association of the luxembourg fund industry

ALFI

Public Comment on IOSCO Retail Market Conduct Task Force Report

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About ALFI

The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge.

Created in 1988, the Association today represents over 1,500 Luxembourg domiciled investment funds, asset management companies and a wide range of business that serve the sector. These include depositary banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax advisory firms, auditors and accountants, specialised IT and communication companies. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg domiciled investment funds are distributed in more than 70 countries around the world.

We thank the Board of the International Organization of Securities Commissions (IOSCO) for the opportunity to participate in this consultation.

Questions

Q1: In their risk analysis, should regulators specifically consider/target specific demographic profiles/groups for additional or enhanced investor protection measures? If so, should greater attention be focused on younger age groups or older age groups? Is there a tipping point in behaviours beyond which regulators should become concerned?

We generally support the comments by IOSCO regarding the key areas of risk and believe that specific demographic profiles is one of the most important criteria that the regulators should consider when focusing on the enhancement of investor protection measures. Both younger and older investors should be targeted in such analysis.

As mentioned in the report, young investors tend to "self-direct" themselves and invest in "non-classic" securities by relying on information provided on social media. Digitalisation of financial services allowed young investors an easier access to investment products on digital platforms. Studies show a raising interest to invest into riskier asset classes under an execution-only service. In addition to that, younger generations seem to be more interested in the crypto space and are more tempted to invest in newer alternative asset classes such as crypto, NFTs etc. The latter are still largely unregulated and the unregulated nature of these investments may entail risks that are not always disclosed, understood and consequently considered and mitigated by retail investors. Such vulnerability could be mitigated by increased regulation.

In this context, financial education and early access to financial products for the younger generations should be given priority by regulators. Education may protect young investors from taking bad decisions.

The following actions could be addressed by the regulators in our view:

- As also mentioned in ALFI's response to ESMA's call for evidence on retail investor protection aspects, there is an emergence of investment by young investors and disclosure requirements

should in our view grant reliable, proportionate and specific criteria which can help a young investor to make a decision.

- It is also of importance that the regulatory frameworks (continue to) allow the consideration of the generation of young investors as they represent a particular population within the retail investors and are the investors of the future. Their particular needs in terms of information and protection should be taken into account, e.g. when determining the target market of products and when performing the suitability test.
- Make financial investment education accessible to all young investors through digital means and free of charge.
- Provide clear and consistent information on the cost and charges of all investment products.

On the other hand, the more an investor approaches his/her retirement age, the less time he/she has to recover from possible financial mistakes. Therefore, financial advisers and professionals should be particularly diligent when providing services and advice to senior retail investors.

Q2: Does the consultation report capture accurately the important retail trends and the reasons for increased retail trading? Are there any missing concerns or issues and other potential risk magnifiers? What may be the current and potential long-term implications of increased retail participation in markets in your view?

With regard to the topic of investments in "riskier assets" as addressed in the consultation paper, we would like to take the opportunity to raise the point that in ALFI's view not all products which are currently classified as complex within the MiFID framework (according to the ESMA Q&A on "MiFID complex and non-complex financial instruments for the purposes of the directive's appropriateness requirements" dated 3 November 2009) are necessarily risky. It should therefore be considered not to send the wrong message to investors and the general public that complexity, stemming from innovation in asset management, necessarily involves higher risks and a contrario that funds using less complex investment techniques and instruments are risk free, including potentially from an investment performance perspective. ALFI believes it is essential to make a clear distinction between the use of complex, innovative asset management techniques and strategies on the one hand and the risks that may be associated with complexity, if any, on the other hand.

We would like to highlight that there are currently non-UCITS retail fund products available in a number of European markets (e.g. in Luxembourg this would be Part II funds) that, were they UCITS funds, would be considered as non-complex products. In addition, we would also like to highlight that Alternative Investment Funds ("AIFs") could also have UCITS-like investment restrictions or objectives but again, only because they are AIFs, would not be able to be considered as non-complex due to the ESMA Q&A on "MiFID complex and non-complex financial instruments for the purposes of the directive's appropriateness requirements" dated 3 November 2009.

To summarise, in our view, each fund should be subject to individual complexity and risk assessments and then appropriately classified based on the criteria of MiFID II. AIFs should still be able to be qualified as non-complex, subject to an individual assessment of the characteristics of the fund under the MiFID II regime. ALFI also suggests the consideration of certain AIFs as non-complex under Article 57 of the MiFID II Delegated Regulation which would be an acceptable fall-back-option if the solution preferred by ALFI to apply a case-by-case analysis of each fund should not be endorsed).

Q4: How should regulators consider whether to monitor crypto-asset trading by retail investors? Are there ways that the apparent data gaps with regard to retail investor crypto-asset trading could be filled or other protections for retail investors or ways in which regulators could begin to monitor crypto-asset trading? Are different approaches likely to be more or less effective in jurisdictions with different regulatory, statistical and other governmental and private sector approaches to data gathering?

