3 August 2021

FIA EPTA response to the European Commission public consultation on a retail investment strategy for Europe

Introduction

The FIA European Principal Traders Association (FIA EPTA) appreciates the opportunity to provide feedback to the European Commission Public consultation on a retail investment strategy for Europe.

FIA EPTA represents 30 independent European Principal Trading Firms (PTFs) which deal on own account, using their own money for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets for a wide range of financial instruments, including shares, options, futures, bonds and ETFs.

FIA EPTA members are independent market makers and providers of liquidity and risk transfer on trading venues and end-investors across Europe. Market making and liquidity provision (also referred to as principal trading or dealing on own account) is a distinct activity that is undertaken by non-systemic investment firms rather than banks, in a highly dispersed and varied ecosystem of independent Principal Trading Firms. These firms operate in an innovative and competitive fashion leading to a vibrant, dynamic and diverse ecosystem which massively reduces interconnectedness and increases substitutability. This fundamentally reduces systemic risk whilst improving market quality and lowering costs for retail and institutional investors alike.

FIA EPTA members appreciate the European Commissions' consideration of our comments and suggested solutions and stand ready to provide any further input as required.

1. General questions

<table>
<tr><th>Question</th><th>FIA EPTA response</th></tr>
<tr><td></td><td></td></tr>
<tr><td>Question 1.1 Does the EU retail investor protection framework sufficiently empower and protect retail investors when they invest in capital markets?</td><td>No.

FIA EPTA members believe that the current retail investor protection framework is an important tool to ensure retail participation in capital markets. However, an update is necessary. Over the past years, retail participation on lit markets has gone down, and the ways in which retail investors participate in the markets has changed. New technologies and platforms have emerged and are rapidly changing how retail investors interact with the market. The Platforms are a great way to promote retail participation, however, they also create new challenges concerning investor protection. FIA EPTA members believe that the principles of transparency and the promotion of fair competition should always be at the core of any retail strategy. Keeping these two principles in mind, we suggest that the European Commission focusses on several key issues:

Best execution – The current best execution framework needs to be updated. The definition and criteria around best execution are overly complex for retail investors. This lack of transparency has allowed certain brokers to abuse PFOF and route orders to singular entities regardless of the quality of execution. Simplification of what constitutes ‘best execution’ for retail order should be centred around price, speed and likelihood of execution. FIA EPTA Members see the recent statement published by ESMA as a step in the right direction.
Addressing complexity of products – Less complex products suitable for retail investors exist in different areas, such as UCITS and certain Exchange Traded Funds (ETFs) and have been set as the default option of PEPP. However, retail investors can also invest in more complex products. FIA EPTA members believe that the trade-offs when trading these products should be clear. Measures should be introduced to encourage and highlight the benefits of exchange-listed products. FIA EPTA members believe that products that meet these requirements i.e. simpler investment products, that are traded on a regulated market such as equities, futures, and options versus products that are traded bilaterally between the issuer and retail investor without any competition for the order as with CFD’s Turbos and warrants. Furthermore, investor education and a clear distinction between retail investors, semi-professional investors and professional investors are important aspects to address investment risk.
Sustainability – Retail investors can be an important factor in increasing the demand for sustainable products. However, currently, it is hard to verify if an investment is sustainable or not. This is partly due to the large variety of ESG ratings available. This makes comparing between ratings very difficult, and this
</td></tr>
</table>

	might thus lead to greenwashing or retail investors hesitating to enter the market. Standardisation and transparency of financial products are key for citizens to make an informed decision.

Question 1.4 What do you consider to be factors which might discourage or prevent retail investors from investing?

