RETAIL INVESTMENT IN THE DIGITAL AGE

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Digitalisation in the perspective of the EC policies for the Union

Digitalisation is a game changer for consumers' engagement in the financial sector, triggering innovative developments in capital markets and financial intermediaries operating models. However, at this stage it is difficult to predict time and scope of these changes, and most likely this progress will continue for long.

Policymakers and regulators are striving to keep pace with speed and intensity of digital changes and have undertaken steps in the direction of being better acquainted with these developments, whilst keeping the objectives of financial stability, investor protection and market integrity.

At EU level, the overall consumer protection objective in digital finance is developed in different strategies and acts along horizontal (digital economy) and sector specific axes (in line with the traditional siloed regulatory approach).

The Retail Investment Strategy (RIS) recently adopted by the European Commission (EC) is a piece of this complex puzzle meant to foster data-driven innovation while at the same time stimulating the participation of retail investors incapital markets. Since digitalisation is changing the way in which investors are approached (e.g. through social media and fin-fluencers), the proposal introduces measures allowing a better use of digital means in providing information to clients as well as changes to the existing marketing communications regime. Investor education is also part of the proposal, as a tool to minimise the risk of self-directed investing.

The RIS has been published in parallel with a proposal for a regulation on open finance (FIDA) to ensure data standardisation and portability in the financial sector, while granting customers control over their data.

The RIS with the standardized report on information collected by a firm on its client for the purpose of the suitability or appropriateness assessment, "*is expected to facilitate, if the client requests that report, more seamless and cost-effective data sharing and re-use of such information by other firms selected by the client*" (explanatory memorandum to the proposal). Such data, together with nearly all financial services data within the open finance scope (related to mortgages, loans, savings, investments, crypto-assets, pensions, and non-life insurance products) will empower consumers to share it in a secure way so that they can get a wider range of better and cheaper financial products and services.

The EC policies aim to foster data-driven innovation and a competitive digital ecosystem paving the way to the development of multi-service digital platforms open to third-party providers of services to end-users.

Current demographic trends exacerbate the need for enhanced financial planning by households with regard to their future financial needs. In this respect, a framework that offers retail investors investing in capital markets a wider range of opportunities is a good step in the direction of more efficient and effective financial planning. While reshaping strategies, business models, and operations in response to the new opportunities, the financial sector could potentially develop more collaborative business models where different actors work together, exploiting the wide data set available, to address not only investment needs but also offering risk protection (for example ensuring adequate availability of financial resources during retirement). Even though the FIDA proposal envisages tight conditions to access, share and use data that could hamper the potential benefits of open finance, accessing, sharing and using data without making use of the data access obligations established by FIDA is still possible on a purely contractual basis, subject to customer's consent.

This would entail for the financial sector to adhere to a different approach than the traditional one, switching from wealth management to welfare management.

While, as mentioned above, on one hand the RIS could contribute to the achievement of this broad picture, on the other hand, it seems to only foster the development of specific (often traditional) business models.

Consumer protection in digital finance is developed along horizontal and sector specific axes.

One example is the introduction of new rules addressing biases in the advisory process. The EC has introduced targeted changes to the legislation that add to complexity of the already detailed sectoral rules. These rules will ensure enhanced consumer protection only if adequate and effective supervision and enforcement are conducted by supervisors.

Also, the new rules on marketing communications and practices that are applicable only on authorised entities will not address the threat coming from non-licensed individuals and entities operating in the digital space.

Overall, the EC has taken an approach not perfectly fit for the digital era, running the risk of developing a regulatory framework not always aligned to the fast-evolving digital transformation.

FAUSTO PARENTE

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Innovation is crucial to incentivise retail investments

The COVID-19 pandemic accelerated the digitalisation of the insurance sector, resulting in easier delivery of products and services, lower distribution costs, and more tailored offers, thanks to increased interactions between insurers and consumers.