As a preamble to answer this question, it is relevant to highlight the distinction between the technology from which the crypto-asset is stemming from and the intermediary infrastructures supporting its deployment as an

investment opportunity (such as crypto-asset markets, issuers, custodians, wallet providers and service providers). While a technology agnostic perspective is advocated for, an alignment with existing requirements and frameworks for financial instruments is deemed relevant for supporting crypto market and investment infrastructures in order to ensure a level playing field.

For crypto-assets, the stakes evolve around transparency, suitability, investor protection, fair treatment, market resilience, price discovery and AML (among others). The abovementioned existing framework (financial instrument) addresses those matters and provides principles on which the crypto-asset trading regulatory framework could be aligned. In the sphere of crypto-assets, alignment recommendations already exist (e.g. FATF). In Europe, the MiCA proposal provides, overall, a basis for an alignment (for the crypto-assets in scope).

In addition, a transaction reporting to a Trade Repository, similar to the one already deployed under EMIR and SFTR, could be relevant to monitor the exposure to the various types of Crypto Assets.

Q5: How should regulators approach these trends (e.g., both trading for crypto-assets or brokerages using hidden revenue raising mechanisms) and when should they seek to intervene?

Regarding the trends depicted in this chapter, most of them relate to fraudulent activities and/or lack of financial literacy exploited/aggravated by modern communication means. Accordingly, regulators intervention could be declined along two axes. Firstly, while surveillance of online activities and misconducts is inherently very difficult, regulators should still endorse this role as it is already done for traditional financial services. Although new technologies can facilitate illicit activities, they can also enhance and reinforce surveillance technics. Secondly, harmful consequences could often be related to sub-optimal decision making and inadequate financial literacy. Regulators role in broadly educating customers and conveying a clear message is also of paramount importance[1]. Again, modern communication tools can also support these initiatives such as social media platforms.

Regarding the specific case of the illustration provided, referring to hidden revenue, we refer to the previous question and call for alignment with financial instruments (and financial industries) where an emphasis has been put on disclosure to reduce information asymmetry and related agencies issues.

In our view, regulators should aim to regulate online investment platforms and brokers (including the ones in relation to crypto investments). We would like to highlight that there is a need for consistency regarding the rules applied, not only in relation to social media platforms (reference is also made to the ESMA Marketing Guidelines[2]).They should also aim to regulate the promotion/advertisement of investment services or platforms by any natural or legal person in order to avoid conflict of interests. Persons that may publicly influence investment decisions of retail investors have a responsibility towards their audience and should disclose in a clear and comprehensive way when they receive revenues or inducements for such promotion or when a conflict of interest situation may arise.

Q10: What may be the concerns or issues that regulators should ask for disclosure of (at both firm and product level), keeping in mind the balance between quantity of disclosure and the ability of retail investors to absorb such disclosure? Should markets continue to seek to put in place special arrangements that could encourage companies during stressed market events to provide disclosures and updates that help retail investors better evaluate current and expected impacts of such events? If so, what may be the practical options to achieve this, including who should provide this information? Are there specific technological measures or non-technological measures (e.g., changing the timing, presentation of the information) you would suggest to

[1] Example of regulatory initiative in this context:
https://www.cssf.lu/en/2022/04/guidance-for-consumers-in-the-context-of-virtual-assets/

[2] ESMA Guidelines on marketing communications under the Regulation oncross-border distribution of funds:
https://www.esma.europa.eu/sites/default/files/library/esma34-45-1244_-_final_report_on_the_guidelines_on_marketing_communications.pdf

enhance the ability of retail investors to process the disclosure?

It is a challenge to strike the right balance between comparability and provision of meaningful information. The comparability of the same type of investment products is important and ensures a level playing field in terms of product disclosures. However, requirements for same or similar information partly goes to the detriment of meaningful information. For the majority of retail investors, financial products are not easy to understand, therefore, concise product specific information in clear language is key. One should also avoid multiplication of information levels especially with regard to products which are also themselves subject to certain disclosure/information requirements (like funds).

AIFM and UCITS Directives, PRIIPs Regulation all incorporate high levels of protection and transparency requirements towards investors at product level.

The information provided by the PRIIPs KID was so far not consistent with the cost information under MiFID, and even if the PRIIPs methodology may be used for MiFID disclosures, this does not lead to an alignment of methodologies. MiFID uses a zero-return assumption while the PRIIPs Regulation uses the cost disclosures tied to future performance scenarios. Moreover, the regulatory technical standards (RTS) under MiFID neither specify a methodology, nor make explicit reference to the detailed description of the transaction cost methodology under the PRIIPs RTS. While the 'arrival price' methodology incorporates certain fundamental flaws that were not rectified by the revision of the PRIIPs RTS, it is essential to point out again that it can result in misaligned transaction cost disclosures under PRIIPs and MiFID. The same was and still is the case regarding the ongoing charges figure, notably the cost types in scope for the calculation of ongoing charges under UCITS, PRIIPs and MiFID. The overarching MiFID and IDD frameworks should provide the overall cost disclosure points and methodologies, which could then be inserted into the PRIIPs KID.

