



FESE Capital Markets Academy
Retail investing

The speakers and moderator



Dr. Gerrit Fey
Head of
Capital Markets
Department,
Deutsches
Aktieninstitut



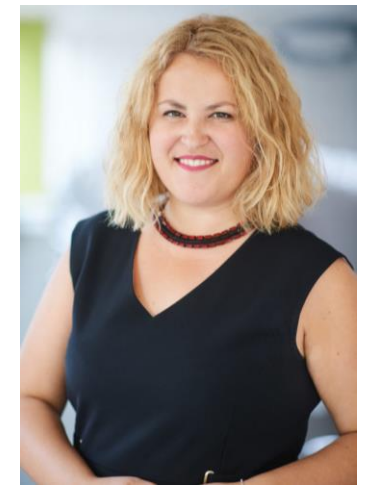
Dr. Norbert Kuhn
Deputy Head of
Capital Markets
Department,
Deutsches
Aktieninstitut



Donato Di Dio
Policy Advisor
Capital Markets Policy
and Digitisation,
Deutsches
Aktieninstitut



Dr. Sandra Vincent
Head of Market
Structure & Regulation,
Deutsche Börse



Sara Baldi
Senior Policy Manager
FESE

FESE - Federation of European Securities Exchanges

FESE represents **36 exchanges** in equities, bonds and derivatives

13 Multilateral Trading Facilities (MTFs) dedicated to listing and trading of SMEs

From **EU member states** as well as **Iceland, Norway and Switzerland**

16 Full Members and **1 Affiliate Member**



35 Regulated Markets
13 MTFs dedicated to SMEs

1 Affiliate Member

Key figures: European financial markets



~9,000
Listed companies



~€9.4 tn
Market cap for
listed companies



~€51 bn
Money raised at IPO



~€6.5 tn
Equity turnover



~€511 tn
ETDs notional
turnover



~€6 tn
Bonds exchange
turnover

Source: FESE 2020 data

Key facts: Exchanges



Market venues where investors can **buy or sell** different financial instruments at prices they can trust and which they know in advance



Investors buy and sell financial instruments for several reasons: return on investment, diversification, protection against market fluctuations, etc.



Frequently traded instruments: shares, bonds, currencies, commodities and derivatives



Companies use financial instruments to finance themselves and to manage their risk

What you will learn today



1.

How is retail participation evolving and which impact does it have in the economy?

2.

How can we lower the barriers to entry to financial markets?

3.

Why is payment for order flow (PFOF) contentious? How does it work?

All topics will be addressed from a functional as well as a policy perspective and there will be a focus on EU regulation.

Index

1. Let's talk basics - facts and figures
2. Why is retail participation important?
3. Explaining the limited participation puzzle and policy options
4. The issue of payment for order flow
5. Q&A



1

Let's talk basics - facts and figures

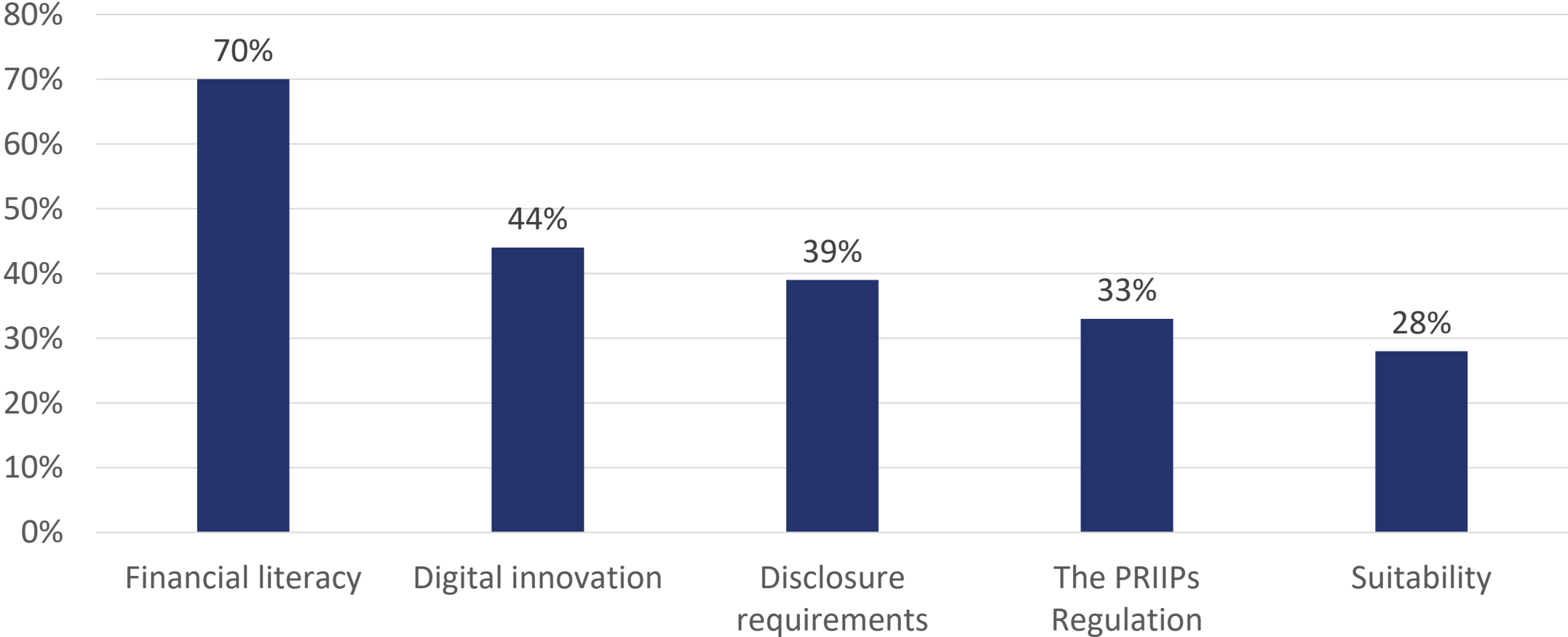
Retail investment is on the Brussels agenda

“In line with the Commission’s stated objective of “an economy that works for people”, the Commission is seeking to ensure that a legal framework for retail investments is suitably adopted to the profile and needs of consumers, helps ensure improved market outcomes and enhances their participation in the capital markets.”

