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Call for Evidence

Retail investment: new package of measures to increase consumer participation in capital markets

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No ban on inducements.
We are in favour of keeping the choice between commission-based and fee-based model. The current legal framework on inducements is appropriate to protect clients against potential conflicts of interest. A ban on inducements - that would leave room only for the fee-based model - will inevitably lead to an advice gap for retail clients and only a small number of wealthier investors would continue to invest in capital markets whereas the vast majority of retail investors would refrain from it. Two recent KPMG studies for the German and the French, Italian and Spanish markets show that commission-based advice is best fit to actively introduce retail investors with small and medium-sized assets to securities. Overall, a ban on inducements will avoid accomplishing the aim of the EC to raise the level of participation by retail investors in financial markets (a key milestone of the Capital Markets Union).
Furthermore, fee-based advisory service is definitely no guarantee for (content-wise) better consulting and generates conflicts of interest of its own. Moreover, those fees are not bound to quality improvements, so customers will be worse off again. However, we believe that some adjustment may need to be done in order to achieve a common understanding across Member States of what an inducement is and avoid different interpretation by National Competent Authorities that undermine the level playing field.

Reducing information overload.
The flood of information introduced under MiFID II overwhelms clients. The vast majority of clients would like to have the option to waive some of the mandatory information (opt-out), which they do not perceive as helpful. Providing information to investors during investment advice or when submitting orders takes time which runs counter the interest of investors. The information requirements have not been entirely subject to the Quick Fix as the legislator had the opinion that the issue needs closer examination.

Harmonisation of different investor protection requirements.
When providing investment advice or selling financial instruments investment firms have to comply with several different requirements (MiFID II, PRIIPs,

SFDR, etc.) Many of these requirements are not harmonized and it's a huge problem for both advisors and investors.

Adjustment of the criteria for professional clients.
Many retail clients do not need the large number of information requirements under MiFID II and feel patronized. The EC should revise the existing opt-up regime in Annex II of MiFID II so that the criteria focus on the client's knowledge rather that portfolio size.

Best Execution reports.
RTS 27 and RTS 28 should be abolished. With the MiFID Quick Fix a temporary exemption of RTS 27 was introduced and this exemption should be permanent. We would like to emphasize the high cost for financial entities to prepare these documents and the low demand of clients for it.

PRIIPs.
ESBG is aligned with the ESAs advice on the review of the PRIIPs Regulation and we call the EC to take into account in order to include these points in the Retail Investor Strategy. The scope should not be extended to new products, at least until it is possible to introduce a more differentiated approach between products under the PRIIPs Regulation and it is necessary to maintain the exemption from the scope of PRIIPs for pension products. Moreover, drafting the KIDs in a machine-readable format - if not already implemented on a voluntary basis as in some Member States - could bring high costs for manufacturers of PRIIPs.

Suitability and Appropriateness assessment.
We don't see any weaknesses in the current suitability and appropriateness regime. We do not see any substantial advantage for the customer if a proposal for the provision of a personal asset allocation strategy was to be realized, neither in terms of time nor in terms of content. Currently, the suitability and appropriateness regimes find themselves to be under extensive development, considering both the requirements from the new ESMA Guidelines on Appropriateness and Execution only as well as the requirements from the implementation of ESG-considerations into the suitability regime (see the ESMA Draft Guidelines on the MiFID II Suitability Requirements).

Position Paper

ESBG appreciates to have the opportunity to share its comments how to increase consumer participation in capital markets. The upcoming MiFID II Review (under the umbrella of the EU Retail Investment Strategy) provides the opportunity to contribute to this goal and in this regard, we want to highlight several priorities that should be addressed as part of the Review.

1) Keeping the choice between commission-based and fee-based model: no ban on inducements

We are in favour to maintain the current legal framework on inducements, we consider it is appropriate in order to protect clients against potential conflicts of interest. The current framework allows any kind of investor to have access to investment advice not only for wealthy investors.

A ban on inducements and a mandatory switch to fee-based advice models would be detrimental to the overall aim of increasing retail investor participation in capital markets. Many retail clients are either not able or willing to pay for advice. But a huge number of retail clients needs to be actively guided to investments in capital markets. An inducement ban would result in a situation where a small number of wealthier investors would continue to invest whereas the vast majority of retail investors would be excluded from capital markets. Investing in securities has become an important component of building up wealth, so it is of utmost importance that all investors, irrespective of their available investment amount, have access to individual expert support in managing their assets.

