EFAMA

European Fund and Asset Management Association

EFAMA RESPONSE TO ESMA CALL FOR EVIDENCE ON CERTAIN ASPECTS RELATING TO RETAIL INVESTOR PROTECTION

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Executive Summary

EFAMA welcomes ESMA's Call for Evidence to assess the rapidly shifting investment landscape and ensure that the current regulatory environment, its underlying market structure, and the existing industry practices safeguard retail investors' interests. It is our strong belief that improving retail investor empowerment in Europe is key to further develop and deepen its capital markets.

Disclosures

We consider it essential that the future EU retail investment strategy does not solely rely on pre-disclosure documents. This is **particularly important for investment funds, which are already providing the most comprehensive financial product information documents for retail investors. Pre-disclosure documents** should be seen as part of a broader holistic and accessible solution together with high-quality advice and higher levels of investor education.

The experiences with the current PRIIP KID over the last couple of years, albeit indirect, have shown us that **meaningful comparisons** between different types of investment products are not always possible. The current **overload of disclosures** (in the form of prospectuses, sustainability-related disclosures, MiFID disclosures, etc.) in addition to Key Information Documents is further levitating the problem.

On the topic of disclosures on sustainability risks and factors, the investment management industry has identified a number of **sequencing issues** causing practical challenges to the **implementation of the ESG amendments to MiFID II and IDD**.

Digital disclosures

Digital disclosures are means to enhance disclosures' efficiency and adapt the legislative framework for investor protection to the increasingly digital environment. We believe the **same level of investor protection** should apply to 'digital sales', any semi-closed forums, social media groups and third parties and they should be closely monitored under the MiFID II scope. It is interesting to note that most recent issues around marketing and advertising of investment products not being suitable for retail investors (for example, CFDs) stemmed from the fact that some actors/products **were not properly supervised and/or not in scope of the current frameworks such as MiFID, IDD or PRIIPs** (unlike UCITS and retail AIFs which are subject to prior authorisation before launch). **It is, thus, rather an issue of failed supervision of financial service providers rather than a lack of investor protection.**

Digital tools and channels

With regards to digital tools and channels, ESMA notes a number of concerns involving digital investment platforms. We would like to highlight that greater retail investor participation in markets is key to growing European capital markets and delivering on the wider CMU agenda; and digital investment platforms deliver on that.

The **MiFID distribution/advice rules need to be applicable whether or not a fund is sold online thus ensuring that the current investor protection rules extend to online brokers.** The same level of investor protection must apply to all distribution channels. Similar to digital advisors who are, and always should be, subject to the same framework of regulation and supervision as traditional advisors.

A reassessment of the retail investor's role

Finally, we reiterate EFAMA's previous observations with regards to the Commission's approach: It should focus on a much-needed reassessment of retail investors' comprehension, their role and their participation in EU financial markets, instead of merely making a number of technical changes (alignment of rules, disclosures, etc.) to existing regulations. The ultimate goal must be greater **empowerment of retail investors**.

Q1: Please insert here any general observations or comments that you would like to make on this call for evidence, including any relevant information on you/your organisation and why the topics covered by this call for evidence are relevant for you/your organisation.

We would like to reiterate some of EFAMA's previous observations with regards to the **Commission's approach** towards a renewed EU retail investment strategy which we made earlier this year when responding to its consultation on the initiative. We agree that the strategy aims to cover are of importance in providing investors with adequate investor protection, access to advice and understandable disclosures. However, it seems like it only intends to make a number of technical changes (alignment of rules, disclosures, etc.) to existing regulations without proceeding first to a much-needed reassessment of retail investors' comprehension, role and their participation in EU financial markets and how best to empower them.

We recommend that the Commission develops an overarching strategy, in collaboration with Member States, focusing on best practices to drive financial health. This would complement actions on financial education by setting out a framework for guidance on core issues of financial health by making it easy for people to set up a financial plan which they are actively encouraged to review and update at key life stages (leaving school, starting work, changes in family circumstances, property acquisition, pre and at retirement). The important driver would be a set of simple steps to nudge people into action and effectively counteract risk aversion.

In general terms, we would also like to point out that the **MiFID II definition of a 'retail investor'** is unnecessarily restrictive. We agree with the Commission's proposal to empower more sophisticated retail investors to benefit from a more appropriate investor protection and disclosures regime. Especially these sophisticated retail investors suffer from a number of additional national requirements set by National Competent Authorities (NCAs) that must be met individually to ensure distribution in a specific EU Member State.

On the third part of this Call for Evidence, digital tools and channels, while ESMA notes a number of concerns regarding digital investment platforms, we also like to highlight that greater retail investor participation in markets is key to growing European capital markets and delivering on the wider CMU agenda. Globally we note that a major structural change is underway in the global investing landscape in 2020 and 2021. Millions of retail investors – individual savers who allocate their own money and make their own investment decisions are now participating in financial markets. Increasingly, they use digital platforms and apps which allow them the ability to trade stocks and listed funds (either actively managed funds or ETFs). Trends that can already be observed in non-EU markets, such as the US, are also starting to manifest in the EU, with millions of new trading accounts being opened, particularly in Germany and the Nordics.

Another catalyst driving retail participation has been the constant evolution of communication technology, with social media platforms and networks enabling greater information-sharing amongst non-professional investors. We believe these channels whether offered by existing market players or by new market entrants can help complement existing distribution channels, allowing consumers more choice in investing for the long-term using well-regulated diversified products, such as UCITS.

We agree with ESMA's focus on assessing this shifting investment landscape to re-evaluate the suitability of the current regulatory environment, the underlying market structure, and the existing industry practices to safeguard the interests of retail investors and maintain market stability while encouraging this move to greater market participation which is key in Europe to developing capital markets. EFAMA supports the necessary reforms to promote retail participation in a fair, orderly, and efficient market. We believe that many of the concerns raised by regulators can be addressed by agreeing on a common supervisory approach and an understanding of new market developments. In doing so, we believe it would be helpful to set out some key principles to drive responsible growth of retail participation through online brokers and digital advisors. These principles – such as transparency, best execution and fair competition – already underpin much of the European regulatory architecture showing that the MiFID/MiFIR framework is already designed to work with responsible market innovation and can continue to be applied to promote fair, efficient, and robust markets.

