, as there are no commissions on listed securities and low-cost index funds (ETFs) – only on more "packaged" retail investment products.

BETTER FINANCE demonstrated how heavily fees weigh on long-term real (after inflation) net returns. Moreover, research by the European Securities and Markets Authority (ESMA), and other research reports, consistently found that – on average - cheaper, passively managed products (e.g., index ETFs) largely outperform the more expensive, actively managed products in net terms.

A "CMU that works for people" must uphold high standards of retail investor protection.

This high level of fees can largely be blamed on "inducements" because the commission for a non-independent "advisor" (actually a sales person) will eventually be borne by the retail client through the fees paid for the product .More problematic, , receiving remuneration or non-monetary benefits for particular products, creates an inherent conflict of interest between the provider and the client: according to MiFID II, investment firms must *"act honestly, fairly and professionally in accordance with the best interests of its clients"* (Art. 24).

Besides the conflicts of interest generated by non-independent advice, a recent scandal involving retail equity trading revealed an additional source of conflicts of interest affecting retail investors: the payment for order flows (PFOF). The stand-off between professional and retail investors following the GameStop case shone the spotlight on the issues with PFOF, that were largely ignored before.

PFOF impairs the retail broker's duty to act in the best interest of its clients and to obtain the best possible execution result. A CFA Institute report demonstrated that a ban on PFOF in the UK by the Financial Supervisory Authority led to *"an increase in the proportion of retail-sized trades executing at best quoted prices from 65% top 90% between 2010-2014"* and also narrowed down price spreads for large cap equities. In addition to poorer execution, PFOF can hinder competition among market makers and securities markets themselves and hurt price formation.

Therefore, BETTER FINANCE recommends to policy makers to urgently ban inducements for all retail investment products (i.e. all "PRIIPs" and pension saving products such as PEPP) as the main source of conflicts of interests in retail financial services, at the very least for independent advice, for portfolio management and for "execution only" transactions. The High Level Forum for the Capital Markets Union has made the same recommendations to the European Commission last year.

ANTE ŽIGMAN
President, Croatian Financial Services Supervisory Agency (HANFA-CFSSA)

Are we failing retail investors?

One of the cornerstones of the new CMU is to increase retail participation in capital markets. The consensus on the how to deliver these objectives has historically been the following: a) increase transparency (more information), b) increase the quality (better information), c) streamline and simplify the information (more accessible information for the average retail investor). While we have come a long way on transparency and quality, work still needs to be done on the simplicity front.

Thanks to regulatory efforts, the retail investor has now easy access to an abundance of information under various sectoral rules (MiFID, UCITS KID, PRIIPs, IDD), but the way this information is presented is often anything but simple and understandable to the average person. The combined effect of high volumes of cryptic information is likely to produce one of two possible reactions of average retail investor: 1) treat the information document as an annoying and verbose user agreement, scroll down and click "agree", or 2) try to read it, give up and opt-out of the capital market entirely.

Both supervisors and legislators are stuck between on the one hand needing the informed consent of the retail investor with regards to the full extent of the risks and rewards involved, and on the other hand keeping the information simple enough for it to be digestible by non-professionals.

We risk turning the information presented to retail investors to protect them into a liability shield for the benefit of financial service providers.

In some cases, this balancing act is just not achievable, and we risk turning the information presented to retail investors to protect them into a liability shield for the benefit of financial service providers. However, opting for simple may get us back to misleading, which then prompts us to incessantly review and improve the information at investors disposal. So far, this has historically led to the scope of the information requirements becoming progressively larger, which in turn, may well be one of reasons the average investor or SME still turns to the banking system, because of the comforting simplicity of a banking loan. Increasing financial literacy, especially for citizens of less established capital markets, will play a major part, but this still does not mean that the average person will be interested or has the time to go through pages of complex information.

Furthermore, information on some products simply cannot be simplified enough for retail clients without it being misleading in some way, not without someone sitting in the retail investor's corner and filling in the financial knowledge gaps, having at heart the interest of the client, not distributor or manufacturer.

This is where a network of financial advisors can play a vital part. Promoting independent advised sales could go a long way to secure a buy-in from the retail market. Instead of trying to educate everyone, why not provide those that need it with additional support?

How the actions from the CMU action plan will be implemented remains to be seen, but key will be to ensure consistency between the different legislative proposals, requiring close coordination both within the Commission and within the co-legislators, which has sometimes been difficult to achieve. However, it should be clear that transparent and simple does not mean risk free, and that capital markets will always have their ups and downs.

STÉPHANIE YON-COURTIN
MEP, Vice-Chair of the ECON Committee, European Parliament

Empowering all citizens to become active consumers in financial products

Mobilising savings for a green and digital economic recovery is not just one of the objectives of the Capital Markets Union. It is a unique opportunity to unlock new funding for SMEs and corporates. It is a political imperative as citizens are demanding closer alignment between economic decisions and long-term sustainability goals.

