Retail Investment Strategy in the digital age

1. Current state of play of digitalisation in the retail investment space

An industry representative observed that digital investment channels are one of the fastest growing trends in the European investment market, changing the business offering of traditional distributors and supporting the growth of new distribution channels. This trend is expected to accelerate with assets invested through digital channels expected to double to €50 billion by 2026. The use of digital technologies is also helping to streamline the traditional advisory process, allowing advisors to analyse risks at product and portfolio level and select products in a more efficient and cost-effective manner. This is making institutional level portfolio analysis affordable by retail investors. The demand for digital analytical tools is also set to grow with the increase in demand for sustainable investments.

Digitalisation has brought a wave of new entrants to the market that are attracting new investors to the capital markets, the industry speaker added. Lockdowns were a catalyst for bringing new investors into execution-only digital platforms and that trend is set to stay. Exchange-traded funds (ETFs) are also a growing product segment despite the challenging investment environment. There are new digital brokers in Italy and, in France, the digital platform Boursorama ranks in the top 50 visited websites in the country, with over 25 million visitors a year. In Germany online ETF savings plans have grown seven times since 2018. An ETF savings plan enables retail investors to invest a small monthly recurring amount into a range of ETFs of their choice, helping to build long-term wealth and benefit from a smoothing out of market movements. These plans have attracted first-time investors and demographic groups that are under-represented in the traditional retail investment market such as the younger population. Past statistics show that the investment approach of investors in these plans is relatively long-term with holding periods of over eight years, showing that such plans could be a cornerstone for further developing retail investment.

An official agreed that digitalisation is progressing in the investment market. A recent survey in Ireland showed that 62% of retail customers already use online channels. Over 50% are making new investments online, and one in four through a trading app.

A second industry representative explained that digital platforms have been in operation in the life and non-life insurance sectors for several years in Europe, but most of the business is still managed physically. Digitalisation is progressing but the pace of change is relatively slow. The significant investments that digitalisation requires to remain competitive in the future are a challenge for the insurance industry. In addition, insurers must continue to support their existing physical network. The balance between those two approaches and getting the transition right towards more digital distribution is quite tricky. Comparisons with other sectors also show that the first players in the market providing effective digital solutions will likely take the largest share of the business and profit most from those evolutions, which requires significant investment.

A third industry representative noted that digitalisation can provide significant cost saving opportunities, particularly with a fully digital customer journey. However, it is important to consider the facts. Only 2% of sales in the life segment in Germany are purely digital and the reality is that the traditional intermediated model is still the most effective for bringing investors into the market. The majority of distribution is expected to be performed in the future by agents or advisors equipped with digital tools, rather than by direct digital distribution, because personal advice is difficult to perform purely online. Investment decisions are also important decisions and even the younger generation does not use fully digital channels in this case. In the end, distributors will adapt to customer needs.

The Chair commented that the situation is due to evolve. In the future the new generation will likely want to interact in a more digital way, so this reality has to be anticipated.

A regulator considered that the simpler products that are traded or invested in more frequently will generally be those that come down the digital channel, whereas once-in-a-lifetime and more complex products will continue to need a component of human advice. There is now a chunk of activity in the investment and trading space that is ripe for digitalisation, but not all member states are equal in terms of digitalisation of their services industry. Germany for example is still quite under digitalised in parts of its service industry. An industry representative commented that digitalisation is a long journey in Germany because the old legacy systems require renovation alongside the investments needed to further digitalise processes.

2. Benefits and challenges from digitalisation for retail investors

2.1 Main benefits for retail investors

An official observed that thanks to digitalisation capital markets are now much more accessible to retail investors. With the growth of neo brokers and robo advisors and the greater dissemination of financial information via digital channels, many barriers that discouraged small savers from entering the investor space have been removed. There is now a clear appetite among the retail saver population to take advantage of these new opportunities.

An industry representative highlighted that digitalisation can provide retail customers with added value in terms of transparency and ease of interaction. Digital customer portals can for example facilitate access to pre-contractual information and the interaction with customers.

A regulator noted that the digital delivery of investment services brings many opportunities in terms of cost, efficiency and self serviceability, allowing individuals to access the market more easily without having to go through an advisor. There are also benefits in terms of competition. New players, such as neo-brokers, offer different or more competitive services, which ultimately may drive the interest of clients.

