



# Distribution systems of retail investment products across the European Union

*Executive Summary*



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## Executive Summary

The general objective of the Study is to provide facts and figures on the current features and functioning of European markets for retail investment products, analysing specifically:

- The supply of retail investment products through various distribution channels;
- The access to financial advice by retail investors and related risks and benefits;
- The impact of on-line distribution on the retail investment offering, notably on the breadth and terms of the offer, and on investor protection; and
- The risks and benefits of new distribution models developed by FinTech companies.

The Study covers 15 Member States chosen based on market size, date of integration into the European Union (EU), and the variety of specific policy frameworks in place: Belgium, Czech Republic, Denmark, Estonia, France, Germany, Italy, Luxembourg, the Netherlands, Poland, Portugal, Romania, Spain, Sweden and the United Kingdom (UK). The Study covers different types of investment advice: independent advice (e.g. through an Independent Financial Advisor (IFA) in a country with a ban on inducements), non-independent advice (e.g. through an advisor of a bank or insurer) as well as robo-advice (i.e. through an automated web-based platform). Investment products in scope of the Study are investment funds, listed bonds and equities, life insurance products with investment components and pension products.

The tender requirements were posing specific methodological challenges as this study had to cover different types of investments products that fall under different regulations. We were not able to identify a suitable existing methodology which would set a common framework for all types of products and related regulations across the countries in scope. As a result, we needed to develop a methodology specifically for this project that would allow for a coherent study of the distribution of different types of investment products to retail investors. A major element of the methodology was the application of two data collection methods that explicitly **mimicked the behavior of a financially less sophisticated retail investor seeking for information and advice on investment products**. As part of this methodology, we searched for information on investment products on the webpages of the largest distributors in each country in scope of the study and we conducted over 500 mystery shops at banks, insurance companies, independent financial advisors (IFAs) and robo-advisors across 10 out of 15 Member States in scope. Through this, we were able to collect information on the types of products actively proposed to retail investors and to assess how general suitability of the proposed investment products was established. The data collection for this project has been performed over the course of 2017, before the entry into force of several regulatory changes that are likely to impact the market.

### Mapping of the distribution systems for retail investment products

In a first step, we assessed the composition of the financial assets of households in the European Union through desk research. Currency and deposits are generally the most common forms of financial assets owned by households in the Member States. The remainder of households' financial assets is composed of the various investment products in scope of this Study, all of which appear to be generally available to retail investors in all the Member States analyzed. Substantial differences in the average

financial portfolio of households can be noticed between countries. Specifically, the representation of asset categories such as Pension entitlements and Life insurance entitlements varies substantially across Member States. These differences can be explained by various factors, including, but not limited to, cultural preferences, taxation, pension systems, and distribution systems.

When mimicking the behaviour of a retail investor looking at the offerings presented on distributors' websites, the most widely available investment products in terms of number of products presented to retail investors across Member States are generally, in increasing order: equity funds, bond funds, and mixed funds. The level of availability of products such as Exchange Traded Funds (ETFs), pension products and life insurance policies is much more country-specific. Overall, information on nearly all products is available on intermediaries' websites in the different Member States; however, the documentation provided is not systematically transparent (especially regarding costs borne by the investor after the acquisition of said products) and is in no way standardized across countries. Both these factors result in the information being difficult to comprehend for retail clients who are financially less / non-sophisticated. Depending on the type of product and Member State, some distributors do not display any or only partial information on applicable costs and charges (at least the information could not be found on a best efforts basis on the distributor's webpages). These elements make it very difficult for a retail investor to autonomously gather information and choose what they believe to be the suitable product or distribution channel for them. Note that there is no legal obligation for distributors to display fees to non-clients.

An average retail investor seeking personal advice from banks, insurance companies (including bancassurance) would end up with relatively similar investment recommendations across Member States in terms of product types, e.g. in-house investment funds, followed by life insurance policies. IFAs in the UK usually also propose to invest in ETFs on top of investment funds and pension products.