The recent GameStop events in the US are a cautionary tale on direct retail investment in financial markets without appropriate consumer protection safeguards. In the EU, such safeguards are seemingly in place and should remain.

Our ultimate goal is to empower citizens to become active consumers in financial products, just as they are more and more active in scrutinising products in shops. There is still much to do to promote safe retail investment, with increased awareness, tailored information and renewed trust.

Firstly, we need to raise awareness that financial products are part of citizens' daily life, whether they are offered insurance when renting a car or buying

appliances, they request a mortgage to buy their new home, or they save for retirement thanks to life insurance contracts or other financial products.

Increase consumers' attention to saving for longer-term goals is crucial to unlock financing potential in the EU's economy. Financial education is not only a matter for school and university courses, but rather as a life-long learning project. Work place trainings and regular financial checks are two concrete suggestions to tackle financial literacy in the EU.

Secondly, consumers should have access to information on all financial products, tailored to their needs and their understanding of financial markets. The EU has made a quantum leap with the PRIIPs Regulation, on the verge of being finally applicable across the whole investment landscape after ten years of debate.

So close to the finish line, better is the enemy of good: we will further improve the PRIIPs KID in the medium term. Most importantly, the PRIIPs Regulation has focused all distributors and providers on the value provided to end consumers, rather than the value they could derive from selling products.

A holistic review of the EU rulebook on distribution should aim at empowering retail investors with relevant information to make informed decisions every step of their financial way. Integrating all dimensions of costs, performance, sustainability and rights for consumers, in an interactive digital format tailored for each consumer's needs, is an inspiring horizon for the next generation of consumer protection rules.

Ultimately, consumers will actively invest and use their financial power if and only if they regain trust in financial intermediaries.

Consumers need to know and see that their financial interlocutors are their partners, and not just vendors. This renewed trust will come from a change of culture by financial intermediaries.

Co-building saving strategies together with consumers rather than offering ready-made packages and products; actively looking for the best investment solutions, tailored to each consumer's needs, rather only presenting in-house products; fostering regular dialogue with each other rather than relying on passive disclosure: all these changes can be implemented in the short-term.

CHRISTIAN STAUB

Managing Director Europe, Fidelity International

Restoring retail financial balance in the post-pandemic era

A natural human response to times of uncertainty is to save resources. And few years have been as uncertain as the one just past. European households reacted to the Covid 19 crisis by increasing their savings rate to more than 17 percent in the third quarter of 2020; the second highest level since records began in 1999, according to Eurostat.

However, savers have been reticent about moving this money from bank accounts into investment accounts. Eurostat data also shows that the investment rate bounced between 8 and 9 percent during the same period. This is a range that has held firm since 2012, and one that is yet to recover from the effects of the 2008 financial crisis, when the rate was above 11 percent.

These numbers tell multiple stories, but one that immediately stands out is about opportunity costs. A euro earning next to zero interest in a bank is one that doesn't contribute to an economic recovery or grow over time in a pension.

This adds up quickly over many households and many years. The European Fund and Asset Management Association estimates that the wealth of European households would be around 1.2 trillion euros higher had they reduced their bank deposits between 2008 and 2019 and invested in stocks and bonds instead.

Policy dilemma

And so, policymakers surveying a post Covid-19 landscape face a difficult challenge. Businesses, and to some extent national treasuries, will be keen for these savings to flow back into the economy via consumption.

But to only focus on short-term consumption as a route to economic recovery would be to miss a great opportunity to revive retail participation in the EU's capital markets, and channel those savings into the type of long-term prosperity that was foregone in the past decade.

We need an investment-led recovery as much - if not more than - a consumer-led recovery.

We therefore welcome the CMU's ambition to stimulate retail participation in markets through programmes such as PEPP, a pensions dashboard and a clean-up of product disclosure standards. We also welcome the upcoming MiFID (and IDD) distribution reviews.

But our post-Covid world requires both a rapid response and one that builds on Covid consumer behaviours in their more positive aspect - a continent-wide shift online. We believe that online financial health and planning tools, built on Open Finance standards and situated within the wider financial inclusion agenda, should be a fundamental cornerstone of policy going forward.

Stimulating financial health

Financial planning tools have a double benefit when it comes to 'retail participation': they both bring long term retail market participants and support strategic investment over event-driven speculation.

This is particularly important in an era where gamified access to speculative market trading is becoming ever easier. The instinct to save can very easily turn into a desire to take increased risk when periods of uncertainty lift.

So, we must do what we can, as soon as we can, to engage potential retail investors, restore public trust in capital markets and stimulate participation. Or risk another lost decade of low investment.

FAUSTO PARENTE
Executive Director, European Insurance and Occupational Pensions Authority (EIOPA)

Closing the pensions savings gap with simple, scalable products like PEPP

Estimates put close to 20% of EU citizens at risk of poverty or social exclusion in older age. This makes pensions adequacy and coverage becomes a priority for governments.

