FESE response to ESMA call for evidence on the European Commission mandate on certain aspects relating to retail investor protection (ESMA35-43-2827)

Brussels, 20th December 2021

Q1: Please insert here any general observations or comments that you would like to make on this call for evidence, including any relevant information on you/your organisation and why the topics covered by this call for evidence are relevant for you/your organisation.

Q2: Are there any specific aspects of the existing MiFID II disclosure requirements which might confuse or hamper clients' decision-making or comparability between products? Are there also aspects of the MiFID II requirements that could be amended to facilitate comparability across firms and products while being drafted in a technology neutral way? Please provide details.

Q3: Are there specific aspects of existing MiFID II disclosure requirements that may cause information overload for clients or the provision of overly complex information? Please provide details.

Many investors complain about an overload of information. Too many documents, some of which are difficult to understand, quickly overwhelm retail investors and deter them from investing. For example, non-professional investors are presented with up to 20 documents to be signed before the contract to buy a security is finalised, which are often over 300 pages long. Concrete examples are provided in a study[1] conducted by the Ruhr University Bochum in 2019 about the implications of MiFID II changes on investor protection. It reveals that the additional material provided in advance of a transaction contains a high risk of drowning clients in information. For instance, 77.3% of surveyed investors say that more comprehensive information did not help them in better understanding the contents discussed. Instead, 62.3% feel overwhelmed by the quantity of information presented to them. The study also outlines that some documents are not fully welcomed by clients, with 35.9% of clients "feeling irritated" by the KID, 64.9% of retail clients wishing to not receive the suitability report, and 50.1% of clients not wanting to get a written record of an order.

Legislators should limit the information overload and instead bundle and make available the most important information in an easily comprehendible way. This would ensure that people with a lower level of financial literacy could also understand the information given to them.

[1] see https://die-dk.de/media/files/DK_Auswirkungsstudie_Mifid_Mifir.pdf

Q4: On the topic of disclosures, are there material differences, inconsistencies or overlaps between MIFID II and other consumer protection legislation that are detrimental to investors? Please provide details.

We emphasise the potential conflict between the PRIIPs Regulation and MiFID II with regard to the role of a neutral regulated market. FESE believes that compliance with some PRIIPs requirements, in particular the 'target audience' and 'recommended holding period' requirements, could cause conflicts with separate regulatory obligations under MiFID II. More specifically, FESE is concerned that some of these requirements could compromise the neutral role of exchanges under different regulatory frameworks. For instance, some requirements under MiFID II are geared towards investment firms. In particular, Articles 24 and 25 of MiFID II include specific obligations for investment firms regarding investment advice, including the suitability and appropriateness assessment. In addition, Article 16 of MiFID II also mandates that investment firms manufacturing financial instruments are responsible for identifying the 'target market' for these financial instruments. In such a position, a retail firm would need to be in direct contact from investment idea to end result, and in order to guarantee that, retailers need a constant exchange with distributors/investment firms which is not the role of a marketplace in the financial system.

These guidelines for product governance require issuers to define a target market for every product, including classic bonds, and retail banks to consider the target market for every buy order by comparing the target market with the individual customer's characteristics.

This also applies to new provisions for product governance defined in the "Guidelines on MiFID II product governance requirements" which further reduce retail investors' opportunities to invest in classic bonds. These increased regulatory requirements have resulted in decreasing the opportunity for retail investors to invest directly in corporate bonds. This is opposed to the EU's objective of creating a CMU. Rather than barriers to investments being dismantled, new ones are being created. Thus, the new rules hinder retail investors from planning independently for retirement by including corporate bonds in their portfolios in light of increasing life expectancy and demographic changes. Retail investors' savings are hence not being mobilised to finance the economy.

In its characterisation of the situation, the joint committee of the European Supervisory Authorities confirmed FESE members' assessment. In practice, even simple classes of bonds with make-whole call provisions are often classified as PRIIPs. Furthermore, since the new rules entered into force, trading volumes in corporate bonds have declined significantly with an impact on the overall market liquidity. We highly welcome that, as part of the MiFID "quick fix", bonds with a make whole clause were excluded from the MiFID II target market definition. However, we urge the co-legislators to expand this approach to other bonds as well.

Q5: What do you consider to be the vital information that a retail investor should receive before buying a financial instrument? Please provide details.

When purchasing financial instruments, investors should be informed above all about how the product functions and the (total) cost involved in the purchase.

Q6: Which are the practical lessons emerged from behavioural finance that should be taken into account by the Commission and/or ESMA when designing regulatory requirements on disclosures? Please provide details and practical examples.