Seeking advice from non-independent advisors via banks and insurers remains the norm for the average retail investor in most Member States where mystery shops were conducted. Advisors proposed broadly the same types of products to the two investment profiles used (i.e. profile A: risk-averse young professional with 10,000 EUR to invest on a long term basis and profile B: more risk-inclined professional before retirement with 100,000 EUR to invest). The products offered were mainly in-house investment funds, with the notable exception of France where life insurance policies are dominant. Generally, equity funds were offered more regularly to profile B than profile A, in accordance with its higher risk-appetite and return expectations. Conversely, profile A was offered safer investments such as bond funds on a more regular basis than profile B. Finally, although the most commonly offered products for both profiles were mixed funds, the strategy followed by these mixed funds varied according to the profile's risk-appetite. In contrast, the situation in the UK and Netherlands differs substantially from other markets probably due to the introduction of ban on inducements. We found that in UK profile A mystery shoppers (with 10,000 EUR to invest) were redirected by all the banks and insurance companies to Independent Financial Advisors who indeed accepted to receive them and did provide advice regardless of the investment amount. In the Netherlands, mystery shoppers were systematically redirected to the institutions' websites where they could invest on their own, in execution-only mode. Banks also propose discretionary portfolio management services, even for investors with limited financial resources, however these services are not considered advice.

The spectrum of products recommended by robo-advisors across investment profiles and Member States is usually limited to ETFs. Some robo-advisors in Spain, UK and Germany also included mixed funds in the recommendations. France remains an

exception in terms of products offered since, according to our research, the vast majority of products offered by robo-advisors are life insurance products.

The share of funds distributed through captive and third party channels strongly depends on the Member State, with continental Europe dominated by distribution through banks and insurers in contrast to the UK where distribution through IFAs and on-line platforms prevails. Generally, our research indicates that advisors of financial institutions predominantly offer in-house products to retail investors. Insurance is sold either directly by insurers or through a number of different channels, the most common of which are brokers, agents and bancassurance. The popularity of each channel varies depending on both the market and the insurance product.

### **Business case: Accessibility of Exchange-Traded Funds (ETFs) to retail investors in the EU**

The ETF market in Europe, predominantly domiciled in Ireland, has been rapidly growing over the last few years (total assets grew by 373% in 14 years). Although dominated by a handful of promoters, retail investors have the choice between a large variety of ETFs. ETFs in the EU are approximately 25% more expensive than their counterparts in the US.

In terms of availability of ETFs to retail investors, the situation is ambivalent. A well-educated and self-directed retail investor is able to easily access ETFs through on-line investment platforms (e.g. websites of banks or fund supermarkets) at a relatively low cost. Also robo-advisors usually tend to base their investment portfolios on ETFs. On the other hand, ETFs were rarely proposed by “human” advisors across Member States when conducting the mystery shops. Only a few bank advisors in Germany and Spain as well as some UK IFAs proposed ETFs as a complement to other types of funds. Overall, retail investors only hold about 10 to 15% of total ETF assets in the EU.

### **Overview of costs and charges of investment products**

When choosing the most suitable investment product, its costs are an important element of the decision making process by the retail investor, albeit not the only one. We analysed the costs and charges of different types of investment products offered through the most frequently used distribution channels, including (offline) purchasing investment products through a branch or by telephone and on-line purchases through on-line sites of banks, fund supermarkets and on-line brokers.

In a first step, we created a list of banks, insurance companies, fund supermarkets, online brokers and social trading platforms for each Member State in scope with the intent to cover 80% of the retail market in terms of assets under management as well as the most relevant online investment platforms. Depending on the Member State, we identified 8 to 15 distributors. Then we visited the webpages of these institutions and identified all individual investment products promoted to retail investors and recorded the associated costs as displayed on the products’ information sheet or on the central tariff sheet of the distributor.

