ECMI EUROPEAN CAPITAL MARKETS INSTITUTE


# The Retail Investment Strategy: Lacking a ban, packing alternatives

Jelmer Nagtegaal*

Retail investment – consumers investing in the opportunities offered by capital markets – is a cornerstone of the Capital Markets Union. Yet retail investment levels in the EU are lagging, hurting the financial prospects of households and businesses alike.

Through the recently proposed Retail Investment Strategy, the European Commission aims to change this. And while those expecting a sea change – particularly in the form of an inducements ban – might be disappointed, a closer look reveals a proposal with potential.

This follows on from a concerted effort to address (1) biased advice, (2) the lack of low-cost, non-complex investment products being offered and (3) the low comparability and comprehensiveness of standardised documents.

The proposal is vast, and contains much more, but these three issues are key to improving competition, lowering costs and increasing trust. Address them successfully and consumers will be enticed to move money from savings accounts to the markets, boosting retail investment levels.

## Biased advice

The discussion around the Retail Investment Strategy is, and always has been, about inducements. Inducements – payments from a fund manager to a financial advisor, kickbacks if you will – incentivise the promotion of induced products, even when a non-induced product might be a better fit for the consumer. While the Commission's retreat from a full ban might be seen as a defeat for the consumer, the pro-inducement camp should not celebrate too soon.

The Commission now proposes a partial ban paired with extensive new cost disclosure requirements and cost reporting obligations. The new cost disclosure requirements will require the exact inducement, as well as its impact on returns, to be disclosed separately from other

* *Jelmer Nagtegaal* *is a Researcher at ECMI and CEPS.* *Comments by Apostolos Thomadakis and Karel Lannoo are gratefully acknowledged.*


© Copyright 2023, Jelmer Nagtegaal. All rights reserved.

costs, in addition to an explanation to the potential buyer of what *exactly* an inducement is. Currently this is not the case, hampering a straightforward cost comparison of induced and non-induced products and consumers' overall understanding of the practice.

Fund managers and financial advisors would be obliged to report their inducement costs to the National Competent Authorities and the European Securities and Markets Authority (ESMA). This would allow supervisors to better understand how widespread the practice of paying inducements is, how high the charges are and what their impact on investors' returns are. This is a significant change, as ESMA – by its own admission – is currently unable to quantify the impact of inducements in their costs reports due to having limited data on the practice.

Taken together, the new disclosure and reporting requirements will bring the opaque practice and the impact of inducements out of the shadows. While that doesn't mean they're banned, the increased scrutiny that inducements will receive from consumers and supervisors alike has the potential to improve competition and consequently lower the height of inducements.

And if that doesn't happen, the Commission will be equipped with the data to make a strong case for banning the practice in three years once the Strategy's review clause kicks in.

In short, industry shouldn't celebrate the continuation of a lucrative practice too soon, and consumer organisations might well see their hopes for fewer and lower inducements materialise over time.

## Where are the low-cost, non-complex products?

As revealed in a 2022 study co-authored by CEPS, most consumers looking to invest in capital markets would be best served by passively managed exchange-traded funds (ETFs), a cheap and well-diversified type of investment fund. Yet their low cost is due in part from not having to pay inducements, and hence they face a clear disadvantage in being recommended to consumers by financial advisors compared to higher-cost products that do pay inducements.

To boost the prospects of ETFs and other low-cost, non-complex products, and in the absence of a full ban on inducements, the Commission proposes to further substantiate advisors' duty to act in consumers' best interests. This would include an obligation for them to prove that they offer clients at least one product without costly additional features that are also unnecessary given the client's personal investment objectives.

As the cheapest and most barebones product, passively managed ETFs fit that bill perfectly.

While the proposal doesn't go as far as to specifically name ETFs, it does provide the potential for ETFs and other low-cost, non-complex products to become more widely included in the advice provided by non-independent advisors. At the same time, the Commission's proposals on how to make advisors more accountable are vague, and their ultimate success will depend on the final text as well as how supervisors interpret and enforce the rules.

## And where is the easy-to-read documentation?

Standardised information documents accompanying investment products are also key to enabling retail investors to pick the product that's best for them. Currently, however, retail investors are often overwhelmed by the sheer amount of information contained within these documents. The documents also fail to properly disclose all costs in a straightforward manner, for example by not specifying the inducement paid to the financial advisor. Finally, they are not optimised for the digital age.

Much of this changes through the Commission's proposals to create new standardised documentation templates that reduce unnecessary information, contain new cost disclosure standards, are comparable amongst different product types and – crucially – are digital-friendly.

Current work on the European Single Access Point should also ensure the machine-readability of standardised documentation. When implemented successfully, these proposals empower consumers to more easily access documentation, understand costs better, and undertake a better-informed comparison of products.

## The only way is up

The proposed Retail Investment Strategy is only the start of a lengthy process that will ultimately result in a new legal framework for retail investment. Moreover, other initiatives in the proposal, such as the value-for-money framework, may considerably impact the retail investment landscape depending on their ultimate implementation and enforcement.

Yet the current proposal is a good start. Despite a retreat on a full inducements ban, considerable efforts are being made to reduce their impact on the quality of advice and investment returns.

Moreover, the range of products advised to investors will improve, and so will consumers' ability to inform themselves based on standardised documents. While no silver bullet, the proposal therefore does contain the raw potential to boost competition, lower costs and improve trust.

Do so, and the scene will truly be set for a significant boost in retail investment levels.

## European Capital Markets Institute

ECMI conducts in-depth research aimed at informing the public debate and policymaking process on a broad range of issues related to capital markets. Through its various activities, ECMI facilitates interaction among market participants, policymakers, supervisors and academics. These exchanges result in commentaries, policy briefs, working papers, task forces as well as conferences, workshops and seminars. In addition, ECMI undertakes studies externally commissioned by the EU institutions and other organisations, and publishes contributions from high-profile guest authors.

ECMI EUROPEAN CAPITAL MARKETS INSTITUTE

## Centre for European Policy Studies

CEPS is widely recognised as one of the most experienced and authoritative think tanks operating in the EU. CEPS acts as a leading forum for debate on EU affairs, distinguished by its strong in-house research capacity and complemented by an extensive network of partner institutes throughout the world. As an organisation, CEPS is committed to carrying out state-of-the-art policy research leading to innovative solutions to the challenges facing Europe and to maintaining the highest standards of academic excellence and unqualified independence. It also provides a forum for discussion among all stakeholders in the European policy process that is supported by a regular flow of publications offering policy analysis and recommendations.

CEPS