FESE position paper on the Retail Investment Strategy[1]

10th April 2024, Brussels

FESE welcomes the European Commission's Retail Investment Strategy (RIS) proposal presented in May 2023. The package comes at a crucial time to shape the ambition of the Capital Markets Union (CMU) to connect issuers and investors across the EU with special consideration, this time, on retail investors.

Increasing retail investors' access to capital markets is vital if the EU aims to secure a sustainable economy, digital adoption, and shared prosperity for the future. FESE believes that the EU needs to empower its retail investors so that they can consciously participate in capital markets by making investment practices simple and transparent. In this sense, the RIS proposal is crucial to steer a paradigm shift in the way retail investors perceive and access EU capital markets.

There are substantial benefits of retail participation in the capital markets:

- The long-term returns on retail investments can help to increase household wealth and support retail investors with their long-term financial planning. For example, saving for retirement, in addition to classical state pension systems, can help to close the growing pension gap and ensure decent retirement levels.
- Mobilising EU citizens' savings will increase the liquidity and depth of EU capital markets and contribute to the development of the real economy, driving further growth through long-term investments.

To date, the level of retail participation in EU capital markets remains low compared with other advanced economies. In 2021, approximately 17% of EU household assets were held in financial securities, well below 43% of household assets held in securities by the US counterparts.[2] A large share of EU households' financial wealth is held as bank deposits offering a negligible return, especially considering recent inflation spikes. This indicates that a large portion of citizens have missed out on capital market investment returns. Meanwhile, many of those who invested in capital markets faced access barriers, costs, and an inability to invest or hedge in financial products that would match their needs and preferences. As a result, low retail participation in the EU leads to an untapped potential from retail bank savings that could, instead, finance the real economy via capital markets.

Retail participation needs to be seen in a broader picture of capital markets in the EU and analysed both through the perspective of primary as well as secondary markets. When it comes to capital markets in the EU, the ultimate aim should be to make it easier for companies to access public markets and for investors across the EU to invest in them. Collective action by European and Member States' policymakers is needed to ensure that European companies, from large caps to small and mid-caps (SMEs), can raise finance

[1] Updated in April 2024, compared to the October 2023 version.

[2] Data source: Eurostat.

efficiently through public capital markets and that investors, particularly retail, benefit from the opportunities such investments provide. It could also help the EU to become more competitive internationally vis-à-vis other regions and attract investors beyond the EU.

FESE welcomes opportunities to suggest improvements to the European retail investment framework aiming at bringing retail investors closer to EU capital markets. Exchanges are pivotal players, bridging the gap between issuers and investors. They provide the platform for capital formation on primary markets, and price discovery and risk transfer on secondary markets, while ensuring transparency, integrity, and investor protection. Part of the Financial Market Infrastructures (FMIs) ecosystem, exchanges want to contribute to the European Commission's objective to empower retail investors and take a step closer to the completion of the CMU.

FESE high-level principles on retail investment

- Access to capital markets should be open for all types of investors, provided they receive all necessary information to make an informed decision.
- Broad availability of financial products should meet various needs and investment strategies of different types of investors depending on their level of sophistication.
- Retail investors should receive only necessary information that is easy to read and understand, and that allows for product comparison. Avoid information overburdening and duplication.
- Cost transparency should be maintained to prevent conflicts of interest and hidden costs for retail investors.

1. Packaged retail and insurance-based investment products (PRIIPs) Regulation

1.1. Scope of the PRIIPs Regulation

With the introduction of the PRIIPs Regulation, co-legislators introduced a coordinated set of transparency rules for packaged products offered to retail investors. This is to ensure that investors can understand and compare the products they are offered.

1.1.1. Corporate bonds

Retail investors' access to classic corporate bonds is increasingly limited because of regulations. The main obstacle is the inclusion of a vast majority of corporate bonds in the PRIIPs Regulation which makes corporate bonds difficult to access for retail investors.

The PRIIPs Regulation was originally envisaged for "packaged retail investment products" – i.e. an investment where the amount repayable to the retail investor is subject to fluctuations because of exposure to an underlying reference value or to the performance of one or more assets which are not directly purchased by the retail investor. However, corporate bonds do not incorporate an underlying asset and are held directly by investors.

When corporate bonds fall under the category of a PRIIP, the PRIIPs Regulation mandates corporate issuers to produce a Key Information Document (KID). Consequently, retail investors cannot access these bonds unless the issuer of the bond publishes a KID. However, corporate issuers often attempt to avoid extra red tape under the PRIIPs Regulation when seeking to get capital from new bonds. They often lack incentives to create a KID, especially when professional investors already constitute the main funding base for the issuance amount. A recent study revealed that 86% of all listed corporate bonds offered for trading on Boerse Stuttgart in January 2024 are not tradable by retail investors.[3] Around 60% (6,803 of 11,025) of these listed corporate bonds are categorised as PRIIPs, which do not have a KID, and thus are not tradable to retail investors. Meanwhile, Euronext research reveals that there is an increase in the number of professional-only corporate bonds. Together with an overall decrease in the admission to trading requests of corporate bonds on the Bond-X segment of the EuroTLX Market (Euronext's MTF in Milan), fewer bonds are available specifically to non-professional investors. Euronext research also shows that even bonds with straightforward pay-off structures, such as fixed rates, were labelled as PRIIPs as they included a make-whole clause. As a result, it led to limited tradability to retail investors.[4]

