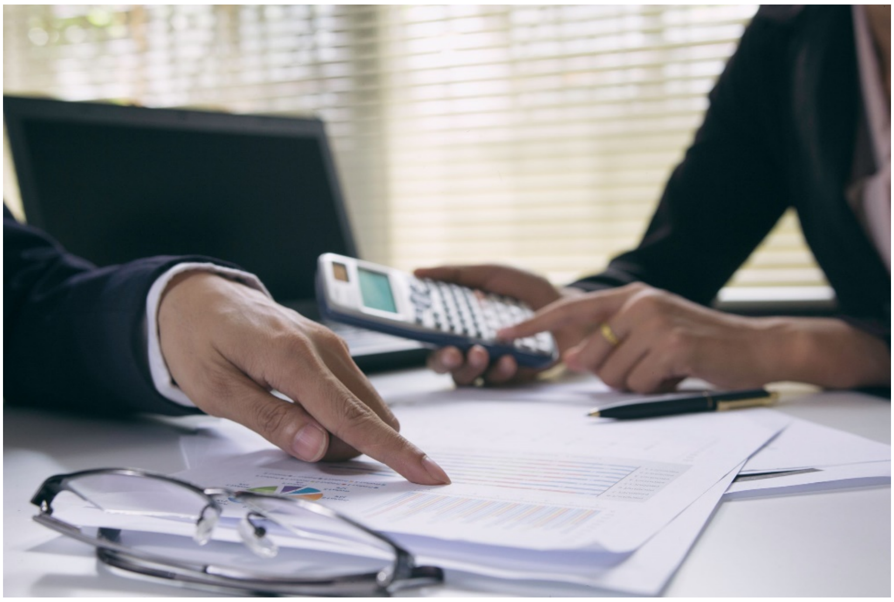
STUDY

Requested by the ECON Committee

Retail Investment Strategy

How to boost retail investors' participation in financial markets



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Retail Investment Strategy

How to boost retail investors' participation in financial markets

Abstract

The study developed herein aims to address the concerns raised as to the field of retail investments. It aims at analysing market practices and the applicable legislative landscape in order to identify room for improvement and, ultimately, propose potential solutions to foster retail investor protection and participation in financial markets.

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CONTENTS

LIST OF ABBREVIATIONS

AI	Artificial Intelligence
AIF	Alternative Investment Fund
AIFMD	Alternative Investment Fund Managers Directive
CMU	Capital Markets Union
CRD	Capital Requirements Directive
DLT	Distributed-ledger technology
DORA	Digital Operational Resilience Act
EBA	European Banking Authority
EC	European Commission
ECSPR	European Crowdfunding Service Providers Regulation
EIOPA	European Insurance and Occupational Pensions Authority
EMD	E-Money Directive
EP	European Parliament
ESAs	European Supervisory Agencies
ESAP	European Single Access Point
ESFS	European System of Financial Supervision
ESG	Environmental, Social, and Governance
ESMA	European Securities and Markets Authority
ESRB	European System of Financial Supervision
EU	European Union
IDD	Insurance Distribution Directive
ISD	Investment Services Directive
KID	Key Information Document

KIID	Key Investor Information Document
MAR	Market Abuse Regulation
MEPs	Members of the European Parliament
MiCA	Regulation on Markets in Crypto-assets
MiFID II	Markets in Financial Instruments Directive
NCA	National Competent Authority
OECD	Organisation for Economic Co-operation and Development
PSD II	Payments Service Directive
PEPP	Pan-European Personal Pension Product
PFOF	Payment For Order Flows
PRIIPs	Packaged Retail and Insurance-based Investment Products
UCITSD	Undertakings for Collective Investment in Transferable Securities Directive

EXECUTIVE SUMMARY

Background

This study addresses certain concerns raised by the European Parliament (EP)'s ECON committee related to the development of the market for retail investments in the European Union (EU).

It aims at analysing some of the most relevant rules and practices applicable to the functioning of EU capital markets, identifying some areas for improvement, in view of the overarching objective of increasing participation and protection of retail investors to develop the Capital Markets Union (CMU). The purpose is to propose further measures to support the achievement of the goals established under the CMU Action Plan and the Retail Investment Strategy.

On 24 May 2023, the European Commission (EC) published a comprehensive package for the implementation of the Retail Investment Strategy (the so-called Retail Investment Package), which comprises:

(i) a Directive amending rules set out in the Markets in Financial Instruments Directive (MiFID II), Insurance Distribution Directive (IDD), Undertakings for Collective Investment in Transferable Securities Directive (UCITSD), Alternative Investment Fund Managers Directive (AIFMD) and Solvency II (the "**Omnibus Directive Proposal**");

(ii) as well as a Regulation amending the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, in particular with regard to rules on the key information document (KID).

The proposals set forth therein elaborate and expand on many rules designed to protect retail investors in the EU market, taking stock from a long period of analysis and a comprehensive impact assessment.

Scope of the analysis

This study explores a number of specific, relevant areas, many of which are also covered by the Omnibus Directive Proposal itself, to support the development of a retail market for investments in the EU. More specifically, the study discusses:

(i) a possible new regulatory approach towards inducements;

(ii) the enhancement of rules addressing the digitalisation of capital markets and the need to improve investors' protection and confidence;

(iii) the opportunity to improve cross-sectoral integration to address legislative misalignments between, as well as quality and content of, disclosure rules;

(iv) the need to improve rules on product mapping;

(v) a (possible) reassessment of the current classification of professional and retail clients; and

(vi) the need to enhance financial literacy.

The study looks at the current perimeter of EU financial legislation. It does not consider the possible extension of the current regimes to assets that are currently not included within its scope. However, as recently pointed out by the European Securities and Markets Authority (ESMA)[1], there is an increasing risk of customers investing in products that are perceived as similar to a financial investment (including,

[1] ESMA, Statement 25 May, 2023, ESMA35-36-2813, "ESMA highlights the risks arising from the provision of unregulated products and/or services by investment firms".

for instance, precious stones and metals, or crypto-assets not included in the scope of the Regulation on Markets in Crypto-Assets (MiCA)), not knowing that they are not regulated at all, or only partially regulated. In the future steps of the CMU, however, these issues as well ought to be addressed in a balanced way, also in their interplay with general rules on consumer protection.

Conclusions

Regulation cannot, *per se,* solve all the problems related to the scarce participation of retail investors in the CMU. The phenomenon is indeed driven by a number of complex factors, starting from macro-economic elements to geo-political and demographic factors, up to the financial culture of certain communities and of society. Regulatory aspects are just one of the elements that can be used to stimulate an increased level of participation of retail investors in financial markets, but they do play a very important role. Rules may, in fact, facilitate or hinder access to the market, and greatly affect the level of consistency in the protection afforded, thereby enhancing, or reducing the confidence of investors. They may support financial inclusion or create undue obstacles. They may result in a significant increase in compliance and regulatory costs, with no concrete impact on the enhancement of investors' protection. Even if regulation is just one of the elements that support the development of financial markets, it is, indeed, one of the most important.

The current state-of-the art of EU legislation in this respect shows, at the moment, several areas for improvement which do not necessarily result in the need for more or additional legislation: rather, as we attempt to demonstrate throughout this study, major interventions are needed in order to simplify the current legislative landscape, to make it more coherent, less fragmented and, ultimately, more effective.

Key findings and initiatives

The main findings and initiatives discussed in the study can be summarised as follows:

(i) Legislation should ensure that retail investors (a) **have a complete and solid understanding of the products and services that are offered to them**, including payments, costs and charges, and (b) **are provided with clear, understandable, and comparable disclosure** in such respect;

(ii) **The notion of "investment advice" under MiFID should be reformed** in order to encompass the different levels of services that can be provided to retail investors, especially considering the debate on inducements;

(iii) Disclosure of any relevant information should be structured in a way that substance prevails over form, as to **avoid overburdening and inconsistencies** between different levels and kinds of information;

(iv) Rules focused on regulating prices may hinder the organic development of markets and represent an obstacle to innovation. The rules proposed by the EC seem to indirectly regulate price formation mechanisms and this too is undesired;

(v) Legislation should be adapted and updated to **better address the functioning and the associated risks of financial markets in the digital environment**. Measures include: (a) to **reconsider the scope of the notion of "investment advice" under MiFID**, so as to capture certain practices and potential abuses that may occur in the digital sphere and better safeguard retail investors from such risks; and (b) to **develop a specific "digital suitability"**

test, especially focused on unexperienced retail investors that are driven to investments through digital tools or gamification strategies.

(vi) Legislative action should aim at **fostering cross-sectoral harmonisation**, which is key to making investor protection more efficient, coherent, and effective in the EU. From this perspective, **the identification of a set of fundamental principles on the protection of "users" of financial services,** to be included in a general "EU Charter" might be important in moving forward.

(vii) Discussions on the development of a ***corpus*** **of private law among Member States for financial law** are highly encouraged and crucial for the development of the CMU and to enhance retail investors' confidence in markets.

(viii) Clients' classification should be modernised. The distinction between retail and professional is not sufficient to capture the different types of investors in the market. **The creation of additional layers of client classification should be developed to include intermediate levels of investors**.

(ix) Client profiling and product governance obligations should be supported by **comprehensive measures on product mapping**. A suggestion, in this respect, is to **create rules developing more objective and accessible methodologies for product mapping**.

(x) Further public investments and **Union-wide policy measures to increase financial literacy in the CMU are crucial**.

1. INTRODUCTION AND OBJECTIVES

The scope of this study is to address the concerns raised by the European Parliament and especially its ECON committee concerning the development of the market for retail investments. It aims at analysing some of the most relevant rules and practices applicable to the functioning of EU capital markets, and to the protection of retail clients, identifying areas for improvement in order to increase their participation and protection. The purpose is to suggest further actions to support the achievement of the objectives of the CMU Action Plan[2], in particular the ones pursued through the Retail Investment Strategy[3].

The proposals set out therein – as finalised by the EC on May 24, 2023 - touch upon a number of elements including, among others:

(i) a possible new regulatory approach towards inducements;

(ii) the enhancement of rules addressing the digitalisation of capital markets and the need to improve investors' protection and confidence;

(iii) the opportunity to improve cross-sectoral integration to address legislative misalignments between, as well as quality and content of, disclosure rules;

(iv) the need to improve rules on product mapping;

(v) a (possible) reassessment of the current classification of professional and retail clients;

(vi) the need to enhance financial literacy.

Each of these topics is considered as a potentially useful area in which to develop strategies to foster and strengthen the implementation of the Retail Investment Strategy. Enhancing the transparency and intelligibility of the financial market, making it more user-friendly and easier to understand, the consideration of behavioural biases and financial illiteracy, the reduction of the many formal inconsistencies and overlaps between applicable rules are indeed key elements in this respect.

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2 EC, 2020a, *Communication on a Capital Markets Union for people and businesses – New Action Plan* (COM/2020/590), Publications Office of the European Union, Luxembourg, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2020%3A590%3AFIN (accessed 14 June 2023).

3 See EC, 2021, *Roadmap for a Retail Investment Strategy (Ref. Ares(2021)2651854, Publications Office of the European Union, Luxembourg*, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12755-EU-strategy-for-retail-investors_en (accessed 14 June 2023). This roadmap was followed by a first public consultation in May – August 2021. Many stakeholders, on the industry and consumer's side, called to simplify, improve, automate and standardise the way investors' profiles are currently assessed. Some have also expressed support for more focus on the overall investor portfolio composition rather than on individual products. A targeted second consultation was launched in February 2022.

2. GENERAL OBJECTIVES AND TIES WITH THE CMU PROJECT

The first CMU Action Plan[4], launched in 2015, set the goals to improve integration and remove cross-border barriers to investments and capital raising through the implementation of a complex set of legislative initiatives[5]. Subsequently to the Mid-term Review[6], conducted in 2017 to strengthen the CMU programme, a new Action Plan[7] was launched in September 2020. Upon that basis, the EC identified three core objectives to pursue[8], supported by a set of 16 actions. Within the context of the 2020 Action Plan, the EC envisaged the implementation of the Retail Investment Strategy, namely the enactment of a set of cross-sectoral initiatives and regulatory amendments aimed at enhancing investors' protection, fair treatment, and participation in capital markets, with a direct focus on retail investors.

Among the actions undertaken so far for the enactment of the Retail Investment Strategy, the EC collected ESMA's[9] and the European Insurance and Occupational Pensions Authority (EIOPA)'s[10] technical advice, presented in their final reports published on 29 April 2022. In particular, ESMA's technical advice focused on the need to improve disclosure and the use of digital tools and channels.

Among several recommendations, ESMA pointed out the opportunity to:

(i) support machine readability and higher standardisation of information subject to disclosure requirements;

(ii) adopt stricter guidelines on marketing communications and protection from aggressive marketing communications;

(iii) avoid information overload through a more effective communication of 'vital information';

(iv) align costs and charges disclosures between PRIIPs and other disclosure documents;

(v) enhance supervisory and intervention powers of national competent authorities (NCAs) in relation to online engagement practices and marketing campaigns, including the power to require firms to provide appropriate risk warnings; and

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4 EC, 2015, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan on Building a Capital Markets Union* (COM/2015/0468 final), Publications Office of the European Union, Luxembourg, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC0468 (accessed 14 June 2023).

5 For a broader, historical analysis, see Thomadakis, A., Lannoo, K., *Moloney, N., November 2022, Time to re-energise the EU's capital markets – Building investable and competitive ecosystems*, CEPS-ECMI Study, Centre for European Policy Studies, Brussels, available at: https://www.ceps.eu/ceps-publications/time-to-re-energise-the-eus-capital-markets/ (accessed 14 June 2023).