Another regulator added that EIOPA research shows that there are clear benefits from digitalisation in terms of product comparison. In a recent survey, 65% of respondents preferred to search, compare and make up their mind online. However, at the purchasing stage 70% preferred in-person advice. People indeed prefer to have some contact with human advisors when making long-term decisions, such as investing in an insurance based investment product (IBIP), because they need tailored advice. The industry should focus on the added value of digitalisation, which is mainly to provide a more effective way to inform customers and help them prepare their investment decisions.

2.2 Main challenges and risks for retail investors

An official observed that the easier access to capital markets facilitated by digitalisation comes with challenges. There is a risk that less informed or financially literate investors might be misled or led astray and there is also potential for financial exclusion in a digital world. There are still many retail investors who prefer traditional channels offering the possibility to interact with human advisors and have paper documents. A number of those may also be among the customers who have larger portfolios and higher investment appetites. It will not be a binary choice between digital channels and human advice. Different access channels need to be maintained, including digitally assisted human channels.

A regulator observed that digital channels have their own risks. It is potentially easier to lead people into more speculative behaviour with digital tools than with analogue tools. Without the social control of human interaction there are greater risks of addiction and being enticed to do things one would not otherwise have done. The fact that betting industries have moved to an online model is illustrative of this. So-called 'dark patterns' can also be introduced in digital investment platforms that attempt to lead people into certain behaviours by the way the trading interface is presented. For example action buttons to encourage trading may be highlighted, whereas the visibility of 'cancel' buttons that may lead people to think twice may be reduced. Action was taken to stop such practices in Germany.

Other issues relate to what happens with the data that individuals provide about their investment preferences, and whether clients using digital service providers always know with whom they are transacting and whether or not these providers are adequately supervised, the regulator added. Since digital services can be provided cross-border at a relatively low incremental cost, some digital platforms may be tempted to seek a less regulated space from which to provide their services, without the client being fully aware of this and of the potential lower level of protection.

Another regulator highlighted several emerging risks from the use of digital tools. A first risk comes from the streamlining of processes on digital platforms, which might not allow a sufficient identification of the customer's expectations and needs, if the questions used to assess the customer's personal situation are over-simplified. This issue also exists in traditional channels, but is more widespread in a digital environment. Second, there is a challenge of ensuring that customers are provided with appropriate information while not getting lost in an overflow of information. Digital channels allow a broader distribution of information, but its quality and relevance need to be ensured, as there is no human filter. Thirdly, the algorithms used in digital channels such as robo-advisors, may produce a bias in the outcome if they are not adequately designed and monitored. The more complex the algorithm becomes, the more difficult it is to spot a possible failure before a large number of people are impacted. It must be possible to understand why a particular algorithm delivers a certain outcome and the integrity of the data used also needs to be guaranteed. Fourthly, it is important to have user friendly and accessible interfaces with clear instructions, as well as a sufficient interoperability across platforms and systems. Finally, care must be taken to avoid digital exclusion and discrimination with digital tools.

3. Expected impacts of the Retail Investment Strategy (RIS) proposals

3.1 Alignment of the RIS rules with the digital environment

A regulator stated that taking into account the challenges raised by digitalisation in the retail investment space is not the RIS's main purpose, but some aspects of digitalisation are touched on in the RIS. There are proposals about adapting marketing communications and pre-contractual information to digital interfaces. In addition, the issue of cross-border supervision is addressed in a context where digital tools facilitate the cross-border provision of financial services and products.

Another regulator observed that although the RIS does not specifically aim to support digitalisation, it should help retail investors to take advantage from the added value of digitalisation in terms of easier access to the market and enhanced competition. Since digitalisation is still an emerging trend, an iterative policy approach will be needed and the RIS is a useful step in this perspective. More generally, there should be trust that, whatever the channel used for accessing financial services, the potential risks to investors are addressed, because that contributes to creating value and reducing costs in the market. The crucial questions are whether proper governance and 'fit and proper' tests are in place at the level of supervised entities, whether the financial education of investors is sufficient and whether risks can be addressed with current supervisory mechanisms. In regard to supervision, with an expected development of cross-border activity supported by digitalisation, closer cooperation is needed among supervisory authorities and investors must be able to verify that an entity is authorised to operate in a given market.