### **Transparency of fees**

Generally the investment products in scope of this Study require a certain level of financial literacy for a retail investor to understand the product specificities, its

associated risks and the fees charged over the investment period. In addition to this inherent complexity, we found that the way information on fees is displayed (or not) on distributor's webpages strongly depends on the type of product and the Member State. Information on fees for investment funds (money market, bond, equity and mixed funds) was usually easy to gather on the distributors' webpages. In roughly 10% of cases, our researchers had to search the web to find the relevant Key Investor Information Document (KIID) to retrieve information on costs. For ETFs and real estate funds, depending on the Member State, information on fees was slightly more difficult to access, with some distributors only displaying partial or no information. Furthermore, we found that in specific cases investors would need to gather information from different documents and, in some instances, combine them correctly, e.g. when investing in funds that are not in-house, additional custody charges would apply. Fees associated with listed bonds and equities were always disclosed by the distributors.

We found that the amount of information on fees for life insurance and pension products varied significantly from one Member State to another. In some Member States information on fees for life insurance and pension products could not be found on the webpage of any distributor. Even when displayed, it is difficult for a retail investor to discern whether the indicated fees include the costs for any underlying asset. This is particularly true for insurance products without capital guarantee. While the documentation provided on the webpages of distributors in Italy, Poland and Romania explicitly mentions that fees for the underlying asset are included, this is not the case for other Member States.

While there is no obligation for distributors to display fees to non-clients on their webpages, it is very difficult for retail investors to collect comprehensive information on fees and correctly interpret the information provided. This impedes their ability to compare fees across different products and distributors. They would need to talk directly with an advisor to receive the necessary information and associated explanations. This in turn increases the efforts a retail investor needs to make to compare different products and distributors. As a result, the retail investor might simply refrain from investing at all in any investment product or simply choose among the products provided by the bank or insurance company where they are already a client, thus preventing them from shopping around.

The feedback from Consumer Protection Agencies (CPA) and Alternative Dispute Resolution agencies (ADR) collected through an on-line questionnaire clearly indicates that an opaque fee structure is the subject of regular complaints by retail investors. Retail investors often feel misinformed by their advisors or the information on fees that is displayed on product sheets is inadequate and difficult to understand. According to the respondents, investors mostly complain about either the costs being too high or that the costs were hidden (e.g. costs of the underlying investment fund in life insurance products).

While this Study reflects the situation during 2017, upcoming regulatory changes, e.g. MiFID II, PRIIPS, IDD, have been designed with the intention to increase transparency on fees and help investors take informed investment decisions.

### **Fees by type of investment product across Member States**

For each type of investment funds, large differences in terms of costs can be found across Member States. As previously stated, the vast majority of funds offered to retail clients through advisors are in-house products thus differences in fees across Member

States might be explained through differing pricing strategies of the distributors as well as potentially local specificities.

Among the Member States in scope, distributors in the Netherlands and the UK appear to present the lowest ongoing charges for all types of funds. This is potentially related to the ban on inducements which has resulted in intermediaries abandoning advice and offering more low-cost options to consumers through their execution-only on-line channel. On the other side of the spectrum, distributors in Italy, Poland, Italy, Romania and Spain appear to indicate the highest average ongoing charges across the various fund types.

Concerning ETFs, proposed products seem to be most expensive in Spain, Denmark, Belgium and the UK while ETFs in Portugal appear to be the cheapest. ETFs are on average almost 60% cheaper than actively managed investment funds across our sample of 15 Member States.

For bonds and listed equities, substantial discrepancies are found across Member States. Distributors display the highest fees for investing in bonds and listed equities in Spain and Italy. In contrast, investors benefit from the lowest fees in the UK, the Netherlands, Romania and Luxembourg.

