

**Response to the European Commission's CMU action on the cross-border distribution of
funds across the EU**

9 October 2015

Question 1.10 – What type of investor are you?

The European Investors' Association (European Investors) was formed in 2015 and aims to defend the interests of investors, primarily retail investors. Through its own direct membership as well as its member organizations, it represents over 45.000 retail investors across the European Union (EU).

Some of our responses to the questions posed in the consultation document are based on the results of a survey that European Investors held among its direct and indirect retail members¹. Some of these results were also presented at the ESAs Consumer Protection Day 2016.

Question 1.11 – Do you invest in investment products?

Our members invest in shares (95%), bonds (34%), structured products (35%), investment funds, ETFs and index trackers (33%) and real estate (35%)².

Please note that most of our members are active retail investors. These figures are therefore not representative for the entire retail investor community. According to research by the Financial Markets Authority (AFM) in the Netherlands, where most of our members are based, 65% of retail investors invest in investment funds, 8% in indextrackers/ETFs and 'only' 51% in shares³.

Question 1.12 – Do you invest directly or indirectly in particular via an insurance wrapper such as unit linked insurance contracts in investment funds?

Most of our members invest in investment funds directly (and online).

Question 1.13 – In which type of fund(s) do you invest [domestic / overseas UCITS / AIFs, EuVECAs, EuSEFs and ELTIFs]?

We do not have the data required to answer this question in full detail. As our members are retail investors, one would assume they mainly invest in UCITS funds.

However, research⁴ indicates that the majority of funds in the EU sold to retail investors do not have the UCITS label, but are an alternative investment fund (AIF). European Investors would like to urge the EC to assess to what extent the AIFMD framework is used to market UCITS-like funds to retail investors. Such practice is not desirable for two reasons:

- the protection offered to investors in UCITS is superior to that in AIFs;
- the AIFM framework does not offer a passport for fund managers marketing their funds to retail investors. Fragmentation of the EU market will persist under this practice.

Question 1.14 – What is the approximate allocation of your assets between funds [In % of your financial assets]?

Approximately 33% of our members invest in investment funds (incl. ETFs/trackers). The higher the investable amount, the higher the probability an investor invests in investment funds. Also, generally

¹ The survey was conducted amongst a sample of 4000 retail investors based in the Benelux from 4 to 23 September 2016, randomly selected from a database of c. 45.000 retail investors who are a direct or indirect member of European Investors.

² These figures are based on VEB data collected in 2011.

³ AFM Consumentenmonitor Beleggen 2016. Available [here](#).

⁴ FSUG Retail Market Integration Report (Oct. 2015). Available [here](#).

speaking, the more risk-averse, the higher the probability that a retail investor invests in investment funds (instead of e.g. individual shares).

Unfortunately, we do not have the data required to give an insight into the allocation our members' assets to funds in general or to specific types of funds (in % of financial assets).

Question 1.15 – How do you inform yourself on available investment opportunities (e.g., advice, online information tools, face-to-face conversation with a bank staff or financial advisor, etc.)?

Our members use all of the methods described in the question but predominantly online information tools. Most of our members are active retail investors who invest on a self-execution basis and do their fund investments online.

Generally speaking, we see a decline in personal investment advice in the Netherlands as it is getting rather expensive for retail investors with a portfolio below € 25.000. This relates to the full ban on commissions that was introduced in 2014. For UK retail investors there seems to be a similar development. European Investors is wary for the implications of this move away from advice for less experienced and knowledgeable retail investors who need such advice to make informed and responsible investment decisions.

Question 3.10 – To what extent is the UCITS Key Investor Information Document (KIID) useful in your investment decision? Is a KIID always provided to you?

43% of the respondents to our survey indicate that they use the KIID.

This is partly because many of the investors do not receive it from their intermediary (bank or broker). Of those respondents that use an adviser, 57% indicated they never received the KIID. The KIID would be used more if all intermediaries would provide them to their clients. We hope that under MiFID II this obligation will be more strictly supervised and monitored.

Still, the fact that the KIID is not used as much as policy-makers (and we also, as investor representatives) would like them to use also indicates that the KIID is not entirely adapted to the information needs of retail investors. Retail investors seem to desire objective information, but it should not be overly formal, dense and complex. In other words, it should still be easily understandable.

It is important to note that the value of the KIID also lies in the information it provides to advisers and portfolio managers who can use it to increase the quality of their services to investors.

