RETAIL INVESTMENT STRATEGY: OBJECTIVES AND PRIORITIES

1. Retail investment trends in the EU

1.1 A low level of participation of EU retail investors in capital markets

A policy maker explained that the main starting point in the reflections of the Retail Investment Strategy lies in the very low participation of retail investors in capital markets in Europe and the growing awareness that developing retail investment is essential for ensuring the financial future of EU citizens, particularly in an environment of low interest rates.

An investor representative explained that bank deposits do not dominate household assets in Europe. Financial savings represent 40% of EU household assets, according to Eurostat when some 60% are in real estate and property. The discussion is therefore about 40% of household assets, of which 30% is in bank and savings accounts, 39% in life insurances and personal pensions, 8% in investment funds directly invested in by households, 4% in listed equities and 2% in listed bonds. Securities such as investment funds, equities and bonds regulated under MiFID therefore only represent 14% of the financial savings of households as direct investments, compared to approximately 40% 40 years ago.

An industry representative gave some additional statistics from Austria, where the Central Bank has reported that Austrian private individuals have around €280 billion in current and savings accounts, producing a quasi-zero interest rate. With an inflation rate of roughly 2.8% to 2.9%, private individuals are losing around €8 billion per year, which is a loss in purchasing power and a threat to future pensions. Generally speaking, the penetration of investment products in Austria and Central Eastern Europe (CEE) is much too low, amounting to e.g. 10% in the Czech Republic and 4% in Croatia.

Another industry representative emphasized that high savings rates and the preference for deposits are present in many European countries. Many EU citizens consider bank deposits and savings to be safe assets, but with practically no interest and an inflation rate of around 2.5% that means that they are losing money and missing out on long term saving opportunities that they could achieve more effectively by investing in capital markets.

1.2 Evolutions with the COVID crisis

A public representative stated that the COVID 19 crisis, which has had adverse impacts for many EU citizens has also offered some opportunities on the investment side, with many retail investors considering equity investment for the first time. This shows that when they are provided with the right tools, context, and framework retail investors will definitely consider entering the markets.

A regulator noted that increased retail investor trading activity has been observed in a number of European countries since March 2020. This trend was confirmed in Belgium for example by two quantitative surveys on retail participation in June 2020 and June 2021 that were based on MiFIR data relating to transactions executed between 2018 and 2021. The number of investors trading BEL 20 shares increased sharply from February to May 2020 and the number of investors in stock exchange index shares increased fivefold compared to the period before the crisis. In Belgium, young and infrequent investors became much more active in terms of share purchasing during the first lockdown, since they were able to save money and had time on their hands. Following the second lockdown at the end of 2020 there was a further increase in the number of active investors and of new investors entering the market. These positive evolutions, which concern mainly young and infrequent investors are encouraging. It is hoped that they will continue in the future. In addition the potential downsides of gamification and the need for sufficient financial education and diversification must also be considered in the EU initiatives underway, the regulator stressed. A policy maker added that the momentum around young people entering capital markets was facilitated by the use of new technologies and financial applications.

An industry representative explained that market data shows both an increase in precautionary savings rates across the EU and an acceleration of new investors coming into the market. There have been significant online broker account openings in Germany, where trading volumes are up by five times. In Denmark, inflows in mutual funds were multiplied by 10 during the first 20 months of the COVID 19 crisis compared to the previous 20 months, with 50% of investors claiming to be driven by the negative interest rates on deposits.

Another industry representative agreed that recent trends since the outset of the COVID 19 crisis are encouraging for retail engagement, but the question is whether people are really starting to invest or whether they are mainly speculating.

2. Objectives of the EU Retail Investment Strategy initiative

A policy maker stated that an important objective of the Retail Investment Strategy is to increase retail participation in capital markets in the EU because savers currently do not benefit enough from the opportunities offered by capital markets. In some member states, this will make it difficult for many citizens to meet their retirement needs and more generally it is also an obstacle to the further development and integration of European capital markets. There are many reasons for the low level of participation of retail investors in capital markets in the EU including financial literacy and distribution issues, which the European Commission is intending to address. In doing so, it will also be important to bear in mind that retail markets differ significantly across the EU in terms of investment cultures and levels of financial literacy, which requires finding responses that fit with the various national situations.