We think that the PRIIPs KID's Summary Risk Indicator (SRI) should also be used for the risks disclosure under MiFID in respect of individual product risk disclosure. An alignment would be welcome from a retail investor perspective recognising that additional descriptions of risk will be required when investment advice or discretionary portfolio management is provided over a broad range of assets.

MiFID does not encompass the mandatory disclosure of performance information to investors in investment funds, but only the disclosure of a product description which "shall explain […] the functioning and performance of the financial instrument in different market conditions, including both positive and negative conditions" (EU/2017/565 – Art 48(1)) i.e. the performance triggers. MiFID only clarifies how performances shall be disclosed (warnings) and provides some information on how it should be calculated if "the information [provided to investors] contains an indication of past performance of a financial instrument" (EU/2017/565 – Art 44(4)) or if "the information contains information on future performance" (EU/2017/565 – Art 44(6)).

The PRIIPs KID uses past data to calculate future performance scenarios. The revised PRIIPs rules will allow past performance information based on historical data. The disclosure of past performance will not directly be included in the PRIIPs KID, it will only be accessible via a hyperlink. We highlight the importance of the availability of UCITS past performance data to investors in assessing the value provided by competing products and for supervisors as part of their ongoing assessment programmes e.g. the current Common Supervisory Action on costs and charges.

As a further inconsistency, we would like to mention the following: Where the investment service is related to bonds with no other embedded derivative than a make-whole clause, an exemption from product governance rules applies further to the MiFID II Quick Fixes (as per Directive (EU) 2021/338). However, no equivalent exemption exists for said bonds with a make whole clause under the PRIIPs Regulation.

With respect to information overload, we would like to highlight that ALFI welcomed the simplifications provided in the Quick Fixes. The provisions ensure exemptions from costs and charges disclosure requirements regarding services provided to professional clients and eligible counterparties. In addition, they provide for a temporary suspension of best execution reports (reference is made to ALFI's response to the European Commission consultation on the MiFID II / MiFIR review). As in our view, the effort and costs required in preparing best execution reports is not justified for the benefit that they provide, we also welcomed the European Commission's proposal for the MiFID II review that the publication requirement laid

down in Article 27(3) of Directive 2014/65/EU will in view of the envisaged emergence of a consolidated tape no longer be relevant and should be deleted.

With regard to digital disclosures (on social media etc), we would like to highlight that there is a need for consistency regarding the rules applied, not only in relation to social media platforms (reference is also made to the ESMA Marketing Guidelines).

Q11: Where product intervention powers exist, what factors should regulators consider determining when it should be used and at what stage to ensure suitability and to mitigate investor harm? For example, should regulators monitor leverage levels in retail trading and/or seek the power to limit leverage? If so, is it possible to describe the kind of situation in which such powers could justifiably be used?

To our knowledge, MiFIR is the sole sectoral application which actually granted product intervention powers to ESMA as referred to in Article 9(5) of the ESMA Regulation and to NCAs (Articles 40 and 42 of MiFIR).

Product intervention measures have been adopted by NCAs and ESMA in 2018 and 2019 with respect to the marketing, distribution or sale of binary options and CFDs to retail clients. In our opinion, this effective use of the product intervention powers was positive (as also disclosed by ESMA in its Technical Advice to the Commission on the effects of product intervention measures dated 3 February 2020, ESMA35-43-2134 (Technical Advice)).

We have not identified any circumstances under which we believe that ESMA and/or NCAs should have used their product intervention powers, without doing so.

Q13: Are the above regulatory tools appropriate, proportionate, and effective? Are there other regulatory tools regulators might consider? What new technologies may help regulators as they continue to address misconduct and fraud (including online/via social media)?

The list of tools provided for in this paper is in our view appropriate and proportionate. Whilst the technology related tools presented by IOSCO members are well thought through, we believe that focus should be on improving financial education to pro-actively prevent retail investor harm and losses. We would encourage national regulators to work with their partners in the government to assess how best to integrate financial education courses so that every individual by the time he/she is 18 years old has completed a certain number of mandatory financial education hours. Additionally, we are supportive of national regulators being more present on social media such as TikTok, Instagram, Twitter, YouTube, Facebook to raise awareness and sensitivity of investors and highlight risks associated with using social media for investing.
With regard to social media and ‘financial influencers’ and in addition to what has been mentioned in the consultation, we are supportive of further regulatory requirements that would apply to those actors to make it clear (by way of disclaimers) that their advices are based on their personal views and should not be considered as financial advices. Licensing requirement for crypto and alternative asset online platforms could also be considered.

A regulatory framework in the following main areas could be assessed:

1. A digital due diligence framework could enable the regulators to identify market participants and investors and combat fraud. RegTech firms are developing AI-based with biometric technology tools to support remote on boarding.

2. Data security and transfer of data framework can also enable the regulator to monitor the risk of data theft to protect market participants and investors.

3. Online and digital marketing tools adapted to new technologies and critical challenges.

4. Continuous risk disclosures and clear and fair information treated with priority.