6 EC, 2017, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Mid-Term Review of the Capital Markets Union Action Plan* (COM/2017/0292 final), Publications Office of the European Union, Luxembourg, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017DC0292 (accessed 14 June 2023).

7 EC, 2020b, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions a Capital Markets Union for people and businesses-new action plan* (COM/2020/590 final), Publications Office of the European Union, Luxembourg, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2020:590:FIN (accessed 14 June 2023).

8 According to the Action Plan, the three key objectives are: (1) support a green, digital, inclusive and resilient economic recovery by making financing more accessible to European companies; (2) make the EU an even safer place for individuals to save and invest long-term; and (3) integrate national capital markets into a genuine single market.

9 ESMA, 2022, *Final Report on the European Commission mandate on certain aspects relating to retail investor protection* (ESMA35-42-1227), available at: https://www.esma.europa.eu/sites/default/files/library/esma35-42-1227_final_report_on_technical_advice_on_ec_retail_investments_strategy.pdf (accessed 14 June 2023).

10 EIOPA, 2022, *Final Report on Technical Advice to the European Commission regarding certain aspects relating to retail investor protection* (EIOPA-BoS-22/244), available at: https://www.dirittobancario.it/wp-content/uploads/2022/05/Final-Report-Technical-advice-on-Retail-Investor-Protection.pdf (accessed 14 June 2023).

(vi) address potentially damaging practices (such as payment for order flows (PFOF)).

On a similar note, EIOPA's technical advice addresses issues of disclosure, digitalisation, and perfecting of the sale process. EIOPA, amongst other topics, flagged up the need to enhance disclosure through increased cross-sectoral coordination, simplification, and further reliance on digital tools. In addition, EIOPA pointed to the benefits that would derive from higher cross-sectoral standardisation of rules governing the distribution of insurance products, as well as from a stricter approach towards inducements to avoid conflicts of interests. Lastly, EIOPA pointed out the need to improve the affordability of the sale process through, for instance, a simplified streamlining process and further supervisory convergence, together with the need to redesign and improve the coordination among the criteria to assess the 'complexity' of a product.

In relation to these issues, a report was requested by the EC, and was thus prepared by Kantar Public, in cooperation with Milieu and the Centre for European Public Studies - CEPS (the "**Report**")[11]. The Report, published on 2 August 2022 is entitled "Disclosure, inducements, and suitability rules for retail investors" and contains significant findings, some of which will be discussed in further depth throughout this study. In brief, with respect to disclosure, the Report points out several shortcomings - also recognised by the EC in its proposal for a Retail Investment Package - of the current regime, essentially consisting of:

(i) excessive complication in disclosure templates;

(ii) divergences in the timing of pre-contractual disclosure, coupled with the fact that information documents are not systematically provided to potential clients at an adequate stage;

(iii) insufficient reliance upon digital formats; and

(iv) lack of clarity, excessive complexity, and insufficient comparability of disclosures between different products and services.

Considering the highly debated topic of inducements and investment advice the Report finds that:

(i) the current rules on the disclosure of inducements are not directly relevant for consumers' choices[12];

(ii) consumers tend to follow the advice they receive even when the advice is bad, and they do so despite the different types of warnings/disclosures[13]; and

(iii) the introduction of independent advice rules under MiFID II does not seem to have increased independent advice[14].

Lastly, the Report conducts an overview of suitability assessments, and notes that:

(i) the relevance of the assessment decreases when done late in the relationship, whereby there is a clear tendency on the market to perform the client's profile screening close to the moment of execution of the contract, as opposed to the initial stage[15];

[11] Uličná, D., Vincze, M., Mosoreanu, M.et al., 2023, *Disclosure, inducements, and suitability rules for retail investors study – Final report, Publications Office of the European Union*, Luxembourg, available at: https://data.europa.eu/doi/10.2874/459190 (accessed 14 June 2023).

[12] Report, pp. 22-23.

[13] Report, p. 25.

[14] Report, p. 24.

[15] Report, p. 29 and p. 326.

(ii) there is great variety among the depth and timing of the suitability assessment[16]; and

(iii) it is complex to achieve a satisfactory level of cost-effectiveness of the screening process.

Following the reception of the commissioned studies and responses from the public consultations, on 24 May 2023 the EC adopted a Retail Investment Package based on the CMU Action Plan's objective to "make the EU an even safer place for citizens to invest in the long term". The package comprises:

(i) the Omnibus Directive Proposal, which purports to amend the rules set in MiFID II, IDD, UCITSD, AIFMD and Solvency II[17]; and

(ii) a proposal for a Regulation amending the PRIIPs Regulation, aiming to improve the legal regime for PRIIPs by adapting disclosures to the digital environment and to sustainability matters, and by providing further clarity on the scope of the PRIIPs[18].

The main aspects of the Retail Investment Strategy will be considered in this study, but a particular focus will be placed on those aspects that are currently being discussed".

16 Report, p. 30.

17 EC, 2023, *Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules* (2023/0167 (COD)), available at: https://ec.europa.eu/finance/docs/law/230524-proposal-omnibus-directive_en.pdf (accessed 24 May 2023).

18 EC, 2023, *Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1286/2014 as regards the modernisation of the key information document* (2023/0166 (COD)), available at: https://ec.europa.eu/finance/docs/law/230524-proposal-priips-regulation_en.pdf (accessed 24 May 2023).

3. LEVEL OF PARTICIPATION OF RETAIL INVESTORS IN FINANCIAL MARKETS

The existing level of involvement and participation of retail investors in financial markets is, currently, quite low. According to the findings of the Report, just over a quarter (28%) of the population of banked citizens in the 10 countries covered by its survey[19] have already invested in financial products, while another quarter of respondents were actively looking to invest (11%) or interested in investing their savings (14%). However, nearly a quarter of respondents (23%) were not interested in making financial investments, despite having savings. For this segment, the Report concludes that "measures other than disclosure or advice would be needed if the policy intention is to make investments more attractive to them as those only reach the population who is already looking into investments"[20]. As we will try to demonstrate, it is difficult not to agree with this statement.

Europe has one of the highest individual saving rates in the world[21], with households from the euro area setting aside about 12.4% of their gross disposable income on average, between the years of 2013 and 2019[22]. For reference, in the same period, retail investors in the US have saved around 7.2%. of their income[23]. Yet, despite such high level of savings, the rate of retail investor participation falls short when compared to markets in the US or other developed markets. To understand the reasons for such a divergence, experts identify three main drivers of retail investment in economies:

(i) financial literacy;

(ii) the maturity of capital markets; and

(iii) the pension system[24].

Participation of retail investors in financial markets is also strictly connected to the broader notion of "financial inclusion", which can be defined as "the process of ensuring affordable, prompt and adequate access to a wide range of financial products and services, as well as proliferation of their use in all parts of society with a special focus on vulnerable groups, through the implementation of existing and innovative approaches, such as financial literacy programmes"[25]. Financial inclusion combines elements such as financial education or literacy, and consumer protection, both of which contribute to a more responsible and active participation of retail financial consumers in financial markets. In

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19 Accordingly, Sweden, Finland, Italy, Spain, Germany, France, Netherlands, Romania, Poland and Greece.

20 Report, p. 10.

21 EUROFI, 2022, *Retail investment: opportunities, challenges and EU policy proposals*, EUROFI Regulatory Update, available at: https://www.eurofi.net/wp-content/uploads/2022/05/eurofi_retail-investment_opportunities-challenges-and-eu-policy-proposals_paris_february-2022.pdf (accessed 23 May 2023).

22 Eurostat, 2021, *Quarterly sector accounts – households*, available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Quarterly_sector_accounts_-_households (accessed 14 June 2023).

23 Federal Reserve Economic Data, 2023, *Personal saving as a percentage of disposable income*, available at: https://fred.stlouisfed.org/series/A072RC1Q156SBEA (accessed 23 May 2023).

24 EUROFI, 2022, *Retail investment: opportunities, challenges and EU policy proposals*, EUROFI Regulatory Update, available at: https://www.eurofi.net/wp-content/uploads/2022/05/eurofi_retail-investment_opportunities-challenges-and-eu-policy-proposals_paris_february-2022.pdf (accessed 23 May 2023).

25 Gortsos, C., 2016, *Financial inclusion: an overview of its various dimensions and the initiatives to enhance its current level*, ECEFIL Working Paper Series No. 15, available at: https://ssrn.com/abstract=2715625 (accessed 16 May 2023). The concept of financial inclusion is often mentioned by international policy documents, especially from the OECD and the United Nations. See, for example, OECD, 2005, *Recommendation of the Council on Principles and Good Practices on Financial Education and Awareness*, available at: http://publications.europa.eu/code/en/en-000500.htm (accessed 16 May 2023); OECD/INFE, 2020, *International Survey of Adult Financial Literacy*, available at: https://www.oecd.org/financial/education/oecd-infe-2020-international-survey-of-adult-financial-literacy.pdf (accessed 16 May 2023); Imoboden, K., Herman, B., Petkoski, D., 2005, *Building inclusive financial sectors for development. widening access, enhancing, growth, alleviating poverty*, available at: https://www.un.org/esa/ffd/wp-content/uploads/2014/10/se-msc2005-Report-WBI.pdf (accessed 16 May 2023).

particular, financial literacy aims to ensure that consumers (in the present context, retail investors) are placed in a position to better understand the function, opportunities and risks involved in financial products[26]. This will be further discussed in Section 10 below.

Regarding the maturity of capital markets, factors in play are variegated and stem from different sources: for example, geopolitical, historical, social-demographic and cultural elements are decisive in defining the structure and characteristics of capital markets. Legislative and regulatory measures are, in this sense, only effective insofar as they are able to correctly identify underlying causes and, accordingly, to steer trends and behaviours towards the desired outcomes. The following sections contain proposals of initiatives and reforms aiming to contribute to addressing the shortcomings identified in the existing rules. Measures to increase participation of retail investors in financial markets can also benefit from some lessons learnt from other jurisdictions – most notably, the United States – and include, among others, further stimulus to improve financial literacy, drastic simplification and clarification of disclosure documents, as well as modernisation of rules in digital contexts. Even though comparison with other systems can be tricky to make, as it is influenced by profound differences in the socio-economic background, these and other measures shall also be touched upon in the following paragraphs.

[26] See, *ex multis*, Ambuehl, S., Bernheim, B.D., Lusardi, A., 2014a, *Financial education, financial competence and consumer welfare*, Global Financial Literacy Excellence Center (GELEC) Working Paper Series No 2014-4, available at: https://ssrn.com/abstract=2585219 (accessed 15 May 2023); Ambuehl, S., Bernheim, B.D., Lusardi, A., 2014b, *The effect of financial education on the quality of decision making*, NBER Working Paper Series No 20618, available at: https://www.nber.org/papers/w20618 (accessed 16 May 2023); Brugiavini, A., Cavapozzi, D., Padula, M., Pettinicchi, Y., 2015, *Financial education, literacy and investment attitudes*, Network for Studies on Pensions, Aging and Retirement (NETSPAR) Discussion Paper No 06/2015-014, available at: https://ssrn.com/abstract=2572297 (accessed 16 May 2023).

4. INDUCEMENTS

Inducements is one of the main areas where EU legislation has, over time, introduced extensive regulation, and also one where the current debate is vivid and articulated.

The subject of inducements first appeared in the context of the 2004 MiFID Directive[27]. Already at the time[28], the issue as to how consider and, eventually, specifically regulate inducements was not entirely new, since inducements could in part be regarded as falling within the scope of the rules on conflicts of interest. The receipt by the intermediary of a fee, commission or other benefit paid to it by parties other than the investor could, in fact, give rise to conflicts of interest, thereby being subject to relevant rules, whose origins could already be found in the context of the Investment Services Directive (ISD) of 1993[29]. Conflicts of interest may arise from the possibility that inducements might distort the conduct of investment services providers, in case they are directing investment choices towards entities whose products or services are not offered or provided in the best interest of the client. A typical example is the distribution of products by networks that are remunerated by product companies through rebates or similar mechanisms. Inducements also have broader impacts: for instance, in relation to the execution of orders, inducements may lower the level of the quality of execution, thus impacting on best execution. Because of the inducements received, orders might be directed to brokers that offer lower quality of execution. Inducements also impact upon the transparency of the costs of the services provided to investors, regardless of whether this also implies conflicts of interest.

Similar problems arise in relation to inducements not received but paid by the intermediary to third parties: for instance, the intermediary might pay other providers, for services that are not provided in the best interest of the client, but in relation to which the intermediary itself receives advantages or benefits.

For several Member States, the introduction of the inducement regime by MiFID I marked a significant break with the past, with far-reaching consequences. In fact, rules on inducements call into question forms of remuneration of intermediaries that have been, since long, widely diffused on the market, starting with the remuneration of placement services (generally not paid by the investor, but by the product company in many Member States), up to the fee structures of various services, including the execution of orders and associated investment research.

After MiFID I, rules on inducements were widened and strengthened by MiFID II. The current regime considers inducements with suspicion. In the current debate on inducements, it is sometimes understated that the basic rule laid down in Article 24(9) MIFID II is that inducements are *prohibited* unless they fall under one of the exceptions provided for in the Directive[30].

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[27] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145 , 30/04/2004 P. 0001 – 0044).

