# DEVELOPING RETAIL INVESTMENT

## 1. Current trends of retail investment in the EU

### 1.1 Current situation of retail participation in the EU

A regulator emphasised that the volume of retail investment in Europe is low, especially compared to other comparable economies like the US, Australia and so on. Despite the recent trend towards more risk taking in the EU with investors moving assets from guaranteed products to unit-linked insurance products because of the low interest rate environment, there is room for further growth in Europe through insurance-type products or third-pillar pensions in particular.

An industry representative noted that the savings rate is currently at a record high of 17% across the European Union. At the same time, investment participation is at 8%, which is lower than it was 10 years ago. Another industry representative confirmed that savings almost doubled during the COVID crisis and this accumulation of savings was one of the major consequences of the crisis. An investor representative stated that directly or indirectly, most of the long-term funding in the EU economy comes from households. Unfortunately, the proportion of equity contained within household portfolios has been stagnant at 4% over the last 5 years and has not even followed the price increases of the stock market. From the statistical perspective, the CMU project has therefore not been a success so far.

### 1.2 Importance of retail investment for the funding of the EU economy

The Chair explained the importance of developing retail investment for the economic future of European citizens, for the funding of corporates and the post COVID recovery. The objective is to make retail investment in the EU a success story, however the EU is still very far from this objective

A regulator emphasized that it is essential that the growth of investments in unit-linked products and pension funds should continue because that is a way to foster long term investment in the capital markets and in the European economy. This is one of the main objectives of the CMU. An industry representative stressed the importance of placing the retail investor at the centre of the debate about the post-Covid recovery. Using an investment led approach will ensure the channelling of money to productive activities is a more stable way than funding based on government debt. As Jacques de Larosière said in a previous session of the Eurofi seminar, Europe will not succeed if it seeks to stimulate its economies solely by producing more debt and expanding its monetary base.

An investor representative stated that Europe needs to create a CMU that works for people and offered a strong warning to the industry about excluding more retail investors from the capital markets. Citizen participation in the economy, notably through the capital markets, is an essential part of democracy and capitalism. Capital markets should not be left to professional investors who mostly commit 'other people's' money.

## 2. Challenges that need addressing for further developing retail investment

### 2.1 Adapting the cost and complexity of products and services to retail needs

A regulator considered that there is an issue with the cost of products offered to retail investors in some cases, which reduces their potential return. Consumers must be confident that the products they can invest in provide good value for money, which requires driving down margins and overhead costs. If they do not trust investment products, there will continue to be an excessive amount of money locked up in bank accounts, which will not foster economic growth. Some products are also overly complex, which does not help to foster the trust and confidence of retail clients in long-term investment. EIOPA has recently launched a consultation concerning these issues in order to tackle the obstacles to retail investment.

An industry representative agreed that financial products should be offered at a reasonable or even low cost, but it is important not to assume that it is possible to have good quality advice without adequate compensation. Talking with customers to understand their needs and make the right recommendations takes time and has a cost. The right measures need to be found to foster the provision of adequate products and advice. 'Blunt' measures such as fee caps do not seem to be the right way forward. For example, the regulation around the Pan European Personal Pension (PEPP) product has a 1% fee cap. This will force the cost of advice into the 1% cap, which will eliminate the incentive to select the right investments and conduct proper risk management.

An investor representative concurred that product costs can be an issue, especially in complex segments such as unit linked products, for which total costs are difficult to figure out. The 1% fee cap of the PEPP however only applies to the default option. With interest rates at zero, having low fees is necessary to offer a remote chance of protecting the purchasing power of savers. In the US, Individual Retirement Accounts have a charge well below 1%.

An industry representative agreed on the need for affordable products and the importance of advice. Advice must however be paid for as was previously mentioned. In countries such as the UK which have banned inducements, advice is now only available to the wealthiest investors. Digitalisation can be part of the solution e.g. with robo-advice, but it is not a 'silver bullet'. A recent poll conducted in France demonstrated that even people in the younger generations, i.e. between 25 and 35 years old, still prefer to rely on physical advice.

