



## PROTECTING RETAIL INVESTORS – DISCLOSURES

On 1 October 2021, the European Securities and Markets Authority (ESMA) launched a Call for Evidence (CfE) on the European Commission (EC) mandate on certain aspects relating to retail investor protection.<sup>1</sup>

### Background leading up to the CfE

In the September 2020 [new Capital Markets Union Action Plan](#), the EC announced its intention to publish a strategy for retail investments in Europe in the first half of 2022.

As part of its evidence gathering, the EC launched in May 2021 an extensive three-month public consultation on a wide array of aspects related to investor protection.<sup>2</sup>

On 27 July 2021 the EC sent to ESMA a Request for Advice (RfA)<sup>3</sup> asking ESMA to assist the EC in the development of its strategy for retail investments and to make appropriate adjustments to the legislative framework.

ESMA was asked to deliver the report to the EC services by 30 April 2022. The EC invited ESMA to provide advice on a number of areas, namely:



Disclosures;



Digital disclosures; and



Digital tools and channels.

### Details of the CfE

Through this CfE, ESMA seeks input on significant overlaps, gaps, redundancies and inconsistencies between MiFID II and other investor protection legislation that might have a detrimental effect on retail investors.

It should be noted that this CfE is focused on disclosures directly addressed to clients<sup>4</sup> and does not aim at covering more general financial and non-financial issuer disclosure regimes.



### Disclosures

ESMA asks a series of questions relating to the following disclosure topics:

- Are there any specific aspects of the existing MiFID II disclosure requirements which might confuse or hamper clients' decision-making or comparability between products?
- What other aspects of the MiFID II requirements could be amended to facilitate comparability across firms and products while being drafted in a technology neutral way?
- Do existing requirements create information overload for clients or the provision of overly complex information?
- Are there material differences, inconsistencies or overlaps between MiFID II and other consumer protection legislation that are detrimental to investors?
- What vital information a retail investor should receive before buying a financial instrument?
- What practical lessons have emerged from behavioural finance that should be taken into account by the EC and/or ESMA when designing regulatory requirements?
- Are there any challenges not adequately addressed by MiFID II that impedes clients from receiving adequate information on investment products and services before investing?
- Any critical issues emerging from an overlap between MiFID II with the SFDR<sup>5</sup> and other legislation covering ESG matters?
- Whether respondents have empirical data or insights based on actual consumers' usage and engagement with existing MiFID II disclosure?



## Digital disclosures

ESMA notes that on the topic of digital disclosures, pertinent work has been published by EU and non-EU bodies, all of which can be relevant for the ESMA technical advice. These include, for example:

- The European Banking Authority (EBA) – Opinion on disclosure to consumers of banking services through digital means under Directive 2002/65/EC concerning the distance marketing of consumer financial services.<sup>6</sup>
- Australian Securities and Investments Commission (ASIC) – Regulatory guide: Facilitating digital financial services disclosures.<sup>7</sup>
- U.S. Financial Industry Regulatory Authority (FINRA) – Regulatory notice on Disclosure Innovations in Advertising and Other Communications with the Public.<sup>8</sup>

ESMA acknowledges that there may be various approaches and design concepts that firms can use in websites, email, social media, advertisements, mobile apps, and other electronic media and that through these channels firms can offer the possibility to clients to view information in narrative, tabular or even audio/video format. Especially when dealing with younger clients, the use of illustrations, cartoons, animations, pictograms, and other media has been used to tailor the user experience to specific target groups.

The ESMA analysis of approaches adopted in the financial sector shows that various approaches are currently used across jurisdictions and legal frameworks.

On the subject of digital disclosures ESMA seeks evidence on the following topics:

- Whether a particular group or groups of consumers are more willing and able to access financial products and services through digital means – so maybe more likely to rely on digital means.
- Which technical solutions can work best for consumers in a digital – and in particular – smartphone – age? Also, how these have proven to be an effective way to provide information that is clear and not misleading.
- In relation to the above, should any of the approaches set out by ESMA be integrated into the MiFID II framework? These approaches include the following:
  - » Easy navigability of information;
  - » Retrievability of information;
  - » Obligation to provide the possibility to save information;
  - » Presentation and format;
  - » Versioning<sup>9</sup>;
  - » Limiting of security risks for clients;
  - » Use of different means; and
  - » Monitoring effectiveness.
- Whether respondents see a general need for additional tools for regulators in order to supervise digital disclosures and advertising behind pay-walls, semi-closed forums, social media groups, information provided by third parties etc.





### Digital tools and channels

The EC aims to address the challenges and risks attached to digital transformation by proposing, where relevant, adaptations to the existing legislative frameworks by mid-2022.

In this section of the CfE, ESMA seeks evidence on topics such as:

#### For financial firms – robo-advice

- Whether there is any increased interest from retail investors to receive investment advice through semi-automated means such as robo-advice, and if so, what automated tools are most popular?
- Barriers that may exist which prevent firms from offering/developing automated financial tools in the securities-sector.
- If the current legal framework causes problems for potential clients to start investing via semi-automated means such as robo-advice. If so, what evidence can be provided in response to the CfE?
- Is the current MiFID II regulatory framework appropriate with regard to robo-advisers?