Q7: Are there any challenges not adequately addressed by MIFID II on the topic of disclosures that impede clients from receiving adequate information on investment products and services before investing? Please provide details.

Q8: In case of positive answer to one or more of the above questions, are there specific changes that should be made to the MiFID II disclosure rules to remedy the identified shortcomings? Please provide details.

Q9: On the topic of disclosures on sustainability risks and factors, do you see any critical issue emerging from the overlap of MiFID II with the Sustainable Finance Disclosure Regulation (SFDR) and other legislation covering ESG matters?

We believe coherence of MiFID II with the Sustainable Finance Disclosure Regulation (and other legislation covering ESG matters) is key, as it allows for the same data points to be used by the financial intermediaries under these different legislative frameworks. This strengthens the decisions of financial intermediaries' clients, as the product disclosures would be the same across all relevant legislative files. We strongly believe it is important that financial intermediaries adequately reflect clients' criteria. In order to do so, it is also important to ensure that the suitability tests are consistent with the requirements for each of its respective files (SFDR, MiFID II, etc…). It is, however, imperative that the administrative burden of financial intermediaries resulting from overlap is minimised, in the sense that the required disclosures, tests and data points should be harmonised and consistent to the fullest extent possible.

Q10: Are there any other aspects of the MiFID II disclosure requirements and their interactions with other investor protection legislations that you think could be improved or where any specific action from the Commission and/or ESMA is needed?

Q11: Do you have any empirical data or insights based on actual consumers usage and engagement with existing MiFID II disclosure that you would like to share? This can be based on e.g., consumer research, randomized controlled trials and/or website analytics.

Q12: Do you observe a particular group or groups of consumers to be more willing and able to access financial products and services through digital means, and are therefore disproportionately likely to rely on digital disclosures? Please share any evidence that you may have, also in form of data.

Q13: Which technical solutions for digital disclosures (e.g., solutions outlined in paragraph 27 or additional techniques) can work best for consumers in a digital - and in particular smartphone - age? Please provide details on solutions adopted and explain how these have proven an effective way to provide information that is clear and not misleading.

Q14: Would it be useful to integrate any of the approaches set out in paragraph 27 above in the MIFID II framework? If so, please explain which ones and why.

FESE believes that digitalisation is key to enabling broad and efficient use of information. From a report users' perspective, there might be obstacles to obtaining data, which should be addressed to make it easier to sort through ("retrievability of information"). At the same time, there should be no disproportionate burden on report preparers. Companies should not be forced to publish in costly digital formats where such an obligation is not required by the relevant reporting legislation. We recommend the incremental introduction of standardised, digitalised, and machine-readable reporting formats for fulfilling investors' needs in respect to finding and comparing data available across the EU.

Q15: Should the relevant MIFID II requirements on information to clients be adapted in light of the increased use of digital disclosures? If so, please explain how and why.

We recommend the incremental introduction of standardised, digitalised, and machine-readable reporting and disclosure formats for fulfilling investors' needs. In this regard, we support industry-led initiatives directed at defining standardised formats for machine-readable reporting, in order to ensure a harmonised approach also from a technical perspective.

Q16: Do you see the general need for additional tools for regulators in order to supervise digital disclosures and advertising behind 'pay-walls', semi-closed forums, social media groups, information provided by third parties (i.e., FINfluencers), etc? Please explain and outline the adaptions that you would propose.

Q17: To financial firms: Do you observe increased interest from retail investors to receive investment advice through semi-automated means, e.g., robo-advice? If yes, what automated advice tools are most popular? Please share any available statistics, data, or other evidence on the size of the market for automated advice.

Q18: Do you consider there are barriers preventing firms from offering/developing automated financial advice tools in the securities sectors? If so, which barriers?

Q19: Do you consider there are barriers for (potential) clients to start investing via semi-automated means like robo-advice caused by the current legal framework? If so, please explain and outline what you consider to be a good solution to overcome these barriers.

Q20: In case of the existence of the above-mentioned barriers, do you have evidence of the impact that they have on potential clients who are interested in semi-automated means? For instance, do they invest via more traditional concepts or do they not invest at all?

Q21: Do you consider the potential risks and opportunities to investors set out above to be accurate? If not, please explain why and set out any additional risk and opportunities for investors.

Q22: Do you consider that the existing MiFID regulatory framework continues to be appropriate with regard to robo-advisers or do you believe that changes should be added to the framework? If so, please explain which ones and why.

