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

Ref: ESMA Discussion Paper on MiFID II investor protection topics linked to digitalisation
Date: 14 March 2024
Link: https://www.esma.europa.eu/press-news/consultations/discussion-paper-mifid-ii-investor-protection-topics-linked-digitalisation#respond-anchor
Contact: policy@betterfinance.eu

BETTER FINANCE answer to ESMA Discussion Paper on MiFID II investor protection topics linked to digitalisation *—selected questions*

Background note

The document "Discussion Paper on MiFID II investor protection topics linked to digitalisation" provided by the European Securities and Markets Authority (ESMA) focuses on various aspects of digitalisation in the financial sector, particularly concerning investor protection under MiFID II. This paper aims to gather insights and feedback on digital engagement practices, content marketing, the use of affiliates and influencers, and the application of gamification techniques – among other topics.

BETTER FINANCE welcomes the positions taken by ESMA in the discussion paper on MiFID II investor protection topics linked to digitalisation. While acknowledging its limitations in its ability to have thoroughly scrutinised the most problematic digital firms or actors within the scope of the discussion paper, BETTER FINANCE aims to provide additional perspectives on selected questions addressed in the paper, that is, those not exclusively geared towards (internal) financial firms' operations. Although BETTER FINANCE's contributions are limited, within these boundaries, our feedback offers supplementary, selected insights to the discussion initiated by ESMA.

Selected questions

Online disclosures.

7. Should the vital information need to be the same for all MiFID financial instruments, or can it be different depending on the type of instrument? If so, how?

Ensuring that vital, digitally available information, such buy/sell price and market value, is consistently presented across all MiFID financial instruments is paramount for maintaining transparency and facilitating a basis for comparison between different instruments. The digitalisation of financial information should empower investors to effectively discern and compare various financial instruments, aiding them in understanding the nuances of each product and making informed decisions that align with their investment strategies and risk tolerance. The standardisation of information presentation, coupled with best practices in information layering, is essential and presents an opportunity to foster a safer digital environment in financial services. To this aim, vital information should only differ when linked to the instrument. In the absence of specific key information documents for simple stocks and certain bonds, digitalisation should leverage on standardising universal data points as "vital information", as well as instrument-specific details, within the digital disclosures' layering structure. For instance, bonds should provide detailed information on interest rates, credit ratings, and maturity dates, while equities should include data on dividends, company performance, and market trends. Similarly, ETFs should always disclose information regarding underlying assets, TER, and tracking performance, whereas commodities should detail the characteristics of the underlying physical asset and relevant market conditions. Moreover, the incorporation of 'risk' information is critical for certain products, enabling investors to assess the potential impacts on their investments. For each financial instrument, specific risk indicators, such as credit risk for bonds or market volatility for equities should be prominently displayed alongside universal data points.

By presenting information in a structured, coherent manner across different instruments, investors should be able to compare different investment options and to navigate product specificities in confidence. BETTER FINANCE advocates for a maximum standardised approach to information disclosure in a layering that ensures that investors are well informed and can compare instruments receiving all necessary details in a consistent and accessible format, yet with tailored specifics

to instruments. This would not only aid in effective side-by-side comparisons but also upholds the principles of transparency and accessibility central to the MiFID framework, and open the way for KID equivalent for securities in the digital age; ultimately fostering a more efficient and investor-friendly market environment.

10. What is your positive and negative experience with layering information?

Most brokers offer charting tools, but the extent of historical data provided varies significantly across platforms. Some brokers cap the historical data at a maximum of 5 years, offering just the bare minimum required for a long-term overview, whereas others provide data extending back to the inception of the security, allowing for a more thorough analysis. Essential security details such as market values, share prices, and ISIN codes are commonly included, complemented by prevalent statistics and, when available, detailed company profiles. In addition to these basics, brokers might present 'analyst views,' which include recommendations to buy, sell, or hold, enhancing the data's analytical value. However, it's important to note that the choice of news sources covering an issuer can vary significantly between different brokerage firms, potentially affecting the information's impartiality. Brokers may also offer supplementary information, like "people also own" suggestions, which could indicate trending investments among other platform users. Advanced brokerage platforms may go further, providing an order-book overview or exhaustive analyses of a company's financials, capital structure, or ESG commitments. While such in-depth data can be invaluable for informed decision-making, it's crucial that these features are presented in an organised and accessible manner to prevent information overload and ensure they support rather than complicate investment decisions for retail investors. Moreover, we note that leveraged products associated with a particular security can be integrated as part of layering, indirectly gearing towards more risk-oriented options.

Content Marketing and Social Media

17. Do you have educational material available to investors in which you actively promote specific instruments and/or firm(s)?

