

Retail Investor Protection Legislation must Avoid Bureaucracy

Responses to selected questions

This position paper reproduces the responses of Deutsches Aktieninstitut¹ to the EU Commission's public consultation on a retail investment strategy for Europe.

Question 1.1 Does the EU retail investor protection framework sufficiently empower and protect retail investors when they invest in capital markets?

Yes/no/don't know

Numerous regulations ensure that retail investors are informed properly and on a competitive basis. Instead of a lack of regulation on investor information we have made the experience that due to existing legal requirements, retail investors are rather faced with an overwhelming amount of information. The mere bulk of information has however two negative side effects:

- First, retail investors might refrain from investment advice due to information overload and the time-consuming documentation procedure.
- Second and at least as important, the increasing compliance duties of banks and other financial service providers have led to a reduced supply of investment advice.

See also our general remarks in our response to question 13.

Question 1.3 Are there any retail investment products that retail investors are prevented from buying in the EU due to constraints linked to existing EU regulation? Yes/no/don't know Please explain your answer

Yes, as mentioned in our answer to Q 1.1. due to excessive regulation investment firms more and more refrain from offering shares in their investment advice and reduce their range of other products like corporate bonds, UCIT funds and index ETFs. Due to the documentation processes clients are often annoyed by lengthy investment advice.

Deutsches Aktieninstitut is of the opinion that this development is triggered

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especially by the following provisions:

Under the current MiFID, the notion of “retail investors” is too generic. . . Retail investors differ greatly regarding their knowledge, experience, number of investment advice they already received and therefore, regarding their information needs. To cover all retail investors by a one-size-fits-all approach (as currently done by MiFID), bears the risk that investors do not have access to the full range of products meeting their needs. The level of investor protection should better reflect these specifics by introducing a category of “semi-professional” investors.

For corporate bonds the PRIIPs-regulation turned out to be a barrier for retail investors to meet their investment needs, although these instruments are assets that are held directly by investors and rightfully do not fall in the KID scope under PRIIPs. Nevertheless, a large amount of corporate bonds are classified as PRIIPs.

As a result, issuers would have to condense a 100 pages (often more) prospectus into a 3 pager KID that will always be contestable and leaves the issuer with unbearable liability risk. This has already led corporate issuers to exclude retail investors of those bonds that are likely to be considered a PRIIP, thereby avoiding the question whether it is necessary to prepare a KID or not.

This limits not only the opportunities and investment scope of retail investors to invest directly and in a transparent, cost efficient way in investment grade corporate bonds. In addition, this deprives corporate bond issuers of a simple access to an important, diversified investor base for their funding needs that is considered “buy and hold”, i.e. adds to market stability.

To avoid these unintended side effects, we urge the legislator to clarify the scope of the PRIIP in the context of corporate bonds. In particular, the legislator should confirm that certain well-established standard terms and conditions do not turn corporate bonds into PRIIPs. Given that the definition of PRIIPs in Art. 4 relates to investments where the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor, the following features of a corporate bond should be considered for exemption from the PRIIPs-regulation:

- caps and floors on the interest rate,
- redemption rights of the issuer (e.g. customarily used “make whole clauses”, “par call clauses 3 months ahead of final maturity”, “clean up calls” or “M&A clauses”),
- floating rate notes.

Question 1.6 Among the areas of retail investment policy covered by this consultation, in which area (or areas) would the main scope for improvement lie in order to increase the protection of investors? Select all applicable choices. Please explain your answer.

A review of the framework for investor categorisation by introducing a “semi-professional” investor would help to adjust the level of investor protection according to the investors needs. “Semi-professional” investors should have the right to waive certain or all investor protection rules by an explicit consent. This would reflect the needs of well-informed, more experienced clients to have a lean and short investment advice process.

In order to facilitate the implementation of the new category among investment firms the definition of “semi-professional” should be as lean as possible. At least, it should be up to the investment firm to offer the category “semi-professional”. Investment firms, who are not willing to implement the category, should be allowed to do so.

Furthermore, to be successful and applicable it should be easy to understand for retail investors. A possible way to consider this could be a comprehensive suitability test, which is conducted “one-off”. Investment firms should not be obliged to repeat the test or to monitor whether the criteria are still met after the test. After having consented to be categorised as “semi-professional” the client should decide for its own, whether all or certain investor protection rules are applicable. It should be also up to the client to terminate the status “semiprofessional”.

Question 4.11 How should disclosure requirements for products with more complex structures, such as derivatives and structured products, differ compared to simpler products, for example in terms of additional information to be provided, additional explanations, additional narratives, etc.? Please explain your answer.