However, digitalisation focused primarily on the distribution of non-life insurance, while the availability of online platforms for insurance-based investment products (IBIPs) remains limited.[1]

Digitalisation and innovation can enhance access to retail investments and promote the uptake of retail investment products by enabling consumers to make informed choices that are aligned with their needs. At the same time, behavioural research highlights the challenges of using consumer disclosures as a tool to protect consumers and to promote their decision-making. Indeed, consumers often fail to read the information they receive and can be overwhelmed when presented with too much information. This hinders comparability, making it difficult to make informed decisions. The current regulatory framework, although intended to be technology-neutral, was designed before the app revolution and without considering digital distribution.

EIOPA is of the view that consumer disclosures need to be presented in a radically simpler and more user-friendly format. Presenting essential information upfront, and offering more in further layers, can facilitate the comparison of key information. And innovation can help in doing so.

Innovative tools, such as simple personal finance aggregator apps, could also enable consumers to access consolidated information on all their investments: from pension entitlements to insurance policies and investment funds, thus improving consumer engagement and decision-making. Virtual agents, chatbots, or oral disclosures could replace traditional paper-based documents, making investment information more appealing and interactive, including on complex concepts such as market risk or biometric risk coverage.

In addition, increased information exchange between insurance undertakings and consumers, including in relation to their demands and needs, is essential to tailor the IBIP design to consumer needs. Innovation can promote well-designed and low-cost methods of meeting the needs of customers with straightforward investment objectives and smaller amounts of money to invest.

A consumer-centric approach will boost retail investments whilst managing risks.

On the other hand, an increase in digitalisation that is not customer-centric can limit retail investments. Two studies carried out by EIOPA in 8 Member States have shown that consumers are more reluctant to buy complex, long-term products (i.e. IBIPs) online, as they commonly require greater consideration and professional advice. Moreover, consumers with limited digital skills can be excluded or discouraged from investing through online tools.

In addition to financial exclusion, data sharing and exchanges pose other risks, not only in relation to data privacy. The more information about individuals that insurance undertakings have and share, the higher the probability that some parameters, or a combination thereof, can be used as a disqualifier or a proxy for a traditional parameter. Consequently, some consumers may unjustly pay higher costs or not be able to access retail investments which meet their needs. There is also the risk that all the data is held by a few, thus restricting competition. Moreover, digital distribution can include aggressive marketing techniques, such as so-called 'dark patterns' or leveraging on social media. Finally, some consumers may have difficulties discerning whether the advice provided through chatbots is that of adequately registered and qualified advisers.

The current Retail Investment Strategy (RIS) proposes measures to leverage opportunities whilst also addressing emerging risks. It calls for a more digital-by-default approach, allowing the layering of information. It further proposes to present the key information document using an interactive tool and to prevent 'finfluencers' who are not registered or adequately qualified from using social media to promote products.

The legislative proposal on a Framework for Financial Data Access (FIDA) could also improve investment advice for consumers and facilitate their access to a comprehensive overview of their financial and investment situation. However, not all risks of digitalisation are addressed by FIDA, for instance the potentially deceptive insurance practice of combining the sale of financial products with other non-financial goods. There are also opportunities that are not directly addressed by the RIS but that can be developed by the industry, such as personal finance aggregators, providing aggregated information on consumers' financial situation.

The key is to continuously monitor risks to ensure regulation and supervision remain fit for purpose for the digital age.

1. *Consumer Trends Report 2022 (europa.eu) and EIOPA publishes advice on Retail Investor Protection (europa.eu)*

MICHAEL MCGRATH

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The impact of digitalisation on retail investment

Retail investment strategy (RIS) is a part of the EU's ambitious CMU action plan *'building retail investors trust in capital markets'*. Empowering retail investors by adequately responding to new challenges in the market like digitalisation of investment advice and the use of digital distribution channels[1] will be important while safeguarding the retail investor. Helping to diversify consumer savings, thus allowing consumers to earn better returns while their funds make a greater contribution to the productive capacity of the EU economy. RIS modernises MiFID marketing requirements to take account of digitalised marketing - including the use of social media, influencers and behavioural biases. These steps will be crucial to protect retail investors from added risks of digitalisation e.g., unregulated marketing and social media platforms and 'gamification'.

The advancement of financial technology has reshaped the way people access financial services, from the introduction of Internet-based trading in the 1990s to the growing importance of mobile apps, the rise of robo-advisors and the growing importance of social media. These digital innovations have removed many of the barriers preventing retail investors from accessing financial markets and this has contributed to retail investors' appetite for investment.

