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

Ref: ESMA Call for Evidence on Retail Investor Protection Topics

Date: 2 January 2022

Link: https://www.esma.europa.eu/press-news/consultations/call-evidence-retail-investor-protection-aspects

EXECUTIVE SUMMARY

General comment	BETTER FINANCE welcomes this call for evidence from ESMA on retail investor protection topics but regrets that it is confined to securities markets (MiFID II) topics only as these financial instruments make up for only a third of the financial balance sheets of EU27 households, and in fact the smallest share of the three largest financial product categories: insurance product and pensions (34%), banking products (32%) and MiFID II product (31%) in 2020. Therefore, BETTER FINANCE's general recommendation is to avoid the silo approach by the European Commission and adopt a more coordinated/harmonised view of retail investor protection topics.
Disclosures	Disclosures must be streamlined and harmonised across all categories of EU retail financial products. These must enforce the rule of "*fair, clear, and not misleading*" information, must be simple and avoid overlaps or inconsistencies with other mandatory disclosures (such as the PRIIPs framework). Key information must also be comparable with that of substitutable investment products.
Digital disclosures	The work on digital disclosures must be coordinated and harness the input and lessons learned from other ongoing projects that already developed digital disclosures, such as the PEPP KID or individual pension tracking systems. In short, digital disclosures must start with simple, unambiguous, clear and comparable information, combine text with graphics to ease understandability and use digital features for explanatory/financial education purposes.
Robo-advisors	One of the main questions remains the accountability of algorithms and how to explain their functioning. There are common concerns that the use of algorithms creates risks in terms of consumer protection. Consumers are not aware of the technology used by such automatisation, and they lack understanding of the underlying process from which the investment advice is proposed.
Online brokers	The most pressing challenges are the use of implicit advice or recommendations (*social trading*) and gamification. We consider that it would be helpful if the CESR guidance on investment advice would be transformed into a Level 2 regulation and replicated for other EU retail financial products categories. Regarding gamification, EU and national authorities should strengthen and clarify the rules applicable in such cases, potentially add regulatory warnings about the risks of "gamification" and closely supervise such practices.
Role of social media	Social media (and "FINfluencers") and social trading can have several benefits, but do also carry significant risks for retail investor protection, most importantly the potential to mislead consumers. EU authorities should conduct mystery shopping in order to identify different practices and, if any, regulatory loopholes, which can then be furthered with closer supervision and financial education campaigns (to reduce the reliance of financial services users of information shared on social media). EU Authorities should regulate and supervise investment advice through social media; also because more and more legal cases show that many

	influencers are paid to disseminate investment advice to their millions of followers: this is becoming in fact commercials or ads and should be regulated as such.
Open finance	N/A

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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 the 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.

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. As such its activities are supported by the European Union since 2012.

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INTRODUCTORY EXPLANATIONS (for non-professional readers)

Since 2015, the European Union (EU) is working towards building the Economic and Monetary Union (EMU), composed of two main pillars: the Banking Union (BU) and Capital Markets Union (CMU). Regarding the CMU, several action plans were launched by the European Commission (EC), the latest being the renewed Capital Markets Union Action Plan of September 2020.

Action Plans are series of reforms concerning the regulatory, institutional, and supervisory frameworks in a certain field, but also comprise campaigns or other types of initiatives. These "actions" are built on extensive public consultations with stakeholders, technical advice received from other EU authorities, impact assessment reports done by the EC, and evidence gathering exercises involving stakeholders.

One of the key work axes highlighted in the CMU Action Plan of 2020 was the publication of an *EU Strategy for Retail Investments* (herein retail investments strategy, or RIS), through which the EC will prepare and propose amendments to and/or new legislative acts to ensure that "*retail investors can take full advantage of capital markets and that rules are coherent across legal instruments*". The EC identified four main objectives to be achieved through the RIS (*for retail investors*):

- adequate protection,
- bias-free advice and fair treatment,
- open markets with a variety of competitive and cost-efficient financial services and products, and
- transparent, comparable and understandable product information.

In August 2021, BETTER FINANCE participated and responded to the EC public consultation regarding the retail investments strategy. In our response, BETTER FINANCE provided key recommendations on twelve headings on which the EC sought input. Among other, BETTER FINANCE highlighted the need for more financial education at the workplace (most notably through employee share ownership), addressing issues in pre-contractual disclosures, providing adequate redress tools for retail investors, or improving the quality of investment advice.

In July 2021, the EC asked to the European Securities and Markets Authority (ESMA) to provide advice on a range of topics in preparation of the retail investment strategy, which could be announced in the second quarter of 2022. Thus, ESMA launched the present *call for evidence*, aimed primarily at investors and consumer organisations, to seek input on: disclosures and digital disclosures, as well as digital tools and channels (robo-advisers, online brokers, and open finance).

BETTER FINANCE's responses in this call for evidence are also based on previous input to public consultations (e.g. Call for Evidence on PRIIPs, response to the RIS etc) and on BETTER FINANCE's research, besides members' input. Our response follows the structure in the consultation document of ESMA and reiterates the questions as provided therein. Where the questions are not applicable to BETTER FINANCE, these are marked with "Not applicable to BETTER FINANCE".

General comment

Q1: Please insert here any general observations or comments that you would like to make on this call for evidence, including any relevant information on you/your organisation and why the topics covered by this call for evidence are relevant for you/your organisation.

BETTER FINANCE welcomes this call for evidence from ESMA on retail investor protection topics but regrets that it is confined to securities markets (MiFID II) topics only as these financial instruments make up for only a third of the financial balance sheets of EU27 households, and in fact the smallest share of the three largest financial product categories: insurance product and pensions (34%), banking products (32%) and MiFID II product (31%) in 2020.

EU27 households	2012		2015		2020	
	in € mil	in % of total	in € mil	in % of total	in € mil	in % of total
Total	**22,046,154.4**	**-**	**25,456,836.0**	**-**	**31,563,360.0**	**-**
Banking products	**7,288,375.9**	**33%**	**7,930,789.6**	**31%**	**10,175,943.6**	**32%**
MiFID II products	**7,112,186.2**	**32%**	**8,532,284.3**	**34%**	**9,816,499.9**	**31%**
IDD products	**7,065,749.0**	**32%**	**8,271,378.2**	**32%**	**10,621,494.0**	**34%**
Other	**579,843.3**	**3%**	**722,383.9**	**3%**	**949,422.5**	**3%**

Source: own composition based on Eurostat data, 2021; *banking products corresponds to currency & deposits (F2); MiFID II products corresponds to equity & investment fund shares (F5), debt securities (F3) and financial derivatives and employee stock option (F7); IDD products corresponds to insurance, pensions, and standardised guarantees (F6).

