FESE Response to Commission Consultation on a Retail Investment Strategy for Europe

EXECUTIVE SUMMARY

3rd August 2021

The Retail Investment Strategy for Europe comes at a crucial time to shape the development of the Capital Markets Union (CMU) and to tackle the economic effects of the COVID-19 pandemic. Increasing retail investors' access to capital markets will be vital if Europe is to secure a sustainable recovery and shared prosperity for the future. While trading venues do not interact directly with retail clients as they access markets through financial intermediaries, **FESE believes that Europe needs to empower retail investors by making investment practices simple, cheaper, transparent, and by taking steps to prevent conflicts of interest**.

The CMU must look after the savings of households and integrate retail investors into capital markets with appropriate rules for investor protection. Too often citizens are only offered expensive packaged products by intermediaries rather than direct investments without management fees.

To incentivise active retail participation and financial planning, simple and cost-efficient products such as equities, bonds, and exchange traded funds (ETFs) must be easily accessible across the EU.

It is counterproductive, then, that the packaged retail and insurance-based investment products (PRIIPs) Regulation restricts retail investor access to classic corporate or bank bonds, when the MiFID II "quick fix" gave them the green light. FESE therefore believes that the scope and the definition of complex products - with specific focus on these bonds as well as exchange traded derivatives (ETDs) – needs recalibrating.

Thus, contrary to the objectives of the CMU, new barriers to retail investment are being created rather than dismantled. With retail investors less able to make independent plans for retirement, their savings cannot be mobilised through capital markets in support of Europe's social and environmental ambitions.

Access to simple products and disclosure requirements

Access to simple and cost-efficient products such as ETFs and bonds is increasingly limited by existing regulation. Under the current regulation, long delays and the possibility to publish selected data points of one single transaction in bonds over a certain period is not only overly complex but it also prevents usable transparency to the public. This is to the disadvantage of EU investors, as proper transparency data in bonds could also enable passive investment in bonds for the benefit of investors and issuers alike.

We further believe that:

- The PRIIPs Regulation should not apply to the offer of corporate bonds with a make-whole clause.
- The scope of the PRIIPs Regulation should also be strictly limited to packaged investment products for which there is a greater need for retail investors' protection.
- The definition of complex products should be revised.
- ETDs should not fall under the scope of

Digitalisation and new technologies bring a series of opportunities and risks to retail investors related to availability of information, access to products and transparency. Open finance, for instance, could bring considerable benefits in leveraging the opportunities brought by new technologies by bridging traditional financial institutions, FinTechs and IT companies. The EU approach of establishing trusted data intermediaries could bring together all actors. Nevertheless, the regulation of such intermediaries, the availability of high IT security standards and the appropriate compensation of original data providers by user companies will be key to ensuring investor protection and to preventing the misuse or leakage of customer data. For investors to make use of the different product offers available through automation and standardisation, a digital identity is crucial – such as provided by approaches like the EU Regulation on electronic identification and trust Services for electronic transactions (eIDAs).

New technologies
Consider new technologies that could enhance the availability of EU data and research. This would facilitate the data collection and understanding of costs and benefits by companies and investors, thus increasing participation.

Further, the business model of online brokerages offering commission-free services – when, as is often the case, it is based on the payment for order flow (PFOF) mechanism – can create a conflict of interest between the duties to their clients and to third parties. This is inconsistent with the best execution requirements of MiFID II. In PFOF arrangements, brokers systematically route retail order flow to certain venues in return for a payment. So, while PFOF may imply lower trading costs, because it incentivises brokers to direct order flow to the venue that offers them the highest payment, investors cannot be assured of the best possible execution quality.

Payment for order flow (PFOF)
PFOF models, in both their direct and indirect forms, are detrimental for the investor and market as they lead to hidden costs and worse prices for end investors, hinder competition between market makers and trading venues (pay to play models), cause negative selection of order flow and most worryingly create an inherent conflict of interest between the broker and its client. PFOF arrangements should be banned.

Consolidated Tape
An end-of-day post-trade Consolidated Tape that covers 100% of all transactions could benefit retail investors and the entire market by enabling ex-post best execution analysis.

In order to strengthen the EU retail investor protection framework, FESE suggests a revision of the best execution regime, aimed at ensuring that retail investors always get the best possible terms for the execution of their orders. An end-of-day post-trade Consolidated Tape that covers 100% of all transactions could benefit investors and the entire market by enabling ex-post best execution analysis. **Moreover, FESE recommends banning the practice of PFOF** as part of the upcoming review of MiFID II/MiFIR in light of the inevitable conflicts of interest – incompatible with MiFID – which arise.

Another aspect affecting retail investor access to financial products relates to the level of expertise and knowledge. FESE supports the introduction of an additional 'semi-professional' client category of investors as a way to increase the accessibility to financial instruments currently out of reach for non-professional investors. This proposal would apply to a newly created category of investors that have sufficient experience and financial means to understand the risks. Such a definition should not be linked to a specific profession but rather experience, knowledge and risk profile. The introduction of this new category could facilitate retail investors' access to a variety of alternative kinds of investments, such as Alternative Investment Funds (AIFs), fixed income securities (e.g. corporate bonds), real estate, and securitisations instruments, provided that it is accompanied by appropriate investor protection rules: safeguarding investor protection is key to ensure confidence in the market. FESE fully shares the EU's objective of ensuring protection and agrees that some product intervention measures at the European level might occasionally be necessary for specific products.

Investor categorisation
The current classification of professional and non-professional investor limits the access of retail investors with a higher level of knowledge to certain financial products. The introduction of a semi-professional investors category, and/or revision of the professional investor category, could increase access to products currently out of reach and lead to greater retail investor participation.

Furthermore, as expertise and knowledge are crucial factors enabling investors to make informed financial choices regarding saving, investing, and borrowing, **efforts should be made to improve overall financial literacy in Europe.** Indeed, while levels of financial literacy remain so widely varied across the EU it will be an impediment to the long-term investments and investor outlook indispensable to a successful CMU.

Financial literacy
The EU should develop and/or fund – with the cooperation of the private sector – educational campaigns promoting financial literacy and equity culture. Care should, however, be taken to avoid information overload.

Beyond these broader considerations, we also advocate:

- the provision of tax incentives for long-term and pension investors
- the elimination of existing tax discriminations for individual investors in the EU (such as double taxation of dividends)[1]
- the promotion of a variety of possibilities for end-investors in relation to equity financing and investment
- the right of retail investors to invest not only through products such as the pan-European personal pension product (PEPP) but also directly in indices based on national, regional, and pan-European equities.[2]

Finally, FESE believes that an ultimate success factor for a full CMU is **regulatory and supervisory convergence** across the EU. The impact of diverging supervisory practices tends to be particularly significant in areas where there is a move towards high-levels of EU regulatory harmonisation, underpinning cross-border business and competition. Efforts should focus on those areas with cross-border characteristics, and supervisory convergence should mean ensuring that legislation is implemented as intended by the legislator to establish a level playing field, while identifying and recognising any situations in which there may be more than one way to achieve these objectives.

[1] While both tax incentives and double taxation issues are within the remit of EU Member States, the CMU should promote appropriate measures in this respect.
[2] Indices used for the benchmarking of those investments should be broad, representing both large enterprises and SMEs.