

# Sustainable Value for Money



**2019 Report**







# SUSTAINABLE VALUE FOR MONEY

A BETTER FINANCE and CFA INSTITUTE  
RESEARCH PROJECT

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## About BETTER FINANCE

*BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users. Its activities are supported by the EU since 2012.*

*BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart.*



## About CFA INSTITUTE

*CFA Institute is the global association of investment professionals that sets the standards for professional excellence. We are a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community.*

*Our mission is to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. CFA Institute stands for creating an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 168,000 CFA charter holders worldwide in 164 markets.*



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## Foreword

Eleven years after the crisis, European retail investors continue to suffer detriment when participating in capital markets, either directly - through breaches of investor protection rules - or indirectly - through mismanagement of financial services and products. The European Union (EU) has gone a long way in improving the investor protection standard and providing safeguards against mis-selling, but there is much more to be done.

Ambition and political will are key, but this may not prove enough. Regulatory reforms must be centred on the practical needs of retail financial services users, which are most of the time inferred or assumed in policy think-tanks or sandboxes, on too many occasions missing by a length their actual necessities.

Moreover, a new trend of utmost importance – *sustainable finance* – is now being framed as a “compromise” for individual investors. The European Union should take the lead in reorienting capital into sustainable projects and ESG-factored investments. Sustainable investments – meaning those that counterbalance negative externalities – should not take place at the cost of retail investors’ returns.

What we wish to achieve through this project is to accurately portray what retail financial services users understand and desire to see as value for their money and long-term value creation and compare it with what providers believe they must deliver. Only then can we determine the state of the market and what needs to be done further, in the regulatory area and beyond.

Guillaume PRACHE, Managing Director, BETTER FINANCE



As the investment industry is undergoing accelerated change, professionals must adapt to a new ecosystem where finance is refocused for the benefit of society and at its service. More than 11 years after the financial crisis, the same issues on business conduct emerge, it is therefore not surprising that trust still remains an issue, especially for retail investors.

At CFA Institute, ethics is part of our DNA. It is enshrined in our CFA Program as well as in our mission statement. It is therefore key for us to work together with financial users to help policymakers better understand opinions from finance professionals and users; we agree that this is a good point to start from!

Furthermore, with the advent of a sustainable economy and ever more information threatening to drown investors and in particular retail investors, the role of finance professionals needs to help users distinguish the grain from the chaff. This time, it will not be enough to go through a superficial washing or greenwashing in sustainability. Everyone living on this planet surely sees the urgent necessity to act; in the finance sector, we have the power to change for good. Let us grasp it with both hands.

Josina Kamerling, Head of Regulatory Outreach, EMEA, CFA Institute



## EXECUTIVE SUMMARY

*The results are clear, promising and depicting an alignment between what financial professionals believe they should provide in order to deliver sustainable value for money and what retail investors expect from sustainable value for money.*

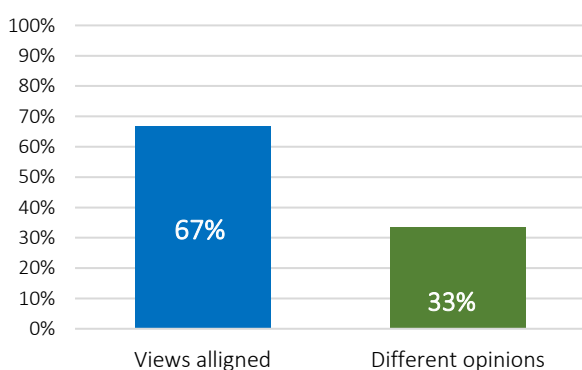
In recent years, retail financial services users and SMEs have been at the centre of policy strategies and regulatory efforts, but the practical implementation thereof seems to have missed their objectives by a length. Consumer trust in financial services is still low, with investors more often opting for non-financial assets and SMEs drifting away from capital markets.

This raises questions about the way in which retail investors and SMEs can be better attracted to capital markets and what professionals should be delivering to achieve *sustainable value for money*.

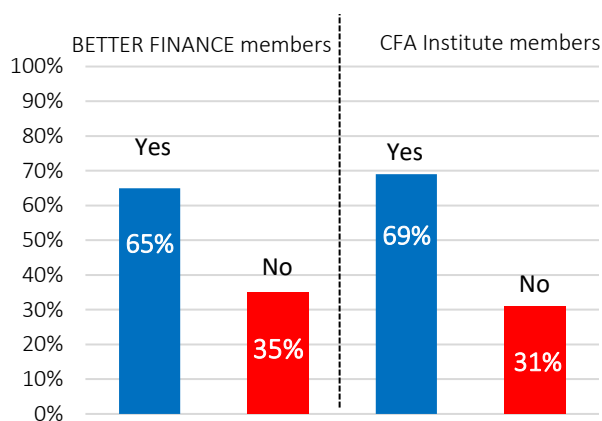
With this in mind, BETTER FINANCE and CFA Institute embarked on a project to analyse what industry and consumer stakeholders understand by *sustainable value for money* and how this can be achieved. This paper examines the results of a survey that took into consideration both consumers and professionals in capital markets. We aim to address six main factors that make up sustainable value for money: *stewardship and the duty of care; investor protection; matching offer and demand; product intervention (supervision); shareholder activism; and sustainable finance and ESG*.

The report is based on two symmetrical questionnaires composed of 10 key questions and circulated among the members of BETTER FINANCE and the CFA Institute. The results are clear, promising and depicting an alignment between what financial professionals believe they should provide in order to deliver *sustainable value for money* and what retail investors expect from *sustainable value for money*.

**Alignment of BETTER FINANCE - CFA Institute members' answers**

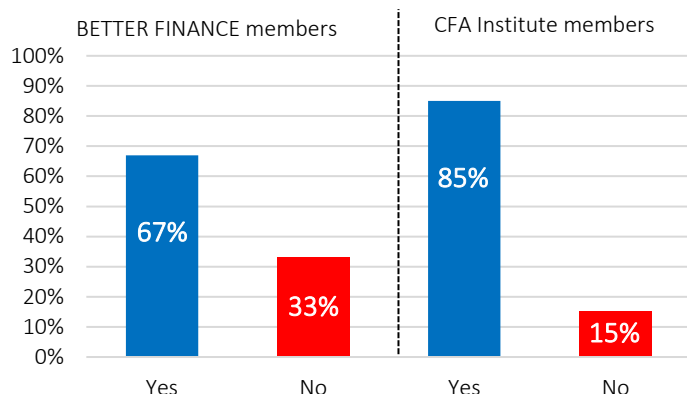


**Should the European Supervisory Authorities have increased supervisory and product intervention powers? (simplified)**

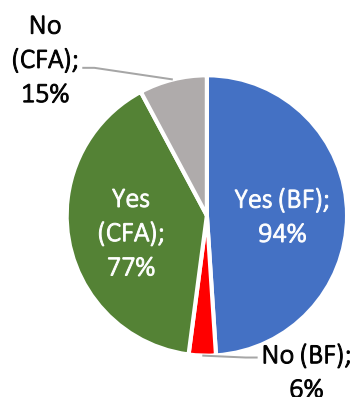


Source: BETTER FINANCE – CFA Institute, 2019

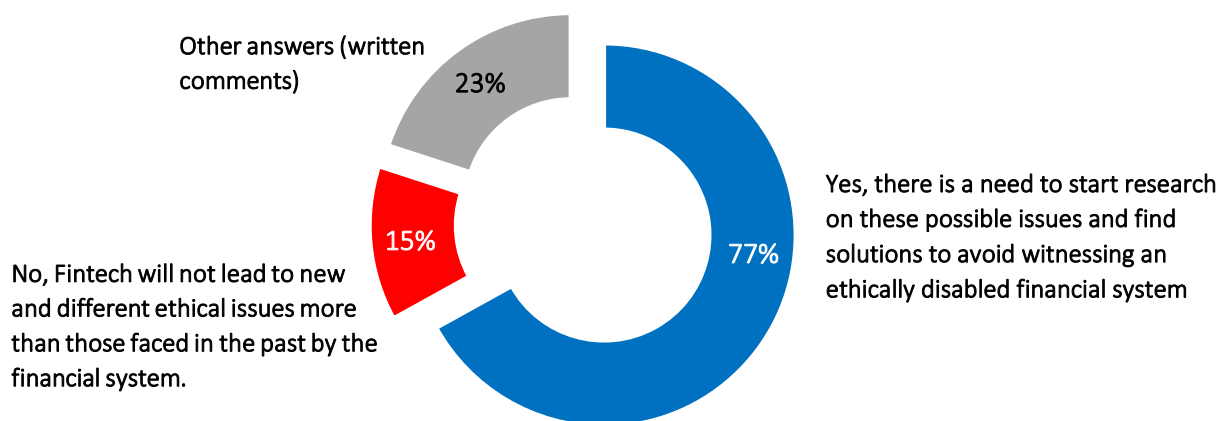
**Should the duty of care be mandatory for finance professionals? (simplified)**



**Should retail investors be presented with simple and standardised information on costs and on past performance of a financial product? (simplified)**

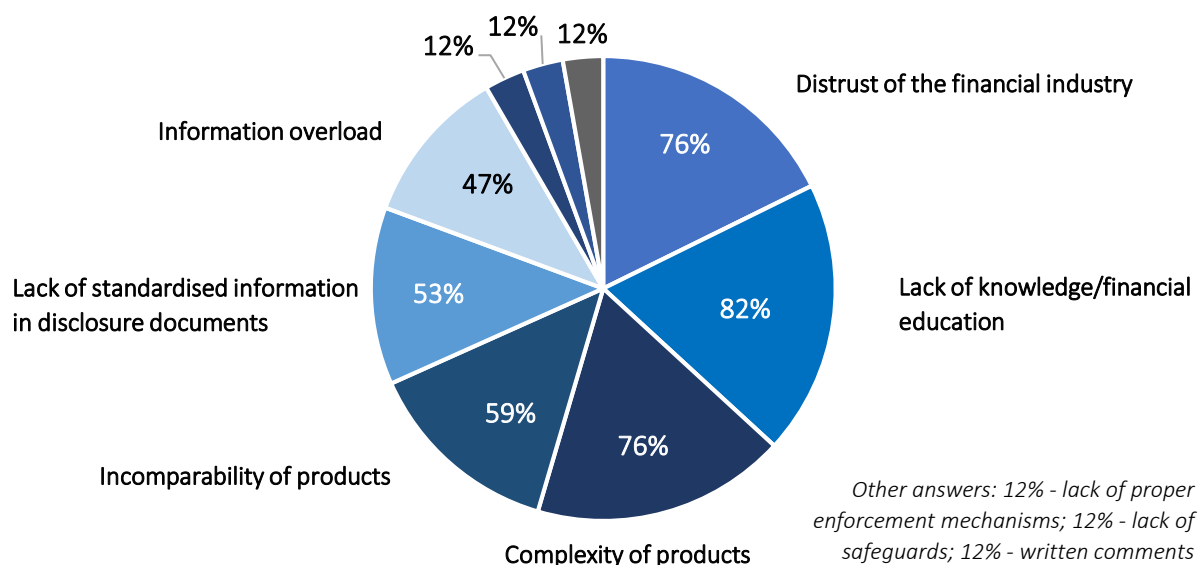


**Are you concerned about possible negative ethical issues and implications of new fintech innovations? (CFA Institute only)**





What barriers or challenges currently exist that deter or impede a higher participation of individual investors in capital markets? (BETTER FINANCE only)



*Source:* (all graphs on page) BETTER FINANCE – CFA Institute, 2019

Most of the questions were the same for BETTER FINANCE and CFA Institute's members, with each six out of nine answers aligned. For two questions, which had multiple-choice answers, the weighting of views differed, although not strongly.

