RETAIL INVESTMENT STRATEGY

BENOÎT DE JUVIGNY
Secretary General - Autorité des Marchés Financiers (AMF)

Make targeted policy adjustments to improve retail access to capital markets

Encouraging the participation of retail investors in EU capital markets is a key priority for the development of the CMU. In this respect, a review of the EU framework to enhance retail investment should aim at developing cross-border investments and providing long-term investment options to European households, while making sure they have access to good quality advice and strong investor protection.

Savings accumulated during the pandemic and the currently low level of returns offered by low-risk investments provide an additional window of opportunity. In France for instance, in the latest 2 years and amid the turmoil of the pandemic, 965,000 new retail clients invested in equities for the very first time (this development remains to be monitored).

Policy-wise, the Commission has rightly set the long-term needs and interests of investors at the heart of its renewed CMU action plan, in particular with its proposals to enhance transparency and give investors more access to trading and company data (through the consolidated tape and the European single access point respectively) ; and to foster long-term savings and investments (through revisiting the EU framework for existing long-term vehicles ELTIF).

To go forward, the recent consultation for a European retail investment strategy is very welcome. Overall, the existing regulatory framework is solid, coherent and satisfactorily protective, and no deep regulatory overhaul is warranted. Yet, some targeted adjustments could be made in response to recent developments within the financial industry and to spur retail participation in capital markets, particularly in equity markets. Rules could be reviewed notably in the following areas.

On one hand, to further ensure investor protection for safe cross-border investments within a digital market, one should aim at limiting regulatory arbitrage between Member States to avoid differences in investors' rights. In the absence of unified supervision at EU level, improvements should be made to the passporting framework to ensure higher and more harmonised protection. Measures should be taken to strengthen coordination between home and host authorities in situations where firms infringe upon the rules in host jurisdictions while acting under the EU passport. No genuine single market in financial services can be established unless confidence is restored in cross-border investment services for retail clients.

On another front, investors must be empowered with adequate knowledge, information and advice to support their investments.

The objective of improving the offer of, and access to, financial products for retail investors is intrinsically linked to the development of financial literacy. Financial knowledge is indeed essential for EU citizens to get the most out of the investment products and services available to them. Notwithstanding Member States' competence in the field of education, there is room to develop initiatives to ensure coherence and coordination within the EU, and reach the highest number of potential investors, on matters of common interest (eg. risks and performance of financial products ; time horizons of projects and investments; typical scam techniques – a major issue in many countries).

Moreover, in order for them to be incentivised to invest, individuals should benefit from relevant, fair and proportionate information: in this field, work should be done to adjust the existing disclosure requirements to make them more meaningful and tailored to investors' needs, hence more understandable. The PRIIPS Regulation is an example where amendments are needed to ensure a better information of investors, with a view to enhance their access to financial products. It is important to review the general approach of the PRIIPS Level I Regulation with the objective of making the key information document a useful, understandable and not misleading source of information for investors.

Ultimately, for less sophisticated investors, information will not be sufficient, and high quality financial advice will be needed. This also means that retail investors should have access to unbiased advice. To ensure that investors effectively receive such advice, the comprehensibility of inducement disclosures should be enhanced; ESMA's recent technical advice contained proposals to improve the clarity of inducement disclosures which should be supported. Conversely, introducing a general ban on inducements would have a detrimental effect on retail investors by depriving them of access to proper advice (at least in some countries like France). Such a ban would have the unwelcome effect of boosting the sale of in-house products by banking networks (who could use other remuneration schemes not captured by a ban, eg. for intra-group money flows) to the detriment of open architectures.

In sum, finding the right balance between appropriate advice, adequate information, and a suitable level of protection for safe cross-border investments should be a driver for a future EU retail strategy.

UGO BASSI

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The EU retail investment strategy

What are we seeking to achieve through a retail investment strategy?

The Commission is seeking to ensure that the legal framework for retail investments empowers consumers, enhances their participation in the capital markets and helps ensure improved market outcomes.