Results for life insurance and pension products need to be interpreted with caution. First of all, as previously stated, only a small sample of the distributors in scope of this Study displayed the costs for these products thus reducing the sample size. In addition, the information provided per product on the distributor's webpage is in many cases unclear as to whether all fees are included, especially those related to the underlying assets. Therefore, it is not surprising that our data shows large discrepancies in terms of fees across Member States.

Generally our data shows that a retail investor is potentially exposed to large differences in terms of fees between the various distributors for each type of investigated investment product. Furthermore, fees for the same category of investment products vary substantially across Member States.

### **Fees when purchasing investment products on-line**

Today a retail investor who decides not to rely on advice may use a variety of on-line investment platforms providing access to a large selection of investment products. These platforms include on-line websites of banks, fund supermarkets and on-line brokers.

Not taking into account promotional campaigns which are limited in time, banks usually do not offer discounts when purchasing investment funds through their on-line platforms. Thus the investor has to pay the same one-off and recurring fees as when purchasing by telephone or at a branch.

When investing into investment funds through a fund supermarket investors may regularly benefit from reduced entry and exit fees. In some cases, investors may even benefit from discounts on recurring fees, i.e. reduced fund management fees. On the other hand, we found that fund supermarkets in some Member States charge a service fee in addition to the recurring fees for the fund.

For ETFs, bonds and listed equities, one-off fees are usually substantially lower when purchasing on-line compared to purchasing at an agency or by telephone. Fund supermarkets and on-line brokers are on average the cheapest way to invest.

In general selling of life insurance and pension products through on-line channels remains marginal in most Member States. However, if an on-line purchase of these products is possible, e.g. life insurance in France and pension products in the UK, our research shows that investors are often better off purchasing on-line compared to buying over the telephone or at an agency.

Concerning the transparency and comprehensibility of fees, there is little difference between how information is displayed on the websites of the different types of on-line investment platforms. A financially less literate retail investor will probably find it difficult to identify and understand all the fees associated with such an investment.

## **Outcomes of different types of advice**

Advice is an important tool to guide retail investors in their investment decisions. In principle, it should enable investors to consider a wider set of investment products, better understand their features and buy products that match their individual profile. We investigated how different types of advice take into account the profile and investment needs of a retail investor and match this with the features of the investment products recommended. More precisely, we investigated how the general suitability of products has been established by distributors during the mystery shops in 10 out of 15 countries in scope for the two investor profiles described above. Due to the lack of a coherent definition of suitability checks across all investment products under scope, our methodology is based on general considerations (through expert advice and literature review) on how to check suitability of the investment products in scope, MiFID requirements and the need to align with the methodology of other mystery shops that have been performed at national level. As this analysis is based on the mystery shopping exercise, the limitations inherent to such methodology (which is described in the full report) should be taken into account when considering the findings described below.

As an outcome of the discussion with most of the advisors, shoppers were proposed to invest in up to three products across the Member States in scope for this particular exercise regardless of the availability of independent and non-independent advice. For robo-advice, investors were proposed only one product or portfolio of products in 80% of the cases. It is important to note that most shoppers had the impression that in non-independent advice settings the impact of the discussion (more specifically the "suitability" questions) on the actual product(s) proposed was quite limited. On some occasions advisors explained that the institution's team of investment experts constructed *ex-ante* a small portfolio of in-house products that, to a large extent, are suitable to cover the needs of different retail investors in terms of knowledge and experience, financial situation, investment horizon, objectives and risk tolerance. The role of the advisor merely consisted in choosing product(s) out of this limited portfolio which were deemed the most suitable for the specific shopper. While this approach potentially reduces the risk of the customer to be exposed to unsuitable products, it also highlights the often reported bias of non-independent advice due to incentive schemes in place at the institution in question.

We also investigated whether and how the different types of distributors establish the general suitability of the investment products in scope of this Study against a set of criteria specifically developed in our methodological approach.

