

DDV Position Paper

on the EU Retail Investment Strategy (RIS)



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German Lobby Register: R001411
EU Transparency Register: 377055313623-72

1. Overall assessment

The DDV appreciates the efforts of the European Commission (EC) to progress towards more protection, and further facilitation and empowerment of retail investors in its proposal for an Omnibus Directive as regards the strengthening of Union retail investor protection rules. To achieve these objectives, a cross-sectoral approach, in particular through aligning the revised Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive (IDD), is highly welcomed.

We note with satisfaction that the EC does not jeopardise the fundamental principle of freedom of the investors, for instance through the remaining possibility of purchasing a financial instrument following a warning. We would also like to highlight the importance of promoting favourable conditions to serve the full range of investors. It is indeed crucial that both the advised and the non-advised businesses consider and respond to the different situations, motives, and expectations of investors.

The DDV welcomes the recognition by the EC that a full ban on inducements would have significant unforeseeable effects. Although we would have preferred that the EC were fully convinced of the positive rationale of this system, we see it as an opportunity to progress towards more appreciation of its benefits. However, we take a very critical view of a partial ban imposed on the non-advised business. We do not believe that this would benefit retail investors; on the contrary, it is likely that a partial ban would lead to a reduction of the product range and a degradation of the online banking environment for retail investors.

Furthermore, some new provisions are difficult to assess as it is foreseen that their details will be ironed out at Level 2. The DDV would like to encourage the decision-makers to set clear guidance at Level 1 and the supervisory authorities to involve the industry in the design of the Level 2 provisions. Effective implementation that meets the targets set at Level 1 will depend on the quality of the crafting of these provisions. Further efforts may also be needed with regards to the information overload, as the suggested changes mainly consist of a standardisation of the existing information and not of the simplification and reduction thereof - which is strongly needed.

Facilitating access to the category of professional clients on request through the streamlining of the criteria is going in a positive direction. In addition, it is welcomed that the need for deepening the knowledge and understanding of both retail investors and advisors is to be addressed through a required high level of qualification for advisors, as well the strengthening of financial education.

Furthermore, the necessary catch up of the regulatory framework with digital developments is well reflected in this proposal, for instance with a digital-by-default disclosure of information through the electronic format which is henceforth established as the standard one. It is also comforting to note that additional competences are being granted to supervisory authorities in order to act against unregulated players who act unfairly.

Proper implementation will require time for the necessary developments, which will be numerous and simultaneous. Therefore, the DDV would like to plead for an entry into force set after the final Level 2 measures are taken.

2. Issues of concern

2.1. **Ban on inducements for non-advised business**

The EC's paradigm, according to which inducements are not legitimate in cases of no advice, is understandable.

However, the DDV's approach, which is widely shared across and beyond the industry, consists of addressing this issue through the perspective of the relationship with retail investors, and the benefits that they can expect from a service which has been designed to meet their situation, motives, and expectations. In this context, the advised and the non-advised businesses respond to different investment objectives and expectations.

The non-advised business is in practice accompanied by high-quality services, which aim to empower clients to make informed and independent investment decisions, while at the same time maintaining a high level of protection. These services consist of obtaining and comparing clients' knowledge and experience in advanced appropriateness assessments, providing educational content, and offering a wide product range from hundreds of manufacturers at low cost, accompanied with high-quality financial data and analytical tools free of charge. To qualify these services as "serviced self-execution" would best reflect the reality.

In more detail, the widely acknowledged advantages and benefits of the non-advised business performed can be described as follows:

- Performance of a systematic appropriateness test in some countries, which goes beyond simple execution and, in the necessary cases, triggers a warning notice;
- Fulfilment of information and reporting obligations towards the investor (e.g., ex ante cost transparency, basic information sheet) and the supervisor (e.g., quarterly reporting, loss threshold reporting, annual cost transparency), which guarantee full transparency;
- A wide range of products from different providers, without conflicts of interests;
- A wide range of tools which go beyond a mere app and contribute to financial education (e.g., free apps and online calculators, online product and service information, information events), including analytical tools (e.g., securities watchlists, charting, fundamental analysis, and securities comparisons using key metrics);
- Sharing of knowledge about a wide range of products, including via structured search functionalities, so that clients can easily find, compare, and select the best-fitting product in an objective and unbiased manner;
- Possibility to select from several national and international trading venues with real-time price comparisons (real-time quotes);

- High-quality data like real-time market overviews, ratings, analyst opinions, and sustainability data, as well as thousands of daily news items on securities, economic developments, and markets;
- Provision of free brokerage account management and favorable order costs;
- Tax benefits when granted by the respective national law.

As a result, the DDV believes that the non-advised business deserves recognition as a service as such, that is provided to the retail investors to allow them to make independent and informed decisions. Such service comes at a cost, which is financed by inducements. Hence, by providing serviced self-execution, online banks pass the inducements received in non-advised execution business on to their clients.