Corporate bonds with a "make-whole" clause allow the issuer to redeem the bond early. In this case, the investor must be paid a form of compensation for the early redemption, making a "make-whole" clause an instrument of investment protection. In the MiFID II recovery package ("Quick Fix"), corporate bonds with make-whole clauses were considered "safe and simple products that are eligible for retail clients".[5] In April 2022, the European Supervisory Authorities (ESAs) also issued a recommendation that bonds with make-whole clauses should not fall under the scope of the PRIIPs Regulation.[6]

The current RIS proposal, among other things, amends the scope of PRIIPs to exclude corporate bonds with make-whole clauses "provided that they are redeemed at a fair value". FESE fully supports this proposal and sees it as a significant step forward to increase retail investors' participation in this type of product. While we welcome the exclusion of corporate bonds with "make-whole" clauses, we encourage co-legislators to further exclude all ordinary bonds[7] (except for structured bonds) from the PRIIPs Regulation. The application of PRIIPs to all ordinary bonds creates significant obstacles to their distribution to retail investors who, in contrast, would like to access these products and invest in EU companies.

1.1.2. Exchange-traded derivatives (ETDs)

FESE believes it is important to re-state that ETD products were not initially meant to fall in the scope of the PRIIPs Regulation, which is aimed at investment funds and other long-term investment products. While FESE understands the rationale of the Regulation concerning packaged products, the framework is ill-adapted for trading venues[8] listing ETDs. ETDs are not designed for any target group and should not be seen as a long-term investment product.

The key difference between traditional ETDs and packaged products is that ETDs are not issued by exchanges. To specify, exchanges are the manufacturers of ETDs because they design the contract terms of ETDs, but the specific product does not exist until the trading member of the exchange starts trading in it. Once orders are matched, the ETD contract "kicks off" (i.e. is created) at that moment, according to the contract terms designed by

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[3] Boerse Stuttgart White Paper 2024, "Less Tradable Corporate Bonds for Retail Investors in 2024", available here.

[4] Euronext White Paper 2024, "Statistics from 2024 underline the trend of retail investors being increasingly disincentivised from trading simple bonds", available here.

[5] Recital 4, MiFID II recovery package ("MiFID Quick Fix"), Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis.

[6] The ESAs, "Call for advice on PRIIPs: ESA advice on the review of the PRIIPs Regulation", available here.

[7] Traditional or classic bonds issued by corporations with predictable payment structures, as defined here.

[8] Regulated Markets (RMs), Multilateral Trading Facilities (MTFs), and Organised Trading Facilities (OTFs), as defined under the MiFID II/R.

the exchange. However, as such, ETDs are not issued in the traditional sense of the word. Therefore, we believe ETDs should not be included in the PRIIPs Regulation.

While exchanges manufacture the ETDs, they have no relation with end investors as trading occurs between their trading members (i.e., MiFID-licensed investment firms). Exchanges that list ETDs are neutral marketplaces and are not involved in the marketing and distribution of these products by intermediary investment firms and brokers. Exchanges do not have the visibility of the final investor, be it professional or retail. This difference leads to the inability of exchanges to complete a KID according to the proposed set of rules.

Exchanges cannot complete certain sections of the KID, while others are simply not applicable to specific features of ETDs. In particular:

- **Costs**: Exchanges face difficulties in completing the section on costs of the ETDs in the KID document because they are not aware of the actual costs that brokers will charge to end investors. The information that exchanges provide in the cost section is the cost that they charge to brokers rather than the actual cost of ETDs that brokers will later charge to the end investors. This section can mislead retail investors as it is incomplete, and exchanges are not able to fill the information gap. Also, current rules require to calculate the costs corresponding to an investment of EUR 10,000 in the product, but this is not consistent with the nature of ETDs, which are leveraged contracts by nature.
- **Performance**: ETDs are leveraged products that track the price movement of an underlying asset. Options and futures do not promise any return on investment but are simply designed to manage the price risk of the underlying and can be used, for instance, as a hedge to equity investments. The underlying has its own published info (for a share a prospectus, for an index ongoing real-time information, benchmarks statements, etc.). It would be misleading to include a section on the performance of an ETD since the product does not “promise” any sort of performance in the first place.

NCAs have partially addressed the issue by allowing for a tailored “standard KID” for ETDs. It is already standard practice to group ETDs from the same family to produce a KID applicable to all. The agreed practice with NCAs avoids a bureaucratic hurdle that would force exchanges to produce thousands of KIDs every day, each one almost identical to one another. While this has been tackled in Level 2 and with ESMA guidelines, FESE believes that the Retail Investment Strategy is the opportunity to fix an unintended consequence of the current text of the PRIIPs Regulation that inadvertently included ETDs in its scope.