In September 2020, in the New Capital Markets Union Action Plan, we announced our intention to come forward with a strategy for retail investments in Europe that seeks to ensure that retail investors can take full advantage of capital markets and that rules are coherent across legal instruments. Our strategy will set out measures to encourage more participation from retail investors by ensuring that they are adequately protected and enabled to make better use of EU capital markets. This is one of the keys to the success of the Capital Markets Union Action Plan.

Our objectives received strong support from both the Council, which called on the Commission to *"initiate, within the mandate of this Commission, the implementation of the other parts of the Action Plan that aim to boost investment activity, including and in particular by retail investors inside the European Union, while maintaining a high level of consumer and investor protection"*[1], as well as from the European Parliament, which in its resolution on the Capital Markets Union Action Plan, called for a mobilisation of retail demand to be made possible through a change in investment culture, which *"[..] will only happen when retail investors become convinced that investment in capital markets is desirable while being subject to risks that are acceptable and clearly defined."*[2]

Evidence gathering

Over the past year, we have been preparing the ground for the implementation of an ambitious new strategy. That has involved a wide-ranging evidence-gathering exercise including work on an extensive external study, issuing calls for advice to the European Supervisory Authorities, holding discussions with Member States, meetings with a variety of stakeholders, as well as a 3-month public consultation to seek stakeholder views on the broad range of issues around the retail investor journey.

> **We need in particular to cater for a younger generation of retail investors.**

186 stakeholders responded to the public consultation, from various backgrounds – business, private citizens, NGOs, consumer organisations as well as public authorities. That variety was reflected in the different views expressed about the state of the current framework and whether, and if so what, changes might be needed in order to stimulate greater retail participation. In particular, we noted the strongly diverging views on questions around potential conflicts of interest in the sales process and the different perceptions as to how understandable current disclosure documents are. On the other hand, we also noted a degree of convergence regarding the need to adjust the framework especially to accommodate digital challenges. The results have provided the Commission with food for thought about all the major topics and constitute a solid basis upon which to make our policy choices.

Next envisaged steps

Our intention is to come forward with legislative proposals before the end of 2022. We are currently working to develop these policies and assess different options in the accompanying impact assessment. While not wishing to pre-empt the outcome of that work, it is already clear that we will need to address a number of problems that have been identified through our evidence gathering exercise. These issues cover the length of the retail investor journey, starting with investor education, but moving on to the way products are distributed to investors, the way in which disclosures are made towards investors and the quality of the advice that is dispensed. We will in particular need to modernise the rules to ensure that they are less product and more client focused, while harnessing the potential benefits that digital and sustainable investing offer and ensuring greater consistency across sectoral legislation.

We must ensure that the new rules cater especially for a younger generation of retail investors, with measures that encourage their engagement whilst at the same time ensuring that the investor protection framework is future-proof and provides appropriate safeguards for retail investors in the digital environment.

[1] *Council Conclusions on the Commission's CMU Action Plan, 3 December 2020*

[2] *European Parliament Resolution of 8 October 2020 on the Further Development of the Capital Markets Union*

GABRIEL BERNARDINO

Chair - Portuguese Securities Market Commission (CMVM)

Towards a new paradigm for retail investors information

It's time retail investors take central stage at the European capital markets. Not only should the financial system be at their service, namely by providing solutions that can offer better returns for their savings and are well aligned with investors' preferences and needs. Retail investors also play a vital key role in the economic recovery in Europe and help European markets compete with other economic blocks.

However, for retail investors to trust European capital markets as recipients of their savings, a new paradigm of information disclosure must be considered. Good, sound and easy to understand information is vital to promote confidence and to engage retail investors, old and new, in capital markets, as this will enhance transparency and trust which are major pillars of a well-functioning financial sector.

The principles laid down in the current rules are correct: information to consumers should be easy to read, understandable and comparable. However, the way these principles have been embodied in the European legislation could be improved. Change is necessary if we wish to be truthful to our own principles and contribute to consumer protection, market development and financial stability.
In this sense, we must start by humbly admitting that there is room for improvement. There are (too) many examples of information complexity that is currently disclosed to investors. This creates unnecessary costs and hinders investors willingness to engage with and trust capital markets.