A regulator described how the problems concerning retail investment started during the great financial crisis of 2008. Since then, there has been a continuous issue of trust from retail investors with problems about cost structure, access to products and available information. The reluctance of retail investors to invest in capital markets or to pay for advice can be explained in part by the strong presence of banks in the EU. When customers leave money with their bank there are no costs whereas with investment products there are often fees to pay upfront. In addition, banks are very cautious with their customers and do not always encourage them to invest in products that have some risk.

**2.2 Striking the appropriate balance between investor protection and participation**

The Chair explained that there is a balance to find between protecting retail investors and encouraging their participation in capital markets. This issue was discussed at the CMU High Level Forum (HLF) in particular.

A public representative agreed that this is a key issue and considered that policy-makers are still seeking the right balance. One of the key challenges for retail investment is to create a regulatory framework that can also be attractive for the industry and offer the industry an opportunity to increase its customer base while providing the necessary protections. These protections should include providing retail investors with sufficient information on the risks and giving them appropriate advice so that they reach a proper understanding of the products and how to manage them.

**2.3 Leveraging digital platforms**

An industry representative considered that digitalisation will be critical for increasing retail participation in capital markets. A public representative noted that there are many different digital platforms that offer the opportunity to participate in different kinds of investment strategies, especially for younger people. Most of them relate to financial indices and are relatively safe, but some are not positioned in this way.

One of the potential risks associated with digitalisation is gamification. An investor representative noted that the GameStop case has revealed many things, in particular the practice of payment for order flow and the role of market makers and dark pools. An industry representative considered that this case shows that it is highly risky when citizens invest directly in equities without any knowledge or advice. It is important to acknowledge that advice is needed but also that it has a necessary cost. A regulator agreed that in some cases fintechs can create problems for investors, as in the case previously mentioned, but on the whole they also help to streamline and cheapen investment.

An investor representative highlighted the role that digitalisation can also play in fostering more investor engagement, especially for the younger generation who are keen to engage more. It is a shame that in the 21st century, more shareholder and investor engagement does not take place via digital channels. Moreover, exercising voting rights within an intermediated product is very difficult. In the CMU HLF report and in the Commission's CMU action plan, there is a proposal to develop an application of distributed ledger technology (DLT) for shareholder voting and the execution of voting rights, along with the creation of a single definition of shareholders throughout the EU. The investor representative however stressed that this may not go far enough, because Europe has a very fragmented system. The project that the Commission Directorate for Justice and Consumers (DG JUST) is currently undertaking regarding sustainable corporate governance could contribute to improving the situation.

**2.4 Channelling investments towards the appropriate economic objectives**

An industry representative highlighted the importance of ensuring that citizens' money is channelled in the right direction, notably the transition towards a sustainable economy, the provision of the necessary energy infrastructures and the improvement of the healthcare systems. In this perspective, asset managers should think about building savings solutions that orient capital towards the areas of the economy that need finance, rather than simply selling products. The industry representative considered there to be several positive developments in the CMU action plan in this perspective, notably the priority to channel more savings towards long term investment. In particular, the possibility being considered in the review of the ELTIF Regulation to extend the access of retail investors to ELTIF products is a step in the right direction because it is likely to encourage retail customers to invest more in capital markets and private equity.

The Chair agreed that solutions must be found for savings to contribute to the recovery of the European economy. At the same time Europe must provide a better financial future for its citizens, given the current challenges in terms of ageing population in particular and the consequent pressure this places on pensions.

## 3. Priorities for developing retail investment

The speakers on the panel emphasized the importance of developing trust and confidence for fostering retail investment in capital markets and generally considered that the CMU action plan published in September 2020 is moving in the right direction in this respect. They highlighted certain areas of the action plan that may particularly contribute to developing retail investment, and proposed some additional policy and industry-driven actions for achieving this objective that would be useful to consider in the context of the CMU action plan, together with some issues concerning the timetable for implementation.

A public representative noted that the Global Retail Attractiveness Index suggests there is a high level of confidence in the EU15 markets, but it is now necessary to develop Europe's information infrastructure and provide reassurance for investors in order to encourage them to participate in capital markets. This issue is currently being debated in the European Parliament.

An investor representative regretted that the Commission's action plan has left out or postponed some of the measures proposed by the CMU HLF report and the ECON Committee's report on CMU from September 2020 that are highly relevant for retail investors. For example, some of the most critical measures from the CMU HLF report have been postponed until after the Commission's 'retail investment strategy exercise', which will not produce any regulatory recommendations and only start next year. This includes reviews of the investor protection rules in MiFID II and of the highly problematic Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation. It is unclear when this will be addressed, but it will not happen before 2023. This is mainly a matter of insufficient political will, the speaker considered.