An industry representative highlighted the technology neutrality of the RIS, as the priority is to ensure good outcomes for consumers, whatever the channel used.

Another industry representative suggested that the dots also need to be joined between the RIS and the Financial Data Access (FIDA) proposal aiming to develop open finance. How retail investors can benefit from open finance and control the sharing of their personal data remains to be clarified.

A regulator emphasised the importance of putting the consumer at the centre of the thinking when assessing the impacts of digitalisation, which the RIS can contribute to achieve. With regard to the risk of discrimination and exclusion associated with an increasingly digital and data-driven provision of financial services, it is important to define a perimeter as to what data can be shared and how this data will be shared in the interest of retail customers. The more data that is shared and processed the greater the risk of data breaches and of potential discrimination against the most vulnerable customers. The concentration of data within certain market players that open finance may lead to also reinforces this risk of exclusion.

An official emphasised that for developing a single market for retail investment, trust is needed in the products, the originators and the distributors, and the activities they perform all along the value chain. Supervisors also need to have confidence in their counterparts in other member states. There is a need for confidence that there are adequate legal protections and frameworks to protect customer rights if anything goes wrong. The RIS and the overall Capital Markets Union (CMU) package of which the RIS is a part of address these different aspects.

3.2 Value-for-money and inducement measures

An industry representative observed that the main points under discussion in the RIS from an industry perspective concern the value for money and the inducement ban proposals. There is a strong focus on cost in the value for money approach, but it is important to consider that cost is just one element of value for customers. A more balanced approach is needed taking into account the performance of investment products, and also the quality of service which can be measured in terms of e.g. customer complaints and lapse rations. With insurance products, the most relevant issues for customers are how claims are handled and paid, the service they obtain and the ease of underwriting a contract, rather than product costs.

The industry representative added that at present the intermediated model is the most likely to attract new retail investors, because of the service and advice provided. That needs to be taken into account in the approach to inducements. Quality advice has a cost, which is covered by inducements. A ban could therefore have a significant impact on the capacity to encourage more retail investment and achieve the CMU.

A second industry representative welcomed the RIS package which contains relevant measures to foster consumer investment, increase savings and close the pension gap, and was optimistic that the issues with the Commission proposal, in particular regarding the best interest test and value for money benchmarking, can be overcome.

A third industry representative noted that there is more work to do to revisit the ban on inducements for execution only transactions taking into account the impact this may have on end retail investors, in particular when they access investment services through digital platforms.

A regulator stated that the core objective of the RIS is to improve fairness and suitability in the investment and sales process and ensure that retail consumers are provided with appropriate products. Some existing products are unable to provide retail investors with a suitable pay-off because of the way they are set up in terms of cost structure and inducements. The RIS package is a call for the industry to tackle these problems. Otherwise a full inducement ban will have to be imposed. Supervisors also need to help the industry find ways to improve their product offering and be able to deliver more consistently the right products at the right price.

Another regulator emphasised the importance of product costs and verifying whether they are really justified, in addition to having a qualitative analysis of the different features of any product. This is one of the objectives of the value for money concept. There is benefit in proceeding with this work because each and every cost should be justified taking into account the product benefits including qualitative aspects.

3.3 Measures to enhance financial literacy

An official emphasised the importance of addressing the risks for the less financially literate consumers from a facilitated access to capital markets in a more digital environment. The RIS measures can help, by further empowering supervisors to intervene where they see inadequate practices or infringements and increasing accountability for promotional and marketing activities. The RIS moreover aims to improve financial education. This is a significant line of defence because more financially literate investors can better assess the risks posed by investment opportunities and act in a more autonomous way. Safeguards and appropriate support should however continue to be provided. Financial education is also important for policymakers, regulators and Parliament to enable them to make the right policy decisions.

An industry representative noted that financial education will also help investors to seek more relevant sources of information. If this cannot be found from financial service providers or platforms, investors will look to alternative channels such as 'finfluencers'. More however needs to be done in the RIS to define the type of guidance and education models that are needed to support this objective. A second industry representative suggested that a concrete proposal for regulators would be to develop a standardised one page pre contractual information document for all retail investment products.

A third industry representative noted that the enhancement of financial and digital literacy are heavily linked. The consequences of digitalisation need to be thought through to define the right transition path for investors and the pace of change needed.