Direct investments like shares and bonds are non-complex instruments and thus easy to understand and should be treated under the investor protection regime as such. Therefore, exemptions from the scope of certain regulations (e.g. PRIIPs) are justified. Nevertheless, it is important that the exemption is clearly defined and includes every type of direct investments (see our answer to Q 1.1).

Question 5.10 Should the scope of the PRIIPs Regulation include the following products? If so, why?

As mentioned in our answer to Q 1.1. the scope of PRIIPs should be clarified for corporate bonds.

Question 7.1 What would you consider the most appropriate approach for ensuring more appropriate client categorisation?

Any of the proposed measures points into the right direction. Nevertheless, we deem the introduction of an additional category “semi-professional” as most appropriate to address different information and documentation needs of investors (see our answer to Q. 1.1 and Q 1.6).

Question 12.4 Do you consider that detailed guidance for financial advisers would be useful to ensure simple, adequate and sufficiently granular implementation of sustainable investment measures?

No, because what constitute a sustainable investment product in the eyes of an individual client strongly depends on the subjective judgement of the client. Thus too strict regulations might lead to a situation where the investment advisor cannot meet this individual preferences.

Question 13 Are there any other issues that have not been raised in this questionnaire that you think would be relevant to the future retail investments strategy? Please explain your answer.

The key objective of the questionnaire is „to understand how the current framework for retail investments can be improved“ (p. 3).

We encourage the Commission to undertake an objective evaluation of new trends in capital markets (such as social media platforms, smartphone-brokers) as well as the regulation addressing retail investor protection.

The Commission should, however, have in mind, that the provision of financial services and advice to retail customers are already heavily regulated.

From Deutsches Aktieninstitut's point of view the high regulatory intensity bears at least two fundamental risks:

- First, retail clients might be overloaded with information and paperwork that causes overly risk adverse behaviour and unjustified distrust regarding the average quality of products and advice.
- Second, as any regulation creates additional compliance costs for banks and other financial service providers, they may choose not to advise clients at all especially in simple but overregulated products – namely shares and corporate bonds. Thus, access for clients to advice has rather been reduced than improved by regulation.

As a consequence, it can be observed that hurdles for capital market participation of retail investors have rather grown than have been reduced by regulation over the past years. The PRIIPs-regulation, which makes it more difficult for investors to access corporate bonds, and the regulation of investment advice, which requires as addition a client category “semi-professional investor” are illustrative examples for that development.

The assessment of the Commission should also consider that additional legislation may result in negative consequences regarding the level of competition in financial markets and thus the number of options clients have.

Looking forward that means, that the Commission should seek to reduce the level of regulation where possible instead of adding new regulation.

Against this background some elements of the questionnaire point in the right direction, e.g.

- potential alleviations for experienced retail clients (Q 7.1.) and potential means of recharacterising investors (Q 7.2.) for application of regulation, especially regarding “semi-professional investors”,
- recognizing that the preparation of investor documents comes at a cost for those who prepare it (Q 5.8),
- and last but not least the recognition that financial literacy may prove more effective than more or overly detailed information (Chapter 2).

However, much more elements of the questionnaire point in the direction of even more regulation or hampering competition. This is e.g. true for

- demanding machine-readability of investor documents which does not help any retail investor (Q 3.3.) (we doubt that it even helps professional investors.),
- adding additional duties with respect to online-activities (e.g. Q 3.5, 3.10.), investor documents (Q 5.1, 5.11, 5.12) and increasing the scope of the PRIIPs regulation to additional products (Q 5.10),
- possible additional regulatory steps regarding the suitability test where the clients have explicitly declared that they want to act without advice (e.g. Q 6.3, 6.4. and 6.8),
- increasing the level of regulation regarding inducements (up to its prohibition) (chapter 8),
- additional intervention powers (chapter 11),
- and additional duties regarding advice to sustainable investments (chapter 12).

We also miss in the consultation the PRIIPs-issue regarding corporate bonds.

In sum, we are concerned that the retail investor strategy will rather add regulation and will take a too paternalistic view. As a consequence, we would expect that in particular direct participation in the capital markets by purchasing shares, bonds and other financial instruments may be further hampered. This should be avoided in any case

Contact

Dr. Norbert Kuhn
Deputy Head of Capital Markets Department / Head of Corporate Finance
Deutsches Aktieninstitut e.V.
Senckenberganlage 28
60325 Frankfurt am Main
Phone + 49 69 92915-20
kuhn@dai.de
www.dai.de

Dr. Gerrit Fey
Head of Capital Markets Department
Deutsches Aktieninstitut e.V.
Senckenberganlage 28
60325 Frankfurt am Main
Phone + 49 69 92915-[Durchwahl]
fey@dai.de
www.dai.de

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