Consultation “A retail investment strategy for Europe”, p. 3

Retail investment strategy for Europe - issues flagged by respondents

Top 5 areas with main scope for improvement



What is retail participation?

Retail participation

Retail participation
(narrow sense)

People invest (parts of)
their savings in stocks,
bonds or funds

Motivation:
wealth building

Retail participation
(broad sense)

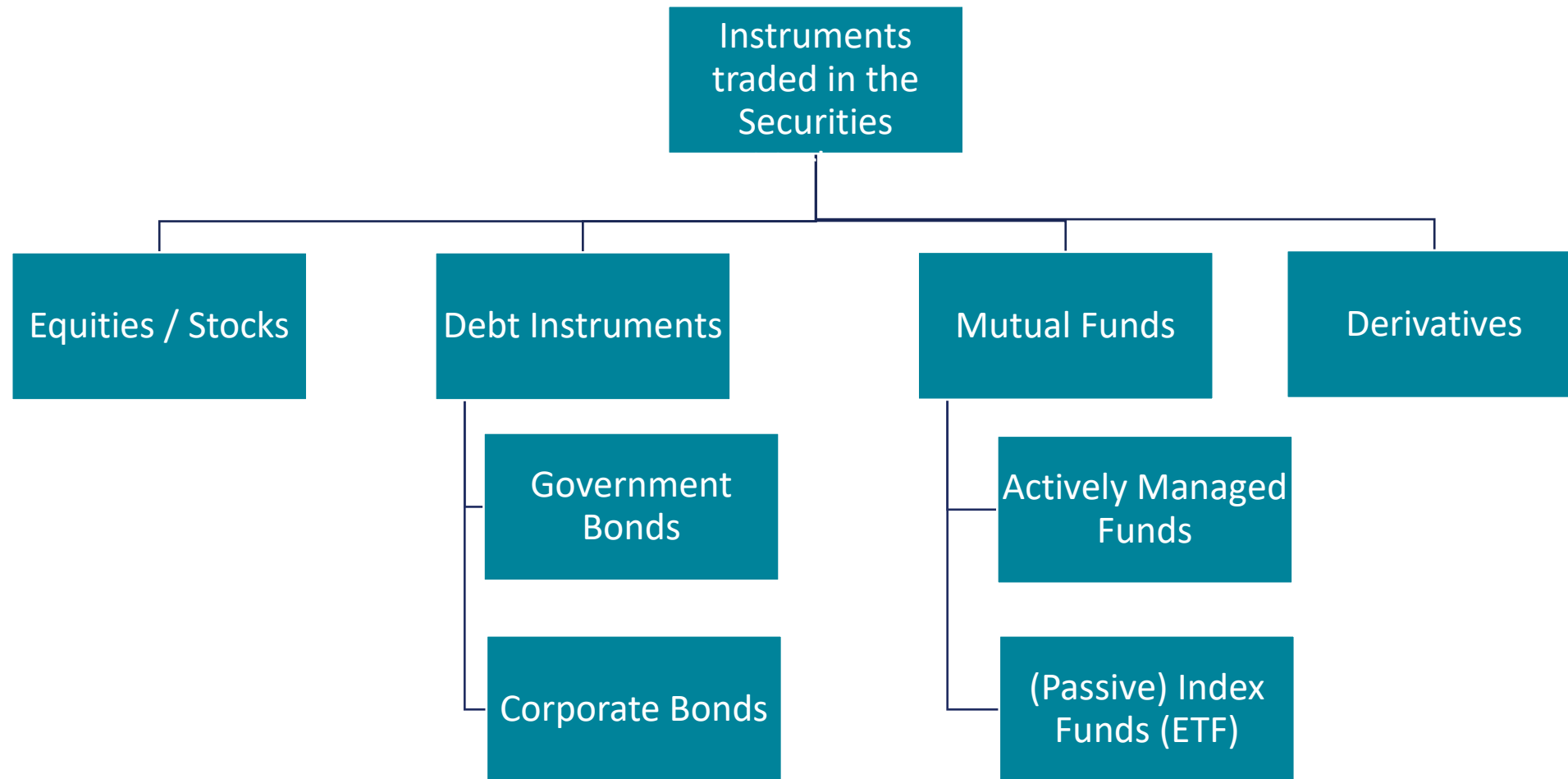
People take part in
employee participation
schemes/employee stock
ownership

Motivation:
ownership, wealth
building

People take part in
pension schemes linked
to securities markets

Motivation:
old age provision

Retail investor capital market instruments



Some key facts about retail participation in Europe

- ✦ Despite the long-term rise in share prices, stock market participation rate among European households remains low compared to the US.
- ✦ US savers hold nearly 55% of their financial assets in the form of securities, primarily equities.
- ✦ In Western Europe, however, this proportion is 28%.