Yet, for many people pensions are a complex and confusing, and this makes people reluctant to invest in long-term savings products. The challenge is to overcome these barriers and to stimulate interest and action.

First, there is a need for clear and transparent information.

The pensions landscape varies considerably across Europe, but better information on gaps in sustainability and adequacy will help countries identify the emerging gaps in theirs system. This type of information will not just help governments in their decision-making. With the right information, people will also be able to make better decisions on how to save for retirement.

Simple, scalable, digital-first products will demonstrate the benefits of CMU to European consumers.

This year, EIOPA will be supporting the implementation of the Action Plan on the Capital Markets Union (CMU) with the provision of advice on the development of pensions dashboards that will help strengthen the monitoring of pension developments in Member States.

With the help of a network of experts, and making use of existing best practice, EIOPA will also map the functional feature of a tracking tool, including how best to present information. We will also provide advice on how to communicate and launch the service.

The goal is to create an attractive, easy-to-use tracking system that provides people with comprehensive information – in other words, a system that meets the needs of savers – so that it is easier to engage people with their retirement planning and encourage them to take action if they see shortfalls in their pensions adequacy.

Second, there is a need for pension products that meet the needs of today's workers. This means designing long-term savings products for people who change jobs frequently, or work on a freelance or casual basis.

Products like the pan-European pension product, or PEPP.

The PEPP is a portable, transparent, cost-effective personal pension product. Savers will be able to take their PEPP with them when they move jobs or countries and the Basic PEPP will offer an affordable and capped default investment option. In addition, savers will receive clear and comparable information about performance and will be able to switch providers if they would like but also with costs being capped.

PEPP also paves the way for more long-term investment in equity-like instruments, in order to increase the potential for better long-term returns for investors and foster sustainable economic growth. Simple, scalable, digital-first products will be key in demonstrating the benefits and the value of a Capital Markets Union to European consumers.

Improving pensions adequacy and coverage are difficult – but not impossible – challenges. Focusing on the demand side and engaging savers in their retirement planning with clear and transparent information will help not only to close the pensions gap, but also provide a source of valuable funding to strengthen the Capital Markets Union.

SIMON JANIN
Head of Group Public Affairs, Amundi

Preserving access to qualified financial advice for retail investors is key for the success of CMU !

Covid-19 crisis has led to an unprecedented increase in European households' savings, especially in cash and deposits. According to estimates made by the European Central Bank, the total of Eurozone household financial assets flows was more than 700 billion euros at the end of 2020, against 570 billion euros a year before. For France only, 220 billion euros were saved in 2020, 60 billion higher than last year[1].

Still, nothing guarantees that this idle money will be invested in the economy, notably in a context where citizens are mostly (64%) pessimistic about the European post-covid-19 recovery[2]. Recent ESMA's analysis[3] showed that while equity UCITS have delivered a nearly 9% net performance during the last decade, only 10% of European households invest in mutual funds.

Therefore, initiatives that aimed at increasing retail investors' participation in financial markets are key. And one can only fully support the new action plan of the European

Commission on Capital Markets Union published in September 2020 which sets out the objective *"to make the EU an even safer place for individuals to save and invest long-term"*. Among the new measures which are supposed to support these objectives - the review of ELTIF Regulation together with the promotion of long-term investment, in particular trough the promotion of employee share ownership - should be engaged in priority.

However, these measures will prove to be effective only if there are not counterbalanced by others. Indeed, among the 16 actions of the new action plan, one that could potentially have unintended consequences pertain to the announced assessment of rules applicable to the remuneration of distributors, with possible amendments of the related provisions in MiFID II. While any initiative that goes towards more transparency should be welcomed, it is nevertheless essential to avoid adopting radical measures that would in the end go against the interests of retail investors, and their ability to access to qualified financial advice, whatever their investment capacity.

It is essential to avoid radical measures that would in the end go against the interests of retail investors.

In this respect, retrocessions of management fees play a key role in remunerating the cost of advice. Conversely, in countries where a ban of these so-called 'inducements' has been adopted (UK, NL), access to financial advice has since then revealed to be particularly challenging. As provided in a study dedicated to the Dutch market[4], *"some groups of consumers are struggling to pay directly for financial advice"*. And as regards the UK, recent figures published by the FCA (2020) show that the global cost of ownership for the investors (including the cost of advice) remains high – leading to exclude the less worthy part of retail investors (with financial assets below 200 000 £).

1. Stat BdF: https://www.banque-france.fr/presentation-trimestrielle-de-lepargne-des-menages https://www.banque-france.fr/statistiques/epargne-des-menages-2020t2
2. https://ec.europa.eu/commission/presscorner/detail/fr/ip_20_1975
3. https://www.esma.europa.eu/sites/default/files/library/esma50-165-1106-asr-performance_and_costs.pdf
4. A commission ban for financial advice : Lessons learned from the Netherlands, Fred de Jong, University of Amsterdam, 2017

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