Last but not least, EFAMA has long supported efforts to improve investor education especially of first-time investors, many of whom may lack investing experience and sophistication. The increasing adoption of regular savings plans will prove beneficial to investors by encouraging regular savings habits and avoiding the temptation to time the market. We are, however, aware of retail investors' increasing interest in increasingly complex instruments including options, cryptocurrencies, and margin-based trading. We support and encourage regulatory efforts to strengthen retail investor education as a means to address potential negative consequences that can stem from broad market access.

SECTION 1. DISCLOSURES

Q2: Are there any specific aspects of the existing MiFID II disclosure requirements which might confuse or hamper clients' decision-making or comparability between products? Are there also aspects of the MiFID II requirements that could be amended to facilitate comparability across firms and products while being drafted in a technology neutral way? Please provide details.

We agree with the Commission and the ESAs' conviction that retail investors (compared to professional investors and eligible counterparties) should always receive the highest level of investor protection as well as appropriate disclosures that can aid their investment decisions. While specific product regulation, such as UCITS, has been an undeniable success, regulatory efforts to date have, unfortunately, created a number of **side effects that inhibit retail investors' participation in the capital markets**.

We have seen that disclosures, in particular, across different product types are difficult to implement correctly. The (indirect) past experiences with the current PRIIP KID over the last couple of years have shown us that **meaningful comparisons** between different types of investment products are not always possible, largely because of its inherent design and requirement to provide such information via a durable medium (i.e. pdf). Digital comparison tools may be helpful for an investor to compare products. Please see Q15 onwards for more information on digital disclosures.

Indeed, one of the current PRIIP KID's fundamental problems stems from its inherent conflict to provide clear, fair and not misleading information and **comparability** between widely different types of investment products. In their current iteration, the detailed PRIIP KID rules are overly focused on comparability, which has come at the cost of misleading information: for us, clear understanding and avoidance of misleading information must be ensured **before searching for facilitating comparison across products**.

Indeed, we believe it is essential to focus as a priority on what information is relevant to retail investors for each type of investment product. Such flexibility is fundamental because each type of investment product provides a **different technical nature and value proposition** and thus requires slightly different disclosures on costs and performance. A loss in theoretical comparability will be more than offset

by better explaining the fundamental specificities of each type of investment product and providing investors with more meaningful information. Standardising the disclosures for similar types of investment products will maintain broad comparability.

With this in mind and as stressed previously, it is essential for the EU's future retail investment strategy not to rely solely on pre-disclosure documents, but rather see them as a part of a bigger set of tools together with high-quality advice and higher levels of investor education. A Key Information Document should not be the sole deciding factor for a retail investor's investment decision.

Q3: Are there specific aspects of existing MiFID II disclosure requirements that may cause information overload for clients or the provision of overly complex information? Please provide details.

Retail investors are currently confronted with a large amount of technical, lengthy, and sometimes contradicting disclosures that are required by the current EU frameworks. We see this as a point of confusion and a major obstacle to investing, especially for retail investors. The current **overload of disclosures** (as prospectuses, sustainability-related disclosures, MiFID disclosures, etc.) in addition to Key Information Documents does not help.

As stated in Q2, providing investors with meaningful information is at the core of effective disclosures. One example of misleading information is forward-looking performance scenarios for open-ended funds. Open-ended funds insist on disclosing past performance disclosures and consider forward-looking performance expectations to be misleading. Also, we strongly doubt that the complex underlying assumptions and calculation methodologies can be easily explained even by financial advisors and, thus, properly understood by retail investors. See Q5 for what we consider vital information that should be conveyed to retail investors.

Q4: On the topic of disclosures, are there material differences, inconsistencies or overlaps between MIFID II and other consumer protection legislation that are detrimental to investors? Please provide details.

In the current regulatory framework, investor protection rules are often misaligned, in particular between financial products falling under MiFID and insurance-based investment products (IBIPs) covered under IDD. In the topics of **financial disclosures**, these **must be holistically reassessed**. They diverge substantially between MiFID II, IDD and PRIIPs. MiFID II and IDD substantially differ in how financial advice is paid for and how it is disclosed to clients. Also, misalignment between the MiFID II and PRIIPs rules requires different cost figures to be produced, unnecessarily confusing retail investors. Furthermore, we do find that certain limitations imposed by this framework may **hinder retail investor participation in the capital markets**, such as for example marketing rules and certain risk warnings.

Some specific examples of misalignment between the consumer protection legislation can be found below:

1. **Product cost information:** Numerous substantial inconsistencies exist between MiFID/IDD and PRIIPs in how product cost information is calculated and presented to investors.

(Those few) retail investors carefully studying all pre-disclosure documents (e.g. MiFID and PRIIP KID) will be confused as to why production costs are not aligned. This regulatory misalignment must be tackled by future EU actions, as it creates mistrust in the financial products itself, adding to the commonly touted view in the media that people are 'ripped off by the financial industry. MiFID uses a zero-return assumption while the PRIIP KID uses the cost disclosures tied to complex future performance scenarios, resulting in diverging cost figures.

First, **future cost disclosure** must be aligned to disclosing the same cost information (i.e. MiFID and PRIIPs) to retail investors. In a sense, overarching frameworks like MiFID and IDD should provide the overall cost disclosure points and methodologies, which can be simply inserted into Key Information Documents. **In any case, the current situation where the PRIIP KID created its cost calculation methodologies (which are different to MiFID/IDD) must be avoided.** This does not mean that all disclosures should be the same, as investment, insurance and pensions products each provide different value propositions and necessitate diverging disclosures.

This being said, we know that the (current) PRIIP KID uses standardised investment amounts (e.g. EUR 10,000) due to its paper-document nature. With a digital PRIIP KID, however, it would be possible also to provide investors with individualised investment amounts and so fully align MiFID and PRIIPs cost disclosures.