Also, the KIID provides a potentially valuable source of information for regulators. The Prospectus Regulation proposal introduces a centralized storage mechanism at ESMA. Article 45 requires ESMA to publish every year a report containing statistics on the prospectuses approved and notified in the Union and an analysis of trends. We would like to see a similar storage mechanism for the KIID/KID.

Question 3.11 – To what extent do marketing communications play a role in your investment decision? Do you consult marketing materials before making your investment decision?

From our survey, we conclude that 59% of investors consult marketing communications before making an investment decision. This percentage is higher than the 43% of investors that consult the KIID. The fact that investors tend to use very loosely regulated information (i.e. marketing materials) more than highly regulated information (i.e. KIID) should make us rethink our approach towards disclosure. Retail

investors seem to desire objective information, but it should not be overly formal, dense and complex. In other words, it should still be easily understandable.

Question 3.12 – To what extent do you consider the marketing communications as providing a balanced views of the up-and downsides of a particular investment and do they contain meaningful information to assess risk and costs associated with the investment products?

89% of the respondents to our survey indicate that marketing communications need to be supervised. Such supervision should:

- make sure information is complete and correct;
- ensure objectivity of information provided;
- prevent investors from being misled and deceived;
- to correct for excessively optimistic information;
- to facilitate trust among investors.

These responses suggests to us that these investors have experienced cases in which they at least had the feeling that marketing communications did not provide a balanced view of the up- and downsides of a particular investment fund. As an investors association, we of course also regularly look into marketing communications and share these concerns.

Question 3.13 – To what extent is it important for you to have marketing communications in your national language?

This question was not included in our survey. We would like to see as a requirement that all marketing communications are made available in the local languages of the Member States in which a fund is marketed. If such a requirement is for some reason not feasible, there should be the requirement to publish all marketing communications at least in English.

Question 3.14 – How relevant is the disclosure of the following information in the marketing communications?

Information on costs and charges

86% of the respondents to our survey indicate that they look at costs when deciding whether to invest in a certain fund. We are very pleased to see this high percentage. Costs tended to be overlooked by our investors in the past while they can have a large (cumulative) impact on net investment return.

It also indicates that work to further improve cost transparency should continue and have priority, in particular with regards to:

- *Transaction costs:* Transaction costs are not included in the ongoing costs charges (OCG) that are to be disclosed in the Key Investor Information Document (KIID)for UCITS. Transaction costs will be disclosed in the KID for PRIIPs. However, we have some concerns on the way transactions costs are calculated in the RTS.
- *Entry fees:* Most retail funds in Europe still include entry fees. This practice is widespread and detrimental to retail investment returns, especially in a low-yield environment. Often, investors are not aware of these entry fees. The impact of these charges on returns is also not disclosed to retail investors in the mandatory past-performance disclosures of the KIID.

Information of past & future performance

63% of the respondents to our survey indicate past performance is one of the factors they take into consideration when deciding whether to invest in a certain fund or not. This suggests to us that the omission of past performance data in the KID for PRIIPs is a serious flaw. Historical performance figures provide a reliable source of information through which retail investors can easily see whether a manager has out- or underperformed the benchmark (as long as the right benchmark is used and the right period of time).

Instead, the KID for PRIIPs introduces mandatory simulations of future performance. As has been extensively discussed in the ECON Committee, such simulations, if not adequately construed, can be misleading. We therefore believe historical performance figures should be added.

Information of fund manager and his investment policy

Information on the fund manager is important to investors (59%). Research by the VEB and Morningstar (covering active fund manager in the Netherlands) indicates that, apart from the name of the fund manager, little information is provided, for example on the extent to which the fund manager is supported by analysts, the background of the fund manager, the applicable decision-making procedures, investments of the fund manager in his own funds etc.

Also the investment policy is important, in particular the degree of active management. The whole discussion around closet-tracking (also known as index hugging) indicates that fund managers should be more open about their investment policy. Investors need to be able to check whether the costs are aligned with the degree of active management. In particular, fund managers should disclose the active share (i.e. a measure of the percentage of stock holdings in a manager's portfolio that differ from the benchmark index).

Last year, research by ESMA showed that up to 15% of UCITS funds in the EU practice index hugging. No follow-up measures have been put forward by ESMA as it leaves it up to the national regulators. We would like to see a more active stance of ESMA (and the EC) to deal with this issue at EU level.

Question 3.15 – Do you consider that rules on marketing communications should be more closely aligned in the EU?

At the moment, marketing communications are supervised at national level on the basis of the general principle that market communications should be fair, clear and not misleading. In particular, they should make no statement that contradicts or diminishes the significance of the information contained in the prospectus and the key investor information.

