How to develop retail investment in the EU?

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No Capital Markets Union without active retail investors' participation

Growth of retail (direct) investments has been a hot topic in recent years' lively debate about policies to increase participation in capital markets.

Fostering retail access to finance has been one of the main goals of the Capital Markets Union project since the initial 2015 Action Plan, and, in this respect, relevant suggestions have lately been provided by both "The Next CMU High Level Group" and the "High level Forum on the CMU".

Issues include a material rise of investors' financial literacy, the need of high-quality, fair and independent financial advice, and the overhaul of disclosure requirements leaving behind the current paper-based approach to dive into a new digital model able to promote intelligibility and comparability.

Particular attention has been especially paid, moreover, to the suggestion of a more proportionate MiFID classification by adding an additional client category ('semi-professional investors'). I think that it would be extremely important, but not enough: it is time to shift the focus from regulation to supervision.

In order to facilitate, or at least not to hinder, non-professional participation in investments, particular attention should be paid in the application and the enforcement of the whole legislative package (MiFID 2, UCITS, AIFMD) on financial products distribution.

A strict translation of the investor protection mission into an overly prudent set of conduct practices by intermediaries could indeed refrain non-professional investors, even in case of the welcomed introduction of the new semi-professional class.

I do understand that easing retail investors direct access to equity or bond instruments (particularly when issued by SMEs or negotiated on SMEs Growth Markets) is considered a controversial topic, particularly in a time, or in countries, recently hit by financial fraud and corporate bankruptcies.

At the same time, however, turning savings into new means of corporate financing becomes crucial in the aftermaths of systemic crises. Post COVID-19 recovery can be funded, after the paramount fiscal response, only with a huge support from private investors aiming at strengthening the capital structure of likely highly-indebted companies.

EU Capital Markets Recovery Package measures proposed by the European Commission at the end of July go in this direction of facilitating investments in the real economy and enabling recapitalisation of listed companies.

All these efforts could however be squandered by local supervisory practices and enforcements regimes that aim in good faith to "protect" retail investors – even those more experienced and financially sound - by means of implicit bans and prohibitions but it may end up in an overly paternalistic framework. Such a supervisory barrier results even more dangerous in the age of permanently low interest rates and historically expensive stock markets. Finding appropriate returns on the usually invested asset classes (large cap stocks, investment-grade bonds) is, and is probably bound to be in the long run, almost impossible for (retail) investors.

> *No trade-off between investor protection and capital markets development because there is no protection to provide in a world without retail investors.*

Halting them from considering, in a well-diversified portfolio, more illiquid but remunerative alternatives and accessing the private (equity or debt) markets, poses a serious problem of inequality in the distribution of financial well-being pushing millions of European consumers into a definitive loss of trust in financial markets. The EU Commission and ESMA should play a fundamental Level 4 role: there will be no CMU without investors' active participation in financial markets.

It is not a matter of trade-off between investor protection and capital markets development, because there is no protection to provide in a world without retail investors.

Investors protection has always been and must remain the guiding light of securities supervisors.

But the lighthouse on the hill flashing towards a sea without ships plays no other role than giving rise to Sunday painters' vanity. ●

Martin Merlin

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More participation of retail investors in financial markets: a worthwhile goal

The current macroeconomic picture confirms that the policies the Commission is pursuing in the financial sector are heading in the right direction. Indeed, everything points to the necessity of increasing the involvement of households in financial markets: public pension systems are under growing pressure due to the ageing population, public finances need to move more swiftly between priorities (today they are health and research, but in the future they could be different), and the current low-interest environment reduces the room for competition in the lending business, and the return on safe assets. According to Eurostat figures[1],in the last 20 years EU households have been saving on average between 11 and 13% of their gross disposable income (i.e. a bit over 2000 euros per household per year). ECB data[2] show that more than half of those savings are in low-yielding currency and deposits, whereas well-diversified long-term investments would have the potential to deliver a higher sustainable return and could, for instance, help provide citizens with a complementary retirement income. At the same time, such long-term investments would support the financing of the real economy and its green and digital transition.

