RETAIL INVESTMENT STRATEGY: OBJECTIVES AND KEY ISSUES

Note written by Marc Truchet, EUROFI

1. Developing retail investment in capital markets is one of the key objectives of the CMU

Making the EU an "even safer place for individuals to save and invest long-term" is one of the main objectives of the new Capital Markets Union (CMU) action plan published in September 2020, which aims to put capital markets "at the service of people". This was confirmed by the Ecofin of December 2020 which identified the development of investment by EU citizens as one of the short term priorities for the CMU.

Retail investment is indeed essential for the funding of the EU economy, with most of the potential long-term funding of the EU economy coming directly or indirectly (i.e. via funds or pension products) from households. Retail investors also tend to have a longer term investment horizon than institutional investors, who are usually assessed and remunerated on a shorter-time horizon. In addition, favouring long-term investment is also essential for the future well-being of EU citizens, notably for the preparation of their retirement. At present, more than 18% of EU citizens are indeed at risk of poverty or social exclusion in older age, making pension adequacy and coverage a priority for the Union and its governments[1].

Europe has one of the highest individual savings rates [2] in the world and it has further increased with the Covid crisis. This saving rate has grown to 19% in the EU at the end of 2020[3], compared to approximately 14% in the US[4]. This has led to the accumulation of significant cash savings in the EU. For example in France it is estimated that more than € 150 billion have been saved by citizens since the beginning of the Covid crisis, corresponding to 7% of the annual GDP and similar trends have been observed throughout Europe.

However, the rate of retail investor participation in capital markets remains low in the EU compared to other major economies such as the US. In 2019, 29% of EU27 household financial assets were held in equity and investment fund shares[5], but it is estimated that this percentage is closer to 15% when taking out securities held by family offices, holding companies etc. In comparison in the US approximately 45 to 50% of retail financial assets are held in equity and investment funds, with about 20% in direct corporate equity ownership compared to 4% in the EU[6]. Consequently, the proportion of household financial assets held in bank deposits and traditional savings accounts is high in the EU (32% of household financial assets, compared to approximately 15% in the US[7]), reducing long-term financing options for enterprises and potential returns for savers. Most of the remaining part of EU household assets (about 34%) was held in pensions and insurance-based products, which usually have a dominant share of fixed income instruments.

There is also quite a strong heterogeneity of situations across the EU, with deposits and currency representing more than 50% of financial assets in several CEE and southern Europe member states[8] for example.

Some positive trends have nevertheless been observed since the beginning of the Covid crisis, e.g. with a significant increase in the number of new openings of securities accounts, particularly among the younger population[9], and a move from guaranteed products to unit-linked products within life insurance contacts. These changes are partly due to the opportunities for gains created by the market downfall at the outset of the Covid crisis and also to the low interest rates served by savings accounts and bond-based products, due to the current monetary policy.

2. A significant retail investment regulatory framework already exists in the EU but its effectiveness has been questioned in several areas

Retail investor protection rules are set out in a number of sector-specific EU legislations addressing different

1.Source CMU High Level Forum report June 2020.

2. Defined by gross saving divided by gross disposable income, with the latter being adjusted for the change in the net equity of households in pension funds reserves. Gross saving is the part of the gross disposable income which is not spent as final consumption expenditure.

3. Source Eurostat.

4. Source FRED – St Louis Fed December 2020.

5. Source Eurostat https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Households_-_statistics_on_financial_assets_and_liabilities#Value_of_assets_and_liabilities
Figures published by Better Finance for the EU28 in 2019 are slightly different with 12% of household assets in listed equity and investment funds, 2% in debt securities 30% in bank deposits and currency (instead of 32%) and 39% in life insurances and pensions (instead of 34%).

6. The EU percentage is the proportion held in listed equity.

7. Source BIS Household wealth in the main advanced countries - 2019.

8. Source ESMA Performance and Costs of Retail Investment Products in the EU 2020 and 2021 and Speech by S. Maijoor October 2020 "Retail investors and asset management are the pillars of a successful CMU".

9. For example, statistics from a major French e-broker indicate that new client accounts increased by +120% in 2020 and that 39% of all new clients are between 28 and 35 years old – Source Eurofi April 2021 seminar "Developing equity funding".

aspects of investor protection at the product, distribution and order execution levels. These rules are completed by general consumer protection frameworks under domestic rules and also supervision that remains largely domestic in this field, although actions are being undertaken at ESMA level to enhance supervisory convergence. Educational aspects are also managed at national level.

Concerning EU frameworks, MiFID (Markets in Financial Instruments Directive) and IDD (Insurance Distribution Directive) provide rules for the distribution respectively of securities and insurance-based products covering issues such as investor classification, product suitability and appropriateness assessment, advice and information at the point of sale and also restrictions on the use of inducements. MiFID, MiFIR and other securities market regulations[10] also regulate the execution of securities transactions.

These distribution and securities market rules are completed by the PRIIPs regulation (Packaged Retail and Insurance-based Investment Products) which aims to enhance the consistency of investor disclosure across comparable investment products and to make it easier for retail investors to understand and compare the key features, risk, rewards and costs of different investment products[11] through the provision of the pre-contractual Key Investor Document (KID) prior to the conclusion of any transaction. Product frameworks such as the UCITS Directive, the ELTIF regulation and PEPP moreover contain measures for ensuring the protection of retail customers investing in these products, and cover in part similar ground to the legislations previously mentioned. UCITS for example, includes eligible asset and liquidity rules designed for retail investors, but also investor disclosure rules.

