Disclosure, Inducements and Suitability Rules for Retail Investors Study. International Bulletin of November 2022.

One of the aims of the Capital Markets Union Action Plan is to strengthen retail investor confidence in such markets. To this end, the European Commission plans to publish its Retail Investment Strategy in 2022, but it could also be in 2023, to promote retail investor access to competitive financial markets, taking into account the effect of digitisation on their development, among other initiatives. The basic thrust of this Strategy will focus on improving the protection of retail investors, ensuring that they receive fairer, more impartial treatment as well as clear and comparable product information.

Before designing this Strategy, the Commission has undertaken a study on the behaviour of retail investors and the application of regulations relating to inducements, disclosure obligations and suitability assessment, prepared by Kantar Public after a public tender, in association with CEPS (Centre for European Policy Studies) and Milieu.

With respect to the methodology employed in this consultation process, the study focused on 15 Member States – Austria, the Czech Republic, Germany, Greece, Spain, Finland, France, Ireland, Italy, Latvia, Luxembourg, the Netherlands, Poland, Romania and Sweden –. It was based on specific information collected from consumer surveys (11,497 responses from 10 Member States[1]), 128 interviews (with national regulators, consumer associations, industry and others), a mystery shopping exercise (in eight Member States involving 13 robo-advisors), a review of the information contained in 560 product documents aimed at retail investors and a mapping of the product catalogues of 240 distributors. A detailed review of the applicable regulatory framework (UCITS, PRIIPs, AIFMD, MiFID II and other regulations) and a number of previous studies was also carried out.

European investment in financial assets has more than doubled over the past 20 years, with insurance and pension products the most in demand (35%), followed by deposits (33%)[2].

Nevertheless, the predominant type of financial asset varies notably from Member State to Member State. In countries such as Luxembourg and Portugal, bank deposits and foreign currencies predominate (with percentages above 45%). In others, including Ireland and the Netherlands, the preference is for insurance and pension funds (with percentages above 45%) while in countries such as Sweden, Latvia and Finland, shares are the preferred option (with percentages equal to or greater than 35%)[3].

The study also takes into consideration the fact that in a number of countries, including Spain, the investment portfolio is mixed, comprising shares, pension and insurance products and investment funds.

Regarding the information obtained directly from the respondents in Spain with at least one investment financial product[4], 17% claimed to have investments in crypto assets (European average:16% of respondents), 29% in life insurance (European average: 30% of respondents), 34% in listed shares (European average: 38% of respondents), 37% in pension products (European average: 27% of respondents) and 66% in investment funds (European average: 46% of respondents).

Meanwhile, 29% of those surveyed in Spain have investments in financial products (European average: 28% of respondents), 10% are looking for financial products in which to invest their savings (European average: 11% of respondents), 16% have savings and would be interested in investing in financial products (European average: 14% of respondents) and 23%, despite having savings, would not be interested in investing in financial products (European average: 23 % of the participants). Finally, 22% of those surveyed in Spain do not have savings (European average: 24% of those surveyed).

DISCLOSURE REQUIREMENTS

Although information is an essential element in the decision-making process for retail investors, the study states that the current approach is insufficient to ensure that the best choice is made.

Other notable observations include the following:

(1) The regulations in place do not make it any easier for the information provided to the retail customer to sufficiently capture their attention, mainly because it is very complex and too extensive, making it difficult to arrive at an informed choice.
(2) There is also a legal vacuum as to what should be understood by the obligation to provide the information in good time, except with regard to the regulations on European personal pension plans (PEPP), particularly where the information in question is provided via the internet.
(3) Documentation is not being delivered systematically during first contact and its reading is only recommended in half the cases.
(4) There are certain inconsistencies in the regulations regarding the format of the information to be delivered to retail investors. The default format in MiFID II is digital, while in the case of PRIIPs it is paper, making it difficult to compare products.
(5) It is, therefore, necessary to develop a regulatory framework for information obligations in digital format.
(6) The performance in the KID (key information document) of PRIIPs (packaged retail investment products) is more geared toward funds than insurance-based investment products (IBIPs).
(7) There is a lack of consistency in the information on costs, which makes it difficult to make reliable comparisons between products.
(8) Comparability between product categories is not enough. Furthermore, when it comes to complex products, it is difficult to identify the most advantageous.

ADVICE AND INCENTIVES

As far as advice is concerned, the study shows that only 28% of those surveyed received independent guidance. For this reason and with the aim of achieving a greater participation of retail investors in financial markets, the Report recommends that regulators improve the quality of the advice they receive, eliminating existing asymmetries, as this is felt to be a determining element when seeking to increase participation and the confidence that investors have in such markets.

