Q&A

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For an effective "retail investor strategy"

How important is the development of retail investment for the CMU and more generally for the EU economy? Is encouraging retail investors to invest in securities markets a relevant objective in the current macro-economic environment?

Encouraging retail investors to invest in securities markets is indeed a relevant and very important objective: both for citizens, for the EU economy but also for democracy.

It is more and more important for citizens themselves, as it is now a key component of what the UN call "***financial health***", and what the EU calls more specifically regarding investments "***pension adequacy***": It is and will not be effective for citizens to save early and a significant portion of their activity income for retirement and other long-term needs, as Public Authorities and professionals are repeatedly recommending. These savings MUST also provide decent, positive net real returns over the long term.

This is not the case today. BETTER FINANCE estimates that Eurozone savers lost about € 1tn last year alone in net real value (purchasing power) terms. This is jeopardizing their financial health, and is contributing to the impoverishment of middle classes, a key trigger for the rise of extreme politics and of threats to democracy.

One powerful way to improve this appalling situation is to enable them to access:

- Better performing capital market investment products such as listed stocks, bonds and ETFs
- and simple, cost-efficient Pan-European pension savings products like the Individual Retirement Account (IRA) and the "401k" (occupational defined contribution pension) in the US.

This is not the case today. Two short examples:

- Today, money market funds (MMFs) are a much better alternative for short term investments than bank savings accounts (about 4% return vs. about 1% in Belgium for example). But they are usually not "advised" to EU citizens, and they are more complex (almost no "stable value" MMFs) than in the US. Plain vanilla fixed rate Government bonds are also a "non-advised" and a very difficult to access option for citizens.
- In France, ETFs represent only 1,6% of funds "advised" and sold to retail investors via unit-linked insurance (two thirds of the total retail fund market).

What are the key factors explaining the limited engagement of EU citizens in capital markets?

The main factor is that retail investment is a very peculiar consumer market. EU citizens as **financial healthcare** users are not treated as fairly as – for example – as **physical healthcare** ones:

- Complex and/or hazardous products are not pre-approved by Public Authorities
- Investment prescribers are mostly not independent from providers and mostly compensated by sales kickbacks by these providers.

The result is that simple and cost-efficient capital market investment products such as exchange-traded equities, bonds and funds are very little explained and "advised" to people versus more intermediated, packaged, complex, fee-laden, cumbersome to subscribe to and geo-blocked by Member State products.

One other factor is the lack of access to capital market products such as plain vanilla fixed rate listed bond markets (citizens have recently been crowded out of these very opaque and often illiquid markets) or to simple Pan-European cost-efficient pension savings ones (there is no single market for such products within the EU; only for listed securities and UCITS funds).

Also, let me address the old tune of people's risk aversion. First, we are all risk averse, and professionals (look at "institutional" investors' own asset allocations versus the ones of "retail"

investors) and even more so regulators are even more risk averse than individual investors. In particular, regulators should reverse their investment risk scale for long term and pension products, by taking into account their time horizon and the impact of inflation. I must repeat here that money market funds or bank savings accounts are a much riskier pension investment than a cost-efficient diversified portfolio of listed equities. Indeed, both the probability and the magnitude of the risk of destroying the real value of pension investments over the long term is much higher for the former than for the latter.

However, regulators keep rating the former a Level 1 risk and the latter a 6 or 7 one, even for personal pension products, pushing the retail investment professionals to advertise the same. Also, they still require nominal-only performance disclosures.

And the ongoing "financial repression" policies of central banks (which ensure that gross nominal interest rates are much lower than the inflation ones) and of national tax Authorities (which usually tax the largely fictitious nominal investment income instead of the real one) is an additional factor. The ECB should at last consider the financial health of people (and not mostly the short-term interests of overindebted Governments) as one of its policy objectives.

Does the Retail Investment Package set out the main measures needed for increasing retail investor participation? What are the priorities?

This package is a once-in-a-lifetime opportunity to create a Capital Markets Union that works for the people. It includes several positive proposals, but falls short of meeting its purported objectives (EC CMU Action Plan of Sept. 2020):

- *"ensure bias-free advice"*
- *"ensure coherent rules across legal instruments"*
- *"transparent, comparable and understandable product information"*
- *"open markets with a variety of competitive and cost-efficient financial services".*

We welcome the specific ban of "execution-only" / "unadvised" sales of retail investment products. However, the scope of this ban is even more limited: Member States would be given an option to ban unadvised sales of IBIPs by making the provision of advice mandatory. Regulators often forget that IBIPs and pension products are much more widely sold (70% of all PRIIPs according to EIOPA) than MiFID-regulated investment funds.

We also welcome the proposals on "Value for Money". However, their goal is quite modest: only trying to make the already existing EU rules on value for money at last enforceable. And I am quite concerned by the long and complicated process to finalise these measures. EU policy makers should benchmark these proposals to simpler, lighter and quicker practices (e.g., UK FCA's value assessments).

Are there any missing points in the Retail Investment Package proposal? Do some measures need adjusting or fine-tuning? Are these proposals ambitious enough?

Yes there are.

First, the wording of key investor protection rules would still be unclear and misleading for people:

- «***Non-independent advice***» (MiFID 2) is an EU Law oxymoron and «*investment advisors*» even omit this "non-independent" qualifier.
- «***Investment advisor***» labeling should not be allowed for retail distributors whose compensation is essentially sales commissions paid by providers: such professionals primarily are and should be called salespersons. After all, car dealers never portray themselves as "transportation advisors".
- The term «***Inducements***» is not intelligible for EU citizens. The first president of EIOPA translated it into plain language as sales kickbacks.

Second, the Proposal fails to tackle the issue of conflicts of interest in a comprehensive and consistent manner across the various categories of retail savings products: MiFID rules on conflicts of interest would not be extended to the other investment products sold to retail investors, e.g., crypto-assets, pension products, crowd-funding. In particular, the MiFID ban on inducements for portfolio management services would not be extended, even to IBIPs.

Third, nothing is proposed to address the appalling content of Key Information Document (KID) for retail investment products to make these key disclosures clear, comparable, relevant and not misleading:

- No ending of the "*Pseudo-science*" of disclosing future performance scenario sonly, based on 5 year past performance
- Cost disclosures are not intelligible ("future RIY"), misleading (based on only one future scenario), not comparable and fail to disclose the total annual cost for all unit-linked products.

Fourth, the EU legal mandate to promote simplicity is once again entirely forgotten in favor of the old tune of the need to promote financial education.

Last but not least, the EU equity markets are still highly fragmented, evolving further into dark trading, and too complex for non-professional individual investors. One result is that even when they can invest directly into capital markets, "retail" investors will tend to go to US listed stocks, especially for innovative and high growth opportunities. And barriers to investor engagement within the "single market" have not been eliminated nor reduced despite the promotion of ESG investing, while the greenwashing risk of intermediated products is higher than ever.

The European Parliament and the Member States can still grab this one-time opportunity for the sake of the middle classes' financial wellbeing and of the future of the European economy and democracy.