A new disclosure framework should offer clear, credible and simple information that is perceived as such by investors. This does not mean we need new data. In fact we must avoid past mistakes that - over and over - have resulted in additional data carried to informational documents. So, I think that incrementing or even partial changing the status quo is not the right answer. The capital markets union and in particular its most recent action plan is the 'perfect moment and place' for all of us to improve financial regulation of information disclosure.

First, we need public disclosure requirements that consumers can effectively use. For example, we could begin by agreeing that information available to retail investors should be layered and less complex than the one provided by product providers and distributors. Such a change would also help supervisors.

Information should be simpler and market conduct supervision should be enhanced.

Second, we should use digital tools to disclose and centralize information. That is, informational requirements should be adapted to the digital age. As an example related to the heart of a real capital markets union, we should aim at developing simulators and comparable fees and costs tables for financial products that are distributed across Europe.

It is also fundamental to ensure that simpler and more appealing 'language' is used in the documents. Information can be made radically simpler. Simplicity should be a foundational stone of the new paradigm. Let's consider the following and simple example - and without disregarding that more complete information should be made available for more sophisticated retails investors – the normal retail investor seeks answers to the following questions: How much will the product cost in terms of fees and charges? On average, how much could I earn or what is the possible return? How much could I lose, particularly in an extreme scenario? And, what are the ESG impacts of my investment decision?

As simple as this may seem, if we add a plain description for the 'common citizen' of what the product is and label it accordingly to its main characteristics, I believe this ultimately will be all the information our fellow citizens will need to invest consciously and in a much simpler way. Labelling of financial products, and not only for ESG purposes, would definitely help. This said, even with simple and comparable information and high levels of financial literacy, investors may fall prey of behavioural biases and limitations. So, when designing informational documents, we must also consider the behavioural dimension in retail investment decisions affected by such documents.

As a corollary, to better support this new information paradigm and to mitigate mis-selling practices we should reinforce market conduct supervision in a coordinated manner. These supervisory actions should include, among others, value-for-money analysis, and result, if appropriate, in the use of the product intervention powers.

In conclusion, I believe that the capital markets union and its latest action plan should seriously consider this new approach and pave the way for a new era for retail investors information disclosure. Such a new approach, one that entails financial instruments that are more transparent and clear, would strengthen investors trust and participation in capital markets. Investors and Europe need this new approach.

STÉPHANIE YON-COURTIN
MEP & Vice-Chair, Committee on Economic and Monetary Affairs - European Parliament

Building a Capital Markets Union for savers and citizens

Building up popular support for the Capital Markets Union project is not an easy task. Still today the financial sector enjoys low levels of trusts from European citizens, and the regulation of financial services has fallen off from newspapers' headlines, fortunately due to lesser perceived risks to financial stability, one decade after the great financial crisis.

Citizens could however unleash their power as savers to unlock new funding for European SMEs and corporates. The forthcoming Retail Investment Strategy should lay the foundations for the CMU action plan to reach every saver, and promote a more responsible capitalism, geared towards the green and the digital transition.

Participation of consumers in finance and investor protection are two sides of the same coin. Consumers' trust that financial intermediaries are acting in their interest have been erode by numerous episodes of local, national and international mis-selling scandals. Rules tailored for each individual consumers will be paramount to restore this trust. These rules should be anchor in three core principles: transparency, accountability and dialogue.

Without free of charge access to meaningful information on financial products, savers will lose appetite to invest. With or without the help of a financial adviser, each consumer should be able to tailor the information they receive based on their needs and their understanding of financial products.

The forthcoming review of the PRIIPs Regulation should bring about the 2.0 version of the Key Information Document. The KID 2.0 will be fully digital and interactive, giving consumers direct access to all relevant information on risks, costs, performance, sustainability and consumer rights in a user-friendly format.

In creating the KID 2.0, we should remain attentive to avoid the exclusion of consumers with lower digital literacy, and we should maintain the original ambition of covering all financial products and providers.

The first PRIIPs Regulation has led to increased attention from distributors and providers on the value provided to consumers. The second PRIIPs Regulation should aim to boost consumers' own awareness on the power of their savings.

Participation of consumers in finance and investor protection are two sides of the same coin.