To sum up, FESE suggests, as the best option, to clearly state in Level 1 that ETDs are not under the scope of the PRIIPs Regulation. Should co-legislators believe a more nuanced solution is sufficient, FESE suggests, as the second-best solution, amending the Level 1 text to clearly state that the KID for ETDs should reflect the specific needs and characteristics of ETDs. It would at least be necessary to specify in the Level 1 text that, specifically for the ETDs case, quasi-identical ETDs can be grouped together, and a single standard KID be produced for them. The Level 1 text should acknowledge the current approach of NCAs to allow a “standard KID” for ETDs grouped in the family, which was addressed in the ESMA guidelines. Furthermore, the “costs” and “performance” sections in the KID are not applicable for ETDs and should be deleted for these products.

Key message:

- FESE very much supports the amendment on the exclusion of corporate bonds with make-whole clauses from the scope of the PRIIPs Regulation because these financial instruments are not packaged products, as confirmed in the MiFID II recovery package (“Quick Fix”) and the ESAs’ recommendation.
- FESE encourages co-legislators to exclude all ordinary bonds (except for structured bonds) from the scope of the PRIIPs Regulation as it poses an obstacle to their distribution.

- ETD products were not meant to fall in the scope of the PRIIPs Regulation in the first place because ETDs are not packaged products. FESE calls for exempting ETDs from the scope of the PRIIPs Regulation by a "quick-fix" in Level 1. Alternatively, FESE suggests a further recalibration in Level 1 of the "standard KID" for ETDs to better match the needs and characteristics of ETDs since ETDs are not packaged products.

1.2. Modernisation of the KID document

The RIS proposal aims at modernising the KID document by introducing a new section, named "Product at a glance" to provide a short summary of the document and highlight the main information. In our view, the new section would not add value for retail investors as its objective is the same as the entire KID document: to provide the summary of the main features of an investment product. The RIS proposal also adds a new section on sustainability, named "How environmentally sustainable is this product". The introduction of this section should be carefully weighted as not all financial products will require a sustainability section due to their characteristics. It is important to ensure that new sections add a clear value for retail investors rather than becoming clutter.

Key message:

- The proposed section on "product at a glance" would only create clutter, doubling information already contained in the KID, while the ESG section should be carefully calibrated and only apply where relevant. The KID should remain a brief document containing only critical information that gives an overview of the product in question.

2. Measures to improve "Value for Money"

The Commission proposal aims to complement MiFID II and IDD by adding new requirements for manufacturers to follow a "pricing process" to identify the cost and charges for financial products. Under the proposal, ESMA and EIOPA are given a mandate to develop cost and performance benchmarks for manufacturers to compare financial products before offering them on the market.

FESE believes that "Value for Money" (VfM) benchmarks, as they are constructed in the current proposal, would add information primarily on the pricing/costs of financial products rather than their overall value. The benchmarks might label certain products as "expensive" and lead retail investors towards cheaper products that might not necessarily reflect a higher value or a better fit for their portfolio strategy. For example, a benchmark focused on costs would favour passive investment funds instead of actively managed funds since the latter are on average more expensive. However, it does not consider that actively managed funds potentially give more tailored investment opportunities and higher returns in the long run. The reference to the notion of "high cost" could lead to legal uncertainty as the concept is rather broad and can vary depending on the investor.[9] Therefore, we encourage co-legislators and the ESAs to consider other qualitative factors, especially the products' distribution channels.

[9] European Parliament, Policy Department for Economic, Scientific and Quality of Life Policies, Directorate General for Internal Policies, "Retail Investment Strategy: How to boost retail participation in financial markets", June 2023, available here.

FESE believes that a clear focus on "cost-efficiency" is needed, meaning that the net performance and other qualitative characteristics of financial products need to be considered besides their cost. Otherwise, if "cost" is the main indicator for constructing benchmarks, OTC products may benefit against transparent financial products traded on trading venues. The analysis of overall costs would appear cheaper for products traded OTC since they do not charge listing, trading, clearing, or settlement fees. As a result, these benchmarks, if constructed with a strong emphasis on the cost aspect, will push retail investors away from trading venues to the OTC space, which does not offer sufficient protection for an average retail investor. Furthermore, benchmarks that do not adequately match financial products will generate inaccurate VfM, which could lead to misallocation of invested capital and unsuitable investment decisions by retail investors. Broad benchmarking by way of regulation risks condensing investment choices on the mean, effectively concentrating the market on a few products, instead of favouring a landscape of diverse financial products.

Since the ESAs are already looking into potential options for the design of VfM benchmarks[10], FESE would like to stress several points.