The technological innovation in financial markets is changing and reshaping the existing models of intermediation processes. In recent years, neo-brokers have gained popularity among retail investors in Europe. These brokers offer low-cost services and user-friendly platforms, making investing in financial markets such as Exchange Traded Funds (ETFs) more accessible than ever. Recent studies suggest that in the long-term, they could supplement human financial advisory. Digital advances bring many positives but there are also risks involved, specifically in terms of supervisory challenges dealing with operational risks, cross border digital finance, cyber/data protection and balancing innovation and consumer protection. The emerging models are creating significant governance and regulatory challenges for governments.

As technology keeps on evolving, it brings additional challenges for regulatory authorities to keep up with the pace of digital innovation. In the face of these challenges, regulatory action needs to strike a balance between mitigating potential risks and enabling the development of innovations that can be beneficial for the economy and society as a whole.

Innovation brings opportunities to retail investors while also creating policy challenges and risks.

Another goal of the CMU 2020 action plan is to empower citizens through financial literacy, thus providing them with the knowledge and skills needed to make the right financial decisions. Every day, thousands of people are deciding where to open a bank account, which mortgage to choose, where to invest their money and how to save for retirement[2]. In general, financial literacy of the average retail investor is low across many Member States. There are, however, wide differences across Member States. A recent study on financial literacy in the EU highlights the need for financial education to target in particular those who tend to be on average less financially literate.[3] In parallel with the digitalisation of our financial systems and economies, the use of digital technologies offer significant benefits when used appropriately for delivery of financial education. It can improve access, facilitate and enhance learning process and support positive financial behaviours.

From the perspective of policy makers, digital tools help them reach target audiences, reduce costs and help in monitoring and review. However, these tools such as websites, social media platforms, mobile apps, artificial intelligence and chatbot applications brings additional challenges to address i.e., adapting content to digital or online platforms, training and skills of trainers, addressing the lack of digital skills, data protection and supervisory challenges[4].

Innovation brings opportunities to retail investors while also creating policy challenges and risks. Digital innovation in finance in particular offers immense opportunities for enhancing efficiency and innovation. However, to fully capitalise on its potential, we must navigate various challenges while safeguarding security, compliance and inclusivity.

1. *Source: https://op.europa.eu/en/publication-detail/-/publication/d83364e5-ab55-11ed-b508-01aa75ed71a1/language-en/*
2. *Source: https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan/action-7-empowering-citizens-through-financial-literacy_en*
3. *Source: Monitoring the level of financial literacy in the EU - July 2023 - - Eurobarometer survey (europa.eu).*
4. *Source: https://www.oecd.org/financial/education/Digital-delivery-of-financial-education-design-and-practice.pdf*

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Attracting retail investors - more than words and algorithms

This transition to a digitally-intensive environment induces changes in the behavior of investors and financial service providers, profoundly alters communication, both in terms of channels and content, and facilitates cross-border activity and disintermediation. However, only if conducted in an ethical and responsible manner will it benefit investors and society as a whole.

In order to do so, we need to take into consideration that, at the end of every product sold and of every service provided, there is a person, with particular expectations, specific experiences, knowledge, objectives and needs. This is particularly relevant in face of digital tools and mechanisms that have the capacity of reaching a much larger number of people.

Digital platforms, such as fund distribution platforms, robo-advisors and on-line trading platforms, are good examples of this kind of tools. Based on algorithms and provided to customers online, they can potentially choose products from a wider variety of suitable ones, are able to process data faster and in a precise manner, at any time of the day or night, and avoid behavioral bias. Less reliance on human intervention in the provision of investment services can certainly bring benefits to the end investor, such as lowering the cost, reducing minimum investment amounts, thus democratizing the service.

However, digitalization is not immune to misalignment of incentives. People design the algorithms and these may contain formulae that bias the outcome, even inadvertently. In that case, the same algorithm can impact many more people and its increasing complexity can make it difficult and slow to recognize failures. It may also encounter limitations in old problems, such as access to product quality information, inability of customers to understand software queries or input of the wrong data.