The accountability of financial intermediaries and advisors should be reinforced, so that consumers know they are acting in their interest. In addition to clarification on the principle of alignment of interests at level 1, ESMA and EIOPA can play a key role in fostering coordination across national competent authorities, notably with their new explicit competences in relation to mystery shopping.

Ultimately, consumers should not face situations when advisers are able to sell the same products with a different rulebook on product governance. Aligning the MiFID and IDD frameworks will limit discrepancies in regulation and supervision. This will require a difficult but necessary legislative debate on the processes ruling the interaction between consumer, distributor and provider.

We should remain mindful of the specificities of each distribution market, linked to national competences on taxation for example, as imposing one-size-fits-all model onto existing practices will only deter consumers from investing more into the economy. Accountability should however run deeply in the veins of the distribution networks for financial products, and the proposed EU competence framework for financial advisors will be a crucial tool to deliver on this objective.

With increased transparency and reinforced accountability will come better dialogue. Consumers and financial intermediaries should be in constant dialogue on saving need and investment opportunities, in good and bad times.

With a change of culture, consumers will be able to see financial intermediaries as partners in their life choices related to their personal finance. Consumers should be not restricted to limited choices based on a few ready-made packages, but should be accompanied to build personal saving strategies tailored to their needs. They should not be offered only the products their intermediaries manufactured, but should be given access to a wide range of solutions.

Financial awareness is not limited to financial education at schools and universities. It is first and foremost a life-long learning project, to which public institutions, employers and trade unions, and civil society organisations can all contribute for the benefits of consumers.

Fostering dialogue at the level of every consumers, and at the broader societal level, on the benefits of active savings strategies, will be a strong driver for support in the Capital Markets Union project, much needed to finance the EU's strategic autonomy.

JOS HEUVELMAN

Member of the Executive Board - Dutch Authority for the Financial Markets (AFM)

The Retail Investment Strategy; one year after the Gamestop Saga

More than a year has now passed since the so-called 'Gamestop saga', when meme stocks entered the mainstream and retail traders took on professional investors. The lockdown and low interest rate environment accelerated existing digital trends.

As more consumers start to invest, or express the intention to start investing, the need to adequately protect retail investors is more urgent. The European Commission announced in 2021 its Retail Investment Strategy to help, protect and facilitate individuals to participate and benefit from Europe's capital markets to realise their financial goals.

The AFM shares this ambition and believes high levels of investor protection go hand in hand with improved access.

In the Netherlands, approximately 85% of consumers invest in capital markets through mandatory participation in cost-efficient occupational pension schemes. With the shift to defined contribution schemes and an increase in the number of self-employed, there is additional need to facilitate and protect retail investors. Trust in financial services and capital markets remains crucial. Hence, retail products must be cost effective and greenwashing must be prevented. People need to be able to trust that something good is being done with their money.

Apply insights from behavioural finance and economics

Digitalization has made investing easier and more accessible but also made sales and marketing techniques such as gamification and online targeting possible. This could increase the number of people that are triggered to invest and subsequently treat investing as a game. Yet, gamification also has its benefits, such as explaining complex subjects playfully and accessibly. IOSCO recently published a landmark report on this issue.

We like to believe that consumers act rationally, however research has shown that consumers are prone to behavioural biases. Research from the AFM has shown that one in three retail investors trade suboptimally. Examples include trading too frequently or buying unnecessarily risky products. With the growing popularity of digital investing apps, the choice environment and how it provides access to investment products has become important.

Firms throughout Europe already employ behavioural aspects in apps and other online environments in ways that do not always benefit consumers.

> **Digitalization made investing more accessible, but it also gave room to methods such as gamification.**

Although online nudging –and even gamification– can be used to promote sensible financial decisions, firms can also use them to steer clients toward risky and more expensive products for their own benefit. A future proof retail protection framework addresses how the online choice environment influences consumer behaviour positively.

Simplify consumer disclosures

Consumer behaviour insights can also be used to simplify and improve pre-contractual consumer disclosure documents. However, relying solely on consumer disclosures about the features, costs and risks involved with financial products does not necessarily lead to better decisions. Although disclosure requirements are a fundamental part of the investor protection framework, using insights from consumer behaviour is crucial to keep a high level of effective protection in the digital age. The design and framing of the information play an important role in consumers' choices. Recently, the AFM published a discussion paper on how firms and policy makers can use behavioural insights to improve and simplify consumer disclosures. Moreover, streamlining the disclosure requirements across financial areas could improve comparability of products and services, while reducing costs for firms and preventing information overload for consumers.

