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A new protective framework for retail investors

Retail Investment Strategy should focus on digital and sustainable investing, cross-sector consistency & financial literacy

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From a supervisor's perspective, it is to be welcomed that the European Commission is planning to take an investor-centred approach to shaping its Retail Investment Strategy (RIS). A renewed focus on the demand side is needed so that citizens can reap the benefits of the CMU via increased retail investor participation, including on a cross-border basis.

A number of recent game-changing developments have strengthened the need for a focus on a new protective framework for retail investors.

Firstly, since the outbreak of the COVID crisis, we have witnessed increased retail participation in the equity markets. This trend was illustrated in Belgium by research by the FSMA on the behaviour of Belgian retail investors over the past four years, based on a data analysis of the reporting of stock exchange transactions. One of the main trends identified was that the stock market continues to attract new and young retail investors.

In addition, technological developments are greatly influencing the retail investor landscape. Investors want to access financial services anytime, anywhere and using various types of devices, platforms and apps. Trading apps are easy accessible and are used mainly by new types of investors who tend to be younger and take more risks.

Investment choices are often made based on the information available on apps, websites and social media platforms, and rely less on regulated financial advisors. Social media are used by non-regulated persons, such as influencers, to send marketing messages and provide investment recommendations to investors.

Thirdly, EU citizens need the necessary tools and the trust to put their savings to work by investing in sustainable capital markets and being part of the climate transition.

The RIS should focus on the following priorities: streamlining disclosure rules, digital and sustainable investing, cross-sector consistency and financial literacy.

Retail investors face an information overload that is not conducive to their protection. It is therefore a priority to streamline the different disclosure requirements stemming from the various regulatory pieces, where appropriate. However, this should not serve as an excuse to withhold essential information from retail investors. Both EIOPA and ESMA's recent technical advice to the Commission suggest possible improvements in this regard.

The regulatory framework needs to be fit for the age of digital and sustainable finance. Disclosure requirements should be digital-friendly. Innovation and technology bring real opportunities to inform retail investors in a more meaningful way, using techniques such as layering: the most vital information (i.e. the information investors "must know") being disclosed in a first layer and in a visually attractive way, layer 2 including information that investors "should know" and layer 3 "nice to know" information.

Flexible rulemaking should be enhanced by empowering the use of Level 2 measures to make it possible to regulate how the clients' best interests can be promoted when they are offered services via trading apps.

Building on its sustainable finance strategy and using feedback from the ESAs or NCAs on possible greenwashing practices, the EC should be constantly looking for areas of improvement of the current regulatory framework regarding the Green CMU.

It is also important to ensure a level playing-field among comparable products, including crypto-assets. The single rulebook should guarantee consistency in the rules applicable to economically equivalent products, in order to avoid regulatory arbitrage between sectors.

The 2020 CMU Action Plan puts forward a number of measures that seek to enhance the financial literacy of retail investors, including regarding sustainable finance, in order to enable them to make better financial decisions as well as to finance the climate transition, and leverage the possibilities provided for by capital markets. On this front, the RIS can provide a boost, complementing consumer protection. As proposed by EIOPA in its Technical Advice to the Commission on Retail Investor Protection, EU directives could be modified horizontally in order to follow the model of the Mortgage Credit Directive and enshrine the task of consumer education in the mission statements of the NCAs and the ESAs.

Over the longer term, it may be appropriate to engage in further reflection on the future of retail investing, taking into account developments in the US (e.g. SEC work on digital engagement practices) or the UK (FCA's initiative on a new 'Consumer Duty') as well. Such reflection may examine a number of key questions (e.g. the possible development of simpler products) with a view to an optimal and holistic investor protection.