[28] The topic of inducements has been extensively analysed in literature. See, *ex multis*, Palazzo, G., Rethel, L., 2008, *Conflicts of Interest in Financial Intermediation, Journal of Business Ethics*, Vol. 81, Iss. 1, p. 193 ff., available at: https://www.jstor.org/stable/25482205 (accessed 14 June 2023); Casey, J.P., Lannoo, K., *The MiFID Revolution*, Cambridge University Press, Cambridge, 2009, pp. 115–116. See also Papaconstantinou, A.G., 2016, *The Regime of Inducements in MiFID II and the Member States' Struggle for Fairness, European Review of Contract Law*, 2016, Vol. 12, Iss. 4, p. 356 ff, available at: https://ssrn.com/abstract=3299630 (accessed 14 June 2023); Kumpan, C. Grütze, R., *Chapter II: Operating conditions for investment firms*, in Lehman, M. Kumpan, C. (eds.), European Financial Services Law: Article-by-Article Commentary, Beck-Hart-Nomos. Baden-Baden, 2019.

[29] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (OJ L 141, 11.6.1993, pp. 27–46).

[30] The rules on inducements are further elaborated in Articles 11 to 13 of the EC Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits (OJ L 087 31.3.2017, p. 5 (the "MiFID II Delegated Directive").

The first exception are inducements paid by or to the client, since there is no influence exercised by a third party which could potentially lead to the investment firm not putting the client's interests first.

Other exceptions occur where the inducement is provided by - or to - a third party, if

(i) the payment or benefit is designed to enhance the quality of the relevant service to the client; and

(ii) the payment of the inducement does not impair compliance with the investment firm's duty to act honestly, fairly and professionally in accordance with the best interests of its clients[31].

This is the so-called "enhancement test" which is usually met either with:

(i) the possibility, given to the investor, of accessing a broad range of services/products, or

(ii) with the provision of investment advice or post-sale services. Article 11(2) to (4) of the MiFID II Delegated Directive specifies the conditions that must be met for the fee, commission or non-monetary benefit to enhance the quality of the service to the client.

Finally, another exception applies to payments or benefits which enable or are necessary for the provision of investment services, such as custody costs or settlement and exchange fees, and which by their nature cannot give rise to conflicts with the investment firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients.

In any case, Article 24(9) of MiFID II requires that firms comply with specific disclosure requirements. The relevant provisions are comprehensive, and disclosure is a cornerstone element of inducements regulation by MiFID II. First of all, the existence, nature and amount of the payment or benefit, or, where the amount cannot be ascertained, the method of calculating that amount must be clearly disclosed to the client. In this respect, disclosure must be done in a manner that is "comprehensive, accurate and understandable", and prior to providing the relevant investment or ancillary services. Where applicable, the investment firm shall inform the client on mechanisms for transferring to the client the fee, commission, monetary or non-monetary benefit received in relation to the provision of the investment or ancillary service. In relation to certain services (i.e., portfolio management) inducements must in any case be passed on to the client; in other services (investment advice) they are subject to further limitations and are entirely prohibited in the context of independent advice[32].

Under MiFID II, the rules on inducements paid by a third party to a portfolio manager or investment advisor now apply both to retail and professional clients[33].

Concerns over the broad use of inducements essentially revolve around investors' protection: critiques of inducements practices usually point to the fact that distributors seeking a more favourable remuneration could neglect clients' best interests and product suitability, thus resulting in low-quality investment products, unduly costs being charged, poor asset allocation, the provision of biased investment advice, and even mis-selling[34].

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[31] Article 24(9) MiFID II. See also ESMA, 2020, *Technical Advice on the Impact of the Inducements and Costs and Charges Disclosure Requirements Under MiFID II*, available at: https://www.esma.europa.eu/sites/default/files/library/esma35-43-2126_technical_advice_on_inducements_and_costs_and_charges_disclosures.pdf.

[32] The disclosure requirements are further detailed under Article 11(5) of the MiFID II Delegated Directive, which requires both ex-ante and, in certain cases, ex-post disclosures of permitted inducements.

[33] Article 24(7)(b) and Article 24(8) MiFID II. See also Busch, D., 2017, *MiFID II: Stricter Conduct of Business Rules for Investment Firms*, Capital Markets Law Journal, Vol. 17, Iss. 3, p. 340 ff.

[34] See Armour, J., Awrey, D., Davies, P., Enriques, L., Gordon, J., Mayer, C., Payne, J., *Principles of Financial Regulation*, Oxford University Press, Oxford, 2016, at 239; Hackenthal, A., Inderst, R., Meyer, S., 2010, *Trading on Advice*, CEPR Discussion Paper No. DP8091, available at: https://papers.ssrn.com/sol3/paperscfm?abstract_id=1701777 (accessed 18 May 2023); Perrone, A., *Per un ripensamento della disciplina sugli*

Although inducements are foreseen as an exception regime under MiFID II, in the markets for investment services, they are still an existing and considerable reality in significant parts of the EU market, which essentially points to the fact that the market regards inducements as a structural element, which in substance is in line with market standards[35].

Principles introduced in the context of investment services were also adopted in other sectors of EU legislation, most notably in the distribution of insurance products. Indeed, in the insurance market, inducements have always been widely used and MiFID standards were taken up in that area by the IDD. However, the rules on inducements established by the IDD are not exactly like those found in MiFID II, since they result in a relatively laxer regime, albeit inspired by common general principles. In particular, the IDD is based on the so-called "detrimental impact" test[36], which is not equivalent to the enhancement test.

More specifically, the quality enhancement test under MiFID II differs from the detrimental impact test applied in the IDD in several ways. In the former, the following result in an additional or higher level service to the relevant client:

(i) the provision of non-independent investment advice, as well as access to a wide range or suitable financial instruments, including instruments from a third party; and

(ii) the provision of non-independent investment advice combined with either (a) an offer to the client to assess the continuing suitability of the financial instruments; or (b) with another ongoing service about the optimal asset allocation of the client; or (c) the provision of access to a wide range of financial instruments that are likely to meet the needs of the client, including instruments from third-party product providers.

In contrast, under the IDD's "detrimental impact" regime, the following elements need to be verified:

(i) whether the inducement could provide an incentive to the insurance intermediary/undertaking to offer/recommend an insurance product/service to the client despite the fact that another insurance product or service would better meet the client's needs;

(ii) whether the inducement is mainly based on quantitative commercial criteria/whether it takes into account appropriate qualitative criteria (such as compliance with applicable regulations, the quality of services provided, client satisfaction);

(iii) the value of the inducement paid in relation to the value of the product/service;

(iv) whether the inducement is paid at the conclusion of the contract or is extended for the whole term of that contract;

(v) the existence of a mechanism for reclaiming the inducement; and

(vi) the existence of any form of contingent threshold unlocked by "attaining a target based on volume or value of sales".

inducements, Banca borsa e titoli di credito, Vol. 69, Iss. 2, p. 129 ff., at 137; Lanoo, K., Casey, J.P., *The MiFID Revolution*, Cambridge University Press, Cambridge, 2009, p. 115. For a discussion in the US, see Krug, A.K., 2018, *Investors' Paradox*, Journal of Corporation Law, Vol. 43, Iss. 2, p. 245 ff.

35 The study shows that, albeit in principle prohibited, inducements are applied in 40% of cases, to the extent that information is disclosed. The inducements are on average 0.7% per annum, or 45% of the ongoing costs charged to the retail investor, making such products 25% more expensive. There is no evidence of a possible decline in inducements.

36 Article 8(2), second subparagraph of IDD Delegated Regulation.

According to some authors, the above differences are mostly justified by the different nature of the product offered, as well as by market structures[37]. Such differences stem from the sectoral approach applied for insurance and investments: however, from a retail investor's perspective, sectoral differences and inducements regimes should not matter so much, at least not when the product provided is not so different from a risk/return perspective (i.e. insurance-based investment products vis-à-vis investment funds)[38]. Moreover, as shown by the Report, there is no clear evidence as to the fact that rules on inducements effectively lead to an advantage for investors in terms, for instance, of the quality of the service they receive[39].

Recently, the discussion has been therefore revolving around a possible revision of the current regime, including the introduction of an outright ban on inducements. In the context of the revision of MiFID II and of the Markets in Financial Instruments Regulation (MiFIR), amendments concerning the ban on the payment of inducements have indeed been considered by the EC[40] and are being discussed by Members of the European Parliament (MEPs)[41]. These positions have sparked a very high volume of comments, and have also drawn massive criticism, which clearly show how sensitive this issue can be.

A common argument put forward by distributors and manufacturers is that a full inducement ban would result in an advice gap because most consumers are not willing to pay for advice[42]. This argument suggests that the ban would result in lower participation of retail investors in the market and in lower levels of investment.

The experiences in the UK[43] and the Netherlands[44] suggest that access to advice has indeed declined once inducements were banned. This led to an increase of execution-only services and resulted in less

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37 See Colaert, V., *MiFID II in Relation to Other Investor Protection Regulation: Picking Up the Crumbs of a Piece-meal Approach*, in Busch, D., Ferrarini, G. (eds.), Regulation of the EU Financial Markets – MiFID II and MiFIR, Oxford University Press, Oxford, 2017, at 596.

38 Report, p. 253.

39 Report, pp. 243-244.

40 See, for example, the Opening remarks by Commissioner McGuinness at the Structured Dialogue with the European Parliament's ECON Committee of 24 January 2023, available at: https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_23_328 (accessed 18 May 2023). See also the Impact Assessment Report accompanying the EC's proposal for the Omnibus Directive: EC, 2023, Impact assessment report (COM(2023) 278-279 final).

41 Hübner, D.M., 2022, *Amendments 314-465, Draft Report, Amending Regulation (EU) No 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders - Proposal for a regulation*, Committee on Economic and Monetary Affairs, European Parliament, Luxembourg, available at: https://www.europarl.europa.eu/doceo/document/ECON-AM-737442_EN.pdf (accessed 18 May 2023). On October 8, 2020, the European Parliament had already issued a resolution on the developments of the Capital Markets Union (https://www.europarl.europa.eu/doceo/document/TA-9-2020-0266_EN.html), that also addressed the topic of inducements, calling "for amendments to legislation to ensure access to independent advice by financial intermediaries without undue promotion of the financial products manufactured 'in-house', and with a thorough assessment of products from a range of manufacturers, and to ensure a fair and transparent marketing of financial products" (par. 51).

42 See Report, p. 292.

43 See the FCA's *Financial Advice Market Review* (FAMR) of 2016, available at: https://www.fca.org.uk/publication/corporate/famr-final-report.pdf (accessed 18 May 2023); FCA, 2007, A Review of Retail Distribution, available at: http://www.fca.org.uk/. See also McMeel, G., 2013, *The Retail Distribution Review and the Ban on Commission Payments to Financial Intermediaries*, Saint John's Law Review, Vol. 87, Iss. 2, pp. 595 ff.; Papaconstantinou, A.G., 2016, *The Regime of Inducements in MiFID II and the Member States' Struggle for Fairness*, European Review of Contract Law, 2016, Vol. 12, Iss. 4, p. 356 ff.

44 Art. 168a of the Dutch Market Conduct Decree prohibits the collection of any inducement associated with the provision of investment services to retail clients (see Cherednychenko, O.O., 2014, *Freedom of Contract in the Post-Crisis Era: Quo Vadis?,* European Review of Contract Law, Vol. 10, Iss. 3, p. 390 ff., at 401; Silverentand, L., Sprecher, J., Simons, L., Inducements, in Busch, D., Ferrarini, G. (eds.), *Regulation of the EU financial markets – MiFID II and MiFIR,* Oxford University Press, Oxford, 2017. See also *Directie Financiële Markten, 2018, Betreft evaluatie provisieverbod, Ministerie van Financiën*, available at: http://decisio.nl/wpcontent/uploads/kamerbrief-evaluatie-provisieverbod.pdf (accessed 18 May 2023); Center Data Research Institute, 2018, *Consumenten en financieel advise. Consumentenonderzoek in het kader van de evaluatie van het provisieverbod*, available at: https://www.eerstekamer.nl/behandeling/20180123/brief_regering_evaluatie/info (accessed 18 May 2023); Decisio, November 2017, *Zakelijker verhouding – de markteffecten van het provisieverbod*, Ministerie van Financiën, available at: http://decisio.nl/wp-content/uploads/Decisio-Periscoop-EvaluatieProvisieonderzoek-Definitief.pdf (accessed 18 May 2023); PwC, September 2017, *The Dutch Disadvantage?*, available at: https://www.pwc.nl/nl/assets/documents/pwc-the-dutch-disadvantage.pdf (accessed 18 May 2023); AFM, July 2017, *Rapport - Naleving provisieverbod financiële dienstverlening,* available at: https://www.afm.nl/nl-nl/nieuws/2015/

complex products, with a consequent decrease of costs for retail investors[45]. Moreover, in both jurisdictions, the ban on inducements did not result in less investment[46]. Notwithstanding such results, literature and stakeholders have expressed the opinion that a full ban of inducements may pose harm to free market initiative and affect price formation mechanisms, especially in Member States where the practice is deeply rooted in national markets' culture and functioning[47].

In the context of the Omnibus Directive Proposal, the EC ultimately decided to refrain from including a full ban on inducements in its legislative proposal. Instead, it proposed a staged approach (to be revised in the future), which allows operators to adjust their distribution systems over time. The immediate measures proposed include:

(i) a prohibition of the payment of inducements in execution-only environments where no advice is provided;

(ii) a strengthened 'best interest of the client' principle applied in both MiFID II and the IDD; and

(iii) improved disclosure to the client regarding the payment of inducements, including a simple explanation of inducements.

More specifically, the Omnibus Directive Proposal would require Member States to ensure that, in order to act in the *best interest* of their clients or customers, financial advisors shall at least

(i) base their advice on an assessment of an appropriate range of financial products;

(ii) recommend the most cost-efficient financial product from the range of suitable financial products; and

(iii) offer at least one financial product without additional features which are not necessary to the achievement of the client's investment objectives and that give rise to additional costs, in order to provide retail investors with more alternatives and possibly cheaper options.

