EFA POSITION PAPER ON THE RETAIL INVESTMENT STRATEGY

Introduction

The European Fintech Association (EFA) welcomes the European Commission's proposal to fulfill the Capital Markets Union's (CMU) objective of ensuring that consumers can fully benefit from the investment opportunities offered by capital markets, through its Retail Investment Strategy (RIS). EFA shares the belief that retail investors must be empowered to make more informed investment decisions that better correspond to their needs and objectives and that retail investors must be adequately protected in the single market. Below we share key areas of the RIS the EFA believes can be improved upon to achieve the European Commission's stated goal.

The following details EFA's key points as regards the RIS

- **Stop a potential ban on execution-only inducements** - A ban on execution-only inducements threatens to increase the price of the exact financial products that have been the biggest asset for retail investor wealth creation.
- **Maintain current Value-for-Money benchmarks** - Value-for-Money test limits the freedom of choice for retail investors (PRIIPs).
- **Eliminate initial barriers to investing -** There are still too many initial barriers, especially for first-time investors, to start using portfolio management services.
- **Ensuring European businesses can scale digitally and across borders**. We believe that in orderto boost the CMU, RIS should also focus on reducing the administrative burdens for investment firms providing access to capital markets for retail investors.
- **Providing more clarity for safeguarding client funds**. In order to ensure better investor protection, we believe it is important to provide more clarity for safeguarding client funds, so that retail investors can benefit from such solutions as buffers against losses or settlement failures.

I. Stop a potential ban on execution-only inducements

In order to lower the barriers of entry for investing, the costs to invest must be lowered. Over the course of the last three years, one of the most promising trends in European retail investing has been the adoption of sustainable, low-cost and broadly diversified investments through UCITS exchange-traded funds (ETFs). ETFs, heralded by consumer advocates for their simplicity, transparency and low fees, have gathered over one trillion euros in retail assets and increased retail investor accessibility to capital markets. EU policymakers' aim should be to increase the uptake of efficacious investment products that provide retail investors real returns for a low price, rather than limiting these products on the market.

The Commission's RIS proposal bans execution-only inducements, threatening a more promising outlook for the European retail investor. We urge EU policymakers to reject a proposed ban on execution-only inducements.

Due to healthy competition among manufacturers, all investors can benefit from highly cost-efficient products. In this environment, manufacturers may still decide to pay inducements to distributors, that in turn reduce fees for a wide range of products. Ultimately, these products' manufacturer-paid execution-only inducements have allowed brokers to decrease investment costs to retail investors, driving the recent growth in retail investor participation. An execution-only inducements ban would undermine recently won and potential retail investor wealth creation.

II. Value-for-Money test limits the freedom of choice for retail investors (PRIIPs)

The proposal aims to increase investment opportunities for retail investors and strengthen investor protection rules. We believe that the proposed Value-for-Money test imposed on PRIIPS manufacturers and distributors will not foster an increase in investment participation but rather a concentration on certain types of investment products that meet the benchmark developed by the ESMA and EIOPA disregarding yield-driven products. The Value-for-Money test is only driven by costs and does not regard return on the investments.

We hold that PRIIPs manufacturers and distributors will have to turn to offer simpler products to be cost-efficient and thus will not be able to offer a broader variety of products to the retail investors. Furthermore, the benchmark imposes a costs-cap that will not regard the return opportunities for the retail investors. In periods of high-interest rates, this is not as severe of an issue. But when the interest rates fall, retail investors will seek alternative investments with a stronger focus on return. Then retail investors would be left with maximum cost-efficient financial products with minimum yield. We believe that this would not encourage the participation of retail investors in capital markets, as they should be given a variety of options to invest in.

III. Eliminate initial barriers to investing

In the opening paragraphs of the RIS package, it is stated that Europe significantly lags behind in the proportion of retail investors being invested in the market. Though we fully agree that the participation rate can be increased by building additional trust in the capital markets through various investor protection activities, the ease of getting access to and using investment services, especially for first-time investors, should be equally important. Unfortunately, the amendments proposed in the RIS package make only marginal changes to the existing practices, which will not bring the necessary results.

During the time when anyone in Europe with a bank account or card is able to make instant transfers to purchase goods or services for amounts fully decided by the individual with “no questions asked”, existing requirements when the same person might want to dip their toes into the world of investing and use portfolio management services from professionals of investment firms makes the user experience less than friction full. For investors, this might result in a decision not to invest at all or, worse, using off-shore platforms with no regulation (and no protection but better user experience), while for regulated investment firms it means a higher cost base to provide the service and less money for innovation and better services to investors.

Therefore, we strongly believe that there should be an option for first-time investors to try out investing in financial markets also through the help of professional portfolio management services with sums that are not material to them and that they can afford to lose without the heavily bureaucratic procedure that investors now need to go through starting with the first EUR invested.

IV. Ensuring European businesses can scale digitally and across the borders

We believe that in order to boost the CMU, RIS should also focus on reducing the administrative burdens for investment firms providing access to capital markets for retail investors. Such requirements as translations of commercial agreements, language requirements for information exchange between a firm and client, and the availability of paper copies of the Key Information Document (KID) may prevent users from accessing the investment instruments and create obstacles for the digital transition.

For instance, the requirement to have a translation of the KID can put smaller Member States at a disadvantage, as the fund manager might decide not to maintain translations for certain languages. As a result, the population in smaller Member States doesn’t have access to investment instruments because of the non-availability of KIDs in the official language of a Member State. We believe that it would be reasonable to have the option to provide KIDs for certain simple products, such as ETFs, in a language agreed between the parties.

The rules on the provision of services also lack clarity on cases where local translations are required and when a language agreed between the parties is sufficient. We believe that investment firms should have a general option to provide services in a language agreed upon with a client. In order to ensure investor protection, we suggest introducing additional safeguards such as verification that the language is understood by a customer (e.g. by asking additional questions on the proficiency and the years of practice). General duty of care as a safeguard is also applicable to such cases. Investment firms should continuously ensure that products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

Additionally, PRIIPS gives the right to customers to request a paper copy of a KID. With the digital disruption of financial services, and sustainability concerns, we believe that this rule is no longer fit-for-purpose.

V. Providing more clarity for safeguarding client funds

In order to ensure better investor protection, we believe it is important to provide more clarity for safeguarding client funds, so that retail investors can benefit from such solutions as buffers against losses or settlement failures. Currently, such a possibility is limited because of the general requirement on the prohibition of mixing client and own funds. The lack of guidance on safeguarding client funds also creates friction on the business side, for instance, when taxes are withheld.

The UK's Financial Conduct Authority's Client Assets Sourcebook (CASS) is an example of a set of rules that provides clear guidance on the segregation of investments and money held under different regimes. Among others, it provides timeframes for placing funds into client accounts and reconciliations, lists exceptions for holding firm's money in a client account, and provides details for pools and sub-pools of client money. CASS is set to reduce the risk of confusion between assets and creates more confidence for investors in the capital markets, ensuring the safety of client money and assets.

We would like to see similar rules being developed in the EU to provide better protection for investors and ease internal processes for investment firms.