Second, both MiFID II and PRIIPs require the **disclosure of transaction costs**. The definition in MiFID (and IDD) explicitly forbids the inclusion of “market movements” as a cost. The PRIIPs RTS, however, have come up with a calculation methodology referred to as “arrival price” (also known as “slippage”), which considers certain market movements as a transaction cost. While the arrival price methodology incorporates certain fundamental flaws (that could be rectified only to a certain degree by the revision of the PRIIPs RTS), in the context of this consultation it is essential to point out that it can result in misaligned transaction cost disclosures between PRIIPs or MiFID. We believe it is important to define the format of ex-post cost disclosure and to ensure that it is made separately to ex-ante cost disclosures such as PRIIPs to avoid overcomplicating disclosure formats. Developing the use of digital formats would allow cost information to be layered allowing more detailed cost breakdowns to be accessed by those investors or their intermediaries or wish to see more granular information.

Third, the new RTS foresee presenting fund cost components in the table “composition of costs” based on 0% annual return. **For performance fees, this should then mean that in most cases, no cost amount will be shown** (because no performance fee is generally being charged in such circumstances), **even if a product has actually charged performance fees in the preceding years** (and is likely to charge them in future). This understanding seems to be confirmed by the provision in Annex VI para. 68 b). Also, the explanatory text in the table “composition of costs” states in relation to performance fees that “The aggregated cost estimation above includes the average over the last five years” which implies that such average is not being presented here. However, this outcome seems not only counterproductive in terms of proper information of investors, but it is also inconsistent with the current cost disclosures under MiFID II. We understand from distributors that under MiFID II, they also assume a net-zero performance for the purpose of illustrating the impact of costs on performance, but still account for the latest known performance fee figures in their ex-ante and ex-post disclosures.

Beyond cost information, other inconsistencies between the PRIIPs Regulation and other pieces of the investor protection regulatory framework remain to be addressed:

2. **Risk information:** Again, substantial differences exist between MiFID and PRIIPs. The former does not contain a standardised risk measure like the PRIIPs Summary Risk Indicator (SRI). This being said, it could be used for risk disclosure purposes under MiFID, creating necessary alignment for retail investors.

With this in mind, it is important to reiterate that our comments reflect only the interlinkages between PRIIPs and MiFID. We understand that not all MiFID disclosures may be suitable for other types of financial products (insurances and pensions with much longer recommended holding periods). Generally speaking, however, the same principle should apply that risk information should be calculated and presented to (retail) investors in the same manner.

3. **Performance information:** there are substantial inconsistencies in how MiFID and PRIIPs calculate and disclose performance information.

Essentially, each of the frameworks provides retail investors with a contradicting view on performance. On the one hand, MiFID II (through its delegated acts) requires product manufacturers to provide investors with an explanation on the "functioning and performance of the financial instrument in different market conditions, including both positive and negative conditions". If past performance is shown, it must carry a clear warning to investors highlighting that past performance does not constitute future returns. On the other hand, the current PRIIP KID requires future performance scenarios, in essence transposing past performance into the future. This situation will be slightly remedied by the revised PRIIPs RTS, which will allow funds to produce product performance scenarios based on historical instead of future scenarios.

In line with our previous comments, **we strongly recommend that funds should provide retail investors only with past performance information (with the necessary disclaimers), as past performance is based on actual (i.e. historical) facts and is presented in a standardised way that shows how the fund is run and allows for easy comparisons**. It also allows investors to appreciate that a fund's value will fluctuate.

Disproving some concerns of MEPs and the Commission, there is very strong evidence that retail investors understand that future performance cannot be accurately predicted by historical information. This was underlined in the original UCITS KIID testing and has since been reaffirmed by the Commission's PRIIPs consumer testing. In addition, as part of the revised PRIIPs RTS, the ESAs argued to "include past performance information within the main contents of the KID on the basis that it is key information to inform retail investors about the risk-reward profile of certain types of PRIIPs".

4. **Other elements:** a more coherent EU disclosures policy should ensure that disclosure elements from the overarching EU frameworks (such as MiFID and IDD) are simply inserted into a Key Disclosure Document without the latter creating its own set of (sometimes contradicting) calculation and disclosure methodologies.

Due to the siloed and prescriptive approach taken for PRIIPs, it is not easily possible to insert (soon to be needed) ESG information into the PRIIP KID without complicated and long-winded changes to the PRIIPs Regulation and its RTS. As the current PRIIP KID is prescriptive in each of the elements to be disclosed, it is impossible to provide this necessary information (unless it is squeezed together with 'other information', such as a link to the past performance), which would be unhelpful in providing such new key information elements to investors.

As noted above, a digital-friendly approach that allows layer and interactive assessment of performance scenarios mean that a linear length-based restriction becomes increasingly less relevant in assessing good consumer understanding.

Q5: What do you consider to be the vital information that a retail investor should receive before buying a financial instrument? Please provide details.

Regarding investment funds, we consider that retail investors already receive today all the needed elements of vital information before any possible purchase of fund units: its main product features; objectives; costs; past performance; and risks. In particular, we believe **that past performance information** for open-ended and non-structured funds is critical for a retail investor's understanding of these products.

Regarding structured bonds and insurance-based investment products, we appreciate that **forward-looking performance scenarios** are essential elements. For these products, past performance may be misleading

and they would consider forward-looking performance expectations to be of crucial importance to ensure a retail investor's understanding of the product. EFAMA believes that future PRIIP KIDs should provide this information instead of historical performance scenarios.

We consider that **insufficient understanding** of financial products might discourage or prevent retail investors from investing. In this sense, an understanding and know-how of capital markets, as well as financial products, cannot be achieved by increased product description and transparency and financial advice alone. Instead, **early education** – be it at schools and/or via common electronic platforms – is required to lay the foundation. Established and trending communication means and language should be used to reach teenagers as well as young adults. This would have an immediate and positive effect on direct investments (such as employees share ownership plans) and increased awareness of the need to save for retirement.

In supporting the current efforts of the financial sector to promote financial education, an important role can be performed by European institutions and national authorities, including NCAs. Financial education should be designed to educate consumers about the possibilities, but also the risks related to investing. It should also be designed to better distinguish the concept of investing in a prudent and long-term manner from pure speculation or gambling.

EFAMA, therefore, considers it essential that the future EU retail investment strategy does not solely rely on pre-disclosure documents - **in particular for investment funds, which are currently already providing the most comprehensive financial product information documents for retail investors** - but rather see them as a part broader holistic and accessible solution together with high-quality advice and higher levels of investor education. A Key Information Document should not be the sole deciding factor for a retail investor's investment decision.

