



Distribution systems of retail investment products across the EU – FSUG response to the study commissioned by the European Commission

The Financial Services User Group (FSUG) advises the European Commission (EC) in the preparation of legislation or policy initiatives which affect the users of financial services, provides insight, opinion and advice concerning the practical implementation of such policies, and proactively seeks to identify key financial services issues which affect users of financial services.

For many years we have been drawing the Commission's attention to numerous cases of mis-selling often arising from misleading information and/or conflicts of interests in the distribution of financial products, instruments and services. Therefore, the FSUG has welcomed it very much when the EC heralded in the Capital Markets Union Action Plan that it would undertake a comprehensive assessment of European markets for retail investment products, including distribution channels and investment advice, drawing on expert input as one of its priority actions. As the FSUG has not been consulted during the evaluation of the study we take the opportunity to comment on its results .

The study on the current features and functioning of the European market for retail investment products released in April¹ draws a grim picture by detailing the numerous obstacles retail investors face when seeking financial advice or wanting to buy an investment product.

We are aware that this study is limited in its findings first and foremost by the very limited availability and comparability of costs and charges of the retail investment products (therefore mostly focusing on investment funds which represent only 8% of EU households' financial savings). Also, it has to be noted that the study was conducted in 2017, i.e. before significant regulatory changes - e.g. MiFID II, PRIIPS, IDD - entered (or will enter) into force.

Nevertheless, the EC study confirms what FSUG in line with consumer and individual investor organisations has been emphasizing for many years.

Distribution of retail investment products

The EC study confirms that an average individual investor is overwhelmed by the sheer complexity of, and uncertainty associated with, the investment products available. The information on distributors' websites is neither very transparent nor sufficiently standardised across products and countries.

As regards costs and charges some distributors either don't display this information at all or present it only partially to potential clients/on publicly available materials. Therefore, it is difficult for the ordinary/average individual investor to find, understand and compare

¹ The European Commission's Study on the distribution systems of retail investment products
https://ec.europa.eu/info/publications/180425-retail-investment-products-distribution-systems_en

this information in order to make an informed investment decision and choose a suitable product.

Not surprisingly, the study draws a different picture for the UK and in Netherlands, where inducements have been banned since a couple of years. In both Member States, individual investors are systematically redirected by banks and insurers to Independent Financial Advisors (UK) or the institutions' websites for best execution. Furthermore, in these Member States distributors appear to present the lowest ongoing costs and charges for all types of funds. Consequently, investors located in the UK or the Netherlands have become more cost-sensitive and better informed about investment products, according to the study.

The study points out that there are large differences in terms of costs of retail investment products across Member States and that fees for the same category of investment products vary substantially across Member States.

Also, in general, low cost ETFs were rarely proposed by "human" advisors but are predominant among robo-advisors. The study also found that non-independent advisors such as banks and insurers almost never recommended the purchase of ETFs. The situation differs in the UK, however, where in contrast Independent Financial Advisors (IFAs) are offering ETFs to their clients. The study suggests that the low willingness of non-independent advisors to propose ETFs to their retail clients may be due to the absence of an incentive scheme, as ETF managers generally do not pay commissions.

Financial advice

The EC study confirms that unfortunately we have not made much progress yet towards an efficient and well-functioning single market for retail financial services. Investment products are still rather sold not bought, and an average individual investor is not able and equipped well enough to differentiate between the benefits and risks of different types of advice. The study further confirms the FSUG's perception that the predominant distribution model across the Member States surveyed still leads to the provision of non-independent advice provided by banks and insurance companies and that an average retail investor seeking personal advice rather tends to go to such a non-independent advisors of banks and insurers (believing it's "free" advice and being unaware of incentive schemes and potential conflicts of interests). As a consequence, they end up with relatively similar investments "recommendations" across Member States in terms of product types, i.e. in-house investment funds and life insurance policies. Moreover, it tends to agree with findings of other recent studies confirming that clients of non-independents advisors achieve a significantly worse net performance than independent clients, with advisors putting their employers' than client's interest first.

Demand side solutions

The study acknowledges that the potential for new distribution models based on FinTech is promising but still needs to be monitored carefully.

