Retail Investment Strategy next steps

1. Objectives of the Retail Investment Strategy proposal and progress made

1.1 A key component of the CMU

The Chair noted that the Retail Investment Strategy (RIS) is a key proposal of the Capital Markets Union (CMU) initiative, but it is also quite controversial in some respects and has led to heated debates.

A public representative stated that with the start of the new political cycle in Europe we are in a 'make or break' moment to develop the EU's CMU. The end goal is to make European capital markets more attractive for citizens and companies to address the EU's huge financing needs. This work started in 2015, but there is now a significant political momentum around the CMU project, which has to be taken advantage of. Europe needs €800 billion per year to fund its objectives such as the green and digital transitions and defence. Since public financing capacity is limited, retail savings must be put at better use to support these financing needs, which is one of the objectives of the RIS. Making the CMU a reality would better channel the more than €35 trillion household savings into the EU economy.

An investor representative considered that the objectives of the RIS proposal to create an attractive environment for retail investment in the EU are relevant. As underlined in the Letta report, the EU is home to €35 trillion of private savings, mainly held in currency and deposits, while also facing the challenge of the pension gap and of providing the necessary financing for the digital and green transition. To encourage citizens to invest, they need to receive decent real returns on their investments and value for money.

1.2 Objectives of the RIS proposal and progress made

The Chair noted that, after the adoption of positions by the European Parliament and the Council on the RIS proposal, the trilogues are ongoing and will be pursued in the coming months.

A public representative stressed that the trilogues must ensure that the RIS proposals remain in line with and support the CMU objectives, which are to support a drive towards a stronger, greener, more digital and more autonomous Europe. Retail savings must be channelled in an inclusive way into the investment needed for Europe. The negotiating positions that have been achieved by the Parliament and the Council go in the same direction and trilogues will be an opportunity to improve the text, by addressing the question of simplification for example. Taking a holistic approach, the Parliament did not ban inducements but strengthened value for money (VfM) requirements. In addition, other priorities were addressed. Financial literacy actions, which are essential for the success of the RIS, were reinforced with more ambitious proposals. Tools are also provided to protect consumers from 'finfluencers' in a context of increasing digitalisation and to help supervisors act more efficiently.

There is however still a significant amount of work ahead to turn the RIS into a reality. The Commission, the Council and the Parliament will have a key role to play in maintaining momentum during the implementation phase of RIS and ensure that all stakeholders are on board.

An official stated that the RIS must be assessed in the context of its primary objective, which is to encourage European citizens to move more of their bank savings into the capital markets. To achieve this, it is critical to boost investor confidence while simultaneously protecting them from potential pitfalls and ensuring they receive high-quality advice. The Council has sought to strike this balance in its approach to the RIS.

An industry representative expressed strong support for the objectives of the RIS, but noted that there is a discrepancy between the CMU's objective of channelling more savings to the capital markets to finance the green and digital transformation and being very cautious about the risks taken by retail investors, with strict investor protection measures. Moreover, the primary focus of RIS should be on ensuring that citizens can save for their retirement, rather than on channelling retail investment into projects aimed at transforming the European economy.

1.3 Conditions for a successful implementation of the RIS

An investor representative observed that the Letta Report has rightly pointed out that tangible progress on the CMU and the further integration of EU capital markets will only be possible if it is clear that the integration does not just serve the finance sector. The problem is that the current status quo and the current positions of the Council and Parliament on RIS are more in favour of the financial sector than of retail investors. There are positive elements in both texts, but neither is a game-changer for retail investors.

The initial RIS proposal set out by the Commission had the potential to introduce positive changes into the market, the most important elements being value for money and a move towards high quality independent financial advice. The Council position acknowledges these issues and proposes principles to be respected, such as treating third-party and in-house products equally, or putting in place a mechanism for reclaiming inducements in case client interests have been harmed. However, the European Parliament has chosen to delete the proposals made by the Commission on inducements in the report it adopted, which does not go in the direction of high quality independent financial advice.

A further question concerns the enforceability of the principles proposed and whether the RIS measures can

be appropriately implemented. For example, the proposed rules on inducements indicate that inducements accepted and retained must not directly benefit the recipient firm, its shareholders or employees without tangible benefit to the client, but the question is who determines what benefits are tangible and how they should be measured.

An industry representative was concerned about the complexity and stringency of the measures proposed in the RIS, which could deter customers from investing in capital markets. The current investment process, which involves filling in many documents with a strong emphasis on investment risks, is already quite cumbersome and time-consuming, which goes against current trends, supported by digitalisation, to simplify access to financial services. RIS should not further complicate the investment process, as this may deter retail investors. In Germany, many people prefer a 3% return on their savings account to a potentially higher return on the capital market because it is easier to manage and savers are not always aware of the impact of inflation on interest rates.

