

ERFF Consensus Paper on the Role of Intermediaries, October 2017

The European Retail Financial Forum (ERFF) is a pan-European forum bringing together around one table consumers, business and policymakers to support the opening up of retail financial markets in Europe. Representing all aspects of the retail sector - traditional, wider investment and digital - we are citizens-focused, favour removing key barriers and increasing choice and transparency for all customers across borders in ways that keep Europe competitive.

Intermediaries (as defined in the Annex) can be instrumental in the development of savings and investments in the European Union. Their role is in line with the objectives in the Capital Markets Union (“CMU”) Action Plan, to foster jobs and growth, to develop the EU market, in order to improve consumer choice of financial services, particularly investment, products and distribution routes, and to identify how to support the development of such channels.

1) More Diversification of Distribution Channels is needed

Opportunity

Research suggests that the development of a wide range of intermediaries – across different legal structures and client relationship models – can develop more fully the depth, breadth and scope of financial markets and products. Where consumers have access to different forms of advice from financial intermediaries, this is shown to strengthen their involvement and, ultimately, their financial position.

Obstacle

As an illustration, compared with international competitors, bank branches distribute some 70-75% of financial savings in the EU, compared with 42% in the UK and 15% in the USA. As is well known in the latter jurisdiction, securities markets occupy a much larger place in the intermediation of savings and investments, for instance notably through the role of mutual and money market funds, and other structural constructs such as self-invested Pension funds (401-Ks), and the generally greater investor risk tolerance, as expressed through the role of Business Angels, crowd-funding and venture capital funds.

Solution

How can we get intermediaries to address this problem in the EU? In the EU context, this is not about replacing the role of banks, as some investors are familiar and comfortable with these product sellers, but broadening investor access to a range of intermediaries, and products, with extensive consistency in terms of investor protections and redress mechanisms, leading to a level playing field across providers. We see co-existence as key. The UK distribution model supports a range of intermediaries from banks, to independent advisers, brokers, and wealth managers. This is underpinned through transparency of fees and commissions, and whether the products are “tied” or not. There is no reason why the European continent cannot support such a system, building on distribution through bank branches (which are strong in savings products or SICAVs) but also diversifying through independent entities such as IFAs and other non-bank entities.

2) A New Approach can overcome Cultural Barriers to Investment

Opportunity

We suggest that diversifying distribution channels is a win/win situation for the firm and the investor, by reducing the costs of delivery for the former, and providing a more cost-efficient solution for the latter. In any event, the firm also has to contend with distinct groups of investors, where traditional methods of (face-to-face) delivery may sit side-by-side with more technologically-driven ones, and thus enhance consumer choice. One group of investors, dubbed the “Millennials” has a different approach to investment, requiring time-efficient solutions, screen and mobile-based offerings, and ethical, sustainable or green products.

Obstacle

We detect that there is still investor resistance to a change of investment culture, and that this has to be overcome. We also note that the absence of truly independent (rather than “tied”) investment advice might also be a factor in preventing diversification. We suspect that a sizeable proportion of investors are at a loss to comprehend the main features of products being offered to them, and truly cannot identify what products are best for them, and what investment strategy to adopt. As a result, they can be at a loss on what decisions to take, and consequently end up taking no decision at all, thus depriving themselves of risk reduction and hedging opportunities, and failing to deepen the market as well.

Solution

So, empowering investors may require encouragement, e.g. via auto-enrolment. We note that some benefit may be gained through remote advice, with the investor being more comfortable (and time-efficient) interfacing with a machine, rather than an individual. However, robo-advice on its own is not sufficient, with human intervention also needed at the behest of the investor, both for validation and comparability purposes. Nonetheless, as with many other segments of the financial services industry, investors still rely to a large extent on traditional distribution models, such as in-store sales of products, but increasingly the landscape is evolving, with technological change at the forefront of that evolution. Technological innovation has always been present in the marketing, distribution and selling of financial services products by a range of intermediaries, but in recent years the rate of change has increased exponentially. The application of Fintech solutions, such as Artificial Intelligence, Blockchain, mobile payments and robo-advice is becoming more prevalent, and it will be vital to harness their power.

3) Regulation may be hindering the unleashing of full competitive forces

Opportunity

An investment intermediary takes many forms, though there are common characteristics as well as differences. For instance, it is possible to distinguish between investment firms and banks, since they are subject to different rules governing them. An investment firm, whether handling client monies or not, is not a deposit-taker in the banking sense. Moreover, it is not exposed to credit risk, and generally should be subject to different capital requirements (the

proposal, by the EBA, to carve out a specific investment firm capital regime from the CRR/CRD is very much to be welcomed).

Obstacle

We detect that a number of inconsistencies in the application of the EU regulatory framework makes it hard for all types of intermediary to offer similar products on a level playing field basis. This is despite the fact that the blurring of the boundaries between banking, investment and insurance products increasingly makes it hard to attribute specific sectoral characteristics to them. The capital issue described above is one. Other examples include consumer protection rules, such as those governing the marketing of products such as PRIIPS; data protection inconsistencies between MiFID II and the GDPR; and moves to impose banking-type requirements such as (“SIFI”) capital add-ons. The regulation of Fintech also has to be handled carefully, both in relation to consistency through the individual approaches taken by regulators such as the ESAs and the Basel Committee, and overall not to strangle such initiatives at birth.

Solution

Diversity is key. There are many different intermediary forms or types: for instance, mortgage and insurance intermediaries, broker-dealers; execution-only brokers; advice only firms. The perception and expectations of individual investors also vary considerably across markets, for cultural as well as legal or historical reasons. These activities can also be complementary to, or “ring-fenced” as, part of a bank. A good example of this is the banks’ wealth management units/sections. We also note that active discretionary investment management (proposing portfolio management to clients) has been particularly effective. Recent history suggests that returns in this area have been better than historical averages: this is different from active/passive fund management techniques. Existing focus on (client asset) safety and trust in the provider/product remain paramount. And these can be addressed through conduct of business rules. Finally, the role of the regulator also has to evolve, and one typical response is the use of regulatory “sandboxes”, where firms can test new products and methodologies and gain timely regulatory approval for them.

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About ERFF

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Members: Allianz, Barclays, Commerzbank, Erste Group, ING, KBC, PIMFA (Personal Investment Management & Financial Advice Association)

Associates: CEPS (Centre for European Policy Studies), Eurofinas (European Federation of Finance House Associations), FECIF (European Federation of Financial Advisers and Intermediaries), VEB (Dutch investors association).

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DEFINITION OF AN INTERMEDIARY

The definition of an intermediary can vary from place to place, but with the following common characteristics:

- has retail clients and deals for them, invests for them, or advises them
- or handles client assets: legal ownership of the assets always remains with the client (and the assets are protected, e.g. in bankruptcy)
- generally, the intermediary does not bear any credit risk, which would be covered by a separate banking license