	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree
Lack of understanding by retail investors of products?				x	
Lack of understanding of products by advisers?			x		
Lack of trust in products?				x	
High entry or management costs?				x	
Lack of access to reliable, independent advice?				x	

Lack of access to redress?			x		
Concerns about the risks of investing?				x	
Uncertainties about expected returns?				x	
Lack of available information about products in other EU Member States?				x	
Other					

Question 1.5 Do you consider that products available to retail investors in the EU are:

	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree
Sufficiently accessible		x			

Understandable for retail investors		x			
Easy for retail investors to compare with other products	x				
Offered at competitively priced conditions		x			
Offered alongside a sufficient range of competitive products			x		
Adapted to modern (e.g. digital) channels		x			
Adapted to Environmental, Social and Governance (ESG) criteria			x		

2. Financial literacy

Question	FIA EPTA response
Question 2.2 Which further measures aimed at increasing financial literacy (e. g. in order to promote the OECD/Commission financial literacy competence framework) might be pursued at EU level? Please explain your answer, taking into account that the main responsibility for financial education lies with Member States:	FIA EPTA members believe that the variety and complexity of investment products and services offered to the retail market can be bewildering. Institutional investment vehicles, whilst generally catering to less sophisticated investors, can also leave retail investors uncertain as to the risks and rewards to which they are being exposed. A strong strategy to ensure that retail investors have secured essential core principles in Financial Literacy can help to ensure that individuals make better and more confident investment decisions. Financial Literacy courses delivered by independent and validated educational providers can support the European Commission's efforts to empower the retail investor community in navigating the Capital Markets landscape. Taught and self-taught courses delivered on electronic platforms are trusted for certifying knowledge in diverse fields for the consumer market already including driving theory and marine certification have long been successfully implemented globally. Over the last 18 months of the pandemic, innovations in the sphere of financial education have advanced rapidly with educators delivering both self-taught and guided learning for recognised and audited courses from level 2 through to level 5 and up to level 7 (post-graduate) courses. This experience should be combined with the legislative and regulatory practices that ensure the content and testing of knowledge in areas such as driving and marine theory can form the foundation of a partnership between the government, financial literacy education providers, and the industry for the benefit of the retail investor community.

4. Disclosure Requirements

Question	FIA EPTA response

Question 4.5 Does pre-contractual documentation for retail investments enable a clear comparison between different investment products? **Yes/no/don't know**	**No.** FIA EPTA members believe that there is not a clear pre-contractual documentation to retail investors to highlight comparable alternatives. It is the case that you can receive an identical exposure to an underlying via listed options over warrants and this is not disclosed to retail investors. This is similar for many other financial products with comparable payoff profiles. As part of the pre-contractual documentation, there needs to be clear information of other products on that particular ISIN so retail investors can better choose between products. With this, the risks of trading bilaterally vs on a regulated central limit orderbook should be made apparent to retail investors as part of this documentation.
Question 4.6 Should pre-contractual documentation for retail investments enable as far as possible a clear comparison between different investment products, including those offered by different financial entities (for example, with one product originating from the insurance sector and another from the investment funds sectors)? **Yes/no/don't know** **Please explain your answer**	**Yes.** FIA EPTA members believe that there should be increased disclosure requirements put on structured products. Structured products and specifically warrants have a closed market structure where the issuer is the sole liquidity provider and as a result, this leads to inflated prices for warrants over directly comparable options. FIA EPTA has shown this as part of an insight paper[1] on the warrants market in Europe. This paper shows that warrants investors are losing millions of euros each year by trading warrants where they could obtain superior pricing in the listed options market. It is not clear to retail investors that they can replicate their desired exposure with listed options and receive the benefit of competitive transparent pricing. The reason for this is that it's often the case that retail investors are not aware of the alternative derivative products on a certain security and as a result select a suboptimal product to trade. This would happen to an afar lesser extent if clear documentation was provided to retail investors on the listed alternatives available to them. There should be disclosure requirements made to retail participants highlighting listed alternatives to structured products. These requirements should make retail investors aware of other derivative products available on a particular ISIN. This would then allow for retail investors to make a better choice from a wider list of products available to them. Alongside this as part of the pre-contractual documentation disclosures should be made as to why different structure products/warrants from certain issuers have varying transaction fees.