Another industry representative stated that the EU Parliament's position on RIS is a step in the right direction and has good intentions, although some details need to be fine-tuned. Ensuring that there is sufficient investor protection and that retail investors receive sufficient value for money and quality advice are valid objectives. It is important to build on the current system in Europe, which works well. Effective investment products are available, many customers buy them and take investment advice, and financial institutions do their best to engage with their customers. But more needs to be done to ensure that regulation is effective and balanced. The RIS is about consumer protection but it is also about enabling consumers to access better investment opportunities. If investor protection rules are too strict, the second objective may not be achieved.

An official pointed out that regulation can help to improve the consistency of the framework for retail investment across the EU market, notably in terms of transparency, but agreed that over-regulation such as potential price controls in the context of the value for money proposals should be avoided.

1.4 The case for a more principles-based approach to the RIS

An industry representative stated that the objectives of RIS are in line with the MiFID and IDD directives. The need to revisit the same issues after 10 years shows the complexity of the issue, but may also indicate that the regulatory approach used so far needs to be reconsidered.

A more principles-based and less rigid approach to the RIS would be more effective, allowing financial institutions to focus on high impact areas. Such an approach, which focuses on achieving outcomes rather than implementing prescriptive rules, would allow financial institutions to better tailor their implementation strategy to their specific contexts and business models, taking into account cultural differences across Europe. Small and medium-sized financial institutions in particular, would be able to use their more limited resources more efficiently to find new solutions to serve retail investors. This would promote a culture of compliance where business objectives are aligned with customer needs and would encourage innovation by allowing banks to explore different solutions, such as investing in fintechs and digital platforms, to meet regulatory requirements and enhance their service offering. Principles can also provide a robust framework for risk management by emphasising the importance of sound judgement and ethical decision-making, allowing financial actors to tailor their risk management practices to their unique risk profiles and business environments.

A principles-based approach can also help foster the trust that is essential to encourage retail participation in capital markets by focusing financial institutions on achieving high standards of conduct and customer-centric service under the supervision of national competent authorities (NCAs). This approach will also help to strengthen customer relationships and loyalty. For example, a strong know-your-customer (KYC) approach is much more effective than a long, standardised questionnaire.

2. Inducement rules: pending issues and next steps

A public representative stated that the Commission's initial proposals on inducements only focused on tackling conflicts of interest and did not take sufficient account of other aspects, such as the potential impact of a ban on inducements on access to advice and inclusiveness of investment. A ban on inducements would reduce access to investment for most average savers by making advice too expensive. After the Netherlands introduced its ban on inducements in 2013, the percentage of customers receiving advice fell from 21% to 5% between 2013 and 2021, providing a cautionary example of the potential negative impact of a ban. Enhancing financial literacy is also essential. Ambitious proposals were made by the Parliament that will hopefully be taken up in the final text.

An official agreed that many retail investors rely on advice and it is difficult to provide advice in an accessible way without inducements. The focus on reducing costs and ensuring value for money must be maintained to address potential conflicts of interest. Alternative approaches aiming to maintain the availability of objective and high-quality advice have been explored by the Council. The forthcoming trilogue discussions will determine in particular whether the inducement test proposed by the Council can provide clarification. Further measures are also needed to enhance financial literacy.

An industry speaker believed that an inducement ban would prevent most people from obtaining proper advice. This would be problematic, as self guided investors generally do not take enough advantage of the possibilities offered by capital markets. They tend to have insufficient diversification and excessive concentration in certain risky assets, which do not correspond to a long term investment strategy for retirement.

An investor representative disagreed that people who have enough savings to invest in capital markets cannot afford independent advice. They should be willing to pay for independent advice that can provide better long term outcomes. A case study conducted on the French market showed that one off independent advice is cheaper than non independent advice with recurring trading commissions. Customers who cannot afford independent advice are usually those who do not need it and would rather need broader financial guidance for example about the risks of indebtedness.

It is also important not to overestimate the impact of financial education, which cannot be considered as a substitute to independent advice. A study conducted by the Central Bank of Ireland shows that people with very high financial literacy are not much more effective than average savers in taking care of their own financial future and pension. EU citizens should be able to benefit from independent financial advice, and there should be more nudging to increase their participation in capital markets.

In addition, while financial education is essential for achieving the objectives of the RIS, it is challenging to implement and this will take time. Financial education should be part of the school curriculum, but it is a long-term project that will not yield significant results until 10 or 20 years later. It is also very difficult to bring adults back to the classroom. Financial education for adults should mainly happen at the point of sale, but this is currently not happening there because advisors are mostly sales representatives of in-house products trained to sell those products and incentivised for their sale. Developing independent advice is vital, as it would allow consumers to get access to and information on the products that are best for them. That has to be combined with efforts to improve financial literacy over time.

A second industry representative agreed that both advice and financial literacy are needed. Advice is sometimes presented as a palliative for insufficient financial literacy, but it is essential, even if consumers are more literate. Improved financial literacy can help customers better understand the different products proposed and ask the right questions when they discuss investment options with an advisor, but it does not enable them to be fully autonomous in most cases, because investment is a complex subject.