Some key facts about retail participation in Europe

Figure 13: Equities or not, Part I – Asset classes in percentage of total gross financial assets, by regions, in %

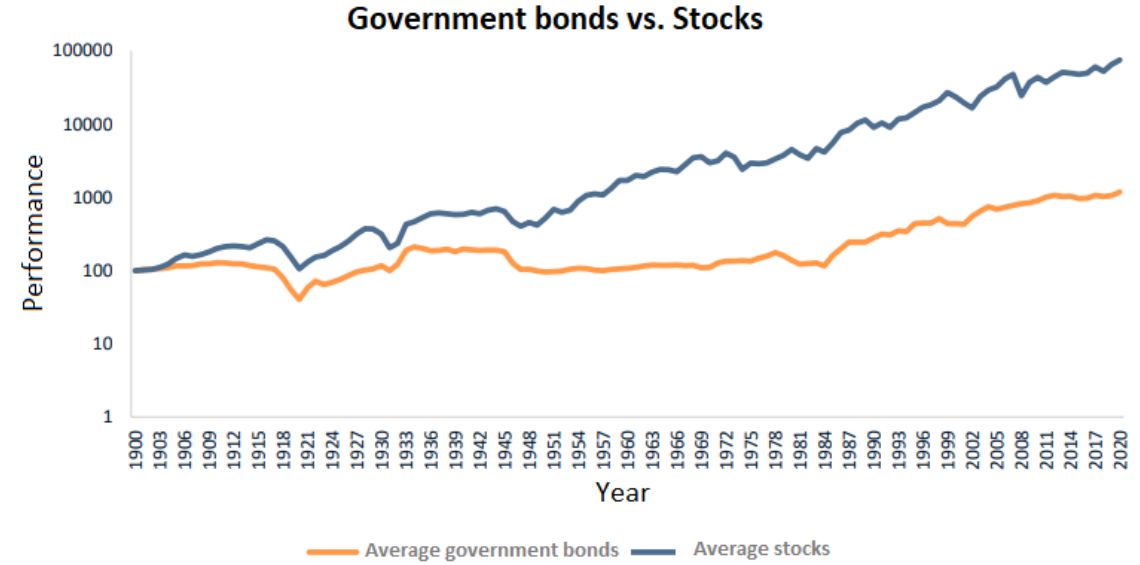
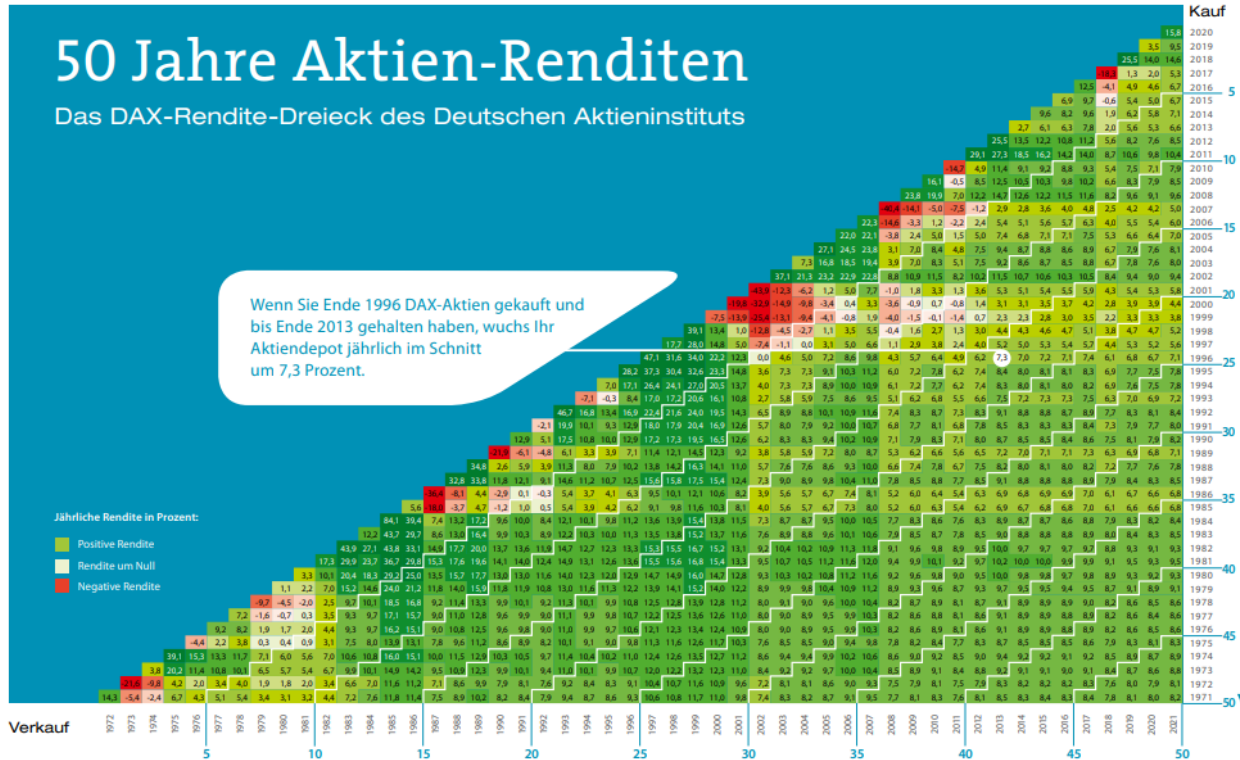


2 Why is retail participation important?

Benefits of retail participation in Europe

- ✦ Long-term returns helps to increase household wealth.
- ✦ Saving for retirement in addition to state pension systems helps to close the growing pension gap.
- ✦ Retail participation can contribute to the development of the economy and drive growth through long-term investments (financing of the economy).

Benefits: long-term yields from shares or share-based funds at a glance



- Overall, equities generated an real annual return of 5.7 percent between 1900 and 2020; government bonds only 2.1 percent.

Source: Deutsches Aktieninstitut, Kapitalgedeckte Altersvorsorge mit Aktien! 120 Jahre Aktien und Staatsanleihen im Renditevergleich, 2022

Benefits: old age provisions

- ✦ Many EU households still rely too heavily on the pay-as-you-go system (e.g. Austria, France, Italy, Germany).
- ✦ Shares are the ideal instrument for retirement provision. They provide an opportunity for households to save for retirement and, at the same time, help the efficient allocation of long-term capital.
- ✦ Some EU pension systems emphasise stock saving in their system. General, these systems tend to be more sustainable, cheaper and ranking higher in international studies.