FESE supports the need to supervise automated advice platforms to ensure their algorithms are designed to adequately respond to clients' risk profiles and needs. From an investor protection point of view and in line with the approach 'same activity, same risk, same rules', it should not make a difference whether the clients are advised by a robo- or a human advisor. If a company uses robo-advisors, the company needs to ensure that investor protection rules are respected. FESE supports Better Finance's position on the need to better supervise automated advice platforms to ensure their algorithms are designed to adequately respond to clients' risk profiles and needs.

Q23: Do you think that any changes should be made to MiFID II (e.g., suitability or appropriateness requirements) to adequately protect inexperienced investors accessing financial markets through execution only and brokerage services via online platforms? If so, please explain which ones and why.

Whilst MiFID II requires investment firms to assess both the suitability and appropriateness when providing certain investment services, Article 21 of Regulation (EU) 2020/1503 requires crowdfunding service providers only to assess whether and which crowdfunding services offered are appropriate for prospective non-sophisticated investors. In our opinion, consideration should be given to whether the MiFID II rules on suitability and appropriateness assessment should be revised and whether the simplified regime, where appropriate, should be aligned across crowdfunding service providers and investment firms. The aim would be to enhance retail investors' access to the market and ensure a level playing field for products and activities having a similar risk profile.

In addition, some online trading platforms' marketing communications are unclear in relation to the costs of services and/or products. Retail investors' attention is often drawn to the offer of no or very little direct costs, without an adequate representation of the total costs, which remain undisclosed. In our opinion retail investors should be able to fully understand and assess the total cost of the service/product offered. Therefore, we believe that an indication of the total cost of the service/product offered or at least the existence of a fee should be clearly disclosed in every marketing communication. If regulators conclude that they have no means of proper oversight of these market practices, FESE recommends a policy change to bring supervisors and the public into a position where they have access to information through stricter rules on broker information disclosures and publication.

In this context we welcome the recent proposal made by the European Commission on PFOF.

Q24: Do you observe business models at online brokers which pose an inherent conflict of interest with retail investors (e.g., do online brokers make profits from the losses of their clients)? If so, please elaborate.

FESE would like to address the conflicts of interest arising from PFOF models which can affect online brokers but are not restricted to those. Indeed, all kind of brokers might receive PFOF, offer low or no executions costs and exhibit a clear conflict of interest. On the one hand, brokers are obliged to execute retail orders considering the best price and execution costs for the relevant instrument among other dimensions in the best interest of the investor (so-called best execution principle). On the other hand, those brokers are profit-maximising companies. As such, they have an interest to route orders to the venue that pays (the highest compensation) for the orders received. However, because the venue paying for the order flow must somehow recover their costs, it is questionable whether the venue or market maker actually provides the best quotes in the investor’s interest[1]. Ultimately, the investor might be subject to higher implicit costs which overcompensate the gain on explicit costs. This implicit cost component of an order execution is also more difficult for retail investors to compare than the explicit cost of an order fee.

[1] See Battalio/Loughran (2008). Does Payment for Order Flow to Your Broker Help or Hurt You?, Journal of Business Ethics, 80(1), 37–44.

Q25: Some online brokers offer a wide and, at times, highly complex range of products. Do you consider that these online brokers offer these products in the best interest of clients? Please elaborate and please share data if possible.

In this context, it is important to emphasise that many retail investors appreciate being able to choose from a wide range of financial products the ones that fits most for them.

For an investor who has studied a product intensively and wants to purchase it as a self-decider, it can sometimes be disappointing if the product is not available to them for regulatory reasons. This is the case, for example, with corporate bonds that include a so-called “make-whole” clause. These are currently classified as PRIIPs, which is why an extensive Key Information Document (KID) must be prepared before selling them to retail investors. Since many issuers shy away from this effort, the retail investor is denied a rather “safe and simple” product, as the European Commission stated in recital 4 of the so-called MiFID II “quick fix” published in February 2021. In practice, this leads to repeated expressions of dissatisfaction from retail investors who try (in vain) to order these products.

We therefore urge the regulators to adopt the regulatory relief from the MiFID II amendments of February also in the PRIIPs regulation and, thus, exempt corporate bonds with make-whole clauses from the PRIIPs regulation.

Q26: One of the elements that increased the impact on retail investors in the GameStop case was the widespread use of margin trading. Do you consider that the current regular framework sufficiently protects retail investors against the risks of margin trading, especially the ones that cannot bear the risks? Please elaborate.