### 3.1 Providing appropriate information and financial education

An industry representative emphasized the importance of meaningful information for retail investors, who are not sophisticated investors. There could be some flexibility in the current legislative framework regarding the MiFID opt in, but this is a topic for a future review. Policy makers must in particular address the problems raised by the PRIIPs key information document (KID), which is a 'nightmare' for investors and could end up being counterproductive. Financial education is also essential as well as creating the right incentives for investors through the tax system. One issue is that often the tax system incentivises investment in insurance products that ultimately invest in government bonds. In addition, tax incentives are mostly in the remit of member states.

Another industry representative agreed on the need for there to be appropriate disclosure and transparency, but was very sceptical about investors engaging directly in the financial markets, which is not a healthy way to increase investment. A guided approach is needed for fostering more retail investment. A suggestion could be for the European authorities to provide individuals with regular individual financial health checks. Individuals could provide their information and objectives and then receive information about their potential financial future and the types of savings that would correspond the best to their financial objectives.

An investor representative agreed on the importance of improving financial literacy and providing investors with adequate information. Unless the idea of a regular state-funded financial health check is put in place, there are only two points at which it is possible to provide retail savers with financial education or information: the retail point of sale or the workplace. There should be a stronger focus on this latter point, the speaker believed, which is quite underdeveloped in most of Europe.

A regulator highlighted EIOPA's current work on pensions. EIOPA received a call for advice from the Commission and is now working on a national tracking system and a pension gap dashboard aiming to help citizens to understand how much they will earn during their retirement period and how much they need to save to fill the gap. Every country in Europe has a problem with their pillar 1 pension system. EIOPA is seeking to create the infrastructure for people to understand these issues. The regulator stressed that information should be of good quality, come in a simple and engaging form, and be comprehensive. In this perspective, information should be based on behavioural research rather than supervisory or market transparency objectives. It is the right moment to do this, the regulator emphasized because the Commission is currently rethinking the system.

Another regulator considered that regulatory requirements have helped to improve transparency and the access to information, but more needs to be done to simplify, streamline and improve the quality of the information for retail investors. Indeed, the way this information is presented is often anything but understandable for the average person and the volume is excessive. This often produces two types of reactions from retail investors: either they ignore the information and simply agree to purchase the product or they give up the investment altogether. Supervisors and legislators are caught between the need to secure the informational consent of the retail investor and the need to keep the information sufficiently simple to be understood by non professionals. In some cases, this balancing act is not achievable. There is a risk here that the information presented to retail investors will be used as a liability shield for financial service providers. Historically, this problem has led to the scope of information requirements becoming progressively larger, which could explain why the average investor or SME still relies very much on the simpler banking system.

The regulator suggested that there are two main options for improving the level of understanding of investors. One option could be to educate all users of financial services, which is impossible. Alternatively, investor information could be simplified to make it understandable by everyone, but there is the risk of over-simplifying inherently complex issues. It is essential to bridge this gap, and the best way to do this is by teaching investors to ask for help and providing them with professional, independent and affordable financial advice that may guide them towards investments with an appropriate risk reward. Another challenge, because of the ageing of the population, is educating investors early enough, so that they can start saving as early as possible.

### 3.2 Providing investor guidance and advice

Several panellists emphasized the importance of appropriate guidance and advice for retail investors and exposed examples of measures that could be taken in this regard.

An industry representative outlined the importance of intermediation for investors wishing to invest in SMEs in particular. SMEs are an essential for the European economy, but are risky. Intermediaries are required to guide such capital allocations. Some platforms such as Moonfare for example provide access to private equity and private debt investing at a very low-ticket size and could be an appropriate channel for such investments.

A public representative highlighted two interesting ideas that could be picked up in the regulatory framework concerning digital platforms in order to provide investors with further guidance. First, platforms should be required to offer demo accounts. Younger people sometimes perceive these platforms as a kind of game and some form of demo account could give investors a more accurate perception of the risks involved in trading activities. Another suggestion is to have a framework that differentiates between professional traders and retail investors in the features that may be accessible on these platforms.