Another consequence of banning inducements would be that customers will be pushed towards online advisory tools. However, those tools lack personal interaction, and will therefore not be an option for a lot of people, resulting in an overall significant lower number of client interactions.

In general, fee-based advisory service is definitely no guarantee for (content-wise) better consulting. It rather has its own potential for conflicts of interests, which are not as regulated as the potential conflicts of interests resulting from inducements. Also, those fees are not bound to quality improvements, so customers will be worse off again.

Commission-based advisory services bring the following advantages for the customer:

- no time dependency; with commission-based advisory service, the customer only incurs costs when a contract is concluded; advisors can take sufficient time for the customer, as no hourly rate is charged (keyword "drudgery of hours").
- Dissatisfaction with advice: if a customer is dissatisfied with a consultation, he/she does not have to pay for it financially. He/she can end the conversation, get up and leave.
- There is no limit to any minimum investment; fee-based advisory services only pay off from a high investment amount, both for customers and for financial service providers.

- With ex ante cost disclosure, clients know the exact amount the advisor receives when investing in a financial instrument. The commission-based model ensures that retail investors are willing to get financial advice and are charged ex post, in line with the Commission's goal to democratize access to the capital markets.
- The two inducements studies show that the commission-based model offers retail clients a similar or even lower level of costs than the fee-based model.

We therefore strongly advocate for keeping the choice between the remuneration models as it is currently provided for in the regulatory regime. Clients should be able to choose between commission-based and fee-based advice. Two recent KPMG studies for the German and the French, Italian and Spanish markets show that commission-based advice is best fit to actively introduce retail investors with small and medium-sized assets to securities. A ban on inducements, however, would inevitably lead to an advice gap for retail clients. The UK and the Netherlands can serve as negative examples in this regard. In the UK, retail clients with investible assets below 50,000 GBP (approx. 60,000 EUR) typically receive no investment advice at all. In the Netherlands, mass retail clients have limited or no access to investment advice under 500,000 EUR of invested assets.

Finally, a ban on inducements will avoid accomplishing the aim of the EC to raise the level of participation by retail investors in financial markets (a key milestone of the Capital Markets Union). However, we believe that some adjustment may need to be done in order to achieve a common understanding across Member States of what an inducement is and avoid different interpretation by National Competent Authorities that undermine the level playing field .

2) Reducing information overload.

Another big issue for investors is the information overload. The flood of information introduced under MiFID II overwhelms clients. On the basis of different studies, the vast majority of clients would like to have the option to waive some of the mandatory information (opt-out), which they do not perceive as helpful. Providing information to investors in the course of investment advice or when submitting orders takes time which runs counter the interest of investors The information requirements have not been subject to the Quick Fix as the legislator had the opinion that the issue needs closer examination. We consider that this Strategy should address this issue.

In particular, the following aspects should be taken into account:

- No cost information for sell orders / recommendations to sell a product: When clients want to sell financial instruments, costs are rather unimportant (they rather want to avoid losses or need the money for other purposes).
- Extending the new exemptions for the cost information for professional clients to the information regarding inducements: The exemption introduced under the Quick Fix should be expanded to the disclosure of inducements in order to reach the purpose of the exemption (facilitation of orders by professional clients).
- Quarterly reporting (Art. 63 (2) MiFID II Del Reg) should be dropped: The quarterly reporting requirements should be dropped given that clients are widely able to view their portfolio online.
- Loss reporting – change of threshold (Art. 62 MiFID II-Del Reg): The current loss threshold of 10 percent, which triggers an information obligation, should be increased to 20 percent (both with respect to asset management custody accounts (Art. 62 para. 1) and regular securities accounts (Art. 62 para. 2)).

3) Harmonisation of different investor protection requirements

When providing investment advice or selling financial instruments investment firms have to comply with several different requirements (MiFID II, PRIIPs, SFDR, etc.) A big problem for both advisors and investors is the fact that many requirements are not harmonized.

We consider that is necessary to extend the electronic communication introduced under the Quick Fix to other provisions such as PRIIPs. No client will understand that they will receive some information electronically and other in paper. Additionally, there are several provisions on how to provide information (durable medium, website or paper by demand, the timing, prior to the transaction or the possibility to provide information after the transaction with the client's consent). It seems that most of these requirements are similar but not yet fully harmonized so that different processes have to be implemented when providing information to investors, which is both expensive and time consuming.