Concerning the client's investment objectives, we found that the intended investment duration is generally covered across the board independent of the type of advice. In

contrast, substantial discrepancies appear across Member States and types of advice for the criteria of investment purpose as well as of risk profile of the investor. Advisors seem to be less comprehensive and methodological on these two criteria in some countries.

In relation to the client's experience and knowledge, the customer's prior experience with investments is covered to a very large extent by all types of advisors and across all Member States. In contrast, the degree to which the client's profession is asked varies strongly across Member States. Across the board, the level of education of the investor was very rarely touched upon.

With regards to the client's ability to bear the investment, advisors very frequently inquired about the customer's current financial situation in terms of assets. On the other hand, they do seem to care significantly less about the client's income and regular commitments.

Inquiring about the client's ability to bear losses is not a requirement under the current regulation and was tested merely in anticipation of the upcoming MiFID II regulation. While the rates vary widely for this criterion, advisors in some Member States do frequently inquire about this point.

While the results between independent and non-independent advisors seem to be globally comparable across and within Member States, independent advisors seem to ask more frequently questions on the ability to bear losses than non-independent advisors.

In terms of differences between profiles, there is evidence that advisors tend to ask less questions on the financial situation (e.g. resources, source of income, assets, and expenses) to clients wishing to invest larger amounts (such as profile B: 100,000 EUR to invest and higher willingness to take risks). Such clients being more valuable customers in the eyes of a financial institution than clients with less capital, it may be that distributors typically choose to adopt a more commercial approach with them, less centred on potentially intrusive questions and more focused on product marketing and investment objectives. This is also reflected in the fact that clients with more capital are generally asked more questions on investment experience, horizon, objectives and risk-appetite than the ones with less capital. It should be noted, however, that although they are asked less resource-related questions, clients looking to invest larger amounts are also asked much more often about their ability to bear potential losses than clients looking to invest less capital.

Concerning risk disclosures, there are no substantial differences between independent and non-independent advice at EU-level. At a Member State level, UK IFAs tend to explain risks in more detail to retail investors than non-independent advisors. No significant discrepancies are to be noted for the explanations of fees between the three different channels. Shoppers reported that their advisor usually showed them the past performance of the product. A projection of a potential future performance was shown much less often. There are no major differences between independent, non-independent advisors and robo-advisors when it comes to providing the details of the recommended investment products.

### **Focus on robo-advice**

It is difficult to compare robo-advisors with human advisors due to the inherent limitations of the pre-defined set of multiple-choice questions that are used by robo-advisors. While the results in terms of percentage values might seem comparable for any of the above general suitability criteria, one needs to keep in mind that each of the previously-mentioned criteria is usually covered by only one to three basic questions by a given platform.

Most robo-advisors presented additional clarifications on many criteria through pop-up explanations or illustrative examples. All automated platforms in our sample also provided the possibility to rely on assistance through human interaction although the level of intervention is not immediately clear. Most robo-advisors provide explicitly the possibility to be put in contact with a human advisor through a hotline (generating costs) or a chat functionality to receive further information and guidance. In contrast, other platforms only provide the possibility to contact a “technical” helpdesk which does not complement the advice process. In general, our mystery shoppers had the (subjective) impression that questions were worded objectively thus not guiding them to make a particular investment decision. When the shopper indicated to be a complete novice to investment products, about half of the robo-advisors did not allow the shopper to continue the advice process and suggested either that a human advisor could assist or that robo-advice is not suitable. A customer in such a situation could choose either of the two options proposed or go back in the advice process (or even launch a new process) and adapt their responses to be able to complete the process nonetheless.

Robo-advice relies on the self-assessment of the investor in terms of current financial situation, experience with investment products and risk appetite. Overconfidence of the investor or unreliable information provided by the investor might lead to the proposition of an unsuitable product at the end.

## **Initiatives to guide the distribution process of retail investment products**

Across the Member States we identified a number of national initiatives undertaken by the National Competent Authorities (NCAs) and consumer associations that aim at enhancing the protection of retail investors beyond the key regulations in place.

