BARBARA ANTONIDES

Manager International and Public Affairs - Dutch Authority for Financial Markets

Deep seated market trust is achieved when clients' interests are truly at heart

The CMU aims to create a single market and get money from investments and savings flowing across the EU. This is ambitious and important for the EU capital markets. Flourishing capital markets will benefit companies, investors and consumers.

Creating a culture of investing is not an easy task and legislation is a key instrument to enhance participation in capital markets, particularly from retail. In legislative proposals, it is important to strike the right balance between making capital markets more attractive (less regulatory complexity and administrative burdens), while at the same time safeguarding the interests of investors. The proposed measures regarding clearing services, insolvency rules and the Listing Act are welcome steps in the right direction. This article discusses proposed amendments to various legislative frameworks, proposes to consider an advise-light regime and emphasizes that clients' interest should be the core in financial services.

Legislative frameworks

The existing EU frameworks for financial instruments such as UCITS, PEPP and AIFMD contribute to standardization. Within these frameworks products can be designed that serve consumers' needs and interests. As a regulator we appreciate the prospect of further clarification and harmonization of delegation structures and liquidity management tools in the AIFMD and UCITS. Further clarification on delegation and substance is very welcome to reach the desired level playing field within the EU. Funds should have sufficient instruments to manage and mitigate liquidity risks. Having adequate and sufficient LMTs is key in addressing micro- and macroprudential risks.

Standardized portfolio investments might be a way to lower barriers for certain investors. Depending on clients' risk appetite, investment horizon and goals, a portfolio with a standardized asset allocation is an option. In NL, the guided execution-only is offered as an alternative to investors. Under strict conditions, simplified portfolio management could be achieved with a less extensive suitability test.

Firms should focus on low costs and ongoing expectation management in their product offering.

Costs

It is questionable whether regulatory changes are needed to facilitate the industry's creativity to make their propositions attractive for clients. A light-advice regime applicable to such products would be a cost-effective alternative to full-on advice (with all the costs and quality requirements).

Yes, we are focusing on the costs again. Basic mathematics demonstrate slight percentual differences in costs have a significant impact in the long run. A fee of 0.50%, median fee for equity funds according to Morningstar in NL[1], at first glance does not differ that much from for example 1.70%, not an uncommon percentage in the EU. It may not look like a big difference for the average investor. However, on the long-term investing horizon it has a significant impact. If you invest 1.000 euro in an equity fund with 0,5% costs and a yearly return of 5%, the nominal value of your fund after 30 years in NL would be: 3.750 euro. With 1.70% the value would be: 2.630 euro. That is a difference of more than 40%.

Clients' interest at heart

In addition to clear legislation, it is important that also the financial services industry puts the clients' interest first. Only when clients' interest is at the heart of business decisions can the needed investor's trust in financial services be preserved or (re-)gained. We cannot expect all investors to understand everything in the financial sector; information asymmetry in the financial sector will always be high. Therefore, it is key that especially consumers are able to rely on financial products that are well designed, that distribution channels function appropriately[2] and that correct and useful information is provided.

It is particularly important to carefully consider the design of a product. Clients' interest is key in the product development phase. A product should always live up to its expectations. For this reason, the intention to enable open end ELTIFs is viewed with some scepsis. Having exposure to infrastructural products enables diversification and may contribute to optimizing portfolio return, particularly for a long run investment for retirement. Yet, the characteristics of the underlying investments (e.g. bridges, tunnels) make it not that easy to liquidate these assets when investors of an open end fund want to sell their participation. Therefore, managing expectations on illiquid assets is key!

To conclude: one must be very careful, particularly when it comes to expanding the product offering to retail clients. Foreseeable issues are at hand and as we all know trust is hard to gain but easy to lose.

[1] https://newsroom.morningstar.com/newsroom/news-archive/press-release-details/2022/Morningstar-Publishes-Global-Study-of-Fees-and-Expenses-in-the-Fund-Industry-Finds-Fees-Continue-to-Fall-Yet-Room-for-Improvement-in-Industry-Structure-Remains/default.aspx

[2] In NL a ban on inducements was introduced in 2013 for financial advisors.