Our research and BETTER FINANCE members' input covers ample evidence on insurance-based investment products and pensions as well. At the same time, we believe that the recent Call for Evidence on PRIIPs (ended 23 December 2021) should have been included in the scope of the present call for evidence (or vice-versa) in order to obtain a coordinated and homogenous view, particularly since half of this call for evidence concerns disclosures.

Given that this call for evidence (based on the request of the EC) will feed into the advice for the retail investment strategy, BETTER FINANCE will include – where relevant, information on insurance-based investment products and PRIIPs as well.

As highlighted in the Call for Evidence (CfE) on PRIIPs, BETTER FINANCE's survey with individual investors and member organisations on the implementation of the 2018 reforms (MiFID II and PRIIPs):

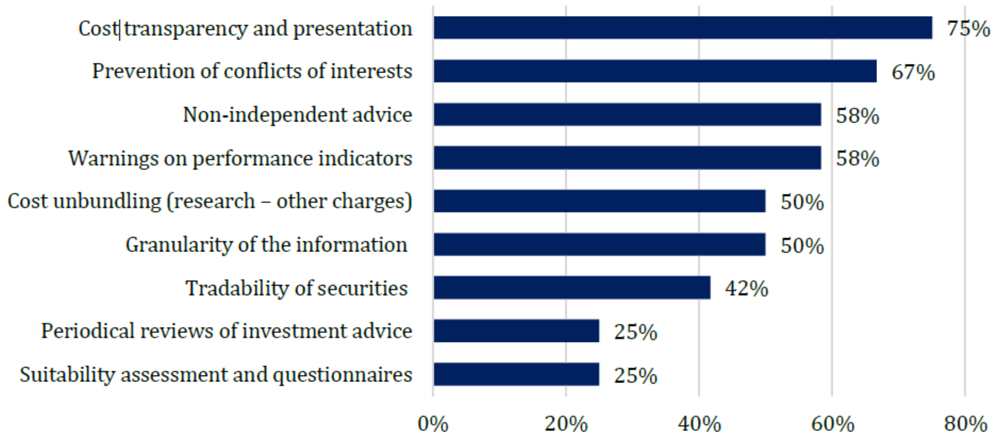
- 85% of individual respondents were dissatisfied (score between 1 to 7 on a scale from 1 to 10);
- 92% of member organisations were dissatisfied (score between 1 to 7 on a scale from 1 to 10),

with the newly applicable rules.

In terms of recommendations, individual respondents answered (suggested) to the question on "*areas of improvement*" and requested improvement in the following areas: clarity/intelligibility of information (48% of respondents); risk transparency (42%); amount of information (36%); cost transparency (32%); performance transparency (29%); quality of advice (22%); suitability assessment and questionnaires (21%) "other" (such as , 16%); and tradability of securities (10%). It was worth mentioning that the relatively low concentration of answers on "rooms for improvement" reveals that the opinions of individual respondents were much more diversified, especially when looking at more granular data (by jurisdiction); these percentages represent averages. For instance, for Portuguese respondents, *quality of advice* ranked among the highest (57%), whereas *risk transparency* was the most chosen answer for both Finnish and Danish respondents.

In this light, the answers from BETTER FINANCE's member organisations were more consolidated around several topics:

On which of the following areas do you see room for improvement? (BF members)



Source: BETTER FINANCE, 2019

BETTER FINANCE, in light of the findings in this survey, proposed a series of policy recommendations, which are reiterated below: minimize inducements and conflicts of interests in "retail" investment products; increase the clarity and intelligibility of information disclosed to non-professional savers; reduce the amount of information disclosed; improve cost, risk and performance transparency; key Information Documents for "retail" investment products should be fully reviewed at Level 1; and create an additional qualified, non-professional client category. These recommendations are fully reflected in the more recent policy recommendations made in calls for evidence and public consultations.

Disclosures

Q2: Are there any specific aspects of the existing MiFID II disclosure requirements which might confuse or hamper clients' decision-making or comparability between products? Are there also aspects of the MiFID II requirements that could be amended to facilitate comparability across firms and products while being drafted in a technology neutral way? Please provide details.

In BETTER FINANCE's view, the disclosure framework must be, first of all, streamlined and harmonized: key information documents for investment products and key information (summaries) of prospectuses for other securities. In addition, as mentioned in the general comment, the European Commission should make a cross-sectoral analysis and ensure that all categories of EU retail financial products have simple and consistent disclosures and eliminate overlaps with the PRIIPs framework. Currently, product manufacturers and distributors must disseminate ex-ante or ex-post cost, risk, and performance disclosures, which do not have the same rules or methodology as in the PRIIPs or UCITS frameworks.

Third, the rule on "*fair, clear, and not misleading*" information communicated to clients or potential clients should be adopted and enforced for all types of disclosures. Last, disclosures must also highlight what *value for money* the product delivers to the client or potential client. The actual content of the disclosure should be, of course, aligned with the supervisory requirements on delivering value for money: a good example to start with is the EIOPA supervisory statement on value for money in the unit-linked insurance-based investment products' market (https://www.eiopa.europa.eu/content/eiopa-sets-out-framework-delivering-better-value-money-consumer-centric-way_en)

Q3: Are there specific aspects of existing MiFID II disclosure requirements that may cause information overload for clients or the provision of overly complex information? Please provide details.

Currently, consumers are faced with information overload, not only due to MiFID II requirements, but also due to the existence of additional disclosure documents at national level (e.g. in Germany, the same pension product may be categorised under four types of products, which each has its own product information sheet) and due to the existence of the PRIIPs/UCITS framework for pre-contractual disclosures. While it seems simple and straightforward when analysing the disclosure requirements in abstract (e.g. the MiFID II provisions), the European Commission and the ESAs should attempt to make case studies by product category and jurisdictions (with real examples) in order to see that, in most hypotheses, consumers are given a large suite of documentation, both regulatory and marketing communication materials.