Q27: Online brokers, as well as other online investment services, are thinking of new innovative ways to interact and engage with retail investors. For instance, with “social trading” or concepts that contain elements of execution only, advice, and individual portfolio management. Do you consider the current regulatory framework (and the types of investment services) to be sufficient for current and future innovative concepts? Please elaborate.

In our view, technological innovation provides many benefits and is of utmost importance for the future development of the EU’s financial sector to be competitive and offer better services to consumers. Consequently, to realise those benefits, the EU regulatory framework for new technologies should be designed in a way that keeps the balance between innovation and safety for financial markets. More specifically, appropriate safeguards should comply with the principles of “same activities, same risks and same rules", coupled with a technology-neutral approach, in order for innovation to present low risks for financial market participants and guarantee the proper functioning of the financial system. We see regulators and authorities already addressing these issues, providing regulatory frameworks for new technologies (e.g. ESMA Guidelines for Cloud Outsourcing, the Digital Operational Resilience Act (DORA) Regulation and the Markets in Crypto Assets (MiCA) Regulation).

Q28: Are you familiar with the practices of payment for order flow (PFOF)? If yes, please share any information that you consider might be of relevance in the context of this call for evidence.

Yes, FESE is familiar with the practices of PFOF, especially as PFOF has become more and more widespread in Europe over the last years. The situation is different in Europe than in the US, for example, where the market makers paying for the order flow have to make public the amounts they pay and where they have to commit to providing price improvement to the retail clients. In the EU, PFOF is not applied uniformly, with a ban in the Netherlands and less strict rules in other Member States. This creates regulatory arbitrage opportunities.

FESE believes that PFOF arrangements are detrimental for the investors as it may increase bid-ask spreads, distort competition, and make the price formation process less transparent and efficient[1]. The impact of PFOF begins with the conflict of interest arising from the fact that the broker receives payment from a trading venue to direct their flow towards it whereas it is also supposed to send its clients' orders to the venue offering best execution. However, and even though the broker is obliged to act in the best interest of its clients, they have an economic incentive to direct order flow to the execution venue that offers the highest payment to the broker. Consequently, the best execution duty of the broker gets compromised.

While PFOF may imply lower explicit trading costs as the broker can use the payment they receive to this end, it does not automatically translate into investors obtaining the best possible execution quality. The best execution regime under Article 27 of MiFID II establishes that investment firms executing (or arranging for the execution of) trades on behalf of clients must take all reasonable steps to obtain the best possible result for their clients. These steps include, amongst others, considering the price, fees, speed, and probability of execution of the order, explaining execution policies in detail, and disclosing the top execution venues used and the quality of execution. Any remuneration, discount, or non-monetary benefit for routing client orders to a particular venue that would infringe the requirements on conflicts of interest or inducements is banned. Investment firms are also obliged to inform and obtain the consent of clients for executing orders on systematic internalisers (SIs) or over the counter (OTC). As a result, while some platforms may offer commission-free trading, they do not always provide best execution and may cost more to retail investors, as they need to recover the payments made to the broker.

Furthermore, as brokers are incentivised to route orders to the bidder offering the highest payment rather than to the venue offering the best execution, there may be price deterioration compared to other exchanges. Retail brokers may even limit the choice of venues for retail investors to only those that offer PFOF either on screen or effectively (only one trading venue is available). When choosing an execution provider, retail investors are thus best served by finding a broker that will execute their orders on the venue that offers the best execution conditions for the client, taking also into account transaction costs, the natural liquidity present on the venue, and the overall quality of execution.

Thus, we welcome the recent proposal by the European Commission to instate a ban on receiving payments for forwarding client orders for execution.

[1] See Better Finance (2021). Consumer access to EU equity trade data. Available at: https://betterfinance.eu/wp-content/uploads/BETTER-FINANCE-Report-Consumer-Access-to-EU-Equity-Trade-Data-25032021.pdf

Q29: Have you observed the practice of payment for order flow (PFOF) in your market, either from local and/or from cross border market participants? How widespread is this practice? Please provide more details on the PFOF structures observed.

Following a report by ESMA on digital platforms, "digital trading platforms are sometimes dubbed 'neo-brokers' or 'zero-commission' brokers. Thus, their habit is to advertise low or no costs as their business model."[1] As indicated before, many zero-commission brokers apply PFOF models. Thus, the presence of neo-brokers in a given market may serve as an indication for the degree of presence of PFOF. Neo-brokers' assets under management (in EUR million) in Europe has increased by over 200% from 2017 to 2020. Their revenue experienced similar growth, from EUR 177 million in 2017 to EUR 558 million in 2020. In Europe, the number of users in 2021 is estimated to amount about 13 million.[2]

The figures show that neo-brokers are present across Europe, and thus the practice of PFOF is also observed across Europe. As mentioned under Q29, however, PFOF is not applied uniformly across the Union. For instance, it is banned in the Netherlands but there are less strict rules in other Member States. This creates regulatory arbitrage opportunities.