An industry representative noted that there are worrying omissions in recommendation 8 of the CMU action plan concerning inducements, advice and disclosure. While it is a good idea to improve disclosure and to seek a level playing field between the various pieces of distribution legislation (MiFID, IDD), the cost of advice must ultimately be paid by someone because there is no ‘free lunch’. It is important to preserve the distribution ecosystem in Europe and avoid adopting a radical solution that will ultimately work against what is in the best interests of investors, which is to have access to qualified financial advice.

An investor representative noted that the CMU HLF report contains measures to curb the damaging potential for conflicts of interest at the point of sale. Investors need to be educated at the point of sale, but not in a biased way. One issue is charging commission on execution-only transactions, because there is no advice there. There is also a question about whether biased advice is better than no advice. The problem is that commissions are charged on packaged and complex multi layer products mostly, not on simpler products like index exchange-traded funds (ETFs) and therefore this influences the advice provided. This report also points towards creating a level playing field between insurance products and MiFID regulated products. Under MiFID, there is a prohibition on commissions for independent advice and portfolio management, which is not the case for insurance based products regulated by IDD.

A regulator emphasised the need for a functioning and incentive balanced network of independent financial advisors. Europe must design a distribution network that is truly neutral with the interests of clients at its centre in order to foster more trust and retail investment. The regulator also stressed that the financial incentives of advisors must be divorced from distributors and manufacturers in order to place retail investors at the centre of the whole process.

### 3.3 Understanding the nature of European investors and ensuring adequate protection

A public representative suggested that the precise nature of retail investors in Europe needs to be identified in order to determine which areas the regulatory framework should focus on. According to the latest data, the average retail investor is of the younger generation, approximately between 35 and 40 years old. These are the people who use the various platforms enabled by digital infrastructure and technology.

A regulator agreed on the need to understand the nature of retail investors, including their limitations. Two elements need to be borne in mind. First, is that it is not realistic to turn every retail investor into a qualified financial analyst, before they are allowed to invest. Second, is to acknowledge that the investment decisions of non qualified investors have nevertheless made for a healthy financial system and that their decisions can be both rational and profitable.

An investor representative stressed that the CMU HLF report had recommended that retail investors in capital markets should be in the scope of the Collective Redress Directive, but this has not yet been done. There have been scandals like Wirecard, in which €20 billion of pension savers’ money will disappear without indemnity due to Europe’s lack of tools here. The public representative noted that given that retail investors are the least protected participants in the market they should be subject to more regulations that guarantee their safe inclusion in the investment market.

### 3.4 Clarifying the responsibilities for enhancing retail investment at the EU level

An industry representative emphasized that more clarity is needed on who will be in charge of carrying out which parts of the plan for developing retail investment. The point has been made previously that some of these proposals should be done at EU level and some should be done at national level. The problems concerning tax treatment for example cannot be solved at EU level and must be tackled at the national level. The same goes for financial education.

The Chair agreed that issues regarding tax treatment is not something that is within the Commission’s remit. It is essential to persuade national politicians that changes need to be made because of the importance of increasing retail investment for the European economy.

A public representative added that European consumers would benefit from a further consistency of the regulatory framework concerning retail investment at the European level, because at present national regulations differ quite substantially. It should be possible to create a regulatory framework that does not contravene most of these national regulations while providing a common level of specification for regulating retail investment.

### 3.5 Developing workplace participation and pension products

An industry representative highlighted the fact that the own initiative report on CMU published by the European Parliament contains ideas that are not in the CMU action plan, notably about increasing the financial participation of employees in their companies’ capital and workplace schemes. These instruments are important for educating financial investors since company saving can be the first step to broader investments.

An investor representative agreed that the provision of financial education in workplaces is thoroughly underdeveloped in Europe. This is not only about employee share ownership; it is also about corporate savings plans and corporate defined contribution pension products. If Europe had the same asset value level of employee share ownership as the US, the amount of money in SME employee share ownership would be multiplied by 100.

A public representative emphasized the importance of the PEPP in this context. It is essential to determine whether potential providers would be willing to offer such a product and what considerations would inform their decision in this regard. It would be good practice for Europe to consider the examples used elsewhere in the world, where this process is already happening on a broader scale.