RETAIL INVESTMENT STRATEGY NEXT STEPS

RODRIGO BUENAVENTURA

Chair – Spanish Securities and Exchange Commission (CNMV)

RIS: moving to a larger market through quality and competition

The Retail Investment Strategy (RIS) is one of the most important and far-reaching legislative initiatives of recent years initiated by the European Commission. The objective pursued is necessary for the revitalization of European capital markets as a flagship measure aimed at deepening the Capital Markets Union: to broaden the retail investor base in the markets.

Despite the heated discussions and different positions it has caused in the industry, the investment community and the EU institutions, legislators have designed a wide range of measures aimed at improving the information that investors receive, making it more suitable for digital distribution and increasing transparency, accessibility and understanding in terms of costs and returns. It also includes measures to improve value for money, improving the quality of advice to clients and skills of advisors, financial education and the communications and dialogue with investors.

The two main issues of discussion focused on the concept of value for money in financial products and the prohibition of inducements in the fund distribution process. However, an important question remains: why is it necessary to regulate prices (to some extent) and rebates? Is competition not sufficient to expel the least competitive producers and distributors and to ensure that only the most efficient, best and cheapest products and providers survive? Why do we need to intervene products and commercial or management fees? Is competition not working properly? And, if so, why?

Part of the answer relates to complexity for retail investors in differentiating total costs charged, value for money obtained and in comparing products in a multi-variant fashion. Comparing products is not a one-dimension exercise (volatility, risk, price, target, fees, liquidity…all of those matter). But the other part of the answer relates to the difficulty of comparing providers and even combining providers. In the European investment distribution model, it is common for retail investors to invest through a single intermediary (in many cases, their general-purpose bank). Changing intermediaries, when a better product is identified, is an operational problem, having to reproduce all the necessary information (KYC, AML, personal profile, experience, suitability) in each and every one of the providers, keep multiple apps and websites and control different tax information sources, with all the operational problems and attached fuzz. Matters such as a digital portability of the client's profile - in terms of portfolio, investment experience, knowledge and investment profile - or aggregators of investments through multiple intermediaries in a single app or dashboard, are not yet widespread in the European investment services industry. This hampers true and effective competition and may be the reason behind more invasive regulatory measures.

The Retail Investment Strategy, fortunately, also contains a set of interesting proposals to redesign the information provided to the client, adapting it to the digitalization era that we are living in. These proposals, which have almost gone unnoticed, should make it possible to lay the groundwork for a healthier relationship between investors and providers and even expand the investment distribution model we currently have, in order to improve the experience of the retail investors, bring more competition and therefore better service and lower fees.

Why do we need to regulate products fees? Is competition not working properly? And, if so, why?

The main focus of the Retail investment Strategy should not be exclusively to expand the retail investor base. Quality of service, fairer treatment of clients, better tailoring to their investment profile, significant cost reductions and improved products should also be a major driver of the legislative proposal. Indirectly, better quality should also attract more investors to the market and strengthen the competitiveness of the European asset management industry, its efficiency and its growth.

Looking forward, when the trialogues conclude, the successful implementation of the new legislation, will greatly depend on the subsequent legislative development of the measures designed. One of them, the definition of benchmarks, will be one of the most complicated. The regulation will have to establish the principles, the comparison methodology and the different product clusters. Also, how to determine what levels of deviation from the benchmark are considered acceptable and what threshold deviations should be justified with a catalog of reasons explaining the deviations. A lot of further work is still needed to make this new regime work.

ALEKSANDRA MACZYNSKA
Managing Director – BETTER FINANCE

A missed opportunity to turn EU savers into investors

BETTER FINANCE, the European Federation of Investors and Financial Services Users has supported the EU flagship project – the Capital Markets Union (CMU) – from the very beginning. In 2023, we welcomed the publication of the Retail Investment Strategy (RIS) that had the potential to finally improve the situation for individual investors. Moreover, at the beginning of 2024 with the Eurogroup statement (calling e.g. for "low-cost investment products with appropriate risk return profiles for all EU citizens") and then subsequently with the Letta report we have been pleased to see more effort on the political level to look for solutions to drive retail participation in capital markets.

However, we have not seen this effort from the side of financial industry. There have been numerous independent reports and analyses published over the years with the accompanying evidence of the consumer detriment caused by the current state of the distribution system in the European retail investment market. Unfortunately, many market participants still fail to even acknowledge and address these core problems, instead opting for short-sighted defensive strategies like the ones proposed in the recent industry paper[1].