The two pie charts above focus on the only different question between the two surveys, as CFA Institute members focused on the negative disruptive effects FinTech innovations may bring – and what, if any, concerns are expressed hereto – while BETTER FINANCE highlighted the perceived barriers to a higher degree of retail investor participation in capital markets.

## INTRODUCTION

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*The nature of the Brussels lobbying arena has been intensely debating EU policy recommendations on the reforms necessary to improve access to financing for SMEs and investor protection standards. However, none of these measures, such as the MiFID rules on inducements, seem connected to the practical reality in the market and at the point of sale.*

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### *Problem statement*

Retail financial services users, such as fund investors, shareholders, life insurance policy holders, bond investors etc., are walking away from capital markets and voluntarily saving more in non-financial assets. We believe the main reasons for this chronic dislocation are the low levels of perceived trust and reliability of the finance industry for retail investors and the regulatory trends in the past decade.

Financial law reforms have been targeting stability, resilience and global competitiveness of the Capital Markets Union (CMU) and the single currency. However, the latter are external objectives, which only improve the position of financial providers on the global market, thus having little effect for the internal market and our economies.

More recently, the EU has undertaken some efforts to also improve the internal situation, in particular by focusing on EU households and SMEs in order to reconnect them to capital markets. However, after five years, the situation has stagnated and in certain aspects worsened, in spite of increased regulatory and supervisory activity. The Brussels lobbying arena is engaged in intense an debate and putting forward policy recommendations for necessary reforms to improve access to financing for SMEs and the investor protection standard, but none of these seem connected to the practical reality in the market and at the point of sale.

What retail investors are truly looking out for is sustainable value for money, representing a framework of elements that need to be found in the investment service or product. Among these elements, some may concern cost disclosure, a duty of care of providers or simply transparency of information. In Europe, the discussion on how costs and charges are disclosed has recently heated up. In 2017, the European Commission gave a mandate to the European Supervisory Authorities (ESAs – ESMA, EIOPA and EBA<sup>1</sup>) to issue recurrent reports on costs and past performance of the main categories of retail investment, insurance and pension products.

Although an ambitious exercise, the “annual supervisory reports” have fallen short of, or failed to achieve, the purpose of the mandate: to identify, map out and disclose the costs and performances of

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<sup>1</sup> European Securities and Markets Authority, European Insurance and Occupational Pensions Authority, European Banking Authority.

all retail investment products sold to EU citizens across the Single Market. BETTER FINANCE analysed this report and found that the coverage and quality of data was severely insufficient in the case of all three supervisory authorities.<sup>2</sup>

It is clear that retail investors suffer detrimental effects under the current market conditions, both from the lack of transparency or clarity of information, as well as from the results provided by investment services and products. BETTER FINANCE's annual research projects on pensions and investment funds unfortunately continue to put out negative and worrying conclusions. Private retirement provision vehicles in the EU underperform capital markets in real net terms over long time horizons (at least 15 years), and a considerable part even return negative performances.<sup>3</sup>

Many investment funds charge high fees for active management,<sup>4</sup> although it is proven that the more the retail investor pays, the less he/she profits,<sup>5</sup> and many of them are falsely advertised as such, actually engaging in "closet index tracking".<sup>6</sup> As if this was not enough, ETF providers don't seem to be transparent with regards to the split of revenues generated from securities lending, with wide divergences on what seems to be paid as "operational costs".<sup>7</sup>

With regards to investment advice, the situation is similar. In 2018, the European Commission conducted a study on the distribution systems of retail investment products across the European Union.<sup>8</sup> This includes an overview of costs and charges of a variety of investment products purchased from different financial players. The main finding was that lack of transparency on fees does not help investors take informed decisions.

Scarce transparency has also contributed to a dramatic decrease in trust in the industry over the last decade. Nevertheless, the CFA Institute "The Next Generation of Trust" report shows that millennials have more confidence in the financial services sector than older investors do. This is mostly explained by the increasing use of technology in financial services. 70% of CFA Institute members, aged between 25 and 34, responding to a global survey said that financial technology has changed their relationship with their adviser and enabled them with more valuable information and services. This result confirms that there is a strong link between the use of financial technology and a rise in trust in the industry from the younger generation<sup>9</sup>.

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<sup>2</sup> See BETTER FINANCE, 'Analysis of the EU Public Authorities' Reports on Cost and Past Performance of EU Retail Financial Products' (4 February 2019) <https://betterfinance.eu/wp-content/uploads/ESAs-Reports-with-Assessment.pdf>.

<sup>3</sup> See BETTER FINANCE Pension Savings Report, 2019 edition - <https://betterfinance.eu/wp-content/uploads/Pension-Savings-The-Real-Return-2019-Edition-1.pdf>.

<sup>4</sup> See BETTER FINANCE CMU Assessment Report, 2019 edition - <https://betterfinance.eu/wp-content/uploads/CMU-Assessment-Report-2019.pdf>

<sup>5</sup> See BETTER FINANCE, Study on the Correlation of Cost and Performances in EU Equity Retail Funds (20 June 2019), <https://betterfinance.eu/wp-content/uploads/BETTER1.pdf>.

<sup>6</sup> See BETTER FINANCE Replicates ESMA Study on Closet Indexing, <https://betterfinance.eu/wp-content/uploads/publications/EN - Press Release and Annexes 2 3 - Better Finance replication of ESMA study on Closet Indexing.pdf>; see BETTER FINANCE *Benchmark Disclosure Compliance Report* (2018), <https://betterfinance.eu/wp-content/uploads/PR-Benchmark-Disclosure-Compliance-Research-040618.pdf>.

<sup>7</sup> See BETTER FINANCE, Efficient Portfolio Management Techniques: Attribution of Profits Derived from Securities Lending by Equity UCITS ETFs (11 May 2019) <https://betterfinance.eu/wp-content/uploads/BETTER-FINANCE-Research-Paper-Securities-Lending-11062019.pdf>.

<sup>8</sup> See European Commission, 'Distribution systems of retail investment products across the European Union: Final report' (2018) [https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems\\_en.pdf](https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems_en.pdf).

<sup>9</sup> See CFA Institute, "The Next Generation of Trust, 2018: <https://nextgentrust.cfainstitute.org/wp-content/uploads/2018/04/CFAITrust-Global-Report.pdf>

BETTER FINANCE tried to tackle the issue of automated investment advice, and whether it represents a suitable alternative to “human” advisors. The findings of the Robo-advice report show that several platforms fail to provide personal and suitable investment advice, thus not complying with EU law in terms of equity allocation, portfolio allocation and portfolio diversification. In addition, strong discrepancy in terms of investment gains and high dispersion of asset allocation for the same investor profile is alarming.

The divergences that have come to light during the mystery shopping exercise, highlight the importance of the disclosure of standardized relative past performance for the investor. Our findings show that two investors profiles (Millennial and Baby-boomer) received very divergent investment advice from the same advisor the second year around, despite having the same investment amount and time horizon, education as well financial literacy. Wildly diverging advice has been encountered in terms of future investment gain, equity allocation and correlation between portfolio composition and expected return. Consequently, it is difficult for a potential retail investor to compare offers from different platforms and take an informed decision.<sup>10</sup>

Both BETTER FINANCE and CFA Institute identified inefficiencies in practices concerning the sale, distribution and management of investment products. As such, it may not seem surprising that retail investors lack trust in the financial services industry. However, which of these factors are pure breaches of investor protection rights and which would just be needed in order to improve a valid, legal investment service, was not ranked.

Therefore, “sustainable value for money” is, as yet, an unclear concept as it might include various issues (for example, transparency of fees and past performance, other type of charges, clients’ interests being put first, etc.). What general advocacy efforts and policy making seems to be missing is a practical representation of what value for money really means for individual investors (and other capital markets stakeholders) and finance professionals. Consequently, there seem to be many opinions (and therefore confusion) on what upcoming regulations should include to address the financial community’s demands.