1. VfM benchmarks should not be released to the public and should be used only as a supervisory tool by the ESAs and NCAs to catch outliers (products performing remarkably poorly). Qualitative factors should be added on top of quantitative factors.
2. Clustering and benchmarking should be appropriate for all financial products to avoid generating inaccurate VfM benchmarks. Product clusters should be comprehensible and designed with only relevant indicators. Too many indicators would make it significantly more difficult to properly classify the cluster, which could lead to misinterpretations. The following indicators could be used:
    - Net returns,
    - Reduction in yield (RIY),
    - Return-to-cost-ratio (in absolute terms, total costs).
3. Certain products should be excluded from the scope, such as vanilla derivatives and their securitised equivalents (e.g. warrants and turbos) traded on exchanges. These financial instruments are issued in large numbers (over 100,000 ISINs per year for the largest issuers) and they have a different pricing method which depends mainly on whether they are "in the money" or "out of the money".
4. Finally, the use of the standardised figures provided by the PRIIPs KID should be the primary source to calculate performance measures that ultimately lead to product cluster distribution.

Key message:

- While the VfM of an investment could be a good tool for comparison, cost should not be the only parameter to take into consideration, as it would misrepresent certain financial products that offer a robust price formation process.

[10] EIOPA consultation on the VfM benchmarks methodology, available here.

- VfM benchmarks should not be released to the public and should be used only as a supervisory tool by ESMA and NCAs to catch outliers (products performing remarkably poorly). Qualitative factors should be added on top of quantitative factors.
- FESE considers that certain products should be excluded from the scope, such as vanilla derivatives and their securitised equivalents (e.g. warrants and turbos) traded on exchanges, as they are issued in large numbers and have a different pricing method.

3. Access to financial products

3.1. Information disclosures on "particularly risky products"

The Commission introduces additional information disclosures as to "particularly risky products" through the Omnibus Directive. The amendments to Article 24 MiFID II and Article 29 IDD oblige investment firms as well as insurance intermediaries to display risk warnings about potential losses from "risky" financial products. The mandate is given to ESMA to develop the concept of "particularly risky products" as well as the content and form of the warnings.

FESE believes that these warnings should not lead to limited or no tradability of financial products by retail investors. It is crucial to keep the market accessible both to institutional and retail investors, provided that they have sufficient information about the product and its associated risks. FESE does not see any deficiencies with the current risk warnings framework in place and considers the existing investor protection requirements (e.g. assessment tests) sufficient to inform and warn retail investors of potential risks. For example, appropriateness tests already inform retail investors whether they are suitable for certain products by giving, when appropriate, a risk warning while maintaining their freedom to decide whether to continue trading in those products. As such, we urge policymakers to maintain retail access to a broad range of products listed on trading venues and remove the new Article 24(5c) and Article 69(2)(w) of MiFID II.

Providing retail investors access to a broad range of products will enable them to fully benefit from long and short-term investment opportunities as well as from hedging opportunities and diverse portfolio offers. In recent years, there has been an evident rise in retail participation in more complex products such as derivatives. In its report on retail conduct, IOSCO underlined that there is increasing use of leverage by retail investors, which is closely associated with leveraged product markets.[11] Leveraged products allow investors to use borrowed capital to increase the return on the investment, without owning the full financial asset. Leverage can help to amplify gains, but it also creates potential for losses. It is on this point that FESE would like to stress that the use of the term "risky" carries a negative connotation. It would inevitably lead to a wrong perception that these financial products are not appropriate investment or hedging tools in general, no matter the circumstances or the investors seeking access to them.

The right investor assessment should take into consideration the risk profile and the investment strategy and goal of the investor. Depending on these factors, more complex instruments might be the appropriate product type to address the overall investment need. For example, when hedging and thus protecting the portfolio. Hence, the term "risky" is

[11] The International Organization of Securities Commissions (IOSCO), March 2023, *Retail Market Conduct Task Force Final Report*, IOSCO Report, available here.

misplaced and only adds negative perceptions to certain products performing an important function in market risk management a portfolio or investment is exposed to.

As mentioned above, appropriateness tests already act as speed bumps for retail investors and become more and more stringent as financial products become more complex. The goal should be to incentivise retail participation in capital markets and assess their knowledge profile using testing, not deterring them from using risk management tools with the use of buzzwords such as "risky products". In sum, FESE suggests refraining from using misplaced terms such as "risky" and, instead, referring to complex financial products as, in fact, "complex". This better reflects the characteristics of the product and does not carry a negative connotation. It is therefore important to consider the potential reduction of diversified product offerings as a result of this measure.

In the same report, IOSCO underlined that investment firms that trade retail OTC derivatives to retail investors have persistent conflicts of interest as they often both design and trade these financial products. Considering these aspects, FESE emphasises that retail access to trading venues, contrary to OTC markets and especially vis-à-vis derivatives products, is a crucial element to ensure sufficient investor protection, market transparency, and alignment with the objectives of MiFID II/R.