Q6: Which are the practical lessons emerged from behavioural finance that should be taken into account by the Commission and/or ESMA when designing regulatory requirements on disclosures? Please provide details and practical examples.

First, we note that many types of disclosures are designed in a way that they rather discourage investors from taking action rather than making active investment decisions. In this respect, the current disclaimers and warnings should be reassessed to put risk warnings into perspective with the aim of certain investment products. For example, it is highly unlikely for a retail investor to lose all of her/his money by investing in a well-diversified UCITS for the long term. Current disclosures, however, require highlighting the statistically very unlikely event that all money may be lost, discouraging investment in the first place.

Second, some countries have seen positive outcomes regarding the implementation of nudging techniques that try to steer investors, at certain points in their life, into investments rather than savings.

Third, we also note that disclosure standards focus on presenting information in a single format thus failing to recognise the breadth of cognitive diversity across the population. Consumer testing has too frequently focused on a single preferred presentation rather than focusing on how a common data set can be presented in different ways and reaching to a much wider population.

Q7: Are there any challenges not adequately addressed by MIFID II on the topic of disclosures that impede clients from receiving adequate information on investment products and services before investing? Please provide details.

As previously mentioned, there is a wider challenge around disclosures that needs to be addressed in order not to impede retail investors' engagement. On the one hand, investors are struggling with the amount of

detailed information being presented (i.e. information overload). On the other hand, the information itself is not aligned, resulting in different figures being presented simultaneously. Some national authorities require specific additional disclosures, which also increase the complexity.

We would like to highlight here our (indirect) experiences with the PRIIP KID, which also aims at providing adequate information to clients. All funds distributed to retail investors, whether UCITS or AIFs, require a UCITS KIID or a PRIIP KID. However, **a number of financial instruments do not fall within the scope of the PRIIPs Regulation** and no key information is provided on an ex-ante basis. It may, therefore, be beneficial for retail investors to receive high-level information for investment products, not in the scope of PRIIPs.

As mentioned previously, disclosures alone are not enough. A **crucial linkage to financial literacy** must be made to allow the use of important financial concepts to be more easily understood by retail investors. With the currently low levels of financial literacy, we stress again the crucial role financial advice plays for retail investors. For example, sector-specific terminology (even simple expressions like equities, bonds etc.) cannot be avoided and may still be difficult for retail investors to understand. Please see our additional comments on financial literacy above.

Other key aspects related to disclosure arose recently, linked to the development of digital techniques:

- Development of crypto-assets complementary of financial instruments potentially offered to retail investors;
- Development of purchases of financial instruments through smartphones;
- Development of influencers through social media;
- Development of proactive online advice or product marketing.

Regarding the development of crypto-assets, they are not covered by PRIIPs while being significantly bought by retail investors – potentially leading to an uneven level playing field.

Regarding the development of social media and in particular influencers, as well as proactive online advice or product marketing, there is a growing risk that non-regulated advisers (e.g. influencers) lead retail investors to invest in financial instruments without being provided with any type of KID.

While we welcome ESMA's recent supervisory statement on the latter, we believe that further work by ESMA is needed. Without such action, a growing number of retail investors investing would start investing without any awareness of the required pre-contractual information (or even aware of the mere existence of such documents) or any potential conflicts of interests.

Q8: In case of positive answer to one or more of the above questions, are there specific changes that should be made to the MiFID II disclosure rules to remedy the identified shortcomings? Please provide details.

As explained in our response to Questions 2-4, alignment between MiFID II disclosure rules and other consumer protection legislation, notably PRIIPs and IDD, should be ensured. Please refer to the previous responses for the examples of changes that should be made to the MiFID II disclosures rules regarding product comparability, overload of information, inconsistencies between MiFID and PRIIPs (product cost, risk and performance information) and the link to financial literacy.

And the newer digital issues mentioned above should also be urgently tackled by ESMA.

Q9: On the topic of disclosures on sustainability risks and factors, do you see any critical issue emerging from the overlap of MiFID II with the Sustainable Finance Disclosure Regulation (SFDR) and other legislation covering ESG matters?

The industry has identified a number of sequencing issues causing practical challenges to the implementation of the ESG amendments to MiFID II and IDD (effective as of 2 August 2022). These sequencing issues have become even more pressing following the deferred application date of the SFDR level 2 measures and the timing adjustments for entity-level reporting under the Article 8 Taxonomy Regulation delegated act.

The operationalization of ESG amendments to MiFID II in relation to sustainability preferences rely on:

- **Pre-contractual and periodic disclosures in relation to the percentage of sustainable investments as defined under SFDR for Article 8 and 9 SFDR products** – These obligations are prescribed under the SFDR level 2 measures which will only apply from 1 January 2023. There are no existing obligations under the level 1 SFDR that could allow product manufacturers and distributors to make this information available on time for 2 August 2022.

- **Pre-contractual and periodic disclosures in relation to the percentage of environmentally sustainable investment under the Taxonomy Regulation and/or Taxonomy alignment for Article 8 and 9 SFDR products** – These obligations are being phased in from 1 January 2022 in respect to the first two environmental objectives (mainly on a qualitative basis) and from 1 January 2023 in respect of the remaining four environmental objectives. In addition, it is important to note that products will not be able to commit to a 'minimum proportion' of investments in line with the Taxonomy (as prescribed by Article (7a) of MiFID II Delegated Regulation) before 1 January 2024. In fact, according to the new text of the Article 8 Taxonomy Regulation delegated act (adopted by the European Commission on 6 July 2021), non-financial undertakings' Taxonomy reporting obligations will only start in January 2023, for the 2022 reporting periods. This means that no fund will be able to accurately provide the proportion of its taxonomy-alignment before January 2024 for a reporting period of 2023 (i.e. when investee companies start reporting on Taxonomy alignment in January 2023).

- **Pre-contractual and periodic disclosures in relation to PAI consideration at the product required under Article 7(1) SFDR** – These obligations will only be implemented from 30 December 2022 (i.e. before investee companies start reporting on Taxonomy alignment in January). Before that date, the standardised annexes to pre-contractual disclosures for Article 8 and Article 9 SFDR products will only contain a brief indication of whether PAIs are taken into account as part of the investment strategy.