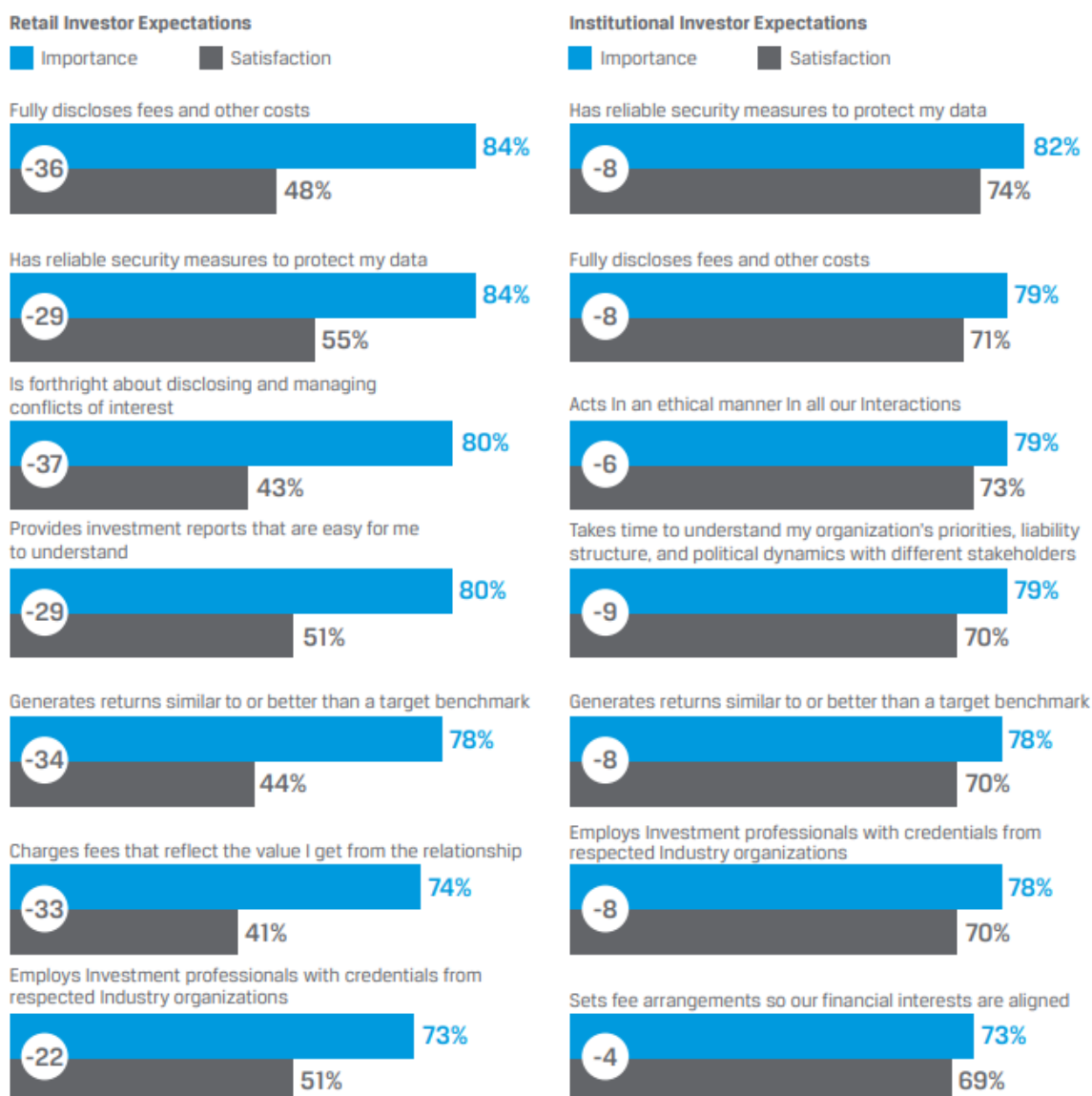
Investors are not always satisfied with the service they receive from investment managers. According to a CFA Institute study, the biggest gaps between investors’ expectations and satisfaction concern the full disclosure of fees and costs as well as data security. Investors often do not realise the amount of their expected net return, as little explanation about the fees and costs is provided.

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<sup>10</sup> See BETTER FINANCE Robo-Advice Report, 2019 edition – link not yet available.



Graph 1. Gap between investor expectations and satisfaction



*Source:* CFA Institute, From Trust to Loyalty: A Global Survey of What Investors Want, 2016).

Ensuring minimum standards for investors would help financial professionals better engage with retail clients and gain their trust. CFA Institute developed “The Statement of Investor Rights” with the aim of advising investors of the conduct they are entitled to expect from financial service providers. When engaging with a financial service professional or organisation, an investor has the right to:

1. Honest, competent, and ethical conduct that complies with applicable law;
2. Independent and objective advice and assistance based on informed analysis, prudent judgment, and diligent effort;
3. His/her financial interests taking precedence over those of the professional and the organization;
4. Fair treatment with respect to other clients;
5. Disclosure of any existing or potential conflicts of interest in providing products or services;

*6. Understanding of his/her circumstances, so that any advice provided is suitable and based on*

*His/her financial objectives and constraints;*

*7. Clear, accurate, complete and timely communications that use plain language and are presented in a format that conveys the information effectively;*

*8. An explanation of all fees and costs charged, and information showing these expenses to be fair and reasonable;*

*9. Confidentiality of his/her information;*

*10. Appropriate and complete records to support the work done on his/her behalf.*

*Moreover, it is worth underlining that all information about financial products and services should be provided in the native language of the investors in order to prevent any misunderstanding.*

### **Regulatory perspective**

The negative experiences of the 2008 and 2010 financial crises were “game changers” for the landscape of the EU Single Market for financial services. It was in the aftermath that the Capital Markets Union (CMU) and Banking Union (BU) projects were launched, under whose umbrellas a wide and complex series of new regulations were adopted and, of which, many more (the majority) are still under debate. It was following this negative experience that the EU strengthened pan-European supervision of financial services (CESR, CEIOPS and CEBS became ESMA, EIOPA and EBA) and instituted preventive and backstop mechanisms (ESM, SRB).

Many efforts have gone into building a resilient and competitive Capital Markets Union (CMU) that provides financial stability and financing opportunities. However, the key drivers of the CMU projects seem to have been skipped in the policy formulation, in particular to reconnect EU households to the real economy, diversify funding sources for SMEs and setting a high standard of investor protection, in particular by improving transparency and disclosure of information.

Recent developments in the field of investor protection are headed the right way, but there is more to be done. The entry into force of the MiFID II rules on investor protection concerning investment advice, conflicts of interest and disclosure of information seem now behind their time. Moreover, MiFID II does not extend to the insurance sector, which is regulated by IDD, which does not contain a similarly high standard of protection.

The PRIIPs Regulation has clearly set back investor protection. While the UCITS KIID did constitute a good example of regulatory practice, the model should have been transposed both to the PRIIPs KID and PEPP KID. BETTER FINANCE and CFA Institute have clearly warned EU regulators that the current approach does not disclose the complete information that investors need to have when making an investment decision.

On the supervisory side, ESMA updated a series of Q&As on the disclosure of benchmarks in UCITS KIIDs, but these measures are soft law and do not have the necessary binding power. A review of the PRIIPs Regulation is therefore imperative as disclosure of information on past performance and costs should be included in the KID.

### Policy perspective

The new Commission promises to attempt to complete the Banking Union and to work towards building the Capital Markets Union by diversifying “*sources of finance for companies and tackle[ing] the barriers to the flow of capital*”.<sup>11</sup> However, none of the objectives set out for the new Commissioner charged with Financial Services mention or identify the retail investor at the forefront of the CMU, as it should be.

BETTER FINANCE published its *Key Priorities for the Next Legislature (2019-2024)*.<sup>12</sup> Among the proposals, it calls on the European Commission and ESMA to continue fighting short-termism and focus on the creation of real value for retail investors, improving reporting on performances and reducing the number of UCITS and AIFs distributed in the EU. Moreover, policy makers are advised to drive the asset management sector towards providing more *value for money* by improving transparency and disclosure of information, addressing conflicts of interest at the point of sale and enabling easier access to simple and cost-efficient retail investment products across the EU.

ESMA should follow-up with concrete actions in its report on short-termism in capital markets, investment advice, securities financing transactions and creating an attractive environment for SMEs to publicly list on stock exchanges.

The CFA Institute Blueprint for the next five-year legislative period make a series of recommendations for the EU institutions. In particular, CFA Institute calls for better consistency of rules regarding reporting requirements on costs, charges, risks and returns across the main regulatory frameworks, such as MiFID, AIFMD, and PRIIPs. In addition, the European Commission should monitor the possible unintended consequences of MiFID II rules pertaining to unbundling investment research costs, and, together with ESMA, should review the PRIIPs Regulation. The latter does not provide sufficient investor protection, as past performance information, which is a key measure of investment managers’ performance, is excluded from the disclosure requirements.

As shown below, the questions this project essentially asked local stakeholders, are aimed at comparing the actual needs of financial services users with the current market practices and regulatory developments.

### Sustainable finance

An important trend in 2018 for the new legislature is addressing climate change through capital markets. Although terms such as sustainable finance and ESG are increasingly present in advocacy proposals and political speeches, evidence shows that there is no common understanding of the underlying concepts and actions that should be taken. BETTER FINANCE and CFA Institute highlight that action plans should consider how to best integrate *sustainable finance*, which encompasses green finance, climate change mitigation goals, and social, labour and governance factors.

Sustainable finance comprises a series of factors (as described above) that constitute “externalities” linked to investment services. As pointed out during ESMA’s public consultation on *integrating sustainability risks and factors* into MiFID II and UCITS/AIFMD, the initiatives are well placed, but the EU must first set a common working basis in order to truly deliver for citizens. The latest debates and initiatives present financial markets as the main drivers for mitigating climate change and tackling social

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<sup>11</sup> Mission Letter to Vice-President-elect for An Economy that Works for People, Valdis Dombrovskis (10 September 2019) [https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-valdis-dombrovskis-2019\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-valdis-dombrovskis-2019_en.pdf).

<sup>12</sup> BF Key Priorities

or labour externalities, thereby highlighting the necessity for higher and more active engagement in corporate governance by investors. A focus on long-termism and transparency should be at the centre of the sustainable finance debate in the EU.

Sustainability is one of the most important aspects of the investment decisions of EU citizens. Retail investors are naturally less risk averse than institutional investors and more long-term oriented, for which incorporating externalities of sustainable finance and addressing ESG issues is key. As part of the focus of sustainable finance policies, ESG currently occupies the forefront of debates.

This joint research project of BETTER FINANCE and CFA Institute builds on this regulatory and policy background and attempts to provide further clarity on whether and where improvements are needed.



## RESEARCH QUESTIONS & METHODOLOGY

### *Purpose of the study*

This project took a closer look at whether it would be more appropriate to have a single regulatory framework on *value for money* in the investment management sector or multiple regulations (such as the various rules on transparency inside the MiFID II, UCITS and PRIIPs frameworks in the EU).

The purpose of this project is very pragmatic and anchored in the perceived experience of market participants with the latest regulations applicable and practices: on one side, financial advisers and planners, product manufacturers and asset managers; on the other side, the recipients of financial services and products, retail investors. Therefore, the project aims to present these views through a “magnifying glass” from the vantage point of several perspectives: duty of care, transparency, supervision and investor protection, shareholder rights, and ESG-factoring.

### *Questionnaire(s)*

BETTER FINANCE and the CFA Institute designed a simple and concise questionnaire that captures the core of the identified factors or aspects that would create “*value for money*”. The questionnaire comprises 10 questions, out of which 9 are mixed (simple and multiple-choice answers) and the last is open for comments.

The questions are divided into six categories: *stewardship and the duty of care* (Q1 and Q2); *investor protection: pre-contractual information disclosure* (Q3 and Q4); *product intervention* (Q5); *connecting funding offer and demand through capital markets* (Q6); *shareholder activism* (Q7 and Q8); *sustainable finance and ESG disclosure* (Q9 and Q10).

The questionnaire was common for both BETTER FINANCE and CFA Institute, with some aspects of the questions adapted to the specificities of financial advisers and investment managers (CFA Institute) and those of retail financial services users (BETTER FINANCE).

### *Methodology*

The project is focused on the actual experience of market participants. In order to capture these views, the project was approached in three phases. The first phase comprised dissemination of questionnaires and aggregation of results. On the retail investors’ side, 17 member associations – representing 59% of the EEA population by geographic spread – responded to the questionnaire. From the CFA Institute side, we received 13 answers representing 84% of the EEA population by geographic spread.