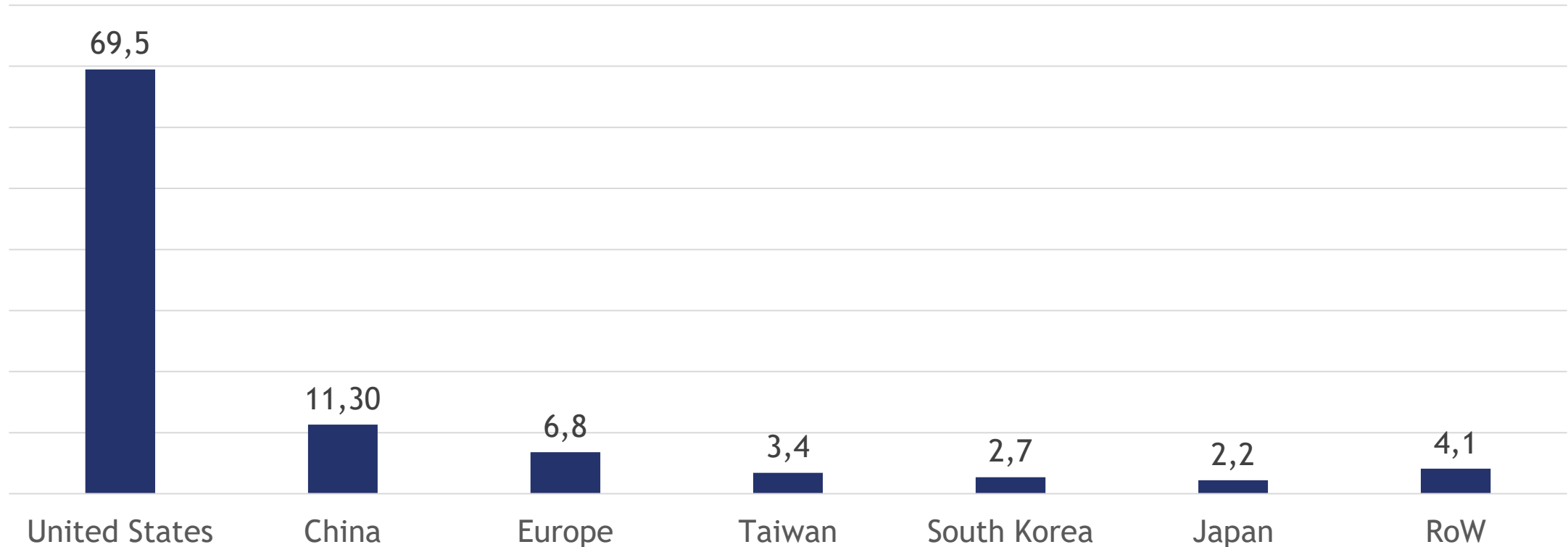
The 20 best pension systems worldwide



Source: Mercer CFA Institute Global Pension Index, 2021

Benefits: financing the economy - Europe lacks behind

Market cap of global public tech companies by selected major regions
(percentage of total)