Effective cross-border cooperation

Digitalization contributed to more choices for consumers and an increase in cross-border activities. However, supervisors have less sight on activities in other member states, especially if this takes place in closed channels. Transparency of market practices necessitates better cooperation between national competent authorities (NCAs), it prevents the risk of greenwashing and increases the trust of investors.

AFM believes that cooperation between NCAs is the pillar of success by enhancing the single rulebook and promoting supervisory convergence. The AFM and the French AMF have jointly published a position paper on cross-border retail services advocating for providing host member state NCAs and ESAs with adequate instruments and competences so that they can effectively assume their supervision responsibilities.

Strengthen product governance

AFM encourages to strengthen the application of the Product Oversight and Governance (POG) framework to risky and complex investment products in non-advised services to prevent consumer harm. In the Netherlands, POG rules have been a key element to ensure that retail investors have access to suitable products, to prevent misselling, and to ensure that firms have their clients' interests top of mind when developing and distributing financial products.

GUILLAUME PRACHE
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Retail investor Strategy: some inconvenient truths on biased advice

The EU initiatives – the "Capital Markets Union" Action Plan and the EU Strategy for retail Investors - both rightly set as a key objective to "ensure bias-free advice".

What is most at stake here is the conflicts of interests in the distribution of retail investment products, as the dominant distribution model in Europe is commission-based (providers paying sales commissions to retail distributors, often surprisingly labelled as "investment advisors"). EU legal jargon calls those "inducements", a term most EU savers do not understand. The former chair of EIOPA used to call them "kickbacks", which is much more plain language for retail investors.

"Inducements" are purely sales commissions, certainly not "advice" ones

Commissions never remunerate advice, but in fact sales: they are solely linked to sales: no one will get commissions by advising a product but not selling it under the commission-based model. Vice versa, advice-less sales get the same commissions as "advised" ones. This is indeed the best and most egregious poof: so-called "execution only" investments - which by definition include no advice at all – yet pay the same commissions as for "advised" sales.

These commissions are in reality much higher than disclosed as they are charged 12 to 25 times or more for each single investment. For one investment product sale, the sale commission is typically also due every future year for its entire holding period, that is to say 12 years on average e.g. for the most sold retail investment products in France (life insurance), or20 years or more for personal pension products.

Therefore, average sales commissions in France for unit-linked insurance and for personal pensions are not 0,75%, but about 10 to 15% or more on each investment (including the average entry fee).

The massive negative impact of biased advice on investment performance is being ignored.

The total cost of retail investment products is severely understated

A recent industry-funded report, but also, unfortunately, several regulators' reports, severely underestimate the annual ongoing cost of retail investment products sold with commissions. The main reason is that they refrain from looking beyond about only 9% of retail financial savings in the EU: mostly the small minority of retail investment funds distributed without any wrapper. These reports ignore the reality of the retail distribution where most sales of investment funds sold to retail investors are done via life insurance and pension products. For example, in France, the average annual cost of equity funds held economically by retail investors is not 1,55% as estimated by the regulator, but 2,88% at least for most of them (i.e. those sold via insurance wrappers).

The massive negative impact of biased advice on investment performance is being ignored

These reports also do not look at all at the impact of the conflicts of interests generated by the commission-based model on the performance of retail investment products, which is extremely harmful to European pension and long-term savers. For example, recent findings unveil that 62% of the funds sold to French retail investors (i.e. those sold via unit-linked insurance) include almost no "clean share class" ones and almost no low-cost index ones. Those two categories do not pay commissions or much lower than the other funds. Even the very tiny portion of index ETF funds sold is charged more than twice the market average for example in the case of French stock index ETFs (not even adding the cost of the insurance wrapper).