These are important reasons why the Commission is working to further improve the foundations that will allow wider participation of retail investors in the capital markets. Financial awareness and a strictly enforced regime of legal protection of retail investors are necessary, but not sufficient pre conditions for this. The Capital Markets Union High Level Forum has covered many important aspects in its balanced and comprehensive recommendations. Financial literacy enables savers to ascertain which financial products correspond to their needs and preferences, and to understand what they are buying when choosing an investment product. The legislative framework should underpin a fair investment outcome for retail investors. The information provided on different investment products must be comparable, true, non-misleading and sufficient for investors to take an informed decision (including on the level of risk). The interests of advisors must be transparent and, ideally, as much aligned as possible with those of the client, to ensure that any advice provided is fair and adequate. Furthermore, with the objective of client interests, suitability assessments need to be thorough and must lead to a range of products that meet the expectations, the needs, and the profile of the investors. During the execution of the contract and afterwards, the consumer must have access to redress and out-of-court procedures in case anything goes wrong. The entire investor journey has to be rigorous, smooth and oriented towards the best functioning of the system.

Technology also plays a very important role, as it can facilitate some steps of the process and enable new functionalities that can make the lives of investors easier, if enacted safely. The Commission has recently launched several initiatives to interact with innovative digital finance companies in an effort to better understand how the latest innovations can help businesses to be more efficient and can help consumers to improve their user experience. Before discussing the possible need to revise some of the current investor protection rules, the Commission must thoroughly evaluate the efficiency and coherence of the legislative framework in place, which largely follows a sectorial approach.

To achieve the objective of increased participation of retail investors in capital markets, the cooperation of the EU with Member States and with industry is essential. With regard to the Member States, it is essential to harmonise the national policies that could benefit from more coordination and to iron out the national differences in laws and law enforcement or taxation that impede cross-border investments. Actors on smaller local markets should benefit from integration, notably access to a large investor base. For this reason, the Capital Markets Union is more urgent than ever. Industry must also cooperate and adapt its offer of investment products to facilitate a wider retail participation in the financial markets. The goal is a better allocation of capital, to the advantage of both consumers and businesses, and as such, it is worth the effort it will require.

1. Eurostat - https://ec.europa.eu/eurostat/web/products-eurostat-news/-/WDN-20180830-1
2. ECB data - https://sdw.ecb.europa.eu/reports.do?node=1000004900

Jean-Paul Servais

Chairman, Financial Services and Markets Authority, Belgium (FSMA)

How to strengthen retail participation in the CMU?

The key to building a successful Capital Markets Union depends not only on the supply side, but also on the demand side. Consumers will invest in products only if they have the assurance that the products offered are sound, appropriate and well supervised.

A harmonised set of rules should ensure that financial products placed on the market are sound and appropriate. In this regard, important steps have been taken to improve transparency to consumers by introducing standardised key information documents. However, behavioural research has shown that transparency is not sufficient. Therefore, the regulatory system should also ensure that inappropriate or particularly complex products are not allowed to be marketed to retail investors.

It is important to assess the potential impact of the High Level Forum recommendations on consumer protection and market integrity. We need to sustain high levels of consumer protection and market integrity, as

these foster retail participation in capital markets. In this respect, I wish to guard against the proposed easing of the MAR rules, as some of them (especially regarding the concept of inside information) may have a negative effect on the integrity of the market.

The HLF report highlights in many instances that barriers to investment need to be removed. While it is true that disproportionate or unnecessary barriers should be analysed, we need to be very cautious with removing measures that are intended to protect retail investors and foster investor confidence, such as marketing rules and MiFID II consumer protection rules.

> *We need to sustain high levels of consumer protection and market integrity, as these foster retail participation in capital markets.*

We have seen that during the COVID-19 crisis retail investors, especially young people, have increasingly been investing in shares. In order to contribute to a continuing and durable trend of retail participation in financial markets, it is important to prioritize the measures aimed at fostering financial literacy and digital financial skills. A successful CMU can be strengthened by enhancing financial literacy, given the wide disparities in levels of financial education across the Member States. Faced with increasingly complex financial products, consumers and SMEs may make unwise financial decisions if they lack a proper understanding of the risks involved, or they may miss out on optimal investment or funding opportunities, especially cross-border ones.