Moreover, apart from the EC, the co-legislators seemed to be more influenced by the industry point of view and than by consumers' best interest. The final text of the European Parliament's negotiating mandate from April 2024 and the agreement of the Council of the EU from June 2024 pave the way to start interinstitutional negotiations. Regrettably, the amendments introduced by the co-legislators are pushing the CMU (aka Savings and Investments Union) further out of reach and don't offer solutions to 1) access to good quality independent advice, i.e. competent financial advisors whose advice is beyond doubt in the interest of their client, 2) value for money (and in case something goes wrong there is no real access to an EU collective redress mechanism).

The EU Parliament and Council neglected the interests of retail investors and the establishment of a competitive CMU for the sake of keeping the status quo favourable for the financial industry that will not drive the retail participation. The European Commission's proposal was not perfect, in particular regarding its stated objective of ensuring "bias-free advice". Nevertheless, it included several significant advancements, notably on the Value for Money (VfM) requiring investment firms and life insurers to quantify and justify the costs of their products in relation to their performance ('value for money'). We were disappointed to see that the EP and the EU Council did not prioritise improving the financial wellbeing neither the competitivity of the European economy and effectively removed the crucial valuable elements of the Commission's proposal (like the ban of inducements on execution-only investments) or diluted them (like the VfM framework).

One of the most dire needs is the one for a clear and robust VfM framework.

BETTER FINANCE has put forward many concrete recommendations on the way forward in our Manifesto[2]. We remind that advisors should assess and recommend products based on their quality, i.e. their capacity to meet the investor's specific objectives and needs selecting the most cost-efficient products among those deemed suitable, and in line with the risk profile. Investors want advice, not a sales pitch. To this end, in our Manifesto we propose that the terms 'advice' and 'advisors' should be reserved for situations where a professional is remunerated by its client for researching and selecting the most suitable and cost-efficient products. One of the most dire needs is the one for a clear and robust VfM framework. However, reading the co-legislators' compromise texts we have concerns about its effectiveness as there would not be mandatory benchmarks integrated in manufacturer's and distributors' product governance process, but instead only European supervisory benchmarks and it is not clear how they should interact with peer group assessments conducted by companies.

The critical negotiations between Parliament, Council and Commission will take place behind closed doors. The obscurity of the trilogues process itself is not going to drive EU citizens trust in the new law either.

1. *BETTER FINANCE's comment on the recent industry's report Charting the Course: Unlocking Retail Participation in EU Capital Markets that was published on 11 April annexed to the report itself.*
2. *https://betterfinance.eu/publication/individual-investors-key-priorities-for-2024-2029-sustainable-value-for-money-reconciling-individuals-enterprises-the-planet/*

JEROME LACHAND

General Secretary – CCF Group

European Retail Investment Strategy: two important success factors

Further incentivize individual consumers who wish to invest in EU capital markets : the Retail Investment Strategy (RIS) approach is fully in line with the previous regulations (MIFID and IDD in particular), that banks and insurers have been implementing for years now. The need for the regulator to come back on the same issue tends to show the complexity of the topics. This should lead to pay a specific attention to two sets of issues in particular, to ensure the goals are properly met.

1. A principle based regulatory approach will make this new regulation more effective

Within the EU, diversity prevails in terms of cultures, markets, laws, banks. Given the current market fragmentation, a fully harmonized set of rule will be more effective if implemented via a flexible framework under the supervision of the national competent authorities (NCA).

A principle-based approach allows banks to tailor their implementation strategies to their specific contexts and business models. This flexibility is crucial for small or medium-sized banks that may not have the same resources as larger institutions but need to comply with regulatory standards effectively.

By focusing on the desired outcomes, such as enhanced investor protection and market transparency, rather than prescriptive rules, banks can innovate and find efficient ways to meet regulatory objectives. This encourages a culture of compliance that aligns with business goals and client needs. It would foster innovation by allowing banks to explore diverse solutions to meet regulatory requirements, such as investing in fintech and digital platforms to enhance their service offerings.

Principles provide a robust framework for risk management by emphasizing the importance of sound judgment and ethical decision-making. This can help banks develop more effective risk management practices that are tailored to their unique risk profiles and business environments.

Adopting a principle-based approach can improve client trust and satisfaction by demonstrating a commitment to high standards of conduct and client-centric service. This can strengthen client relationships and loyalty, which are critical for banks competing in a crowded market.

A principle-based framework can help banks use their resources more efficiently by focusing on high-impact areas and avoiding the rigidity of prescriptive rules. This can lead to better resource allocation and more effective compliance strategies.