The second phase was a roundtable event, gathering stakeholders who responded to the questionnaire on both sides and discussing the issues at stake in more detail.

The last phase contained a peer-review process and additional written comments from respondents. This last step was meant to validate the responses and input given at the roundtable event, as well as the findings and policy recommendations discussed in the last part of this paper.

Overall, both BETTER FINANCE and CFA Institute benefited from active collaboration and input from their members, enabling us to put forward robust and statistically relevant (*representative*) conclusions on what is need in EU financial markets to generate more *value for money*.

## ANALYSIS

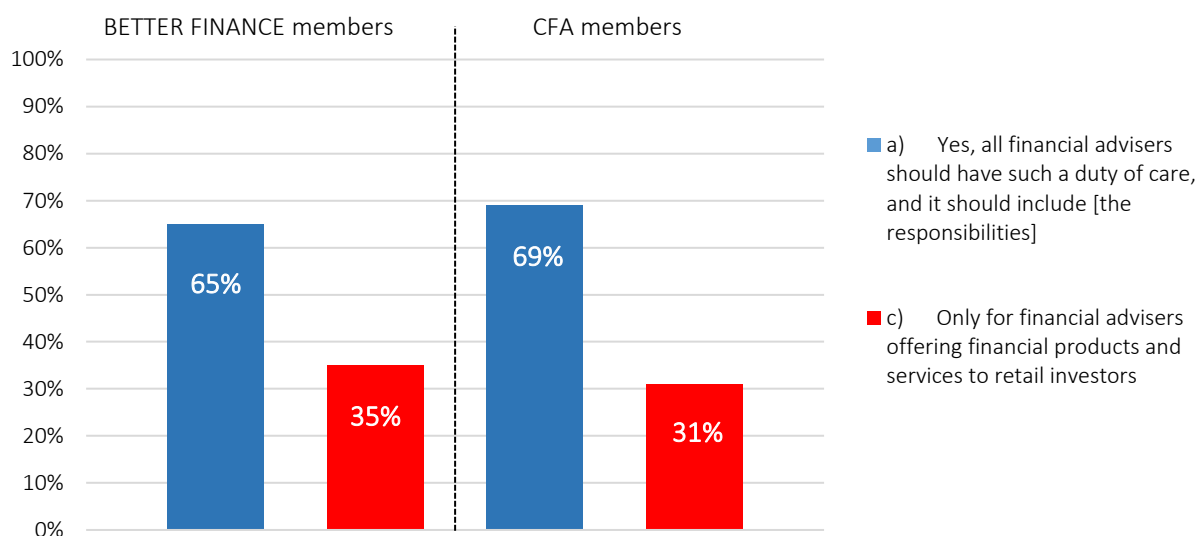
### Stewardship and the duty of care

*It is clear that the introduction of clear rules on duty of care and stewardship is essential to regain the trust of individual investors in capital markets.*

The first two questions of the survey concern the duties of financial advisers towards the clients and potential clients. The central element is the “duty of care” which could be potentially be seen as similar to the *Hippocratic oath*, i.e. a commitment to always act in the best interests of the investors.

Looking at BETTER FINANCE’s survey, the majority of respondents (65%) consider that all financial advisers should have such duty of care (graph 1). From those respondents that are in favour of duty of care, 65% consider that it should be mandatory (graph 2).

**Question 1: Should all financial advisers have a duty of care, including a series of responsibilities that they owe to the clients (similar concept as for medical professionals who decide to abide by a Hippocratic Oath)?**

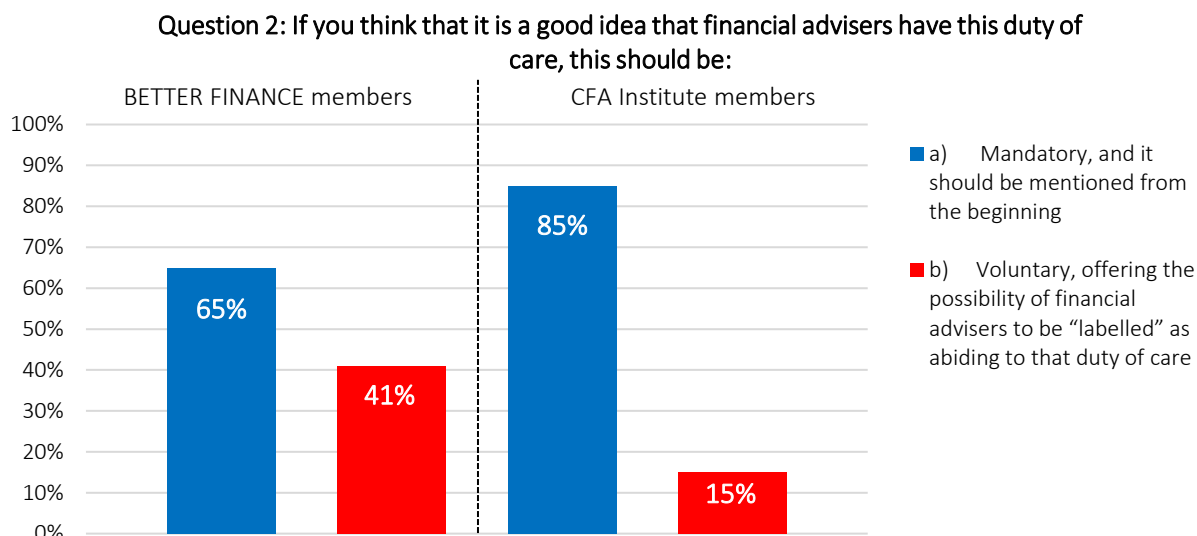


Source: BETTER FINANCE & CFA Institute, 2019

Judging from the answer, it is clear that retail investor associations have a broader scope of duty of care in mind, which applies to all financial advisers. This is due to the fact that, even if the retail investor in some cases is not the direct beneficiary of the advice, he might be the end-beneficiary of the service provided. An example would be in company pension plans, where the client is the company, acting on behalf of its employees.

Very similar results are observed among CFA Institute members. 69% of respondents are in favour of having duty of care and responsibilities for financial advisers towards individual investors. In addition, the highest share of respondents (85%) from CFA Institute’s survey would prefer to have such duty of care to be mandatory for financial advisers. The majority of survey respondents also remarked that all

investors should benefit from the duty of care, including wealthy investors and those investing in hedge funds.



Source: BETTER FINANCE & CFA Institute, 2019

However, some problems may arise from the different interpretations of stewardship and duty of care. This is particular true for retail investors who lack an understanding of these two concepts and are not aware of financial advisors' obligations towards the client. Indeed, stewardship and duty of care might be complementary, but they are not the same.

For CFA Institute members, in particular in the UK, stewardship is the relation between the investor and the investee which represent the entity/company in which an investment has been made. On the contrary, duty of care is the relation between the investment firm (the agent) and the end-investor (the principal). For the other members of BETTER FINANCE, stewardship encompasses the definition of duty of care and refers to aspects linked to corporate governance in seeking long-term utility and pro-social behaviour, instead of a definition that would see duty of care as being confined to the relationship between the financial advisor and the retail investor.

In the UK, the Financial Reporting Council introduced the *Stewardship Code* in 2010<sup>13</sup>. The Code set a number of good practices in order to improve the quality of engagement between institutional investors and companies. The code aims to foster a dialogue on strategy, performance, meetings' vote and risk management. However, even though institutional investors are free to follow these practices, their decisions need to be justified following their investment approach (comply or explain basis).<sup>14</sup>

Looking at EU legislation on financial markets, MiFID II<sup>15</sup> refers only to the duty of care of financial advisors towards their clients, but no references have been made regarding stewardship. Article 24 of MiFID II, on the general principles and information for clients, enounces:

*"Member States shall require that, when providing investment services or, where appropriate, ancillary services to clients, an investment firm act honestly, fairly and*

<sup>13</sup> <https://www.frc.org.uk/getattachment/e223e152-5515-4cdc-a951-da33e093eb28/UK-Stewardship-Code-July-2010.pdf>

<sup>14</sup> *Ibid.*

<sup>15</sup> DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

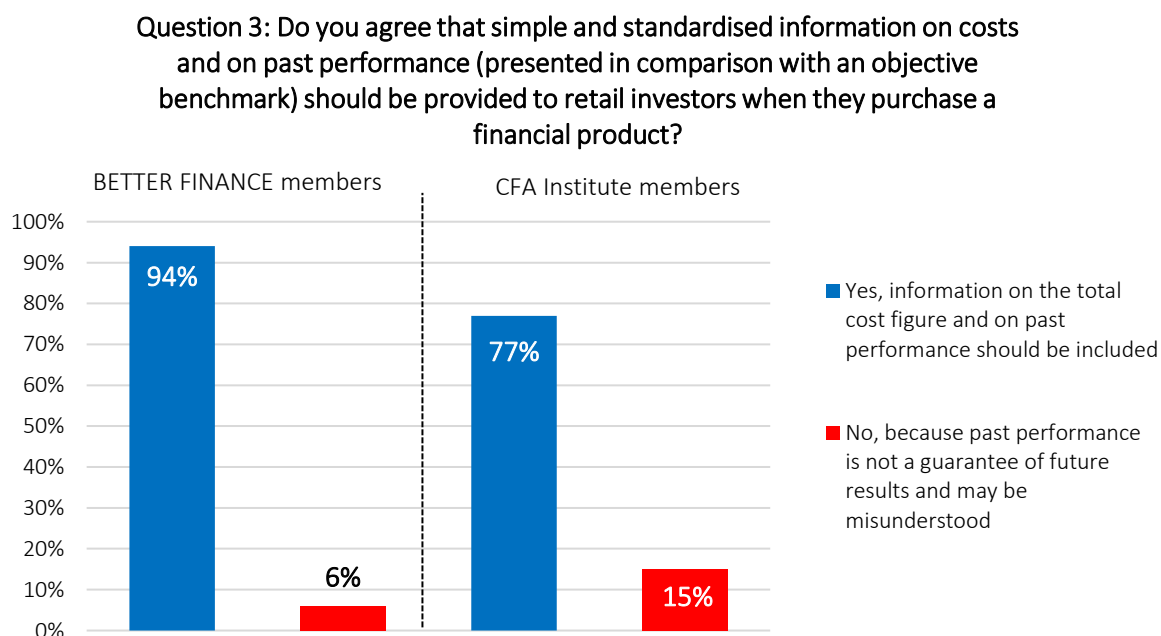
*professionally in accordance with the best interests of its clients and comply, in particular, with the principles set out in this Article and in Article 25.”<sup>16</sup>*

The article sets a series of duties that investment firms need to follow with regard to the information provided to their clients.