[1] FIA EPTA insight paper: *Higher cost, higher risk: The impact of the closed market structure on the European warrants market: price analysis and recommendations*; https://www.fia.org/epta/resources/higher-cost-higher-risk (November 2020).

Question 4.13 How important is it that information documents be translated into the official language of the place of distribution?	***Not at all important***
Please explain your answer to question 4.13	FIA EPTA members believe that the requirement that information documents be translated into the official language at the place of distribution has been a barrier to Europeans seeking to invest in the most globally liquid, low-cost ETFs (e.g. SPDR), as issuers often do not wish to incur the costs of translation into myriad European languages. This forces European retail investors to purchase products with less liquidity, wider spreads and higher cost ratios, which is counter to the interests of retail investors. In our view, English language documents should be acceptable.

7. Reviewing the Framework for Investor Categorisation

Question	**FIA EPTA response**
Question 7.1 What would you consider the most appropriate approach for ensuring more appropriate client categorisation?	
Introduction of an additional client category (semi-professional) of investors.	Yes
Adjusting the definition of professional investors on request	No
No changes to client categorisation (other measures, i.e. increase	--
product access and lower information requirements for all retail investors)	--
Question 7.2 How might the following criteria be amended for professional investors upon	

request?	
"the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters"	
No change	--
30 transactions on financial instruments over the last 12 months, on the relevant market	--
10 transactions on financial instruments over the last 12 months, on the relevant market	--
Other criteria to measure a client's experience: please specify	Frequency of transaction is not necessarily a good measure for classification as a professional-client (although may be suitable in the context of a semi-professional category should that be adopted), particularly in a context of a move towards commission-free trading and apps that can facilitate a "gamification" of the market. It would be more appropriate to base Elective Professional classification on the combination of the ability to bear financial risk (which is already well defined in the current MiFID requirements) in conjunction with genuine professional trading/financial market experience and/or relevant training/qualifications.
"the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500,000"	
No change	Yes
Exceeds Euro 250,000	--
Exceeds Euro 100,000	--
Exceeds Euro 100,000 and a minimum annual income of EUR 100,000	--
Other criteria to measure a client's capacity to bear loss: please specify	Should explicitly exclude pension/retirement accounts or any other accounts to which there are term requirements or other restrictions on liquidating or withdrawing the funds.
"the client works or has worked in the financial	

sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged"	
No change	
Extend definition to include relevant experience beyond the financial sector (e.g. in a finance department of a company).	No
Adjust the reference to the term 'transactions' in the criteria to instead refer to 'financial instruments'	Yes
Other criteria to measure a client's financial knowledge: please specify	With the inclusion of a category of semi-professional investors, it would make sense to increase the threshold to be treated as a professional investor to those who genuinely had professional trading experience in the products/markets in question.
Clients need to qualify for 2 out of the existing 3 criteria to qualify as professional investors. Should there be an additional fourth criterion, and if so, which one?	
No change	
Relevant certified education or training that allows to understand financial instruments, markets and their related risks.	Yes
An academic degree in the area of finance/business/economics.	No
Experience as an executive or board member of a company of a significant size.	No
Experience as a business angel (i.e. evidenced by membership of a business angel association).	No
Other criteria to assess a client's ability to make informed investment decisions: please specify.	--

8. Inducements and Quality of advice

Question 8.1 How effective do you consider the following measures to/would be in protecting retail investors against receiving biased advice due to potential conflicts of interest?

	Not at all effective	*Rather not effective*	*Neutral*	*Somewhat effective*	*Very effective*
Ensuring transparency of inducements for clients				X	
An obligation to disclose the amount of inducement paid				X	
Allowing inducements only under certain conditions, e.g. if they serve the improvement of quality		X			
Obliging distributors to assess the investment products they recommend against similar products available on the					X
market in terms of overall cost and expected performance					

Introducing specific recordkeeping and reporting requirements for distributors of retail investment products to provide a breakdown of products distributed, thus allowing for supervisory scrutiny and better enforcement of the existing rules on inducements			X		
Introducing a ban on all forms of inducements for every retail investment product across the Union		X			

Question 8.5 How should inducements be regulated?