The result of this massive "anti-selection" generated by sales commissions is devastating, knowing - through many independent academic works - that "active" funds are on average under-performing capital markets over the mid- and long term, and that costs and mid-and long-term net performance are reversely correlated:

- Over the last 21 years to 2020, the French UL market delivered a net real performance of -14% when capital markets delivered +77% (source: BETTER FINANCE).
- Over the last 5 years to 2020:
  - the main French stock index returned an average annual: 7,82%,
  - the very few ETF units (priced more than double the market average): 6,06%,
  - the very few "clean share class" units: 5,52%,
  - and the remaining 98% high-commission units: 4,07%.

(source: GoodValueForMoney).

It is therefore time for at least minimal action against widespread biased "advice" as recommended by the High-Level Forum on the CMU in 2020:

- End the massive regulatory arbitrage by extending the MiFID provisions on conflicts of interests (regarding in particular independent advice and portfolio management) to all other (and much larger) categories of packaged retail investment products (such as life insurance and pension savings), by harmonizing the provisions of IDD, PEPP, IORP, etc.
- End the inducements charged on all the "execution only" transactions. The recent EC's proposal to ban payments for order flows is hopefully a good sign of walking the talk on ensuring "bias-free advice".

SIMON JANIN
Head of Group Public Affairs - Amundi

Qualified financial advice is key to foster retail investment in capital markets

Despite a slight decline in early 2021, the level of household savings remains particularly high compared to the pre-Covid-19 crisis level. The European Central Bank sees euro area household savings rising to extraordinary levels since the beginning of 2020, half of which has been invested in cash and bank deposits[1]. In France, the savings rate was 36% higher in mid-2021 than at the end of 2019[2].

Such a level of savings is a real opportunity to finance the recovery of the post-Covid-19 economy by improving access to financing for SMEs through the deepening of European capital markets. A better allocation of households assets would not only help to finance sustainable growth and the European digital transition, but also allow the investors to have access to more diversification and the possibility to achieve higher returns.

In view of this, initiatives to increase the participation of retail investors in financial markets shall only be encouraged. The European Commission's Action Plan on Capital Markets Union (CMU) published in September 2020 is definitely a step in the right direction. In it, the Commission rightly aims to revise the ELTIFs Regulation, in order to fill a crucial gap in the current European fund regulation landscape, allowing long-term savings to be invested in 'long-term' assets. It is indeed essential to give retail investors the opportunity for greater diversification and the benefit of the returns associated with investment in long-term assets. Proposed amendments to MIFIR are also rather well designed to increase financial markets' transparency, thus to make access to financial products cheaper. However, some market specificities, especially in the area of fixed-income, should be factored in to achieve the right balance between transparency and liquidity.

Also, the Commission's efforts in developing its forthcoming Retail Investment Strategy should be highlighted. Its work on information disclosure is very valuable. Similarly, we praise the Commission for looking closely at ways to improve financial literacy and investor access to financial products through technology and digital means. However, any reform should be properly calibrated in order to really improve the investor experience and not create additional barriers for investors. In this respect, we invite the Commission to carefully consider reviewing the distribution models by banning retrocessions of management fees for distributors. As a KPMG study[3] points out, such an outright ban of inducements would be detrimental for the own interests of retail investors, as it would lead to restrict access to qualified financial advice without reducing the total cost of ownership.

It is essential to give retail investors the opportunity for greater diversification.

Reduced access to qualified financial advice for retail investors has already been observed in those countries where a ban of inducements has been adopted (UK, NL). On the contrary, under the 'commission-based' model, the mass retail investors are all given access to advice at a reasonable cost and can benefit from added value services.

Replacing the current freedom of choice with a single regulatory model, that does not suit the preferences of retail investors, would be then detrimental to the latter. It would also be counterproductive to the CMU's objectives of channeling capital flows towards the financing and the speeding up of the economic recovery and the green and digital transition. In addition, a "one size fits all" approach may not be appropriate in this specific case since many differences exist amongst member states in the level of investor education, risk approach, access and use of mobile services, as well as attitude to invest in capital markets. Therefore, the current system, allowing each Member State to adapt its legislation to the specific characteristics of the national retail investment market, should be preserved.