These are particularly challenging issues for European asset managers and distributors who are currently working on how to best implement these rules, which require substantial changes to the target market and the suitability assessment, ahead of the application date. A proper sequencing between the three distribution channels under the Delegated Regulation (EU) 2021/1253 is necessary for the industry to properly translate the new standards into understandable client preferences and to align the target market assessments with the new client sustainability preferences categories.

We include below a table summarising the different conflicts between the 4 implementation deadlines:

Date	Regulatory changes	Updates needed from the industry
1 January 2022	Article 8 Taxonomy Regulation Delegated Act applies.	The Delegated Act does not apply in full, and both financial and non-financial undertakings will primarily report qualitative information. The only quantitative information reported will regard the proportion of taxonomy eligible assets, which is not relevant to the % of taxonomy aligned assets utilised in the MiFID II DA ESG preferences.
2 August 2022	Application of the Delegated Regulation (EU) 2021/1253 and the Delegated Directive (EU) 2021/1269	The target market and the suitability assessment will need to include the new sustainability preferences regime. This will require asset managers to send distributors the following products' ESG information: • Percentage of sustainable investments under SFDR • Percentage of Taxonomy alignment • PAIs taken into consideration
30 December 2022	Application of SFDR Article 7 (Transparency of adverse sustainability impacts at financial product level)	Updates needed to reflect the following: 1. Clear a reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts 2. Statement that information on principal adverse impact is available in periodic reports
1 January 2023	Application of the SFDR RTS	Pre-contractual templates need to be added to existing pre-contractual documents. This will include the percentage of sustainable investments under SFDR and the disclosure of the percentage of the products´ Taxonomy alignment for Article 8 products with sustainable investments and all Article 9 SFDR products.
1 January 2023	Full application of Article 8 of Taxonomy Regulation Delegated Act to non-financial undertakings	First quantitative taxonomy reporting for non-financial undertakings for the 2022 reporting period. Before this date, no taxonomy data will be available on investee companies.
1 January 2024	Full application of the Article 8 Taxonomy Regulation Delegated Act to financial undertakings.	Financial undertakings falling under NFRD/CSRD start quantitatively reporting their entity taxonomy alignment levels.

Q10: Are there any other aspects of the MiFID II disclosure requirements and their interactions with other investor protection legislations that you think could be improved or where any specific action from the Commission and/or ESMA is needed?

In line with our response to Q38, we believe that more clarity is needed regarding the specific responsibilities for fund distributors and management companies with regard to marketing communication. In its Guidelines on marketing communication under the CBDF Regulation, ESMA clarified that the Regulation specifies the requirements for marketing communications and does not explicitly address the responsibility of funds managers for their content.

We believe that the responsibility of the management company must be limited to the one given through its license and scope of activities, while fund distributors must bear their own responsibilities governed by their license as well as bilateral agreements with the management company (if any). In essence, the management company cannot assume responsibility for the third party's marketing documents over which the former has no formal control or influence (i.e. it is the distributor who actively develops his own marketing strategy).

SECTION 2. DIGITAL DISCLOSURES

Q12: Do you observe a particular group or groups of consumers to be more willing and able to access financial products and services through digital means, and are therefore disproportionately likely to rely on digital disclosures? Please share any evidence that you may have, also in form of data.

Younger generations of investors generally tend to use digital means for their purchases, including investments. These demographics are, therefore ,more likely to rely on digital disclosures.

In addition, and more worryingly, for these younger generations also (to a growing degree) rely on social media influencers who are more actively proactively marketing both financial advice and/or products. Thus, **there is a growing risk that non-regulated advisers (e.g. influencers) lead retail investors to invest in financial instruments without providing any type of KID** to make their own investment decisions – including making use of non-regulated investment advisors and/or without even being aware that regulated product information documents exist and should be provided to them.

Q13: Which technical solutions for digital disclosures (e.g., solutions outlined in paragraph 27 or additional techniques) can work best for consumers in a digital - and in particular smartphone - age? Please provide details on solutions adopted and explain how these have proven an effective way to provide information that is clear and not misleading.

Some solutions directed to improve digital disclosures can be found below:

- Clear rules to prescribe presentation formats (e.g. readable font size, use of designs/colours, etc.)
- Certain key information (e.g. fees, charges, payment of inducements, information relative to performance, etc.) is displayed in ways that highlight the prominence
- Format of the information is adapted to use on different kind of devices (for example through the use of layering). As regards the format and layout, we are certain that a clear structure helps investors to understand the information (e.g. graphics/charts/narratives).
- Appropriately labelled and relevant hyperlinks are used to provide access to supplementary

information

- Use of hyperlinks is limited (e.g. one click only – no cascade of links). We believe that the layering of information (and the use of hyperlinks) can help in finding a balance between disclosing key information while at the same time allowing for more details if required by the investor.

Q15: Should the relevant MIFID II requirements on information to clients be adapted in light of the increased use of digital disclosures? If so, please explain how and why.

The starting point for such considerations should be how a retail investor nowadays consumes information, and subsequently build an information framework around this. We have been supportive of the recent **MiFID 'quick fixes'**, which established electronic disclosure by default ('digital first' disclosure policy) while allowing investors to request paper disclosure. This is essential as not all retail investors have access to the internet. This guiding principle should be extended to all disclosures requirements so distributors of retail financial products are required to make pre-contractual disclosure documents available in **electronic format by default, but on paper upon request**.

Therefore, EFAMA believes that the current **static paper-based format of the KID no longer meets investors' needs**. Investors increasingly require interactive digital formats with information layered to render it more accessible, rather than overloading them with information. In this respect, we welcome the more interactive approach shown by the PEPP KID.

More generally, information should also be digitally accessible and allow for **interactivity** to empower and engage consumers. Current disclosure documents are currently paper-based and can be made available only in a non-interactive pdf format. There is a number of ways of presenting costs and performance information that would be more engaging and informative. Investors have different cognitive preferences to consuming data and disclosure standards. This being said, it must be ensured that these disclosures follow certain high-level principles to ensure that investors receive the same essential information no matter what type of information medium is being used. Otherwise, there is a risk of creating an uneven level playing field depending on the medium used – leading to regulatory arbitrage. For more information, please see our response to Question 16.