As a customer organisation, we have noticed that some webinars, marketed as educational, are often used to promote specific financial instruments or services by brokers. These sessions, particularly those focusing on complex products like Warrants, Leveraged & Short ETFs, and Turbos – commonly associated with Exchange-Traded Products (ETPs) – might subtly motivate investors to delve into these intricate offerings. The issue arises when such webinars tempt clients to try

products that are sophisticated and may not align with their long-term investment goals, increasing their risk exposure. Even when risks are mentioned, there's a possibility that clients might underestimate them, assuming a brief introductory session provides adequate understanding. It's vital for investors to thoroughly assess these webinar contents and for providers to clearly communicate that these are mere introductions to complex and high-risk products. When complex trading services or products are advertised, it is essential to ensure that retail investors are equipped to make decisions that are consistent with their investment objectives and risk tolerance. Equally concerning are seemingly 'independent' online interactive tutorials or comparison website featuring training or simulation trading apps that feature complex financial products presenting themselves as educational resources. However, those can harbour underlying promotional intents (as affiliates) and forward to specific brokers offering those services. While they can be useful for learning, there's a significant concern that these tools might act as gateways, subtly gearing users towards engaging with complex products. A major risk associated with these educational tools is their potential to instil a false sense of confidence among users, leading them to make investment decisions without a full understanding of the associated risks or how these decisions align with their long-term financial objectives.

Digital Engagement Practices (including gamification)

28. Do you incentivise your clients to log in on a daily basis? For instance, by pop-up messages, frequent email updates, etc.?

Clients are often incentivised to log in daily to their brokerage or neo-bank accounts through strategies like pop-up messages and email updates. These notifications can inform users about market changes or suggest trading opportunities, potentially influencing increased platform engagement and trading activity. However, some users may find it challenging to understand the relevance of these notifications or to disable them, which could unintentionally encourage more frequent trading. While these engagement tactics can keep investors informed, there is a risk they might promote impulsive trading behaviours, underscoring the need for clear customisation and opt-out options for users.

30. If you do not use above-mentioned incentives and gamification techniques, have you observed problems or difficulties with any of them?

One commonly observed client engagement technique is the use of "referral programme", where existing clients are incentivised through rewards such as discounts, securities, or cash bonuses to introduce new clients to the platform. In

certain instances, these referral bonuses come with conditions, such as a need to execute trades within a specified time frame to qualify for reimbursements or other rewards. These time-sensitive incentives may encourage consumers to make hurried trading decisions to avail the benefits, leading to actions that might not align with their long-term investment goals. This scenario poses a risk as the client's decision-making process may be swayed by the immediate incentives, potentially diverting them from their original investment strategy or objectives. Pressure and rushed decisions (time-constrained incentives) can lead to 'influenced,' self-directed choices that do not align with the initial investment strategy or risk tolerance of the client.

Open question

40. Do you have any (other) observations with regard to the topics covered under this discussion paper that you would like to share with ESMA

In an evolving digital and fintech-oriented financial ecosystem, where savings, investment, and payment functionalities converge, the application of extra nudging techniques to influence customer behaviour merits close examination. While nudges such as automated savings transfers can promote healthy financial habits, they need to be meticulously crafted to prevent misconceptions, such as alluding that increased spending would equal enhanced savings. For instance, while features like automated investment roundups aim to boost savings, they necessitate clear communication to avert any confusion regarding the interplay between spending and saving.

Moreover, new business models in the financial sector are evolving "simple products" into "complex services" by integrating functionalities of traditional payment linked to an investment account. These risks become particularly pronounced when investment assets are utilised for daily transactions on an execution-only basis, without requiring appropriateness tests. The intermingling of investment and payment services can inadvertently lead customers to use their investment assets for routine purchases, subjecting them to market volatility and potentially destabilising their financial security. To protect investors, it's imperative to furnish them with explicit information on the risks and how these services operate, including clarity on valuation of assets and the impact of market fluctuations on purchasing power. Providing tools that facilitate informed decision-making, like immediate notifications of asset values before transactions, is crucial. Moreover, it's essential to evaluate regulatory adaptations for these hybrid services to decide if appropriateness tests should be applied to "complex services" (and not solely to "complex products") to bolster consumer protection. It's also important to

avoid promotional messaging or marketing that could mislead consumers into mottos equating increased spending with higher savings.

Furthermore, digitalisation is reshaping traditional financial advisory roles, intertwining advisory services with self-execution functionalities. Robo-advisors, utilising algorithms for investment suggestions, symbolise this shift. Conversely, neo-brokers, employing 'nudging' strategies by offering basic objectives, risk assessments, and modifiable predefined investment portfolios, blur the boundaries between execution-only, non-advisory, and advisory roles. This blending, especially the nuanced nudging, poses a risk where clients may modify their portfolios in ways that significantly alter their risk profiles without an in-depth understanding of the potential implications.