

BVI¹ comments to the European Commission's call for evidence for a retail investment package ((2022) 3391353)

We welcome the goal of reinforcing the participation of retail clients in the capital markets. This is particularly necessary due to the low interest rate environment and, in particular, for funded retirement provision.

However, we believe it is necessary to carefully examine which measures help and which, if any, may be more of a deterrent for customers or are not advisable in light of a cost-benefit comparison.

In the context of this topic, there have been several consultations on which we have commented:

- ESMA Call for evidence on retail investor protection aspects (ESMA35-43-2827):

https://www.bvi.de/fileadmin/user_upload/211230_ESMA_cfe_on_retail_investor_protection_BVI_reply.pdf

- European Commission's Consultation on a Retail Investment Strategy for Europe

https://www.bvi.de/fileadmin/user_upload/210803_EC_CP_on_EU_Strategy_for_retail_investors_BVI_response_fin.pdf

- European Commission's Targeted Consultation on options to enhance the suitability and appropriateness assessments

https://www.bvi.de/fileadmin/user_upload/220321_Consultation_on_options_to_enhance_suitability_appropriateness_assessments_BVI.pdf

From an investor's point of view, we consider some of the proposals to be counterproductive or not yet sufficiently elaborated or reviewed. We will address these in the following comments.

I. Consistency across sectoral legislation

We strongly support the ESAs' intentions to align PRIIPs cost figures with MiFID II disclosures. Due to the vast majority of funds being distributed in a MiFID II environment, it is absolutely crucial that investors receive consistent cost disclosures at the point of sale. Such cost disclosures will comprise both the PRIIPs KIDs and the ex-ante information prepared by the distributor. Hence, it is essential that

¹ BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.



the figures on product costs presented in both disclosures interrelate in a consistent way and provide investors with a meaningful overview of costs related to a specific investment product or service.

However, we see major problems with presentation of relative costs as monetary amounts based on a number of assumptions. The difficulty can be best illustrated by reference to the presentation of performance fees for funds under MiFID II and PRIIPs. The current market standard under MiFID II is presentation of costs assuming a net zero performance over the relevant time period. The same approach is proposed to be applied for the PRIIPs cost calculations under the final ESA report from July 2020. While appreciating the intended alignment of product cost calculations under both frameworks, we are concerned about the implications of this approach for the overall comprehension by investors. Performance fees have to be presented under PRIIPs as the average of the last five years, i.e. by reference to fees accrued on the basis of the actual fund performance. However, if such average is shown under the scenario of zero net performance, investors will likely get the impression that performance fees will in any case drag down the net yield of their investment, even though in such circumstances performance fees will never be incurred.

In our view, it is essential to inform investors about the key features of a product by explaining the general mechanism of calculating and charging performance fees in line with the current practice in the UCITS KIID. Presentation of specific monetary figures might appear plain and easily to understand at first glance, but will never accurately reflect the actual amount of charges that will be incurred in future by the individual investor.

Directive 2016/97 (IDD, Insurance Distribution Directive) and MiFID II should be aligned. MiFID II is significantly more restrictive than the IDD in several areas (e.g. investor categories, inducements). Since insurance and other investment products are in direct competition with each other, this leads to an unlevel playing field. This is also to the disadvantage of investors: Irrespective of their objectives, wishes and needs, insurance products could become much more prominent due to the lower regulatory requirements regarding the distribution process. However, the aim should be to focus solely on the investor's perspective.

II. Options to enhance the suitability and appropriateness assessments

The EU Commission has consulted proposals to enhance the suitability and appropriateness assessment in February 2022. The focus is on a standardised personal investment plan for all retail clients. We can understand the Commission's approach, but we also have some concerns.

We are of the opinion that both the suitability assessment and the appropriateness assessment are well-designed and proven processes that do not require extensive change. We are not aware of any significant defects and the alleged (general) weaknesses are not specified at all. From the perspective of both investors and investment intermediaries, careful consideration should be given to whether known and well-functioning processes really need to be redesigned. Such a significant change in the system of obligations for certain investment services would have a massive impact on both investors and investment intermediaries regarding processes, procedures and IT infrastructure.

As stated in the Call for evidence under "evaluation", one focus should be on the costs and benefits resulting from the implementation of investor protection rules. Hence, a very careful consideration must be made as to whether such a significant change is appropriate and in the interest of both the demand side and the provider side.