Under the above proposal, three years after the date of entry into force of the amended Directive, the EC, after having consulted ESMA and EIOPA, will assess the effects of the new inducements rules on retail investors and evaluate whether an extension of a ban on inducements should be put in place.

Considering the current debate, often unduly polarised on the "inducement yes/no" discussion, there seems to be two areas to be carefully re-considered. The first relates to the substantial rules on inducements; the second is on disclosure.

a) Substantial rules

Concerning how substantial rules on inducements are currently drafted, and how they might be improved, even with the introduction of the new test proposed by the EC, the impression that one gathers is that the discussion is somehow out-of-focus. Rather than simply concentrating on the alternatives between allowing or prohibiting inducements, what legislation should ultimately ensure is that investors are able to effectively understand and evaluate whether, in a certain context or transaction, they are indeed being provided with some kind of "support" for their investment decisions

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juli/rapportprovisieverbod (accessed 18 May 2023); AFM, July 2015a, *Rapport - Naleving provisieverbod financiële dienstverlening*, available at: https://www.afm.nl/~/profmedia/files/rapporten/2015/naleving-provisieverbod.pdf; AFM, July 2015b, Marktbeeld Beleggen, available at: https://www.afm.nl/~/profmedia/files/doelgroepen/beleggingsondernemingen/2015/marktbeeld-beleggen.ashx (accessed 18 May 2023).

[45] See Report, pp. 25-26 and p. 292 ff.

[46] See Report, p. 298.

[47] See, *ex multis*, Insurance Europe, December 2022, *Position on inducements (COB-DIS-22-171),* available at: https://insuranceeurope.eu/publications/2799/position-on-inducements%20 (accessed 19 May 2023).

or not, and, if so, what this support effectively consists of. The disclosure of the costs embedded in the inducement structure is certainly important but should not overshadow the substance of providing full transparency on the kind of service provided (and of any possible alternatives). The impression one might get is that the debate on cost transparency sometimes overshadows the one on the quality and nature of the services provided.

In this respect, firstly, a broad definition of investment advice should be adopted, wider and more articulated than the current definition of advice under MiFID II. The rather strict and technical definition of investment advice provided by MiFID, associated with rules on inducements, is not sufficient to cover those situations where an investor is receiving some kind of support, or is being directed in his/her investment decisions, without actually being offered a specific, suitable investment recommendation as (narrowly) defined by MiFID II.

What we believe to be important is that the client is made aware of what kind of support he/she is receiving. The client should also be in a position to choose freely between different options: high-quality personalised advice (resulting in a higher level of costs, and inducements); generic advice; post-sale services, etc., or a combination of the above. Each of these different service models should be priced differently, to reflect the different levels of assistance provided. Alternatively, if only one option is offered to the clients – as investment firms should not be obliged to necessarily develop different business models - this ought to be made clear beforehand, so that the client is aware that only one kind of service/support is being provided. Disclosure of inducements should naturally follow, without overshadowing the need to make the client fully aware of what kind of assistance it is indeed receiving.

The quality of the assistance/advice provided should be the focus of the debate: investors might not be interested so much in knowing whether the firm receives inducements, or what is their amount, but would, instead, be quite interested in understanding "how much" advice they are receiving, and what the effective depth of that advice is: e.g. a fully-fledged, personalised recommendation, or a high level assistance, or something in-between (such as a mere asset allocation, without reference to any specific financial instrument). These different kinds of "advice" should be considered by the regime on inducements, leading, at the same time, to potentially different levels of remuneration to be considered for the service provided. The strict correlation that seems to be central to the current debate between inducements and proper investment advice should be constructed in a broader way, and more attention should be paid as to the different kinds of "advice" and "support" that investors might receive in a certain context/transaction. Disclosure to investors, and clarification as to what kind of support they are receiving, should be of paramount importance, probably as much, if not more, than the mere disclosure of the amount paid or received as an inducement. The dualistic perception of investment advice and inducements needs therefore to be replaced by a broader notion and a range of possible services provided to clients. In this respect, post-sale assistance should also continue to be taken into account in the enhancement test.

Another potential area to be addressed is the provision of "access to a wide range of suitable financial instruments". It is the second parameter for the current enhancement test under MiFID II which is not linked to investment advice being effectively provided. As already recalled above, this is an alternative to investment advice in relation to the enhancement test[48]. Even though the rationale of this rule is understandable, it has at least two flaws: on the one side, it is unclear, as there are different ways to understand the notion of "broad range", thus resulting in different levels of services being provided to investors and different levels of protection. Actually, there is also no sufficient evidence that the mere fact of having access to a broad range of services effectively leads *per se* to a higher level in the quality

[48] See Article 11(2)(a)(i) EC Delegated Directive (EU) 2017/593.

of the service provided. There is room either for clarifying/improving this rule, or even to consider its elimination.

b) The disclosure regime for inducements

A second area for improvement relates to disclosure. The effectiveness of disclosure of inducements to clients should be improved. Recent surveys have shown that most investors do not understand the concept of inducements and are primarily concerned with the overall product costs rather than the costs associated with inducements[49]. This actually leads back to what was considered in the previous paragraph in terms of clarifying what is the context in which the client is operating (fully-fledged advice; generic support; mere provision of information, etc.). Surveys indicate that investors do not understand the concept of inducements[50], and information documents rarely refer explicitly to inducements[51]. Clients, in fact, often assume that advice is free and are not even aware of conflicts of interest in advice[52]. The disclosure of inducements, therefore, should be profoundly redesigned in order to attain the fundamental objectives of the rules on inducements: to make consumers effectively aware of costs and prices. Disclosure rules should also consider the need to facilitate comparability among different products and services.

Concerning the abovementioned proposals by the EC on inducements in the Omnibus Directive, there seems to be an intention to directly regulate mechanisms of price formation, with the view that "[s]ome retail investment products on the market still incorporate unjustifiably high costs and/or do not offer value to retail investors"[53].

However, such an approach may risk failing to address the actual problem faced by retail investors with respect to inducements, as we tried to illustrate above, as it places an excessive accent on costs. Instead of intervening directly in the market's pricing structure and recurring to notions such as "high costs" - which can be broad and variable, causing legal uncertainty and imprecisions – legislation should be focused on ensuring that retail investors properly understand the products and services that are being offered, allowing them to reasonably decide whether they should or should not take a certain investment decision. There is also the potential danger that the EC's approach leads to the market moving towards a common benchmark or standard, stifling financial innovation: benchmarking against a single parameter/test might lead to undue rigidities in the market.

Ultimately, looking at costs *per se* is not sufficient: costs are strictly related to the nature, characteristics and risk/return profiles of the investments and, without more clarity on the classification and mapping of products (an issue that the EC's proposal does not take properly into account, save – probably – for "high-risk products"), these proposals do not seem to properly address the real issue. More on that below.

49 See Report, p. 22.

50 See Report, pp. 248-249.

51 See Report, p. 262: "The information documents analysed rarely contain explicit information about inducements. It is necessary to search for information about inducements in other types of documents and even there this information is not provided in a clear and direct manner. Inducements are also frequently not disclosed during client conversations as observed during the mystery shopping exercise".

52 See, for example, Report, p. 295.

53 See EC, Omnibus Directive Proposal, pp. 6-7.

5. DIGITALISATION

Digitalisation of financial markets has been steadily increasing over the past years, including in the area of investment services. According to the Report, for instance: "Some 14% of respondents stated that they had received digital advice. When asked about the more granular sources of advice, we see that 12% say they received advice or guidance through a robo-advisor, web-comparator or equivalent. In other words, while digital advice (or digital means to search and select products) still concerns a minority, it is not negligible, as today more than 1 in 10 investors/aspiring investors use it. The share of consumers using digital sources to select products is particularly high in Poland (22%) and Romania (19%), while it is low in Italy (7%)"[54].

Digitalisation[55] can impact retail investors in different ways, from the simple automatisation of transactions through online platforms, to robo-advice and new types of financial products and services offered in the digital context, such as crypto-assets[56].

Service providers have embraced digitalisation by enlarging the range of products and services offered, and by innovating the ways customer relationships are managed, e.g. through the use of mobile apps, automation and self-learning technologies.

Digitalisation may provide several advantages to markets and investors. A first advantage offered by the increased digitalisation of the financial market lies in the speed and efficiency of the services provided, potentially leading to a reduction in costs. A larger share of population may thus benefit from cheaper access to financial services and products.

Moreover, digitalisation favours a transformation in the mechanisms of customer value creation by allowing for the emergence of new players and, most notably, a more direct and empowered participation by the clients themselves in the financial market[57].

However, digitalisation also creates new risks for consumers and investors[58]. Aside from well-known risks, such as operational and cybersecurity risks, which are threats not only to capital markets, but rather to the entire financial system, an added risk arising from digitalisation concerns in particular retail investors. It stems from the so-called "gamification" of investment and trading activities through online platforms[59]. In essence, gamification is the practice of infusing game-like elements into non-game contexts to encourage engagement with a product or service[60]. It is a technique that has been

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54 Report, p. 230.

55 See, *ex multis*, Böffel, L., Schürger, J. (eds.), *Digitalisation, Sustainability, and the Banking and Capital Markets Union: Thoughts on Current Issues of EU Financial Regulation*, Palgrave Macmillan, London, 2023.

56 See Macchiavello, E. (ed.), *Regulation on European Crowdfunding Service Providers for Business: A Commentary*, Edgar Elgar Publishing, Cheltenham, 2022.

57 Lähteenmäki, I., Nätti, S., Saraniemi, S., 2022, *Digitalization-enabled evolution of customer value creation: An executive view in financial services*, Journal of Business Research, Vol. 146, 504 ff, available at: https://www.sciencedirect.com/science/article/pii/S0148296322003320/pdf (accessed 14 June 2023).

58 See, among others, Barefoot, J.A., 2020, *Digital Technology Risks for Finance: Dangers Embedded in Fintech and Regtech*, Harvard Kennedy School M-RCBG Associate Working Paper Series No. 151, available at: https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/AWP_151_final.pdf (accessed 14 June 2023).

59 See CFA Institute, 2022, *Fun and Games: Investment Gamification and Implications for Capital Markets*, available at: https://www.cfainstitute.org/en/research/industry-research/investment-gamification-implications. See also Ljungkvist, H., Moore, M., 2022, *Gamification and its effect on investor behaviour: a qualitative study investigating the gamified trading platform Avanza*, Umea School of Business Economics and Statistics, available at: https://www.diva-portal.org/smash/get/diva2:1676541/FULLTEXT01.pdf (accessed 20 May 2023).

60 See, *ex multis*, Huotari, K., Hamari, J., October 2012, *Defining Gamification—A Service Marketing Perspective*, MindTrek '12: Proceeding of the 16th International Academic MindTrek Conference, pp. 17–22, available at: https://dl.acm.org/doi/10.1145/2393132.2393137 (accessed 14 June 2023).

employed in a variety of settings, including education and healthcare, and which is now being adopted in financial markets.

ESMA's final report on retail investor protection[61] discusses the risks and benefits of gamification techniques: while, on the one hand, they offer the potential of simplifying investment processes, thereby expanding the access to financial products and fostering engagement, on the other hand, gamification can unduly influence the behaviour of unexperienced investors[62]. Specifically, gamification may nudge investors towards the adoption of more aggressive investment choices, may induce trading in complex or high-risk products by unexperienced investors, and may encourage harmful behaviours[63].

Different aspects of digitalisation are being discussed in the prevailing and burgeoning literature on the topic[64]. This paper, we believe, is not the proper venue to conduct a full overview of such a wide and articulated debate, which, by the way, is not limited to the EU context. However, one point needs to be raised: retail investors may not understand appropriately the risks arising from digitalisation, nor how to properly use new technologies. These many difficulties include not fully understanding the role of machines *vis-à-vis* the human component, such as in robo-advice[65], those that relate to the use of digital interfaces used for taking investment decisions (such as trading platforms), or to the interaction between the machine and the human being in an automated communication system, such as chats. It is equally relevant to understand how artificial intelligence and machine learning are being employed, and what their potential but also limitations in a digital context are.

In this context, we herewith propose the introduction of a new "digital suitability" test, as a way to directly enhance the level of protection of retail investors in the digital context, before they actually have access to digital services and platforms (in particular, the ones that may induce gamification processes). This test would aim at assessing the knowledge and awareness that the investor has in relation to the financial digital context, its basic instruments and dynamics, and would be required before the investor is allowed to interact with digital financial instruments. Depending on the kind of platform or service that is being accessed, the test should focus on different aspects. For instance, in relation to using robo-advisory, an investor should at least be requested to show that he or she understands that the service is being provided thorough automated systems, with little or no human

61 ESMA, 2022*, Final Report on the European Commission mandate on certain aspects relating to retail investor protection*, p. 41 ff, available at: https://www.esma.europa.eu/sites/default/files/library/esma35-42-1227_final_report_on_technical_advice_on_ec_retail_investments_strategy.pdf (accessed 14 June 2023).

62 An example of how gamification is strictly related to digital finance is found in crypto-asset exchanges. Interestingly, certain UK legislators are now considering to regulate crypto-assets similarly to online gambling (see Jones, H., May 2023, *Crypto should be regulated as gambling, UK lawmakers say*, Reuters, London, available at: https://www.reuters.com/technology/crypto-should-be-regulated-gambling-uk-lawmakers-say-2023-05-16/ (accessed 21 May 2023).