Finally, we need to ensure that retail markets are well supervised. The toolbox of a modern financial regulator should include transparency requirements, rules of conduct, product governance and product intervention. Building on the progress made in the ESAs' review in terms of supervisory tools such as the coordination of mystery shopping at EU level, and in terms of supervisory convergence across the EU, the CMU project should further strengthen the resources available to regulators to reinforce consumer confidence in financial markets. ●

Gabriela Figueiredo Dias

Chairperson, Portuguese Securities market Commission (CMVM)

Europe needs to offer better alternatives and information to retail investors

As we deal with the challenges posed by the current health and economic crisis and the exit of the UK from the European Union, the contribution of retail investors to European capital markets has never been more important.

As rightly identified by the European Commission (EC) and by the High Level Forum (HLF) on capital markets union (CMU), Europe urgently needs to develop a suitable common capital market that enables the recovery to be financed by more equity over debt and allows retail investors to finance the recovery, and benefit from it. In this regard, both the recent CMU HLF report and actions already taken and envisaged by the EC should be highly praised.

That said, I would argue, however, that a vibrant and sustainable CMU will require a stronger focus on building retail investors' trust in the capital markets, namely by improving likely returns – through lower and more transparent costs and tax incentives – and ensuring better and simpler information to the public.

> *After the Covid-19 crisis and the Brexit completion, retail investors will be key to relaunch the CMU.*

Of the 17 recommendations put forward by the CMU HLF, the creation of a European Single Access Point for companies' data and the promotion of an open finance approach that offers consumers a comprehensive view of their financial situation, are definitely a welcome step in the right direction. Their success will rely in the ability to offer 'usable' information to consumers when

making financial choices. On the other hand, financial literacy is fundamental and HLF recommendations address it properly. But it is equally important to offer simpler and safer instruments to consumers, with transparent and fair fee structures and, thus, higher and comparable returns. In this regard, the recommendation on distribution, advice and disclosure should never lose sight that the average EU citizen is looking for simple and trustworthy ▶

savings alternatives to guaranteed deposits, and that when new online and digital channels are involved (which may benefit investors), proper protection and supervision must be ensured.

Addressing retail investors' needs and their trust in EU capital markets should also translate into a stronger and more harmonised consumer complaints regime and analysis, that works alongside a horizontal and cross-sectoral policy approach to markets, products and supervision that promotes a real single European financial market. Finally, the current proposals would also gain from a stronger focus on ethics, professionalism and governance to prevent conflicts of interest, reinforce independent advice, and to foster ESG concerns more generally. The powers enshrined in several Directives allow regulators to assess and act on boards' culture, effectiveness and integrity and should be strictly enforced. Investors' trust in capital markets depends vertically on a critical cultural change in companies and on fierce adherence to the highest ethical and quality standards.

The relaunch of the CMU must be a priority, if we aim to regain our economies to full potential as soon as possible. For this to happen, the entire financial community needs to strengthen investor trust in the capital markets by being more transparent and clearer regarding instruments, fees, rules and procedures; by being more focused on investors' needs; and by improving professional and ethical standards. ●

Verena Ross

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Unleashing the potential of retail participation in EU capital markets

With thousands of retail investors entering the markets in the turmoil caused by the COVID-19 pandemic, the retail investment gap in the EU seemed to be in reverse. Lured by relatively low valuations, many retail investors felt that this was the right time to open an investment account.

Retail participation in EU capital markets remains relatively low, especially when compared to the US. Data on EU household financial assets show that there is significant potential for increased capital market participation of retail investors. Unleashing this potential should be high on the agenda, not only because it may give consumers the opportunity to improve their financial situation, but also because it will increase the amount of funding available to finance the recovery from the COVID-19 pandemic and the transition to a low-carbon economy.

However, several mis-selling cases have eroded investor trust, coupled with the continued dominance of non-independent advisors distributing almost entirely self-placed and inducements-paying in-house products. In addition, ESMA studies show that high costs remain a critical component in lowering long-term returns, exacerbated by the low-interest rate environment.

Several policy actions should be considered to address these issues. First, the role of inducements and their concomitant conflicts of interests in the distribution of investment products should be assessed. ESMA's review of the MiFID II inducement regime demonstrated that MiFID II has had limited effect in steering investors towards independent advisors or on triggering changes to advisors' product catalogues.

Disclosure on its own appears insufficient as retail investors find it difficult to assess the impact of inducements on the quality and cost of the services and products provided to them. To ensure that retail investors have access to better services and low-cost products, ESMA has recommended that the European Commission conducts a more fundamental analysis of the MiFID II inducement framework. Such an analysis should review carefully the experience of countries that have banned inducements.