Should the Commission continue to address the issue, we consider it essential that the alleged weaknesses in the existing requirements were clearly identified. The assertion that there are abuses is not sufficient for such a significant and thus cost-intensive change. Furthermore, abuses of individual persons or within individual member states should not lead to the entire financial industry being subjected to stricter regulations without this really being necessary for investor protection or investor interests. Rather, in such cases, national supervisory authorities should be encouraged to monitor and enforce existing requirements more strictly.

Furthermore, it must be taken care to ensure that the processes are not too complicated and time-consuming for investors. Already today, an advisory process takes a considerable amount of time due to the regulatory requirements. By adding the sustainability preference query, we expect that the discussions will take even longer, and they will also become significantly more complex. The additional determination of a personal investment plan would take even more time. This could also have a negative impact on the willingness of investors to take advice and participate in the capital markets at all. The Commission itself sees this point in this Call for Evidence: Under paragraph “B. Objectives and policy options” it states that the Commission could explore to address the identified problems for example by “reducing the administrative burden for retail investors with sufficient financial capacity and knowledge and experience”.

Furthermore, the tiered approach (suitability assessment, appropriateness assessment, execution only) should be maintained. Clients are free to decide whether they want investment advice or act as self-deciders. We continue to be of the opinion that the appropriateness assessment is sufficient for self-decision-makers and that full client exploration is not appropriate in this context. It is to be feared that this could tie clients up more time and deter them from participating in the capital market due to the time factor. Therefore, we are very critical of the proposal to create an assessment regime for all investment services.

Please also refer to our comments to the European Commission's Targeted Consultation on options to enhance the suitability and appropriateness assessments.

III. Inducements and quality of advice

In the context of the revision of MiFID II and the Commission's consultation on the Retail Investment Strategy for Europe, a ban of inducements has been discussed again. Even though it is not explicitly part of this consultation, we would like to point out that a ban on commission-based investment advice would have major disadvantages for retail investors.

The criticism of inducements is based on the assumption that because the commissions paid to the advisor may lead to conflicts of interest, commission-based investment advice is of inferior quality compared to fee-based investment advice (so-called independent investment advice) and should be abolished. We do not share this view; on the contrary, both advisory models must continue to coexist.

Investment advice is not automatically better just because it is paid with a fee instead of a commission. The idea of strengthening fee-based investment advice stems from a time when it was not sufficiently clear to clients where and which commissions were paid. As a result of the disclosure requirements introduced by MiFID II, the types and quantities of commissions are now clearly presented to the clients so that they can make their decisions freely in the knowledge of this. It goes without saying that the



interests of the client are also taken into account by the advisor in any commission-based investment advice: on the one hand, this is stipulated in Art. 27 MiFID II Delegated Regulation in conjunction with Art. 16, 23 and 24 MiFID II; on the other hand, the advisor also has an interest on her or his own in advising the clients in line with their interests because after all she/he wants the client to come back. Furthermore, it is a common misconception that fee-based advisors are free of conflicts of interest. For example, an advisor might restructure a portfolio because he or she can generate additional fee-based advice.

Clients should be free to decide which type of investment advice they wish to make use of. The fact that clients often do not want to receive investment advice on a fee basis is not recognised. In Germany for example the demand for this type of investment advice as an alternative is very low. If one type is abolished in order to promote the other, clients are deprived of their freedom of choice. Here too, however, it is true that clients being patronised does not equal protection of clients.

Commission-based investment advice can be very beneficial for retail investors, particularly for those with smaller amounts of money to invest. Since commissions are based on the investment amount, the advice can be offered to investors with small amounts as well as to investors with higher amounts to invest. With fee-based investment advice, on the other hand, it is to be expected that advisors will focus on wealthy clients. Access to advice for less wealthy clients will therefore be cut off. From the perspective of many clients, fee-based investment advice is also likely to be extremely expensive in relation to the concrete investment amount because the fee is set in absolute terms. It is to be feared that retail investors with smaller amounts will no longer make use of an investment advice service of their own accord. This would counteract one of the objectives of the EU Retail Investment Strategies, namely to facilitate access to the markets for retail clients. Retail investors might be tempted to invest money by way of execution only instead of following individual advice tailored to their needs. This entails a considerable risk, especially for inexperienced investors.

