# Retail Investment Strategy proposals

## 1. Overall objectives of the Retail Investment Strategy

### 1.1 The Retail Investment Strategy, a key component of the CMU

The Chair observed that the Retail Investment Strategy (RIS) is one of the flagship initiatives of the Capital Markets Union (CMU). The measures proposed in the RIS proposal published on 24 May 2023 cover many different areas, including product distribution, advice, product disclosure and information, investor access, education and supervisory cooperation.

An investor representative stated that the RIS is a unique opportunity to create a CMU that works for retail investors, which is one of the key objectives of the CMU. In the public debates on the RIS, there has been broad agreement on the need to increase retail participation in the capital markets and an acceptance that this will only happen if there are better outcomes for consumers. Transparency and trust will be crucial factors in driving increased retail participation.

A regulator emphasised that the RIS adopts a cross-sectoral approach that will apply similar rules to all packaged investment products, including investment funds and insurance-based investment products (IBIPs). This should contribute to building investor trust.

An industry speaker emphasised that the need to develop retail investment is made more acute by ageing populations across Europe and the requirement for new investment in the energy transition. More than €500 billion will be needed to modernise Europe's outdated energy grids, which will have to come in part from retail investment.

A challenge however, an industry speaker noted, is that many European savers are risk averse. They worry more about maintaining their capital rather than obtaining significant net return. This explains why guaranteed savings products remain popular although they provide a real negative return when considering inflation.

### 1.2 Enhancing financial literacy

An industry speaker emphasised that improving financial literacy is one of the main challenges faced by European society and should be a key objective of the RIS. Investors must be taught to invest into capital markets in order to improve their long term financial prospects. School curricula must be reviewed to include this. This is becoming even more important in light of the ageing populations across Europe and is also a challenge in many other countries, notably in Asia. This will also create more demand for investment solutions and contribute to increase retail investor participation over time.

A regulator agreed on the importance of improving financial literacy and noted that financial education is already part of the Belgian school curriculum. People need to be aware of the need to invest for the long term and the benefits they can get from financial advice. Retail investors will only fully benefit from the RIS proposals if they have a sufficient level of financial education. For example, to benefit from additional disclosures, retail investors need to be able to understand the information that is being provided. Financial education is also needed to ensure that investors understand the risks and opportunities offered by the green and digital transitions and can detect possible scams or misguided recommendations made by financial influencers. Another regulator agreed that it is crucial to make progress on financial literacy, and also underlined that the role of influencers needs to be addressed. France has recently published a new regulation on the latter subject, notably creating a certificate for 'responsible' finfluencers.

A third regulator noted that conducting initiatives on financial literacy is essential. This will require extensive work at European and NCA level. However, not all NCAs currently have a mandate in this space.

### 1.3 Strengthening cross-border supervision

A regulator welcomed the measures proposed to improve the equilibrium between home and host supervision. There is indeed increasing cross-border provision of financial services in the EU under the freedom to provide services principles, which is due to continue with digitalisation, but investor complaints about transactions and services provided on a cross border basis are also growing. Therefore, without questioning the European passport, the relations between home and host supervisors must be enhanced. Since the passport is still not supported by a single supervisory model, the enforcement powers regarding conduct and product governance rules should also lie with host supervisors, to ensure a homogenous implementation of regulations across the EU.

## 2. The RIS proposals on value-for-money

### 2.1 Objectives of the value-for-money measures

The Chair explained that the value-for-money (VFM) measures will require manufacturers and distributors to compare their products against relevant product benchmarks developed by ESMA or EIOPA to ensure that they provide retail investors with sufficient VFM. The assessment of VFM should not only include cost, but also performance and a wider range of characteristics that create value for retail customers.

The objectives of the VFM proposals were welcomed by several panellists.

A regulator stated that improving VFM should help build the trust of retail investors, which is essential for increasing retail engagement in the capital markets. Investors must believe that they will get VFM when they embark on their investment journey. ESMA's annual reports on cost and performance show that high product costs have a significant effect on investor returns. The Common Supervisory Actions (CSA) undertaken with the national competent authorities (NCAs) have identified cases of overcharging, which negatively impact the outcomes for retail investors.