With regard to inducements, the Report highlights the importance of providing them with sufficient information, stressing the importance of notifying retail investors of the profit that the advisor/distributor makes from the placement of a financial product. The surveys undertaken show that only 36% correctly understand what this concept implies and that what really worries them is the total cost of the product.

Other observations made in terms of advice and inducements are as follows:

(1) Information on inducements is not the determining factor in consumer choice. In addition, the provision of

this information does not lead consumers to feel that they were not otherwise receiving good advice.
(2) Variations in the ways in which inducements are treated in different sectors: while the regulations relating to financial markets (MiFID II) prohibit them (except in certain circumstances), those relating to the distribution of insurance allow them. Nevertheless, the study found that it is actually a fairly widespread practice in both sectors.
(3) Incentive-related information is difficult to identify in documentation provided to retail customers and, in many cases, does not exist. With regard to the mystery shopping exercise, it can also be surmised from conversations with customers that this information is not being systematically provided.
(4) Incentive transparency does not result in better value for money for investors.

SUITABILITY ASSESSMENT

In order to guarantee the effectiveness of the suitability assessments of retail investors, the Report takes the view that they should be adopted sufficiently early on in the process when making investment decisions and that their result is taken into account by the advisor when recommending products to the client.

Other relevant observations from this suitability assessment study are as follows:

(1) The quality of the questionnaire does not guarantee the quality of the advice.
(2) If the assessment is carried out late, its effectiveness diminishes. The main failure detected in the mystery shopping exercise is that the assessment is often carried out at the end of the process, before the signing of the contract.
(3) The review of the client's profile is not done systematically during the initial phase of the contact but rather before the signing of the contract, with no possibility of subsequent recommendations. Furthermore, the quality of the screening and the questionnaire varies considerably.
(4) Distributors need to make more systematic use of this assessment before recommending products to retail customers. The Report also takes the view that there should be greater supervision by the authorities in this regard.
(5) The cost-effectiveness ratio of this assessment is only positive if the advice is tailored and of high quality.

MAIN CONCLUSIONS

The Report ends with a series of conclusions, the most significant of which are the following:

(1) In the European Union, a number of categories of people can be distinguished, depending on the types of financial products in which they have invested or would invest, as well as their level of confidence when making an investment decision. For example, the study distinguishes between those capable of making their investment decisions without the need for advice from those who need guidance, even where this does not turn out to be the most appropriate.
(2) Regarding the assessment of the regulatory framework as a whole, the existence of tensions between the various pursued objectives is recognised, especially between the transparency and comparability of information on the one hand and its attractiveness and the extent to which it encourages investment on the other.
(3) The existence of a clear legal vacuum is noted in relation to the moment during the process at which the information is delivered to the client or the suitability assessment undertaken, which has given rise to differing practices. The problem that manifests itself in this study is that the delay in its delivery means that the investor does not have access to the information necessary to make their decisions at an opportune moment.
(4) Information obligations do not eliminate the complexity of a product. In addition, information on complex products does not necessarily lead the retail investor to arrive at the most appropriate decision. However, the study recognises that the higher the level of a person's financial education, the more useful the information provided will be when making their choice.
(5) EU regulations on advice and inducements have not led to the expected increase in independent guidance,

with most of that offered coming from non-independent distributors. In fact, the study suggests that the main factor that has led to investment in financial investment products in recent years has been low interest rates. However, it also suggests that the new economic context, with higher inflation and rising interest rates, could alter investor behaviour.

(6) Nor has regulation achieved the intended objective of reducing the use of inducements (except in the Netherlands, where they are prohibited), despite being only allowed in those cases in which the amount is used to improve a service (in MiFID II). In fact, this study has verified that 40% of the investment funds analysed apply inducements. This percentage could be even higher in the case of other products with unclear information in this regard.

(7) Digital advice is experiencing significant growth.

Finally, the Final Report also highlights the following positive aspects in the application of the regulations regarding information obligations, inducements and suitability:

(1) Information availability is acceptable, although it may be less easy to locate for non-complex products such as bonds or stocks.

(2) The comparability that product information allows is also acceptable, except in terms of its cost.

(3) In general, the advice received during the mystery shopping exercise was in line with the profile and objectives of the “presumed customers”.

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1 The total number of interviewed persons, that replied validly, were 10.470. In Spain 1.013.

2 Source: Eurostat 2021.

3 Source: Eurostat 2021.

4 The study has considered as investment financial products, among others: investment funds, listed shares, pension products, cripto-assests, exchanged-traded funds, mutal funds, sovereign bonds, portfolio management, corporate bonds, structured products, and derivatives.

Useful links:

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