These EU frameworks tackle the main areas of investor protection, but since they are related to specific products they can differ from one instrument to another or overlap to a certain extent. This makes investment decisions across comparable products potentially more difficult for consumers and increases the complexity for producers and distributors of marketing investment products to the retail market. In addition the effectiveness of MiFID and IDD rules regarding suitability assessments and inducements in particular has been questioned, as well as the product disclosure requirements of PRIIPs. The current client categorisation in MiFID is also criticized as it may lead to unnecessary precautions and burdensome suitability verification processes particularly for the more sophisticated retail investors.

The appropriate way forward for addressing these different issues is still under discussion. Many stakeholders are in favour of a more consistent or holistic approach to investor protection across EU regulations. However some are against a significant overhaul of the current approach[12], if this implies merging or significantly modifying current legislations, considering that existing legislations have common bases concerning investor protection that need to be preserved and that making targeted improvements within the existing legislations would be sufficient.

Inducement rules also give rise to heated debates. While some stakeholders consider that the current restrictions on inducements[13] are not sufficient for eliminating biased advice, others argue that a stricter ban of inducements would be detrimental for investors, potentially increasing the price of advice and reducing its availability for non-high net worth clients.

Furthermore, digitalisation, which is becoming an increasingly important feature for retail investment with the development of investment apps, robo-advice platforms and social media needs to be appropriately taken into account in legislation. Investor protection rules need to be adapted to the new digital environment in order to allow investors to benefit from the new opportunities offered by digitalisation (e.g. in terms of easier access to investment products and information, improved comparability, lower costs) and also to mitigate related risks (e.g. related to an easier access to risky products or to possible gamification). Sustainable finance is another major trend that needs to be taken into account in the retail investment approach.

Finally, additional areas of improvement have been identified in the context of the CMU initiative concerning the level of financial literacy of retail investors, the skills of financial advisors and the access of citizens to appropriate information about their pensions.

3. Objectives of the EU Retail Investment Strategy

In the new CMU action plan proposed in September 2020, the Commission announced its intention to publish a comprehensive strategy for retail investment in Europe in the first half of 2022 aiming to ensure that retail investors can take full advantage of capital markets and improve the coherence of rules across different investment products. The objective of the upcoming Retail Investment Strategy is to ensure that retail investors benefit from (i) adequate protection, (ii) bias-free advice and fair treatment, (iii) open markets with a variety of competitive and cost-efficient financial services and products and (iv) transparent, comparable and understandable product information. In addition, EU legislation is this area should be forward-looking and should reflect on-going developments in digitalisation

10. Together with other market regulations such as the Market Abuse Regulation (MAR) and post-trading regulations (EMIR, CSDR).

11. The following products are in the scope of PRIIPs: Investment funds (UCITS have exemption until 31 December 2021); Life insurance-based investment products (such as unit-linked or with-profits policies); Retail structured securities (including instruments issued by securitisation institutions and corporate bonds); Structured term deposits; Derivatives; Convertible bonds and other structured securities with embedded derivatives; Pension products and annuities not recognised by the national law.

12. See for example FBF contribution – EU strategy for retail investors – May 2021.

13. The general inducements MiFID II rule prohibits firms from paying benefits to or receiving benefits from third parties, unless the benefits are designed to enhance the quality of the relevant service to the client, and do not impair compliance with the firm's duty to act honestly, fairly, and professionally in accordance with the best interests of its clients.

and sustainability, according to the Commission, as well as the increasing need for retirement savings. The new CMU action plan also includes further proposals concerning financial education[14], inducements, investor categorisation, professional qualifications[15] and pension adequacy[16].

In this perspective the Commission is conducting an extensive study of the different disclosure regimes in the EU, of current practices in terms of advice provision and of the impact of inducements. A consultation for preparing a proposal for a Retail Investment Strategy has also been launched[17]. This consultation covers the main topics that have been identified as potential areas of improvement for encouraging more retail investment in the context of the CMU initiative and also of the reviews of existing regulations such as MiFID II, IDD or PRIIPs including: financial literacy, digital innovation, disclosure requirements, PRIIPs, suitability and appropriateness assessment, investor categorisation, inducements and quality of advice, product complexity, redress and complaints, intervention powers and sustainable investing.

Other on-going areas of assessment include the performance and costs of retail investment products, which are monitored on an annual basis by ESMA and EIOPA.

14. Feasibility assessment of the development of a financial competence framework aiming to develop a common understanding among Member States of financial competence (Q2 2021). Introduction of requirements for member states to promote learning measures supporting financial education in particular in relation to responsible investing (Q1 2022).

15. Amendments to applicable rules in the area of inducements in order to ensure that retail investors receive fair and adequate advice (Q1 2022). Introduction of a new category of qualified investors in MiFID II and reduction of the current information and administrative overload for these investors (Q1 2022). Measures to improve the level of the professional qualification of advisors including the introduction of a possible pan-EU competence certificate as part of the MiFID II and IDD reviews (Q4 2021 / Q1 2023).

16. Development of pension dashboards with indicators for facilitating the monitoring of pension adequacy; development of best practices in the area of pension simulations and tracking (Q4 2021). Assessment of current auto-enrolment practices in occupation pension schemes and identification of best practices across the EU (Q3 2020).

17. Consequently, the reviews of MiFID II, IDD and PRIIPs concerning retail investors will probably not be implemented until the Retail Investment Strategy has been completed.