In this context, Germany is one of the countries with the largest presence of neo-brokers in Europe. Currently, a total of nine "neo-brokers" are active in the German market. Of these, five are based in Germany and four operating from other EU countries.[3,4] They apply various PFOF models, which vary significantly depending on the trading venue and type of financial instrument:

- Fixed percentage reimbursements of, for example, 0.01% to 0.04% of the transaction volume;
- Fixed absolute reimbursements of, for example, EUR 1.30 per transaction; or
- Sliding-scale provisions of EUR 1.00 to EUR 2.00 per transaction depending on the order volume transmitted.

"Neo-brokers" often use a single venue (PFOF platform) and/or a single market maker to which they direct their orders. In the past three years, platforms of these brokers have gained a considerable market share in Germany. According to a study conducted by Boerse Stuttgart, this can be illustrated by price determinations based on the number of order executions on German trading venues.[5]

[1] ESMA (2021). TRV – ESMA report on trends, risks and vulnerabilities (No.2). Available at: Link.

[2] All figures from Statista (2021). Neobrokers. Available at: Link.

[3] See: Deutscher Bundestag (2021). Finanziellerer Verbraucherschutz bei der Nutzung von Neo-Brokern (Drucksache (19/32243)). Available at: Link.

[4] Oliver Wyman (2021). Online-Wertpapier-Brokerage 2021. Etabliert ausgerechnet das Coronavirus eine Wertpapierkultur in Deutschland?, 9. Available at: Link.

[5] Please note that by the time of this response, the study was not published.

Q30: Do you consider that there are further aspects, in addition to the investor protection concerns outlined in the ESMA statement with regards to PFOF, that the Commission and/or ESMA should consider and address? If so, please explain which ones

and if you think that these concerns can be adequately addressed within the current regulatory framework or do you see a need for legislative changes (or other measures) to address them

In addition to the impact on retail investor protection, PFOF has also negative implications with respect to competition and the price determination process.

PFOF activities have a detrimental impact on competition between execution venues or market makers. PFOF creates a "pay-to-play" market between venues and/or market makers [1]. In the long run, those who pay any or the highest PFOF will prevail. This puts significant competitive pressure on exchanges as neutral and non-discriminatory platforms that want to compete on the best performance for investors rather than on the highest rebate. Moreover, a non-uniform approach of NCAs regarding the authorisation or prohibition of PFOF distorts competition between brokers in EU Member States. Currently, brokers from countries with strictly interpreted bans are disadvantaged by cross-border offerings from other brokers who cross-subsidise their offerings through revenues from PFOF.

PFOF can also undermine a core function of exchanges: The efficient and transparent price formation process on the basis of matching of buy and sell orders. The creation of a "pay-to-play" market and the conflicts of interest inherent in PFOF lead to a reduction in transparency and worsen the price building mechanism to the detriment of investors but also for issuers raising capital in the financial market for growth and innovation. The execution against the market maker (so-called internalisation) often observed in PFOF practices implies the segmentation of the institutional flow and the retail flow and drains liquidity away from traditional exchanges. This is particularly problematic as traditional exchanges serve as reference markets for alternative execution venues regarding the price of a financial instrument and observing the growth of the retail participation to capital markets. With a sub-optimal mix of retail and institutional flow on reference markets, implicit costs increase, and the price efficiency deteriorates. Thus, a spiral of decreasing price quality is set in motion at traditional exchanges as well as at PFOF execution venues.

Other issues related to PFOF besides the inherent conflict of interest (refer to Q25) are the deterioration of competition and transparency. PFOF leads to an environment where there no longer is competition on transparent prices but only between market makers and execution venues paying for order flow – not providing best execution. Transparent trading plays a central role in price formation as a well-functioning market is where information is easily available. But opaque trading reduces the information available for the price formation process and the depth in limit order books, which can have adverse selection risks and result in higher spreads. By intercepting retail order flow, SIs and other execution venues face no competition and deprive the main market of liquidity with uninformed orders being diverted from transparent venues, increasing spreads. Consequently, the optimal balance between those price referencing models with limited pre-trade transparency and transparent systems is undermined.

