Retail Investment Package: objectives and key proposals

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1. Main objectives and issues to overcome

1.1 Increasing retail participation in capital markets is a key objective of the Capital Markets Union initiative (CMU)

Developing retail participation in capital markets is important both for improving the financial prospects of EU citizens and for supporting the funding of the EU economy, which are two key objectives of the CMU initiative. Particularly at a time of high inflation and with interests served on bank savings accounts remaining relatively low, it is necessary to ensure that consumers can benefit from the investment opportunities offered by capital markets. Long term investments in stock markets in particular have delivered substantial gains in the past and are considered to be the main instruments that allow the provision of sufficient return for long-term projects such as preparing retirement. In addition, retail investment is a key driver of the development of capital markets that are essential for channelling private funding into the real economy and financing the green and digital transitions.

In the EU, the level of retail participation remains relatively low compared to other advanced economies. According to the Commission, in 2021, approximately 17% of EU household assets were held in financial securities, well below the amounts held by US households[1]. In addition a large share of EU households' financial wealth (around 40%) is held as bank deposits offering limited return.

Other statistics published in a recent CEPS study[2] show that during the 2015-2020 period, on average, EU households held 32% of their financial assets in securities directly or via investment funds compared to 51% in the US[3]. In addition, while EU household capital market savings grew during the pandemic, they have decreased in 2022, practically going back to pre-pandemic levels according to recent AFME figures[4], as economic uncertainty has increased.

The situation in terms of retail investment however varies to a large extent across EU member states. In the Nordics and NL, securities and pension fund based assets are the largest categories of financial assets. Currency and deposits in these countries represent around 20% of financial assets, a little over the US proportion of 12 to 15%. Whereas in many Southern European and CEE countries, bank deposits and savings accounts represent between 35 and 50% of household financial assets. The CMU indicators published in August 2023 consequently show significant variations across member states in terms of % of financial assets held by households in securities, investment funds and insurance and pension products compared to total financial assets (18 to 80%)[5].

1.2 Main issues and obstacles to overcome

A number of demand and supply problems hinder the development of retail investment in the EU. These were identified in the context of the consultations and assessments undertaken by the Commission for preparing the Retail Investment Strategy proposals.

A first issue underlined in the documents published by the Commission accompanying the Retail Investment Package proposal, is the low level of trust of retail investors in capital markets. The risk averseness of EU retail savers and their relatively low level of financial education[6], limiting their capacity to make the right investment decisions,

1. See European Commission – Q&A on the Retail Investment Package – 24 May 2023.
2. Source CEPS "Time to re-energize the EU's capital markets" Nov 2022.
3. The CMU indicators – European Commission August 2023 – show that in 2021 in the EU27, households held 59.5% of their financial assets in securities (bonds and listed shares), in investment funds and in claims against insurance and pension funds. The average proportion of the 5 previous years is similar.
4. Source AFME CMU Key Performance Indicators 5th edition November 2022.
5. Source: CMU indicators – European Commission August 2023 – Indicator 22: Direct and intermediated investment by households. The same dispersion across member states can be observed in terms of direct investment of households in bonds and listed shares (Indicator 20) ranging from 5 to 42% across the EU27 with an average of 17.2% and intermediated investment by households in investment funds and insurance / pension products (Indicator 21) ranging from 12 to 79% across the EU with an average of 55.7% in 2021.
6. The Financial knowledge indicator of the CMU indicators published by the Commission in August 2023 (Indicator 26) shows that on average in the EU27 only 26% of respondents in a representative panel were able to reply correctly to at least four out of five standard knowledge questions on finance. This score varies from 13% in Romania to 43% in the NL.

are also put forward. The consumer markets scoreboard has generally ranked investment services among the services that consumers trust the least. Specifically on investment advice, according to a recent Eurobarometer survey[7], only 38% of consumers are confident that the investment advice they receive from financial intermediaries is primarily in their best interest[8].

A second issue emphasized by the Commission, which is relevant from a supply side perspective, is that retail investors, when they invest, do not always get the best deal in terms of value for money of products and services or are not offered the most appropriate products. The relatively high fees and commissions charged by product providers and distributors in many cases may have a negative impact on the return that retail investors can potentially obtain. For example, in 2021, retail clients were charged on average around 40% more than institutional investors across asset classes[9]. The conflicts of interest, which may arise from the current distribution model in Europe involving the payment of inducements from product manufacturers to distributors, are also pointed out, as they may lead to the sale of more expensive and less performing products, providing investors with insufficient value for money. Further issues identified are the complexity of certain products sold to retail investors and the insufficient availability of independent advice.