In BETTER FINANCE's view, the European Commission and the ESAs could consider further streamlining and simplifying the information disclosed to "retail" clients, with the possibility for qualified, non-professional clients of opting out and receiving more complex or detailed information.

Q4: On the topic of disclosures, are there material differences, inconsistencies or overlaps between MIFID II and other consumer protection legislation that are detrimental to investors? Please provide details.

See answer for Q2 and Q3 – in addition, the most straightforward example is the duplication of disclosure of cost, risk, and performance information on an *ex-ante basis* under the MiFID II and PRIIPs/UCITS frameworks. In essence, if the PRIIPs/UCITS frameworks already provide *ex-ante cost disclosure* for MiFID II products, then product manufacturers and distributors should be exempt from the MiFID II requirements. Nevertheless, this circles back to the consistency between the PRIIPs framework and the sectoral legislation, as for those products that are not in the scope of the PRIIPs framework, consumers will receive a different type of disclosure that is not comparable with that in the KID.

Q5: What do you consider to be the vital information that a retail investor should receive before buying a financial instrument? Please provide details.

There are several types or categories of information that is vital for the consumer to read and understand before making a decision and buying a financial instrument, but it is paramount that the information is communicated in a simple and concise language (avoiding jargon) and in a format that does not demotivate the consumer from engaging and reading it. Possible solutions (in terms of the format) are listed in the *digital disclosures* section below, but in short lessons should be learned from the PEPP KID and the individual pension tracking systems work, where in essence the same exercise was done by EIOPA: depending on the layer, what information is key for the pension saver to know is a crucial element which will be, with the help of experts and stakeholders, decided.

In short, there are three main elements the consumer should receive before buying a financial product (we refer here to all categories of EU retail financial products):

- simple and clear description of the product and its investment objectives;
- the risk profile of the product;
- the total actual costs of the product; and
- the actual net performance of the product, in comparison with its benchmark, on long-term periods (10 years);
- additional key features, for instance if the product manager can undertake securities lending.

Q6: Which are the practical lessons emerged from behavioural finance that should be taken into account by the Commission and/or ESMA when designing regulatory requirements on disclosures? Please provide details and practical examples.

In the Technical Working Paper on the PEPP (1/2020 - https://betterfinance.eu/wp-content/uploads/BF-Technical-Working-Paper-PEPP-1_2020.pdf) published by BETTER FINANCE, the consumer's behaviour when faced with disclosures is explained, as well as the key elements that drive its engagement and understanding of disclosures. In short, "*information is easier to understand when it comes to combining text and graphics*" (p. 52), which is why we also refer to the next section on digital disclosures. Second, layering (which is the equivalent of vital information for paper-based disclosures) is key for consumers engaging and understanding the disclosed information. Third, disclosures (in terms of content and order in which information is presented) must provide the information that the consumer seeks to answer when reading

about an investment product. Thus, the disclosure document must guide the decision-making process of the consumer. Last, and highlighted for the questions above, the information (actual content) must not be abstract or ambiguous, must avoid jargon and must be simple and concise: "*Another important aspect is the use of comprehensible language, i.e. avoiding the use of technical terms used in financial economics, which should be explained in a way that the saver understands, because research has shown that he/she is easily discouraged if he/she encounters heavy texts and ambiguities that he/she does not understand*" (p. 52).
One other damaging behavioural bias is monetary illusion. So it is necessary for any mid to long term investment product to disclose and explain the compounding negative impact of inflation on returns over time. Mid and long term returns should be disclosed in real terms, not nominal ones, in particular for pension-related investment products.

Q7: Are there any challenges not adequately addressed by MIFID II on the topic of disclosures that impede clients from receiving adequate information on investment products and services before investing? Please provide details.

See answers to Q2 / Q3 / Q6.

Q8: In case of positive answer to one or more of the above questions, are there specific changes that should be made to the MiFID II disclosure rules to remedy the identified shortcomings? Please provide details.

See answers to Q2 / Q3 / Q6.

Q9: On the topic of disclosures on sustainability risks and factors, do you see any critical issue emerging from the overlap of MiFID II with the Sustainable Finance Disclosure Regulation (SFDR) and other legislation covering ESG matters?

The alignment and consistency of the regulations is crucial to ensure that the regulatory framework actually benefits the investor.

In the area of sustainability, the uncertainty about the scope of services and financial instruments covered by MiFID II and SFDR is problematic. As an example "portfolio management" is an "investment service" under MIFID II but a "financial product" in SFDR. In addition, the sustainability preference rules in MiFID II apply to "financial instruments" just to prove the point of non-alignment. At the same time, it is not at all clear under which circumstances financial instruments that are not covered by SFDR can be referred to as "sustainable". Moreover, MiFID and IDD´s distribution rules as far as IBIPs (insurance-based investment products) are concerned and should be aligned. The IDD does not contain detailed rules on the demands and needs test, and leaves it to Member States to decide on the details of how the test is applied in practice. This results in differences between Member States.

Second, MiFID and PRIIPs cost and performance disclosure information should be tackled as their discrepancy (MiFID uses a zero-return assumption while the PRIIP KID uses the cost disclosures tied to complex future performance scenarios resulting in diverging cost figures) creates confusion for individual investors , and could generate mistrust in the financial products itself, adding to the common sentiment that people are "ripped off" by the financial industry. The retail investors carefully studying all pre-contractual disclosure documents (e.g. MiFID and PRIIP KID) will indeed be confused as to why product costs are not aligned. This regulatory misalignment should be addressed through e.g. the insertion of MiFID/IDD disclosures points and methodologies in the PRIIPs KID by eliminating the overlapping information – if the PRIIPs KID already discloses costs and the effects on returns, the MiFID II ex-ante cost disclosure should be eliminated and distributors/advisers/sellers should direct to the PRIIPs KID (provided this one is thoroughly improved (re: SMSG reply to the EC Consultation on the retail strategy for investors).

At least In essence, future cost disclosure must in future be aligned to disclosing the same cost information (i.e. MiFID and PRIIPs) to retail investors. In a sense, overarching frameworks like MiFID and IDD should provide the overall cost disclosure points and methodologies, which can be simply inserted into Key

Information Documents. In any case, the current situation where the PRIIPs KID uses its own cost calculation methodologies (which are different to MiFID/IDD) must be avoided at "all costs".