Another regulator underlined that more investors' engagement is needed. The concept of VFM is key in this perspective. Supervisors have an essential role to play (through their controls, they may witness unacceptable cost structures that do not allow any return for investors).

Under the VFM proposals, manufacturers and distributors will be expected to assess the cost and performance of products against regularly updated benchmarks, the first regulator noted. Benchmarks can be helpful for allowing supervisors to identify outliers that are not providing sufficient VFM. However, the VFM proposals could be made more effective by disclosing these benchmarks and comparisons to investors as well as to supervisors. These benchmarks could indeed enable investors to compare products, make better decisions and potentially obtain a better deal in a competitive market.

A third regulator considered that the VFM proposals should be beneficial to retail investors. These measures further develop and enhance existing requirements in MiFID and the EU AIFMD and UCITS fund frameworks and also take into account recent initiatives at European and national level around product costs, such as the ESMA CSA. The benchmarks proposed will introduce more objectivity in the assessment of product costs. This is not price regulation, but a way of identifying outliers and enabling the NCAs to tackle them with the firms concerned. As the RIS introduces explicit rules and more objectivity, this can make supervision easier and more efficient, and it should contribute as well in enhancing convergence. The significant focus on documentation in the proposals will also facilitate supervision and increase the responsibility of product manufacturers and distributors in this area.

An investor representative was supportive of the VFM framework as a way to improve outcomes and create better safeguards for retail investors, even though its goal is mostly to enforce the existing rules. The perspective of higher long term returns should encourage more retail investment and therefore the VFM framework is a positive step forward.

Some panellists were however in favour of considering alternative approaches to improve VFM.

An industry speaker regretted that the discussions about VFM have focused mainly on costs and product benchmarks. These considerations might be relevant for people who have already made investments, but they will not attract new investors. The objective should be to enforce the existing rules more effectively with a focus on tackling outliers, rather than imposing new rules.

A second industry representative suggested that the VFM objectives could be more effectively achieved in the context of the governance of fund management companies, by ensuring that the independent directors of fund management companies have a clear mandate to consider product costs.

A third industry speaker felt that benchmarks do not need to be coordinated by regulators; the process can be handled by the market as for household appliances.

### 2.2 The definition of product benchmarks

Several panellists emphasised the importance of adopting a holistic approach to VFM benchmarks rather than focusing solely on cost.

An industry representative stated that the current proposal regarding product benchmarks is too cost-centric. This is not how clients think about their investments. VFM is not only about cost; it is also about performance. Clients want to understand how their investments are performing, the risks they are facing and whether they could obtain a better performance with another product. In addition, consumers' interests go much further than net return: they are interested in advice and in obtaining information about new market developments such as ESG. Comparing the fees across different products is secondary for most clients. Any product comparisons should take into account all of the different factors of performance. It would also be more useful to provide investors with an indicative median return net of fees, rather than comparing product costs.

A second industry speaker emphasised the importance of taking a holistic view to VFM, which is driven by different factors. The main driver is performance, which includes cost and also other factors. The first of those is risk. Customer's tolerance of risk will depend on the situation of the customer, their investment horizon, the composition of their household, their tax environment and their life project. The liquidity of assets is another important consideration. There is an increasing appetite for real economy assets such as private equity assets, for example, which are less liquid than securities. Some other customers want to prioritise objectives such as ESG, sustainability or EU sovereignty in their investments.

It is also important to take into account some of the qualitative dimensions of VFM, such as the quality of service or of the trading platform, the industry speaker added. Some customers will need support not only during the transaction but also over time, notably during periods of crisis. The execution platform needs to be efficient and user friendly, with the ability to provide human interaction where necessary. The reputation of the management company and the track record of the firm intermediating the transaction are another part of how a customer will view an investment solution. The advice a customer may receive will be another key component, as well as its scope i.e. whether it is limited to a transaction or extends to broader wealth

management. This holistic approach to VFM is at the heart of the industry's business model and is the basis of the competitive game in the retail investment business.