The complexity and insufficient comparability of the information that investors are provided with is a third issue. Retail investors have difficulties accessing relevant, comparable and easily understandable investment product information to help them make informed investment choices, according to the Commission's assessments. Retail investors are also exposed to a growing risk of being influenced by misleading product communications on social media and via new marketing channels.

Some obstacles to the access of retail investors to capital markets have also been identified. The more experienced and sophisticated retail investors in particular, may face disproportionate administrative burdens related to retail investor protection measures when accessing the capital markets. The less experienced investors also face limitations in their access to capital markets, some observers suggest, due to the limited availability of simple products such as ETFs or of adequate pension products in certain member states[10].

A further issue is adapting current investment processes to the digital environment, which is both an opportunity and a challenge. Digitalisation presents many opportunities in terms of facilitating order execution, product and information comparability, and access to information *e.g.* with more user-friendliness and visual layering. Digital channels, in conjunction with AI tools, also offer a cost-effective means to deliver online guidance and advice. However, harnessing these advantages requires an adaptation of disclosures and investment processes to the new digital environment and also amplifies the potential for digital exclusion among certain customer segments.

Lastly, the dispersion of investor protection rules across a range of sector-specific legislative instruments – including the MiFID, UCITS, AIFMD, Solvency II and IDD Directives and the PRIIPs Regulation – leads to potential inconsistencies of requirements across comparable instruments and differences in the way they are implemented across member states. This results in differences in the requirements imposed on financial institutions and may also create confusion for retail clients investing in different types of products.

2. Key measures proposed in the Retail Investment Package (RIP)

The Retail Investment Package (RIP) published by the European Commission on 24 May 2023 aims to empower retail investors to make investment decisions that are aligned with their needs and preferences and to encourage more retail participation in capital markets, while ensuring that investors are treated fairly and are duly protected. This is in line with the objective of the CMU to make the EU an even safer place for people to invest their savings in the long term.

The measures proposed address some key issues that hinder retail investment at present, notably in terms of trust, value-for-money and financial literacy and also aim to adapt the retail investment framework to the digital age. The RIP package includes a wide range of measures in four main areas, covering the entire investment journey of retail investors: (i) product distribution and advice; (ii) product disclosures and information; (iii) investor education and access; and (iv) supervisory cooperation.

7. See Eurobarometer survey monitoring the level of financial literacy in the EU, 2023. The relevant question is Q12: "How confident are you that investment advice you receive from your bank/insurer/financial advisor is primarily in your best interest?"
8. According to this survey, 45% of consumers are not confident that the advice they receive from financial intermediaries is in their best interest.
9. See ESMA, Performance and Costs of EU Retail Investment Products, 2022.
10. See Eurofi Views Magazine September 2023 G. Prache, Better Finance "For an effective retail investor strategy". The difficulty of accessing to bias-free advice is also pointed out in this article as a further obstacle for retail investors.

These new requirements and improvements are included in two texts amending existing legislation:

- An amending Directive, which revises the current rules set out in the MiFID II, IDD, UCITS, AIFMD and Solvency II Directives
- An amending Regulation which revises the PRIIPs Regulation

2.1 Product distribution and advice

The review of **inducement rules** is the area that gave rise to most debate in the preliminary phases of the Retail Investment Strategy initiative.

The possibility of a full ban on inducements was evaluated by the Commission in the impact assessment accompanying the RIP proposal and was considered to be potentially the most effective measure for removing or significantly reducing conflicts of interest and improving investor outcomes[11]. However, given the possible consequences for existing distribution systems (notably a potential loss of revenues in vertically integrated distribution networks that are predominant in many member states) and the possible negative impacts for investors (risk of fostering closed distribution models focusing on in-house products, possible advice gap for the less wealthy clients), the decision was taken to propose a staged approach allowing operators to adjust their distribution systems progressively and minimize the related costs.

The Commission therefore proposed a prohibition of inducements for execution-only environments, where no advice is provided, as a first step, as well as an improvement of disclosures and explanations given to the client regarding the payment of inducements. The extension of inducement measures to IBIPs (insurance-based investment products) is also proposed with the introduction of the proposed changes regarding inducements in a uniform way in both MIFID and IDD. These measures concerning inducements will be reviewed 3 years after the adoption of the RIP package, with the possibility of making further proposals, including an extension of the inducement ban, if the situation has not sufficiently improved.

In order to improve the **quality of advice**, the Commission has also proposed replacing the current 'quality enhancement' test of MiFID inducement rules – that allows for the payment or receipt of inducements to the extent that they enhance the quality of the service – with strengthened 'best interest' criteria that would apply to all advice provided with or without the payment of inducements in both MiFID and IDD.

Advisors would be required to (i) base their advice on an assessment of an appropriate range of financial products (*e.g.* a sufficiently broad range of products); (ii) recommend the most cost-efficient product from the range of suitable financial products; and (iii) offer at least one financial product without additional features which are not necessary to the achievement of the client's investment objectives and that give rise to additional costs, so that retail investors are presented also with alternative and possibly cheaper options to consider.