63 See, *ex multis*, Weinmann, M., Schneider, C., Vom Brocke, J., 2016, *Digital Nudging, Business & Information Systems Engineering,* Vol. 58, p. 433 ff.; Özdemir, S., 2020, *Digital Nudges and Dark Patterns: The Angels and the Archfiends of Digital Communication*, Digital Scholarship in the Humanities, Vol. 35, Iss. 2, p. 417 ff.; Chapkovski, P., Khapko, M., Zoican, M., 2021, *Does Gamified Trading Stimulate Risk Taking?*, Swedish House of Finance Research Paper No. 21-25, available at SSNR: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3971868 (accessed 20 May 2023).

64 See*, ex multis*, Zetzsche, D.A., Arner, D.W., Buckley, R.P., 2019, *Fintech for Financial Inclusion: A Framework for Digital Financial Transformation*, UNSW Law Research paper No. 18-87, available at SSNR: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3245287 (accessed 18 May 2023); Zetzsche, D.A., Arner, D.W., Buckley, R.P., 2020, *Decentralized Finance*, Journal of Financial Regulation, Vol. 6, Iss. 2, p. 172 ff.; Schär, F., 2021, *Decentralized Finance: On Blockchain- and Smart Contract-based Financial Markets*, Federal Reserve Bank of St. Louis, Vol. 103, No. 2, p. 153 ff.; Brummer, C. (ed.), *Crypto Assets: Legal and Monetary Perspectives*, Oxford University Press, Oxford, 2019; Kanungo, R.P., Gupta, S., 2021, *Financial inclusion through digitalisation of services for well-being*, Technological Forecasting and Social Change, Vol. 167,120721; Arner, D.W., Buckley, R.P., Charamba, K., Sergeev, A., Zetzshe, D.A:, 2021, *Governing FinTech 4.0: BigTech, Platform Finance and Sustainable Development*, Fordham Journal of Corporate & Financial Law, Vol. 27, Iss. 1, p. 1 ff.; Arner, D.W., Castellano, G.G., Selga, E., 2022, *Financial Data Governance: The Datafication of Finance, the Rise of Open Banking and the End of the Data Centralization Paradigm*, EBI Working Paper Series No. 117, available at: https://ssrn.com/abstract=4040604 (accessed 18 May 2023).

65 See, for a survey on the information properties for retail investors of robo-advisors' websites in Switzerland, Mezzanotte, F.E., 2020, *An examination into the investor protection properties of robo-advisory services in Switzerland*, Capital markets law Journal, Vol. 15, Iss. 4, p. 489 ff, available at: https://ssrn.com/abstract=3768972 (accessed 14 June 2023).

intervention, and be aware of the basic functions of the algorithms in that respect. In relation to electronic trading platforms, an investor should possess sufficient knowledge to understand how the placing of the orders works, and what the fundamental elements of the website/interface he would use are. Automated or semi-automated protocols could be used to trigger a digital suitability test for users wishing to invest in digital contexts.

Users failing to pass such an assessment would either receive a pop-up warning discouraging them to access certain categories of products, or be prohibited from concluding the transaction. They would then receive a recommendation to seek forms of investment advice better suited for them, in order to be able to safely carry out certain types of particularly complex or risky transactions. Naturally, in either case these indications should be made in plain-language messages that are easily understood by non-sophisticated retail investors.

Another field of action, which would require immediate attention, is the development of good and sound market practices aimed at properly construing the digital context in which retail investors might operate. Legislation should therefore better address the specific risks stemming from online platforms, online advertising and offering of financial products/services: a topic that involves a combined approach of financial, consumer, antitrust and general private law.

An area that has been developing recently and that requires more attention is the onboarding of clients through social media channels or through unregulated entities (for instance, when the latter provide a banner that offers a link to an investment services provider). In the digital context, the issue of the adequacy of the strict notion of “investment advice” provided under MiFID II[66] arises once again. That notion seems to be too narrowly defined to properly protect investors acting on digital platforms, social media and other digital contexts. What can be found in those contexts is often confusing in this respect. Under MiFID II, investment advice is characterised by two core elements:

(i) the personalised nature of the recommendation or advice; and

(ii) the specificity of the transaction to which the advice refers.

In the absence of both these elements, the service falls out of the scope of the definition of "investment advice” under MiFID II and risks being left unregulated. In the recent past, the EU supervisory agencies have drawn the attention to these risks, including those that arise when investment advice is not being formally provided, but nonetheless information is conveyed to the investor in such as a way that it might be easily misunderstood as “advice”[67]. Another related point is the lack of sufficient clarity as to when, in the MiFID II context, a certain service is effectively being “offered” through a digital platform: for instance, a digital platform may display a banner that, when clicked upon, leads to the site of a

[66] See Art. 4(1)(4) MiFID II: ”’investment advice’ means the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments”. See also Giudici, P., Independent Financial Advice, in Busch, D., Ferrarini, G., *Regulation of the EU Financial Markets: MiFID II and MiFIR*, Oxford University Press, Oxford, 2017.

[67] In that regard, in 2009 the CESR carried out a consultation, using a questions and answers format, on the definition of investment advice precisely with the aim of clarifying the definition and provide guidance to investment firms to avoid the risk of incorrectly qualifying their activity as provisioning of investment advice. Among the issues tackled, the CESR attempted to provide clarification on the correct meaning of ’provision of personal recommendation’ to dispel doubts on ”whether other forms of presenting information such as "investment research", filtering, general recommendations, generic advice, presenting multiple products or access to model investment portfolios could constitute investment advice”. In such context, before the enactment of MiFID II, another concern regarded the correct understanding of the concept of ”distribution channels” and the convenience of removing the safe harbour provided by Art. 52 of the MiFID Implementing Directive under which ”[a] recommendation is not a personal recommendation if it is issued exclusively through distribution channels or to the public”. There was the concern that such exception, coupled with the increasing use of new communication channels, would leave unregulated communications that substantially amounted to provisions of investment advice. See CESR, April 2010, Questions & answers: Understanding the definition of advice under MiFID (CESR/10-293), available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/10_293.pdf; CESR, April 2010, *Feedback Statement: Understanding the definition of advice under MiFID* (CESR/10-294), available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/10_294.pdf (accessed 20 May 2023).

service provider. The platform merely shows the banner, but the service is provided by another entity: for a retail client, this distinction may not be sufficiently clear.

The rising cases of digital influencers openly or less openly advertising financial products in social media or recommending certain products or strategies in chats (either collectively or individually) also calls for attention.

On the one side, legislation should aim at making the digital context safer and more comprehensible for retail investors, reducing the risks associated with overconfidence in digital tools; on the other side, it should reduce the risk of elusive conducts in relation to the provision of highly sensitive and important services, such as investment advice, or the "placing" of financial services and products.

The measures proposed herein complement the suggestions contained in the Omnibus Directive Proposal. The latter introduces an obligation for investment firms as well as insurance undertakings and insurance intermediaries distributing insurance-based investment products to explain the purpose of the assessments to clients and customers in a clear and simple way, and to obtain all relevant information from clients and customers which may be necessary and proportionate for the assessments. The proposal clarifies that retail investors need to be informed, via standardised warnings, about the consequences on the quality of the assessment if they do not provide accurate and complete information. However, as shown in the above paragraphs, the rules on a revised suitability test for digital environments ought to be more stringent to better protect the retail investors' interests.

Finally, the proposed introduction of provisions destined to address the risk of unbalanced or misleading marketing communication emphasising benefits only, and to clarify the responsibility of investment firms and insurance distributors in relation to marketing communication when using digital channels, will be beneficial for addressing the issues discussed in this paragraph.

6. SECTORAL INTEGRATION

EU financial law is based on a sectoral approach, clearly identifiable in the three traditional sectors that broadly identify financial markets: banking, capital markets, and insurance/pension funds. Each sector has its own body of legislation, embedded in silos or "packages" (Capital Requirements Directive (CRD), MiFID, UCITSD-AIFMD, Solvency/IDD, etc.)[68]. This is reflected at the institutional level in three EU agencies (the European Banking Agency (EBA), ESMA and EIOPA) which perform an increasingly wide array of regulatory and supervisory (only for ESMA, at the moment) functions. Together with the ESRB, they form the European system of financial supervision (ESFS).

Each sector addresses the issues of protecting the "users" of certain financial services or products in their own way, based on the objectives of the relevant legislation. The identification of the subject to be protected - whether a "depositor", a "client", a "customer", an "investor", a "policy holder", etc. – varies considerably across sectors, rendering the identification of the target of the protection awarded by different statutes variable in accordance with each of their respective objectives and aims.

Over time, the articulation of this regulatory and institutional set up has undergone several changes, which occasionally challenge the sectoral approach: some examples of this are the regulation of financial conglomerates, or the PRIIPS Regulation[69]. However, these exceptions do not change the overall picture.

This creates the risk of normative fragmentation, which can be detrimental to the achievement of a reasonable level playing field for the protection of (especially) retail investors. As clearly shown by advanced studies in this area, cross-sectoral harmonisation is key to make investor protection more efficient, coherent, and effective in the EU. In that context, technical differences in applying similar rules across different sectors often overburden the current state of EU financial legislation, most of the times with little or no value added[70].

First, the need arises for a comprehensive overview of the legislation currently in force in order to eliminate, or at least reduce, minor, technical differences in applying similar provisions, without any effective enhancement of investors' protection across different sectors. A comprehensive exercise, such as the one conducted in the Report concerning disclosure rules, should be extended to other fields as well.

Second, cross-sectoral harmonisation should be pursued with more energy by legislators. This is of paramount importance in order to coordinate the action of regulators, supervisors and courts in supporting the interpretation and enforcement of sectoral EU legislation[71], especially for a uniform application of similar principles. Harmonisation would also foster supervisory convergence across different markets, products and actors that are becoming increasingly overlapped and intertwined.

The case of the abovementioned inducement regime, which is regulated both by MiFID and IDD, is an example that shows how a similar rule is applied differently across sectors, without this generating any apparent benefit: when one considers insurance-based investment products, which are substantially

[68] For a comprehensive analysis, see Colaert, V., Busch, D., Incalza, T. (eds.), *European Financial Regulation: Levelling the Cross-Sectoral Playing Field*, Hart Publishing, Oxford, 2019.

[69] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs). On the shortcomings of PRIIPS, see Colaert, V., January 2016, *The Regulation of PRIIPs: Great Ambitions, Insurmountable Challenges?*, available at https://ssrn.com/abstract=2721644 (accessed 8 May 2023).

[70] See for an analytical and comprehensive analysis of most of these differences, see Colaert, V., Busch, D., Incalza, T. (eds.), *European Financial Regulation: Levelling the Cross-Sectoral Playing Field*, Hart Publishing, Oxford, 2019.

[71] See Crinjs, J., Haentjens, M. and Haentjens, R., *The enforcement of EU Financial Law*, Hart, 2022.

similar to fully-fledge financial products, rules on inducements should work in the same way. The same applies to investment advice, suitability, and other requirements.[72]

Finally, it should also be noted that the efforts of building a CMU will hardly be complete without addressing the gaps created by the absence of a uniform corpus of private law among Member States[73]. There are several examples of cases where private law and private remedies play a prominent role in ensuring the effectiveness of capital markets rules[74]. As these are left entirely to national jurisdictions, the consequence is an intense divergence in the treatment of civil responsibility arising from transactions with financial products and services[75]. Without a minimum alignment of national legislations on private law rules specifically applicable to capital markets, integration within the CMU will be significantly hindered: as indicated in the preceding chapters, retail investors greatly rely upon legal certainty and foreseeability in order to make their investment decisions. For example, there is a wide variety of approaches as to the relevance of MiFID conduct rules in private law remedies: in some Member States, conduct rules are not *per se* directly enforceable under contract law, while in others the situation is the opposite. There is also no common approach as to the consequence that would arise, should conduct rules be relevant for private law remedies: nullity, damages, or other contractual remedies are applied inconsistently across the EU on the basis of national law.[76]

The introduction of a harmonised set of standards for an EU financial private law would therefore be a welcome initiative, which would greatly contribute to the development of an accessible and attractive CMU.

In this respect, a robust effort needs to be undertaken to truly understand if, and up to what point, this objective is attainable or out-of-reach of EU harmonisation rules.

This also suggests, among other measures, a stronger effort in developing alternative dispute resolution mechanisms, which should be easily accessible to retail investors, in order to increase legal certainty and the reliability of judicial protection within the CMU.

In light of the above, a further dimension should be considered, one that has been mostly neglected until now. In a context where the sectoral approach still moulds EU financial legislation, one also witnesses a slow, albeit relentless establishment of cross-sectoral rules and standards aimed at protecting consumers. Such standards are, mostly, the core of the MiFID investors' protection regime, as established in a steadily evolving way, starting from the ISD of 1993, up to the MiFID II package, and recently complemented by new cross-sectoral objectives (specifically, sustainable finance and environmental, social, and governance (ESG) goals). Those standards now ought to be properly singled out as the common core of rules of protection for any kind of "user" of financial services: whether it is a depositor, a client, an investor, a unit-holder, or a policy-holder.

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[72] It should be noted that, for instance, in Italy national legislation implementing the IDD on insurance-based products has aligned the rules on inducements for the distribution of such products to the ones found in MiFID. This was possible since, as already discussed, the IDD is a minimum harmonisation Directive.

[73] See Lehmann, M., 2023, *Union des marchés de capitaux et droit privé*, Banque & Droit, 40 ff.

[74] The Prospectus Regulation, for instance, when dealing with responsibility attaching to the prospectus, is limited to establishing in Article 11(2) that: "Member States shall ensure that their laws, regulations and administrative provisions on civil liability apply to those persons responsible for the information given in the prospectus".

[75] For example, under MiFID II rules, while France considers any violation of the rules on the distribution of financial instruments and related services as a breach of contract, German courts deny any effect of the EU regulation on the content of the contracts themselves. See Lehmann, M., 2023, cit., p. 41.

