RETAIL INVESTMENT STRATEGY

STÉPHANIE YON-COURTIN

MEP and ECON Coordinator for the Renew Europe Group - European Parliament

Why the Retail Investment Strategy can and should be the next CMU building block

Jacques Delors rightly said that the liberalization of capital movements required more European cooperation, to attract outside capital and increase our financial strength. We need to build on his legacy. But if our internal market has been up and running for 30 years, why are we still lagging behind with our Capital Markets Union (CMU)?

Although the need to ensure its completion has never been higher, we reflect each year on the same issues with yet little solutions to face them. Our markets are still fragmented and highly overbanked compared to other economies like the US. In addition to this, financing needs have never been higher. With an annual investment gap of 620 and 125 billons euros respectively for the green and digital transitions, we know that public money will not suffice. Furthermore, current demographic evolutions increasingly raise the question of private financing solutions for pension schemes.

Building the CMU will require a long-term effort to achieve durable change. Legislation will only be one part of it, but nevertheless it has a decisive role to play. This is why we need a Retail Investment Strategy (RIS) at EU level, to tackle one of our most important challenges, which is the lack of retail engagement in financial markets. The work of EU legislators, notably the work I carry out as Rapporteur on the file in the European Parliament, is an opportunity for us to rethink the current system, putting ourselves in the shoes of European citizens. What hurdles do they face? What drives their investment decisions? This is the moment to identify the regulatory do's and don'ts.

My goal is to achieve a text that both, promotes a more protective and attractive financial environment for citizens, while ensuring its feasibility for market actors. Because to ensure durable change, we need everybody on board.

If our approach is ambitious, the impact of the RIS will be two folds. Not only will we optimise the current "traditional" investment environment but also we will seize current opportunities to create the next CMU milestone.

The challenges of today represent an opportunity for building tomorrow's CMU.

Improving our current framework is one of its main objectives, which translates into making it more attractive and ensuring sufficient safeguards for citizens. This is done through multiple means. First, if almost 50% of Europeans still rely on financial advice, banning inducements would be counterproductive. Instead of cutting citizens' access to advice, let's address the issue in a targeted manner (transparency, better quality of advice, safeguards). Second, we need to ensure an ambitious value for money framework that gives supervisors better means to act, holds companies accountable, and ensures feasibility for market actors. Third, consumers need to be better protected on national and European levels when they invest their money. This goes through giving more powers to national competent authorities. Forth, it is time for us to ramp up financial education on national level. The RIS is the perfect channel to set ambitious rules in that regard. These measures will be a game changer on the long term for citizens, giving them the tools and more trust when making their financial decisions.

But if we want to build the CMU, addressing current flaws is not enough. We need to adapt to a new world, where the fight against climate change, an increasing digitalised society, the need to secure our strategic autonomy, has become our new reality. Those challenges come with massive financing needs, for which we don't have any durable solution yet. This is why the RIS represents a huge opportunity.

The challenges of today represent an opportunity for building tomorrow's CMU. Younger generations are more socially, environmentally and politically engaged. A study showed that half of the respondents were more likely to invest in products financing the green transition. But if our continent is leading with its green financial agenda, and if there is demand for it, why are we not promoting it properly? This will be tackled in the RIS. In addition, digitalisation has taken over our societies in many areas, including finance. While it undeniably brought new opportunities to build our CMU, those come with risks and younger generations are the most vulnerable to them. If "traditional" financial advisors are subject to strict rules, "financial advisors 2.0" or so called "finfluencers" cannot fall through the cracks. The responsibility lies on us to ensure a framework that protects young consumers online, if we want them to continue engaging in finance through digital means.

All those elements show that the RIS can and should be the next CMU milestone. Today our system failed Europeans, that still are unwilling to engage in financial markets. The RIS is thus a now or never opportunity to build our CMU, by improving our current environment and seizing today's new challenges.

GUILLAUME BÉRARD

Advisor, Policy Department - Financial Services and Markets Authority, Belgium (FSMA)

RIS: a complex matter which deserves a more nuanced debate

The proposed Retail Investment Strategy (RIS) aims, as the name itself indicates, to increase retail investment in EU capital markets. It is part of a broader policy initiative aimed at enhancing the Capital Markets Union and creating the conditions to make EU capital markets as dynamic as in the USA.

The objective pursued is not an easy one. There are various reasons why retail participation in the EU capital markets remains (too) low. Those can be cultural or fiscal in nature, or, indeed, the result of regulation. The RIS is therefore proposing to modify the regulatory framework in order to allow for increased retail participation. Tangible effects are expected to appear in the medium term at the earliest.

