Dutch Ministry of Finance
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The Netherlands' position on effective consumer and investor protection to stimulate long term retail investment

Improving consumers' access to capital markets is an important objective of the new Capital Markets Union (CMU) action plan. In this non-paper, the Dutch Ministry of Finance and the Dutch Authority for the Financial Markets (AFM) underline the importance of increasing retail participation and better protecting retail investors. Increased retail participation and protection in capital markets contributes to deepening the CMU, strengthening the European economic and financial system. Furthermore, this paper will reflect upon the aspects put forward by the Commission in the roadmap for the Retail Investment Strategy (RIS) and forms a basis for further discussion.

We share the Commission's ambition to ensure that retail investors can take full advantage of capital markets to enable them to achieve their financial goals. In order to make retail investing and wealth accumulation even safer and more attractive, it is vital to ensure that the legal framework for the capital markets is future proof, protects consumers better and effectively, and creates a level playing field for market participants. A high level of investor and consumer protection strengthens trust in the financial sector. We note that stimulating pension contributions will also increase retail participation in capital markets, as is the case in the Netherlands where approximately 85% of Dutch workers already invest (indirectly) through occupational pension schemes.

The Netherlands welcomes the Commission's approach to look across sectors at better facilitating a well-protected environment for citizens to invest their savings. In our view, the Markets in Financial Instruments Directive (MiFID II), Packaged Retail and Insurance-based Investment Products (PRIIPs), Undertakings for the Collective Investment in Transferable Securities (UCITS) and the Insurance Distribution Directive (IDD) contributed to improved consumer protection across the EU. Any amendments to these regulations should therefore lead to further improvements and should not water down the current level of protection of consumers when seeking suitable and cost-effective investment opportunities.

As more consumers become active on capital markets, or express the intention to start investing, the need to adequately protect non-advised retail investors is more urgent. Currently, one in every five Dutch households invest. The past year, the low-interest rate environment was cited more often than before as an important reason to start investing. New investors are typically younger, bring a smaller amount of investable capital but trade more.[1] Especially for these new investors, who are usually less experienced, the choice environment and how they access investment products is very important. Given the popularity of investment apps, investment choices are often made based on the information available on apps, websites and social media platforms, and rely less on financial advisors.

In this non-paper, we highlight five key priorities for improving the access and protection of retail investors by means of:

1. applying behavioural insights to improve the choice environment and disclosure;
2. addressing conflicts of interest;
3. providing suitable products;
4. improving financial literacy; and
5. stimulating green finance.

1. Applying behavioural insights to the choice environment and information disclosure

Understanding the behavioural aspects of choice architecture and consumer biases allows us to improve consumers' decisions. Consumers do not always act fully rationally as assumed by most traditional economic models. The behaviour of consumers is influenced by much more than

[1] Consumentenmonitor Beleggen. AFM, 2021.

just a cold calculation of presented costs and perceived benefits. The role of behavioural science in financial regulation and supervision therefore becomes increasingly important.

Disclosure requirements are a fundamental part of the investor protection framework due to its direct and indirect effect on the consumers' choices. Directly, disclosure encourages sensible decisions of retail investors. However, merely informing (potential) investors about the costs and risks of a financial product does not necessarily create an informed investor or lead to sensible financial decisions.[2] The context of information and how products are distributed is very relevant with respect to the effectiveness of the information provided. The most important information should be provided in the right choice architecture. Disclosure indirectly affects the behaviour of providers of financial services and products through the so called 'spotlight effect', contributing to more transparency about costs and performance.[3]

Both direct and indirect effects can be enlarged by careful design and framing of the information. More information does not always lead to better informed consumers and result in better financial decisions. Therefore, the usage of key information documents should be improved, by avoiding jargon and complex language, customising information to the target market, layering information and determining research-based new harmonized names and formats. Optionally, linkages to financial education can be provided. A consumer should still be able to download the full information in, for instance, a pdf. We could further explore whether it is cost-effective and useful for consumers to provide the data gathered in these standardised documents as open data to allow others, such as fintech companies, to develop tools for better comparison of financial services and products, and innovations in the area of robo-advice.