In fact, robo-investing platforms could lead to significant benefits for EU citizens as savers and individual investors - and therefore to the real EU economy as a whole – as they are in bad need of a more direct and stronger link between savings and the real assets they are invested in. As confirmed by the study, already now the emerging sector is charging lower

and more transparent fees with few or no commissions from providers. However, these platforms still deal with products and services that require clients to be relatively financially literate to really understand the value of their offers.

The results of the study furthermore confirm the need for independent and cross-border comparison websites that would support retail investors in finding the most suitable investment product².

The EC therefore should follow up on its “Consumer Financial Services Action Plan”³ released in 2017 and go beyond the non-binding “Key Principles for Comparison Tools”. EU citizens are in dire need of comparable information on past performances relative to the objectives of the providers (their “benchmarks”), and on costs. It should be accessible via independent web-based comparison tools for retail long-term and pension investments.

However, next to a variety of demand-side barriers that need to be tackled by policy makers (enhance financial literacy⁴, reduce information asymmetries, regain consumers trust, making comparable information more accessible), the FSUG is of the opinion that policy makers especially need to provide supply-side solutions to existing barriers affecting financial services users.

Supply-side solutions

Consumers and investors do not need more choice – they need better choice. In fact, they need fewer, simpler, better quality, and better value products. Unfortunately, the EU Authorities fail to fulfil their legal duty to promote simplicity and transparency of investment products and the current intermediary landscape with dominant distribution models prevents better value products or new competitors getting access to (new) markets. This behaviour will continue unless distributors are forced to change their behaviour by robust enforcement of existing regulations – both at the local and European level⁵. The ongoing European Supervisory Authorities’ reform is a historic opportunity to propose an ambitious reform of the ESAs to deliver the protection EU financial consumers need⁶. Our firm belief is that a truly effective single market can only emerge if it is built on functioning local markets.

We furthermore believe that intermediation needs to become more efficient, safe and resilient to better serve the purposes it has been originally designed for:

- To get investors’ capital from where it is to where it is needed in the real economy, in the most efficient, safe way; and
- To ensure those assets are managed efficiently and responsibly.

The role of intermediaries/ distributors (such as financial advisers, sales agents, and banks) in the supply chain remains critical (even if many investors now buy investment funds on an ‘execution-only’ basis). FSUG has concluded that one of the biggest barriers to an

² Please see FSUG Response to the Green Paper on Retail Financial Services
https://ec.europa.eu/info/sites/info/files/file_import/1603-retail-finance-reply_en_0.pdf

³ The EC’s Financial Services Action Plan https://ec.europa.eu/info/publications/consumer-financial-services-action-plan_en

⁴ Please see FSUG paper on financial guidance file:///C:/Users/User/Downloads/1611-fsug-financial-guidance_en.pdf

⁵ Please see FSUG paper “For better supervision and enforcement in retail finance”
https://ec.europa.eu/info/sites/info/files/file_import/1610-supervision-enforcement-retail-finance_en_0.pdf

⁶ Please see FSUG Open Letter on the EU financial supervisory reform
https://ec.europa.eu/info/sites/info/files/fsug-opinions-180705-financial-supervisory-reform_en.pdf

effective single market is the behaviour of intermediaries who continue to recommend high cost funds with no justification (for example, there may be cheaper funds with the same investment objectives available). It is not possible to identify *ex ante* those funds which will outperform a peer group of funds. But, it is possible to control costs. Remember, high costs extract value from investors' funds. This ultimately reduces the size of retirement funds and reduces the amount of capital going into the real economy.

Therefore, FSUG urges the Commission to introduce new measures to require intermediaries/ distributors to act in the interest of the investor by ensuring that best value for money is considered when recommending funds to investors. This could be achieved by introducing a version of the RU64 rule which was very effective at reducing costs on personal pensions in the UK⁷.

Fund governance

The other important actors in the investment supply chain are the fund governance bodies which are meant to act in the interest of fund investors and oversee the behaviours of fund managers. Although this is not strictly an issue related to distribution, these fund governance bodies play a critical role in determining whether investors get good value.

There has been a number of concerns raised about the role and efficacy of fund governance bodies⁸ including:

- Independence and conflicts of interest: directors of fund governance bodies are not sufficiently independent of the asset managers they are supposed to oversee;
- Lack of oversight: fund governance bodies do not do enough to i. ensure that asset managers are delivering value to the end-investor or ii. manage conflicts of interest between the investor and asset manager; and
- Commitment and focus: individual directors hold positions on the boards of numerous fund governance bodies – it is not possible for directors to provide acceptable levels of oversight if their attention is spread across numerous funds.