Just as the issues it is trying to tackle, the RIS is complex and has a wide-ranging scope. It affects different parts of the retail investment journey.

An important objective of the RIS is to reduce the current fragmentation of the landscape. The fact that investor protection rules are currently set out across different sector-specific legislation (mainly MiFID and IDD) adds to the complexity. The Council therefore decided, right from the beginning, to follow a topic-by-topic approach rather than discussing each instrument separately. This approach has the advantage of consistency among those texts. As far as possible, there should be similar rules in place irrespective of whether the services are provided via credit institutions, investment firms or insurance undertakings/intermediaries.

The debates at the Council have been constructive and insightful but given the complex and sensitive nature of the matter, more discussion is needed. While the co-legislators have not yet determined their respective negotiating positions, we have already seen and heard some strong voices on both sides. Opposition has been (loudly) voiced, for example against the proposed partial ban on inducements, one of the most talked-about elements of the proposal.

It is important to inject greater nuance into the debate. One should never forget as well that enhancing retail participation also means building trust. The proposals contained in the RIS require a careful assessment and we should try to ensure that the debate around those proposals remains as objective as possible and includes sufficient technical nuance.

The proposed RIS contains several important and complex measures which are interrelated and need to be assessed simultaneously. It is true that the proposal provides for numerous delegated acts. In many instances, this is motivated by the technical nature of these proposals.

It is important to inject greater nuance into the debate.

However, it remains important to find an appropriate balance here. First, essential parts of the framework should always remain in the level 1 text, while the level 2 texts should focus strictly on technical aspects. Second, we should be conscious of the fact that delegated acts mean, in many cases, a longer timeline, since those texts often require preparatory work by the ESAs and stakeholder consultations, and the relevant technical details should be available in a timely manner before the texts enter into application.

An area where delegated acts will be of particular relevance are the proposals on Value-for-Money, especially those concerning the relevant benchmarks. This is one of the main novelties of the RIS. It is important to get it right, as this will have an impact on the products proposed to consumers. Some of the important questions that the concept of Value-for-Money raises and that will need to be properly answered to enable the system to work include: how will similar products be defined? How will the benchmarks be set up? What reasons should be deemed acceptable to deviate from the benchmark?

In order to make the Value-for-Money proposals workable in practice, many methodological issues need to be answered. It would not be possible, however, to incorporate every detail, for instance on product clustering, in level 1. This is an area where level 2 texts are more appropriate and where the expertise of ESMA and EIOPA will have an important added value.

In conclusion, I think that we need to be optimistic and always look for a way forward. Although it will not always be easy, we should not abandon this aim. The Belgian Presidency will therefore further build on the very useful work done by the Spanish Presidency. Tackling conflicts of interest, increasing cost transparency, and clarifying the Value-for-Money process are important topics on which we should try to bring meaningful changes, to the benefit of European retail clients.

MARIE-ANNE BARBAT-LAYANI
Chair - Autorité des Marchés Financiers (AMF)

The challenges of designing benchmarks for retail investment products

The Value for Money (VFM) framework proposed in the Retail Investment Strategy is among the topics that have sparked the hottest debates so far.

Every year, ESMA's report on the performance and costs of EU retail investment products points at retail products whose net returns are below zero once costs are deducted. This suggests some poor practices in the markets and room for useful legislative action.

To address the risk that some products may not always offer sufficient value for money to investors, the proposal therefore seeks to make firms accountable for the cost structure of their products. The product governance obligations of firms is enhanced with a new mandatory pricing process. The aim is to encourage firms, both at the product design phase and during the product lifespan, to carefully assess the level and nature of each cost component.

The pricing process is introduced horizontally in all relevant texts (MiFID2, IDD, UCITS and AIFMD) and aims to apply to manufacturers and distributors alike, in broadly similar terms. This is highly commendable. As retail investors are exposed to several layers of costs (including for advice and distribution, and the cost of the insurance wrapper where the product is distributed through insurance packages), focusing the benchmarking exercise on manufacturers only would be seriously flawed.

As such, the new VFM rules consist of a two-step approach. In the first step, a firm is expected to identify and quantify all costs and assess whether they are justified and proportionate. This applies to the entire product range. It should not be contentious, as many firms already perform such assessment. The second step requires a firm to identify within its product range those products that may not offer value for money to clients and perform additional scrutiny on such "outliers". Since access to comprehensive cost data for comparable products from competitors may be challenging, the policy choice is to organize the filtering on the basis of centralized benchmarks which ESMA and EIOPA will develop. For that purpose, a large-scale reporting of cost, performance and risk data for all retail financial products available in the EU will be established.