[76] See, with a comparative perspective, the broad and comprehensive study by Della Negra, F., *MiFID II and Private Law: Enforcing EU Conduct of Business Rules*, Hart Publishing, Oxford, 2021.

The usefulness of this exercise is motivated by the possibility of identifying a shared set of principles that, notwithstanding sectoral differences, identify common approaches to the protection of such "users", leaving at the same time space and flexibility for more specific, sectoral-oriented or detailed rules of protection. Most, if not all of these principles are already embedded in current EU law, and would not require any further legislation or the amendment of the existing one.

There may even be sufficient ground to consolidate those principles (which are, indeed, already visible) within a general Charter for the protection of financial users in EU legislation, to be intended on a cross-sectoral basis. The Charter would not be aimed at replacing sectoral-specific legislation, which remains necessary because of the different approaches and goals, to be achieved in each context (notwithstanding the need to reduce cross-sectoral differences altogether), but it would identify overarching, mandatory standards valid throughout the entire range of financial services, products, activities[77].

The exercise leading to the establishment of the Charter is far from being merely theoretical.

First of all, within each sector of EU financial legislation, the Charter might prove useful in orienting and shaping the action of regulators, supervisors and Courts in supporting the interpretation and enforcement of sectoral EU law, filling its gaps, and supporting the uniform application of its core principles. Second, the Charter might be useful to uphold supervisory convergence across different markets, products and actors that are becoming increasingly overlapped and intertwined.

Third, the Charter would have a high political impact, clearly placing the direct protection of customers, clients, investors, policyholders at the centre, and at the core, of the objectives of EU financial legislation.

Considering the trend that is visible in the different areas of EU financial legislation, the Charter might include, among others, the following principles (but not necessarily in this order, nor in this form):

(i) the right of being properly and timely informed on the nature of the services/products;

(ii) the right to be provided with properly documented and formalised contracts, which are easily accessible and retrievable at all times;

(iii) the right to get fair treatment;

(iv) the right to have access to suitable products and services that meet and satisfy the requirements of users;

(v) the right not to be damaged by conflicts of interests that are not properly identified and addressed;

(vi) the right to have full disclosure of any cost, whether explicit or implicit, related to the products and services provided, including any inducements, in a clear, easily understandable way;

(vii) the right to have access to products and services that duly take into account the user's preferences in terms of sustainability objectives, when disclosed and known to the service provider;

[77] See on this issue Colaert, V., *MiFID II in Relation to Other Investor Protection Regulation: Picking Up the Crumbs of a Piecemeal Approach*, in D. Busch and G. Ferrarini (eds.), *Regulation of the EU Financial Markets: MiFID II and MiFIR*, Oxford University Press, Oxford, 2017, draft also available at https://ssrn.com/abstract=2942688 (accessed 8 May 2023). On the research agenda on cross-sectoralisation, Colaert, V., March 2018, *European Financial Regulation: Levelling the Cross-Sectoral Playing Field. A Research Agenda*, available at: https://ssrn.com/abstract=3153754 (accessed 8 May 2023) and, more recently, the contributions to be found in Colaeert, V., Busch D., Incalza, T., 2019, cit.

(viii) the right to be duly informed upon the termination of the service, and to receive full, complete and intelligible final statements;

(ix) the right to a swift and prompt provision of services, in compliance with contractual terms, including – where applicable – any duty of best execution; and

(x) the right to a safe digital context, in relation to digitalised services.

Further principles might, naturally, be considered over time, as the Charter should be flexible, and capable of adapting to the evolution of markets.

As to its form, considering the current architecture of EU legislation and supervision, there seem to be good arguments to uphold the idea that the Charter might be entrusted to a soft law instrument, such as a joint position document, or joint guidelines, adopted by the three European Supervisory Agencies (ESAs). Some significant examples in the recent history of the ESAs show that this could, indeed, be a practical and reasonable way to address cross-sectoral issues, without necessarily elaborating new secondary legislation, or amending the existing one, especially when new trends are still developing. The ESA's 2013 Joint Position on product governance could be a good paragon in that regard. It laid down a common foundation of principles and subsequently triggered further, important legislative amendments[78].

[78] See Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight & Governance Processes (JC-2013-77), available at https://www.esma.europa.eu/sites/default/files/library/2015/11/jc-2013-77_pog_-_joint_position_0.pdf (accessed 29 April 2023). On the use of soft law during the pandemic, Moloney N., Conac, P., 2020, *EU Financial Market Governance and the Covid-19 Crisis: ESMA's Nimble, Responsive, and Speedy Response in Coordinating National Authorities through Soft-Law Instruments*, European Company and Financial Law Review, 2020, Vol. 17, Iss. 3-4, 363 ff.

7. DISCLOSURE RULES

Amongst the topics discussed herein, as well as in the Report, disclosure is decisively one of the most critical elements that need to be thoroughly reviewed and streamlined. The findings of the Report, in this respect, are merciless and clear in the sense that:

(i) disclosure rules, scattered over different layers and sources, are not applied consistently[79]. Consumers are not able to find their way through the complex terminology of investment products and costs[80];

(ii) information provided to clients is not sufficiently clear, nor is it standardised across Member States[81];

(iii) excessive disclosure requirements and disclosure documents lead to choice and information overload for consumers[82]. Clients pay limited attention to the information disclosed, especially when they are complex. This is aggravated by the high volume of products on the market, which leads to further risks of information overload; and

(iv) comparison across products is difficult, especially for more complex products[83].

Considering the current state of EU legislation, it is impossible not to uphold these remarks. There is also another point that needs to be singled out.

Disclosure rules were at the origin of the entire body of EU capital markets law back in the late 1980s, starting from the original Directives on prospectus and listing, and have been developing steadily in all other areas of financial legislation since then. This development has been carried out by concentrating on the need to provide increasing, more expansive and granular information, rather than focussing on the quality and the effectiveness of disclosure. In most, if not all areas of financial legislation there is now an intricate web of disclosure rules, most of which need to be carefully reconsidered in terms of their effective utility, especially for retail investors.

Over time, and in relation to disclosure, EU legislation did not adequately address the following matters:

(i) disclosure rules are a double-edged sword. On the one hand, they are generally designed to protect investors, and to support them in taking appropriate and informed investment decisions. On the other hand, they may serve as a means to shield issuers and product companies from issues of liability, and thereby function in order to serve objectives quite opposite to the ones that they were initially designed to pursue. This risk becomes evident especially when disclosure is excessive, inflated, and difficult to understand, as is – unfortunately - often the case in the existing legislations, as clearly shown by the Report. The recent attempts of the EC to revisit and simplify, for instance, the rules on prospectus[84] are a clear indication of how important this aspect is, but they are too timid;

[79] Report, p. 18.

[80] Report, p. 14.

[81] Report, p. 90.

[82] Report, p. 91.

[83] Report, p. 16; p. 96; p. 102; p. 125; p. 192, among others.

[84] See, lately, the EC's so-called Listing Act: Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) 2017/1129, (EU) No 596/2014 and (EU) No 600/2014 to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises (COM(2022) 762 final).

(ii) further to the above, disclosure rules should be structured in such a way as to provide only information which is effectively useful, if not essential, from the perspective of the investors;

(iii) multiple layers of information in relation to the same transaction ought to be avoided. As the Report points out, there are overlapping and concurring information duties that result in information excess: for instance, when a certain product is placed to retail clients in the context of the provision of investment services, the comprehensive information duties established by MiFID II combine with those on the underlying product (prospectus, key investor information document (KIID), etc.);

(iv) across different sectors, disclosure rules do not consider the need to have substance prevail over form. Most of the times, disclosure regimes differ on the basis of purely formal elements, disregarding the fact that the products share many similarities: this is the case, for instance, of several insurance-based financial products vis-à-vis investment funds;

(v) ultimately, it should be kept in mind that the core legislation on disclosure was developed in times when EU rules did not include provisions covering, amongst other, investment services, investment funds, and other major areas of financial intermediation. The founding "father" of EU capital markets regulations – the prospectus regime – was conceived decades ago in a context were there was little or no further legislation in that field, particularly as to service providers or conduct of business rules (the ISD dates back to 1993). Disclosure rules should therefore be re-considered and re-assessed in a context where the roles of intermediaries, in supporting and intermediating investors' decisions, has become decisive. Information to the market is in fact mostly filtered, in different ways, by professionals, and the approach to the disclosure regimes should consider this evolution.

As summarised by the Report, an urgent need to decrease the quantity of disclosed information and to significantly enhance its quality and effectiveness has arisen. In this respect, retail investors should be able to fully and quickly understand:

(i) the essential features of the product they are considering in terms of risk/return;

(ii) their rights and the available remedies;

(iii) the costs; and

(iv) their right to exit from the product.

Contrasting with the above, the status of EU legislation is, in this respect, unsatisfactory: form prevails over substance; disclosure regimes are scattered in a plethora of different measures that are not properly coordinated; and little attention is paid to the need for disclosure to be carried out in a clear, basic, and truly comprehensive way. Legal requirements regarding costs disclosure are also excessively complex, requiring costs to be broken down into several categories, which are mostly irrelevant or difficult to assess by retail investors[85]. Surveys demonstrate that investors are interested in the product's total cost, not necessarily how these are broken down into different cost categories[86].

[85] See Report, p. 93.

[86] Id., p. 93.

Language and framing are also extremely important factors to be taken into account, since the same information conveyed in different ways is processed differently[87]. Measures should therefore include:

(i) the obligation to always use plain language and to structure risk alerts that retail investors are able to immediately understand;

(ii) increase the use of examples to clarify complex concepts;

(iii) layering the information and using formats so that substance prevails over form, i.e., similar or substitute products should be directly comparable (e.g., a unit-linked insurance product vs. an investment fund); and

(iv) the offering documentation should always be accompanied by a short, clear summary of the rights of investors and the remedies they are entitled to pursue, in a non-technical, user-friendly and objective manner.

The EC's Omnibus Directive proposal contains several provisions aiming to revise disclosure obligations, and even to reduce the information load presented to retail investors. In fact, when analysing the existing legislation, the EC reached similar conclusions than the ones outlined above, stating that "[d]espite existing rules governing disclosures, information can still be complex (in particular relating to costs), or not sufficiently useful or relevant to guide retail investors so that they make informed decisions"[88].

Among the measures proposed, we highlight the following:

(i) the introduction of a new provision in MiFID II dealing exclusively with investment firms' regulatory disclosures on costs, associated charges and payments made by third parties, in conjunction with the standardisation of the presentation of such information;

(ii) the introduction of a mandate for ESMA and EIOPA to develop draft regulatory technical standards setting out the format and terminology that should be used by firms for the disclosure of information on costs and charges under MiFID, and for pre-contractual disclosures under IDD; and

(iii) an obligation for investment firms, insurance undertaking and insurance intermediaries to provide all retail clients with an annual statement providing information on costs and charges, as well as performance indicators.

Although the proposals certainly represent a step forward in the simplification of disclosure rules towards a more efficient regime, measures on this front are still modest and should definitively be much more ambitious. As discussed above, a coordinated review – and significant reduction – of disclosure obligations is, in this sense, highly encouraged. The lack of coordination as well as overlaps amongst EU legislative texts must also be addressed in a consistent way, to avoid information duplication and overburdening.

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[87] Id., p. 94. This phenomenon has been widely observed with respect to the impact of digital context design on the choices of investors. In addition, recent contributions from behavioural studies applied to the financial sector (so-called behavioural finance) have been crucial to better understand the elements that play a role in investors' choices and conducts. It is currently widely acknowledged that "a plethora of psychological heuristics and biases steer the behaviour of the investor" (Colaert, V., 2017, *Building Blocks of Investor Protection: All-embracing Regulation Tightens its Grip*, Journal of European Consumer and Market Law, Vol. 6, Iss. 6, 229 ff., p. 230). See also Prentice, R., 2002, *Whither Securities Regulation? Some behavioral observations regarding proposals for its future*, Duke Law Journal, Vol. 51, Iss. 5, p. 1397 ff., available at: https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1157&context=dlj (accessed 14 June 2023); Gentile, M., Linciano, N., Soccorso, P., 2016, *Financial Advice Seeking, Financial Knowledge and Overconfidence: Evidence from the Italian Market*, CONSOB Working Paper No. 83, available at: https://www.consob.it/documents/1912911/2006254/wp83.pdf/111fe7a0-a078-56d6-0a8c-e537478ec081 (accessed 18 May 2023).

[88] EC, Omnibus Directive Proposal, p. 6.

8. THE DISTINCTION BETWEEN PROFESSIONAL AND RETAIL INVESTORS

From a historical perspective, the distinction between professional and retail clients has been a cornerstone of EU capital markets legislation. Sometimes, the distinction marks the applicability or not of a certain legal regime (as in the case of prospectus rules), in other cases the distinction implies a differentiation in the treatment of investors, due to their different needs for protection, as in the case of MiFID or of the AIFMD. The distinction is of paramount importance in order to avoid excessive costs and burdens from legislation, and to target regulatory safeguards towards investors in actual need of protection.

However, the high level of fragmentation across EU legislation hinders the correct classification of clients: for example, while MiFID II provides for a well-defined distinction between retail and professional investors, IDD does not.