Another example of the confusion is the use of the word and concept of "cost" which is different in MiFID II Cost & Charges, Best Execution and SI quotes, respectively.

In terms of comprehensibility of the terms used, it should be noted that some other regulations mandate the key terms or wording to be used, therefore limiting the ability of regulated firms to simplify their documentation or avoid jargon. The SMSG advises to make an overview of such problematic requirements (with the help of stakeholders).

Q10: Are there any other aspects of the MiFID II disclosure requirements and their interactions with other investor protection legislations that you think could be improved or where any specific action from the Commission and/or ESMA is needed?

See answer to Q2.

Q11: Do you have any empirical data or insights based on actual consumers usage and engagement with existing MiFID II disclosure that you would like to share? This can be based on e.g., consumer research, randomized controlled trials and/or website analytics.

Not available.

Digital disclosures

Q12: Do you observe a particular group or groups of consumers to be more willing and able to access financial products and services through digital means, and are therefore disproportionately likely to rely on digital disclosures? Please share any evidence that you may have, also in form of data.

Yes: based on BETTER FINANCE's research, the global lockdowns have prompted a wave of young, tech savvy savers to start investing in capital markets. In many cases, as is for the Netherlands, most investors prefer self-investing ("DIY") through online brokerage accounts. In addition, many other – previously active – investors have started to also open brokerage accounts with online providers, to use robo-advisors, or simply have started to use digital applications due to the heavy investments and financing by financial services providers in the digitalisation of services. Thus, a larger and larger group of investors are willing and able to use digital services and rely on digital disclosures.

Q13: Which technical solutions for digital disclosures (e.g., solutions outlined in paragraph 27 or additional techniques) can work best for consumers in a digital - and in particular smartphone - age? Please provide details on solutions adopted and explain how these have proven an effective way to provide information that is clear and not misleading.

The solutions provided in paragraph 27 of the consultation paper are additional, useful features of digital disclosures, with which BETTER FINANCE agrees. However, digital disclosures should be designed based on three key principles: layering and nudging (1), combining text and graphics to help the reader understand and (3) simplicity, clarity and comparability of information:

(1) the key or vital information should be presented in the first layer / first sections of the document, and it should be sufficient for the average saver to understand, compare, and make an informed decision; if warnings or comprehension alerts are mandated, digital solutions should be used to nudge the saver towards reading them;
(2) graphical representations must be designed in a way that it complements the text in the disclosure and helps the user better understand the information disclosed or concepts (such as hovering to obtain explanations);

(3) in line with the previous answers, digital disclosures must be "*fair, clear, and not misleading*" and the ESAs should better enforce their mandate of promoting simplicity. Consumers also need and want to be able to compare key and simple information between substitutable investment products on their smart phones. For example on risks, past performance compared to investment objective / benchmark, actual costs.

Q14: Would it be useful to integrate any of the approaches set out in paragraph 27 above in the MIFID II framework? If so, please explain which ones and why.

Yes, we agree with the approaches set out in paragraph 27, with the caveats mentioned in Q13.

Q15: Should the relevant MIFID II requirements on information to clients be adapted in light of the increased use of digital disclosures? If so, please explain how and why.

There should not be differences between paper-based and digital disclosures. However, since the principles or key recommendations of reform are the same for both types, paper-based disclosures should follow digital disclosures.

Q16: Do you see the general need for additional tools for regulators in order to supervise digital disclosures and advertising behind 'pay-walls', semi-closed forums, social media groups, information provided by third parties (i.e., FINfluencers), etc? Please explain and outline the adaptions that you would propose.

Yes, social trading and FINfluencers are an ever-growing phenomenon, which poses a series of risks and challenges. Our proposals are detailed in the section on *online brokers* below.

Digital tools and channels: Robo-advisers

~~Q17: To financial firms: Do you observe increased interest from retail investors to receive investment advice through semi-automated means, e.g., robo-advice? If yes, what automated advice tools are most popular? Please share any available statistics, data, or other evidence on the size of the market for automated advice.~~

Not applicable to BETTER FINANCE

~~Q18: Do you consider there are barriers preventing firms from offering/developing automated financial advice tools in the securities sectors? If so, which barriers?~~

Not applicable to BETTER FINANCE

Q19: Do you consider there are barriers for (potential) clients to start investing via semi-automated means like robo-advice caused by the current legal framework? If so, please explain and outline what you consider to be a good solution to overcome these barriers.

Currently we have not observed any barriers for potential clients to start investing in semi-automated/Robo advisors.

Q20: In case of the existence of the above-mentioned barriers, do you have evidence of the impact that they have on potential clients who are interested in semi-automated means? For instance, do they invest via more traditional concepts or do they not invest at all?

We did not observe any barriers.

Q21: Do you consider the potential risks and opportunities to investors set out above to be accurate? If not, please explain why and set out any additional risk and opportunities for investors.

Opportunities: BETTER FINANCE found these services to be attractive thanks to their cheaper, fee-based advice models: "*generally far simpler and more transparent fees from robo investing are also much lower than fees charged by 'human' financial advisors or private bankers*",[1] ranging between 0.69% and 1.69% (fund and wrapper fees included).

Most importantly, robo-advisors were offering – and continue to do so – overall cheaper services by using low-cost, index-tracking UCITS ETFs.

Risks: One of the main questions remains the accountability of algorithms and how to explain their functioning. There are common concerns that the use of algorithms creates risks in terms of consumer protection. Consumers are not aware of the technology used by such automatisation, and they lack understanding of the underlying process from which the investment advice is proposed. BETTER FINANCE in its annual research on Robo advisors observed divergences in asset allocation advice and expected returns**:** The research also analyses differences in terms of risk, asset allocation and expected returns for the two investor profiles.

Robo-advisors' algorithms generate significant divergences in expected returns, equity allocation and associated risk between platforms for the same investor profile.

In some cases, a conservative risk-reward profile composed of 51% of equities, is expected to yield more than twice as much as a portfolio with 90% of its capital invested in equities.

Also, the comparative analysis across 4 years reveals, besides important differences between platforms and investor profiles, significant divergences in expected returns between the years for the investor profiles on the same platforms.[2]

Q22: Do you consider that the existing MiFID regulatory framework continues to be appropriate with regard to robo-advisers or do you believe that changes should be added to the framework? If so, please explain which ones and why.