Key message:

- The right investor assessment should take into consideration the risk profile and the investment strategy. The current risk warning framework as well as investor protection requirements are sufficient. FESE proposes to delete the new Article 24(5c) and Article 69(2)(w) of MiFID II to preserve the current risk warning framework.
- In order to give an objective description and avoid subjective connotations, the term "risky" should be replaced by "complex". Complex instruments perform an important function in market risk management where a portfolio or investment is exposed to it.
- It is critical to facilitate retail access to trading venues as it allows for full transparency, safeguards in execution, and intermediation. This is a crucial element to ensure sufficient investor protection given by the existing and highly regulated market infrastructures, in line with the spirit of MiFID II/R.

3.2. Investor categorisation

Currently, under MiFID II, retail investors are defined as those who do not qualify to be professional investors. Where investors choose to opt into the professional category, the intermediary must warn the investor of the level of protection they will cease to have and the investor must comply with several criteria such as frequency of transactions and size of financial instrument portfolio, among others. Retail investors are currently subject to several additional investment protection measures, such as the prohibition to acquire certain products as well as additional disclosure information. Some stakeholders have argued that for certain investors that currently fall under the retail investor category, these protections are not necessary. The creation of a new client category or the modification of the existing requirements for professional clients on request could thus give a subset of experienced investors broader and more comprehensive access to the capital markets and would bring additional sources of funding to the EU economy.

FESE welcomes the lowering of the wealth criterion from EUR 500,000 to EUR 250,000 for retail investors to qualify as professional investors, as outlined in Annex I of the Omnibus Directive. However, FESE believes that wealth should not be the primary criterion for retail investors to be considered professional. Knowledge, experience, and training are more decisive factors when it comes to the categorisation of retail investors. Not all retail investors have the same level of financial knowledge. Some might have an advanced level of financial literacy to understand more complex financial products and make the appropriate investment choices, while others might not. Therefore, FESE encourages policymakers to place more emphasis on knowledge, experience, and training rather than wealth when it comes to investor categorisation. As such, if appropriate, we would also support further lowering of the wealth criterion to, e.g. EUR 200,000, EUR 150,000 or EUR 100,000, to allow more retail investors to access more products.

FESE welcomes the proposal to insert a fourth criterion relating to relevant education or training. The new criterion in Annex II of MiFID II on the categorisation of investors specifies that retail investors can present proof of recognised education or training to satisfy one of the 4 criteria to be considered a professional investor. Adding this new criterion helps to widen the opportunities for retail investors to be qualified as professional investors. In addition to that, we would further suggest lowering the number of trades criterion. According to the current text, investors must have carried out at least 10 trades per quarter over the previous 4 quarters to satisfy it. We suggest, instead, assessing whether a certain investor has gained experience in a particular asset class over a period of at least 5 years and has completed at least 20 transactions in this asset class. This would maintain the original objective of the number of trades criterion while making it more flexible.

Finally, as mentioned above, FESE would also support the introduction of a semi-professional category, to enable those retail investors to access products currently out of their reach. This proposal would apply to a newly created category of investors that have sufficient experience and financial means to understand the risks. Such a definition should not be linked to a specific profession but rather to experience, knowledge, and risk profile. Furthermore, this new semi-professional category should not, as a side effect, further restrict the existing retail category access to certain products. Rather, it should unlock products that are, today, only available to professional investors. It will allow for differentiation on the grounds of informational needs and will define protection requirements from other investors. In the case of a risk of liability of brokers, the broader industry could design a test to promote convergence.

Key message:

- FESE welcomes the Commission's proposal to reduce the wealth criterion and introduce a new criterion on relevant education and training. FESE would also welcome further lowering of the wealth criterion since wealth should not be a decisive factor.
- To further widen the opportunities for retail investors to be qualified as professional investors, FESE proposes to readjust the number of trades criterion. For example, a track record of at least 5 years of experience in a certain asset class and completed at least 20 trades in this asset class.
- FESE would also support the introduction of a semi-professional category, to enable those retail investors to access products currently out of their reach. This new semi-professional category should not, as a side effect, further restrict the existing retail category access to certain products.

3.3. Suitability and appropriateness tests

The Commission's proposal introduces amendments for suitability and appropriateness tests. First, it proposes the inclusion of investors' risk tolerance and the capacity to bear losses in the assessment tests for non-advised products (Articles 1(14) and 2(22) of the Omnibus Directive). If included, this new version of appropriateness tests would closely resemble suitability tests. The latter already includes investors' risk tolerance and capacity-bearing assessments for advised products in Article 25(2) of MiFID II. Second, the Commission is also introducing a new requirement that, in case of a negative assessment test, the financial intermediary can proceed with the concerned transaction only if the client expressly requests it (Article 1(14) of the Omnibus Directive on Article 25(3) of MiFID II). Effectively, both the demand of the retail investor as well as acceptance of the financial intermediary should be recorded. Instead, the current requirements allow retail investors to proceed with a concerned transaction after a warning is issued following the appropriateness test without any formal request for the transaction to be executed.