Two RIS success factors: principle-based regulation and strong banks advisory role.

2. Banks' advisory role should be promoted

One of the challenges to be taken up is to improve EU retail customers' understanding of financial markets. In addition to public sector initiatives to promote financial literacy, such as educational programs and online tools, banks can and should play a pivotal rule.

Banks are employing experienced financial advisors with a good knowledge of market trends and investment products. This investment in staff education should be pursued: banks should expand certification programs for bank advisors to ensure they possess the necessary knowledge and skills to provide high-quality investment advice. Promoting ongoing training and professional development for bank advisors would keep them updated on market trends, regulatory changes, and innovative investment strategies.

Highly skilled advisors will make the difference when discussing with customers the best investment possibilities. Because of their knowledge of their customers, they will provide suitable advice aligned with clients' best interests. This could also involve adopting data analytics technologies to better understand client profiles.

In the CCF, our advisors are already keen to propose the best products for the customer regardless of productor. In todays' bank highly competitive environment, the upcoming "value for money" test is something that already exist, otherwise affluent customers in particular are quick to move to another bank. Decoupling more production and distribution could allow for an enhance level of competition within the industry, and ultimately benefit to the final retail investor.

Expanding bank's advisory role obviously has a price, that banks need to be able to ultimately charge to the customer in a transparent way. That is why any regulatory ban on inducement should be carefully weighted. Automation helped the industry to significantly lean the securities management process over the past years, and customers have to benefit from these evolutions. Time has probably come for banks to step up their investment in human capital.

The significant additional costs that the RIS project will impose to EU banks who are facing an already highly competitive market is a clear challenge. But there might be a path to a joint success, if the regulation is implemented in a way that will allow for local flexibility under the NCA's close scrutiny, and if banks invest more in their human capital.

GIULIO TERZARIOL
Chief Executive Officer, Insurance – Generali

Retail Investment Strategy at the service of an Investment and Savings Union

The RIS proposal aims to position citizens and investors at the center of regulatory design and implementation. Positive impacts in terms of market accessibility are foreseen, following the enhanced transparency of PRIIPS and the effort to promote financial education. The latter, alongside sound and meaningful advice, is crucial for secure and efficient participation in financial markets. However, to unlock the full potential of retail investment in the EU, Generali believes that some elements could be further improved during the finalization of the political discussions. The most relevant are:

Inducements: Generali, despite opposing a total ban on inducements, appreciates that the restriction was limited to independent advisors by the Council and the European Parliament. While we expect the final agreement to reflect these elements, concerns remain about the 'inducement test', whose adoption appears complex. In addition, the possibility for varied local implementation approaches could disrupt the Single Market's uniformity negatively impacting market functionality.

Value for Money: The latest political developments have reduced operational workload by curtailing reporting obligations, through the exclusion of data submission already accessible via the IBIPs KID and other existing reports. Furthermore, additional European regulations regarding the definition of VfM methodology and the criteria for justified and proportionate costs have been excluded. However, the focus remains mainly on costs and performance, and we recommend the inclusion of additional elements to fairly consider for instance the value of advice or the financial stability of the product manufacturer.

Benchmarks: both EU benchmarks and the peer grouping analysis are maintained in the co-legislators' positions and manufacturers will be charged a fee for the provision of peer group data. This approach will be a considerable challenge in case benchmarks are made public. They could be perceived as implicit definitions of thresholds or caps along the different dimensions analyzed. Companies could therefore start focusing only on the elements captured by the benchmarks, thus limiting product innovation and excluding features that might effectively provide value, leading ultimately to less choices for the customers and degrading the competition between products.

Industry attention on RIS persists despite the important developments from EP and Council proposals.

Furthermore, if the proposed benchmarks (which would not reflect the complete value proposition of insurance-specific solutions due to a simplified reporting) are made available to the public, there's a concern that customers may misinterpret them, potentially leading to choices that don't match their requirements and needs. This might be more pronounced for customers with less financial literacy or those using self-service or direct platforms. In this sense, financial education is a fundamental lever to guarantee customers' protection. Our recommendation would be to maintain the use of benchmarks for regulatory activities, excluding the introduction of further "peer grouping" as it appears to be a duplication with disproportionate effort and without clear benefits .

Best Interest Test: We also welcome the proposed improvements to the best interest test, including the exclusion of the reference to the "cheapest option". However, some refinements are still needed to make it more suited for the insurance market (e.g. wide products catalog still required, lack of qualitative elements to reflect customer needs).