For the fourth time in a row, the findings of our robo-advice report show that several platforms provide investment advice The European Commission should consider adopting the CESR Guidelines on investment advice under the MiFID II Delegated Regulation (EU) 2017/565, in particular to clarify that:

- both explicit and implicit advice fall under the scope of Arts. 4(1)(4), 24(1), 24(7) and 25(1);
- implicit advice can take either the form of actions or behaviour, including written and oral communications, which by their purpose or reasonable impression, amount to investment advice as regulated under the abovementioned provisions
- practices meant to circumvent the rules applicable to investment advice are explicitly banned and sanctioned;

For the purpose of implicit advice, the Level 2 MiFID II regulation should clarify the two circumstances, i.e.:

- **purpose**: if the nature and aim of the communication is to guide or steer the client's investment decision in a certain direction through the power of the "*value judgment on its relevance*" towards the client;
- **reasonable impression**: if the communication/behaviour of the advisor makes the client believe that the recommendation is (a) made in consideration of his/her personal circumstances and (b) it is suitable for him/her.

The European Commission, with the advice of ESMA, EIOPA, and EBA, should harmonise the definition and applicable rules for financial advice across all EU categories of retail financial products.

Digital tools and channels: online brokers

[1] Ibid, p. 4.
[2] https://betterfinance.eu/publication/are-robo-advisors-sufficiently-intelligent-to-provide-suitable-advice-to-individual-investors/

Q23: Do you think that any changes should be made to MiFID II (e.g., suitability or appropriateness requirements) to adequately protect inexperienced investors accessing financial markets through execution only and brokerage services via online platforms? If so, please explain which ones and why.

Evaluating whether a certain financial product is aligned with the characteristics and needs of the "retail" client is a key safeguard as part of the financial services users' protection framework. However, the differing levels of protection awarded through the suitability, appropriateness, and demands and needs test bring limited effects for non-professional investors and create a regulatory burden in the distribution process. To begin with, the rules on the distribution process for EU retail financial product categories differ from one type of market to another.

In our view, the appropriateness test is not fit for purpose and falls short of delivering an adequate standard of investor protection. The current provisions are a middle ground between the suitability assessment and no protection, creating a regulatory and bureaucratic burden with limited effects for non-professional investors. This is because the knowledge and experience of the client relevant to the specific product is not sufficient for the seller to assess whether the product could be sold or not to the individual non-professional investor. The same reasoning applies for the creditworthiness assessment for mortgage credit: the seller should either inquire fully about the personal and financial circumstances of the client (incl. income, expenses) and his/her objectives or not distribute complex products.

The safeguard awarded for execution-only services, i.e. to distribute only non-complex products, is sufficient on the other hand; what would be relevant is for the distributor or financial services provider to warn the client, if an explicit request concerns a complex service or product, that a suitability assessment would be needed in that case.

Q24: Do you observe business models at online brokers which pose an inherent conflict of interest with retail investors (e.g., do online brokers make profits from the losses of their clients)? If so, please elaborate.

No, BETTER FINANCE's research did not reveal such practices, besides PFOF.

Q25: Some online brokers offer a wide and, at times, highly complex range of products. Do you consider that these online brokers offer these products in the best interest of clients? Please elaborate and please share data if possible.

BETTER FINANCE identified several issues or gaps between what EU law (MiFID II and IDD frameworks) define as complex products and what national supervisors and product manufacturers understand at local level. However, this is an issue of closer and more coordinated supervision (by ESMA, EIOPA, or EBA).

Q26: One of the elements that increased the impact on retail investors in the GameStop case was the widespread use of margin trading. Do you consider that the current regular framework sufficiently protects retail investors against the risks of margin trading, especially the ones that cannot bear the risks? Please elaborate.

No further input on this topic.

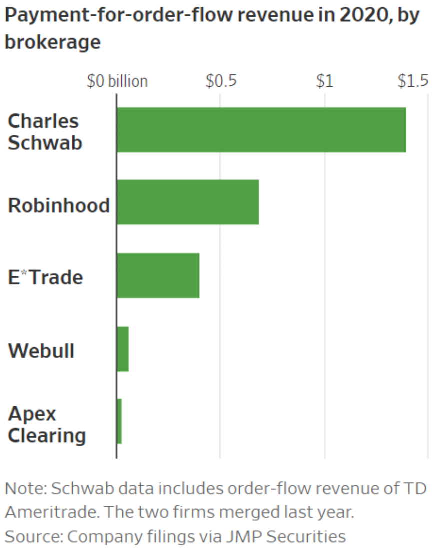
Q27: Online brokers, as well as other online investment services, are thinking of new innovative ways to interact and engage with retail investors. For instance, with "social trading" or concepts that contain elements of execution only, advice, and individual portfolio management. Do you consider the current regulatory framework (and the types of investment services) to be sufficient for current and future innovative concepts? Please elaborate.

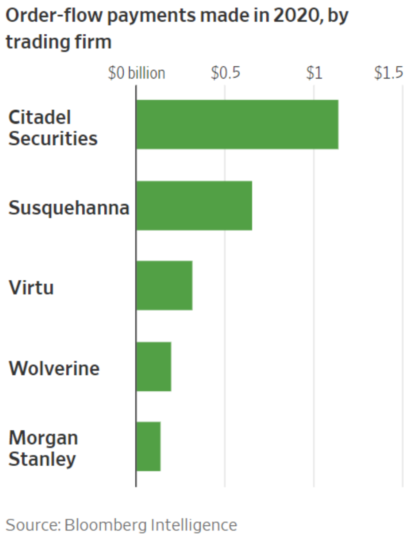
As highlighted in the Robo-advice report (2021 edition) and in Question 34 below, the most pressing challenges are the use of implicit advice or recommendations (*social trading*) and gamification. We consider that it would be helpful if the CESR guidance on investment advice would be transformed into a Level 2 regulation and replicated for other EU retail financial products categories. Regarding gamification, see our response to Q34 below.

Q28: Are you familiar with the practices of payment for order flow (PFOF)? If yes, please share any information that you consider might be of relevance in the context of this call for evidence.