According to the two surveys, it is clear that the introduction of clear rules on duty of care and stewardship are essential to regain the trust of individual investors in the capital market. Society at large would be reassured to see that the relation between financial advisers and clients is taken seriously, reason why a Hippocratic oath, like in the medical profession, might restore confidence in the financial system as a whole, fostering investment firms to behave responsibly and operate as good stewards. Stewardship requires the right framework in order to work correctly. Therefore, a series of policies and procedures needs to be put in place in order to ensure client assets are safeguarded.<sup>17</sup>

## Investor protection – pre-contractual information disclosure

Questions 3 and 4 concern the only pre-contractual disclosure document addressed solely to retail investors, the key information document (KID). Currently, the EU financial acquis obliges product manufacturers to provide: a key investor information document (KIID) for potential investors in UCITS funds, and a key information document, for all other packaged investment products sold to individual savers. The main issue at stake is what type of information to present to the prospective retail client in the KID. Overwhelmingly, all of BETTER FINANCE members (94%, excepting one) answered that standardised past performance disclosure must be restored in the KID for packaged retail and insurance-based investment products (PRIIPs).



*Source:* BETTER FINANCE & CFA Institute, 2019

Neither past performance, nor future projections are reliable indicators of future results. However, past performance (historical track record) has the great advantage of showing the retail investor whether

<sup>16</sup> *Ibid.*

<sup>17</sup> <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/3-research-and-position-papers/stewardship.pdf>



the asset manager was able to achieve his stated investment objectives in the past, and to show how this performance compares with that of an objective indicator. The CFA Institute Global Investment Performance Standards (GIPS®)<sup>18</sup> provide a standard for the calculation and presentation of historical performance so that investors can easily make comparisons between managers and obtain the information they need to make informed decisions.

Three main aspects were discussed by stakeholders: costs reporting, investment advice and web-comparison tools for investment products. Finance professionals agree that investment companies should report total costs. However, the main issue is that historical costs should be reported on a standardised basis across all types of products. Currently in the Netherlands, PRIIPs is not applied to funds but it is for life insurance products.

One important issue highlighted from the perspective of the German market is that retail investors are presented with too many different KIDs (for shares, bonds, UCITS, etc.) which cannot be compared and are not standardised. Therefore, regulators should focus on consolidating statutory pre-contractual documentation and ensure comparability of the information presented therein across all retail investment products.

With respect to investment advice, retail investor representatives noted the confusion between the role of the distributor (salesperson) and that of the advisor. Unfortunately, most advisors are actually salespeople who push to sell products but do not design a customized solution for each investor. In the French market, only 8% of individual savers' capital is directed to the economy (equities, bonds), the rest is invested into packaged products (funds, life insurances).

BETTER FINANCE called for a ban on toxic products<sup>19</sup> as they are not fit for any market (they would likely destroy the value of people's savings), highlighting that "no advice is better than biased advice". In the EU, a big obstacle stems from the fact that advisors are mostly paid by their product providers or the manufacturers (doctors are not mainly paid by their providers).

For the insurance sector, independent advice is not the solution. Since the implementation of the IDD,<sup>20</sup> fee-based advice has worsened because insurers are not obliged to establish contracts with them. This means that customers have to go to another intermediary so as to sign a contract. Fee-based advice risks disappearing as the position of brokers has been strengthened. The example of the newly adopted law "PACTE" in France was given. A 15-years old ban on commissions on pension products and funds was lifted through this legislative reform. As such, it is expected that, at least, an additional 20 billion euros of cost will be incurred over the lifetime of products, which will be charged from pensioners' savings by distributors.

Finance professionals noted that it is paramount that investment managers focus on the well-being and the interests of the end client. The former should also have a solution-oriented approach and the suitability test (currently prescribed by MiFID II) must be customised for the client, not standardised. In response, some stakeholders noted that trying to replace duty of care with a test (similar to an online financial supermarket) is risky as it may add another layer of costs.

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<sup>18</sup> To learn more about the CFA Institute GIPS® standards, click [here](#).

<sup>19</sup> BETTER FINANCE understands through "toxic products" those that not only do not provide decent returns (aligned with the investment objectives of the saver), but actually destroy the value, in real terms, of the retail investor's contributions or investments.

<sup>20</sup> Insurance Distribution Directive: Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution, OJ L 26, 2.2.2016, p. 19–59.

However, CFA Institute members agreed that advisors should defend - in writing – their recommendations or proposed solutions to retail investors. This approach should focus on the suitability of the investment advice with regard to the needs of the client.

Concerning web-comparison tools, it was suggested that platforms such as *fund supermarkets* would prove a useful instrument for retail investors. The information presented therein (such as past performance) should reflect the KID/KIID, as the younger generation is migrating to digital access to information. Another suggestion tabled was to combine supermarkets for financial products on the one hand, and specialised, tailor-made advice on the other.

Nevertheless, a potential pitfall – to which regulation should pay particular attention – is the extent to which the sale of products through online platforms can be regulated and whether toxic products could be banned.

Question 4: Is there any information lacking from the current mandatory disclosure documents (KIID/KID)?		
	BETTER FINANCE	CFA Institute
a) Standardised information on past performance of investment products	65%	40%
b) Future Performance scenarios are not easily understandable for the majority of investors	59%	54%
c) The future “Reduction-in-Yield” cost approach of the PRIIPs KID is not intelligible and difficult to compare	53%	46%
d) Performance-based compensation and incentive payments are not always considered as costs, and are not disclosed as such	47%	31%
e) Others (please explain)	29%	N/A

Source: BETTER FINANCE & CFA Institute, 2019

In addition, we asked BETTER FINANCE and CFA Institute members what other information should be included in the KIID/KID. Most answers from retail investor representatives pointed to the fact that past performance should be present in key information documents (65%).

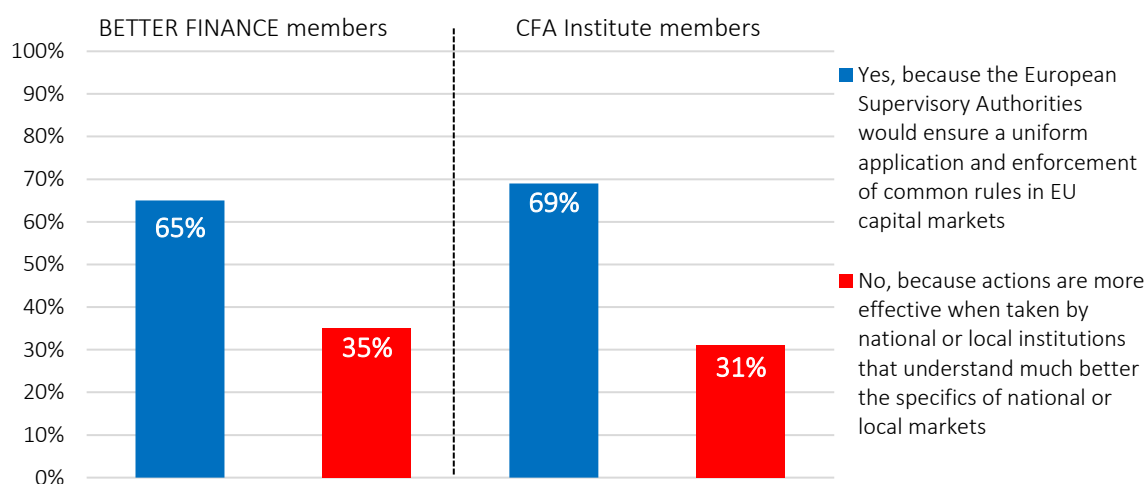
Furthermore, both sides of the stakeholder groups agreed that future performance is difficult to understand (59% and 54%), and that the Reduction-in-Yield (RiY) method for presenting costs in the PRIIPs KID is difficult to understand or to compare (53% and 46%). Four members of BETTER FINANCE provided additional comments: that the lack of disclosure of actual costs and total ongoing costs (as % of assets) in the PRIIPs KID makes cost comparison between investment products impossible; that past performance comparison against a relevant benchmark could better explain what the quality of the product is compared to low-cost peers; that intermediary costs, such as banking commissions and fees, are generally not clearly disclosed, whereas in Europe, contrary to the US, most retail investment products are sold through banking and insurance channels, (often) taking a high additional commission; and that the growth assumption used for the computation of the RiY should be disclosed.

*The general conclusion on the issue of supervision and product intervention was the dire need for more independence and increased powers for EU supervisory authorities. A vast majority of respondents agree that the powers and competencies of the ESAs should be increased.*

## Product intervention

Question 5 concerns the competences of the European Supervisory Authorities (ESAs), in particular the European Securities and Markets Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Banking Authority (EBA). Most respondents (65% BETTER FINANCE and 69% CFA Institute) answered that currently there is a need to increase the supervisory and product intervention powers of the ESAs in order to promote better supervisory convergence and product intervention measures.

### Question 5: Do you think that increased supervisory and product intervention powers for European Supervisory Authorities would be beneficial for individual investors in the EU?



Source: BETTER FINANCE & CFA Institute, 2019

This is one of the questions for which BETTER FINANCE and CFA Institute's members responses were most closely aligned. Following the roundtable consultation, the general conclusion on the issue of supervision and product intervention was the dire need for more independence and increased powers for EU supervisory authorities. The ESAs reform legislation was limited, with the only notable improvement being the possibility for the EBA to address decisions relating to Anti-Money Laundering (AML) directly to individual banks in last resort.

Stakeholders mentioned the recent review of the powers and governance structure of the European Supervisory Authorities (ESAs), with a vast majority of views agreeing that the powers and competencies of the ESAs should be increased.

Cross-border supervision for cross-border products is of significant importance for the CMU. This would reduce the existing barriers that are currently preventing the development of a more integrated market for cross-border fund distribution. Barriers such as different national requirements on the marketing of investment funds and the fund registration process could be eliminated by granting ESMA more supervisory powers, for instance the competence to directly authorise cross-border distributed funds. Nevertheless, stakeholders mentioned that national authorities' powers should not be restricted too much in order to strike the needed balance of powers. Finance professionals underlined that, in terms of market supervision, it is very difficult to see something similar to a Banking Union approach, even though granularity of investments is different from banks. However, it would be ideal to have ESMA as a fully-fledged supervisory authority, with extended competencies and attributes.

However, if the objective of the CMU – and financial reform in general - is to achieve a single market for financial services and products, then it would be a contradiction to have different investor protection rules or standards across EU Member States. What is more, the finance industry would benefit from an arbitration and adjudication system, potentially under the jurisdiction of ESMA, that would facilitate quicker resolution of disputes.<sup>21</sup> Moreover, in the context of the Collective Redress Directive currently under debate between the co-legislators,<sup>22</sup> retail investors' stakeholders noted that the proposal excludes direct investors from - but includes indirect individual investors in - the collective redress mechanism (as such, this would include those purchasing packaged products). If direct investors are not covered by the final legislation, this would negatively affect the level of trust.