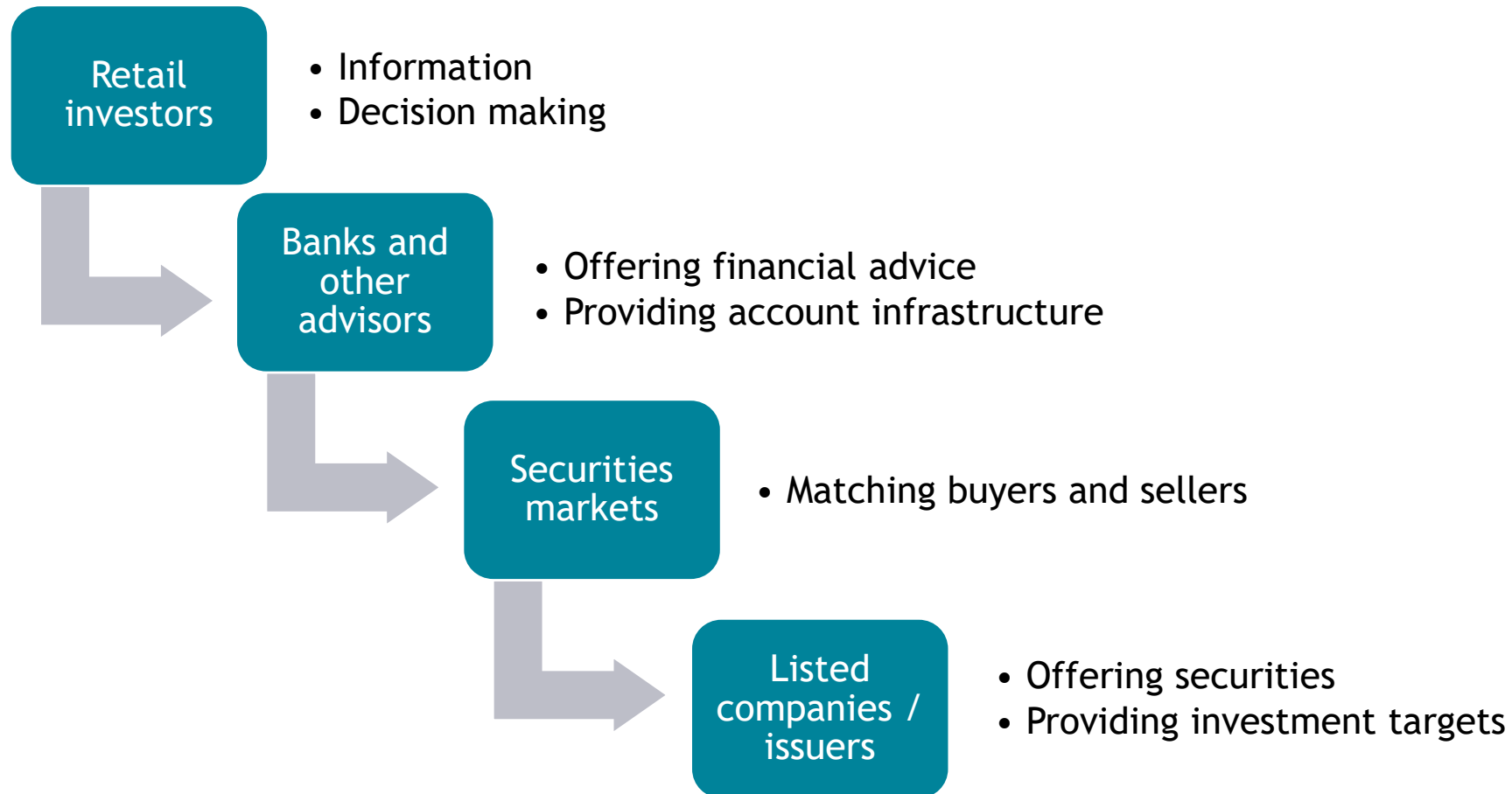


Source: atomico: State of European Tech 21, November 2021



3 Explaining the participation puzzle and policy options

The retail participation puzzle - many stakeholders involved



Investors

Stakeholder	Key objectives	Field of action
Investors	Empowering, setting incentives	<ul style="list-style-type: none">• Financial literacy• Pension system• Tax environment• Employee participation schemes

Empowering citizens through financial literacy - the EU is taking a step into the right direction

- ✦ Increased financial literacy enables retail investors to better understand financial information
 - Financial literacy varies widely across the European Union
 - On average, 52 percent of adults are financially literate
- ✦ The EU tries to improve financial literacy with a number of initiatives
 - Part of the capital markets union (CMU) action plan is to empower citizens through financial literacy
 - The European Commission has published a joint EU/OECD financial competence framework for adults
 - It will support the development of public policies, financial literacy programmes and educational materials. It will also support the exchange of good practices by policy makers and stakeholders in the EU.

Supporting people in their retirement - some good ideas but member states are in the driver seat

- ✦ Pension systems are a key element of broad retail participation.
 - Direct effect: Properly designed pension systems make people participate (more or less) automatically in capital markets (= retail participation in a broad sense).
 - Indirect effect: People lose scepticism and get more familiar with capital markets.
- ✦ EU may help to make transparent best practices and improve old age provision for people moving in the EU.
 - Important recommendations of the High-Level Forum on the future of the capital markets: pension dashboards, individual pension tracking systems, supporting auto-enrolment in occupational pension schemes.
 - Pan-European Pension Product (PEPP): proposed pension product available to residents of the European Union - improved choice for the people, but rather designed as an insurance rather than a saving product (guaranteed element involved).

Taxation - fair, efficient and growth-friendly taxes need to be set ... by member states

- ✦ Taxation may (dis-)incentive retail participation.
 - post tax return on investment
 - psychological effect
- ✦ EU may influence the agenda of member states, existing initiatives are ambiguous or difficult to implement.
 - An EU-wide Financial Transaction Tax ("FTT"), which has recently been controversially discussed among the ten member states of the so called enhanced cooperation, would counter retail participation as well as the Capital Markets Union project.
 - Initiative of the EU Commission on debt-equity bias reduction allowance (DEBRA): Addresses the problem, that equity is taxed twice, on company and investor level, while debt is only taxed on investor level.
 - “Individual savings accounts”, which are already implemented in twelve member states, are discussed by the EU Commission as part of the Capital Markets Union.

Employee share ownership is a fertile ground for a broader retail participation

- ✦ Employers provide their employees shares of their own company for a discount (e.g. 30 per cent of the market value or buy two get one free after three years) or for free.
- ✦ Contribution to retail investor participation
 - Discount of the employer equals a low level access to capital market instruments like shares.
 - Helps to increase understanding of capital market issues.
 - Nevertheless: Employees should learn to diversify their portfolio and to not only focus on shares of the own company (double risk of losing money and the job).
- ✦ Other benefits
 - Contribute to job satisfaction
 - Enhances attractiveness as employer
- ✦ As part of the Capital Markets Union the EU Commission promotes best practices. Nevertheless, dissemination of employee share ownership depends heavily on national fiscal incentives.

Banks and other advisors

Stakeholder	Key objectives	Field of action
Investors	Empowering, setting incentives	<ul style="list-style-type: none">• Financial literacy• Pension system• Tax environment• Employee participation schemes
Banks, financial service providers	Ensuring adequate advice Ensuring a sufficient number of advisors	<ul style="list-style-type: none">• Regulation of investment advice

Banks and other advisors: tailored investor protection regulation - a lot of potential / still seeking the right balance

- ✦ Regulation of investment advice is still seeking the right balance.
 - Legislation of the past (e.g. MiFID, PRIIPs) has created a huge amount of investor protection rules.
 - Documentation (e.g. suitability report)
 - Information (e.g. key information documents)
 - ...
 - Negative side effects
 - Information overload - new hurdles for retail participation.
 - Banks refraining from advice due to regulatory costs and liability risks - limitation of their role as multipliers for those that need advice.
 - The great reversal? Evaluation of investor protection rules (MiFID review, consultation on „Retail investment strategy for Europe“).
 - New investor protection rules: sustainable investments.

Securities Markets

Stakeholder	Key objectives	Field of action
Investors	Empowering, setting incentives	<ul style="list-style-type: none">• Financial literacy• Pension system• Tax environment• Employee participation schemes
Banks, financial service providers	High number of multipliers providing adequate advice	<ul style="list-style-type: none">• Regulation of investment advice
Securities markets	Fair and cost-efficient trading opportunities	<ul style="list-style-type: none">• Regulation of trading venues

Listed companies

Stakeholder	Key objectives	Field of action
Investors	Empowering, setting incentives	<ul style="list-style-type: none">• Financial literacy• Pension system• Tax environment• Employee participation schemes
Banks, financial service providers	High number of multipliers providing adequate advice	<ul style="list-style-type: none">• Regulation of investment advice
Securities markets	Fair and cost-efficient trading opportunities	<ul style="list-style-type: none">• Regulation of trading venues
Listed companies	High number of listed companies, sufficient information	<ul style="list-style-type: none">• Regulation of listed companies

Listed companies: The EU Commission is asking the right questions

- ✦ Regulation of listed companies has been a key area of action for the EU in the past 20 years.
 - Examples: EU Transparency Directive I & II, EU Market Abuse Directive/Regulation I & II, IAS Regulation, EU Prospectus Directive/Regulation I & II.
 - High level of investor protection.
 - Negative side effect of decreasing attractiveness of organised capital markets as a source of finance.
- ✦ Regulation needs to be adjusted to better reflect the needs of listed companies.
 - Consultation of an EU Listing Act rightly picks up these negative side effects and seeks views on adjustments of the regulatory framework of listed companies.
 - Growing sustainability regulation might overburden listed companies if it is not properly designed and companies' is not granted sufficient time to adjust.