FESE believes that adding the above-mentioned assessments to appropriateness tests would only add additional red tape for retail investors to access financial products and, thus, raise administrative barriers to their participation in capital markets. Suitability and appropriateness tests are different in their content and aim, precisely because they are targeted to two different ways on how retail investors approach capital markets (i.e. advised vs. self-directed). We believe that the status quo already has a satisfactory level of protection and, as such, investors should be able to execute transactions after acknowledging a warning notice following a negative assessment. Intermediate steps of an explicit request by the investor to the financial intermediary would only add an administrative burden.

Key message:

- The existing appropriateness tests ensure a sufficient level of investor protection. The current proposal, as it is, would only add unnecessary red tape.
- FESE proposes to preserve the current status quo of appropriateness tests to proceed with a concerned transaction after acknowledging a negative assessment and warning. Issuing a formal request to financial intermediaries would only add administrative barriers to retail access to capital markets without adding any significant investor protection advantage.

4. Inducements

One of the most debated topics of the RIS proposal is the ban on inducements that cover execution-only services where no advice relationship exists between the investment firm and the client. According to the Commission proposal, investment firms will be obliged to inform clients about the cost of inducements and how they can impact the return on investments when they offer advice. The Commission also introduces a three-year review clause to assess the effects of the partial ban and potentially reconsider the need for the full ban on inducement in the future.

FESE takes note that the ban on inducements might be an instrument to support retail investors against hidden costs and possible conflicts of interest. The practice of inducements can result in situations where financial products are offered to retail investors because they benefit the seller rather than taking into consideration the needs and preferences of the buyer. On the other side, the ban will still have significant impacts on financial intermediaries providing services to retail clients. The adjustments could be detrimental to retail investors in the form of a lower product range, higher transaction costs, and exclusion from advice. This impact will greatly depend on how banks and investment firms will implement the new rules.

We welcome the proposal to introduce disclosure obligations to better inform retail investors of inducements and their costs as it improves transparency. Strengthening suitable disclosure requirements to inform the customer about payments of inducements will contribute to achieving investors' protection.

Key message:

- FESE welcomes the proposal to introduce further disclosure obligations to avoid hidden costs and possible conflicts of interest.

5. Misleading marketing communications and practices

One of the core parts of the RIS proposal is to prevent misleading marketing communications and practices that mislead retail investors into buying investment products that do not suit their needs and preferences. The new amendments require investment firms to have a clear policy on marketing communications and provide for clear obligations on marketing practices. Investment firms, according to the proposal, will be held liable in case of any violations of their obligations on marketing practices, including on social media and through "*finfluencers*". FESE Members, as regulated and transparent exchanges, have a genuine interest that influencers act as reliable marketing actors. Misleading practices and scams related to any financial product would inevitably have a negative ripple effect on the overall perception of financial markets. Popular and cost-efficient products like ETFs and blue-chip equities would suffer as well from a marketing and image perspective.

FESE is also concerned about the widespread misuse of the term "exchanges" and the way some dubious market operators are labelling themselves. It is crucial to have a clear differentiation between regulated lit trading venues and other offshore unregulated trading platforms. There should be a clear indication of which market operators are regulated under EU legislation and which are not to the benefit of all investors, especially retail. This labelling should be made clear and perceptible and incorporated into the marketing practices of firms. This could take the form of e.g. a visible "EU regulated" label on marketing documents.

Key message:

- FESE welcomes the Commission's proposal on curbing misleading marketing communications and practices because even a few unregulated offshore companies could have an overall negative effect on retail investors' perception of financial products regulated and distributed according to EU law.
- FESE proposes to introduce a clear labelling of which market operators are regulated under the EU legislation, and which are not, to the benefit of all investors and to improve transparency.

6. Supervisory practices and product intervention powers

The RIS proposal aims at strengthening supervisory enforcement in the context of cross-border cases. The Commission proposes to introduce reporting requirements for investment firms and insurance distributors on their cross-border activities to NCAs and later communicate to ESMA. The Commission also proposes to create collaboration platforms to facilitate cooperation between NCAs and the ESAs. The RIS proposal specifies that ESMA can set up a collaboration platform either at its own initiative or at the request of NCAs in the cases of concerns on investor protection to facilitate the exchange of information on a cross-border basis.

In response to a rising trend of retail participation in derivatives products, various jurisdictions introduced measures aiming at limiting the access of retail investors to certain risky financial products, such as contracts for difference (CFDs) and binary options.[12] [13] FESE fully shares the objective of safeguarding investor protection and agrees that some product intervention measures at the European level might occasionally be necessary for specific products. For instance, ESMA's product intervention measures on binary options and CFDs are necessary measures to promote investor protection for products that are less suitable for retail clients.