The Omnibus Directive Proposal contains provisions to ease the restrictions for investors to qualify as professional. In this sense, to ensure more appropriate classification of clients and to reduce administrative burdens, the proposal establishes identification criteria for clients who may be treated as professional upon request. It also reduces the wealth criterion from EUR 500,000 to EUR 250,000 and inserts a fourth criterion relating to relevant education or training. The amendments proposed to also create the possibility for legal entities to qualify as professional on request, when they are fulfilling certain criteria concerning the balance sheet, net turnover, and own funds. However, these measures, despite being based on a correct identification of the need for more flexibility, fail to tackle the issue of fragmentation and to identify more appropriate ways to address the classification of clients. Indeed, instead of keeping the duality between professional and retail clients, the need arises to create further, more granular layers to the notion of professional investor. As the market develops and becomes increasingly complex, with different segments of population (possessing different levels of financial literacy) engaging in investments, it might become insufficient to calibrate the regime based solely on the dualism of retail-professional investor as currently defined under MiFID[89]. In addition, these criteria were introduced in EU law more than 20 years ago and, in the meantime, the markets' evolution requests them to be revised. Current rules on classification of clients seem to be outdated. As a consequence of these rules being unable to categorise intermediate and more granular levels of investors, the classification system in place precludes certain investors from accessing potentially interesting and suitable products, without necessarily enhancing investor protection[90].

A third category, that of the "qualified" or "semi-professional investor", was already established in certain Member States, such as Luxembourg and Germany, which may, for instance, provide for a more granular and precise application of current rules and ensure that clients are better represented by appropriate profiling[91].

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[89] See Frankie G., Mosk T., Schnebel E., 2016, *Fair Retail Banking: How to Prevent Mis-selling by Banks*, White Paper No. 39 SAFE: Sustainable Architecture for Finance in Europe Konstanzer Online-Publikations-System (KOPS), Goethe University, available at: https://d-nb.info/1112601317/34, p. 10 (underlining the same issue within retail banking).

[90] In response to such limitation, with the aim to favour access to SMEs markets by non-professional yet sufficiently qualified investors, CONSOB, the Italian national competent authority for supervision over securities markets, expressed the willingness to support at the European level the proposal to introduce a new category of client, intermediate between retail and professional investors. See CONSOB, *Piano Strategico* 2022-2024, available at https://www.consob.it/web/area-pubblica/piano-strategico (accessed 10 May 2023).

[91] In Germany, for instance, one reason for the introduction of the intermediate category of "semi-professional" investors in the German Capital Investment Code (Kapitalanlagegesetzbuch, the KAGB) has been to allow a broader distribution of German 'Spezial' Alternative Investment Funds, which would not be limited to professional investors only.

9. PRODUCT MAPPING

Proper client profiling is not the only aspect in need for adjustments. Retail investor would benefit from higher quality protections if more attention was paid to the interconnected issue of product classification. Currently, the most advanced system of investors' protection to be found in the context of EU capital markets legislation is the one of the MiFID regime. It revolves around three great pillars: product governance and oversight; suitability; and appropriateness. These regimes are based on two closely related pillars: client profiling and product profiling. Product governance rules identify target markets for products by considering, on the one side, clients' profiles and, on the other side, the characteristics of the product. Suitability and appropriateness refer the same exercise to a specific investor/client, by combining clients' profiling with product mapping.

However, while over time clients' profiling under these rules have been extensively developed under MiFID (and similar regimes, including the IDD), little attention has been given to the classification and mapping of products. These two profiles are deeply intertwined and cannot work regardless of the other: the intermediary is able to assess the suitability or appropriateness of a certain product or service for a client with a given profile only under the condition that such product or service has been properly categorised, and its characteristics have been properly identified.

To avoid mis-selling and to make sure that products or services are directed toward the right investor, both clients and products need to be properly profiled according to rational, precise and, to a certain extent, commonly shared criteria, which supervisors must also be able to understand and verify. Only once both assessments were performed correctly, can a product be properly placed, and investors would be given a satisfactory level of protection.

However, it is evident that the EU legislators have so far focused more on client (rather than product) profiling issues. The assessment of the product is thereby mostly left to the effort and due diligence of the intermediary, who is indeed required to have a full and complete knowledge and familiarity with the product offered to his clients (such standard to be also derived from the general principles of contract or private law as applicable in each Member State). Nevertheless, the provision of high standards of conduct remains without a more robust legislative reference. Different methodologies and different criteria for product mapping and classification can be used and applied in different contexts, including the establishment of stress or average scenarios. Depending on the criteria and methods adopted by intermediaries in profiling products, the range of products that are concretely suitable (or 'appropriate') for a given client segment, or for a specific client, can be widened or narrowed, sometimes even by a significant margin. This has wide repercussions on the level of protection offered.

Precisely with the aim of fostering the highest possible level of participation in financial markets and increasing the inflow of funds by retail investors, at the time of writing, several solutions are being considered at European level to update and simplify the current safeguards in the distribution phase. In this regard, the proposals announced by the EC as part of the retail investment strategy on a new configuration of suitability and appropriateness rules call for attention[92]. In any case, these proposals do not address product mapping in a proper way. Rather, a greater degree of homogenisation of the profiling methodologies adopted by individual market players should instead be pursued by the co-legislators.

[92] The EC has announced its intention to revise the current model, through the introduction of a 'one-size-fits-all' type of assessment, which would transcend the boundaries currently envisaged by the MiFID and IDD disciplines. Furthermore, the proposal would provide for possible portability between different intermediaries of the client's profile and asset allocation; this would pave the way for greater uniformity in the way client profiles are determined between different market players.

The recent proposals under the Retail Investment Strategy confirm the necessity of tackling this issue. Within the scope of the reforms to MiFID and IDD under the EC's Omnibus Directive Proposal, a new measure is put forward to require investment firms, as well as insurance intermediaries and insurance undertakings distributing insurance-based investment products, to display appropriate risk warnings in all information materials concerning "particularly risky financial products", in order to alert retail investors to specific risks of potential financial losses. The notion of "particularly risky" products then would be further developed by ESMA and EIOPA through guidelines, as well as through implementing technical standards, specifying the content and format of such risk warnings. In our view, this is a valuable contribution and represents a step in the right direction: namely, addressing product mapping gaps which hinder client suitability assessments. However, there is no particular reason why product mapping rules should be limited to "particularly risky financial products", as it should be a general standard, applicable to all kinds of products.

In this respect, a further advice might be to identify and define a standardised set of data and product profiling information, and the subsequent sharing of this set through, for example the European Single Access Point (ESAP) platform, whose setup is currently being discussed. Classification and mapping of products might also benefit from the use of artificial intelligence, and from the standardisation of offering documents in a machine-readable form.

On the one hand, market players could use the profiling dataset available in the ESAP platform to compare ex-ante the profiling parameters of a given product - determined through their own internal methodologies - with those of competitors. On the other hand, the improved availability of product profiling data would make it easier for the internal control functions of investment firms, as well as that of the relevant supervisory authorities, to carry out ex-ante and ex-post checks on the classification and mapping of products. This would also contribute to the simpler detection and timely identification of possible opportunistic behaviours, which would be an essential factor in preventing mis-selling at an early stage.

In addition, the Omnibus Directive Proposal contains rules aiming to intervene on product oversight and product governance disciplines, also by using purposefully crafted benchmarks, to ensure that no undue costs are charged, and that products deliver so-called "Value for Money" to retail investors. Specifically, the proposal envisages to introduce:

(i) new requirements on manufacturers and distributors to set out a pricing process allowing for the identification and quantification of all costs and charges, and an assessment of whether such costs and charges do not undermine the value which is expected to be brought by the product, and

(ii) in relation to PRIIPs, as well as UCITS and alternative investment funds (AIFs), a requirement for manufacturers and distributors to compare the costs and charges of the relevant products before their distribution to the market, against the costs and performance benchmarks specifically developed and published by ESMA and EIOPA. Such benchmark shall be developed on the back of the information relating to costs, charges, and performance, that manufacturers, distributors, and NCAs are required to share with the ESAs.

Under the EC's proposal, such benchmark should guide the pricing process in a way that "[a] deviation from the relevant benchmark should introduce a presumption that costs and charges are too high, and that the product will not deliver Value for Money, unless it can be demonstrated otherwise"[93]. However, as discussed in Section 5, legislation should not only be focused on imposing external standards to

[93] Omnibus Directive Proposal, p. 18.

define "high costs" and the pricing structure of markets, but rather on ensuring that retail investors have the necessary information to understand all the essential elements of the products and services offered. Rules focused on (indirectly) regulating prices, as the ones currently proposed, may hinder the organic development of markets and represent an obstacle to innovation. They may lead to stifling financial innovation, by introducing benchmarks for costs actually supported by the legislation itself.

Ultimately, while the proposal concentrates on standardising products' costs and charges, it seems rather oblivious of the need to incentivise standard mapping practices with respect to all other relevant aspects of product or services offered to retail investors. Without standardisation of products, comparability and price formation becomes severely hampered, and not really useful.

10. THE PROBLEM OF INSUFFICIENT FINANCIAL LITERACY

As anticipated, it is important to focus on the need to support Union-level initiatives and the associated budgetary provisions aimed at increasing financial literacy, especially among retail investors. In particular, further subsidies and policy measures are to be considered, so as to bridge significant gaps that might potentially undermine other actions destined to foster the CMU.

Significant gaps in financial literacy have direct and profound effects on the approach of retail investors to financial markets. Insufficient literacy may lead either to driving investors away from financial investments, which they may consider per se as something dangerous and incomprehensible, or to taking unwanted and undue risks.

Without basic knowledge on how financial markets operate, on the advantages and risks of investing in financial products, and on fundamental notions of personal finance, EU citizens will not be encouraged to become investors, or will likely access markets in a sub-optimal (and potentially harmful) way[94]. The public and the private sector should equally be involved in a broad discussion with EU legislators on how to develop further public and private mechanisms to increase financial literacy across the Union.

Gaps in financial literacy have the potential to negatively affect the economies of each Member States regardless of their wealth: significant studies agree upon that financial illiteracy is widespread across countries regardless of their national income levels[95]. The promotion of financial literacy among retail investors shall not be conceived as mere delivery of financial notions. Indeed, knowledge of basic financial concepts requires wealth-management skills and the development of a rational level of confidence in engaging in investment activities. As the Report shows, a non-negligible percentage of households refrain from investing not (only) because of their lack of basic financial knowledge, but of their lack of confidence in the ability to invest successfully and choose the right financial product[96]. This is coherent with the Organisation for Economic Co-operation and Development (OECD) definition of financial literacy, which refers to the "knowledge and understanding of financial concepts and risks, and the skills, motivation and confidence to apply such knowledge and understanding in order to make effective decisions across a range of financial contexts, to improve the financial well-being of individuals and society, and to enable participation in economic life"[97].

At the same time, financial education should also be construed in light of the process of digitalisation described above. Indeed, a consequence of the rapidly evolving use of new technologies is that investors' financial literacy needs to expand so as to include a proper technical understanding of new tools and digital services, as well as of the risks implied[98].

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94 For instance, it has been shown that the level of financial literacy directly impacts upon te level of portfolio diversification. See Gaudecker, S.H., 2015, *How Does Household Portfolio Diversification Vary with Financial Literacy and Financial Advice?*, Journal of Finance, Vol. 70, Iss. 2, 489 ff., available at: https://ssrn.com/abstract=1810560 (accessed 14 June 2023).

95 See Lusardi, A., 2019, *Financial literacy and the need for financial education: evidence and implications*, Swiss Journal of Economics and Statistics, Vol. 155, Iss. 1, 1 ff., p. 3, available at: https://sjes.springeropen.com/articles/10.1186/s41937-019-0027-5 (accessed 14 June 2023).

96 Report, pp. 226-227.

97 See OECD, 2014, *PISA 2012 technical background*, in OECD (ed.), PISA 2012 Results: Students and money (Volume VI): Financial literacy skills for the 21st Century, OECD Publishing, Paris,123 ff.

98 See Elsinger, H., Fessler, P., Feyrer, J., Richter, K., Silgoner, M., Time, A., 2018, *Digitalization in financial services and house-hold finance: fintech, financial literacy and financial stability*, Financial Stability Report, Oesterreichische Nationalbank (Austrian Central Bank), Iss. 35, 50 ff., p. 55, available at: https://www.oenb.at/dam/jcr:eff740da-10a3-42f4-a66c-7f391cb64da3/fsr_35_digitalization_financial_services_and_household_finance.pdf (accessed 14 June 2023).

The Omnibus Directive Proposal put forward by the EC embraces the objective of promoting financial literacy. New provisions are to be included by means of amendments to the MiFID II and the IDD[99]. In short, the proposed articles establish dedicated provisions on "financial education" and set forth a generic obligation for Member States to promote financial education measures at national level, so that

(i) in the case of MiFID, existing and prospective retail investors are able to invest responsibly when accessing investment services or ancillary services; and

(ii) in the case of the IDD, responsible purchase of insurance products when accessing insurance services or ancillary services is fostered.

The initiative moves in the right direction and will require further efforts in the definition of the exact policies to be implemented. As mentioned above, it would be also advisable to envisage a Union-wide initiative supported by a dedicated budget.

[99] Articles 1(22) and 2(9) of the Omnibus Directive Proposal respectively insert a new Article 88a MiFID and Article 16a IDD.

11. LEGISLATIVE MISALIGNMENT

Enhancing the alignment among different sectors of EU legislation on financial markets is a measure likely to result in positive effects.

This is a different aspect from the one (already addressed above) of cross-sectoral harmonisation. Misalignment refers to the risk that different legislative measures are not in themselves coordinated, leading to overlaps or possible conflicts.

Ensuring consistency of EU rules is also a crucial step for fostering alignment on a cross-border basis and ensuring that the CMU is indeed developed in a coherent manner in different Member States.

