

POSITION PAPER ON EU RETAIL INVESTMENT STRATEGY

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Research and Recommendations
to deliver on CMU Objectives



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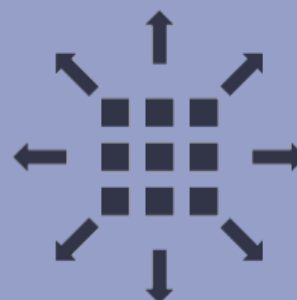
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The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

BETTER FINANCE POSITION PAPER ON THE EU RETAIL INVESTMENT STRATEGY

The European Federation of investors and Financial Services Users fully supports the clear stated objectives of the European Union's very welcome "Retail Investor Strategy".

Before the European Commission's proposal is put forth, BETTER FINANCE reminds of the key necessities for a Capital Markets Union that shall *"work for the people."*

ENSURE A LEVEL PLAYING FIELD IN SECTORAL LEGISLATION

The European Commission's stated goal for the EU Strategy for Retail Investors (RIS) is to: *"ensure that (...) rules are coherent across legal instruments"*.¹

Article 38 of the EU Charter of Fundamental Rights requires a high standard of consumer protection to be ensured across all Union policies. Unfortunately, EU rules are too often inconsistent between one category of "retail" investment products and another.

BETTER FINANCE proposes to adopt a uniform approach to both MiFID II, MiFIR, IDD, PEPP, IORP, MICAR, etc., to ensure that individual, non-professional investors benefit of the same level of protection when buying packaged investment products, regardless of the type.

Such a legislative work would ensure a higher standard of investor protection, stimulate cross-border distribution of services and products, reduce regulatory arbitrage, increase legal certainty, clarity of the legal framework and, ultimately, trust in investment services.

A common body of investor protection rights would be key to achieve this objective and build towards a Capital Markets Union *"that works for People"*.

CLOSE THE UNBIASED ADVICE GAP FOR RETAIL INVESTORS

The EC's stated goal for the RIS is also to ensure that *"an individual investor should benefit from (...) bias-free advice"*.²

EU citizens must trust that investment professionals act honestly, fairly, and professionally in accordance with their best interests. This requires the elimination of biases in investment services and closing the advice gap in the EU.

Currently, the EU market for "retail" investments faces a huge shortage of advice for non-professional savers. This is because the dominant distribution model (of retail investment products) is *commission-based*, meaning that product manufacturers pay distributors to influence what to sell to their clients.

EU law should end this confusion between selling and independent advice: at the very least, investment firms should not receive and retain third-party remunerations for providing independent advice, portfolio management, and execution-only services to retail clients. Currently, only MiFID II lays down such a prohibition (except for execution-only, Art. 24(7) and (9) MiFID II) and it should be extended for all retail investment sectors (IDD, PEPP, MiCAR, etc.).

¹ European Commission, *Consultation Document: A Retail investment Strategy for Europe* (11 May 2021), available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2021-retail-investment-strategy-consultation-document.pdf, hereinafter "the RIS document".

² *Ibidem*.

DELIVER VALUE FOR MONEY

Another stated goal for the RIS is that individual investors “*should benefit from (...) a variety of competitive and cost-efficient financial services and products*”.³

Value for money incorporates *suitability* or *appropriateness* of a product with a client's profile (knowledge, needs, investment horizon, risk tolerance), but it goes much further. Value for Money (VfM) should be designed as a fundamental safeguard for consumer protection, building on the already existing – but not enforced – MiFID II or Investment fund rules prohibiting “undue costs” and requiring providers to assess the cost of their product with regard to that of equivalent products on the market.

CLEAR, NOT MISLEADING, AND COMPARABLE PRODUCT INFORMATION

It is also the stated goal for the RIS to ensure that individual, non-professional investors benefit from “*transparent, comparable and understandable product information*”.