The term 'fair, clear and not-misleading' is of course very open to interpretation and does therefore not allow for strict and consistent application throughout the 28 Member States. While some of the Member States have turned this general principle into detail rules, this should preferably be done at EU level in order to avoid fragmentation of the EU market. The actual supervision and enforcement should stay at national level, with the NCAs. They should in our view approve all communications ex-ante on the basis of detailed requirements drafted at EU level.

Question 3.16– Is there a case for harmonising marketing communications for other types of investment products (other than investment funds)?

Yes, advertisements for public offerings of securities should be harmonised as well. Article 15 lays down some general principles that are applied differently throughout the EU. The Commission proposal for a Prospectus Regulation leaves this article (renamed Article 21) untouched.

Advertisement in relation to such offerings tends to downplay the risks associated with the investment, and to overemphasize the potential return.

Question 3.17 – What role do you consider that ESMA – vis-a-vis national competent authorities - should play in relation to the supervision and the monitoring of marketing communications and in the harmonisation of marketing requirements? If you consider both should have responsibilities, please set out what these should be.

European Investors believes the setting of detailed requirements, referred to in our answer to question 3.15, should be done at EU level through Level 2 measures (EC on the basis of ESMA technical advice), possibly complemented by Level 3 guidance. This is necessary to achieve the supervisory convergence and consistency that is required for the proper functioning of the passporting regime and the single market in investment funds.

But detailed requirements are merely part of the solution. Such requirements need to be adequately supervised and enforced. This is primarily a task of the NCAs. Some Member States (e.g. Belgium) require ex-ante approval of the marketing communications where other Member States monitor the communications ex-post (e.g. Netherlands). We believe all Member States should require ex-ante approval of marketing communications.

Question 3.18 – Do you consider that detailed requirements– or only general principles on marketing communications should be imposed at the EU level when funds are marketed to retail investors?

General principles and detailed requirements. As stated in the previous questions, we fear that general principles only will not lead to the extent of supervisory convergence and consistency in the EU that is required for the proper functioning of the passporting regime and of the single market in investment funds.

It is also important that the regulatory framework allows for up-to-date comments or guidelines by ESMA through Level 3 if market circumstances call for such specific regulatory guidance.

Question 3.19 – Do you consider that the requirements on marketing communications should depend on the type of funds or the specific characteristics of some funds (such as structured funds or high leverage funds) when those funds are marketed to retail investors?

Some funds (AIFs and structured UCITS, i.e. those funds that are considered complex by MiFID II) might warrant extra warnings of the risks to which the retail investor is exposed.

For those funds, if purchased through execution-only, an appropriateness test is required according to MiFID II. However, the warnings that come from these tests are often ignored. Research by the AFM

shows that 59% of investors ignore these warnings. Only 2% percent decides to not invest in a product upon such warning (and further research)⁵.

Question 6.9 – In general have you experienced any problems in being able to obtain information on, and invest, in foreign EU funds?

Sometimes it is not possible to invest in a certain fund due to residence requirements, simply because the fund provider for whatever reason (e.g. regulatory requirements) has decided to only market his fund(s) in one or a few Member States.

Another important reason for the lack of investment in EU foreign funds is the 'closed architecture' of distribution networks.

In many EU countries, banks are the biggest distributors of retail funds, offering in some cases predominantly in-house funds. A large part of retail assets are thus actually 'captive' and cannot be accessed by foreign EU independent fund management companies.

In order to ensure retail investors are made more aware of the opportunities to invest in EU foreign funds and get the right information, independent advice should be promoted.

Of course, online platforms also offer a major opportunity to open up markets. However, investing through those platforms requires a certain level of self-reliance not all retail investors possess.

Question 6.10 – Which facilities would you deem necessary to invest in EU funds domiciled in another Member State?

It is to be seen to what extent MiFID II will contribute to more open distribution networks. While restrictions on inducements normally contribute to such openness (e.g. in the UK and the Netherlands), the impact of MiFID II might be limited.

The ban on inducements in MiFID II (as well as the requirements to analyze a suitable range of products) only applies to independent advice. As already indicated in our answer to question 6.9, most retail investors make use of non-independent advice. Also, some of the fund platforms are non-independent as they only offer funds of a specific fund provider, or receive inducements.

We also fear that some rules in MiFID II might in a way contribute to the sale of in-house funds:

- 1) MiFID II requires investment firms to provide retail clients information that is not included in the KIID for UCITS/retail AIFs. Article 50(4) of the Delegated Regulation states that:

“In relation to the disclosure of product costs and charges that are not included in the UCITS KIID, the investment firms shall calculate and disclose these costs, for example, by liaising with UCITS management companies to obtain the relevant information”.