I dare say that it is also very difficult for the algorithm and the structure of the service based in it to address specificities of persons of different regions and cultures. European investor associations have also warned of customer segmentation that can result in the exclusion of some and even discrimination. The challenge of considering the whole person behind the profiling mechanism is not different from that of a human, but the way to address it in an automated service is certainly different. ESAs have been particularly alert in their reports to how digital finance can lead to unfair and discriminatory practices. Here, the supervisory effort has to be on detail.

Despite acknowledging digitalization as a driver of change in the provision of retail investment services, the recently announced retail investment strategy does not propose rules regarding this particular challenge. However, it proposes modernizing the rules on the digital presentation of key information on investment products, whilst stablishing a preference towards the electronic format and allowing for a greater degree of personalization and layering in the provision of information via mobile devices or web applications. While the disclosure of information in electronic format is yet to be seen, as ESMA together with EIOPA are mandated to develop specific guidelines, it is paramount that retail investors are not left abandoned in a sea of information. Afterall, it may be just another patchwork of messages that the client does not really pay attention to.

In the case of wrong enticement of clients via web pages, our experience in Portugal has shown that some situations require a quick reaction that is dependent on the intervention of multinational companies that host those contents. In face of some big tech companies, the supervisory power of a national competent authority may be very limited. In these cases, an effective supervisory answer has to take advantage of the existence of European authorities, with a pivotal position.

In the current technological context, targeted rules on intermediaries are only part of the answer to attracting retail investors. We need a culture of compliance from intermediaries and to equip investors with the knowledge and awareness to, among other things, spot inconsistencies and report them quickly - they will often be the first to realize that something is wrong. We need supervisory alignment in Europe and key strategic messages. Strong political commitment, particularly at national level, is also essential in order to build strong national capital markets, which are a fundamental pillar of a robust CMU.

At the end of every product sold there is a person, with particular expectations and specific needs.

Broadening the base of people accessing capital markets via digital tools can undoubtedly be a major boost to the dynamization of European capital markets. However, if we want to attract and keep retail investors, so that they can take full advantage of the EU's capital markets union, we all need to be committed to this objective.

VICENTE CANCIO GARCIA

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EU retail investment strategy: seizing the digital moment

Given the unmatched pace and scale of the transformation of our economies and societies, empowering retail investors is more important than ever. The increased digitalization of financial services and deployment of new technologies have enormous potential to advance the objectives of the EU Retail Investment Strategy (RIS), offering consumers easier access to investments and improved delivery of financial advice. Zurich Insurance strongly supports the objectives of the Retail Investment Strategy and is committed to play its part to foster retail investment. So, how do we make retail investment easier and how do we make best use of digital opportunities?

When it comes to communication with customers, it must be as clear and user-friendly as possible. The Kantar study commissioned by the European Commission highlighted that whilst customer disclosure may be compliant with current regulation, it is not always appealing enough to capture customers' attention. At Zurich Insurance, the customer is at the center of our decision-making. We know that customers are more informed, more connected, and more demanding than ever before. To make sure we are really effective in engaging our customers, Zurich runs a dedicated customer office which is constantly testing and refining our communications. As such, we strongly believe that any legislative changes that affect retail disclosure should be thoroughly consumer-tested in advance.

Digital disclosure would help to make mandatory disclosure more digestible. An increasing number of customers are asking us to provide more digital options and digital techniques can make complicated information more accessible. For example, via layering, which is frequently used in apps, customers can receive complex information one step at a time, with the possibility of getting more information or an explanation of the terminology used. We have integrated digital tools in the advice process, for example in our business in Austria, where a digital advice tool is used by our advisors in every step of the advice process. It visualizes preferences, options, and choices, with an additional focus on sustainable investment. I am convinced that these digital advice tools will complement rather than replace advisors, enhancing their skills and resulting in a better outcome for customers, who we know value face-to-face advice.

Empowering retail investors is more important than ever.

We also see RIS embedded in the broader ambition of the European Commission to foster the digital transition. Indeed, we applaud the fact that Europe is embarking on the most ambitious digital regulatory framework in the world, and we call on regulators and policy makers to encourage innovation in financial services allowing consumers and industry to reap the benefits of digitalization. At the same time, more energy should be devoted to identifying inconsistencies amongst the various sources of EU financial legislation. For RIS, a concrete improvement would be aligning provisions on layering and apps across the whole RIS package. In parallel, retail investors' financial literacy needs to expand to include a proper technical understanding of new digital tools and services. We stand ready to offer our insight in financial literacy and protection gaps.