A specific example can be given in the segment of collective investment funds, which experienced a significant development in the Union since the introduction of the UCITSD in 1985, followed by the AIFMD in 2011. The enormous diversity of funds across Member States has led to a greatly variegated market, in which differences between available products might not be easy to understand, especially by retail investors[100]. For instance, an open-ended investment fund may be subject to the UCITS regime or fall outside it, and be included in the AIFMD, because of minor differences in the way in which the product is structured. Another case is that of a UCITS fund, that, while complying with the UCITSD rules on portfolio composition and management, pursues an investment strategy that brings it closer to an alternative fund[101]. The regime applicable to these products are grounded in different legal texts, with a different structure, and for no apparent benefit. For investors, the difference between legal regimes applicable to similar products might be difficult to appraise, assuming that it is relevant in the first place.

Other examples can be gathered from the impact that digitalisation is having on EU legislation. As new technologies emerge and enable the development of new forms of financial products and of provision of services, EU legislators have rightfully tackled the emerging areas with tailor-made regulations that address the particular issues and risks created by technological developments. Striking examples of this new trend are, naturally, MiCA, together with the distributed-ledger technology (DLT) Pilot Regulation and the Digital Operational Resilience Act (DORA), and also the recent European Crowdfunding Service Providers Regulation (ECSPR). The upcoming Artificial Intelligence (AI) Act[102], even though it is a horizontal measure, is also addressing issues of AI relevant to financial markets.

These new legislative measures inevitably intertwine and overlap with a whole set of existing pieces of EU legislation: among others the CRD package, the PSD II, the E-Money Directive (EMD), MiFID II, the Prospectus Regulation, and the MAR. In this respect, several inconsistencies emerge, leading to fragmentation in the levels of protection offered to investors: for example, the taxonomy of crypto-assets falling within (or outside) the scope of MiCA is clearly a crucial point to be addressed.

Most of the recent legislative measures claim to follow the principle of technological neutrality, according to which a certain activity should be subject to equivalent rules regardless of the manner in which it is carried out: however, evidence often points in quite a different direction.

While some inconsistencies between different legislative measures are minor or formal in nature, others deserve careful consideration, as they produce contradicting rules that can hinder investor

[100] Thomadakis, A., Lannoo, K., Moloney, N., November 2022, *Time to re-energise the EU's capital markets – Building investable and competitive ecosystems*, CEPS-ECMI Study, Centre for European Policy Studies, Brussels, available at: https://www.ceps.eu/ceps-publications/time-to-re-energise-the-eus-capital-markets/.

[101] Such products are also known on the market as "alternative UCITS" or "Newcits".

[102] EC, 2021, *Proposal for a Regulation of the European Parliament and of the Council Laying Down Harmonised Rules on Artificial Intelligence (Artificial Intelligence Act) And Amending Certain Union Legislative Acts* (COM/2021/206 final).

protection. It is therefore advisable that more energy is devoted to identifying inconsistencies amongst the various sources of EU financial legislation and trying to level the playing field between the different areas.

12. CONCLUDING REMARKS

As mentioned in the previous pages, Europe has one of the highest saving rates in the world, yet the rate of retail investor participation is significantly low, especially when compared to other developed markets. Just over a quarter (28%) of the population of banked citizens in 10 countries assessed by the Report commissioned by the EC have already invested in financial products, while another quarter or respondents were either actively looking to invest (11%) or interested in investing their savings (14%). Such numbers demonstrate the immense gap – and potential – of the CMU with regard to retail investors.

The level of participation of retail investors in EU financial markets is driven by a number of complex factors, starting from macro-economic elements to geo-political factors, up to the financial culture of a certain community and society. Literature usually identifies three main drivers of retail investment in economies:

(i) financial literacy;

(ii) the maturity of capital markets; and

(iii) the pension system.

Regulatory aspects are just one of the tools that can be used in order to steer those drivers and stimulate an increased level of participation of retail investors in financial markets, but they do play an important role. They may, in fact, facilitate or hinder access to the market, and greatly affect the level of consistency in the protection afforded to investors, thereby enhancing or reducing the confidence of investors. They may support financial inclusion or create undue obstacles. They may result in a significant increase in compliance and regulatory costs, with no concrete impact on the enhancement of investors' protection, but with an increase in the cost of the services provided. Even if regulation is just one of the elements that support the development of financial markets, it is, indeed, one of the most important ones.

The current state of EU legislation shows several areas of possible improvement, which do not necessarily result in the need for additional or new legislation: rather, major interventions are needed in order to simplify, consolidate, even reduce the bulk of the current legislative landscape, and to make it more coherent, less fragmented and, ultimately, more effective. The EC's proposals under the recent Retail Investment Package offer a fertile terrain for initial discussions, but further and more ambitious measures can certainly be considered in order to make the CMU more attractive, open and safe to retail investors.

In particular, we discussed:

(i) a possible new regulatory approach towards inducements;

(ii) the enhancement of rules addressing the digitalisation of capital markets and the need to improve investors' protection and confidence;

(iii) the need to improve cross-sectoral harmonisation and to address legislative misalignments;

(iv) the need to revise comprehensively and substantially the current, over complicated disclosure regimes, as applicable in different contexts of capital markets legislation;

(v) the need to introduce new rules on product mapping;

(vi) the reassessment of the current classification of professional and retail clients; and

(vii) the need to enhance financial literacy.

All of these areas are highly intertwined and often a measure proposed for one area has effects also in other areas of legislation.

c) Inducements

Regarding inducements, we analysed the substantial rules on inducements and the rules related to their disclosure, identifying aspects that could be significantly improved in both areas.

For substantial rules on inducements, the focus of the debate should be the quality of the assistance or advice provided to clients. Rules should ensure that investors are able to effectively understand and evaluate whether, in a certain context or transaction, they are indeed being provided with some kind of "support" for their investment decisions or not, and, if so, what this support effectively consists of. The strict correlation that seems to be central to the current debate between inducements and proper investment advice should be construed in a broader way, and more attention should be paid as to the different kinds of "advice" and "support" that investors might receive in a certain context/transaction. This also involves the need to reconsider the scope of "investment advice" under MiFID as to capture the entire set of broadly speaking "advisory" services that can be provided, which would also involve different levels of remuneration for different services.

With regard to disclosure rules for inducements, the disclosure of the costs embedded in the inducement structure is certainly important but should not overshadow the substance of providing full transparency on the kind of service provided. Disclosure to investors, and clarification as to what kind of support they are receiving, should be of paramount importance, probably as much, if not more, than the disclosure of the amount paid or received as an inducement. The rules on inducement disclosure contained in the EC's Omnibus Directive Proposal seems to focus too much on prices and do not address these issues.

d) Digitalisation

As to the digitalisation of financial markets, we have shown how automation, robo-advisors and new financial products (such as crypto-assets) may provide several advantages to markets and retail investors, potentially leading to a reduction in costs and a facilitation of access to markets. However, digitalisation also creates new risks, which mainly revolve around the difficulties that retail investors find in properly dealing with the technologies employed in a digital environment. Most notably, the use of digital advice and gamification techniques have been rapidly increasing over the past few years in EU capital markets, posing new threats and offering new opportunities to retail investors in the Union. In this sense, we propose the introduction of a "digital suitability" test, to directly enhance the level of protection of retail investors in the digital context, before they actually have access to digital services and gamified platforms. Users failing to pass such an assessment would either receive a pop-up warning discouraging them to access certain categories of products, or be prohibited from concluding the transaction.

Furthermore, in the digital context, the issue of the adequacy of the strict notion of "investment advice" provided under MiFID II arises once again. That notion seems to be too narrowly defined to properly protect investors acting on digital platforms, social media and other digital contexts. A reform of the concept of "investment advice" (already proposed in the context of inducements) should therefore also address the concerns stemming from the digitalisation of investment services. Legislation should aim, on the one side, at making the digital context safer and more comprehensible for retail investors, reducing the risks associated with overconfidence in digital tools; and, on the other side, it should reduce the risk of elusive conducts in relation to the provision of highly sensitive and important services, such as investment advice, or the "placing" of financial services and products. The measures proposed herein would complement the suggestions contained in the Omnibus Directive Proposal, which we understand should be more stringent and complete to better protect the interests of retail investors.

e) Cross-sectoral integration

EU financial law is based on a sectoral approach, clearly identifiable in the three traditional sectors that broadly identify financial markets: banking, capital markets, and insurance/pension funds. Each sector has its own body of legislation, embedded in silos or "packages" (CRD, MiFID, UCITS-AIFMD, Solvency/IDD, etc.). We argued that this creates a risk of normative fragmentation, which can be detrimental to the achievement of a reasonable level playing field for the protection of (especially) retail investors.

Our study proposed two concrete measures to tackle cross-sectoral fragmentation:

(i) first, regulators should invest energy and resources to identify the several points where investor protection rules could be made more efficient, coherent and effective in the EU across different sectors, and thereby stimulate robust cross-sectoral harmonisation;

(ii) a set of fundamental principles on the protection of "users" of financial services ought to be identified and possibly be spelled out in a general EU Charter, also by way of soft law instruments.

Finally, efforts to develop a uniform corpus of private law for financial law are highly encouraged and deemed crucial for the development of the CMU and the enhancement of efficiency and trust of investors in markets.

f) Disclosure rules

The current state on EU legislation on disclosure is highly unsatisfactory: form prevails over substance; disclosure regimes are scattered in a plethora of different measures that are not properly coordinated; and little attention is paid to the need for disclosure to be carried out in a clear, basic, and truly comprehensive, straightforward way. Legal requirements concerning costs disclosure are also excessively complex, requiring costs to be broken down into several categories, which are mostly irrelevant or difficult to assess by retail investors.

In this regard, we have argued that there is an urgent need to decrease the quantity of disclosed information and to significantly enhance its quality and effectiveness.

In essence, retail investors should be able to fully and quickly understand:

(i) the essential features of the product they are considering in terms of risk/return;

(ii) their rights and the available remedies;

(iii) the costs; and

(iv) their right to exit from the product.

In addition, language and framing are also extremely important factors to be taken into account. A reform of disclosure rules should promote:

(i) an obligation to always use plain language and to structure risk alerts in a way that retail investors are able to immediately understand;

(ii) an increase of the use of examples to clarify complex concepts;

(iii) layering the information and using formats so that substance prevails over form, i.e., similar or substitute products should be easily comparable by a non-sophisticated retail investor; and

(iv) the offering documentation should always be accompanied by a short, clear summary of the rights of investors and the remedies they are entitled to pursue, formulated in a non-technical, user-friendly and objective manner.

The measures contained in the Omnibus Directive Proposal are welcome, but the initiatives on this front should be much more ambitious: a coordinated review and reduction of disclosure obligations is therefore highly encouraged.

g) Classification of professional and retail investors

We found that current rules on classification of clients are outdated and unsuited to categorise intermediate and more granular levels of investors. As a consequence, the classification system in place precludes certain investors from accessing potentially interesting and suitable products, without necessarily enhancing investor protection.

In this sense, the study suggests the creation of additional layers of client classification, so as to identify intermediate levels of categories.

h) Product mapping

The study found that client profiling is strictly related to product mapping and classification, both of which are essential elements to properly protect retail investors. To avoid mis-selling and to make sure that products or services are directed toward the right investor, both clients and products need to be properly profiled according to rational, precise and, to a certain extent, commonly shared criteria, which supervisors must also be able to understand and verify. Only once both assessments are performed correctly, can a product be properly placed, and investors are provided a satisfactory level of protection.

Within the scope of the reforms to MiFID and IDD under the EC's Omnibus Directive Proposal, a new measure is put forward to require stakeholders to display appropriate risk warnings concerning "particularly risky financial products" in all information materials, in order to alert retail investors to specific risks of potential financial losses. In our view, this is a valuable contribution and represents a step in the right direction: namely, addressing product-mapping gaps which hinder client suitability assessments. However, we have argued that product mapping rules should not be limited to "particularly risky financial products", as it should be a general standard, applicable to all kinds of products. In addition, we have suggested using the ESAP platform to facilitate the sharing of standardised sets of data and product profiling information.

The Omnibus Directive Proposal also contains rules aiming to intervene on product oversight and product governance rules, making use of purposefully crafted benchmarks to ensure that no undue costs are charged and that products deliver so-called "Value for Money" to retail investors. The Proposal also includes mechanisms that would contemplate benchmarking of prices for certain products.

We have argued, however, that rules focused on (indirectly) regulating prices, as the ones proposed, should be carefully considered, or even avoided, as they can potentially hinder the organic development of markets and represent an obstacle to innovation. Ultimately, while the EC's proposals concentrate on standardising products' costs and charges, they are oblivious of the need to incentivise standard mapping practices with respect to all other relevant aspects of product or services offered to retail investors.

Also, most of the Proposals set out in the Omnibus Directive are of little or no value if clear *product mapping* rules are not adopted as well.

i) Financial literacy

Financial literacy has direct effects on the approach of retail investors towards financial markets. Insufficient literacy and education may drive retail investors away from financial markets, precisely for considering them as dangerous or incomprehensible, or may lead them to take unwanted risks, or risks they do not understand properly.

We have argued, therefore, that public and private initiatives aimed at increasing financial literacy, especially among retail investors, should be highly encouraged. In particular, further subsidies and policy measures are to be considered, so as to bridge significant gaps that might potentially undermine other actions destined to foster the CMU. At the same time, financial education should also be construed in light of the process of digitalisation, considering the risks and challenged we have analysed above.

The Omnibus Directive Proposal put forward by the EC embraces the objective of promoting financial literacy, leaving however the concrete measures to be proposed in the hands of Member States. We believe that it would also be advisable to envisage a Union-wide initiative supported by a dedicated budget.

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The study developed herein aims to address the concerns raised by the European Parliament, and especially its ECON committee, as to the field of retail investments. It aims at analysing market practices and the applicable legislative landscape in order to identify room for improvement and, ultimately, propose potential solutions to foster retail investor protection and participation in financial markets.

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