CMU WORKSHOP ON FOSTERING RETAIL INVESTMENT IN CAPITAL MARKETS BRUSSELS, 7 FEBRUARY 2017

In the context of the mid-term review of the Capital Markets Union (CMU) Action Plan, DG FISMA organised a Roundtable on Fostering Retail Investment in Capital Markets. This Roundtable brought together more than 45 representatives of retail investors, national and EU supervisors, the industry and other interested market participants. It allowed the European Commission to get targeted input on specific questions to inform its reflection on the review of the CMU Action Plan.

Supply of investment solutions to retail investors across Europe

The first session explored whether the current supply of investment solutions meets retail investors' needs across the European Union. Do retail investors have easy access to the investment products that best meet their needs? Should the European Commission support the creation of new retail investment products or vehicles? What are the best practices adopted at national level to guide the supply of retail investment products?

Daniel Godfrey in his keynote speech insisted on the need for the investment industry to change its business model from short-term profit-maximisation to long-term wealth creation, investing in sustainable growth that benefits its clients and society. The tools to deliver supply that is fit for purpose exist - UCITS, AIFs and ELTIFs - but are not used in a way that is fit for purpose. There is a need to break captive distribution and deliver a marketplace where consumers can make informed choices about long-term investment opportunities through simple and transparent disclosure of objectives, strategies, costs, measures and timeframes.

The Swedish Shareholders Association presented the Swedish Investment Savings Account, a financial savings product that became available to investors in early 2012 and is widely used today (about 2 million accounts). This account has been created to make it easier for retail investors to trade in financial instruments. It overcomes complex tax rules and reporting obligations which were disincentivising retail investment in capital markets. This certainly contributes to the current high level of engagement of the Swedish population with financial markets: 80% of the Swedish population have some of their savings in funds or equities.

Finally, the European Federation of Employee Share Ownership (EFES) presented the state of development of employee share plans across the European Union compared to the USA. Today, there are 10 million employee shareholders across the European Union for a total amount of EUR 350 billion. Beyond contributing to the creation of an equity culture, employee share ownership allows to align the interests of a company's employees with those of the company's shareholders. The EFES called for a European action for informing and educating on employee share ownership.

The subsequent discussions insisted on the importance to create an appropriate environment to support retail investment in capital markets.

- Taxation is a key determinant for retail investment as illustrated by the two last presentations. Further exchanging best practices of successful fiscally incentivised investment solutions may be beneficial.

- Misselling scandals tarnished the reputation of financial markets among European savers. An effective enforcement of consumer-related financial legislations and banning the distribution of toxic products are essential in this respect. Financial products are complex for the average investor.
- The EU single rulebook should tend towards simpler and more consistent disclosure requirements across the product landscape. The complexity of the regulatory framework was underlined by industry representatives, with negative effects (homogenisation) on the supply of investment products to retail investors.

Another part of the discussions addressed the categories of products in which retail investors should be encouraged to invest. Some participants insisted on the need to encourage direct investments in shares, bonds and ETFs, and on the role that regulation has to play in that respect. The question of the opportunity for retail investors to invest for the longer term and capture the illiquidity premium, with the associated constraint of a lower redeemability, was also debated.

Finally, the low level of competition in some financial markets and / or countries was pointed out by some participants. Initiatives such as the development of a pan-European pension product are welcomed in this context.

Cost / performance transparency in retail investment

Retail investors lack a comprehensive picture of the financial performance of capital markets and of the different categories of investment products. This second session discussed the informational mechanisms that could be put in place to increase retail investors' understanding of the net performance of the main families of retail investment products across the European Union and the impact of the costs and charges on this performance.

Guillaume Prache from Better Finance introduced the debate by highlighting the differences in performance between capital markets and retail investment packaged products (notably due to fees and commissions) and the disparity of the returns earned on pension savings across Europe. Taking as a starting point the assumption that the actual net returns and fees of the long term retail and pension products are unknown to European savers, Better Finance called on the European Commission and the European Supervisory Authorities to take forward action to remedy this situation as provided in the CMU Action Plan.