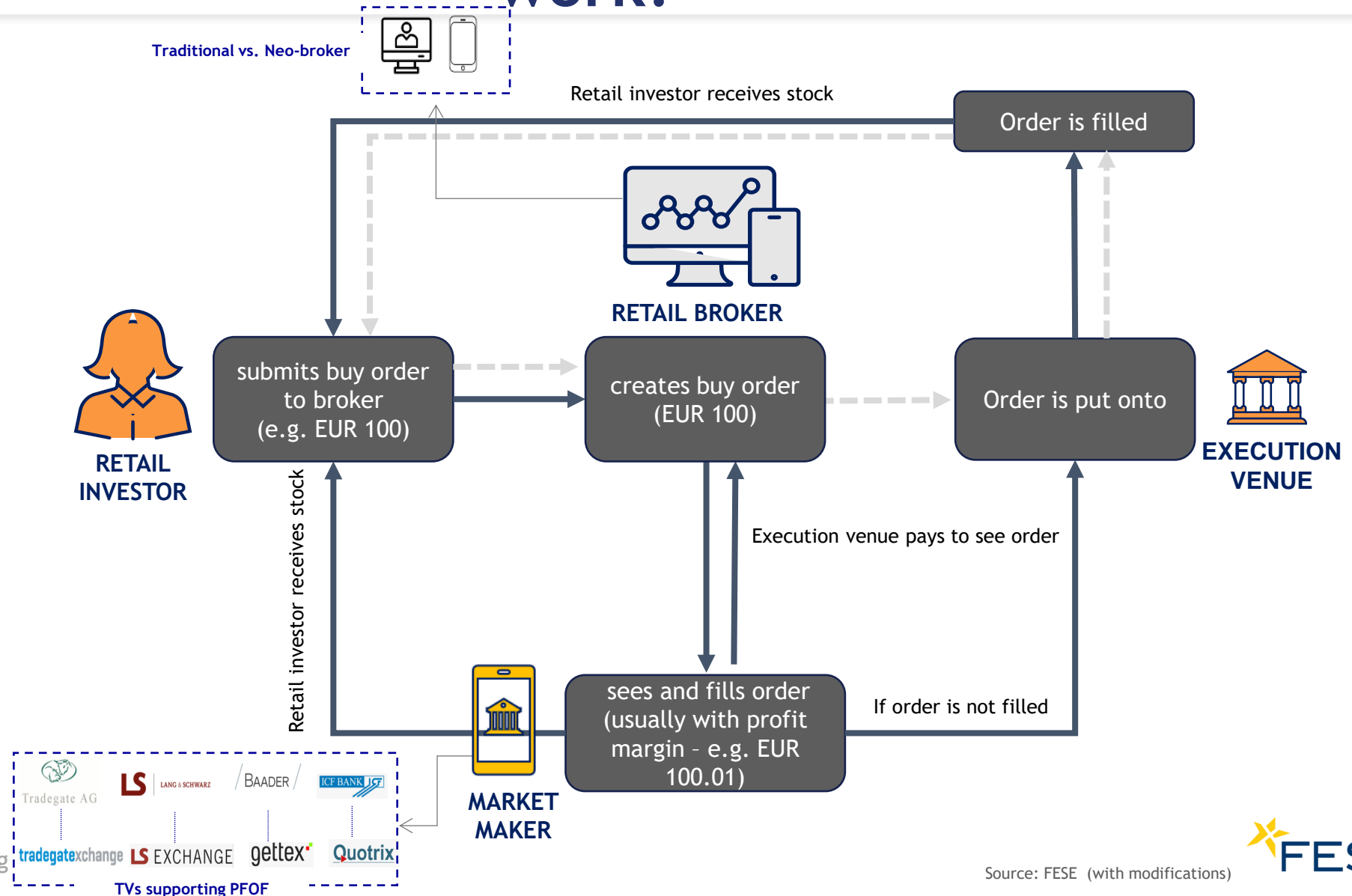
Summing up the retail participation puzzle - drivers and policy options

Stakeholder	Key objectives	Field of action	Role of the EU?
Investors	Empowering, setting incentives	<ul style="list-style-type: none"> • Financial literacy • Pension system • Tax environment • Employee participation schemes 	<ul style="list-style-type: none"> • Moderator, • Setting impulses • Solve cross border issues
Banks, financial service providers	High number of multipliers providing adequate advice	<ul style="list-style-type: none"> • Regulation of investment advice 	<ul style="list-style-type: none"> • Key competence of the EU (internal markets) • Initiatives of the past have ensured a high level of investor protection • Avoiding negative impact should also be in focus
Securities markets	Fair and cost-efficient trading opportunities	<ul style="list-style-type: none"> • Regulation of trading venues 	
Companies	High number of listed companies, sufficient information	<ul style="list-style-type: none"> • Regulation of listed companies 	



4 The issue of payment for order flow

What is payment for order flow and how does it work?



What are retail brokers offering in return for receiving payments? They actively direct order flow by ...