CFA Institute argues that EU and national competent authorities should facilitate retail investors' access to Alternative Dispute Resolution (ADR) by introducing ADR schemes with the ability to make binding decisions and with compulsory participation from financial service providers.

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*Stakeholders highlighted that it' is necessary to use regulations instead of directives in order to avoid "gold plating".*

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## FinTech, SMEs' and retail investors' participation in capital markets

Questions 6 and 8 of the BETTER FINANCE survey concern the challenges in accessing capital markets for EU households and small- and medium-sized enterprises (SMEs). On the retail investors' side, most answers (multiple-choice question) indicated that the low levels of financial literacy of EU households

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<sup>21</sup> See CFA Institute, *Redress in Retail Investment Markets: International Perspectives and Best Practices* (2015) <https://www.cfainstitute.org/-/media/documents/article/position-paper/redress-in-retail-investment-markets-international-perspectives-best-practices.ashx>.

<sup>22</sup> For more information, access <http://betterfinance.eu/campaigns/collective-redress>; see also Directive on representative actions for the protection of the collective interests of consumers, 2018/0089/COD, [https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2018/0089\(COD\)&l=en](https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2018/0089(COD)&l=en).



(82%), coupled with the complexity of products (76%) and lack of trust in the industry (76%) deter retail investors from investing more in capital markets.

Question 6: What barriers or challenges currently exists that deter or impede a higher participation of individual investors in capital markets? (BETTER FINANCE only)	
a) Distrust of the financial industry	76%
b) Lack of knowledge/financial education	82%
c) Complexity of products	76%
d) Incomparability of products	59%
e) Lack of standardised or intelligible information in disclosure documents	53%
f) Information overload	47%
g) Lack of proper enforcement mechanisms	12%
h) Lack of safeguards (e.g. guarantee/compensation schemes)	12%
i) If any other, please specify	12%

Source: BETTER FINANCE & CFA Institute, 2019

Incomparability of products and lack of standardised and intelligible information in disclosure documents rank high in the perceived barriers to higher participation rates in capital markets for investors. These answers are correlated with those to Questions 3 and 4 relating to pre-contractual disclosure of key information to investors. On the retail investors' side, several respondents added (answer i) the non-transparent and non-capped up-front distribution costs or the lack of independent information, especially regarding valuation of traded SMEs.

However, these answers should not be viewed as a ranking – such as which is the higher barrier – as the respondents did not perceive them as such.

Stakeholders also remarked on the division of regulatory competence. The distribution of powers between DG FISMA<sup>23</sup> and DG JUST<sup>24</sup> of the European Commission does not work effectively, particularly in the context of shareholder rights that are covered (also at national level) by the justice and consumers department (DG JUST).

One of the most important remarks concerned the *choice of legal instruments* in financial regulation. Stakeholders highlighted that it is necessary to use regulations instead of directives in order to avoid “gold plating”, which is one of the issues causing capital markets fragmentation in Central and Eastern Europe.

CFA Institute focused the sixth question on a different topic for finance professionals, directly linked to the daily activities of investment advisors and managers. The question essentially asked professional stakeholders whether FinTech disruptions may have negative effects on ethics in financial services provision. The vast majority of finance professionals indicated that FinTech poses a risk with regards to ethical issues and implications, underlined by the necessity to test these new technologies against potential problems and find proper solutions.

<sup>23</sup> Directorate-General for Financial Stability, Financial Services and Capital Markets Union of the European Commission.

<sup>24</sup> Directorate-General for Justice and Consumers.

**Question 6: Are you concerned about possible negative ethical issues and implications of new fintech innovations? (CFA Institute only)**

- |  |     |
|--|-----|
| a) Yes, there is need to start research on these possible issues and find solutions to avoid witnessing an ethically disabled financial system | 77% |
| b) No, Fintech will not lead to new and different ethical issues than those that financial system has faced in the past.                       | 15% |
| c) If any other, please specify  | 23% |

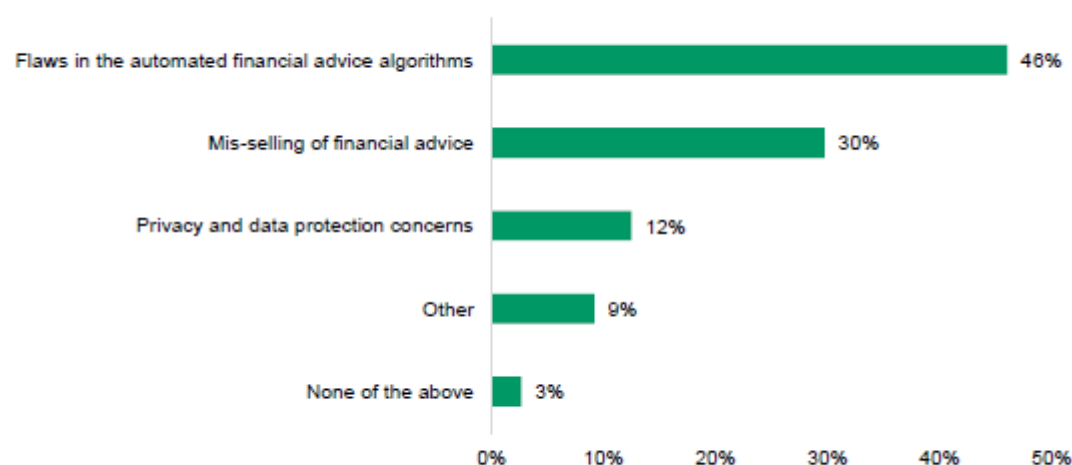
*Source:* BETTER FINANCE & CFA Institute, 2019

Finance professionals from CFA Germany indicated that automated platforms are not neutral white labelled algorithms, and that therefore audit is a key element for preventing ethical breaches that should be started as soon as possible to better understand what, in particular, needs auditing. While stakeholders suggested that supervisory authorities should further investigate this aspect, giving the example of the United Kingdom where a regulatory sandbox had been set up to pilot an online pension tool, finance professionals from Spain suggested that all national competent authorities should engage in these kind of exercises.

It was also pointed out that mis-selling presents a risk due to potentially hidden algorithms on the platforms or uncertainty on whether advice was given by a “human” or “robot”. The latter also raised the question on accountability, and who should be responsible for breaches of law or ethics in FinTech.

Moreover, the rise of automated financial advice caused by the evolution of financial technology may bring about issues in the re-evaluation of existing risks and, in particular, flaws deriving from the use of algorithms<sup>25</sup>. Respondents to the CFA Institute Fintech survey, conducted in 2016, stressed that the use of technology in the financial sector could increase the likelihood of flaws from automated financial advice. Behavioural biases from clients could occur as investor objectives and constraints might not be properly taken into account. Mis-selling of financial advice is another issue tied to the increasing use of financial technologies. Ultimately, regulators need to find a trade-off between Ethics and the disruptive trend of artificial intelligence.

**Biggest risk introduced from automated financial advice tools\***



Question: What do you consider to be the biggest risk, if any, that could be introduced from automated financial advice tools?

\* Excludes not sure

*Source:* CFA Institute Fintech Survey Report, 2016

<sup>25</sup> See the CFA Institute Fintech survey report 2016 - [https://www.cfainstitute.org/survey/fintech\\_survey.pdf](https://www.cfainstitute.org/survey/fintech_survey.pdf)

Retail investor representatives remarked on the experience gained from the annual report on testing automated investment advice (robo-advisors), highlighting that the same investor profile returns different results (performance, asset allocations) for the various platforms.

With regards to matching sources of funding with SME needs, most of BETTER FINANCE and CFA Institute respondents' views identified the *lack of research coverage* and *lack of liquidity* as the factors driving low investor interest in small- and mid-caps. According to our stakeholders, investor appetite for buying more equities from SMEs is also influenced by the different rules compared to main-market (Primary and Secondary) rules for listing and delisting (29% and 46% of answers) and the different accounting standards and quality of financial statements of SMEs compared to large caps (46%), as well as the more illiquid nature of these markets (47% and 69%).

A number of respondents (24% and 31%) added reasons not mentioned in the questionnaire for the low levels of SME investing: insufficient publicity (awareness); poor regulatory enforcement and limited penalties for directors; insufficient equity research as a negative effect from MiFID II; and that public authorities, the media and industry often mistakenly consider equity markets to only mean blue chips or large caps; lack of independent research (the same as the main issue under Question 8) and the non-transparent and high (not-capped) up-front distribution costs.

Question 8: What barriers, if any, currently exist that impact investor interest in Small and Medium Enterprises (SMEs)?		
	BETTER FINANCE	CFA Institute
a) Economic uncertainty	29%	15%
b) Different accounting standards and quality of financial statement disclosures compared to large companies	29%	46%
c) Different listing standards compared to main-market companies	24%	38%
d) Lack of research coverage	65%	69%
e) Lack of liquidity	47%	69%
f) Others (please specify)	24%	31%
g) There are no barriers	0%	0%

Source: BETTER FINANCE & CFA Institute, 2019

Other barriers indicated by CFA Institute members are the poor suitability of SMEs securities as liquid investments for the majority of retail investors, and the excessive focus on short-term performance, which disincentivises fund managers from taking active risks in SMEs, a fact that gets compounded by inherent lower liquidity and lower levels of research coverage in this category. The roundtable consultation of respondents provided valuable input on this question. An external, but unquantifiable factor is the manner in which EU institutions, public authorities and media refer to “capital markets” and “stocks”. It is perceived that most information that reaches retail investors equates equity with large cap companies, which considerably narrows the knowledge and choice of households for stocks. Despite the important role individual investors play in the SME segment of the market, the fact that reference is always made to big equity indices is framed as a cultural problem.

A simple comparison with the U.S. shows that a common, wide equity index (large cap and SMEs) in the EU consists of 1300 companies, whereas an analogous one in the U.S. comprises 5000 companies. Moreover, ETFs do not frequently track these wide benchmarks, which creates a barrier for actual exposure of individual investors to SMEs.

Lack of “media attention” was observed in the German SME market as well. Due to the fact that publicly listed SMEs are not sufficiently known to individual investors, the latter do not invest in these undertakings as there is insufficient information about their economic and financial performance.