	Yes/no
Ensuring transparency of inducements for clients	***Yes***
Ensuring transparency of inducements for clients, including an obligation to disclose the amount of inducement paid	Yes
Allowing inducements only under certain conditions, e.g. if they serve the improvement of quality	Yes
Obliging distributors to assess the investment products they recommend against similar products available on the market	Yes

Introducing specific record-keeping and reporting requirements for distributors of retail investment products to provide a breakdown of products distributed, thus allowing for supervisory scrutiny and better enforcement of the existing rules on inducements	Yes
Introducing a ban on all forms of inducements for every retail investment product across the Union	No

Question	**FIA EPTA draft response**
8.6 Do you see a need for legislative changes (or other measures) to address conflicts of interest, receipt of inducements and/or best execution issues surrounding the compensation of brokers (or firms) based on payment for order flow from third parties?	FIA EPTA members note and welcomes ESMA's recent public statement[2] regarding payment for order flow ('PFOF') practices in Europe. We believe that the legislation currently in place is sufficient to prevent harmful market practices in Europe only where it is enforced by sufficient supervisory oversight and action. PFOF practices in some EU markets, where brokers "sell" their retail clients' order flow to market makers who then pay the broker in order to act as the sole counterparty to the retail investors, often leads to retail investors being disadvantaged as their orders trade at worse prices compared to a competitive execution market. FIA EPTA members are aware that in Germany nearly all retail-focused exchanges (RMs and MTFs; incl. the by far largest retail exchange 'Tradegate' which executed over 54mn trades in 2020) operate a single-market maker trading model, whereby only one market maker per product segment is responsible for the entire order book. Such systems are often characterised by PFOF practices whereby the retail broker, in exchange for steering its clients' order flow to a specific system, receives a monetary inducement from the relevant market maker on that system who will be the exclusive counterparty to the retail investors' orders. This does not appear to be in line with MiFID II requirements concerning best execution and inducements. Furthermore, by implementing bespoke anti-competitive exchange rules in order to protect their de-facto monopoly, other market makers – who could easily narrow the spread and therefore decrease execution costs of retail orders – are prevented from participation. On top of this, the strict segregation of uninformed retail flow makes it easy for the monopolistic market makers to make money whereas at the same time this retail flow does not contribute to the actual price finding mechanism on the incumbent exchanges where only the highly informed institutional as well as the HFT flow remains. Hence it is eventually

[2] ESMA35-43-2749

	quite easy to price-improve the incumbent exchanges but this 'improvement' gives actually a false impression of the real execution quality of such exchanges. However, PFOF can also be beneficial to both the market and the retail investor where the broker appropriately manages its conflicts of interest **and** achieves the best possible outcome for its client. Properly disclosed PFOF can reduce barriers to entry for small retail brokers while reducing execution costs for retail investors. Markets, where execution quality is transparent, have robust and competitive execution ecosystems. However, the opaque nature of PFOF arrangements in Europe makes it difficult to measure whether these obligations are being met. To remedy these issues FIA EPTA recommends: i) enhancing rules relating to best execution and transaction cost disclosure to allow for transparent, comparable, and understandable product information (see Q8.7) ii) strict supervisory enforcement for brokers who do not abide by the investor protection rules. iii) Introducing specific recordkeeping and reporting requirements for distributors of retail investment products to provide a breakdown of products distributed, thus allowing for supervisory scrutiny and better enforcement of the existing rules on inducements. These enhancements would bolster the CMU's objective of introducing more retail investors to Capital Markets while ensuring they trade simplified and risk-appropriate products, such as equities, on transparent trading venues.
Question 8.7 Do you see a need to improve the best execution regime in order to ensure that retail investors always get the best possible terms for the execution of their orders?	**Yes.** FIA EPTA members believe that the current best execution regime is not sufficient to allow retail investors to measure the execution performance of their brokers. The definition and criteria around best execution are overly complex for retail investors. This lack of transparency has allowed certain brokers to abuse PFOF and route orders to singular entities regardless of the quality of execution. We believe this is in contravention of MiFID rules currently in place. We share ESMA's concerns that some firms receiving PFOF from execution venues present a list of execution venues to their clients and ask their clients to choose the specific venue to execute their orders. The execution venues providing PFOF are presented in a prominent or more appealing manner. In doing so, the order is supposedly executed according to the specific choice made by the client and thus the execution of the order would fall outside the remit of the firm's