The regulators in the UK and the Netherlands introduced specific national regulations which, among others, introduced a ban on inducements. These regulations have had a substantial impact on the national investment landscape and led to a shift in investor behaviour from obtaining advice through banks and insurers to retail investors either taking investment decisions on their own through on-line investment platforms or obtaining advice through IFAs. Generally, local investors have become more cost-sensitive and better informed about investment products. Another example is the Spanish CNMV which introduced upper limits on entry and exit fees. Some NCAs also forbid or discourage non-suitable investment products from being sold in their territories either through legislation or voluntary moratoria.

In collaboration with their EU counterparts, NCAs regularly issue alerts to the general public when they discover products and services that infringe statutory and/or regulatory requirements.

NCAs also conduct their own investigations and inspections on financial actors as well as current practices. In particular, mystery shops are used by some NCAs to assess compliance of market practices with regulation.

Some NCAs support initiatives aimed at strengthening the financial education of retail investors. Initiatives on financial guidance by NCAs are still quite rare but may have the potential to effectively support the retail investor in their decision making.

In view of improving its supervision of investment advice the German financial regulator has introduced the obligation that all companies providing investment services are required to keep written minutes of all investment advice given to retail investors.

Consumer associations advocate the development of simple, transparent and comparable investment products and highlight the need to further support the provision of unbiased advice and transparent information in order to guide the retail investor without being exposed to conflict of interest or misleading or incomplete information. Furthermore, consumer associations request improvements in the enforcement of conduct of financial business rules to combat mis-selling of financial products. They also request that the potential of new technologies be further developed in order to provide retail investors with suitable low-cost products.

## **Challenges for consumers with regard to investment products**

The Consumer Markets Scoreboard which monitors how markets are functioning from the perspective of consumers clearly indicates that financial services are consistently ranked among the poorest performing service markets in Europe. Combined with a general low level of financial literacy, the average retail investors in Europe have little confidence in their own financial decision making as well as in financial institutions in general. Nevertheless the latest trend suggests that the efforts of public and private stakeholders are starting to pay off, consumers now have more trust in their banks, private pensions and investment funds.

We investigated more specifically the most frequent problems encountered by retail investors in relation to investment products and explored how consumers perceive the benefits and risks of different types of investment advice and how they valued these in terms of willingness to pay.

Today, an average consumer is overwhelmed by the sheer complexity of, and uncertainty associated with investment products which is partly due to the generally low familiarity with basic financial concepts. This is the case across the EU. Consequently, most households do not invest at all on capital markets or do so very infrequently across their lifetime.

When facing an investment decision, a retail investor in continental Europe often relies on advice in a face-to-face setting through a non-independent advisor of a bank or insurance company. Research suggests that different socio-economic groups make use of advice in a different way. On one hand, wealthy and informed investors consult an advisor to complement their own knowledge and further support their own decision-making. Financially less literate and less wealthy investors strongly rely on advice provided by their bank or insurance agent to guide them in their financial decision-making with too little financial knowledge to challenge unsuitable recommendations. Furthermore, retail investors frequently consider this type of advice to be free of costs as they do not realise the incentive scheme of the non-independent advisor and are therefore unable to identify potential conflicts of interest. CPAs and ADRs report that retail investors most frequently complain about mis-selling of products due to the provision of insufficient or unclear information about the product, its associated risks or the product being not adapted to their risk appetite. Retail investors also frequently complain about the fees associated with the investment products they purchased, claiming that fees actually charged are higher than those explained during the advice process. As a consequence, one can assume that today the average retail investor is not able to differentiate between the benefits and risks of different types of advice.

Due to the technological and societal changes of the digital age, the share of self-directed investors among the younger generation is increasing. Instead of consulting (independent or non-independent) financial advisors, they rather rely on their social networks (friends, family or social media) when faced with an investment decision.