Currently, the classification of inducements as costs of products or cost of service differs between MiFID II and PRIIPs. This means clients are being given different information about the product costs for one and the same product, even if both information sheets base their calculations on the same investment amount might differ significantly.

To sum up:

- The priority of electronic communication introduced under the Quick fix should be extended to other provisions such as PRIIPs. No client will understand that they will receive – within one advice session or when purchasing the same instrument – some information electronically and other in paper.
- Harmonisation of product costs under MiFID II and PRIIPs: the requirements to calculate product costs under MiFID II and PRIIPs need to be harmonized. It is very positive that ESMA addresses this issue in its "Final Report on the European Commission mandate on certain aspects relating to retail investor protection".
- Different definition of sustainable products under MiFID II and SFDR: the different definitions need to be harmonized. From our point of view, the fact that all financial instruments are included, as well as the fact that the content-related characteristics are dealt with more directly with clients, speak in favour of adopting the MiFID definition.

4) Adjustment of the criteria for professional clients

Many retail clients do not need the large number of information requirements under MiFID II and feel patronized. Therefore, we encourage the European Commission to revise the existing opt-up regime in Annex II of MiFID II so that the criteria focus on the client's knowledge rather that portfolio size, and thereby facilitate a more effective regime for retail clients to opt-up as elective professional clients. For example, customers with more than three years of experience in certain securities transactions or customer who have conducted more than ten securities transactions in a year could be considered as elective professional clients for the relevant product groups in the future. The same should apply to customers whose professional experience or career requires knowledge of securities transactions.

In this regard, the Swiss law under the Federal Act on Financial Services[1] should be taken into account: Article 4 establishes the client segmentation and Article 5 introduces different possibilities in order to inter alia allow that high-net worth retail clients would decide to be treated as professional clients without any additional requirements. We consider that it is important to introduce similar facilitations that allow clients who feel overprotected to be treated as professional clients and to prevent the outflow of capital to third jurisdictions that have introduced lower requirements.

[1] https://fedlex.admin.ch/eli/cc/2019/758/en

5) Best Execution reports

We believe that RTS 27 and RTS 28 should be abolished. With the MiFID Quick Fix, it was introduced a temporary exemption of RTS 27 and this exemption should be permanent. We would like to emphasize the high cost for financial entities to prepare these documents and how the clients rarely ask for it.

6) PRIIPs

ESBG is aligned with the ESAs advice on the review of the PRIIPs Regulation and we call the Commission to take into account in order to include these points in the Retail Investor Strategy. The scope should not be extended to new products, at least until it is possible to introduce a more differentiated approach between products under the PRIIPs Regulation and it is necessary to maintain the exemption from the scope of PRIIPs for pension products. Moreover, we consider that annuities should be excluded because they do not fit for any category of product. Furthermore, plain vanilla bonds with a make whole-clause should be excluded as well. Moreover, drafting the KIDs in a machine-readable format - if not already implemented on a voluntary basis as in some Member States - could bring high costs for manufacturers of PRIIPs.

7) Suitability and Appropriateness assessment

Basically, we do not see any weaknesses in the current suitability and appropriateness regime. As a general statement, we would like to point out, that we do not see any substantial advantage for the customer if a proposal for the provision of a personal asset allocation strategy was to be realized, neither in terms of time nor in terms of content. Currently, the suitability and appropriateness regimes find themselves to be under extensive development, considering both the requirements from the new ESMA Guidelines on Appropriateness and Execution only as well as the requirements from the implementation of ESG-considerations into the suitability regime (and the ESMA Draft Guidelines on the MiFID II Suitability Requirements). Implementing any changes envisaged in this call for evidence / impact assessment within a short period of time after implementation of changes due to the two above mentioned topics do not appear to make sense and will lead to considerable sunken costs within all the affected entities.

Even if a standardized questionnaire could avoid potentially the current discrepancies among National Competent Authorities, this questionnaire can only be focused on the objective questions: the ones related to assess the knowledge and experience of the retail client. However, there are other questions more subjective, e.g. those analysing the financial capacity of the

client, the risks that the client can tolerate, which can definitely not be integrated in this standardized questionnaire.