A third industry representative emphasised that financial advisors play a key role in building trust. Banks strive to recruit experienced financial advisors and invest in training their staff. Certification programmes should be expanded to ensure that all advisors have the right level of skills. KYC is also very important, because if advisors know their clients well, they are more likely to recommend relevant products. If this is not the case, customers, especially the most affluent ones, will move to another bank. However, investing in staff training to achieve high quality advice comes at a cost, which in one way or another must be passed on to the client.

The Chair noted that an interesting question is whether it is preferable for customers to pay knowingly and specifically for advice, or if it is better to embed it in the overall cost of the service or product.

3. Value for money requirements: pending issues and next steps

An official highlighted that the main objective of the value for money (VfM) measures of the RIS is to eliminate outlier products that are excessively costly. VfM measures introduced in France for unit-linked insurance products and also in Denmark and the UK have shown positive results,. These measures can be effective if they are flexible and avoid unnecessary complexity. However, the financial industry has expressed concerns that the RIS's VfM provisions could create additional regulatory burdens at both the national and European levels. How they can be simplified while preserving their effectiveness will be discussed during the trilogue negotiations.

An investor representative stated that the Commission's VfM proposal was not perfect, but it required firms to list and quantify all costs and it required manufacturers and distributors to compare the cost/benefit balance of products. Producers should be able to say how much it costs them to make a product and it should be possible to analyse the market to evaluate the competitiveness of different producers. The pricing process remains a VfM assessment in the Council text, which maintains the requirement to identify and quantify costs, as well as the other benefits of products..

The benchmark proposals to evaluate VfM referred to peer group comparisons. This is useful for identifying outliers, but will not work if the whole market for a particular type of product consists of expensive, underperforming products. A comparison with the performance of the underlying assets in which the products invest would be useful, but is not mentioned in any of the current proposals on RIS. The Council's proposal that supervisory VfM benchmarks should be made public is welcome, as is the fact that these benchmarks should be conducted at European level. National benchmarks should be limited to cases where they have already been implemented before July 2024, as RIS should promote a single market for capital in line with the CMU.

An industry speaker commented that VfM should be about getting value for the money spent and not only about costs because low cost products are not always adequate and do not necessarily provide the best return. Including an insurance component in an investment solution has a cost for example. In addition, VfM measures should not lead to an obligation to disclose profit margins, because it might be misleading and is not required in any other industry. Disclosing fees and charges can be helpful, but profit margins require complex aspects to be taken into account such as the cost of capital associated with protections and guarantees.

If the VfM benchmarking concept is applied in an overly restrictive and complex manner, it could reduce consumer choice and ultimately drive some investors away. Product diversity is valuable, and it is important to avoid a system that forces all offerings toward a limited, one-size-fits-all benchmark. This could lead companies to focus only on aspects directly measured by the benchmarks, limiting innovation and excluding

potentially valuable features. The result would be fewer options for customers and diminished competition among products.

The Chair questioned whether achieving VfM requires regulatory measures or if it should be the result of effective competition. The reasons to introduce specific VfM regulatory measures could be that complexity makes it difficult for consumers to compare products, that integrated distribution channels prevalent in Europe mean that consumers do not look beyond the bank where they have their account, or that retail investors lack the knowledge and experience to compare products.

An investor representative agreed that VfM is not necessarily a question of regulation. Effective competition should normally lead to well performing products and cost-efficient intermediation. However, assessing the degree of competition in financial services markets is complex. Open finance and digitalisation could help to enhance competition.

An industry speaker suggested that competitive market forces should be the main driver to improve the product offering and drive inefficient products out of the market. The current VfM proposals are not moving in the right direction and should rather focus on improving transparency. There is already a significant degree of transparency in the investment product market, but reporting by product providers could be made more systematic, consistent and independent. In Germany, for example, customers can access a database that compares current account costs, to which all providers must contribute. This would be a more pragmatic and simpler way to compare products without interfering with pricing decisions, which should remain the responsibility of the firms providing the products. In addition, competition is not lacking in the market; there is strong competition from digital players and fintechs leading to increasing demand for low cost securities accounts and zero fee trades.

4. Further aspects to consider for developing retail investment beyond the RIS proposals

An industry speaker considered that taxation and Pillar 2 and 3 private pensions are key drivers to encourage retail investors to invest in the capital markets. The open finance framework can also be helpful to facilitate innovation and competition.

An official highlighted that digital tools could help to improve the transparency, simplicity and affordability of investment solutions, but potential concerns need to be addressed. Digital tools and improved analytics could lead to overly individualised risk assessment. This could limit the possibility of offering insurance, which is by nature mutualised across customers. In addition, while increased data sharing can facilitate the development of more appropriate products and services, it should not go so far as to require incumbents to share proprietary models or data resulting from internal assessments with new entrants, potentially giving them an unfair advantage.

A public representative agreed that further work is needed on digitalisation, which is reaching a tipping point in the market. Other proposals made in some reports on the future steps of CMU also need considering, such as the creation of new European long-term savings products.