It is fair to say that this second stage is the focus of many debates. It does face challenges that the co-legislators will have to address.

Focusing the benchmarking exercise on manufacturers only would be seriously flawed.

First, according to the proposal, benchmarks combine costs and performances. The use of performances raises difficulties, especially if these are absolute performances. If the intention is to consider as outliers those funds with the lowest (absolute) performance and the highest costs, then the exercise is likely to capture 'false positives', namely funds exposed to those economic sectors that performed the worst over a given period. In other words, market effects will pollute the identification of outliers. Performance may be used as a criterion to build peer groups, among other criteria, and to justify the proportionate nature of product costs. It should however not be used in a benchmark alongside costs to identify outliers.

As for the composition of peer groups, the exercise seems set on a course to create pan-EU groups of similar products. Still, does it really make sense to consider in the same peer group products which are distributed in totally different EU markets, through different distribution channels? Considering instead peer groups of products distributed in the same market would appear more relevant. There is a case for developing national benchmarks, not pan-EU ones, if one wants to avoid biased comparisons.

The draft proposal suggests that benchmarks would not necessarily be developed for all types of retail investment products. Yet, one might expect that the more one strives to make relevant peer groups of similar instruments that are granular enough, the more one runs the risk of ending up with a very high number of peer groups, insufficiently populated and of scare statistical relevance. There is obviously a trade-off here.

Overall, the contours of the VFM mechanism will greatly depend on a methodology which remains unknown as it will be developed in Level 2 delegated acts. Such methodology will involve decisions on key parameters with wide-ranging consequences for firms' practices and for investors. If the VFM is to hinge on centrally-produced benchmarks, then more safeguards and clarity deserve to be set out in the omnibus directive on all the aspects above. This would secure the process and avoid years of potential messy implementation.

Besides, it is essential that a "proof of concept" be developed first as various methodologies are possible. Not only should they be assessed against each other to identify possible false positive and negatives, but a test-and-try phase should be provided in the law to ensure that biases and shortcomings are solved before firms are exposed to the full responsibility of complying with the new VFM rules.

ALBAN AUCOIN

Head of Public Affairs - Crédit Agricole S.A.

A missed opportunity for the European Union

The European Commission (EC) has proposed a Retail Investment Strategy (RIS) aimed at ensuring that retail investors can take full advantage of capital markets, in line with the objective of "an economy that works for people". However, this proposal will miss its target.

The first reason is that retail investors can only take advantage of capital markets investment opportunities in a fully functioning Capital Markets Union (CMU). Unfortunately, scant progress has been achieved in this area during the current mandate. As a result, the RIS will not foster a CMU, but, at best, fuel 27 small capital markets, with limited new opportunities for retail investors.

Second, we need a RIS that makes it easier to invest in the EU economy to finance the green and digital transition. Europe has no lack of financial resources but it does lack physical investment, especially in sustainable projects. According to ECB balance of payments, the eurozone has a growing net positive International Investment Position of more than EUR 350 bn, meaning that we export our savings to finance the rest of the world. We need to channel EU savings towards investment projects in the EU; what the RIS will do is export retail EU savings more and foster investment abroad.

Third, one of the EC's aims is to promote ETFs - funds that replicate market indexes. Not only does this goal overlook the fact ETFs are already developing and largely accessible to retail investors, it also potentially undermines the objective of increasing the EU's strategic autonomy. Indeed, more than 60% of ETFs distributed in the EU are sold by American asset managers, who mainly sell indexes on US securities. The share of EU issuers in equity funds varies significantly by country: while it is 69% for funds domiciled in France, it is only 12% for those domiciled in Ireland, where most US asset managers operating in the EU are located. If ETFs are not composed mostly of European assets, they will mostly benefit investment abroad.

Fourth, the EC's RIS proposal is likely to enhance consumer protection only for the wealthiest investors, to the detriment of the majority, who will lack appropriate guidance.

Indeed, one of the main obstacles to retail financial investment is a lack of financial literacy and risk culture. This means that most consumers need personal advice. However, the EC favours a partial ban on retrocessions, as a staged approach to a full ban. These retrocessions mainly finance advice, which has a significant cost. In countries that have banned retrocessions, such as the UK and the Netherlands, only the wealthiest consumers still have access to advice. Indeed, independent advice is proportionately much more expensive for small investors, who generate little inducement.

It is high time to focus on building a RIS that promotes the protection of the majority of consumers.