However, some intervention measures might excessively limit the access of retail investors to capital markets and fall short of taking specific characteristics of financial products into account. For example, BaFin decided on 30th September 2022 to ban the marketing, distribution, and sale of futures with additional payment obligations to retail investors.[14] ESMA, on 26th October 2022, issued a positive opinion on the product intervention in this respect by BaFin. As of 10th July 2023, the Spanish CNMV announced intervention measures regarding CFDs and other leveraged products. They came into force on 3rd August 2023 after a very short implementation timeline of 20 days. With this intervention, the CNMV expands the 2019 CFDs resolution on futures and options traded on regulated exchanges, imposing limitations on leverage and the obligation to close positions when the value of the position is reduced to half the initial margin.[15] [16] The regulatory action left industry participants a very short time to adapt systems and inform clients about the new circumstances. Some market participants have decided to stop offering access to certain leveraged products, including ETDs, as they were not able to guarantee full compliance with the new rules. In July, ESMA also issued an opinion, expressing support for this intervention measure.[17] As a general principle, FESE suggests that an appropriate time period between the publication of new rules and their implementation should be granted.

It seems that BaFin, CNMV, and ESMA believe that high leverage in futures increases the probability that small investors will suffer losses or have to pay additional margins. However, the leverage of a futures contract is determined by the amount of initial margin required for each futures contract. The more volatile the underlying asset of a future is, the higher the initial margin requirement by the CCP. The leverage for futures with more volatile underlyings is, therefore, lower than for futures with underlyings that have only very small price fluctuations. The margin requirements set by CCPs, under the EMIR requirements, also apply to exchange participants and intermediaries, which derive their own clearing and

[12] In 2016, FSMA (Belgium NCA) prohibited the distribution to retail investors of binary options traded via an electronic trading system, that have a duration of less than one hour or that directly or indirectly involve leverage. In 2019, ESMA adopted measures with a view to curtailing the marketing of CFDs and binary option products to the retail investor base. Following the lapse of these measures, individual Member States adopted similar measures. In the UK, in 2019, the FCA imposed a complete ban on the sale of binary options to retail consumers and introduced various restrictions on the sale of CFDs to retail consumers. More recently, BaFin (German NCA) imposed a ban on the distribution, marketing, and sale of futures to retail investors.

[13] CNMV (Spanish NCA) launched a public consultation, closed on 31st January 2023, proposing new restrictions to the advertising in the commercialisation, distribution, or sale to retail investors of CFDs. The proposed measure came into force as of 20th July 2023.

[14] BaFin press release 30th September 2022, Product intervention: BaFin protects retail clients from unlimited losses in futures trading, available here.

[15] CNMV press release, The CNMV restricts CFDs advertising and limits operations of leveraged instruments, 12th July 2023, available here.

[16] CNMV resolution, Product intervention measures relating to contracts for differences and other leveraged products, 11th July 2023, available here.

[17] ESMA, "Opinion on the product intervention measures relating to contracts for differences (CFDs) and other high-risk products proposed by the Spanish Comisión Nacional del Mercado de Valores (CNMV)", available here.

margin rules towards retail investors. Therefore, unlike other financial instruments, retail investors cannot use unreasonably high leverage on volatile underlying assets in futures. Against this backdrop, the assumption that high leverage for futures directly increases the probability of losses is wrong.

It is important to emphasise that product intervention measures should be proportionate and appropriate to ensure adequate investor protection but not excessively limit the access of retail investors to capital markets. Considering the recent trend of intervention measures across multiple Member States in the EU, FESE believes that these developments are shifting the EU retail investment framework in the wrong direction, by focusing on limiting the access of retail investors to financial products. Instead, intervention measures should only be used as a last resort option after careful analysis and evaluation of investor protection-related market practices. The guiding principles for retail participation in capital markets should focus on responsible and thoughtful participation, and there should be a fair balance between protective measures and ensuring retail access to the markets.

Regulatory and supervisory measures should also ensure that retail investors are integrated into regulated trading venues in accordance with MiFID II/R. These venues are recognised for offering the highest degree of transparency, security, and fairness to all classes of investors. The BaFin ban on futures with additional margin calls would, instead, restrict retail investors' choice of regulated products, pushing some of them towards risky and non-standardised OTC products. We consider it incompatible with the objective of investor protection for retail clients if product intervention measures do not take into account the use of derivatives for purposes such as hedging risk, capital extraction, etc. Thereby resulting in the hedging of business transactions or investments no longer taking place within established and regulated market structures and with standardised contracts. Further alignment with the use of the proposed collaboration platform should also contribute to reaching sufficient levels of supervisory convergence.

Key message:

- It is important to emphasise that regulatory and supervisory measures should aim at integrating retail investors into regulated trading venues in accordance with MiFID II/R, instead of being nudged into unregulated OTC markets.
- Product intervention measures should be a proportionate and appropriate measure of last resort to ensure adequate investor protection without excessively limiting retail investors' access to capital markets.

7. Financial literacy

Expertise and knowledge are crucial factors to enable investors to make informed financial choices. Hence, as a general and long-term objective, efforts should be made to improve overall financial literacy in the EU. RIS introduces further amendments to ensure that Member States promote financial education on the national level. On top of this, it is worth stressing that investment advisors also must abide by high standards of knowledge. FESE welcomes the strengthening of the requirements on the knowledge and competence of financial advisors introduced by RIS. Financial advisors should be able to demonstrate that they possess the necessary knowledge and competence to perform their tasks and should have access to certified training throughout their work life. We would support mandatory minimum professional qualification requirements for intermediaries providing financial advice.

