Our position

Retail Investment Strategy

American Chamber of Commerce to the European Union
Speaking for American business in Europe

Avenue des Arts/Kunstlaan 56, 1000 Brussels, Belgium • **T** +32 2 513 68 92
info@amchameu.eu • amchameu.eu • European Transparency Register: 5265780509-97

Executive summary

The recent European Commission proposal on the Retail Investment Strategy (RIS) appropriately aims to empower retail investors and facilitate their ability to take full advantage of capital markets. We commend the European Commission for introducing measures that aim to:

- Enhance financial literacy.
- Increase digitalisation.
- Ease restrictions to qualify as professional investors.
- Improve suitability and appropriateness assessments.
- Define standards for advisors.

However, despite the good intentions behind certain proposals, some may have negative unintended consequences and should be examined in greater detail as part of the co-legislative process – in particular:

- The introduction of costs and performance benchmarks.
- The concept of the 'Best Interest Test'.
- The revised advice process, including the execution-only inducements ban.

Introduction

In the context of a new macro-economic and geopolitical reality, making further progress on building a more dynamic Capital Markets Union (CMU) is more important than ever. A key pillar in achieving this goal is better facilitating retail investors' participation. Therefore, the European Commission introduced a proposal for a dedicated Retail Investment Strategy. Through this consumer-centric review of the financial services' regulatory framework, the European Commission aims to encourage retail investment participation in capital markets. Increasing retail participation would not only improve the individual financial resilience of EU citizen, it would also help meet Europe's sustainability and digital transformation goals by channelling private money into capital markets.

We welcome the work undertaken by the European Commission within the context of the Retail Investment Strategy aiming to:

- **Enhance financial literacy** – financial literacy is the bedrock upon which strong retail participation in capital markets needs to be built. Consumers need to be engaged and empowered to take action – this further develops trust in the financial system and allows citizens to confidently deploy their savings in European capital markets.
- **Embrace digitalisation** – by adopting digital-by-default disclosure. The new generation of investors are digital, and the entire investment process should be adapted to facilitate their experience – while also allowing the optionality for face-to-face interactions with intermediaries/advisors.
- **Facilitate classification as professional investors** – the proposal simplifies the ability for certain clients to opt-in the professional client category by lowering the wealth criteria threshold from €500,000 to €250,000, and it recognises relevant training and education. This balanced approach will enable more clients to access certain sophisticated products or services.

- **Improve the suitability & appropriateness assessments** – these are key provisions in ensuring retail investors receive the best fit products, and the co-legislators should improve these tests to better meet the needs of investors at the different stages of their advice process.
- **Ensure high professional standards for advisors** – the co-legislators should also build a stronger framework for professional advisors, in particular through minimum requirements for advisor, to ensure retail investors are receiving the best quality advise.

Despite the good aim of other aspects of the RIS, there may be potential unintended consequences from some of the proposals – notably relating to the advice process and the introduction of costs and performance benchmarks.

Value for money

The concept of value for money (VfM) is multi-faceted and should be judged relative to investor's objectives. We are therefore concerned that the RIS, under the umbrella of VfM, places a nearly singular emphasis on costs. The proposed cost and performance benchmark is particularly concerning. While increasing transparency and comparability to ensure value for money is indeed of utmost importance, it is not certain that as proposed, the framework would in practice result in greater value for money for citizens. It may potentially reduce product diversity and have unintended price setting implications.

In more detail, focussing purely on cost could lead to potential distortive outcomes for investors. The proposed benchmark may essentially penalise strategies which diverge from the specific benchmark and therefore have a negative impact on the diversity of the EU funds market. Individuals have many different investment goals in their lifetime and each goal has a unique risk and objective, which investors may have preferences on how they wish to achieve. A well-functioning regime would allow considering costs relative to the full range of value provided based on the different needs and wants of investors.

When developing a VfM framework, there needs to be a recognition that retail investors are not all the same – they are at different stages in their life, have different preferences and are saving to meet different objectives. Therefore, the focus cannot solely be on costs and certainly not only on intermediation, distribution and advice costs – as there are many different factors that need to be taken into account for each individual investor when determining what creates value for them. Thus, a well-calibrated value for money framework would need to consider both qualitative as well as quantitative information – which together bring a more meaningful picture of an investment product.

While there are improvements to be made on how to best ensure value for money for retail investors in the EU, we support the position expressed in the European Parliament (EP) Draft Report, which appropriately deletes the benchmarking provisions.

Best Interest test

An investment firm must act honestly, fairly, and professionally in accordance with the best interest of its clients. However, the newly introduced 'Best Interest test' risks inadvertently limiting investor choice and directing investors to financial instruments that might not meet their investment needs. Moreover, the proposed test does not adequately consider the existing suitability and disclosure obligations and inappropriately places an undue focus on the cost of a financial product. The requirement to select products without additional features that are not necessary to the achievement of the client's investment objectives is particularly concerning. This requirement is at odds with an investment firm's suitability obligation and could potentially result in recommendations that are not in fact in the best interest of the client.

The proposal creates legal uncertainty and puts unproportionate focus on costs without considering qualitative aspects or consumer behaviour. Additionally, products with less or more features and cost efficiency are more an issue at product governance level than at the level of the advice. Ensuring advisors act in the best interests of investors is a key point to guarantee the outcome for consumers. It also ensures that they are provided with a real, meaningful choice at the end of the advice process.

There also needs to be careful consideration on how a potential new 'Best Interest test' would fit with the existing advice process – in particular with the suitability and appropriateness assessments – to prevent duplications and ensure a streamlined and simple process for investors.

The EP Draft Report proposes a more holistic approach to 'best interest' of customer by considering level of risk, implicit costs and charges rather than just costs, and removing the requirement to offer at least one financial product without additional features within the 'best interest of client' principle, which is a positive development. However, more consideration is still necessary – in particular on how this fits within the existing advice process.

Advice

Given the relatively low level of financial literacy across the EU, a consumer-centric approach to the advice process is needed. There needs to be an acceptance that different advice models exist across the EU – due to different capital markets structures and different investor preferences. The focus should be instead on the final output – the advice the end investor receives. This is why the changes embracing digitalisation and standardising requirements for advisors are welcome.

The proposed changes to the inducements regime could result in extensive disruption to the market – potentially hindering consumer access to investment and insurance products, contrary to the goal of the strategy. For this purpose, the EP Draft Report has appropriately removed the proposed changes to the inducements regime.

Conclusion

The Retail Investment Strategy is a real opportunity to engage European citizens for their financial future and improve the retail investor experience. If designed correctly, the revised framework could facilitate access and empower retail investors, while also ensuring high levels of investor protection.

An overly-narrow approach that focuses on costs alone could be detrimental and we encourage policymakers to have a more holistic view of what constitutes value to investors. The co-legislators should carefully consider the practical impact the proposed changes would have on retail investors and the potential adverse impacts, which may ultimately results in less choice for investors.

Retail investors' trust and participation is imperative to further developing European capital markets, as well as to meeting the EU's sustainability and digital transition goals. Therefore, policymakers should carefully examine the proposed measures so real improvements in the retail investor experience can be achieved.