Furthermore, improved delivery of financial advice can be achieved if regulators seize the opportunity to advance clarity and transparency in the distribution process. Ireland is a good example. As an insurer active in Ireland, we have good experiences with the Irish practice to disclose the amounts of commissions paid for the individual contract (or, if not possible, the methodology). Providing this information in a digital, layered format brings consumer empowerment to yet another level without unintended consequences such as information overload.

Overall, I am convinced that these important measures – clear communication, digital disclosure, and enhanced clarity in the distribution process - help advisors to engage with customers beyond mere transactions, supporting customer understanding and ultimately, a better customer experience. However, for the benefits of these digital opportunities to be realized, care will need to be taken in how the RIS package as a whole is designed to avoid unintended consequences to the advice ecosystem in individual member states.

STEFAN LEHMANN

Chief Executive Officer - Generali Deutschland AG

Digitalization in the RIS: an enabler, not a substitute, for personal advice

The Retail Investment Strategy (RIS) presented in May 2023 by the EU Commission can play a significant role in boosting the EU's Capital Markets Union. The proposal seeks to encourage more retail customers to take part in Europe's Capital Markets and to facilitate long-term investments and savings across the continent. This is crucial to closing the existing protection gap in pensions throughout the EU. More savings also means improved access to finance for businesses and accelerating the digital and environmental transformation of our economy.

While the public debate has so far focused on a potential commission ban, other elements are just as important to achieve the goals of the RIS. Among the lower-hanging fruits, the increased use of digital opportunities needs to be reflected in the regulatory environment. However, a stronger emphasis on the digital ecosystem is not a substitute for other measures; rather, an integrated approach is required to successfully promote retail investment.

Digital tools complement and enrich the range of services in insurance already available and create new opportunities. Therefore, we particularly welcome the proposal that "digital-by-default" should become standard for product disclosure as well as for the pre-contractual information for all insurance products. Adapting the IDD and the PRIIPs key information document to the digital age is important to meet customer expectations and improve operational efficiency.

Digitalization also has a role to play when it comes to increased transparency. More transparent information, as set out in the RIS, should be made available to the customer digitally. To make full use of digitalization's potential, it is also important to provide information in a way that is easy to understand. Transparency requirements should be focused on key aspects - those that really matter to the customer, in order to limit the risk of an information overload. At the same time, it should still be possible to obtain more detailed information in a timely manner if requested. Digital instruments such as chatbots and self-service tools could contribute to this.

Insurance distributors are increasingly using digital tools for communication and interaction with customers. However, to date, there is no clear trend for advice-intensive insurance-based investment products to be distributed digitally. According to data from the German Insurance Association, the share of digital sales (via website or app) in new business of life insurance policies in Germany is less than 2 % (in terms of premiums).

Digitalization is central for more transparency and increasing Value for Money.

Pension products must be individually tailored to the needs of the customer in terms of taxes, eligibility, coverage needs, risk and investment preferences as well as personal situations. One size doesn´t fit all. For many customers seeking products, digital tools cannot replace the human touch that customers are seeking when it comes to high quality advice. All distribution channels, digital and physical, are important and should be used in a targeted manner, putting the customer first. Regulation must ensure, that private old-age provision is accessible to a large part of society. We therefore welcome the proposal by the EU Commission for now to preserve fee- and commission-based distribution models to avoid the risk of advice gaps.

Digital sales can be useful for standardized products that are easy to understand. In this case, customers should already know their protection needs and investment preferences, and they should also have sound financial knowledge, which should not be taken for granted. Overall, due to different customer preferences, standardized products can only be an option for a very small target group.

This doesn't mean digital tools cannot boost traditional advisors. Where there can be improvements to the underwriting process, taking a first measure of customers priorities and overall process simplification, there can be an improvement in customer satisfaction. This can increase value for money, another objective of the RIS which needs to be reinforced in a holistic sense, by always keeping the interests of customers at the center. Currently, the RIS value for money approach focuses mainly on costs. However, the real value for the customer is also through a personal service provided by the advisor during the whole contract period - also supported by digital tools.