The AMF, the French Supervisory Authority, explained to the audience the main findings of its recent mystery shopping exercises on retail investment. An overall improvement in the quality of the appropriateness tests is noted and questions on investors' profiles are in most cases adequately targeted and fit-for-purpose. On the negative side, the AMF regretted that risk appetite and time horizon are insufficiently covered, and that online platforms tend to overly rely on self-assessment. These mystery shopping exercises also revealed that some products are not proposed to retail investors despite seeming to correspond to their investment needs (for example, the cheapest investment funds, the ETFs etc.) and that in half of the cases, retail investors are not informed about the cost components of the proposed investment products. The early entry into force of MiFID II is to be welcomed in that context.

The Financial Conduct Authority presented some key interim findings of its study on the UK asset management market[1]. This interim report found that there is a weak price competition in a number of areas of the asset management industry in the UK, a considerable price clustering for funds and limited evidence of prices falling as fund size increases. Their evidence suggests that on average actively managed funds underperform their benchmark after costs. The interim report also found that there is no clear relationship between price and performance - the most expensive funds do not appear to perform better than other funds before or after costs.

Some representatives of the industry highlighted the complexity of the new disclosure framework and the difficulties created by the piecemeal approach adopted by the European Union in this area, with disclosure requirements emanating from numerous legislative texts (UCITS, PRIIPS, MiFID II, IDD, Solvency II etc.). They called for simplification and coherency across the product landscape. The issuance of further targeted guidance could play a role in that respect. Other participants insisted on the need to reassess the situation once the new regulatory framework will produce its full effect.

Beyond the disclosure of information on investment products, financial education of European savers is essential to ensure they fully grasp the information provided, notably the information on costs (today only sophisticated retail investors seem able to understand what the various costs actually entail), and interpret it in the broader context of the capital markets.

One participant insisted on the importance to not only focus the attention on the costs of retail investment products but also to consider their performance.

The importance to duly enforce the consumer-related financial legislations was again underlined, notably when mystery shopping exercises show weaknesses in the application of rules.

Innovation for retail investment

François-Kim Hugé from Deloitte introduced the third session of the Roundtable dedicated to the innovation for retail investment. His presentation highlighted notably the following: the expected strong growth of the robo-advisory markets over the coming years, the positive impact of the facilitated account opening processes on investment diversification and the possible disruption of the traditional asset management distribution models by innovative digital solutions such as social investing and by the penetration of the financial services industry by non-traditional players such as Apple, Facebook, Google, Amazon or eBay.

EFAMA gave the views of the asset management industry on these new distribution models. While underlining the continued importance of traditional distribution channels for older investors, EFAMA highlighted the benefits of digitalisation for investors, notably in terms of lower distribution and management costs and easier access to comparable information. The creation of a digital passport was mentioned as a way to facilitate retail engagement in capital markets in the current digital environment. EFAMA called on the European Commission to develop a forward-looking regulatory framework, taking in consideration technological developments and new business models.

[1] https://www.fca.org.uk/publications/market-studies/asset-management-market-study.

Digitalisation is set to profoundly change the way European savers make their investment choices according to BEUC. New distribution models and innovative products and services will challenge the current regulatory framework. Today, retail investors are not getting the advice they really need. Recent mystery shopping exercises showed the low quality of advice, often steering consumers to investment products not suitable for their risk profile. Automated advice presents proven benefits, notably in terms of access to cost-effective products such as ETFs and affordable advice for the mass consumer market. Increased cost transparency has still to be demonstrated. BEUC warned about the blurring boundaries between execution-only, portfolio management and advice business models and the uncertainty this creates for consumers and insisted on the need for regulatory oversight of the algorithms guiding consumers through the advice process.

During the ensuing debate, the potential of robo-advisors to take consumers / millennials on an educational journey was underscored. Some participants insisted on the need to complement automated advice with a human interaction with a qualified advisor when there is a need.

The benefits and risks of the use of Big Data were also discussed: information from millennials' social profiles can be used to tailor investment recommendations but this raises the question of privacy.

Conclusion

The European Commission warmly thanked the speakers and participants to this Roundtable for their active participation. It reminded that the conclusions of this debate together with the outcome of the ongoing on-line public consultation and the future public hearing scheduled on 11 April 2017 will feed into the mid-term review of the CMU Action Plan (to be adopted in June 2017).