Savings in the EU are highly concentrated (30% of households account for 70% of savings, the median savings amount is 11 k€), especially for financial products, with 10% of households accounting for two-thirds of such investments in France, for example. Independent advisers will remain affordable for the wealthiest retail investors, while the majority, with very limited financial literacy, will be unable to pay for advice and will have to fend for themselves. In European jurisdictions with fee-based models, such as the United Kingdom and the Netherlands, net fund sales between 2013 and 2022 decreased substantially compared to other EU countries. So for most consumers, this reform will not make it easier to invest.

Fifth, today there are different distribution models: with or without advice, in-branch or on-line, fee-based or commission-based. These models coexist and savers can choose freely between them based on both their income and wealth and their financial knowledge, with open competition between models. Consumers are not tied to their bank; they can go wherever they want. Banning most inducements would be a distortion of competition through regulation, calling into question the universal and relational banking model in favour of the transactional, brokerage model. We believe that reducing competition and an administered economy are invariably detrimental to consumers and to growing investment. Such measures would result in an advice gap, well documented in countries that have already banned inducements.

Sixth, banning inducements would entail a major reduction of the number of bank branches (-70% in the Netherlands in ten years), irrespective of differences between individual countries and consumers' preference for personal relationships.

Last but not least, the proposal includes administrative benchmarks that put the emphasis on costs and do not take into account the actual qualitative elements of the products and services provided to retail investors. Such an approach would further reduce choice without adding benefits for investors.

It is high time to focus on building a RIS that promotes the protection of the majority of consumers, that really finances the EU economy and that allows open competition in a market economy.

CHRISTIAN STAUB
Managing Director Europe - Fidelity International

Balancing investor protection and competition: assessing the RIS

The Retail Investment Strategy (RIS) proposed by the Commission aims to enhance investor protection and foster competition in the European market. This strategy includes several well-intentioned approaches, such as the harmonisation of disclosures and the strengthening of consumer protection by prioritising the value for money (VfM) proposition. While these initiatives are commendable, it is vital to ensure, during the ongoing negotiations in the European Parliament and the Council, their effective implementation and consideration of the needs and expectations of investors, as well as potential unintended consequences.

A comprehensive evaluation of value for investors should extend beyond cost considerations. While cost management and appropriate disclosures are important, it is equally crucial to address other factors that impact investors' outcomes. These factors include performance outcomes, the quality of services provided, sustainability outcomes, and effective risk management. By adopting a broad perspective, the RIS can provide investors with a comprehensive value proposition that aligns with their needs and expectations.

It is therefore essential to define VfM as investor-centric outcomes that can be measured both quantitatively and qualitatively, rather than just as a cost equation. In the process, we must also be conscious of the different participants in the value chain, particularly the complementing roles that product manufacturers, distribution platforms, and distributors play. Finally, the fact that value for money is being overstressed may have the opposite effect of what policymakers want to achieve by undermining confidence in the whole financial system.

It is also necessary to carefully evaluate the potential consequences of the proposed ban on inducements for non-advised and discretionary managed services. Its impact on competition, particularly in the emerging digital investment platform sector, may undermine the very competition that the Commission aims to encourage, potentially limiting innovation and choice for retail investors. Implementing a ban before providing a credible alternative for investors to access advice would be a missed opportunity and risk suboptimal outcomes in the name of customer protections. Striking a balance will ensure that competition remains vibrant and innovative, while also safeguarding the interests of retail investors by providing a diverse range of investment options and opportunities to understand the implications of their decision making.

A comprehensive approach will provide investors with a well-rounded value proposition.

Maintaining a healthy and competitive European financial market is essential for our economy; any changes to established European funds with global recognition and success must be approached with caution. While it is important to regularly consider ways to improve our systems and operating models, it is also essential to recognise their strength and the positive impact they have had on retail investors. In line with the aim of the RIS focused on empowering investors, enhancing their trust in financial services firms, and ensuring they are protected, it is of the utmost importance that we maintain equilibrium between investor protection (OR what matters to investors) and fostering competition. It is a delicate task and should not be an afterthought.

To support the successful implementation of the RIS, it is necessary for the Commission to provide clear guidelines and detailed explanations. Clarity and timely communication are crucial to prevent confusion and unintended non-compliance. Market participants need a clear understanding of their obligations to comply effectively and maintain confidence in the industry and capital markets. Additional clarity will also be required for the timelines of any changes that the industry can anticipate and innovate accordingly. Collaboration with relevant stakeholders, including industry experts, consumer advocacy groups, and regulatory bodies, can further strengthen the RIS and ensure its effectiveness.