Insurers are taking these steps, embarking on a digital transformation process. EU legislation should support insurers in this journey through an appropriate regulatory environment – including a level playing field among stakeholders – and a focus on streamlining processes and information. Through this path, insurers will be ready with the advice, tailored products and customer experience that customers are looking for.

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Introducing savers to investment through effective use of digital propositions

Encouraging innovative ways to connect retail investors with markets is crucial for boosting retail participation in EU capital markets. Successful case studies provide insight into factors that drive future growth. Notably, the EU has experienced rapid growth in digital brokerage platforms. These platforms allow retail investors to trade investments like ETFs with minimal or no transaction fees. This has led to increased investment awareness and participation, with an estimated 10 million new brokerage accounts opened in Europe in 2020 and 2021.[1]

To further empower retail investors, we need effective policies built on these successes to demystify investing, thereby opening up investment to the millions of citizens who think investing is out of reach. The effective use of digital technologies can streamline the investment process, offer more choice, in a cost effective and transparent and way.

A key factor contributing to the success of digital platforms is the development of regular ETF savings plans, introducing retail customers to investments for the first time while offering institutional pricing at the fund level. These plans offer a straightforward way to invest even with small amounts, making capital market participation accessible to individuals with lower incomes. By investing in broad market exposures, investors avoid exposure to idiosyncratic risks. Monthly contributions enable investors to benefit from euro-cost averaging, smoothing the impact of potential market fluctuations from month to month, and aiding in long-term wealth accumulation. Such plans also encourage retail investors to adopt a long-term investment approach. Indeed, investors tend to hold these investments for an average of over 8 years.[2] The focus on user-friendliness and cost transparency has also attracted interest from historically underinvested demographic groups, including women and the under 35s.[3]

While the Retail Investment Strategy considers recent technological advances, we believe more can be done to ensure the EU regulatory framework fosters consumer-friendly innovations.

1. The current approach of a blanket ban on inducements for execution-only transaction overlooks business models where asset managers work with digital platforms to offset ETF transaction costs which typically represent a far higher proportion of the amount invested by retail investors than by institutional investors. By lowering investment cost for retail investors, digital brokers have driven higher participation. The proposed ban on inducements would prevent managers from subsidising retail investor costs and likely dissuade retail investors due to higher up-front dealing and transaction costs.

2. We also welcome initial steps toward developing a simplified advice model, especially for investments in non-complex products with relatively small amounts or regular contributions. Lengthy and complex initial assessments can discourage first-time investors. Alternative approaches, such as digital models could boost the adoption of ETF savings plans or products such as the pan-European Personal Pension Product (PEPP). Supervision and/or certification of social media "finfluencers" could also support this objective.

3. The shift to "digital by default" disclosure with changes to the Packaged Retail Investment and Insurance Products (PRIIPs) regulation is a starting point in recognising that rigid disclosure formats fail to cater to diverse investor needs and have in the past led to level of detail which is better consumed by intermediaries than by end retail investors. Digital formats that present the same core data in various ways, coupled with the ability to access additional information through hyperlinks, could enhance engagement.

4. Lastly, efforts in the proposed Financial Data Access (FIDA) legislation to promote open finance by aggregating investor's holdings data, with consent, could expedite the take up of digital planning tools. These tools would help investors and their advisors to join the dots on what they own, to better manage asset allocation and risk across portfolios. Ensuring investors have a clear initial point of contact to access this information is crucial, given that asset managers often lack end-client data due to intermediated investment channels.

Bringing together digital propositions will enhance trust and accessibility. Digital tools can enable large-scale implementation, complement existing advisory models, and improve investor communication. A digital-first environment will ensure that regulations align with and support advancements in disclosure standards, account opening, portfolio allocation, and advisory and trading practices.

1. *Source BlackRock proprietary research*
2. *Source BlackRock proprietary research*
3. *See Financial Times – 18 May 2023 BlackRock spies rapid growth in European retail ETF market | Financial Times (ft.com)*