Additionally, **digital comparison tools** (but also labelling & certification) may enable investors to compare different investment products more efficiently than existing information sources like the PRIIP KID.

Q16: Do you see the general need for additional tools for regulators in order to supervise digital disclosures and advertising behind 'pay-walls', semi-closed forums, social media groups, information provided by third parties (i.e., FINfluencers), etc? Please explain and outline the adaptions that you would propose.

We believe the **same level of investor protection** should apply for 'digital sales', any semi-closed forums, social media groups or third parties should be closely monitored under MiFID II scope. It is interesting to note that more recent issues around marketing and advertising of investment products not suitable for retail investors (for example, CFDs) stemmed more from the fact that these actors and **were not properly supervised and/or in scope of the current framework** (unlike UCITS and retail AIFs which are subject to prior authorisation before launch). **It is, thus, rather an issue of proper supervision of all actors in the financial space rather than a lack of investor protection.**

We, therefore, consider that recent problems have arisen not from regulated financial products but from financial actors not properly regulated and licensed under the existing EU framework. Consequently, it should be the Commission's focus that all financial actors are properly regulated and licenced rather than

increasing existing distribution rules (in an online context).

More generally speaking, disclosure rules must be adapted to fit the existing format constraints of social media (e.g. size issues in social media channels or problems integrating long-winded disclaimers into videos and banners posted on social media or websites).

Also, we agree that there is a number of existing differences in terms of marketing and distributing financial instruments throughout the EU. Different rules on marketing and advertising of investment products constitute an obstacle for retail investors to access investment products. We would welcome EU coordination/harmonisation of national rules on online advertising and marketing of investment products. More attention must be paid in the future to ensure consistency regarding the rules on marketing communications between the different regulatory frameworks (MiFID, SFDR, etc.).

SECTION 3. DIGITAL TOOLS AND CHANNELS

3.1 Robo-advisers

Q17: To financial firms: Do you observe increased interest from retail investors to receive investment advice through semi-automated means, e.g., robo-advice? If yes, what automated advice tools are most popular? Please share any available statistics, data, or other evidence on the size of the market for automated advice.

Some evidence shows that robo-advice has had an underwhelming start, with low demand resulting in many initiatives in the sector disbanding. However, there remains great potential in this area, recognising that many customers may still prefer some form of direct interaction, which could, in turn, drive further development of different approaches such as hybrid models.

Contrary to what had been expected some years ago, we have not observed during an increased interest from retail investors regarding robo-advice.

Q18: Do you consider there are barriers preventing firms from offering/developing automated financial advice tools in the securities sectors? If so, which barriers?

One of the biggest challenges for manufacturers is to understand robo-advisors use of data, mainly the sources of information these robo-advisors use to consider different financial instruments in their selection process. We would, therefore, have an interest in robo-advice providers being more transparent about their selection process. This would in turn benefit investors' understanding of robo-advice and may encourage its use in the future.

Q19: Do you consider there are barriers for (potential) clients to start investing via semi-automated means like robo-advice caused by the current legal framework? If so, please explain and outline what you consider to be a good solution to overcome these barriers.

We do believe that the reasons for the limited use of robo-advisors are multi-faceted. First of all, the differences among the different types of robo-advisors are not always well identified and disclosed and this could cause uncertainty among retail investors.

However, we do not think that these are any barriers as such. The main reason in the EU for the limited use of robo-advisors is a greater trust in human advice still prevails. We do believe that this trust in human advice is going to be complemented by better financial literacy in the near to medium-term future.

Q21: Do you consider the potential risks and opportunities to investors set out above to be accurate? If not, please explain why and set out any additional risk and opportunities for investors.

It is important that a level-playing field is established regarding the provision of advice in order to mitigate against consumer harm: third-party providers seeking to offer advice would need to be regulated in the same way as any other investment firm or intermediary and subject to the same threshold conditions. Equally, where any regulated advice is given, investors need to be assured that the same standards of consumer protection apply to this as to any other kind of advice.

Q22: Do you consider that the existing MiFID regulatory framework continues to be appropriate with regard to robo-advisers or do you believe that changes should be added to the framework? If so, please explain which ones and why.

We believe that robo-advisors (or hybrid advisors) are already appropriately covered under the current investment advice and disclosure MiFID rules.

Digital advisors are, and always should be, subject to the same framework of regulation and supervision as traditional advisors. However, the emphasis of the investor protection rules may differ in some cases. We suggest that regulators focus on the following key areas:

1. Know your customer and suitability. Suitability requirements (not only in the EU but across the globe) require advisors to make suitable investment recommendations to clients based on their knowledge of the clients' circumstances and goals, which is often gained from questionnaires. These rules apply equally to digital advice, though the means of assessing suitability may differ somewhat. Suitability assessments must be tailored to the clients' goals and the services that are being offered. Digital advisors should clearly state the objectives their services are designed to meet in order to ensure the services being offered are in line with client needs and objectives.

2. Algorithm design and oversight. Digital advisors should ensure that investment professionals with sufficient expertise are closely involved in the development and ongoing oversight of algorithms. Algorithm assumptions should be based on generally accepted investment theories, and a plain language description of assumptions should be available to investors. Any use of third party algorithms should entail robust due diligence on the part of the digital advisor. It is increasingly important to ensure that an algorithm does not embed any hidden biases. A diverse governance structure around its implementation can help mitigate against the use of such hidden or implicit bias.

3. Disclosure standards and cost transparency. Disclosure is central to ensuring that clients understand what services they are receiving as well as the risks and potential conflicts involved. Like traditional advisors, digital advisors should clearly disclose costs, fees, and other forms of compensation prior to the provision of services. Digital advisors should similarly disclose relevant technological, operational, and market risks to clients.

4. Trading practices. Digital advisors should have in place reasonably designed policies and procedures concerning their trading practices. Such procedures should include controls to mitigate risks associated with trading and order handling, including supervisory controls. Risks associated with trading practices should be clearly disclosed.

5. Data protection and cybersecurity. Digital advisors must be diligent about sharing and aggregating only information that is necessary to facilitate clients' stated objectives. Digital advisors should use the strongest data encryption, conduct third-party risk management, obtain cybersecurity insurance, maintain business continuity management plans, and implement incident management frameworks.