[1] This is also one of the decisive justifications of the ban on PFOF in the United Kingdom. See FCA (2019). Payment for Order Flow, para. 1.3. Available at: Link.

Q31: Have you observed the existence of "zero-commission brokers" in your market? Please also provide, if available, some basic data (e.g., number of firms observed, size of such firms and the growth of their activities).

As outlined in our response to Q30, "zero-commission brokers" are present across Europe, with a strong presence in Germany. According to a study by Oliver Wyman and the Deutsche Bundestag, there are nine "zero-commission or neo-brokers" active in the German market.

According to a recent study by Oliver Wyman, the market share of "zero-commission brokers" among all brokers in Germany is expected to increase significantly: from 1.2% in 2019 to 20-25% in 2023 (forecast).[1]

[1] Oliver Wyman (2021). Online-Wertpapier-Brokerage 2021. Etabliert ausgerechnet das Coronavirus eine Wertpapierkultur in Deutschland?, 9. Available at Link.

Q32: Do you have any information on "zero-commission brokers" business models, e.g., their main sources of revenue and the incidence of PFOF on their revenue? If so, please provide a description.

Please refer to the response to Q30. The "zero-commission brokers" apply various PFOF models, which vary significantly depending on the trading venue and type of financial instrument:

- Fixed percentage reimbursements of, for example, 0.01% to 0.04% of the transaction volume;
- Fixed absolute reimbursements of, for example, EUR 1.30 per transaction; or
- Sliding-scale provisions of EUR 1.00 to EUR 2.00 per transaction depending on the order volume transmitted.

According to Oliver Wyman, the reimbursements stemming from those PFOF models are at the heart of the business model of zero-commission brokers in Germany.[1] (Oliver Wyman, p. 10).

[1] Oliver Wyman (2021). Online-Wertpapier-Brokerage 2021. Etabliert ausgerechnet das Coronavirus eine Wertpapierkultur in Deutschland?, 10. Available at: Link.

Q33: Do you see any specific concern connected to "zero commission brokers", in addition to the investor protection concerns set out in the ESMA statement that the Commission and/or ESMA should consider and address? Please explain and please also share any information that you consider might be of relevance in the context of this call for evidence. Please also explain if you consider that the existing regulatory framework is sufficient to address the concerns listed in the ESMA statement regarding zero-commission brokers or do you believe changes should be introduced in the relevant MiFID II requirements.

Please refer to the response to Q31. FESE does not consider that the existing regulatory framework to be sufficient to address the concerns listed in the ESMA statement regarding zero-commission brokers.

As outlined above, PFOF models, which may be applied by online brokers but are not restricted to those, are detrimental to competition and the price building mechanisms, and it creates an inherent conflict of interest between the broker and the retail investor. To address the problem properly, policymakers should consider ensuring a harmonised approach across the Union. Thus, we welcome the recent proposal by the European Commission to instate a ban on receiving payments for forwarding client orders for execution.

Q34: Online brokers seem to increasingly use gamification techniques when interacting with clients. This phenomenon creates both risks and potential benefits for clients. Have you observed good or bad practices with regards to the use of gamification? Please explain for which of those a change in the regulatory framework can be necessary. Do you think that the Commission and/or ESMA should take any specific action to address this phenomenon?

There are some elements of gamification that could be considered positive, while others rather negative with respect to retail investor protection. The design of many trading applications with very easy handling ("tap, tap, trade", etc.) is sometimes stated as an example of gamification. This sort of gamification is not a problem. User-friendly designs can facilitate retail investors' access to capital markets and thus foster capital markets participation. However, other elements of gamification can pose serious risks. Those elements comprise bonuses like free stocks for new accounts, referral contests among investors, push notifications, an instant availability of funds, social-media-like feeds, and other graphical effects. A recent study by Arnold et al. (2021)[1] empirically analyses the effect of attention induced by push notifications, which can be defined as gamification elements on the investment decisions of individuals. They find that push notifications lead to investors taking higher risks and indicate that this attention-induced risk-taking especially affects younger and inexperienced investors. Thus, it is welcomed that the European Commission has expressed concerns regarding gamification of trading and that the German BaFin has announced to closely monitor the advertising behaviour of brokers.

However, as gamification may drive more people into capital markets, regulators should not prohibit gamification practices per se. They should rather focus on providing clear guidance where to draw the line between those gamification practices that reduce the barriers for retail investors to participate in capital markets, and those practices of gamification that are detrimental to retail investor protection.

[1] Arnold, M., Pelster, M., & Subrahmanyam, M. G. (2021). Attention Triggers and Investors' Risk-Taking. Journal of Financial Economics.