“This is a triumph of pseudoscience over common sense” – Prof. John Kay.⁴

The “PRIIPs” (packaged retail and insurance-based investment products, excluding listed securities and personal pensions) Key Information Document is for the most part, and especially on performance and costs, not clear, misleading (e.g. future performance data based on 5-year past performance) and not comparable – even for similar products. It must be reviewed ASAP to meet the EC's objective.

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³ *Ibidem*.

⁴ John Kay, “I Kid You Not, New European Rules Rely on a Bent Coin” (FT.com, 15 January 2018), accessed 24 October 2022, available at: <https://www.ft.com/content/9fb9516e-f616-11e7-88f7-5465a6ce1a00>.

SPECIFIC POLICY RECOMMENDATIONS

“The economic purposes of securities markets are to meet the needs of companies and savers”.

- John Kay, Other People's Money (2021)

Harmonise the existing regulatory frameworks across all categories of EU retail investment products

All product categories under EU law should benefit of the same, high standard of consumer protection, which is currently not the case. Unfortunately, only MiFID II-regulated products have a complex framework aiming to prevent mis-selling, and it is still not enough, particularly since investment funds and listed shares make up for just 15% of households' financial balance sheets.

Ban commissions for “retail” investment services

The payment of benefits or monetary remunerations from product manufacturers to distributors of retail financial products, which should act *“in the best interests of clients”* creates a conflict of interest and can lead to mis-selling. EU law should at the very least ban payments for retail order flows (PFROF) as there is no “advice” provided to justify such remuneration.

End EU Law confusion between “advice” and “selling”

Currently, EU law confuses selling and advising on investment products when dealing with “inducements”: in particular those are charged as much on execution only investments as on “advised” ones. This is because currently “inducements” are paid only for selling investment products, never for advising them.

BETTER FINANCE proposes a distinction between distributors who sell and those who advise (recommend) on investment products or services.

Clarify the general duty of care towards “retail” clients

EU law should make clear that *“acting in the best interest of clients”* (MiFID and IDD) should imply the obligation to *“not charge undue costs”* (2010/43/EU, Art. 22) and *“assess, while taking into account cost (...) whether equivalent (...) financial instruments can meet their client's profile”*. (Regulation EU 2017/565, Art. 54.9).

It would be much easier for supervisory authorities and consumers to enforce their safeguards awarded by EU legislation if these requirements *were clarified, more specifically defined and applied to all retail investment products*.

Define conflicts of interests

Conflict of interests rules need to be more clearly defined. In order to harmonise the application and enforcement of this rule, BETTER FINANCE recommends adding a clear and unambiguous definition for conflicts of interests.

“Ensure transparent, comparable and understandable product information”

Investors are faced with information overload and too many warnings. At the same time, the current Key disclosures are not intelligible, do not enable citizens to compare even similar investment products and do not include the most relevant information such as the actual performances (compared to the objectives of the provider) and costs. EU law should:

- impose and enforce the rule on *fair, clear, and not misleading* information to all retail investment products and services;
- streamline and reduce the volume of consumer disclosures, adapted to digital format with drawdowns or links for more detailed disclosures;

- information documents must be simple, clear, and concise, understandable and comparable, with as few warnings and waivers as possible.

The key information for consumers should include:

- comparable actual performance and cost disclosures;
- inflation warning and inflation-adjusted actual returns;
- clear and comprehensible investment objectives and how the product will deliver value for money.

[See BETTER FINANCE response to the ESAs JC Public Consultation on PRIIPs.](#)

[See BETTER FINANCE PRIIPs webpage.](#)

For the growing number of retail investors who invest directly into capital markets:

- Ban payments for retail order flow ("PFOF")

Investment firms receiving and executing trade order on behalf of retail clients must obtain the best possible result in terms of price, volume, and speed. Payments for order flow, which are a specific type of inducements, should be banned for retail order flows as they contravene with the rules on conflicts of interests and the general duty of care.

- Retail Equity and bond orders and trades transparency in the EU

In order to increase transparent trading in the EU, systematic internalisers and other dark venues should be subject to the large-in-scale (LIS) threshold: orders below the LIS should be executed on regulated markets and transparent MTFs only, or otherwise venues should follow the same transparency standards (see above).