In conclusion, the Retail Investment Strategy holds significant potential to enhance retail investor protection and further strengthen capital markets in the European Union. By addressing concerns regarding clarity and the potential overemphasis on cost, the co-legislators can ensure that the RIS achieves its objectives while promoting competition. Taking a comprehensive approach that considers various aforementioned factors will provide investors with a well-rounded value proposition.

Clear guidance, timely communication, and a balanced approach within the VfM framework will support the successful implementation of the RIS, benefiting retail investors and contributing to the growth and competitiveness of the European economy.

ALEKSANDRA MACZYNSKA
Executive Director - BETTER FINANCE

Don't let conflicts of interest ruin our chance to turn EU savers into investors

Can a significant improvement be expected from the Retail Investment Strategy in terms of retail participation in capital markets, considering the approaches of the co-legislators?

BETTER FINANCE, the European Federation of Investors and Financial Services Users, welcomed the publication of the Retail Investment Strategy (RIS). Despite significant and regrettable opposition from the financial industry, the European Commission (EC) managed to incorporate elements in the Proposal that hold the potential to finally improve the situation for consumers. Now, over half a year later and with a slow progress on this file, we still consider RIS a once-in-a-lifetime opportunity to create a capital markets union that really works for people (and improves their financial well-being, as well as the competitivity of the European economy). We acknowledge that the legislative proposal is not perfect (e.g. it lacks any significant ban on "inducements" – even for execution only investments - and doesn't address the serious disclosure issues of the Key Information Document), but it includes several significant advancements.

Abundant research has evidenced the consumer detriment caused by the current state of the distribution system in the European retail investment market[1]. If we want to encourage savers to invest more in capital markets, we must reverse the status quo that has served individual investors' interests very poorly. We hope that the co-legislators will prioritise the interests of consumers and will support crucial steps in the right direction, such as the 'value for money' framework and the very limited ban on kickbacks for non-advised —"execution-only"—sales. We hope that they will acknowledge the RIS's potential to reshape the highly dysfunctional European retail investment market: widespread conflicts of interest interest pushing sales of highly packaged products instead of giving access to capital market instruments such as listed stocks, bonds and ETFs, inconsistent rules, and inadequate key product information.

We must change the status quo as it has served individual investors' interests very poorly.

Unfortunately, many market participants still fail to acknowledge the problem and the co-legislators seem to be influenced by the industry point of view and less by long-term and pension savers' best interest. BETTER FINANCE and other NGOs representing consumers read the European Parliament's, i.e. "the EU's only directly-elected institution's", draft reports with severe disappointment: effectively all crucial elements of the Proposal that were of genuine value to individual investors, to the environment and society, have been removed without presenting an appropriate alternative.

What are conditions for a successful implementation of the RIS?

BETTER FINANCE fully supports the EC's RIS objectives: consistent rules, enhanced retail investor protection, unbiased advice, competitive financial markets, and transparent and comparable product information. But for an appropriate RIS to be adopted and effectively implemented, the conditio sine qua non is to first acknowledge the existence of a problem. Once this is achieved, the main elements of the proposal can be seen for what they really are: an attempt to solve the problem and not pure "controversies".

Since being an individual investor is not a full-time job, we need urgently:

1. access to good quality independent advice, i.e. competent financial advisors whose advice is beyond doubt in the interest of their client,
2. value for money, and in case something goes wrong,
3. access to an EU collective redress mechanism.

For instance, advisors should assess and recommend products based on their capacity to meet the investor's specific objectives and needs, selecting the most cost-efficient products among those deemed suitable, in line with the risk profile. Investors want advice, not a sales pitch: they are in dire need of a clear distinction between 'sales of' and 'advice on' investment products. To this end, the terms 'advice' and 'advisors' should be reserved for situations where a professional is remunerated by its client for researching and selecting the most suitable and cost-efficient products.

If adopted and implemented, the RIS has the potential to facilitate long-term investments by EU citizens. Supplemented with other measures on both EU and national level, like learning from best in class (e.g. Sweden) and adapting successful solutions, providing the right incentives and removing the barriers, it can finally connect people with their savings and the economy, turn them from long-term savers into investors and enable them to profit directly from the economic growth[2]. This long-term outlook is the very reason why trust as well as cost and performance of retail investment products are the core issues that need to be addressed if we want to increase individual investors' participation.

1. *See, e.g. BETTER FINANCE's "Evidence Paper on Detrimental Effects of Inducements"*
2. *For the list of such measures please refer to BETTER FINANCE's Manifesto (link)*