Yes: BETTER FINANCE previously expressed its concerns regarding payment for order flow (as part of the large discussion on inducements) and the detrimental effects it has for consumers. In our view, PFOF should be banned for retail clients.

Evidence from the US is much more abundant thanks to SEC Rule 606 that requires both the payer and the beneficiaries to disclose the amounts paid and to whom. This is the last annual data for the main players. This information is public in the US but not in Europe:





The question is why a market maker or SI would pay more than one billion dollars to retail brokers to get their retail order flow. The obvious response is that they make at least that amount in extra revenues from these retail orders. How then can one not question whether these orders were executed in the best interest of the retail investors.

Q29: Have you observed the practice of payment for order flow (PFOF) in your market, either from local and/or from cross border market participants? How widespread is this practice? Please provide more details on the PFOF structures observed.

As highlighted in the aftermath of the GameStop case, many online brokers use PFOF and can generate consumer detriment. See our detailed recommendations concerning PFOF in the position paper available here: https://betterfinance.eu/wp-content/uploads/BETTER-FINANCE-Position-Paper-Consolidated-Tape-final-22112021.pdf.

Q30: Do you consider that there are further aspects, in addition to the investor protection concerns outlined in the ESMA statement with regards to PFOF, that the Commission and/or ESMA should consider and address? If so, please explain which ones and if you think that these concerns can be adequately addressed within the current regulatory framework or do you see a need for legislative changes (or other measures) to address them?

In terms of retail trading and market structures, see our recommendations in the position paper regarding the consolidated tape: https://betterfinance.eu/wp-content/uploads/BETTER-FINANCE-Position-Paper-Consolidated-Tape-final-22112021.pdf.

Q31: Have you observed the existence of "zero-commission brokers" in your market? Please also provide, if available, some basic data (e.g., number of firms observed, size of such firms and the growth of their activities).

No further input on this topic.

Q32: Do you have any information on "zero-commission brokers" business models, e.g., their main sources of revenue and the incidence of PFOF on their revenue? If so, please provide a description.

No, we do not have sufficient research or evidence on the topic.

Q33: Do you see any specific concern connected to "zero commission brokers", in addition to the investor protection concerns set out in the ESMA statement that the Commission and/or ESMA should consider and address? Please explain and please also share any information that you consider might be of relevance in the context of this call for evidence. Please also explain if you consider that the existing regulatory framework is sufficient to address the concerns listed in the ESMA statement regarding zero-commission brokers or do you believe changes should be introduced in the relevant MiFID II requirements.

We agree with the ESMA supervisory statement concerning PFOF and "zero-commission brokers".

Where zero-commission or neo-brokers provide services of safekeeping of shares, administration of shares or maintenance of securities accounts on behalf of shareholders or other persons, they are considered intermediaries by the SRD II. Where such intermediaries provide services to shareholders or other intermediaries with respect to shares of companies which have their registered office in a Member State and the shares of which are admitted to trading on a regulated market situated or operating within a Member State, they have to comply with the rules of SRD II and its Implementing Regulation. In particular, they have to facilitate shareholder engagement by facilitating the communication between issuers and shareholders especially around a general meeting. There are however strong shortcomings at neo-brokers in terms of voting rights execution and transfer of information for shareholders. Not only various neo-brokers do not ensure to offer these services, some even publicly state that they have no obligations to inform shareholders and facilitate their voting rights, which is contradicting the requirements of Shareholder Rights Directive (SRD II) and its Implementing Regulation.

Therefore, EU authorities should assess the compliance of online brokerage platforms acting as intermediaries with the SRD II requirements and address shortcomings in the transposition of the Directive and its Implementing Regulation into national law across Member States.

Q34: Online brokers seem to increasingly use gamification techniques when interacting with clients. This phenomenon creates both risks and potential benefits for clients. Have you observed good or bad practices with regards to the use of gamification? Please explain for which of those a change in the regulatory framework can be necessary. Do you think that the Commission and/or ESMA should take any specific action to address this phenomenon?

Indeed, many online brokerage platforms and/or neobrokers are prone to share market insights as a service and can regularly notify users of new assets or stocks availability. The merging of these commercial and educational aspects may have a strong impact on non-professional investors, to the point of leading to what has been coined as the "*gamification*" of investing.[3] As part of (novel) promotional tactics encouraging frequent trading, this trend has become more and more apparent. Therefore, the drive to take control of their finances among millennials and centennial (or 'generation Z') has skyrocketed.[4] Moreover, the UK's FCA voiced concerns about certain neobrokers "*online ads or high-pressure sales tactics to purchase higher-risk products, which in all likelihood are not appropriate*" for retail investors.[5]

[3] For example, novice investors entering retail brokerage in 2020 tend to have smaller account balances and to trade more frequently. – See "Investing 2020: New Accounts and the People Who Opened Them", FINRA Foundation and NORC at the University of Chicago, 2021, https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf; see also For the US Market, see Rick Fleming's Speech on the occasion of the *SEC Speaks,* 'Investor Protection in the Age of Gamification: Game Over for Regulation Best Interest?' (13 October 2021), available at: https://www.sec.gov/news/speech/fleming-sec-speaks-101321.

[4] Deloitte Center for Financial Services, *The rise of newly empowered retail investors*, 2021, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-the-rise-of-newly-empowered-retail-investors-2021.pdf

[5] https://www.bbva.com/en/finfluencers-financial-education-and-regulator-surveillance/

Thus, yes, BETTER FINANCE strongly recommends ESMA, EIOPA, EBA, and the European Commission to take action in this sense: first, undertake mystery shopping to observe the different practices across the EU, in order to identify if there are regulatory loopholes or there is a need for closer supervision.

Q35: The increased digitalisation of investment services, also brings the possibility to provide investment services across other Member States with little extra effort. This is evidenced by the rapid expansion of online brokers across Europe. Do you observe issues connected to this increased cross-border provision of services? Please elaborate.

No, we do not have evidence on this topic.

Role of social media

Q36: Do you observe an increasing reliance of retail clients on information shared on social media (including any information shared by influencers) to base their investment decisions? Please explain and, if possible, provide details and examples. Do those improve or hamper the decision-making process for clients?