A third industry representative considered that transparency and product comparability are important for investors, but it will be difficult to build the type of product benchmark framework envisaged in the RIS. These proposals might also have the unintended consequence of fixing a price cap on investment products. This would be detrimental for the development of high performing products that may support the EU's strategic objectives of increasing long term and sustainable investment. Such an approach could be particularly damaging to European Long Term Investment Funds (ELTIFs), which are inherently expensive to manage due to the cost of accessing the private markets. Equally, sustainable investments involve higher governance and monitoring costs, which will need to be factored in.

The Chair underlined that VFM is about more than simply the price of the product. The challenge is in striking the right balance between the different factors to take into account. The concept must not be overly static either.

An investor representative highlighted that the RIS proposal explicitly mentions performance as well as cost as the two crucial factors for assessing the VFM of investment products. The impact of costs must not be overlooked. Studies on cost and performance in UCITS funds have found a correlation between higher fees and lower returns and shown that high fees were almost singlehandedly to blame for disappointing real returns for investors. Better Finance's research also shows that the costs of retail investment are often too high and identified cases of overcharging.

A regulator agreed that a holistic approach to VFM is needed including costs and different factors of performance such as risk-return and liquidity. The concept of VFM already exists in the current regulatory and supervisory framework, but the RIS proposals will allow to enhance it further. The solution cannot be one-size-fits-all either as the perception of VFM may vary across investors depending on their personal situation, the moment in their life cycle etc.. The use of benchmarks should enable to facilitate the comparison of packaged products on criteria that are important for a majority of retail investors. In the past, supervisors have had to use their enforcement powers to deal with unacceptable products with advertised levels of returns that were impossible to achieve with their cost structure.

Another regulator also noted that VFM is not only about cost, but about the overall value for investors. This should be taken into account in the benchmarks established by ESMA and EIOPA. The idea of performance scenarios should also be reconsidered as work continues on improving the Key Information Document (KID) for packaged retail investment insurance products (PRIIPs).

### 2.3 Implementation challenges concerning the VFM measures

A regulator stressed that implementation will be key for the effectiveness of VFM requirements. This requires a careful drafting of the level 2 and level 3 measures, which will be challenging. Another regulator explained that ESMA will be playing an important part in the implementation of the VFM proposal. There is still a large amount of detailed work to do to define the product benchmarks and determine how they can be used in the supervisory process. Detailed requirements will be needed to build the benchmarks, including clear definitions to ensure there is broad agreement on the aims of these measures. Data will also be needed to build the benchmarks, which might lead to additional reporting obligations.

Another regulator highlighted the main challenges raised by the implementation of the VFM measures. First, there is the need to build an appropriate methodology to establish the benchmarks. One part of the work in the design phase will be to produce a cost structure that is meaningful for supervisors and clients, using a sufficiently holistic approach. There will be a challenge in identifying the relevant peer groups, especially if the benchmarks apply across Europe, because retail investment markets are very fragmented and differ quite significantly from one country to another, making it difficult to make comparisons across products. In the Netherlands, for example, pension funds are very important, while in France, life insurance products and regulated savings accounts are more prominent. Tax treatments vary also, as do financial investment cultures. There will be a second challenge around the assessment of product performance. Under the current PRIIPs framework, forward-looking performance scenarios are compulsory and the use of historical performance is prohibited. However historical data can also be useful for certain investors to understand how a product has performed in the past. Finally, there is a challenge about the data on which these benchmarks will be based, because creating an additional unnecessary layer of reporting should be avoided. The data from PRIIPs KIDs could be a basis for establishing the benchmarks potentially.

An investor representative acknowledged the concerns about the difficulty of implementing the VFM measures. EU policy-makers should compare the measures proposed in the RIS with some lighter measures such as the value assessments introduced by the UK Financial Conduct Authority (FCA). Similar measures could be very beneficial in the EU.

An industry speaker agreed that the implementation of the VFM measures is a complex challenge. The information given to consumers should also be concise, understandable and useful to avoid a detrimental information overload. The framework should also be innovation friendly and stable. This will be a costly process, which will require significant investment from financial firms.

Another industry speaker felt that it will be challenging to implement a system of benchmarks. Market participants already have difficulties today in mapping funds to fulfil NCAs' reporting requirements. Agencies such as Morningstar also face challenges for certain products, let alone (hedged) share classes and currencies. How this type of benchmarking can remain feasible while still having the required impact remains to be clarified.