Further, streamlining the different disclosure requirements stemming from the various regulatory pieces where appropriate, will allow applying the best practices holistically. This will have to result in more retail investors being able to both understand the information documents provided and improving the comparability of the key aspects of financial services and products. This can reduce costs for investment firms and should therefore be welcomed as long as it does not lower consumer and investor protection standards.

Information disclosure can be made more effective by ensuring the key aspects are provided in the right choice architecture. The usage of key information documents should be improved by avoiding complexity, customized to the target market and the goal of the document's usage. Streamlining disclosure requirements could improve comparability of products and services, while reducing costs for firms and preventing an information overload.

2. Reducing conflicts of interest to enhance investor outcomes

Whether a consumer decides to invest by means of an app, online or through an in-person advisor, they should be able to rely on a safe environment that enables them to make the right choices. Conflicts of interest threaten this. It should not matter whether conflicts of interests manifest themselves by advisors being paid by product manufacturers or in the practice of "payment for order flow" (PFOF). Both may result in suboptimal environments where the interests of the broker or advisor does not align with the interest of the end consumer, the retail investor. Again, transparency alone would not sufficiently resolve the conflicts of interests.

To ensure fair treatment of consumers and investors, conflicts of interest should be minimized. A ban on inducements for financial products is a very efficient way of solving this issue, as shown by our experience over the past decade. An inducement ban for investment products and services will improve (price) transparency and reduce the costs of investing.[4;5] Furthermore, firms are incentivised to act in the interest of the retail investor and diversify their offering with more cost-efficient and innovative products and services. After banning

[2] Disclosure: Why it shouldn't be the default. Joint report from the Australian Securities and Investments Commission (ASIC) and the Dutch Authority for the Financial Markets (AFM), 2019.
[3] Loewenstein, G., Sunstein, C. R., & Golman, R. (2014). Disclosure: Psychology changes everything. Annu. Rev. Econ., 6(1), 391-419.
[4] European Fee Study. Morningstar, 2020.
[5] Performance and Costs of EU Retail Investment Products. ESMA Annual Statistical Report, 2021.

the payment of inducements for many products in the Netherlands in 2013, an evaluation of the effects of that ban revealed that it had benefitted consumers without negatively affecting the access to financial advice.[6]

A European ban of inducements for investment products and services will reduce conflicts of interest that may result in investment choices that are not entirely in the interest of the end consumer. It improves price transparency and contributes to lowering the costs of investment through innovation, enabling more consumers to access capital markets.

3. Suitable products and adequate supervision

In line with the objectives of the CMU, European retail investors should benefit from open markets offering a variety of cost-efficient and competitive financial services and products, with risks that suit the respective target markets. The Netherlands encourages to strengthen the application of the POG framework to risky and complex investment products in non-advised services in order to prevent misselling and harm to retail investors while promoting suitable and sustainable access to capital markets. It is important to ensure the distribution strategy is aligned with the target market. This implies that the use of evolving digital distribution techniques such as gamification should only be applied in the best interest of consumers.

Behavioural studies reveal that the choice environment strongly influences consumer decision-making. The choice environment – how financial institutions present choices and information to consumers – substantially influences consumer decisions. Firms throughout Europe, especially rapidly growing low-cost or zero commission brokers, already make use of behavioural aspects on apps and other online environments. However, not always in the consumer's best interest. Some firms use choice architecture to steer consumers to financial services or products that are not suitable or expensive. Nudging can be effective though to stimulate consumers make more sensible choices by thinking about risks and reward and long-term investment goals. We should prevent that the design of the choice environment is not in the interest of the retail investor.