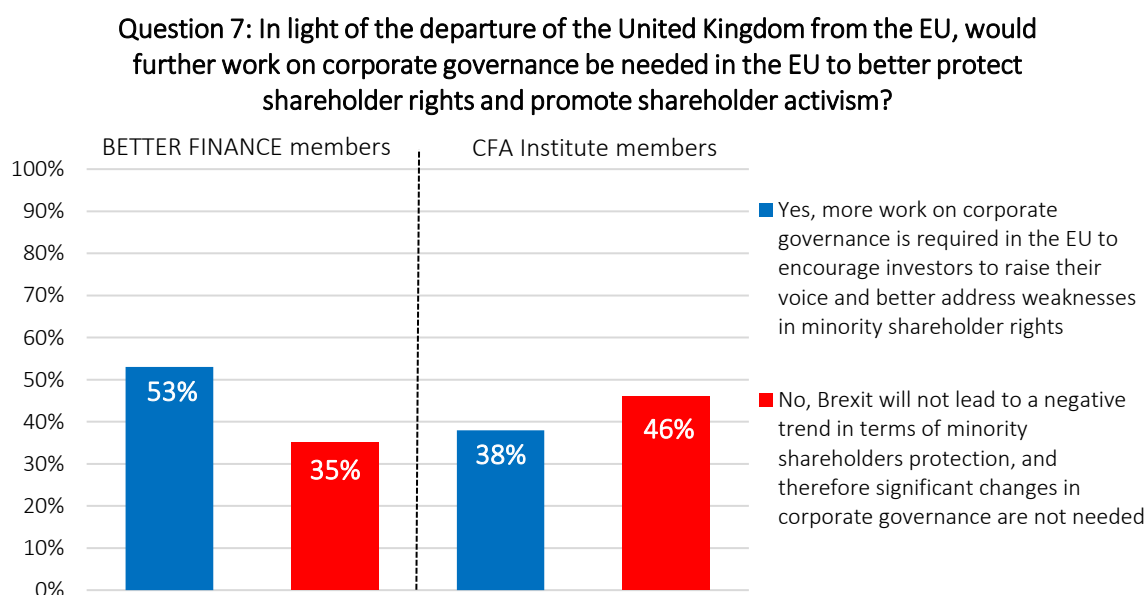
Another issued signalled in this regard is trade-data reporting. Although stock exchanges collect all data on companies before they are publicly listed, the exchanges are not responsible for the quality of this data. Therefore, there are no safeguards in place, such as control or verification, for data collection and prospectus issuance. Supervisory authorities should play a bigger and more active role in this process.

## Shareholder activism

Although it has constantly (and significantly) decreased in the past 50 years, EU citizens are still important stockowners of European businesses, on average holding a quarter of equity (public and private) issued in the EU. However, looking at the balance sheets of retail savers, equity represents merely 7% of their savings. The seventh question concerns shareholder protection and shareholder activism as a potential means to incentivise more households to directly invest in the economy by purchasing shares.

In essence, this question asks what can be done, in light of Brexit, to promote stockownership and enhance protection for existing direct retail investors. The answers from retail investors are more balanced than for other questions, but the winning majority indicated that more work on corporate governance is required in the EU to encourage investors to raise their voice and better address weaknesses in minority shareholder rights (53%) in light of Brexit.

On the other side, 46% finance professional respondents mostly indicated that Brexit does not mandate action in particular as it “will not lead to a negative trend in terms of minority shareholder protection”



*Source:* BETTER FINANCE & CFA Institute, 2019

Respondents mentioned that corporate governance should not necessarily be linked to the UK understanding, as a different meaning in EU Member States leads to different results. Nevertheless, the EU should make progress on corporate governance regardless of Brexit. More corporate governance is required in the EU, but Brexit is not perceived to have an impact. The notion of

subsidiarity, for example, impacts the Shareholder Rights Directive and makes shareholders hesitant about thinking about a pan-European governance framework on minority shareholders. Thus, shareholders are forced to rely more on national levers.

Retail savers raised the issue that there is still no harmonised definition of shareholders at EU level, as it remains an area regulated by national law. There is room for improvement with regards to exercising shareholder rights, such as timelines to provide voting material to shareholders or inform them of the procedure. German representatives of minority shareholders indicated that there were improvements on the timeline with regards to voting documents and that the exchanges between issuers and investor saw a significant improvement thanks to the review of the Shareholder Rights Directive (SRD II). It was also added that German shareholders perceive that this aspect of corporate governance was properly covered.

However, investor rights are currently misaligned with investing companies as the average turnover rate of active managers is above 100%. This means that, on average, institutional investors hold shares for less than one year. Therefore, the natural question to be asked is: what can determine shareholder activism (active engagement) knowing that voting rights are not kept for long? A suggestion was tabled to institute an obligation to exercise voting rights for institutional investors, on the basis that large asset managers can merely employ 36 representatives to exercise shareholder rights in over 17,000 companies.

Finance professionals from the United Kingdom gave the example of a potential “*comply or explain*” principle, by which institutional investors would need to exercise shareholder rights responsibly or otherwise explain why they didn’t. In this sense, large investors must produce a report on their engagement in corporate governance and justify action or inaction. They also remarked on the relevance of proxy advisors since, without them, individual investors cannot exercise their voting rights.

## Sustainable finance and ESG disclosure

Sustainable finance is gaining momentum in Europe, becoming one of the major policy debates at EU level. In May 2018, the European commission adopted the action plan on sustainable growth that wants to set a series of key actions to reorient the capital flows towards a more sustainable economy, manage financial risks stemming from climate change or environmental disasters and to foster transparency and long-term value creation.<sup>26</sup>

In order to reach the aforementioned objectives, the financial sector has been singled out as a key contributor and is asked to take into consideration **Environmental, Social and Governance (ESG)** as a structural part of investment decision making. ESG factors are a set of criteria established for assessing companies’ activities and assets that an investor can use to screen potential responsible investments. **Environmental** criteria refer to how a company performs in relation to sustainable use and protection of natural resources, gas emissions and transition to a circular economy, waste prevention and recycling, and pollution prevention and control. **Social** criteria look at how a company handles the relationship with its employees, suppliers, customers and the community in which it operates and whether it respects all regulatory or non-regulatory but binding provisions on social, labour, human rights law, as well as the sectors of activity in which it operates. **Governance** refers to company’s management, executive pay, audit, internal control, including due diligence in establishing and

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<sup>26</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52018DC0097&from=EN>



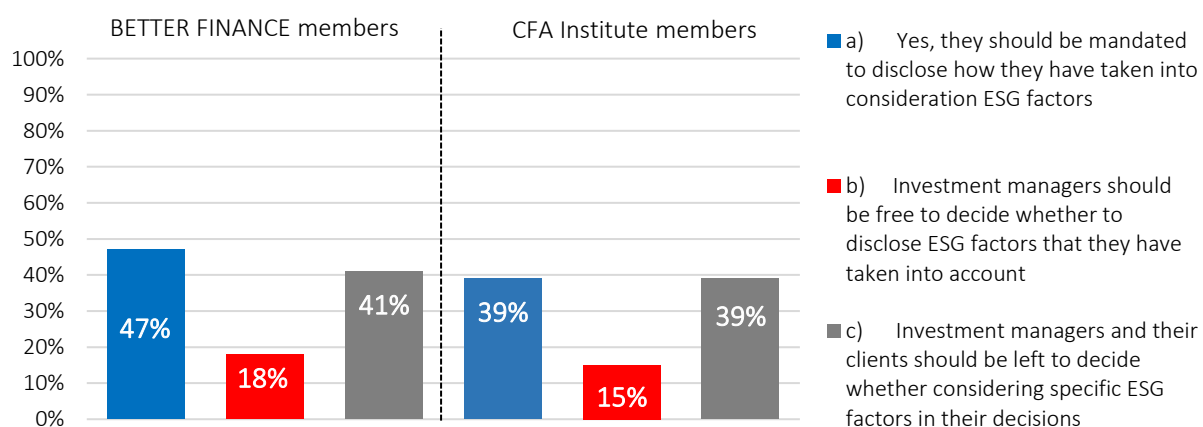
managing selection and monitoring of sustainable assets, investment policies, conflicts of interest and risk management, and shareholder rights.

EU citizens as savers and individual investors are the main providers of long-term funding to the EU economy and are mostly by nature long-term oriented, as their needs are often long-term ones: pension, home purchase, children education, etc. Therefore, they are concerned with the impact of the investment of their savings on sustainability.

The last set of questions (9 and 10) address the ongoing trend to reorient capital into sustainable projects and properly disclose how the ESG factors defining them (economic, social, and governance), are taken into account. Considering climate and energy domains alone, the European Commission forecasts that at least 170 billion EUR of investments are necessary every year to reorient the capital market towards renewable energy generation and efficient buildings.<sup>27</sup>

One of the major discussions at EU level is whether ESG-disclosure should be a general reporting obligation, or whether it should occur only when an investment product is labelled as such. *Question 9* investigates whether ESG-factoring disclosure should become a general, specific or voluntary obligation for investment services providers. Most of the answers from BETTER FINANCE's survey show that the 47% of respondents are in favour of always disclosing ESG factors when designing the financial product. However, an almost equal share of responses (41%) take a different approach indicating that it should be up to the client and the investment manager whether ESG should be considered the background analysis of a product and further disclosed.

**Question 9: Should investment managers explain how ESG factors (including negative externalities) have been considered in their investment analysis and decisions?**



*Source:* BETTER FINANCE & CFA Institute, 2019

Finally, 18% of BETTER FINANCE's respondents consider that it should only be the responsibility of the investment manager whether to disclose ESG factors or not.

On the other side, CFA Institute members have very similar considerations being divided on whether to have mandatory ESG factors or to leave the investment managers and their clients to decide whether to apply specific ESG criteria or not. An equal share of 39% of respondents appears to be in favour of

<sup>27</sup> [https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report\\_en.pdf](https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf)

one or the other approach. Regarding the possibility of leaving this decision in the hands of the investment managers, 15% of CFAs members appears to be in favour.

From a general point of view, CFA Institute members consider that to achieve results, the industry should be more inclusive and adopt collective thinking. This also means having integrated and customised approaches and processes, with deep knowledge and wide perspectives. As another possible solution, BETTER FINANCE's members raised the point that rather than implanting mandatory ESG factors, the European Commission would have done better to penalise negative externalities (e.g. carbon tax) which can be a more effective message to investors.

Question 10 was open to comments without pre-determined answers and looked into whether the European Union should take the lead in ESG investing by mandating the consideration of ESG criteria in the investment decision process or whether it should let investment firms adopt their investing strategy in global capital markets. 47% of respondents are of the opinion that ESG criteria should not be mandated by the EU. Two Members consider that ESG criteria should not be mandatory, but stewardship, proper reporting and pressure from investor/ shareholders should become an obligation where such factors are considered. One Member highlighted that, first, there is a need to ensure proper returns of investment products before considering ESG, since the latter is not a “panacea” for good or superior investment returns and should not be advertised as such. Another member stated that ESG-considerations should be optional and left to market practices. However, if investment firms claim to use such ESG criteria, this information needs to be regulated, verified and audited along a common standard/framework. One member, even though recognizing the importance of ESG criteria, raised the concern that their mandatory integration in the investment process could encourage greenwashing, and that therefore, this should be an integration process coming from the request of clients. However, a common framework on ESG disclosure should be regulated by the EU in order to avoid any kind of manipulation.

