Q&A

RENAUD DUMORA

Deputy Chief Operating Officer of BNP Paribas,
Head of Investment & Protection Services (IPS)

Safeguard the access of retail investors to advice and diversification

How important is the development of retail investment for the growth of EU Capital Markets? Is encouraging retail investors to invest in securities markets a relevant objective in the current macro-economic environment.

BNP Paribas concurs with the Commission's objectives:

- to enhance retail investors' trust and confidence to safely invest in their future and take full advantage of the EU's capital markets union.
- to channel private funding into our economy in order to finance economic development, fund the green and digital transitions and strengthen European sovereignty.

Today, international comparisons show that European households tend to prefer more short-term savings products and low risk investments. Beyond the necessary build-up of precautionary savings, investors should also invest for lifetime projects and for retirement. Investment should be tailored taking into account the specific needs and choices of each investor (risk appetite, time-horizon, risks tolerance, ESG preferences and portfolio diversification) as well as his personal situation (age, social and educational background).

The higher interest rates provide new investment opportunities for retail investors but also call for investing a higher share of household's wealth because non-invested savings are eroded faster by inflation. Of course, the most relevant way for households to invest in securities market is through continuous and gradual investment in order to smooth out macro-economic fluctuations.

Does the Retail Investment Package set out the key measures needed for increasing retail investor participation?

Investment decision is a complex process driven by various factors, most of them bearing a strong national dimension due to tax treatment, pension schemes, locally regulated savings products etc. Households therefore need very customized advice to decide what investment fits best their profile, experience and environmental objectives. Moreover, several studies[1] show that between 70% and 90% of investors prefer human advice over digitalized interaction or robo-adviser and the proportion is higher among less wealthy investors. This physical and highly customized advice requires continuous local presence which is costly for distributors.

The proposed Retail Investment Package appears to be largely focusing on cost levels and built on the assumption that a fee-based remuneration model for distributors (as opposed to a commission-based model with inducements) would be more beneficial and attractive to retail investors. However, the impact assessment provided by the European Commission to support its proposal shows no simple correlation between remuneration models and the level of participation of retail investment in capital markets.

Ban on inducements and introduction of value for money tests could have a very significant impact on the industry, specifically on its distribution models and on the range of products proposed to clients. Our main concerns at BNP Paribas are about the proposed inducements ban, the new set of standards for advisory services, and the overweight given to cost parameters. The downside for distribution models with few mis-selling cases since the full implementation of MIFID2, is obvious. This could endanger the primary objective to increase retail participation.

Can a significant impact be expected from the measures concerning inducements, quality of advice and value for money in particular for the development of retail investment. What are the conditions of a successful implementation of the

proposals? Do some measures proposed have potential downsides or unintended consequences?

The quality of advice and the value for money are the key ingredients to foster retail investment. However, we are concerned that imposing a fee-based distribution model and cost benchmarks while promoting Exchange-traded funds (ETFs) versus actively managed funds will not achieve the objective.

Inducement ban on RTO[2] services does not seem the appropriate policy solution. Full transparency on costs is already in place thanks to MIFID 2. RTO services and execution services include appropriateness tests under MIFID and non-advised sales under IDD[3] which provide valuable investor protection and will become even more costly if appropriateness tests are enhanced and Open Finance framework emerges. Moreover, a partial ban on inducement coupled with the need to link any advice to a transaction will lead national regulators to stiffen the definition of advice, therefore extending very significantly the inducement ban in practice. A switch from advice to execution-only would impact the mutualisation of advisory costs, leading to an increase of advice costs for least wealthy households.

The obligation included in the Retail Investment Package for advisors to propose "*a product without additional features (...)*" presumes advised products are necessarily too complex and assumes ETF to be the sole reference. At BNP Paribas, we believe this could have the side effect of reducing the offering and financial innovation as well as increasing concentration risk and introducing a bias to global investment. Actively managed and structured products that have a variety of features by design can be better suited to investors needs as they offer better diversification of underlying assets or payoffs compared to ETFs and can adapt to evolving ESG data or macro-economic outlook.

Value for money (VFM) tests are welcome but relying on cost/performance benchmarks to assess VFM is a strong concern, as centrally defined benchmarks will not sufficiently capture the specificities of the products or services.

The assumption that the cheaper and the simpler the products are, the better it is for the end investor may be questionable. Requiring advisors to offer alternative financial products at the lowest cost possible is moreover redundant with VFM, and materializes an approach driven by quantitative factors only. This is not attentive enough to the quality of services, such as long-term physical relationship and support, and obviously risk management or ESG integration. We all know that these components must be considered when two different offers from two different financial intermediaries are to be benchmarked.

A successful implementation requires simplicity to avoid the accumulation of implementation costs that would increase costs for end-clients. MIFID 2 and IDD have come into force quite recently. We need more time to assess their full impact.

Is the role of digitalization and digital tools sufficiently taken into account in the Retail Investment Package? Could more be done to adapt the Retail Investment Package to the digital age?

Digitalization of client journey and advice should be at the heart of any initiative aiming at increasing retail investor participation in capital markets. While all European banks and distributors are investing strongly in technology, it is a big challenge to build seamless multichannel investment journeys which also allow the possibility of human interaction at every step. Digitalized advice requires high quality granular data on client profile, experience and preferences as well as powerful algorithms to optimize the advice. Artificial intelligence based on large language models will enhance the quality of the interaction between customer and distributors.

Regulation can also contribute to the digitalization efforts. RIS provisions on regulatory disclosures and on marketing to retail clients will contribute by ensuring electronic format as default, clarifying how product disclosures should be presented in a digital environment and introducing additional safeguards for marketing communications. Still, Retail Investment Package could better address risk related to recommendations on social media, which today are partially disrupting advisory processes.

Given the enormous potential of digitalization to increase household investment and the massive investments required, one might question the timing and priorities of the Retail Investment Package.

At BNP Paribas, we believe policymakers should first accompany the digital transformation instead of putting at risk the distribution models and the quality of advice, and then assess whether advice has been sufficiently improved by digitalization and the new FInancial Data Access (FIDA).

1. *Ernst & Young advisory (Dec. 2022), Vanguard (Apr. 22) and McKinsey (Feb. 2022) studies*
2. *RTO: Reception and Transmission of Orders*
3. *IDD: Insurance Distribution Directive*