Another issue that the European Commission is intending to tackle with the proposed Retail Investment Strategy is the low level of satisfaction of many stakeholders with the current investment environment, the policy maker mentioned. The investor protection framework needs to be improved to ensure that clearer and more understandable information is given to investors, that any advice given is accurate and fair, and that potential conflicts of interest are addressed notably concerning inducements. Another objective is to enhance the consistency of investor protection approaches across different sectoral legislations and to ensure that supervisors have the proper tools and powers to crack down on poor practices and investment scams. The European Commission has already made some progress on these different issues, but further work is needed. The intention of the European Commission is also to harness the benefits of technology and innovation and build on the increased appetite for sustainable investing, which are likely to drive retail participation in capital markets going forward.

If the European Commission manages to attain these objectives, more trust should be instilled among retail investors and they will be more willing to participate in capital markets. However policy-makers and industry representatives will have to engage constructively because they will quickly encounter extremely difficult issues such as the tackling of inducements, the adjustment of disclosure and suitability regimes and the challenge of reducing complexity.

An investor representative emphasized that the Retail Investment Strategy is a once in a generation opportunity to make a difference in investor trust and foster the development of capital markets for an innovative and sustainable economy. Different elements including investor protection, value for money and pension adequacy need to be considered in this context, as more citizens are encouraged to move their savings to investment products for the preparation of their retirement instead of the traditional pay as you go state run systems.

A public representative added that a holistic approach covering a wide scope of products and of private and public sector stakeholders and considering new trends such as digitalisation is necessary to bring more retail participation to the capital markets. The educational capacity relies on member states, and therefore they must be involved in this initiative. Entrepreneurs and small and medium-sized enterprises (SMEs) must also be included in this effort, alongside individual retail investors.

3. Key policy priorities for increasing retail participation in capital markets

3.1 Improving financial information, education and financial capability

A public representative stated that while investor protection measures and addressing new issues such as gamification are important, retail investors must also be provided with adequate financial education and access to full and transparent information in order to enhance their understanding of capital markets, which is the best way to improve their protection. Retail investors who have been able to save significant amounts of money in their bank accounts can make their own decisions provided they have the right level of information and explanation. Ensuring that they achieve a sufficient level of diversification in their investments is also essential. The different situations of member states in terms of retail investor culture and financial education need to be considered. A European perspective is needed with a clear legal framework, but understanding the singularity of each member state is essential for increasing the participation of retail investors, because the same answers will not work in all member states, particularly those where retail investment is practically inexistent at present.

One aspect which is often overlooked when discussing retail investment is the issuer side, the public representative stressed. The financing of innovative projects and companies needs to have a more prominent position in the public debate. SME managers and entrepreneurs especially need to be encouraged to seek sources of financing in the capital markets when launching new projects, rather than relying exclusively on bank debt, which requires enhancing their financial culture. Bringing small investors into a project from the very beginning is also an option that should be considered by more European entrepreneurs. Moreover, employee shareholding should be further encouraged in Europe because this will contribute to enhancing the knowledge and experience of citizens in capital markets.

An investor representative stated that financial education and information on capital markets and products are essential for increasing retail participation in capital markets, but this can only be done at the retail point of sale. The current problem is that advisors in most European distribution systems are sellers of products remunerated by sales commission and not advice fees. This limits the development of the lower cost instruments such as index exchange traded funds (ETFs) or listed equities because there is no commission on those products. The investor representative acknowledged the objective put forward in the Retail Investment Strategy to move towards more bias free or independent advice, which would contribute to improving investor education about the opportunities offered by capital markets and the characteristics of different investment products, including those that offer best value for money.