In the UK, these assumptions are supported by the “Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review” of the FCA published in December 2020. For example: “Our firm survey shows that even firms without a formal minimum threshold generally have high average pot sizes among their current customers. This indicates that access to advice is, in practice, limited for consumers with smaller pots.” (p. 33)

Also the KPMG-Study “The future of advice”, published in November 2021, supports these assumptions (https://hub.kpmg.de/the-future-of-advice?utm_campaign=FS%20-%20Studie%20-%20Zukunft%20der%20Beratung&utm_source=AEM&_hstc=214917896.dfd59f7dca8e2bbccd29b0ed5828c35.1638957760981.1638957760981.1638957760981.1&_hssc=214917896.1.1638957760981&_hsfp=3662856533):

- “Asked about their reaction to the introduction of an advisory fee, 35% of respondents said they would no longer seek advice.” (p. 24)
- “In addition to the willingness to use investment advice, the introduction of advisory fees would also reduce the willingness to buy financial products. Just under a quarter of respondents said they would buy financial products less frequently (12%) or stop buying them at all (12%) in this case. The correlation between the use of advice and participation in the capital markets is shown by the above-mentioned FCA study from 2020.” (p. 24)
- “The commission-based model has clear cost advantages over feebased investment advice for smaller investment amounts; only for investment amounts above €25,000 do the benefits exceed



the fees payable. In relation to the typical investment amount of retail clients, the costs of fee-based investment advice are disproportionately high.” (p. 29)

The FCA report and the above-mentioned study show that fee-based investment advice does not only fail to solve the existing problems but also generates additionally new ones.

Commission-based investment advice also offers another advantage: Clients can obtain advice from different advisors several times before investing without incurring additional costs. Clients who have to pay a fee would certainly refrain from doing so. In addition, clients can decide against an investment after receiving advice without incurring any costs. Abolishment of commission-based investment advice would also create a further distortion of competition compared with insurance distribution regulation, where commission-based advice is still permitted – even under less stringent regulatory conditions than under MiFID II.

The coexistence of commission-based investment advice and fee-based investment advice is proven and tested, creates choice for clients and ensures that all clients have access to high-quality investment advice. Knowing all the costs involved, the mature investor can decide which type of investment advice he/she wants to take advantage of. We therefore expressly oppose a ban on commission-based investment advice.

IV. Competence of advisors

In addition to the remuneration set-up, the competence of the advisors should also be reviewed. Here, too, we consider it imperative to check whether a lack of competence is actually an EU-wide problem that makes a change/strengthening necessary. It might also be sufficient to call on national supervisory authorities to pursue abuses more consistently and to sanction violations.

For Germany, we can say that the staff of investment firms providing investment advice and other relevant information have to complete a bank or insurance-related vocational education or academic studies and are subject to ongoing training and qualification requirements. In Germany, therefore, the staff must already meet certain qualifications; an additional certificate is not necessary. Supervision is carried out by national authorities. We do not see any need for an EU-wide framework for a uniform certification, neither do we see any benefit. A test or exam can be very superficial, then such a certification would have no added value. An in-depth exam, on the other hand, makes only limited sense: although the same legal framework conditions apply within Europe, there are differences in the Member States. Open-ended real estate funds can be mentioned as an example for the German market. These funds, which are in strong demand in Germany, play a subordinate role in other EU member states. Hence, the focus of the necessary qualifications of the staff providing investment advice and other relevant information can vary greatly within the EU.

V. Financial literacy, complex information

From our perspective, the main objective is to enable the investors to attain an informed decision about their investments. The requirements of MiFID II provide the investors with all the information needed. Furthermore, they are supported in their investment decisions by being provided high-quality investment advice. But an understanding and know-how of capital markets as well as financial products cannot solely be achieved by increased product transparency and advice. Instead, early education – be



it at schools and/or via common electronic platforms – is required to lay the foundation. However, in doing so, the client must not be put under tutelage. The investor must be left with the decision what information and what type of financial service he/she wishes to obtain.

We are of the opinion that the language used in the pre-contractual documents is sometimes too complicated. For KIIDs/PRIIPs-KIDs, and partly also for the prospectuses, there are many specifications and wordings that must be used. There is little leeway for own (simpler) wordings. The use of jargon and sector-specific terminology is thus already encouraged at this level. The limitation of pages for the KIID/PRIIPs-KID also promotes the use of jargon and sector-specific terminology – a paraphrase requires more words and thus space. Insofar as the language is to be simplified in order to promote the comprehensibility of information documents, it is imperative that this is taken into account in the regulatory requirements.