With this in mind, FSUG urges the Commission to introduce measures to:

- Ensure fund governance bodies are truly independent – for example, by requiring boards to have an independent chair and minimum number of independent directors;
- Ensure directors have an explicit duty to deliver value for investors and exercise proper due diligence to manage conflicts of interest; and
- Reduce the number of directorships individual directors can hold.

⁷ RU64 requires an adviser to explain in writing to the investor why a personal pension they are recommending is *at least* as suitable as a stakeholder pension. The introduction of RU64 had the effect of bringing costs on personal pensions down to the level of stakeholder pensions (which had charge caps). The same principle could be applied to investment funds. Intermediaries/ distributors should be required to explain to investors if they are recommending a higher cost fund when a cheaper fund with the same objectives is available. <http://www.fsa.gov.uk/pages/Library/Communication/Statements/2007/ru64.shtml>

⁸ See for example, the major review of the asset management industry undertaken by the UK FCA <https://www.fca.org.uk/news/press-releases/fca-publishes-final-report-asset-management-sector>

The way forward

Contrary to what was planned in the CMU Action Plan the study does not really identify ways to improve the policy framework and intermediation channels so that retail investors can access suitable products on cost-effective and fair terms. Neither has the study provided an assessment of how the policy framework need to evolve to benefit from the new possibilities offered by online based services and fintech.

The FSUG considers that not more but rather a better regulation and better enforcement is needed to effectively protect consumers, investors and all other financial services users and to work towards a true single market that works for EU citizens. In order to achieve this, the FSUG has identified the following key areas of activity for policymakers.

1. Stop the silo approach

Already in 2015, the FSUG has noted that over time, financial regulation in key markets has “tended to develop in silos with separate legislation and regulation for specific products and activities even though these products and activities may perform the same core function” (as it is the case for MiFID II, IMD, PRIIPS, AIFMD etc.). This has resulted in unnecessary complexity, overlaps and loopholes in consumer protection, and higher regulatory costs than necessary. In our view, this silo approach emerged because legislation and regulation has been designed to reflect the different legal and corporate needs of the financial services industry not to meet the needs of financial users and as a reaction to the numerous financial scandals and serious misconduct in the markets. (see FSUG paper “Strategic priorities for the new Commission”).

2. Enhance enforcement of existing regulation

Since 2008, European authorities have prioritized the prudential supervision, while consumer protection and conduct of business have remained on the sidelines. We have witnessed an insufficient public enforcement⁹ and ESAs’ failure to comply with their legal duty to take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products. We have also seen the consequences of the lack of effective mechanism for ESAs to hold the national supervisors accountable. Therefore, FSUG believes that the ongoing ESAs review should be used as an opportunity for a reform that will truly deliver the protection that EU financial services users need¹⁰.

3. Address the redress deficit

There is a general consensus that abuses in the financial sector need to be more effectively identified and sanctioned by default by administrative authorities, and the victims need to be properly indemnified. Therefore, FSUG welcomed the proposed framework for collective redress mechanisms that cover many financial services users, such as savers, retail investors, life insurance policy holders, pension fund participants. However, in order to make the new tool truly beneficial for financial services users, FSUG pleads for¹¹:

- extending the protection to small and individual shareholders. In cases where individual investors suffer damages by the same issuers (e.g. if there is misleading

⁹ Please see FSUG paper “For better supervision and enforcement in retail finance”

¹⁰ Please see FSUG Open Letter on the EU financial supervisory reform

¹¹ Please see FSUG position on “New Deal For Consumers”

information by the company), they should be able to join their claims together into one single action in all Member States. To this end Annex 1 to the Directive should include both Market Abuse Directive (MAD) and Market Abuse Regulation (MAR).

- reconsidering by the co-legislators the requirement obliging claimants to first obtain a final injunction order from a court before the judge decides whether to allow for some form of collective compensation as may severely prolong the procedure and increase its cost to the detriment of consumers.
- reconsidering by the co-legislators the benefits of the opt-out system
- a minimum harmonization character and thus neither precluding better national rules nor forcing Member States to amend their existing collective redress systems to the disadvantage of consumers.