- Access to trade market data

Any venue executing "retail" orders should follow the same transparency and accessibility rules as regulated markets and multilateral trading facilities regarding retail clients. Pre- and post-trade data should be freely, clearly (in the MiFID sense) and easily accessible and downloadable within maximum 15 minutes in a language and format that can be used by the "average" retail client.

- Shareholder rights

Barriers to shareholders and retail investor engagement within the EU remain very high despite the entry into force of SRD II, and the EU initiatives on ESG matters also require more investor engagement with investee companies for sustainability reasons. There should be an EU-wide definition of "shareholder" (as mentioned in the CMU Action Plan, Action 12). As required by SRD II, non-professional individual investors trying to vote cross-border within the EU should not be charged more than for voting domestically, etc.

[See BETTER FINANCE SRDII study \(2021\).](#)

- Employee Share Ownership

A very powerful tool to reach the objectives of the EU Strategy for Retail Investments and create an equity investment culture is the development of employee share ownership (ESO), as recommended by the High-Level Forum on the Future of the CMU and by the European Parliament in 2020.

ESO has proven to foster equity investing among citizens, make companies more resilient to financial turmoil and more sensitive to sustainability issues. ESO should be a key factor of the social taxonomy in terms of social contribution to ESG objectives and should be promoted by the EU and by Member States.

[See detailed recommendations here \(EFES\).](#)

Strengthen the suitability assessment for retail clients

To increase the availability of simple products and enhance the design of those that are already intended for retail investors, EU law should:

- replace the appropriateness test with the suitability assessment for non-advised services, except for execution-only (Art. 25(2) MiFID II, Art. 30(1) IDD);
- incorporate in the target market determination the probability of meeting the provider's investment objective and the client's return expectations, in real net terms:
 - i. over or at the end of the recommended holding period, or
 - ii. at least a reasonable probability not to erode the purchasing power of his savings over the same horizon;
- define *toxic products* as those that have a very high probability of delivering negative value for money from the start to the client in real net terms over the recommended holding period.

[See detailed recommendations on the new suitability regime proposed by the European Commission \(February 2022\) here.](#)

[See detailed recommendations on complex products here.](#)

Enhance the product oversight and governance process

The product oversight and governance process creates bureaucratic hurdles that result in the unavailability of certain investments to retail investors. EU law should:

- give enforceability to the rule prohibiting asset managers from charging retail clients with undue costs and assessment if equivalent products better meet client needs;
- all costs must be correlated to a clearly identifiable service, which must directly amount to the objective of the service/product;
- make the existing rule consistent across retail investment products (apply to all PRIIPs, not only to MiFID products) (level 1);
- incorporate the obligation for manufacturers to explain how the product will deliver value for money for the intended retail client and how can this be evaluated ex-post;
- replace the target market identification for non-complex products sold through execution-only services with the Key Information Document;
- exempt distributors from determining the target market;
- oblige product manufacturers to identify the target market for all complex products that cannot be offered to clients through execution-only services;
- allow distributors or advisers to sell or recommend complex products which do not have a target market identified by the manufacturer if they voluntarily identify the target market;
- allow experienced investors (qualified non-professional) to benefit from less stringent investor protection rules as for professional investors.

Digitalisation

Digitalisation and data availability bring significant benefits for "retail" investors:

- algorithm appropriateness for robo-advisors: the EU Commission and ESMA to investigate the algorithms used by Robo advisors in order to test their appropriateness and suitability for retail investors;
 - The EU Commission should consider the following initiatives for EU financial services users:
 - i. Independent savings products databases requiring standardised Key Information on actual costs, performances and risks;
 - ii. Independent web comparison tools;
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- iii. Rethinking mandatory disclosure documents such as an adapted KIID for digital / smart phone use;
- iv. Enabling individual shareholder engagement within the EU by facilitating voting or giving power to a proxy through one's smartphone.
- the pre-contractual documentation should be machine-readable and fed into an EU-wide, freely accessible web-comparison tool for investment products;
- Robo advisors and other digital intermediaries such as neo-brokers must enable and facilitate the engagement of individual investors, notably by offering and facilitating the exercise of their shareholders' rights;
- consumer disclosures in digital format should follow behavioural insight principles to make them easier to read, compare, and understand (e.g. nudging features);
- proxy voting and participating in virtual or hybrid AGMs should be enabled through digital tools;