Q35: The increased digitalisation of investment services, also brings the possibility to provide investment services across other Member States with little extra effort. This is evidenced by the rapid expansion of online brokers across Europe. Do you observe issues connected to this increased cross-border provision of services? Please elaborate.

FESE believes that coordination between the authorities on all levels becomes increasingly important. However, we would also highlight the need for increased efficiency in contrast to adding more complexity. We acknowledge the work of the EU institutions on DORA to address possible concentration risks if many financial institutions rely on the same third-party service provider, especially with regards to big techs. In such cases, systemic risks of the financial sector could swap over to these critical third-party service providers. Further, sector-specific rules should have precedence over cross-industry rules (e.g. NIS2 / CER), therefore a "lex specialis approach" should be taken.

From a more general perspective, this oversight approach could be used as a blueprint for big techs activities also in other sectors. Small EU countries might not possess the necessary resources for in-depth oversight activities of Big techs. Instead, it should safeguard the approach of "same activity, same risk, same rules", enforcing the existing and upcoming rules (Digital Markets Act (DMA) and Digital Service Act (DSA)) also to these new platform companies. The European oversight approach for the financial sector could be adapted also for other sectors. With regards to regulatory data supervision, we agree that templates and formats for reporting requirements need to be harmonised. Financial Markets Infrastructures (FMIs) are subject to strict and detailed incident reporting requirements, which are mandated by their primary regulator in the jurisdiction they operate in. This regime has been in place for many years and has worked well so far.

Changing the approach to create a centralised reporting structure, while seemingly an attractive option because of the uniformity, might, in reality, introduce issues due to lack of familiarity with and understanding of local markets. Primary financial regulators should remain responsible for FMIs in the jurisdiction they operate in. Furthermore, regulators across multiple jurisdictions should work to harmonise their testing requirements.

Q36: Do you observe an increasing reliance of retail clients on information shared on social media (including any information shared by influencers) to base their investment decisions? Please explain and, if possible, provide details and examples. Do those improve or hamper the decision-making process for clients?

The GameStop/AMC short squeeze in the US at the beginning of 2021, which was largely driven by retail investors acting based on information shared on social media, has shown that these types of platforms more frequently play a role in driving investment decisions of retail customers. Although such behaviour also existed in the past where people were influenced by legacy media (e.g., newspapers), the speed of sharing information has considerably grown in recent years.

Q37: What are, in your opinion, the risks and benefits connected to the use of social media as part of the investment process and are there specific changes that should be introduced in the regulatory framework to address this new trend?

FESE supports ESMA's action in warning investors about the risks of relying solely on social media information for investment decisions. In addition, they raised awareness of certain regulatory requirements in order to avoid market abuse. This includes the dissemination of investment recommendations through any media and online platforms, as these platforms are subject to several regulatory requirements. We support ESMA's positive stand on the increased retail investors' participation in the market but also its efforts in monitoring and scrutinising the developments around retail trading platforms' business models.

Social and mirror trading should be carefully monitored by regulators as it could create market integrity issues as well as significant losses for private investors following such trading practices. It should be ensured that social media platforms that offer market access as well as online brokers provide full transparency concerning risk-checks, investor profiling, disclosure of costs and any agreement in place so as to offer no-fee trading. This includes PFOF, routing of orders, etc. The same rules and enforcement of these rules applicable to other providers should be applied to them.

Q38: Are you aware of the practices by which investment firms outsource marketing campaigns to online platform providers/agencies that execute social media marketing for them, and do you know how the quality of such campaign is being safeguarded?

Q39: Have you observed different characteristics of retail clients, such as risk profiles or trading behaviour, depending on whether the respective client group bases their investment decision on information shared on social media versus a client group that does not base their investment decision on social media information? Please elaborate.

Q40: Do you have any evidence that the use of social media (including copy/mirror trading) has facilitated the spreading of misleading information about financial products and/or investment strategies? Please elaborate and share data if possible.

Q41: Have you observed increased retail trading of 'meme stocks', i.e. equities that experience spikes in mentions on social media? Please share any evidence of such trading and, if possible, statistics on outcomes for retail investors trading such instruments.

Q42: Do you consider that the current regulatory framework concerning warnings provides adequate protection for retail investors? If not, please explain and please describe which changes to the current regulatory framework you would deem necessary and why.

Yes, it provides adequate protection for retail investors. If the investment service or product purchase is assessed as "inappropriate" vis-à-vis the client's knowledge and experience, the client is made aware of this by means of an explicit warning. In our opinion, such an unambiguous and clear warning is an adequate means of protecting retail investors from making the wrong decision.