3.2 Online brokers

Q23: Do you think that any changes should be made to MiFID II (e.g., suitability or appropriateness requirements) to adequately protect inexperienced investors accessing financial markets through execution only and brokerage services via online platforms? If so, please explain which ones and why.

Concerning units or shares in EU investment funds (UCITS and AIFs), we understand the **MiFID distribution/advice rules to be applicable no matter whether a fund is sold online or not which should extend to online brokers. It is essential that the same level of investor protection must apply regardless of the distribution channel.** At the same, it needs to be ensured that retail investors have access to and benefit from high-quality investment advice.

While some of our members see growth of retail participation in funds through online brokers (and digital advisors), these developments should be looked at it in more detail. Especially since online brokerages are currently scrutinized for providing easier access to less regulated products, which hold lower consumer protection standards vis-à-vis UCITS and retail AIFs (which are subject to prior authorisation before launch UCITS' and PRIIPS' product information as well as MiFID distribution rules during the pre-marketing and marketing phases).

Q35: The increased digitalisation of investment services, also brings the possibility to provide investment services across other Member States with little extra effort. This is evidenced by the rapid expansion of online brokers across Europe. Do you observe issues connected to this increased cross-border provision of services? Please elaborate.

Provided that retail investors' interests are properly safeguarded, we believe increased cross border provision of services will be beneficial to consumers. We note the importance of ensuring that retail investor education is appropriately tailored to the needs of individual markets.

Role of social media

Q36: Do you observe an increasing reliance of retail clients on information shared on social media (including any information shared by influencers) to base their investment decisions? Please explain and, if possible, provide details and examples. Do those improve or hamper the decision-making process for clients?

Yes (see above). It may lead to a growing segment of de facto unregulated investment advisers, which is dangerous in terms of retail investor protection.

Q37: What are, in your opinion, the risks and benefits connected to the use of social media as part of the investment process and are there specific changes that should be introduced in the regulatory framework to address this new trend?

Building on our response in Q23, the development of investment recommendations on social media and in particular influencers, as well as proactive online marketing of advice or products by non-regulated players, there is a growing risk that non-regulated advisers (e.g. influencers) lead retail investors to invest in financial instruments without providing any type of appropriateness test (or PRIIP KID).

We would like to take the opportunity to welcome ESMA recent Statement on Investment Recommendations on Social Media. While it is important to highlight that people offering investment recommendations online

is covered under EU MAR, we believe all financial actors should be properly regulated and licenced regardless they are in an online context. In this sense, we believe the **same level of investor protection** should apply for 'digital sales', any semi-closed forums, social media groups or third parties should be closely monitored under MiFID II scope. Please see Q16 for further detail.

Having said this, there are a number of technical and practical reasons which need to be addressed when considering social media channels, not least the online versus off-line form of the communication channel used (e.g. paper-based v. non-paper-based media).

In particular, the description of risks and rewards need to reflect the constraints of different means of communication channels. Whilst we agree that, regardless of communication type, firms need to ensure that all communications are compliant, it is important to retain the necessary flexibility in how the requirements are applied. For example, printed marketing materials (being an off-line communication) and any YouTube content (being an online communication) have unlimited space to deliver information to investors, even though one is online and the other is an off-line communication channel. In contrast, materials distributed via LinkedIn / Instagram / Twitter accounts have only very limited space available to deliver information to investors.

Thus, to adequately regulate the contemporary need of the market players and effectively protect the interests of the investors, we recommend provisions on how to describe risks and rewards in an equally prominent manner in marketing communications in those cases when the contents are distributed on such communication channels which provide only very limited space available to their users to deliver information to investors (e.g. LinkedIn / Instagram / Twitter).

Q38: Are you aware of the practices by which investment firms outsource marketing campaigns to online platform providers/agencies that execute social media marketing for them, and do you know how the quality of such campaign is being safeguarded?

Regarding ESMA Guidelines on marketing communication under the CBDF Regulation, EFAMA continues to state that fund managers cannot assume responsibility for the third party's marketing documents over which the former has no formal control or influence (i.e. it is the distributor who actively develops his own marketing strategy). In this regard, it should be clearly stated in the Guidelines that management company responsibility must be limited to the one given through its license and scope of activities, while distributors must bear their own responsibilities governed by their license as well as bilateral agreements with the management company (if any).

Q39: Have you observed different characteristics of retail clients, such as risk profiles or trading behaviour, depending on whether the respective client group bases their investment decision on information shared on social media versus a client group that does not base their investment decision on social media information? Please elaborate.

Younger generations make more use of social media – as well as digital tools and assets (such as crypto-assets). It will become a growing issue over time, both because the use of digital media will spread out, and because younger generations will become richer and therefore represent a wider share of the whole retail investor community.

Q40: Do you have any evidence that the use of social media (including copy/mirror trading) has facilitated the spreading of misleading information about financial products and/or investment strategies? Please elaborate and share data if possible.

The GameStop case should be investigated further from this perspective.

Q41: Have you observed increased retail trading of 'meme stocks', i.e. equities that experience spikes in mentions on social media? Please share any evidence of such trading and, if possible, statistics on outcomes for retail investors trading such instruments.

The GameStop case should be investigated further from this perspective.

Risk warnings

Q42: Do you consider that the current regulatory framework concerning warnings provides adequate protection for retail investors? If not, please explain and please describe which changes to the current regulatory framework you would deem necessary and why.

Certain risk warnings in this framework may hinder retail investor participation in the capital markets. Though warnings about the risks related to investing are important, risk warnings may put off investors for investments products where this may be less necessary, such as non-complex investment funds, whilst similar risk warnings are not required for unregulated instruments, such as crypto-assets.

One should also consider that general risk warnings may have a deterrent effect on potential investors and hence may form an unnecessary obstacle for retail investors to access investment products, in particular if no distinction is being made between e.g. non-complex investment funds and leveraged complex derivatives or CFDs.

Also, warnings play an important part in the perception of risks. While current warnings slightly differ between non-complex and complex products, they may not be easily understood by retail investors. In particular, if each type of investment product carries a standardised risk warning that investors can lose all their money. From the investors' perception, this means all products are similarly risky. For example: While the risk of losing all your money by investing in an investment fund is theoretical, this may be different when investing in leveraged derivatives. Essentially, we must differentiate between disclosure requirements in terms of risk warnings for more speculative products, on one hand, and non-complex products, such as investment funds intended to be sold for the longer term, on the other.