BETTER FINANCE's recent research into the determinants of the increased retail trading during 2020-2021 points to evidence of the effect of news being spread much faster and wider through social networks. Research on the US market showed that the presence of retail investors may have been also media-driven, attenuating liquidity shortages and reducing bid-ask spreads.[6] Earlier research on the role of social media over the returns of a US index shows that "*social networks influence investors' decisions, and that this influence leads to a variation of market risk*", highlighting that the effects are more pronounced for non-technical investors.[7]

In addition, social media may have spiked the participation of young investors. Studies show that millennials are much more connected to one another (thus, multiplying herding effects), which comes on the background of growing consumer decision-making based on online reviews.[8] In other words, consumers are more and more inclined to rely on peers' experience and guidance, which seems to be the case also for investments.

A study found that, at the beginning of the pandemic, many retail "*investors turned to social media to search for and to discuss financial information*", which did have an impact on global stock market returns.[9] Empirical analyses showed a correlation between financial tweets and Google searches of COVID-related keywords. The first demonstrated that fear and uncertainty about the spread of the virus, as well as hopes about vaccines and treatment, spread rapidly through social media and were highly reflected in the daily returns of US indices.[10]

The second demonstrated a positive correlation between Google search queries and volume and the stock indices performances during the pandemic in 64 jurisdictions.[11] The latter finding is consistent with

[6] G. Ozik, R. Sadha, S. Shen, 'Flattening the Illiquidity Curve: Retail Trading During the COVID-19 Lockdown' (2020) Journal of Financial and Qualitative Analysis, Cambridge University Press, p.6, available at: https://www.cambridge.org/core/journals/journal-of-financial-and-quantitative-analysis/article/flattening-the-illiquidity-curve-retail-trading-during-the-covid19-lockdown/7D5EBA559DC12E2BD65D53E9BAE924A1; see also G. W. Eaton, T. Clifton Green, B. S. Roseman, Y. Wu, 'Retail Trader Sophistication and Stock Market Quality: Evidence from Brokerage Outages' (2021) Oklahoma State University, Working Paper, available at: https://ssrn.com/abstract=3776874.

[7] Juan Piñero-Chousa, Marcos Vizcaino Gonzales, Ada Maria Perez-Pico, '' (2017) 34(1) Psychology and Marketing, 101-108, 106, available at: https://onlinelibrary.wiley.com/doi/abs/10.1002/mar.20976.

[8] Randy Priem, 'An Exploratory Study on The Impact of the COVID-19 Confinement on the Financial Behaviour of Individual Investors' (2021) 16(3) Economics, Management, and Financial Markets, p. 13, available at: https://addletonacademicpublishers.com/contents-emfm/2216-volume-16-3-2021/4053-an-exploratory-study-on-the-impact-of-the-covid-19-confinement-on-the-financial-behavior-of-individual-investors.

[9] Mandy Chiah, Angel Zhong, 'Trading From Home: The Impact of COVID-19 on Trading Volume Around the World' (2020) 37 Finance Research Letters, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3700572.

[10] Mohammad Al Guindy, 'Fear and Hope in Financial Social Networks: Evidence from COVID-19' (2021) Financial Research Letters, p. 8, available at: https://www.sciencedirect.com/science/article/abs/pii/S1544612321003135.

[11] Chaiyuth Padungsaksawasdi, Sirimon Treepongkaruna, 'Chasing for Information During the COVID-19 Panic: The Role of Google Search on Global Stock Market' (2021) Cogent Economics & Finance, available at: https://www.tandfonline.com/loi/oaef20.

findings that the evolution of equity indices worldwide would seem less influenced by the pre-pandemic state of the economy and of the market itself, rather more by news about public health measures and macroeconomic intervention policies taken by public authorities.[12]

The power of social networks and forums, where peers share views, has also been demonstrated on the occasion of the GameStop case at the beginning of 2021.[13] This episode was, in our view, a clear footprint of the "social trading" trend, which is becoming more and more significant. The most recent ESMA report on *Trends, Risks, and Vulnerabilities* provides a large amount of useful insight on the additional determinants of the new retail trading environment, and what characterises it, including the "social trading" phenomenon.[14]

In many aspects, these new developments on social media can further increase the participation rate of EU households, especially the younger generations, into capital markets. This does not come, however, without risks: without adequate supervision, consumers can be mislead into making suboptimal decisions. Actions to be taken at EU level are :

- financial education campaigns, to reduce the reliance of financial services users on information shared through social media platforms, and adequate supervision of these practices.
- Regulating and supervising investment advice through social media, and also because more and more legal cases show that many influencers are paid to disseminate investment advice to their millions of followers: this is becoming in fact commercials or ads and should be regulated as such.

Q37: What are, in your opinion, the risks and benefits connected to the use of social media as part of the investment process and are there specific changes that should be introduced in the regulatory framework to address this new trend?

Research shows that some categories of consumers exhibit a tendency to trust peers more than other sources. As mentioned in the response for Q36 above, social trading can bring benefits, but also carries challenges from an investor protection point of view. ESMA also highlighted in a recent supervisory statement the rules that need to be observed when making recommendations online, to which BETTER FINANCE also adds the need to understand the differences between investment advice (implicit and explicit advice), investment recommendations, and sharing of objective information on social media. By taking these steps, coupled with the actions highlighted in Q36 above, the role of social media can be harnessed to its full potential of making finance more inclusive and bringing more retail savers to capital markets.

Q38: Are you aware of the practices by which investment firms outsource marketing campaigns to online platform providers/agencies that execute social media marketing for them, and do you know how the quality of such campaign is being safeguarded?

We have observed that social trading evolved into a fully-fledged movement with various communities and forums where non-professional investors get insights, share experiences, obtain financial information or explanations about investments. Recent statistics show that certain hashtags (keywords by which users find content, such as videos, profiles, photos etc) gathered enormous attention on social networks such as

[12] See Gunther Capelle-Blancard, Adrien Desroziers, 'The Stock Market is Not The Economy? Insights from the COVID-19 Crisis' (2020) CEPR Covid Economics, p. 28, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3638208.

[13] See BETTER FINANCE's Press Release "GameStop Case Highlights Discrimination of "Retail" Investors in Stock Markets", available at: https://betterfinance.eu/publication/gamestop-case-highlights-discrimination-of-retail-investors-in-stock-markets/.

