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Retail investment strategy must help nudge financial well-being

The retail investment strategy is a key component of the Capital Markets Union, one that is aimed at promoting sustainable financial well-being of citizens. This is as close to the AFM's core mission as it gets. The AFM promotes fair and transparent financial markets, protection of consumers in vulnerable situations and ensuring long-term financial well-being.

The retail investment strategy addresses several issues. One is to unlock capital that is needed for the digital and green transformations. With increased access to capital, European companies are in a better position to take advantage of digital and sustainable opportunities. Second, the strategy aims to improve consumer outcomes by making capital markets accessible.

Recently, AFM published a paper[1] demonstrating that about half of Dutch citizens have adequate buffers to invest responsibly but currently do not. Depending on, among others, individual trading behaviour, this could offer returns of several hundred euros per year.

Value for money

In the Netherlands, approximately 85% of citizens already participate in capital markets through occupational pension schemes. The Netherlands has one of the lowest old-age poverty rates globally. This contrasts with the broader EU situation where one in seven EU citizens have inadequate pension savings. For this group, and for the self-employed, additional pension savings, sensibly invested in the long-term, may be necessary to supplement old-age income. There need to be ample products that offer value for money and cater to financial needs of citizens and society.

There is plenty of work to do in this regard. EIOPA[2] has repeatedly conducted research showing consumer detriment. This detriment can take the form of high-commissions which mis-align the incentives of advisors and clients, high fees (sometimes in excess of 4% per year, as also shown in ESMA's recent research[3]), or highly complex products that are simply not suitable for the majority of retail investors. All this substantially hurts the legitimate interest of retail investors and will ultimately lead to a decline in trust in the financial sector.

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Nevertheless, supervisors are not price police. While we can address excessive costs, firms should be able to offer competitive and fair market prices for their services. Similarly, supervisors neither can or ought to tell consumers which products to invest in, as long as firms operate within the consumer protection framework. Speculation has always been part of financial markets; while we can combat excesses, consumers should have a fundamental freedom to choose.

Financial literacy and behaviour

An increase in financial literacy may seem a win-win situation. Indeed, there is nothing against education and better understanding of finance and economics. Financial markets are inherently complex and difficult to navigate for average citizens, hence financial literacy can never be your only shot. Expectations on the real impact of increased education should be managed. Increased financial literacy does not change that consumers (even those with high levels of education) are not the rational homo economicus that economics textbooks presume. They will remain prone to exploitations of behavioural biases and unfair commercial practices by firms. Especially in a highly digitalized financial sector.

Choice environment

Nudging consumer behaviour happens all around us but is especially potent in a digital environment. Particularly in the financial sector, mis-selling can lead to long-term detriment. Traditional protection measures, such as disclosures and transparency, are not effective in the face of irrational consumer behaviour. A more powerful tool would be to require the design of the choice environment of trading apps and platforms promotes sensible decision-making by consumers or at least prohibits promotion of the products that have the highest risk of mis-selling.

A truly successful Retail Investment Strategy considers the supply-side of the market, i.e., the products. Making sure they offer value for money through strengthened product governance norms, by aligning the interest of the advisor and the client and taking away perverse incentives in the advisor-client relationship and making sure that digital distribution models work in the interest of the client by offering suitable products that meet demands as well as needs at a reasonable cost.

[1] AFM, "Meer Nederlanders zouden kunnen beleggen in plaats van sparen," 24 maart 2022, https://www.afm.nl/nl-nl/nieuws/2022/maart/meer-nederlanders-beleggen-sparen.

[2] See for example EIOPA's annual Cost and Past Performance Report for costs of IBIPs and UL products.

[3] See also ESMA's research on performance and costs https://www.esma.europa.eu/system/files_force/library/esma_50-165-1677_asr_performance_and_costs_of_eu_retail_investment_products.pdf?download=1.