Reiterating our comments in Q1, we believe risk assessment of an advised or discretionary managed portfolio will inevitably be different from a single product volatility-linked indicator such as an SRI. A professional intermediary will look at risk over time rather than at risk at a point in time. This longer-term approach to risk is important when managing increasingly important risks such as inflation risk or managing products with a dynamically changing risk profile such as a life-cyling product. In the area of sustainability, the ability to include forward-looking projections such as transition risk and climate scenarios is gaining in importance and needs to be reflected in risk metrics and reporting.

3.3 Open finance

Q43: Do you believe that consumers would benefit from the development of an 'open finance' approach similarly to what is happening for open banking and the provision of consumer credit, mortgages, etc? Please explain by providing concrete examples and outline especially what you believe are the benefits for retail investors.

While there are advantages for investors, a framework for open finance in the field of retail investments should be very **carefully designed to avoid mis-selling and ensure continued data protection**. First and foremost, we see certain risks to consumer data protection if the consumers do not fully understand what and who they give consent to when ticking a consent box. Having more and more citizen data copies all over the internet will exponentially grow data breaches and privacy risks, and by proxy, risks to asset managers due to huge increases in identity theft and fraud.

Second, while we agree that open finance could produce a quicker assessment of an individual's financial picture, it is important that **a level-playing field is established with regard to the provision of advice in order to mitigate consumer harm**. Third-party providers seeking to offer advice would need to be regulated in the same way as any other investment firm or intermediary and subject to the same threshold conditions. Where any regulated advice is given, investors need to be assured that the same standards of consumer protection apply to this as to any other kind of advice.

Q44: What are, in your opinion, the main risks that might originate from the development of open finance? What do you see as the main risks for retail investors? Please explain and please describe how these risks could be mitigated as part of the development of an open finance framework.

We encourage policymakers to build an investor-centric framework that balances investor protection and investor inclusion. We see a risk of financial exclusion for a certain group of consumers that don't have access to digital tools and therefore cannot benefit from an open finance policy. Therefore, we strongly recommend always maintaining accessibility for those people. We consider that open finance may be potentially detrimental to retail investors if not well-calibrated, in terms of the wide sharing of their personal data and the risk of mis-selling, as expressed above.

Q45: Which client investor data could be shared in the context of the development of an open finance framework for investments (e.g., product information; client's balance information; client's investment history/transaction data; client's appropriateness/suitability profile)?

Taking into consideration our general comments on open finance in our response to 43, we see benefits in an open finance policy for a variety of investment products. We encourage the use of digital take on procedures, know your client and portable suitability profiles as key tools to achieve greater simplification of the administrative burden of investment, and would recommend that any reforms allow for, if not explicitly build in, these tools. Innovations like an investor digital ID and a personalised and portable fact find are key to improving consumer engagement, giving them greater control of their finances and taking duplicative costs out of the process. The digital ID is not just a key enabler for the portability of consumer information allowing citizens to shop around and to switch to more cost-effective service providers. It also facilitates the creation of dashboards allowing consumers to visualise their pensions and savings in a single place and avoiding orphaned assets in an increasingly mobile economy.

The use of digital onboarding procedures, know-your-client and portable suitability profiles can achieve greater simplification of the administrative burden of investment. An investor digital ID and a personalised and portable fact find may improve consumer engagement, giving them greater control of their finances and

taking duplicative costs out of the process. The digital ID is an enabler for the portability of consumer information allowing citizens to shop around and to switch to more cost-effective service providers and helps building a more holistic and complete picture of an individual's financial position.

Q47: Do you see the need to foster data portability and the development of a portable digital identity? Please outline the main elements that a digital identity framework should be focusing on.

We have already welcomed the Commission's recent initiative on digital ID and we encourage its further adoption into other processes to reduce much of the laborious and time-consuming account opening procedures many investors experience and which constitute a barrier to empowering investors. These data could also support the lengthy and costly Know-Your-Customer and Anti-Money-Laundering processes that accompany this process. Access to such specific client data (such as previous suitability and appropriateness tests, as well as information on their financial situation and financial holdings) may allow financial firms to provide retail investors with potential investment solutions much more quickly than currently is the case. A suitability and/or appropriateness assessment must be undertaken by each investment firm. Making such an assessment portable would allow retail investors to 'shop around' and easily compare offers from different distributors.

As the Commission points out, **important issues around the high risk of mis-selling embedded in Open Finance, as well as data privacy and data protection that are paramount and must be addressed as well**. This is especially true once Open Finance is still in its infancy with few targeted rules in existence. In principle, any approach to Open Finance must be based on the clients' explicit approval to access and use their data. However, additional measures must be taken, as retail clients are usually not aware of the far-reaching access to their confidential data once explicit approval is provided. Indeed, such an explicit approval to access a client's confidential data should come with strict policies ensuring the retail investor is informed of the far-reaching access to personal and financial data he/she is giving consent to – for example, in the form of disclaimers and/or risk warnings.

Q48: Do you consider that regulatory intervention is necessary and useful to help the development of open finance? Please outline any specific amendments to MiFID II or any other relevant legislation.

Yes, to avoid its unregulated development, which would lead to mis-selling and dissemination of individual confidential information, which would be detrimental for retail investors.

Q49: What do you consider as the key conditions that would allow open finance to develop in a way that delivers the best outcomes for both financial market participants and customers? Please explain.

We believe consumers do not like the idea of sharing data when it is not clear what value they get from doing so, therefore it is key to demonstrate the value of sharing their data. **When ticking a box allowing third parties to get access to their individual confidential information, retail investors may not be aware of what they agree on.** Above all consumers should always be in control of their data and it should be easy for them to take away access should they no longer see the benefit of doing so. Businesses should be encouraged to clearly articulate the benefits to consumers of granting access to their data. Examples of benefits could be automated comparisons of financial products relevant to the individual that would not be possible without using data to understand their individual situation.

About EFAMA

EFAMA is the voice of the European investment management industry, which manages over EUR 27 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities.

EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

More information is available at www.efama.org.

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