It is also important to emphasise that retail investors have various levels of sophistication and financial literacy which can allow them to buy more complex products. For instance, securitised derivatives in most cases are traded by self-directed investors that usually have an above-average level of financial literacy. As such, retail investors engaging in the trade of securitised derivatives in most cases know the associated risks of these products. Their investment objectives vary from speculation to hedging purposes. These investor motives need to be taken into consideration when interpreting figures about investors' losses in trading with securitised derivatives. Furthermore, the total investment portfolio of retail clients also needs to be considered as this is closely connected to the use of securitised derivatives as hedging tools. This is an important aspect that is often ignored when analysing the suitability of securitised derivatives for retail investors. Therefore, when designing the regulatory measures, all these factors need to be considered.

Above all, FESE believes that it is crucial to keep regulated markets broadly accessible for both institutional and retail investors. While FESE acknowledges the risks associated with retail participation in certain segments of capital markets and the need for investors' protection, we believe that the focus should be on empowering retail investors through financial education rather than preventing their participation in capital markets. In particular, NCAs should collaborate and design appropriate educational tools and materials to boost the financial literacy of retail investors and equip them with the necessary knowledge to make responsible financial decisions. As a second layer, the industry could complement the measures NCAs deem necessary for the promotion of financial literacy.

Key message:

- FESE believes that is it crucial to keep regulated trading venues broadly accessible for both institutional and retail investors. The focus should be on empowering retail investors through financial education, rather than deploying stringent policies.
- FESE welcomes strengthening the requirements on the knowledge and competence of financial advisors, who should have demonstratable skills as well as continuous certified training. Overall, FESE supports mandatory minimum professional qualification requirements for financial advisors.

8. The way forward

As recent Eurobarometer figures show, only 18% of EU citizens have a high level of financial literacy, 64% have a medium level, and the remaining 18% score low.[18] There are also wide discrepancies among Member States with only 4 Member States having more than one-quarter of citizens scoring high on financial literacy tests. The RIS proposal is an opportunity to improve the retail investment framework in the EU and "empower" retail investors to actively participate in capital markets. The proposed measures should take a step forward to increase retail investors' trust in capital markets and make the EU a front-runner in safe and efficient retail investments.

We feel that the RIS proposal, as it is, seems to be unambitious on the financial literacy front. Only providing information material will not be enough since only those citizens who are already active in capital markets will make use of it. Instead, it should be discussed whether and which concrete measures in the field of education should be undertaken by the Member States to promote financial literacy (e.g. school education). To cite an example, the CSSF, the national competent authority in Luxembourg, launched some educational initiatives such as the creation of the Financial Consumer Protection Committee that later developed a national strategy for financial education in Luxembourg.

[18] Eurobarometer 2023, "Monitoring the level of financial literacy in the EU", available here.

FESE believes that the EU could play a prominent role in facilitating the exchange of national "best practices" across EU Member States and incentivising them to carry out some peer reviews. In addition to the RIS proposal, co-legislators could propose to create a mechanism for sharing "best practices" on retail access to capital markets across EU Member States. The proposed mechanism could help Member States better understand which practices work and do not work in various jurisdictions and incentivise Member States to improve their internal frameworks and approaches toward retail investments. One of the good examples could be to share the experiences of Sweden and whether its model on their local ecosystem could be applied in other Member States, in particular about the pension system. Besides sharing experiences, the proposed mechanism could also help Member States to follow up on the progress made and compare the effectiveness of various practices. The mechanism could serve as the forum for continuous dialogue between NCAs on their national strategies to build an efficient and safe retail investment framework that works for retail investors.

Member States could use the mechanism to bridge the financial literacy gap by sharing their "best practices" on financial education. They could share their experiences with national financial education programs and other relevant initiatives to boost the knowledge of retail investors. In light of rapidly evolving technological developments, it is also crucial to ensure that financial education goes in hand with the processes of digitalisation. The proposed financial education initiatives should expand their scope to technical skills on how to use financial digital services and access the financial system through digital means, as well as associated risks of digitisation. The educational materials should match the wide diversity of retail investors and provide support based on their level of financial and digital skills.

FESE encourages further dialogue among EU Member States on initiatives that can help retail investors access the capital markets securely and confidently with proper consideration of retail investors' needs and preferences. Financial Market Infrastructures, as industry experts, can complement the proposed initiatives with their expertise and knowledge of the financial system.

Key message:

- As the way forward, co-legislators could propose to create an intra-EU mechanism for sharing "best practices" on retail access to capital markets. It would help to incentivise Member States to take additional steps on retail investments, learn from previous experiences of other jurisdictions and follow up on their progress.
- The process of digitalisation should be taken into consideration when discussing proposed initiatives on increasing retail participation in capital markets. In particular, Member States should have a continuous dialogue on financial literacy and expand the scope of financial education programs to digital skills and services.