## 3. Measures on inducements

### 3.1 The issues raised by a ban on inducements

An industry speaker stated that a ban on inducements would not be helpful. The experience in the UK and the Netherlands has shown that banning inducements causes some retail investors to leave the market because they either cannot afford or do not want to pay for advice. A ban is also difficult to implement with the current low levels of financial literacy across the EU. Most investors need advice, and this advice has to be paid for by retail investment activity. In addition, distribution has a cost. It is misleading to assume that execution only products are free. Execution platforms cost money to maintain and listing fees need to be paid. It is also not possible to invest at low cost in impact funds aligned with the SDG sustainable development goals. For these reasons, a balanced approach should be taken to each asset class and consumer segment.

A second industry speaker was similarly against a ban on inducements. There are three groups of investors. First, there are people who want to invest on their own and who usually are educated enough to do so. Secondly, there are wealthy people who are able to pay for personalised advice. Thirdly, there are average retail customers who cannot afford to pay for advice or are not ready to do so, but need to have access to advice in order to take appropriate investment decisions. The best way to provide advice for this third category of customers, which represents the majority of retail investors, is to mutualise the cost of advice among market participants. Inducements are the most effective way to do this.

A third industry representative agreed that retail investor participation will not increase unless retail investors are able to speak to human advisors during the investment process. The only way to pay for this advice in the current system is through the use of inducements. If inducements are banned, the cost of advice will be too high because it will no longer be mutualised and advice will be limited to the most wealthy clients.

A regulator acknowledged that a complete ban on inducements would have unintended detrimental consequences, but stated that progress must be made on this subject. One area of improvement is to make inducements transparent and facilitate their comparability across products, which would help clients to understand the potential influence they may have on advice.

An investor representative considered that the RIS introduces a welcome ban on inducements for unadvised transactions and extends the measures on inducement to IBIPs. However, member states should not have the possibility to opt out of this ban by making advice mandatory. This would further reduce the already quite limited scope of the inducement ban.

A regulator observed that advice is not free and has to be paid for one way or another. People do not want to pay for it upfront, but they often do not realise that they are paying for it already in an indirect way. This issue needs to be dealt with in the approach to inducements.

### 3.2 Best interest of the client criteria

An investor representative emphasised that advice must be provided independently and in the best interests of the client. There is a large amount of evidence showing that advice from conflicted parties does not provide good outcomes for consumers. A Better Finance study on the French market and a recent study published by the Regensburg University on the effect of commission bans on household wealth both show this.

A regulator agreed that advice should be in the best interest of investors, meaning that it must be fair, unbiased and adapted to their needs, profile and objectives. Progress therefore needs to be made in this respect. Access to advice must in any case be ensured.

An industry representative highlighted that the 'best interest of the client' criteria that are due to replace the current 'quality enhancement test' for allowing the payment of inducements are confusing, although the principle is intellectually appealing. The concept is based on the best interests of a standard investor, but there is no such thing as a standard investor. Every investor's situation is unique, which is why MiFID requires personal 'suitability' or appropriateness. In addition, the proposed criteria are unclear, particularly the requirement to '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'. Advisors are supposed to recommend the lowest-cost product without unnecessary additional features, but there is no clarity on how this should be done.

### 3.3 The prospects of digital advice

An industry speaker observed that digitalisation is often presented as a way to further reduce the cost of advice, but financial institutions are already digitalising their processes, including profiling, underwriting and contract management, therefore the incremental gain will be limited in the future. This is a long journey that requires a considerable amount of investment, but it is happening. It is also important to remember that retail investors want to speak with human advisors when it comes to making important investment decisions for the long term. A recent survey conducted in France indicated that 75% of customers want to speak to a human being during the investment process. People are happy to accept a hybrid system, but they want to be able to contact a human advisor if needed for advice or for finalising an investment, which comes with a cost.

A regulator added that digital advice may be a solution in the future, but for the time being most investors, especially those who invest large amounts, tend to be older than the average population. We must remain cautious that a higher reliance on digital advice does not result in a new form of advice gap.