Today investors' willingness to pay for different types of advice is generally low and strongly depends on the past usage of advice and therefore on the overall understanding of the benefits and disadvantages of advice. Experiments suggest that when investors became aware of the conflict of interest of their advisor (due to the incentive scheme in the case of non-independent advice) they were substantially less willing to pay for advice or to follow a recommendation to invest. Although rapidly gaining in popularity among the younger generation, only a minority of retail investors today are willing to pay for automated advice through robo-advice platforms.

Considering that retail investors frequently believe advice to be free of charge and show a low willingness to pay for independent advice, alternatives to advice exist that might help the retail investor:

- Financial education helps people develop the ability to improve their financial decision-making, lowering their overconfidence and valuing the risks and benefits of different types of advice. It is nevertheless questionable whether financial education programs will effectively change customers' behavior at a larger scale. Financial guidance, providing consumers with objective and easily comprehensible information in order to support sound financial decision making, is not widespread yet but could be considered as an important complement to financial education, advice and information.
- Other options, such as simpler products, e.g. a Pan-European Pension Product, and carefully designed default options, could contribute to simplify the choice of investment products for financially less sophisticated investors.

## **Impact of on-line platforms and new FinTech solutions on retail investment distribution**

We described and analyzed business and distribution models proposed by on-line investment platforms in the Member States under scope i.e. fund supermarkets, on-line brokers, robo-advisors and social trading platforms.

### **Fund supermarkets and online brokers**

Although fund supermarkets and on-line brokers are rapidly increasing their market share, the level of development of fund supermarkets varies strongly across Europe with the UK, France, Germany and the Netherlands leading followed to a lesser degree by Italy and Spain. The ban on inducements in the Netherlands and the UK has been a strong driver for fund supermarkets, on-line brokers and on-line investment platforms of incumbents.

Generally fund supermarkets and on-line brokers display lower costs for investing. Nevertheless, due to the complex structure of costs shown on the websites of fund supermarkets and on-line brokers, a retail investor needs to carefully check whether they have identified all relevant costs and charges.

Users need to perform appropriateness checks before accessing on-line brokers although the level of thoroughness of these checks varies substantially. As fund supermarkets generally focus on non-complex products, they are not required to execute appropriateness checks. In contrast, for some on-line brokers, future customers need to pass a complex test, requiring a very high level of financial knowledge before being able to actually purchase products.

Fund supermarkets may cater to retail investors through their larger product range focusing on funds, ETFs and, depending on the Member State, life insurance and pension

products. Most fund supermarkets provide some level of guidance, e.g. listing products in which investors with similar characteristics (age, investment purpose) invest in, and educational material aimed at helping a retail investor with choosing a suitable product. The average retail investor might not be able to understand the difference between the guidance provided by the fund supermarkets (where the responsibility remains with them) and actual advice from an advisor. Therefore, the investor is exposed to a certain risk of mis-buying.

### **Robo-advisors**

Robo-advisors leverage client survey data into complex algorithms that produce customized financial plans and asset allocations. They digitalize and automate client onboarding, investor risk profiling and investment allocation through algorithm-based assessments, and provide on-line investors with on-demand access to financial advice.

Robo-advisors leverage their technological solutions for both B2C and B2B clients. B2C clients are digitally savvy, relatively knowledgeable in financial matters, and invest low amounts. While these clients are considered as early adopters, the robo-advisory client spectrum is expected to widen. Although the market share of robo-advice is strongly increasing across Europe over the last years, only a tiny fraction of retail investors do rely on such platforms, with the UK and Germany leading in terms of current user adoption.

Robo-advisors usually focus on portfolios composed exclusively of ETFs. Some platforms allow the investor to complement the ETF portfolios with stocks, commodities, insurance and bonds.

While the algorithm proposing or deciding on the asset allocation to a specific client is the centrepiece of a robo-advisor, they also provide various degrees of human assistance ranging from pure technical assistance to actual support in investment decisions. The latter is of particular importance, as a retail investor might need to discuss the proposed investment portfolio or might have questions about specific product features that are not explained or available on the website.