Rather than going through this liaison effort, investment firms might find it more convenient to restrict the scope of their advice to in-house UCITS funds.

- 2) MiFID II introduces product governance rules that also apply to distributors. Distributors might restrict the scope of the products they offer to those they manufactured themselves in order to limit their regulatory obligations.

⁵ AFM Consumentenmonitor Beleggen 2016. Available [here](#).

Question 6.11 – What are your main problems when investing in funds domiciled in jurisdictions other than your jurisdiction of residence? Are differences in languages an important issue?

- Currency risk: If the investment fund is denominated in a different currency than the one of the investor, there is a currency risk involved.
- Language and information: Regulated information, the KIID and prospectus, are published in the official languages of all Member States in which the fund is distributed. However, as our survey indicated, investors often tend to use other materials (as well). These materials are not always available in the investor’s language.
- Familiarity: Generally speaking, investors tend to have a preference for fund providers that they are familiar with (i.e. local fund providers).
- Applicable law and NCA: If an investor invests in a fund domiciled in a foreign jurisdiction, local national laws do not apply and the local NCA is not competent. Also, local out-of-court dispute settlement mechanisms do not apply.
- Tax reclaim: Investors face difficulties reclaiming dividend tax paid to foreign tax agencies.
- Residence requirements: see question 6.10.
- Closed distribution networks: see question 6.10

Question 6.12 – What is the best way to overcome such problems and facilitate your transactions?

The first three barriers mentioned in our answer to question 6.10, we believe cannot be resolved through policy measures.

With regards the fact that the applicable law and NCA is different, this can be resolved through more harmonization in the field of investor protection rules and more supervisory convergence. Such harmonization also promotes EU-wide offerings of investment funds.

FIN-NET should be strengthened, through mandatory membership for all financial ADRs in the EU, in order to make out-of-court dispute settlement procedures in cross-border situations easier.

Concerning dividend tax, we believe there should be a ‘relief-at-source’ mechanism as also suggested by the European Commission in the CMU action plan.

The residence requirement is related to the obstacles that fund providers still perceive, despite the passporting mechanism. If these obstacles are removed, fund providers will be less inclined to limit the marketing of their funds to specific Member State(s).

For additional comments on fund distribution, see question 6.10 and 6.11.

Question 6.13 – Which kind of information do you need when making transactions on EU funds domiciled in another Member State?

In addition to the information they normally need, they would need to have information on:

- i) potential currency risk hedging;
- ii) applicable national law and competent NCA;
- iii) out of court dispute settlement mechanisms;
- iv) investor protection rules and procedures, and
- v) possible tax reclaim issues.

Question 7.6 – Do you invest in funds via an on-line fund platform or a website? Question 7.6b – If you have invested in funds online, what kind of information on the suitability or appropriateness of the investment was made available to you?

Most of our members purchase their investment funds online. Again, please note that most of our members are active retail investors who invest on an execution-only basis.

Unfortunately, we do not possess any data on the extent to which online fund platforms comply with their appropriateness testing obligations under MiFID. If platforms offer funds that are considered complex by MiFID an appropriateness test is clearly required.

Some fund platforms offer additional services in the form of recommendations (e.g. short-lists and ratings). It is important that platforms disclose the criteria that are used and the weight assigned to the different criteria. It has to be clear for the investor that the recommendations should not be considered to be advice and that the investment funds that are recommended might not be suitable for an investor due to his or her personal characteristics and needs.

Question 7.7 – What are your expectations when you invest via fund platform or a website?

Fund platforms should either be independent or fully transparent about their links with specific fund providers and the inducements they receive from these providers.

Secondly, full transparency on costs is of major importance. Apart from an administration fee (which can be a fixed one or a variable one that is calculated as a percentage of invested amount), platforms charge a fixed fee for holding shares as well as transaction fees. Platforms should also be transparent about the quality of their execution of orders.

Fund platforms often offer additional services, which include shortlisting and inhouse research, for which investors are charged. It is important that these are not perceived or sold as advisory services.

Question 7.8 Do you invest in funds platform or a website domiciled in another Member State?

Unfortunately, we do not have sufficient data to give you an indication of the percentage of our members that invest in funds through platforms or a website domiciled in another Member State.

Question 7.9 – What do you consider to be the main reasons why EU citizens are unable to invest in platforms domiciled in another Member State?

The requirement to be a resident of the Member State in which the platform is domiciled in order to be able to invest in most of the funds on offer on the platform is a major obstacle.