**Question 10: Should the EU take the lead in ESG investing by mandating the consideration of ESG criteria in the investment decision process or in another manner, or it should let investment firms adopt their investing strategy in global capital markets? Please comment.**

Yes (summarised)	35%
No (summarised)	47%
No comment	18%

Source: BETTER FINANCE & CFA Institute, 2019

On the other side, for 35% of respondents, the EU should take the lead in this field and oblige product manufacturers and investment services providers to consider ESG factors in their analysis and decision processes. A good example is provided by Spain, where a newly adopted amendment obliges certain companies (above a market cap size) to add a chapter in the annual financial reporting that deals with “non-financial matters”, such as ESG or gender equality.

In addition to agreeing and providing an ample explanation on why ESG-factoring should be made mandatory, a BETTER FINANCE member organisation indicated that:

*“Yes, the EU should take the lead in ESG investing by mandating the consideration of ESG criteria in the investment process. Climate risks translate into potential higher costs and lower revenues, potential write-offs, asset impairment and early retirement of assets etc. For investment companies these risks lead to potential depreciation of assets in the portfolio, loss of credit quality and potentially also brand damage in the case of reputational risks. Failing to integrate sound climate policies will be a business and strategic risk for any investment company, whether as part of the investment portfolio or direct operations.*

*Therefore, climate risks should be considered in the portfolio when looking at all aspects of prudential risks, but always keeping in line with the level of risks inherent to the investment. If there are not enough qualitatively and quantitatively appropriate opportunities for ESG investments, there is even the danger of “green bubbles”. Today, many investment companies use an exclusionary approach to their portfolios, which might not be sufficient. An alternative could be favouring another aspect or responsible investing, geared at selecting “best-in class” companies in a specific sector, while engaging with them to improve their performance. The evolving nature of ESG factors has to be taken into account when fixing the expectations which are set for investment companies by the EU.*

*Therefore, the ESAs [European Supervisory Authorities] should indicate to national NCAs [national competent authorities] as to how investment companies would be expected to measure ESG risks in their investment portfolios and design guidelines which help the investment companies getting an understanding of where the potential risks lie and work towards a contingency plan. Consequently, ESAs should develop “best practices” together with national supervisory authorities and industry as well as independent experts, taking into account the national supervisory framework and the implementation of the forthcoming EU ESG taxonomy”*

In general, even if respondents have different views on whether the EU should lead a mandatory integration of ESG criteria in the investment process, it seems that there is an overall inclination towards establishing a common framework and standards at EU level on how to integrate ESG criteria. Thus, facilitating the assessment of these criteria to avoid manipulation and the proliferation of too many methodologies that would have the effect of confusing individual investors.

Indeed, ongoing market practices present several issues such as insufficient disclosure and data on how sustainable financial products are linked to green projects and activities. In addition, there are several inconsistencies in the quality of verification including lack of common definitions in green projects.<sup>28</sup>

CFA Institute members indicated at the roundtable consultation that the consideration of ESG criteria in the investment decision-making process should be voluntary. The choice of taking ESG criteria into account in the investment decision process should be left to investment firms and managers. However, the expectation is that market forces would align and consider ESG factors. The CFA Institute survey respondents agree that the EU should take the lead in ESG investing by mandating the disclosure of whether ESG factors have been taken into consideration. The CFA Institute standards group is exploring an industry standard that aims to provide greater transparency and comparability for investors when they are considering funds or strategies that use ESG data.

Nevertheless, taxonomy should come first. CFA Institute members remarked that the EU should first define what ESG investing exactly means as the industry is likely to adjust its approach accordingly. Eventually, client demand would encourage investment managers to integrate ESG factors in the investment decisions and analyses. CFA Society Spain highlighted that ESG criteria are sometimes viewed in a different manner by market participants and thus a mandatory approach may not represent the best approach. Market-driven solutions are likely to better address conflicting views on ESG factors and the meaning of ESG investing. Disclosure of ESG factors should be the only mandatory approach. But BETTER FINANCE is concerned about the direction in which the taxonomy is heading. The Technical Expert Group (TEG) on Taxonomy is mainly composed of NGO representatives, who are not specialists nor scientists, and this may pose a risk for the accuracy of the taxonomy. Moreover, finance professionals noted that the main issue concerning sustainable finance taxonomy is that the members

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<sup>28</sup> [https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report\\_en.pdf](https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf)

of the TEG and policymakers are setting up a taxonomy without looking at the investment process. As such, the taxonomy is not being set up from the investor standpoint.

## CONCLUSION

It was interesting to observe that a large number of responses from industry and investor stakeholders were aligned. Although the number of respondents differed, thus affecting the percentages presented, finance professionals and retail investors seem to agree that:

- Investment managers should have a mandatory duty of care, of which the client should be informed from the beginning;
- only simple information on the total cost figure and past performance (in comparison with a benchmark) should be disclosed in the key pre-contractual documents;
- the European Supervisory Authorities (ESAs) should be given more powers and competencies in terms of enforcement and product intervention; in addition, the CMU as a whole would benefit from a dispute resolution mechanism (such as arbitration) under the competence of a European authority (such as ESMA);
- Investment managers should disclose how they address ESG factors in their products or investments, whether through mandatory regulation or as they see fit, eventually directed by the end investors;
- More suitable, tailor-made investment advice should be provided to retail investors;
- Lack of liquidity in, and research coverage of, SME markets constitute an obstacle preventing savers from investing more in SMEs.

The only issue on which we observed slight differences in respondents' views was on the risks posed by Brexit in terms of shareholder rights' and corporate governance. Most BETTER FINANCE respondents consider that the EU should do more to improve shareholder rights, regardless of whether Brexit will happen or not, whereas CFA Institute members consider that Brexit will not generate a significant disruption in this field, and believe that the EU will continue working on good corporate governance policies.

Considering disruptive trends, the majority of CFA Institute members agree that FinTech innovations present risks with regards to mis-selling and ethics in finance, in particular for investment advice. They recommended for national supervisory authorities to pay more attention to automated and online platforms to identify and prevent issues that may arise from combining artificial intelligence in a service that is so subjective and human-centred.

Concerning the barriers preventing SMEs from accessing more and diversified funding from capital markets, the views of finance professionals are more technical and are more concerned with the quality of information available to investors and financial reporting, as well as the differences between delisting rules on primary and secondary markets.

Finally, with regards to direct retail investor participation in capital markets, most respondents highlighted the lack of knowledge and financial literacy as the main barrier. Individual and small investors are not sufficiently acquainted with equity or bond investing, nor do political voices or media help, as these sometimes conflate large cap stocks with the broad market, for example.

In addition, distrust of the finance industry, the complexity and incomparability of products, the lack of enforcement mechanisms and safeguards (such as compensation schemes) also act as deterrents, preventing EU households from being more active in capital markets.

In conclusion, not only do retail investors and finance professionals have the same expectations with regards to *sustainable value for money*, but it is clear now – to us at least – what exactly is comprised in this concept.

With this in mind, what should be done at policy level in order to achieve *sustainable value for money* in financial services?

## POLICY RECOMMENDATIONS

The purpose of this project was to learn about market practices and investors' needs in order to frame and clarify the concept of value for money. Based on the findings of these surveys and the input received from stakeholders, BETTER FINANCE and CFA Institute plead for the following:

### 1. *Address the issues related to investment advice*

Investment advisors should be concerned only with the best interest of the investor and should be objective and independent of any selling incentive. The new rules of MiFID II partially addressed the issue of biased advice. However, these rules should be mirrored for the insurance and banking sector as well and should be found in an equivalent regime for closed architecture distribution systems.

A duty of care, in the shape of a code of conduct or “Hippocratic oath” for investment services providers, must be put in place to ensure that the best interests of investors are taken into account at all stages of the investment process: advice, distribution, and execution.

Lastly, EU and national supervisory authorities should pay particular attention to the risks stemming from new FinTech business models that could result in breaches of investor protection and ethical rules. The attitude of public authorities should be proactive in creating tools – such as regulatory sandboxes – to test and identify potential inefficiencies of these innovations and take solution-oriented steps in order to prevent larger negative effects on the financial system.

### 2. *Disclose standardised information on actual costs and past performance in all retail investment products*

Investors suffer considerable detriment from misleading and confusing information presented in pre-contractual documents that are supposed to enable comparison with other products and help savers make an informed decision.

Key Information Documents should disclose only what is certain: actual costs incurred in the past year and long-term past performance, compared to an objective indicator (market index benchmark). Moreover, a single regime for all investment products marketed across the EU should be imposed in order not to overload savers with information and add to the already existing confusion generated by the complexity of products and lack of financial literacy.



### *3. Transform the ESAs into true supervisors*

All stakeholders involved agreed that the recent reform of the powers and governance of the European Supervisory Authorities (ESMA, EIOPA, EBA) was disappointing and fell short of what the Capital Markets Union truly needs: independent ESAs, with fully-fledged regulatory, supervisory and product intervention powers.

### *4. Address short-termism and shareholder engagement barriers in corporate governance*

Small shareholders face many difficulties in exercising their rights in the corporate governance of companies. The EU framework for the Shareholder Rights Directive should go much further in clarifying the rights and obligations of issuers and improving the conditions for individual shareowners to actively participate in the decision-making process.

Moreover, institutional shareholders have the largest impact on corporate governance as the former manage billions of euros of capital on behalf of EU citizens. However, asset managers have little incentive – and put little effort – to actively engage with investee companies and far too often change ownership (buy and sell) in companies. Long-termism in equity markets must be fostered through regulation.

A stewardship code – a framework of duties that asset managers must observe with regards to the issuer – should be instituted, enforcing a *comply or explain* principle. In addition, institutional investors should be obliged to produce reports justifying why their actions in corporate governance of companies best serve the company and their clients (beneficial owners).

### *5. Address obstacles to retail investor and SME participation in capital markets*

On the one hand, retail investors have limited knowledge of, and insufficient information on, SMEs, preventing them from investing in the latter. On the other hand, SMEs see scarce capital offers through public listing, which creates a spiral of causal effects.

The EU should improve financial literacy by re-instating basic financial mathematics and capital markets as minimum requirements for European curricula and promote employee share ownership, which would have a twofold effect: first, increase financial literacy and offer (future) investors experience with equity investing and; second, urge issuers of securities to work on, and improve the quality of, financial information in order to attract more research and investors to raise capital.

The solutions are not one-sided: a bridge must be built between EU households as the main source of long-term financing and SMEs, and the real economy.



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The European Federation of Investors and Financial Services Users  
Fédération Européenne des Épargnants et Usagers des Services Financiers



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