To encourage the provision of independent and cheaper advice, the proposal moreover introduces the possibility for independent advisors[12] to provide advice limited to a range of diversified, non-complex and cost-efficient financial instruments. For these products, distributors will be able to perform a lighter suitability assessment on the basis of more limited information about the client. Given that the advice is limited to well-diversified and non-complex products, an assessment of the knowledge and experience of clients, together with their portfolio diversification, will not be required.

2.2 Product disclosures and information

Value-for-money and product governance are a second area that was much debated during the preparation of the RIP proposal, following the work conducted in these areas by ESMA and EIOPA. According to the assessments conducted by the Commission and the ESAs, evidence shows that some products on the market provide little if any value-for-money for retail clients, due to high product costs[13].

Building on existing MiFID / IDD product governance rules and UCITS / AIFMD product pricing rules, the RIP would require that product manufacturers and distributors assess the overall costs incurred by investors when purchasing a product, and its expected return, and only manufacture / distribute products likely to provide sufficient value-for-money for retail investors. This would be objectivized by the provision of regularly updated benchmarks by ESMA and EIOPA in terms of product cost and performance. Products with a value-for-money inferior to the relevant benchmark would not be

11. The impact assessment accompanying the RIP proposal underlines that the ban on inducements implemented in the NL led to an increase in the number of households investing in low-cost index funds (these more than doubled from 8 to 20% between 2016 and 2021) and to a significant fall of mutual fund management fees (-40% on average), leading to improved investment outcomes for retail investors. In addition, a ban is expected to improve market efficiency on the supply side by allowing providers and distributors to compete on the basis of the merits of their investment product offering, rather than on commissions.
12. Advisors that cannot receive inducements and are required to advise on products from different providers.
13. Some surveys, such as a recent Eurobarometer survey, show that these issues are also perceived by a significant proportion of investors, with around 40% of savers declaring that the products they are sold do not provide sufficient value for money. See Eurofi Stockholm Summary – "Retail Investment Strategy : are we tackling the main issues?" April 2023 .

allowed to be marketed to retail investors, unless further testing demonstrates the contrary.

This measure would be completed by an 'undue cost' rule requiring management companies to evaluate due and undue costs with a standardized pricing process and criteria defining due costs, building on existing UCITS and AIFMD provisions.

The RIP moreover proposes to improve product disclosures with requirements for the provision of more meaningful and standardised information about investment products and services and a better adaptation of disclosure rules to digital channels and to investors' growing sustainability preferences. Proposals are also made to enhance the comparability of product costs with the use of standardized presentations and terminology to help investors identify the products offering the best value-for-money. In addition the provision to clients of a reporting of portfolio performance would be required at least on an annual basis.

Further measures are proposed in the RIP to improve **marketing communications on investment opportunities** in the context of a development of new online channels. Studies indeed show that when making decisions, investors are often influenced by the first piece of information that they see. The RIP proposal stipulates that marketing communications should be clear, fair and should not mislead investors, regardless of the channels though which they are distributed and whether performed directly or indirectly by the investment firms. Requirements would also be introduced in relation to the content of advertisements, which should present risks and benefits in a balanced way and include key product characteristics.

Finally, the RIP addresses the risks associated with finfluencers that advertise investment products or services via social media or other digital channels. Investment firms would be liable under the RIP for any marketing performed on their behalf and would be responsible for the content and compliance of marketing communications, regardless of whether other third parties have been paid or simply incentivized to create promotional content. In practical terms this means that firms would need to keep records on all marketing communications and strategies put in place. In addition, the competent authorities would gain new enforcement powers, allowing them to suspend or prohibit misleading marketing communications and possibly order the removal or the restriction of the access to inappropriate online content.

2.3 Investor education and access

Increasing the level of **financial literacy** in the EU is one of the priorities of the Commission under the 2020 CMU action plan. The objective concerning retail investment is to ensure that citizens feel more empowered to make decisions that may contribute to their financial well-being, particularly those with a long term perspective such as preparing for retirement. They are not expected to become experts in finance themselves, but to understand the benefits and risks involved with investments and the financial advice they may receive. While there is wide support for this objective within the private and public sectors, the challenge is that education is outside the EU's competences. The RIP therefore focuses on encouraging Member States to introduce national measures aiming to improve the financial education of retail investors. This will complete actions already undertaken by the Commission to help Member States in the implementation of domestic financial education initiatives.

The Commission is also working with the OECD on the development of joint financial competence frameworks that lay out the knowledge, skills and behaviours that individuals need to have to ensure their financial well-being throughout their lives. A first framework for adults was published in January 2022 and a second framework for children and teenagers is expected by the end of 2023. These frameworks however still need to be operationalized.