The categorisation of investors is important to ensure products are suited for the proposed target market. In our view, the three current categories are sufficient to allow investors to have access to enough suitable products, while being adequately protected at a reasonable level. An extra investor category would unnecessarily add complexity to the current legal and oversight framework and therefore burden firms with the implementation of new distinctions. It is also important that client categories remain harmonised across the EU to protect the level playing field.

An enhanced and more integrated retail investment market requires a strengthened system of cross border conduct supervision that ensures consumers are sufficiently protected and supervisory arbitrage is avoided. Digitalisation has contributed to an ever faster increase in cross-border provision of products and services. This increases the likelihood that host supervisors are confronted with possible consumer detriment and other risks in their market posed by firms that operate outside their jurisdiction. Home supervisors may not always respond to risks and misconduct in a manner considered adequate by the host supervisor. Effective and timely cooperation between national competent authorities (NCAs) is crucial for the functioning of the CMU in addition to enhancing the single rulebook and continued effort to promote supervisory convergence. Ultimately, host Member States should be empowered to effectively protect investors and the proper functioning of their markets. Host competent authorities and ESAs should be provided with adequate regulatory instruments and responsibilities so that they can effectively assume their conduct supervision responsibilities.

Strengthening the application of the POG framework will prevent misselling while promoting suitable and sustainable access to capital markets for retail investors. It can allow for nudging consumers to more sensible choices for long-term investment goals. Clear and harmonized investor categories are essential to allow for suited target markets. For cross-border provision of services and distribution of products, continued effort to converge supervisory standards and practices is crucial, as well as

[6] Evaluatie provisieverbod, letter to Parliament. Ministry of Finance, 2018.

timely cooperation between NCAs and adequate regulatory instruments that allow for host-country supervisors to effectively protect investors and ensure proper market functioning.

4. Improving retail participation requires improving financial literacy

In addition to supply side measures, it is also important to improve the financial literacy of consumers. Evidence shows that financial knowledge, skills and attitudes are positively related to long-term savings and investment behaviour. Financial education – if provided in an effective manner – contributes to wealth accumulation by households.[7;8] Effective financial education programs incorporate lessons from behavioural economics; they do not limit themselves to transferring knowledge, but including skills and competencies, motivation, attitude and self-efficacy.[9] Many Member States have initiated programs for financial education on long-term savings and investments, but still many households lack the knowledge and skills, as well as the motivation and confidence, to improve their longer-term prospects.

The European Commission could stimulate evaluation of national programs for financial education, promote sharing of good practices and assist in scaling up effective programs. This improves retail participation in long-term savings and investment and increases financial resilience and well-being of households.

5. Promoting and facilitating sustainable investment opportunities

Investments in sustainable activities and companies can contribute to carbon neutrality within the European Union in 2050. Therefore, the Netherlands supports initiatives by the European Commission which promote sustainable investments by creating a common language for sustainability (Taxonomy), improving transparency on sustainability by companies (through the Corporate Sustainability Reporting Directive and the creation of international reporting standards), and developing easy to understand standards and labels for sustainable financial products (e.g. EU Green Bond Standard). This will help retail investors to assess the actual level of sustainability of investment products, thereby improving the credibility of "green" investments and preventing greenwashing. A European regulatory framework for providers of sustainability-related services could strengthen these initiatives.[10]

Initiatives that improve transparency on sustainability will allow retail investors to better assess how green investments are, and thereby prevent greenwashing.

[7] Atkinson, A., et al. (2015). Financial Education for Long-term Savings and Investments: Review of Research and Literature. *OECD Working Papers on Finance, Insurance and Private Pensions*, No. 39, OECD Publishing, Paris.

[8] Kaiser, T., Lusardi, A., Menkhoff, L., & Urban, C. J. (2020). *Financial Education Affects Financial Knowledge and Downstream Behaviors* (Working Paper No. 27057; Working Paper Series). National Bureau of Economic Research.

[9] Effective ways to advance responsible financial behavior. Money Wise and Nibud, 2016.

[10] Position paper French Autorité des marchés financiers (AMF) and Dutch Authority for the Financial Markets (AFM), 2020.