[See detailed recommendations on shareholder rights.](#)

- the European Single Access Point (ESAP) should comprise information on breaches of consumer rights or other relevant legal provisions and the sanctions or fines applied;

[See detailed recommendations on the ESAP.](#)

Redress tools for retail investors

The collective redress Directive currently does not cover direct investors into capital markets, the very ones the CMU aims to foster: the Annex defining the scope should be amended to award equal representation and protection rights as to indirect investors (packaged products).

[See BETTER FINANCE Collective Redress webpage.](#)

For individual redress, alternative dispute resolution (ADR) should handle consumer complaints within maximum 35 days and the members of the ADR bodies should have a cooling-off period (5 years) and restricted financing from the financial industry.

Alternative options

Should EU authorities (Commission, EU co-legislators) choose a different path than harmonising the above-mentioned core obligations into a Single Rulebook, then these proposals should be individually incorporated in the relevant pieces of EU legislation applicable to "retail" investments (namely, MiFID II, IDD, MCD, MiCAR).

Clarify and specify the general duty of care (act in the best interests of clients)

The obligation to "*act honestly, fairly, and professionally in the best interest of clients*" should be enforced equally for all retail investment services (such as Art. 24(1) MiFID II, Art. 17(1) IDD, Art. 7(1) MCD). A harmonised, general obligation in this sense should be adopted and given enforceability by adding a clear, precise and unambiguous definition for clients' *best interests*. The requirement for providers to deliver "value for money" should be included.

Sustainable finance

To ensure that finance contributes to sustainable transition:

- EU law must ensure that suitable sustainable financial products are proposed to individual investors;
- Greenwashing must be more clearly and precisely defined in EU Law and thoroughly addressed by supervisors.
- Retail investors need proper information on financial returns of sustainable investments compared to mainstream capital markets' ones;

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- the sustainable finance framework needs to be completed by developing a social and governance taxonomy;
 - it is crucial to have a framework that improves and facilitates individual investor engagement;
 - it is necessary to adequately assess the engagement of asset managers in relation to sustainable financial products and the respective marketing claims in terms of engagement policies.
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Useful links from BETTER FINANCE

1. [BETTER FINANCE Response to EU Commission's Public Consultation on the EU Strategy for Retail Investors](#)
2. BETTER FINANCE response on the [EU Commission Survey on Value for Money](#)
3. Report: [New Retail Investing Environment: Expectations and Challenges Ahead](#)
4. Report: [MiFID II and PRIIPs Implementation Study](#)
5. Report: [Evidence Paper on Detrimental Effects of "Inducements"](#)
6. Report: [Simple Products for Retail Investors](#)
7. Report: [Individual Redress Tools for Retail Investors](#)
8. Report: [Securities Lending \(2022 edition\): Attribution of Profits Derived from Securities Lending by UCITS Exchange-Traded Funds](#)
9. Report: [Real Returns of Long-Term and Pension Savings \(2022 edition\)](#)

Other publications:

- European Securities and Markets Authority (ESMA) [Interactive Rulebook on securities legislation](#)
- European Insurance and Occupational Pensions Authority (EIOPA) [Interactive Rulebook on insurance legislation](#)
- [Final Report of the High-Level Forum on the Future of the Capital Markets Union](#) (May 2020)
- European Parliament [Report on further development of the Capital Markets Union \(CMU\): improving access to capital market finance, in particular by SMEs, and further enabling retail investor participation \(2020/2036\(INI\)\)](#)

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