	best execution obligations. We agree with ESMA that such a choice does not constitute a proper specific instruction from the client. In addition, it appears that, although firms receiving PFOF must comply with both the quality enhancement and best interest requirements, the current emphasis is on proof of enhancement of the quality of the service with less scrutiny on these firms acting in the best interest of their clients resulting in sub-optimal outcomes for retail investors. To enhance the regime FIA EPTA members recommends: i) simplification of what constitutes 'best execution' for retail order flow. The criteria should be centred around **price, speed** and likelihood of execution. ii) the creation of a 'execution quality report' for retail clients. This should be mandatory for retail brokers to produce and be pro forma, clear and transparent while providing a breakdown of execution quality and associated costs. This would allow investors to measure the performance of their chosen broker without the need for sophisticated investment acumen. iii) ESMA provides further guidance on what constitutes a specific client instruction to determine best execution obligations. iv) The Commission continues to seek the establishment of a European Consolidated Tape to enable the benchmarking of bids and offers across the Union. This would allow both regulators, firms and retail investors to measure execution quality and the provision of best execution.

9. Addressing the complexity of products

Question	**FIA EPTA draft response**
Question 9.1 Do you consider that further measures should be taken at EU level to facilitate access of retail investors to simpler investment products?	**Yes** FIA EPTA members believe that further measures should be introduced to encourage trading in exchange-listed products along with highlighting the benefits of those products over unlisted alternatives. By retail investors participating in regulated on exchange trading for listed products, they receive the benefits of fair and competitive

Yes/no/don't know **Please explain your answer**	pricing as required under MiFID. Alongside this, they have reduced risk given the products are cleared by a CCP. We would regard products that trade on a regulated market as these simpler investment products such as equities, futures and options vs CFD's Turbos and warrants which are traded bilaterally between the issuer and retail investor without any competition for the order. The benefits of trading on a central limit order book should be made clear to retail participants along with the risks of trading bilaterally vs the sole issuers of a particular financial products.

12. Sustainable investing

Question	**FIA EPTA draft response**
Question 12.2 What would help you most to take an informed decision as regards a sustainable investment?	*(Not at all helpful), (rather not helpful), (neutral), (somewhat helpful), (very helpful), (Don't know - No opinion - Not applicable).*
Measurements demonstrating positive sustainability impacts of investments	Very helpful
Measurements demonstrating negative or low sustainability impacts of investments	neutral
Information on financial returns of sustainable investments compared to those of mainstream investments	Very helpful
Information on the share of financial institutions' activities that are sustainable	somewhat helpful
Require all financial products and instruments to inform about their sustainability ambition	somewhat helpful
Obligation for financial advisers to offer at least one financial product with minimum sustainability ambition	neutral
All financial products offered should have a minimum of sustainability ambition	neutral

Question 12.3 What are the main factors preventing more sustainable investment?	(not at all important), (rather not important), (neutral), (somewhat important), (very important), (Don't know - No opinion - Not applicable)
Poor financial advice on sustainable investment opportunities	very important
Lack of sustainability related information in pre-contractual disclosure	somewhat important
Lack of EU label on sustainability related information	very important
Lack of financial products that would meet sustainability preferences	somewhat important
Financial products, although containing some sustainability ambition, focus primarily on financial performance	rather not important
Fear of greenwashing (i. e. where the deceptive appearance is given that investment products are environmentally, socially or from a governance point of view, friendly)	somewhat important
Other	very important