... limiting the choice of execution venues for retail investors to those that offer PFOF

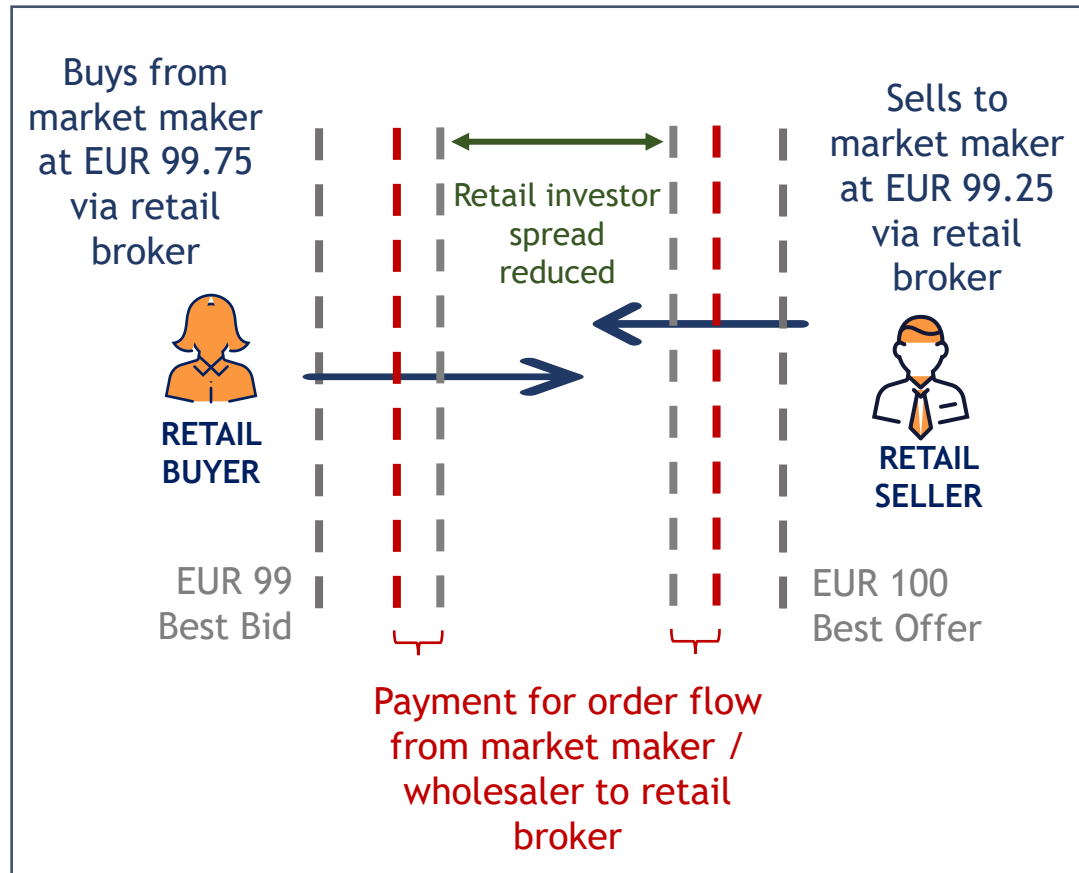
... steering orderflow directly via the order entry mask (self-directed flow) or making significant mark-ups for regular trading venues

... selecting “zero commission” venues in their best execution policies (undirected flow)

... disclosing payments only in advance or ex-post on request

What is the issue with payment for order flow?

- ✦ PFOF has a structural impact on secondary markets and raises investor protection concerns as it...