[14] European Securities and Markets Authority, *TRV: ESMA Report on Trends, Risks, and Vulnerabilities* (1 September 2021) No.2/2021, ESMA-50-165-1842, see sections about *Consumers* and *Financial Innovation*, available at: https://www.esma.europa.eu/sites/default/files/library/esma50-165-1842_trv2-2021.pdf.

"#FinTok" (on TikTok) with 500 million views or "#investing" (TikTok and Instagram) with 3.82 billion views together.[15]

Trading platforms also launched their own forums where traders - ranked by popularity, profitability, or other criteria – share opinions with users.[16] In addition, brokerage platforms have also launched "gamification" formats, by which users are stimulated through competition or game-like features to invest.[17]

In light of these developments, many regulatory authorities reacted promptly to educate investors and warn those who publicise such content online about its risks and pitfalls. To mention a few, the Spanish securities markets authority (CNMV), the UK FCA, the Australian ASIC, New Zealand FMA,[18] and the EU's European Securities Markets Authority (ESMA) issued supervisory statements in this sense. For instance, ESMA reminded all those who participate in these online discussions of the regulatory requirements under the Market Abuse Regulation (MAR),[19] and of the sanctions (financial and criminal) for breaching these obligations.[20]

In France, a social media influencer was fined by the judge when the inquiry discovered that she was paid by the crypto-asset platform she was recommending to her million followers[21].

To date, BETTER FINANCE's research did not find other marketing campaigns outsourced by investment firms or product manufacturers, but we believe this to be a trend for the near future, which requires adequate supervisory exercises coordinated at EU level by the Joint Committee of the ESAs.

Q39: Have you observed different characteristics of retail clients, such as risk profiles or trading behaviour, depending on whether the respective client group bases their investment decision on information shared on social media versus a client group that does not base their investment decision on social media information? Please elaborate.

No, we do not have research or evidence in this respect.

Q40: Do you have any evidence that the use of social media (including copy/mirror trading) has facilitated the spreading of misleading information about financial products and/or investment strategies? Please elaborate and share data if possible.

See answers to Questions 36, 37, and 38 above.

Q41: Have you observed increased retail trading of 'meme stocks', i.e. equities that experience spikes in mentions on social media? Please share any evidence of such trading and, if possible, statistics on outcomes for retail investors trading such instruments.

[15] Vanessa Pombo Nartallo, 'Finfluencers: Financial Education and Regulatory Surveillance' (8 October 2021, bbva.com) accessed 5 November, available at: https://www.bbva.com/en/finfluencers-financial-education-and-regulator-surveillance/.

[16] See also Ines Freré, 'The Rise of Social Trading: How The Internet is Changing Investing' (7 October 2021, Yahoo! Finance) accessed 5 November 2021, available at: https://finance.yahoo.com/news/the-rise-of-social-trading-how-the-internet-is-changing-investing-153643100.html?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAD4_B0QuFeFqQ8WnyAlFjDNHwZRc62YG6aVRrFaC02GlaOaGhW2muaJXSHB5ZambjxLSX7_Pdsc0T8SUMkPSgiFRCK4h035JltpuCBSqpvbSDv52_EbTOdQXas1_uv3vR2_j6-NbIz3KYcat6JSG-Yu1F1H6_qKLlOdUDbRDBMBM.

[17] For the US Market, see Rick Fleming's Speech on the occasion of the *SEC Speaks,* 'Investor Protection in the Age of Gamification: Game Over for Regulation Best Interest?' (13 October 2021), available at: https://www.sec.gov/news/speech/fleming-sec-speaks-101321.

[18] Ibid, the authors makes a recollection of the recent public supervisory statements in a few reference jurisdictions – see Vanessa Pombo Nartallo, 'Finfluencers: Financial Education and Regulatory Surveillance' (8 October 2021, bbva.com) accessed 5 November, available at: https://www.bbva.com/en/finfluencers-financial-education-and-regulator-surveillance/.

[19] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, ELI: http://data.europa.eu/eli/reg/2014/596/oj.

[20] European Securities and Markets Authority, 'ESMA Addresses Investment Recommendations Made on Social Media Platforms' (28 October 2021) ESMA Press Release, available at: https://www.esma.europa.eu/press-news/esma-news/esma-addresses-investment-recommendations-made-social-media-platforms.

[21] https://deontofi.com/nabilla-arnaque-bitcoin-amende-20000-euros/

Yes, there is some evidence – albeit scarce – of such a phenomenon taking place. However, further and more granular research is needed.

Q42: Do you consider that the current regulatory framework concerning warnings provides adequate protection for retail investors? If not, please explain and please describe which changes to the current regulatory framework you would deem necessary and why.

In light of this section's topic, the BETTER FINANCE team is not aware of any particular warnings mandated at EU or national level about the risks of social media or social trading. In light of the EU Strategy for Retail Investments, this is an area that could be further analysed.

Open finance

Q43: Do you believe that consumers would benefit from the development of an 'open finance' approach similarly to what is happening for open banking and the provision of consumer credit, mortgages, etc? Please explain by providing concrete examples and outline especially what you believe are the benefits for retail investors.
BETTER FINANCE does not have input on the topic.

Q44: What are, in your opinion, the main risks that might originate from the development of open finance? What do you see as the main risks for retail investors? Please explain and please describe how these risks could be mitigated as part of the development of an open finance framework.
BETTER FINANCE does not have input on the topic.

Q45: Which client investor data could be shared in the context of the development of an open finance framework for investments (e.g., product information; client's balance information; client's investment history/transaction data; client's appropriateness/suitability profile)?
BETTER FINANCE does not have input on the topic.

Q46: What are the main barriers and operational challenges for the development of open finance (e.g., unwillingness of firms to share data for commercial reasons; legal barriers; technical/IT complexity; high costs for intermediaries; other)? Please explain.
BETTER FINANCE does not have input on the topic.

Q47: Do you see the need to foster data portability and the development of a portable digital identity? Please outline the main elements that a digital identity framework should be focusing on.
BETTER FINANCE does not have input on the topic.

Q48: Do you consider that regulatory intervention is necessary and useful to help the development of open finance? Please outline any specific amendments to MiFID II or any other relevant legislation.
BETTER FINANCE does not have input on the topic.

Q49: What do you consider as the key conditions that would allow open finance to develop in a way that delivers the best outcomes for both financial market participants and customers? Please explain.
BETTER FINANCE does not have input on the topic.