Finally, we very much support the view that the Retail Investment Strategy's political outcome should be framed within the objectives of a Savings and Investment Union, as per the Political Guidelines of President von der Leyen and the Letta Report: this should be the blueprint for action for the 2024-2029 political cycle, which presents a pivotal opportunity to embrace a renewed, comprehensive approach to EU policy action. It is therefore key that the RIS attains the objectives of genuinely facilitating an investment and risk-taking culture in Europe, whereby consumers are encouraged to shift their savings from bank accounts to the capital markets. In this endeavor, co-legislators should be guided by the need to empower citizens so they can consciously participate in capital markets by making investment practices simple and transparent.

The finalization of the RIS proposal is crucial to steer a paradigm shift in the way retail investors perceive and access EU capital markets. Notably, long-term returns on retail investments can help increase household wealth and support retail investors with their financial planning. For example, saving for retirement, in addition to state pension systems, can help close the growing pension gap and ensure adequate resources for retirement. Moreover, mobilizing EU citizens' savings will increase the liquidity and depth of EU capital markets contributing to the development of the real economy and driving further growth through long-term investments.

DANIEL KAPFFER

Chief Financial Officer & Chief Operating Officer – DekaBank Deutsche Girozentrale

Retail investors increasingly understand the need to invest – but still deterred

Historically retail investors did not have a strong desire to invest into capital markets. Retirement benefits have largely been based on state and company pension schemes – up to 75 % in some countries. Additional savings were mostly invested in life insurance and private pension funds and not directly into the market. However, an aging society means that the traditional pension schemes will not be able to sustain the level of benefits anymore. Another factor is the low interest rate environment. Hence retail clients are becoming increasingly aware –28 % have already invested in financial products.

In addition the green and digital transformation cannot be financed just by states or banks.

So if investing in capital markets should be desirable why is the majority of the population not doing so? here are two reasons. The first one is widely accepted – the lack of financial literacy. Most educational systems in Europe do not cover finance in school at all. While this has to be fixed at national level, the legislation on the European level needs to support investment advice. And secondly ease of investing. Well intended but way to complex rules aiming at investor protection deter retail clients from investing into capital markets and give an incentive to investment managers to provide less complex but also less attractive types of investments.

Need for personal advice to access the capital market

One of the main barriers to retail financial investment is indeed the lack of financial literacy and risk culture. Most customers have a lack of understanding of financial instruments and their view tends to associate capital markets with gambling. This means that most consumers need personalized advice to find a suitable investment and build their confidence. Trying to educate consumers to a level where they all can be investment managers themselves underestimates the level of know how required.

However providing investment advice is costly and implies conduct risk. It requires a thorough understanding of the consumer's financial background, his investment goals and willingness / ability to bear losses. While charging the cost of investment advice appears to be more transparent it would deter a significant proportion of consumers from investing in capital markets instead of increasing the participation. So giving the consumer the freedom to choose between fee and commission based models is essential. In addition very often, consumers use non-advised services in the aftermath of investment advice.

Need for personal advice to access the capital market.

At the savings banks, customers are free to choose whether they want to place an order with an advisor in the branch, on the phone without advice, or whether they want to execute it themselves through app or online banking. Customers can switch between channels or even into the advisory service at any time ("multi-channel approach"). More than half of non-advised orders are placed via an advisor - in branch or by telephone.

Value for money clause - no need to repeat history of overregulation by MiFID

The complex investor protection rules of MiFID lead to irritation and uncertainty among customers and deter them from investing. Most of the required documentation is focused on downside scenarios and risks. Sometimes they sound like information sheets provided to patients for surgery.

The RIS was intended to make the investment processes more consumer-friendly and convenient. Instead, the processes are becoming even more complex and cost-intensive due to additional review obligations (expansion of the appropriateness review). The information obligations are to be extended once again (e.g. disclosure of the impact of inducements on returns, disclosure of the calculation method for estimated costs, obligation to provide information also to professional clients and eligible counterparties).

The current value for money proposal focuses on costs and does not take into account the actual qualitative elements of the products and services offered to retail investors. Such an approach would further limit choice without offering additional benefits to investors, ultimately favouring passive allocations via ETFs. As a result, the systemic risk of unidirectional investments will increase further.

A comprehensive assessment of value for investors should go beyond cost considerations. These factors include performance outcomes, the quality of services provided, sustainability outcomes, and effective risk management. The task of the asset manager is to manage default risks which must be done actively.

Furthermore, the main contents of the new requirements are either vague ("best interest test") or are shifted to Level II ("value for money test"), which means that there is huge legal uncertainty regarding the specifics of these regulations.

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