The same conclusion of maintaining the role of the adviser is also reached by a double observation. On the one hand, as the Commission points out, "financial literacy is an essential skill for making good decisions about personal finances, but many people have not yet mastered it"[4]. On the other hand, financial expectations are increasingly coupled with extra-financial concerns, primarily the ESG dimension, whose complex regulatory contours are still under construction and whose KPIs are not easily understandable autonomously by the non-professionals. In this respect, the role of advisor will also be essential to channel the savings of retail investors towards sustainable investments.

[1] *ECB Economic Bulletin (May 2021): https://www.ecb.europa.eu/pub/economic-bulletin/focus/2021/html/ecb.ebbox202105_04~d8787003f8.en.html*
[2] *Stat Banque de France (November 2021) : https://www.banque-france.fr/statistiques/epargne-des-menages-2021t2*
[3] *KPMG (November 2021) : Commission-based remuneration vs. Feebased remuneration: is there a better model for retail investors?*
[4] *CMU Action Plan Action 7*

ROBYN LAIDLAW
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Addressing inherent conflicts of interest is key to an investor-centric CMU

The EU has built strong foundations to facilitate retail investment. It has a world leading investment product – UCITS – as well as a strong policy framework that focuses on investor protection. Yet, levels of retail investor participation in the capital markets remain significantly lower than in the US and the UK. This is particularly problematic in light of the looming pensions' savings gap in Europe and the pressing need for market-based financing of the European green and digital recovery.

To strengthen the culture of investing in the EU and ensure it is truly impactful and positive for citizens' financial wellbeing, an investor-centric reform of current rules is required. We welcome, therefore, the European Commission's stated intention to look at each step of the investor journey and make sure that there is a sufficient level of transparency across the value chain. The publication of a dedicated Retail Investment Strategy later this year is a unique opportunity to promote a holistic approach to making capital markets work for everyday investors in the EU.

Vanguard believes that putting consumer outcomes at the heart of product design and distribution could significantly contribute to the further development of the Capital Markets Union (CMU) and improve long-term financial outcomes for European citizens. To this end, the Retail Investment Strategy should seek to create a framework that helps better engage society in their financial health and resilience and ensure that – when investment is the appropriate choice for citizens – the system delivers valuable outcomes. The CMU will only be a success if retail investor participation in the capital markets increases, and retail investors get a fair deal.

To this end, it is crucial that every part of the investor journey is made easier and more transparent. Further simplification and harmonisation of disclosure and marketing rules (including taking into account recent and future digital developments), enabling greater provision of a sliding scale of advice and guidance options, and removing conflicts of interest in the distribution chain are key steps necessary to ensure retail investors are getting the best possible outcomes.

Facilitating the provision of unbiased advice to meet the differing wants and needs of EU investors.

Their lack of financial literacy is recognized as a barrier to EU citizens achieving long-term financial health. It is therefore essential that we develop the societal infrastructure to encourage people to engage with their overall financial health. Related to this, we need to ensure that those seeking financial advice have access to an open and competitive market that is free of potential conflicts of interest and delivers consumer-centric outcomes. However, the prevalent EU practice of investment product providers making inducement payments to financial advisers threatens this goal and negatively affects the quality and objectivity of advice given to retail investors. We need a system where consumers do not worry about the risk of being exposed to conflicted advice, reduced product choice, and high costs. The Retail Investment Strategy offers a rare opportunity for the EU to catalyse a regime that encourages people to save for their long-term future, reduces barriers to investing, and ensures people have access to a "fair deal". We believe a ban on commission-based sales practices is the best way to ensure the provision of unbiased advice to retail investors. Where introduced, a ban on inducements has had a demonstrable beneficial impact on the type of investment advice and products on the market. Such bans have enabled investors to have access to open and competitive advice market that are free of potential conflicts of interest, whilst also maintaining the commercial incentive for advisers to provide their services.

We also believe that consumers' financial health is improved where they have access to a sliding scale of advice and guidance options, ranging from simple financial guidance through technology-enabled advice to traditional face-to-face advice. Technology-enabled advice has been proven to be particularly helpful in ensuring that the younger generation is engaged with their finances and make better investment decisions as a result of more bespoke and streamlined investing journeys, reduced complexity and lower costs. Alongside technology-enabled advice and guidance services, Open Finance has the potential to radically increase the ability of EU citizens to understand their financial affairs and move between different investment service providers. In doing so, Open Finance could be a further catalyst to creating a successful investing culture in the EU and achieving the goals of the CMU.