> *ESMA studies show that high costs remain a critical component in lowering long-term returns, exacerbated by the low-interest rate environment.*

A second policy action is to further align the various regulatory frameworks in the EU. Alignment of the MiFID and PRIIPS frameworks, currently under discussion, would for instance ensure that retail investors are provided with comparable and consistent information on their investments.

Moreover, to ensure a level playing field and a high level of investor trust across sectors, ESMA has recommended that comparable investor protection rules apply to the distribution of MiFID investment products and to MiFID-like insurance products, notably on the issue of inducements.

Third, the role of occupational pension systems should be reinforced, for example by introducing automatic enrolment across the EU. This could also contribute to fostering financial literacy of EU citizens, the other important driver of retail investor participation in EU capital markets. Financial literacy should be further enhanced by financial education initiatives; for example, the high level forum on CMU suggested developing an EU framework on financial competence. ●

Guillaume Prache

Managing Director, Better Finance

Develop "retail" investment in EU capital markets, really?

Despite all the barriers and deterrents that "retail" investment "advisors", Regulators and schools have raised for decades against equity culture and equity investing in Europe, a few individual shareholders are still hanging on. For how long?

One such deterrent is called mistrust.

On 10 June 2020, the EC publishes the Report of the High Level Forum on the CMU. It includes good recommendations to foster "retail" investments into capital markets[1], including one *"to not discriminate individual direct investments by retail investors in equity and fixed income instruments, by including them in the scope of the Directive on representative actions for the protection of the collective interests of consumers"*.

On 18 June 2020, the huge Wirecard scandal comes out, wipes out about 20 billion euros from abused EU pension savers, and lays bare outrageous failures in corporate governance, in public supervision and in external auditing. Yet today, despite the HLF recommendations to them, despite Wirecard, the EU Authorities are still determined to exclude individual shareholders from the scope of the proposed Directive on collective redress!

This is all the more a shame that we all know it is a must, and we all know how to do it.

It is a must as households are by far the main provider of funding for the real economy, i.e. they provide most of the net savings to the net borrowers of capital (Governments and corporations). Also:

- "retail" investors are more long term oriented than "institutional investors"
- they are less risk averse
- they invest and trade more in SME markets
- they are more "contrarian" investors.

How to do it is quite simple: provide the same levels of access to - and of promotion for listed stocks, bonds and cost efficient funds like index ETFs as for the much more complex, fee-laden, "packaged" products that are also much more estranged from capital markets and from real economy assets such as bank accounts, life insurance, multi asset funds and pension products.

This implies inter alia to:

- Allow adult education at the point of sale on capital markets and equity: end kickbacks on packaged products (as there are none on more direct low cost products);
- Develop equity education for adults at the workplace: promote and incentivize employee stock ownership (a hundred times more developed in the US for SMEs);
- Stop EU rules discriminating against direct investments (like PEPP as opposed to the popular IRA in the US)
- Empower and engage EU citizens as equity owners, i.e. give citizens the ability to vote with their smart phone[2];
- For Public authorities to lead by example and consider public equity infusions in addition to publicly guaranteed (taxpayer) loans for Covid 19 related help;
- End double taxation of investment income within the EU.

For too many years fostering EU citizens' investments into capital markets and the real economy has remained a story of good "recommendations" ... and of a la Wirecard abuses. Unless EU Authorities make it at last a true priority, this story will go on. ●

1. Disclosure: I was a member of the EC HLF CMU representing non professional individual ("retail") investors. Several of our recommendations were adopted by the HLF CMU.
2 See HLF CMU's Recommendation on shareholder identification, exercise of voting rights and corporate actions

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Peter Scharl

Board Member, BlackRock Asset Management Deutschland AG

Delivering CMU by modernising rules and using technology

The HLF Report is one of the most comprehensive roadmaps to date towards realising the ambitions of a strong CMU. A policy framework that promotes greater investor participation and better market-based fundraising opportunities for companies would bring enormous benefits for the economy and savers alike. An investor-centric approach can deliver the capital needed to power the CMU's ambition of deep and robust European markets. Increased investment for the long term can also help finance the transition to a sustainable carbon neutral economy. While household financial assets have increased in the last decade, allocations to financial markets have, irrespective of interest rates, remained constantly dwarfed by holdings of cash and bank deposits. European savings rates have risen even further during the pandemic, with sharp increases in savings held in cash or products reflecting short-term fears. ▶

We need to bring to life the potential CMU can have for savers, highlighting the risks of not investing to meet long-term goals, while not undermining necessary short-term financial resilience.