On average, total annual fees of robo-advisors range between 0.90% and 1.60% of assets under management but are often either difficult to find on the webpage and/or displayed in a complex way, making it hard for an average retail investor to understand the fees they will be paying.

### **Social trading platforms**

Today there is a number of social trading platforms, also referred to as “copy trading” platforms, which allow novice traders to mimic the strategies of more experienced investors. Social trading platforms might be operating as brokers or networks.

In terms of investment products, social trading platforms typically offer complex products and target investors who are digitally savvy, knowledgeable in financial matters, and invest low amounts. Consequently, social trading platforms are less adapted to the average retail investor with little knowledge of financial products looking for a simple investment, as they will probably not understand the risks associated with the offered products (typically CFDs, Forex and derivatives).

Followers on social trading platforms very much rely on the performance of their signal providers' strategy and combined with the complex nature of the offered products, expose a less sophisticated investor to substantial risk.

## **Views of stakeholders pertaining to online investment platforms**

We collected the views of market players on how to improve the policy and regulatory framework surrounding on-line investment platforms.

The lack of harmonization and homogeneity of the regulatory requirements for financial services across the Member States is a common point raised by all managers of online investment platforms interviewed in the context of this Study. They see it as a factor hindering competitiveness and business expansion across borders and suggest the following:

- More regulations should be used because they are directly integrated into national law and give little room for interpretation to Member States;
- The differences among all Member States' regulatory requirements for financial markets should be studied in view of aligning them to the same level of specifications.

Furthermore, they stressed that small financial services providers, such as most robo-advisors, do not have the same size and business complexity as incumbent banks, yet still have to meet the same regulatory requirements in many cases. In this context, they suggested to:

- Create proportionality principles for regulatory requirements that would allow less complex and smaller companies to have lighter regulatory requirements than more complex and larger companies; and
- Ensure the proper consideration of innovative technologies and new business models in regulatory texts.

In contrast, NCAs as well as the European Banking Federation shared the view that any new entrants into the financial sector, be the traditional type of companies or new entrants, should be subject to the same existing licensing requirements and that no new licensing category should be created for new entrants. Innovation in terms of financial products is not limited to the new actors but also the more traditional players are entering this new sector hence the wish to maintain a level playing field across all players. Concerning robo-advice, several NCAs and CPAs insisted on the need to complement automated advice with the interaction of a qualified advisor when there is a need. This could help provide investors with additional information and mitigate the risks associated with the fact that on-line platforms rely on the investor's self-assessment to provide relevant information in terms of suitability. Additionally a human component could alleviate the risks of a faulty algorithm allocating unsuitable products to a (potentially large) set of customers.

Due to the rise of different types of on-line solutions, CPAs warned about the blurring boundaries between business models which provide:

- execution-only services where the customer shoulders the responsibility,
- discretionary portfolio management and
- "regulated" advice where the companies accept liability for the appropriateness of the product sale.

This situation creates uncertainty for consumers and might lead to a rising number of legal disputes due to the unclear allocation of liability. Also, when using on-line platforms across borders, customers should be made aware of the applicable national legal framework including consumer protection laws.

Market players also raised the importance of controls and testing during the development and maintenance of the algorithms calling for regulatory oversight of these algorithms guiding consumers through the advice process. Platforms should develop appropriate systems and controls to ensure the overall consistency of the information collected from clients and to minimize the potential for customers to overstate (willingly or unwillingly) their experience with investment products.

A certification scheme for comparison tools of financial products could ensure that certified platforms effectively guide the retail investors to the service provider and investment product responding to their particular needs and contribute to a better understanding and comparability of costs. Additionally, other voluntary public-private initiatives aiming at educating people and delivering transparent and comprehensible information could be explored, e.g. public databases on key information of investment products.

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