In closing, we welcome the European Commission's efforts to put in place a CMU framework that empowers citizens to make better retail investment decisions. Facilitating the provision of unbiased advice to meet the differing wants and needs of EU investors gives investors the best chance for investment success.

GERBEN EVERTS

Executive Director - European Investors' Association

Allow the next generation to invest in the future they see fit

The world is in a key societal transition. A transition towards digitalization, sustainability, inclusion and equity. The EU Retail Investment Strategy is a unique chance to include the (retail) investor in this transition. This is the momentum, and the EU should lead. A CMU is only a success with retail investors in it. The more investors know how markets work, the more willing investors are to participate, the more eager investors are to assist in the transformation of our society and the more able investors are to sustain their purchasing power despite high inflation and low interest rates. The next generation should be offered every opportunity to invest in the future they see fit.

Although the participation of retail investors is currently low, progress in being made. The strategy is clear: the EU wants a higher level of retail integration and prevent misallocation of capital. Hence, we should manage cultural difference, simplify the volume of information, streamline listing rules, establish a level playing field between different platforms and create a more optimal and tailored distribution of products.

The EU has enormous savings. Considering the Green Deal's dazzling funding ambition, breaking down the barriers for investors preventing them from cross-border, and, truly pan-EU investing, particularly in companies and initiatives that drive the transition toward a sustainable economy, is a crucial precondition for its success and social backing. Therefore, European Investors-VEB firmly subscribes to the urgency as much as the importance of the strategy. Effectuating the strategy engenders tremendous innovation and growth potential, as much as it supports addressing the imbalance inherent in the preponderant bank financing of the EU economy. We wholeheartedly applaud the EU's increased awareness and recognition of retail investors' importance. The Retail Investment Strategy is a prerequisite to a more sustainable economy paired with the ancillary social reforms.

Ideally, the strategy should cross the finish line as one comprehensive package of objectives and initiatives. We recommend that prior approval be sought from the European Parliament and the Council on the strategy as one package. This approach has proven to be successful with the Financial Services Action Plan. Regrettably, the CMU has been unnecessary delayed and with counterproductive fragmentation.

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In view of the coherence between the distinct regulations, directives and recommendations, it is inappropriate to concede on components, to make political trade-offs, or to uphold domestic variances. We strongly call upon the European Commission to secure both the integrity and the progress. Equally, we appeal to the European Parliament and the Council of the European Union to exercise a certain restraint where it concerns adaptations likely leading to fragmentation. Only if the whole package is delivered, more pan-EU allocation of retail money will follow. This requires a combination of trust, opportunities, and retail protection. We must prevent a weakest link.

New entrants to the financial markets are seen to be susceptible to dubious and unregulated investment products. This development should be stemmed. This requires ample dedication to the protection of retail investors, behavioral aspects of investment decisions, and financial literacy. An overly paternalistic approach must be prevented. In principle, retail investors should be offered the same opportunities as large institutions. The more vulnerable amongst them should be offered adequate protection to reestablish the balance between the professional sell-side and retail. EU Supervisors must execute robust enforcement where protection is considered necessary.

Whereas inducements are the single most important barrier to the CMU's success, European Investors-VEB emphatically promote an EU-wide categoric prohibition of inducements, regardless of their form. This includes the current practice of multi-layered fees. As investor education is received from the sell-side, no bias-free advice is currently available. All advisors are in fact sellers and none of them would be incentivized to advise on ETF's for example. This favors expanding the MiFID II prohibition on third-party payments.

Prompt, straightforward, and accessible accommodation of collective redress for harmed investors must be a priority and it ought to be an integral element of the Retail Investment Strategy. It is virtually impossible to obtain legitimate redress in cases of deceit or fraud, particularly in cross-border situations. Investors directly investing in financial markets are excluded from EU collective redress regimes – their not classifying as consumers causes them to be outside the scope of Directive (EU) 2020/1828. This current reality is the most obvious candidate to be the weakest link.