It should be made easier for people to invest in ways designed to meet their lifetime goals. Maintaining high levels of consumer protection is paramount. But we need to modernize the rulebooks to build intuitive processes for account opening, create new dynamic disclosure standards, and develop a complementary framework for financial education, generic guidance and a variety of pathways to personalized advice. Auto-enrolment into default products can encourage a focus on designing investment solutions which meet citizens' goals. This should be supported by a consistent framework for financial intermediaries to follow when servicing clients. We need to encourage the use of new technologies to speed up AML and KYC processes, deliver information in an interactive dynamic format and overhaul the risk analytics and data which underpin upfront and ongoing suitability assessments. These represent significant steps forward in helping investors take informed decisions and build up trust and knowledge in markets.

Furthermore, we encourage the development of a goals-based investment approach in which disclosure and advice are aligned to the needs of individual investors. This should be underpinned by interactive disclosure models away from the current static formats, encouraging engagement while not sacrificing legal certainty. Disclosures should support the delivery of individual investment goals, rather than being tied to multiple individual products allowing intermediaries to focus on the overall service or product solution offered.

The performance of sustainable investments stood out during the COVID-19 pandemic and the recovery from the current crisis provides a huge opportunity for investors and businesses to benefit from this shift towards a more resilient and sustainable economy. We welcome the many ambitions across Europe to lead the world in sustainable finance and we must ensure that competing domestic initiatives do not lead to new barriers such as gold plating or conflicting and confusing product labelling.

Stronger investor participation in Europe will help addressing longer-term challenges such as the pensions gap, and funding sustainable investment goals. ●

Simon Janin

Head of Group Public Affairs, Amundi

Boosting retail investment in capital markets: a priority for CMU

One of the striking consequences of the Covid-19 crisis has been the huge increase of European households' savings rates. According to preliminary estimates, additional savings from European households in Q2 2020 should amount to €1.3tn, representing 10% of the EU GDP.

It is still premature to assess whether this savings surplus will be reinjected into the real economy, especially in a very uncertain global environment. However, there is little chance that the European retail investors' strong preference for holding cash rather than investing in capital markets will change. Currency and deposits represent today around one third of EU households assets which almost matches the amount invested in investment funds, equity and debt securities. Even more concerning is the fact that the proportion of households assets in securities and funds has even decreased during the last 20 years. In this context, one of the key priorities of the forthcoming European Commission Action Plan on CMU should be boosting retail investment in capital markets.

This is not only essential from an economy recovery prospective (i.e. to reinforce the solvability of European companies) but also to ensure that retail investors can benefit from better returns in a persistent context of low interest rates, in particular to meet the financing needs of their retirement. A number of stakeholders share this sense of urgency, including the High Level Forum on CMU that notably recommended, in its final report, to review the uniform application of investor protection rules to all retail investors, irrespective of their experience and knowledge. Indeed, it appears essential to put an end to the systematic "tick-the-box" exercise, which too often contributes to the risk aversion of retail investors. In this respect, investor's education is also key, though however it may takes time before seeing any significant effects.

Furthermore, additional and concrete measures should be promoted. In this respect, the development of employee share ownership (ESO) at the European level could be a game changer for the multiple positive effects it can generate. First, it would be a real trigger to substantially increase households' investment in capital market instruments and favor a truly local based ownership for European companies. Second, ESOs often contribute to draw retails clients closer to financial education improving their attitude to financial matters. Unfortunately, these schemes are much less frequently used in Europe than in the US. Then, a proposal should be made to create a pan-European vehicle that would be a fund structure, recognized as a specific AIF. This would present a number of advantages, notably as it would benefit from the European passport: a fund created in Luxembourg or Belgium could be used for an ESO plan of a company based in Spain or Portugal and offered to its employees in all EU countries where this company has subsidiaries. It would also permit a liquidity mechanism, particularly useful for employees of SMEs and non-listed companies – as ownership in unlisted shares is facilitated by creating a common valuation method that provides for the repurchase of shares. ●