Question	**FIA EPTA response**
Please specify to what other factor(s) you refer in your answer to question 12.3:	FIA EPTA members agree with the European Commission observation that citizens are today increasingly aware of the serious economic, environmental, and social risks arising from climate change and that they are becoming conscious of the potential contribution they might make towards mitigating those risks by making more sustainable choices. FIA EPTA members would like to note that it is difficult to verify for citizens if the investments that they do are truly sustainable. FIA EPTA members observe a large variety of ESG ratings in the market and would like to express their concerns on the comparability of the data. Due to the absence of standardisation of ESG indicators (for example, some rating agencies might take child labour into account while others do not), there is an average correlation of .61 ['Aggregate confusion: the divergence of ESG ratings', Berg, Koelbel and Rigobon, 2019]). Standardisation and transparency of financial products are key for citizens to make an informed decision.

	As FIA EPTA members do not take directional positions in the market and therefore the relevance of the ESG information is limited for our members' activity. However, FIA EPTA members believe that, when ESG information is reliable and harmonised, liquidity providers would have a better understanding into what extent the products they trade are sustainable and have taken ESG factors into account or not. This potentially could play a role when making the decision to start providing liquidity in a product. Looking at the market as a whole, FIA EPTA members believe that ESG information plays a role in getting a better understanding into what extent investments are sustainable or not (this counts for individual ratings and aggregated ratings).

Question	**FIA EPTA response**
Question 12.5 Would you see any need to reinforce the current research regime in order to ensure that ESG criteria are always considered?	Yes.

13. Other Issues

Question	**FIA EPTA draft response**
Question 13 Are there any other issues that have not been raised in this questionnaire that you think would be relevant to the future retail investments strategy?	A 2019 study by Greenwich Associates looking at US markets found that modern retail investors benefitted from zero commission costs, while being able to enjoy many of the advanced tools and capabilities previously reserved for professional or institutional investors, including sophisticated charting options, customizable filtering for trade opportunities, tremendous amounts of data at their fingertips, and even the ability to program some of their own trading strategies. They also found that execution quality metrics have continued to improve decade over decade. https://www.spglobal.com/_assets/documents/marketplace/impact-zero-commissions-retail-trading.20-2009.pdf To a large extent, the same can be said for European retail investors, and in general, we believe the trend toward zero commission is a positive one. However, to stay in business while charging nothing means alternative revenue sources must be available. Some of the traditional means by which brokers generate additional revenue are harder for European brokers compared to their US counterparts, such as investing customer funds in money market assets because

	of extremely low or negative interest rates in Europe and rules against payment for order flow. Moreover, European brokers have higher costs due to the highly fragmented EU markets landscape and the number of parties in trade cycle. Therefore, we believe it makes sense to analyze how European brokers are able to offer comparable commission structures. As we have stated in our response to Q8, we believe there should be a more effective regulatory framework for payment for order flow (PFOF) and stronger supervisory enforcement in case where brokers do no act in the interests of their clients. However, other revenue models related to PFOF may also embed conflicts of interest, such as income from partnerships with providers of financial products (issuers), where issuers pay commissions to brokers in order to advertise their own products in a targeted manner, or income from partnerships with exchanges that pay for traffic, as ESMA has already commented on. We also note that some brokers (zero commission or not) are not clear to their clients about whether they are trading a stock or a CFD. We believe there should be very clear distinctions within a broker's service distinguishing between asset classes and product types to eliminate any potential confusion. Moreover, while brokers may advertise 'zero commission,' often other fees may not be adequately disclosed or explained to retail investors, such as: · High margin rates, as the popularity of highly leveraged strategies grows; · Certain order types that do not provide immediacy of execution but rather execute at the end of the trading day at the closing price, or if placed late in the day, only the following day; · Inactivity fees if investors do not log in and trade in a given period, which discourages buy & hold investing; and · High costs for paying out dividends or transferring positions or cash balances to other accounts. We believe retail investors on balance probably still benefit from such services, but that they should be fully aware of the cost structures and other business model arrangements that make "zero commission" offerings possible in Europe.