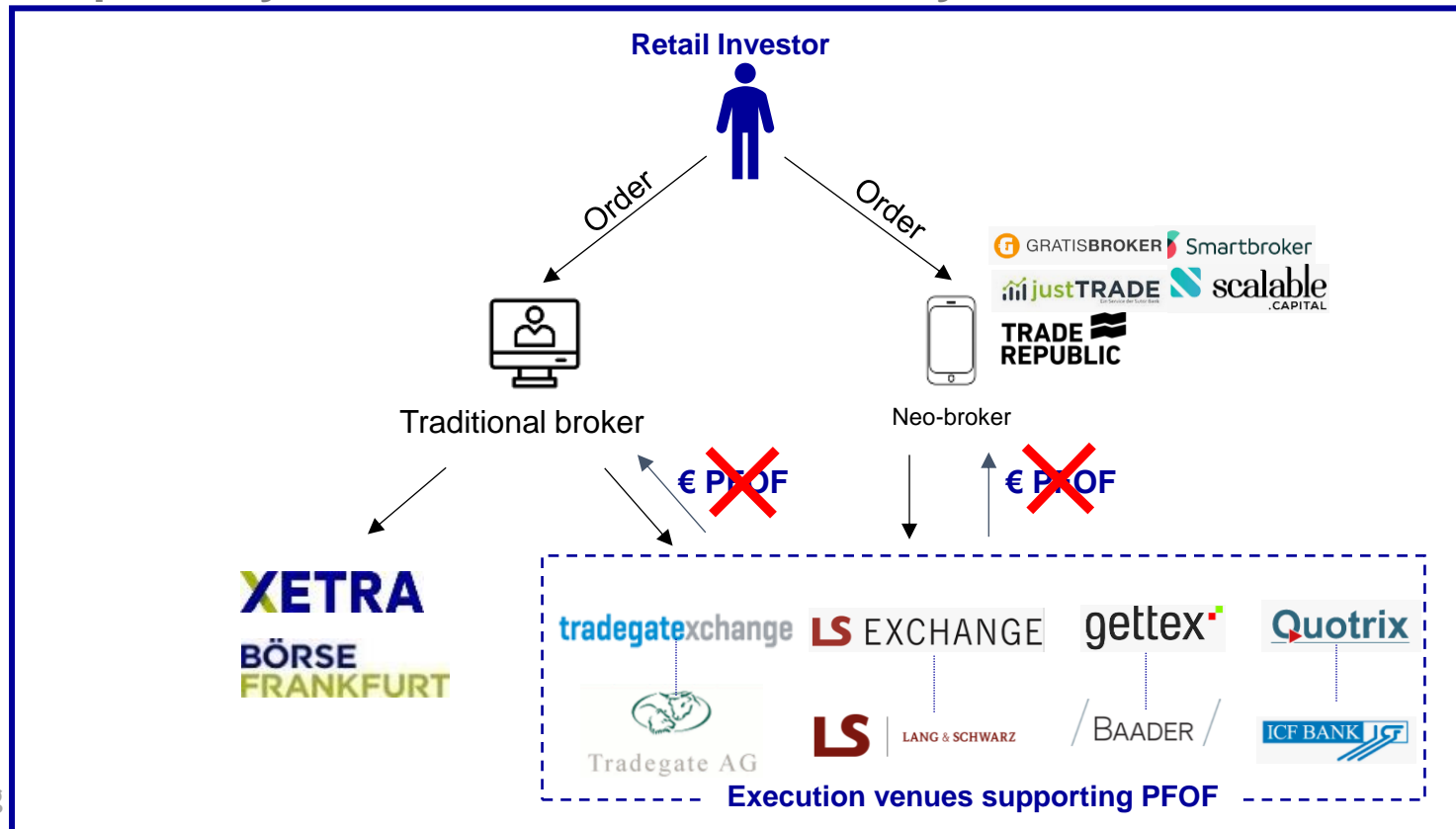


- 1 ... leads to an inherent conflict of interest for a broker
- 2 ... damages market efficiency by the adverse selection of flow
- 3 ... hinders competition among trading venues
- 4 ... may lead to poorer prices for end investors (as the Dutch AFM and Spanish CNMV have found)

How is payment for order flow currently handled in the EU?

- ✦ According to MiFID II, inducements, including PFOF, are only allowed when brokers are complying with conflict of interest rules
- ✦ According to ESMA, PFOF is in most cases incompatible with MiFID II

Proposal by the EU Commission: Ban Payment for Order flow



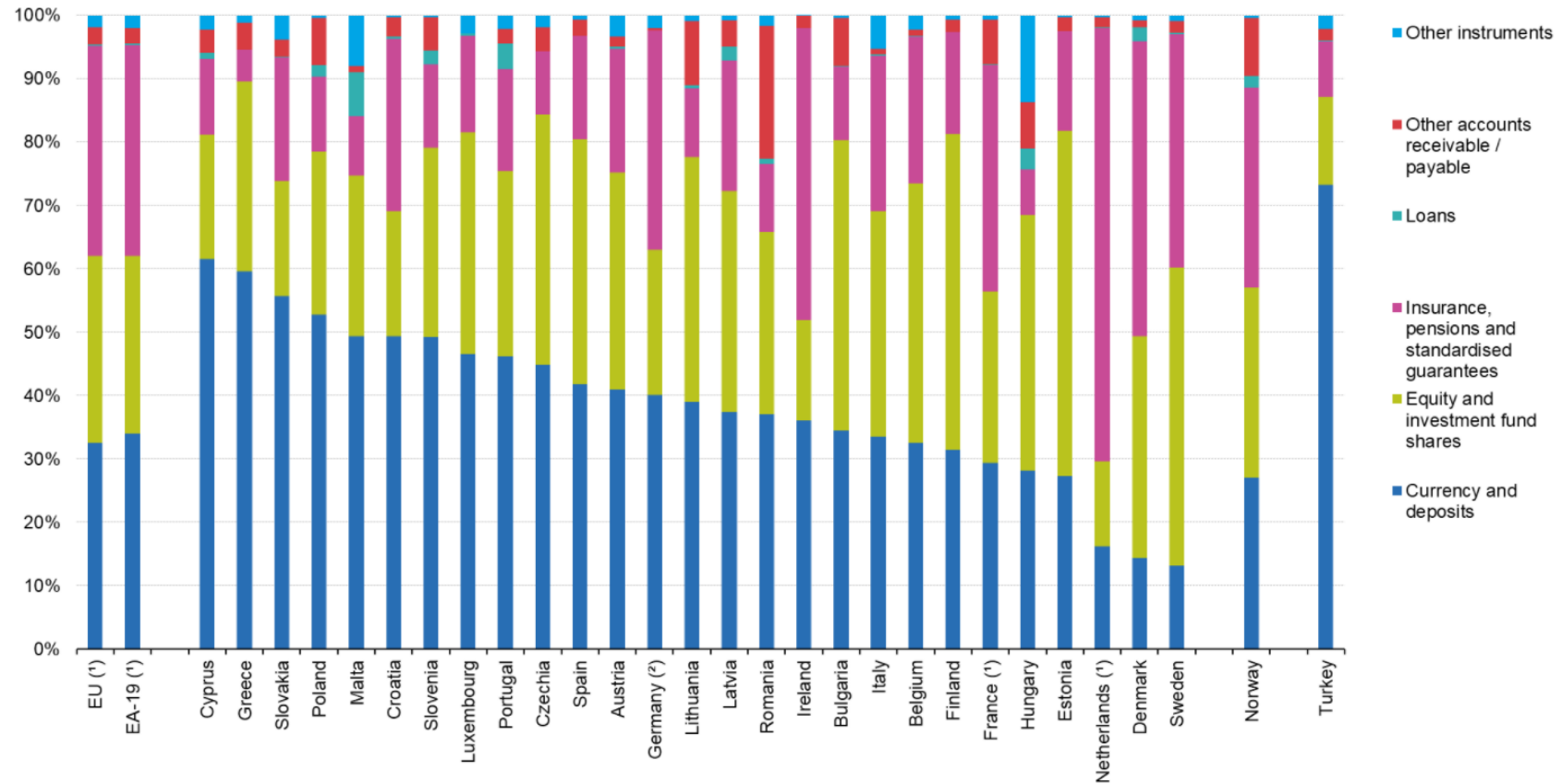


■ Thank you!



 Q&A

Share of type of assets of households, 2020 (% share of total financial assets of households)



Note:

The Other category refers to the sum of four groups:

[F1] Monetary gold and special drawing rights (SDRs)

[F3] Debt securities

[F7] Financial derivatives and employee stock options