#### Online brokers

- What changes should be made to MiFID II in the area of suitability or appropriateness requirements (if any) to adequately protect inexperienced investors assessing financial markets through execution only and brokerage services via online platforms?
- If respondents have seen any business models at online brokers which may pose an inherent conflict of interest with retail investors, such as brokers making profits from the losses of their clients?
- If the current regular framework sufficiently protects retail investors against the risks of margin trading.

- Whether the current regulatory framework is sufficient for both current and future innovative concept e.g. social trading or concepts that contain elements of execution only, advice and individual portfolio management.
- A request for respondents experiences of payment for order flow (PFOF), zero commission brokers, and gamification techniques.

#### Role of social media

ESMA state in its CfE that retail investors are increasingly utilising social media as a source of information on which retail clients base their investment decisions. So ESMA ask respondents to provide information on the following:

- Evidence of increasing reliance of retail clients on information shared on social media.
- The risks and benefits connected to the use of social media as part of the investment process, along with any changes that should be made to the regulatory framework.
- Respondents observations as regards:
  - » Investment firms outsourcing marketing campaigns to online platform providers/agencies that execute social media marketing for them;
  - » Different characteristics of retail clients, such as risk profiles or trading behaviour;
  - » Whether the use of social media (including copy/mirror trading) has facilitated the spreading of misleading information about financial products and/or investment strategies; and
  - » Increased retail trading of 'meme stocks'.<sup>10</sup>

#### Risk warnings

ESMA only asks for feedback on one question in this section of the CfE, which is whether respondents consider the current regulatory framework concerning warnings provides adequate protection for retail investors.



## Open finance

Open finance is the sharing and use of customer-permissioned data held by financial institutions with third-party providers.

ESMA says that open finance can lead to increased competition with a positive effect on innovation and the development/availability of better financial products, whilst also making it easier for investment advisers to gather information on a customer and offer a more targeted approach.

ESMA ask respondents:

- Would consumers benefit from the development of an open finance approach, similar to what is happening for open banking and the provision of consumer credit, mortgages, etc?
- What the main risks are that may originate from the development of open finance; particularly for retail investors?
- Which client investor data could be shared in the context of the development for an open finance framework for investments?
- The main barriers and operational challenges for the development of open finance?
- If there is a need to foster data portability and the development of a portable digital identity?
- If regulatory intervention is necessary and useful in developing open finance?
- What the key conditions are that would allow open finance to develop in a way that delivers the best outcomes for both financial market participants and customers?

## Next Steps

The CfE closes for comments on 2 January 2022. ESMA will then consider the responses it receives to this CfE and will finalise the draft technical advice for submission to the EC.

ESMA will also be holding a public hearing in Q4 2021 and registration for the hearing will be available in the relevant section of the ESMA website in due course.

ESMA intends to coordinate closely with the European Insurance and Occupational Pensions Authority (who received a CfE on similar aspects regarding protection of retail investors investing in insurance-based investment products).

ESMA will also take into account actions resulting from the call for advice sent by the EC to the Joint Committee on a number of areas concerning the PRIIPs Regulation, as well as the request for technical advice sent by the EC to the ESAs on Digital Finance, which covers topics including digital platforms.

ESMA will also consider in its upcoming advice the ongoing U.S. Securities and Exchange Commission's work on matters related to the use of digital engagement practices by broker-dealers and investment advisers.

Due to the tight deadline set by the EC (April 2022) there will be no further consultation.

<sup>1</sup> [https://www.esma.europa.eu/sites/default/files/esma35-43-2827\\_call\\_for\\_evidence\\_on\\_retail\\_investor\\_protection.pdf](https://www.esma.europa.eu/sites/default/files/esma35-43-2827_call_for_evidence_on_retail_investor_protection.pdf)

<sup>2</sup> <https://ec.europa.eu/eusurvey/runner/retail-investment-strategy-2021>.

<sup>3</sup> [https://www.esma.europa.eu/sites/default/files/library/call\\_for\\_advice\\_to\\_esma\\_regarding\\_certain\\_aspects\\_relatng\\_to\\_retail\\_investor\\_protection.pdf](https://www.esma.europa.eu/sites/default/files/library/call_for_advice_to_esma_regarding_certain_aspects_relatng_to_retail_investor_protection.pdf).

<sup>4</sup> Typically "point of sale" ones, conceived to provide retail clients with useful and effective information on investment services and products.

<sup>5</sup> Sustainable Finance Disclosure Regulation (SFDR).

<sup>6</sup> <https://www.eba.europa.eu/eba-publishes-opinion-disclosure-consumers-buying-financial-services-through-digital-channels>.

<sup>7</sup> <https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-221-facilitating-digital-financial-services-disclosures/>.

<sup>8</sup> <https://www.finra.org/rules-guidance/notices/19-31>.

<sup>9</sup> Versioning: a recommendation for firms to retain a copy of all versions of the digital disclosures provided to clients and use technology, where possible, to maintain records of when each version was available in order to allow clients and potential clients to be able to prove which version of the disclosure they relied on.

<sup>10</sup> 'Meme stocks' are equities that experience spikes in mentions on social media.

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