An industry representative emphasized that investor protection and investor empowerment are both essential. Investors' trust needs to be enhanced, but it is also necessary to address the complexity of capital markets for investors and the confusion that this may create for them in order to encourage them to make their first investments. Indeed, generic financial education and advice at the point of sale are not sufficient for developing financial capability because people need to experiment with capital markets. A way to encourage this would be to develop a programme open freely to all EU citizens that would allow them to evaluate their financial positions and develop a lifetime plan for financial resilience. While financial education remains a national competence, the EU could have a role in setting some standards and encouraging the development of this type of programme at domestic level. The industry speaker added that digital investment platforms can play a role in the improvement of disclosures and information provision for retail investors, particularly for the younger audience. It is therefore necessary to support such developments with appropriate regulation. For example, the key information document (KID) of the Packaged Retail Investment and Insurance Products (PRIIPs) legislation needs to be adapted to the digital world in order to encourage new investors to benefit from these tools.

A second industry representative stated that investor protection and education are both important, but an appropriate balance is necessary between the two. Financial literacy needs to be improved, starting in schools, but more effort is also needed to inform citizens about the basic facts of investing, such as the loss in real terms that leaving money on a bank account represents. Concerning investor protection, it is important that regulation should empower retail clients to make investments without imposing unnecessary obstacles or burdens related to investor protection objectives. Over the last few years, many experienced clients have indeed stopped investing because of the burdens imposed by the new MiFID regulation.

A third industry representative emphasized that a key objective of retail investor education is getting savers to understand the benefits of diversification, which also requires providing them with clear disclosures across product categories. Another major objective is getting investors to understand volatility and the implications of liquidity premiums which require investing for a sufficient period of time and accepting that higher longer term returns might involve short term losses. While providing financial education is essential to increase the level of confidence of investors, some will still seek direct advice with more or less support and human interaction. This requires continuing to provide retail investors with access to different forms of advice at different prices from branches and other points. Digitalisation is a huge opportunity that will hopefully be a way to propose educational sessions for investors during which the basic concepts of investment and the long-term benefits of investing can be explained.

A regulator highlighted Wikifin, a financial education initiative that has been put in place in Belgium by the supervisor of financial markets (FSMA) targeting teenagers, which is an interesting illustration of public/private cooperation in this area. Some 16 million people have used the Wikifin website and the Wikifin Lab, which is an interactive education centre on finance, is fully booked until 2022.

3.2 Reducing product complexity and costs

An investor representative considered that when it comes to increasing retail participation in capital markets, a priority should be given to the simplest products and the most effective ones for funding the EU economy. However, these only represent 14% of current retail investments. The share of index funds or ETFs, which are the simplest and lowest cost securities, held by retail investors is very limited in the EU, at 10%, compared to 50% in the US, according to ESMA. A much larger share, representing almost 40% of financial savings, is composed of complex multi layered packaged life insurance or pension products that also have a higher cost and less attractive value-for-money. For example a recent study showed that the average fees of personal pension products in France (Plan d'Epargne Retraite) are around 3%, compared to 1% for US individual retirement accounts. Not all retail investors should invest directly in equities and bonds, but they should have access to adequate professional services, able to direct them to the most appropriate investment solutions.

An industry representative agreed that the priorities for bringing retail investors to the market relate to the simplicity of products, the ease of investing, adequate value for money and the possibility of diversifying investments to a great extent. An industry representative felt that while it is necessary to offer retail clients fair and appropriate investment opportunities, the problem is not on the product side at present.

A regulator stated that the supervisor of financial markets (FSMA), which is organised according to a so called 'twin peaks' model, takes a proactive approach to this issue, acting whenever necessary to ban products that are too complex or have a doubtful added value for retail investors. FSMA was the first supervisor in Europe to formally ban binary options, different forms of contracts for difference (CFD) and the use of bitcoin for derivatives for example. This was done because these products seemed too complex for retail markets. Regarding overly complex structured products, a soft law approach was implemented in conjunction with the financial market players concerned.