Q43: Do you believe that consumers would benefit from the development of an 'open finance' approach similarly to what is happening for open banking and the provision of consumer credit, mortgages, etc? Please explain by providing concrete examples and outline especially what you believe are the benefits for retail investors.

FESE supports the European data strategy proposed by the Commission and advocates for a harmonised approach to speed up the use and investment in technologies and data, so avoiding lagging behind other jurisdictions.

However, we wish to express concerns about the application of an 'open finance' approach, similar to that made in the field of payment services, to that of capital of markets. The provisions from the PSD II may not be applied in the same way in the field of (retail) investments. We would like to emphasise that the payment services sector is different from other financial services, in terms of the services and products that are provided. In addition, the interactions between financial market participants, infrastructures and investors, are different. More specifically, the behaviour of these participants in financial services aim at enabling investments in a product where a future return is expected, whereas payment services primarily aim at establishing a transaction between a sender and receiver of a product. As it stands, its is difficult to understand "open finance" as a concept, based on ESMA's explanation. Thus, it is not possible to assess how it could affect the wholesale business, as PSD II did for banks in the retail space.

Additionally, more specifically in capital markets, existing regulations (IFR/D, MiFID2/R, EMIR and CSDR) are already fully open to competition from new entrants and have had tangible effects on the European competitive landscape. Focusing specifically on trading venues, there are now 128 Regulated Markets in Europe and 352 alternative venues (MTFs, OTFs and Systematic Internalisers).

Q44: What are, in your opinion, the main risks that might originate from the development of open finance? What do you see as the main risks for retail investors? Please explain and please describe how these risks could be mitigated as part of the development of an open finance framework.

The development of open finance may originate security risks such as:

- Supply chain attacks, which can results in customer data leakage;
- Unauthorised access to customer data;
- Unsupervised access to customer data; and
- Customer data tampering.

The EU approach is to establish trusted data intermediaries taking care of the customer data and providing access only to trusted entities. It is important that data intermediaries are regulated in order to ensure investor protection and to prevent misuse of customer data as well as data leakage. High IT security standards and protection against cyber-attacks are also key. Additionally, we believe that the definition of "open finance" should be approached cautiously if this would also include, or connect itself, to the trend of "decentralised finance" (DeFi) emerging with financial products built on Distributed Ledger Technology (DLT) networks, often on public blockchains. For instance, in DeFi, financial services are offered via pure peer-to-peer layers to (retail-) clients without a central intermediary implying certain rules automatically (e.g. on the basis of programmed smart contracts). These new and innovative concepts are attracting growing interest but, to grasp the full potential of this development, it is necessary to ensure a certain level of protection for consumers/investors.

Q45: Which client investor data could be shared in the context of the development of an open finance framework for investments (e.g., product information; client's balance information; client's investment history/transaction data; client's appropriateness/suitability profile)?

Q46: What are the main barriers and operational challenges for the development of open finance (e.g., unwillingness of firms to share data for commercial reasons; legal barriers; technical/IT complexity; high costs for intermediaries; other)? Please explain.

There are underlying costs to the collection, maintenance, and distribution of data. Companies need to invest to develop data products/services and the party sharing data must obtain a reasonable return. Investment incentives are key where a satisfactory downstream yield is necessary. It is fundamental to consider the incentives that the data originator needs to have in order to produce innovative and valuable data, including a satisfactory yield on their investments. The original data holders, if they have invested in structuring the data and/or improving the data quality, should be fairly compensated by the companies making use of (and money from) this data. It is, therefore, important not to create disincentives towards data collection/standardisation and product developments, i.e. allowing for commercialisation of data.

Q47: Do you see the need to foster data portability and the development of a portable digital identity? Please outline the main elements that a digital identity framework should be focusing on.

Lengthy identification processes hamper new business models and competition. Approaches like electronic IDentification, Authentication and trust Services (eIDAs), making national identification schemes interoperable at the borders, and concepts of self-sovereign identities (SSI) are key enablers to make open finance and decentralised finance work.

Q48: Do you consider that regulatory intervention is necessary and useful to help the development of open finance? Please outline any specific amendments to MiFID II or any other relevant legislation.

FESE believes that regulatory intervention is not necessary. We question the rationale for regulatory intervention around the application of a regulatory 'open finance' approach in capital markets.

Q49: What do you consider as the key conditions that would allow open finance to develop in a way that delivers the best outcomes for both financial market participants and customers? Please explain.