The RIP also proposes measures aiming to improve the standards of **professional qualification of financial advisors**, given the variable levels of qualifications and skills currently observed across the EU. A strengthening and harmonization of the requirements on knowledge and competence of advisors that are already set out in MiFID II and IDD is proposed in particular.

A further measure proposed is the reduction of administrative burdens for sophisticated investors with more proportionate eligibility criteria for becoming a professional investor. These criteria will take into account in particular the client's experience and level of education, where relevant, and existing monetary thresholds will be lowered.

2.4 Supervisory cooperation

A final area included in the RIP proposals is supervision, with measures proposed to strengthen **cross-border supervision**. Indeed many mis-selling issues observed in the EU relate to products provided on a cross-border basis through the freedom to provide services provisions. These issues are due to develop with the increasing digitalization of financial product distribution and the progressive implementation of the CMU objectives. Problems related to the cross-border distribution of investment products are challenging to handle at present for host supervisors, because they have no real power when products are sold remotely with no physical presence in the host country. In addition, home supervisors sometimes lack the proper expertise and resources to sufficiently supervise how their firms comply with consumer protection rules when operating in host jurisdictions and may have limited incentives to act swiftly in case a problem arises, if their home market is not concerned.

The RIP thus proposes to facilitate the cooperation between national competent authorities (NCAs) and the ESAs for tackling cross-border fraud and malpractice issues within the EU and to ensure a proper and coherent application of rules across member states (*e.g.* with a facilitation of information exchange and stronger supervisory convergence with regard the authorization of investment firms). Reporting obligations will also be introduced for investment firms and insurance distributors on their cross-border activities to enable the NCAs and the ESAs to have a better overview of the scale of cross-border provision of services and products within the EU.

New articles in MiFID and IDD also set requirements for competent authorities to have adequate procedures in place to prevent the offering and marketing of unauthorised investment services or activities, and to establish information channels to notify and warn investors of such services or activities, *e.g.* through warning lists available on the ESAs' websites. Host member states will moreover be allowed to take precautionary measures in case of harmful behaviour of providers not adequately addressed by the home member state.

3. Next steps and first reactions

The European Commission has requested feedback on the RIP legislative proposal by 28 August 2023. The RIP proposal will then go through the European legislative procedure with the objective to reach a negotiating position in the Parliament and the Council on the Level 1 text before the upcoming European elections (June 2024).

At the time this paper is written, a summarized feedback from the market and from supervisory authorities on the RIP proposal is not yet available, but preliminary statements and reactions show that while the RIP proposal is strongly supported as an important step in the right direction to further develop retail investment, a certain number of issues remain to be further clarified or fine-tuned.

There is generally support for the wide-ranging and holistic approach to retail investment proposed in the RIP and more specifically for the objectives of improving and streamlining disclosures, adapting investment processes to the digital age and promoting financial literacy.

The preservation of both fee and commission-based distribution models, with the staged approach to inducements, is also welcomed although some stakeholders have suggested that the measures proposed may still have disruptive consequences for the European financial sector and that the conditions under which commissions may continue to be paid remain to be clarified.

The new 'best interest of the client' test in particular raises some concern. Industry stakeholders point out that the criteria proposed mainly focus on costs, which may lead clients to prioritise the cheapest or simplest products, rather than those likely to provide most value. The same would go for the product governance and value for money requirements if the proposed benchmarks focus excessively on costs. Market players indeed emphasize that value is not only a question of costs but also of return for investors and alignment with investment objectives and that an appropriate combination needs to be found between these different criteria in the recommendations made. Moreover the potential complexity of establishing such benchmarks is also underlined, as well as the risk of insufficiently capturing the specificities of the products and services concerned[14].

The timeline of the RIP initiative is a further challenge. A first issue is the timing of the Level 1 adoption with the current political cycle ending in less than one year's time. A second issue is the timing of implementation with the challenge of changing many components of product management and distribution at the same time. Some observers have suggested that tackling the issues related to the digitalisation of financial services and to the on-going implementation of open finance should be given the priority, leaving more time to fine-tune the other measures of the RIP that may have significant implications for product manufacturers and existing distribution channels in the EU if they are not appropriately designed and implemented[15].

14. See for example Eurofi Views Magazine September 2023 – M.A. Barbat-Layani, AMF, mentions in her article that providing relevant benchmarks may face methodological problems and take years to develop. This will notably require the establishment of appropriate and commonly accepted definitions, the availability of robust data – which may necessitate adequate product reporting to be in place – and the proper identification of cost outliers.

15. See for example Eurofi Views Magazine September 2023 – R. Dumora, BNP Paribas.