A ban on inducements for the serviced self-execution business would generate negative consequences, increasing costs for retail clients, thereby potentially nudging them out of the regulated sphere where they will face riskier and potentially fraudulent offers. Retail investors might be tempted to make investment decisions themselves without the support of helpful tools and without the protection of an enhanced appropriateness regime.

With these considerations in mind, the DDV supports the idea that the ban should not affect the entire non-advised business, but only the “pure” execution-only business as defined in Article 25 (4) of MiFID II.

Another way forward would be the design of a test that may be denominated an “added-value” test which would mirror in non-advised business the “best interest” test foreseen in the EC proposal for the advised business. The criteria that have been developed above may be a sound basis on which to design such a test.

In general, such an impactful decision should be weighted in the light of the context of the payment for order flow (PFOF) debate, which may have a significant impact on online banks. To make a fully informed decision, it may be appropriate to await the outcome of the related survey launched by ESMA.

At the least, meaningful grandfathering provisions should be granted in order not to jeopardise this sector of the financial business, and the service that it renders to retail investors.

2.2. Reinforcement of the appropriateness test

Although risk tolerance in the context of the appropriateness test may be ironed out, the capacity to bear full or partial losses does not appear to be a relevant criterion.

The information obtained by financial institutions from the investor should relate either to a capacity established based on the acquired knowledge and / or experience (which can be objectively and factually proven) or to the investor’s own appreciation of the risks to bear.

For financial institutions, the introduction of the assessment of the capacity to bear losses would require detaining information going beyond the individual. This would mean having a clear and detailed view of the resources, portfolio, and wealth of investors, which goes beyond the spirit of a test performed in a non-advised business where investors wish to make their own decisions. Such an intrusive and impractical approach would represent a move away from the reliance on the information provided by the investor, which has presided so far in the appropriateness assessment and would bring discomfort to retail investors.

3. Aspects that will require fine-tuning during the legislative process

3.1. Costs, associated charges, and third-party payments

The improvement of transparency on costs with a more simple and uniform approach defined in technical standards, is understandable.

The explanation of their purpose and the quantification of their impact on expected returns will have to be designed in the most appropriate way to reach the objective of comprehensibility by any average retail client. Therefore we would like to invite the decision-makers to closely associate the industry to this exercise.

Moreover, the facilitation foreseen for professional clients and eligible counterparties with regards to ex-ante cost information does not go as far as the MiFID quick fix. An “agreement” with these groups of clients falls short of the exemptions that were created for the purpose of simplification and reduction of information overload.

3.2. Value for Money

We welcome that Value for Money is integrated in the Product Governance process.

Merits exist in an approach that would be principle-based giving a clear frame for Level 2, where details should be established in cooperation with the industry. It is also important that a differentiated and proportionate approach is followed, with exemptions or adapted regimes for financial instruments which specificities justify it. The differences between advised and non-advised services should also be reflected into the text.

In this context, the creation of cost and performance benchmarks by ESMA poses questions, particularly in terms of competition. The focus of the “Value for Money” concept should not be based strictly on cost efficiency.

The new reporting obligation for PRIIPs products to national authorities, as well as the maintenance of records with issuers and distributors’ assessments, will imply efforts. To minimise efforts, it is crucial that the data required to be sent to ESMA is the same as the data already collected for the purpose of reporting to the national authorities.

4. Aspects that will depend on the Level 2 design

4.1. **Warnings for particularly risky products**

The DDV understands the EC's concern that retail investors should be properly alerted regarding the specific risks of potential financial losses in the case of specific investments. Such mechanisms already exist and have proved their value.

However, the definition by ESMA and EIOPA of the concept of "particularly risky products" will require thorough and unbiased analysis, the principle itself and its actual design being subject to diverse interpretations. The DDV stands ready for an open and constructive dialogue with ESMA in this respect.

4.2. **"Best interest" test**

In the context of inducements, the replacement of a "quality enhancement" test with a "best interest" test poses many practical questions. For instance, it is unclear how large the group of the "most cost-efficient" suitable financial instruments would be. The interpretation by ESMA and the national authorities of cheaper products may also lack clarity.

As previously mentioned with regards to Value for Money, costs should not be the almost exclusive point of attention. This also applies to the determination of investors' best interest. The criteria of recommending the most cost-efficient financial instruments as well as products without additional features that give rise to extra costs (with disclosure of additional costs when recommending a product with special features) illustrate this overreliance on costs. Such a focus on costs is all the more questionable as it may become meaningless once a Value for Money test has been performed by the product manufacturer.

Furthermore, the "best interest" test examines the advice on the individual product on the basis of how the recommended product relates to the client's existing portfolio. This requirement may lead to a mingling of traditional investment advice with portfolio advice / management, which raises further ambiguities in connection with the prohibition of inducements in portfolio management.