CFA INSTITUTE BLUEPRINT FOR THE NEXT FIVE-YEAR LEGISLATIVE PERIOD

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Introduction

As the leading global association of investment professionals, CFA Institute sets the standards for professional excellence. We champion ethical behaviour in investment markets and are a respected source of knowledge in the global financial community. Our mission is to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. CFA Institute has more than 160,000 charterholders in 164 countries and territories, working locally on the ground through 154 local member societies. In the European Union, CFA Institute has 23 societies: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Romania, Slovenia, Spain, Sweden, and the United Kingdom.

Our Advocacy Division takes a leadership role in policy, regulatory, and standards matters relating to investor protection, market fairness, transparency, and best practices in investment management. Our team in Brussels has been engaged consistently in the key debates concerning financial markets issues in the European Union. We have given feedback to EU institutions through the production of research pieces and survey reports that reflect not only the diversity of capital markets in EU member countries but also the different features concerning the EU financial markets in regard to other regional markets (an informed pool of survey respondents on financial markets infrastructure).

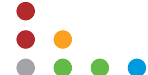
We have been consistently engaged in the key debates concerning financial markets issues in the European Union. Our policy advocacy efforts are focused on three areas:

1. Advancing and promoting policies that serve investor protection over commercial interests
2. Creating content and advancing policy research that improves market structure, transparency and fairness for all investors
3. Supporting the creation and adoption of rules and regulatory standards which improve and expand investment industry professionalism

We work together with our members from 23 CFA EU societies, who have stronger knowledge of the specifics of their local capital market, to publish a blueprint describing the main policy and regulation challenges they encounter in their local financial market and underlining some possible solutions.

This paper includes issues and recommendations raised in past CFA Institute research that, we believe, remain of particular relevance as EU policymakers view the next five-year EU legislative mandate.

This blueprint addresses four principal topics: capital markets union, fintech, sustainable finance, and value for money. These four themes are priorities for CFA Institute members and also represent the areas in which CFA policy experts are most involved and engaged. We remain at the disposal of the European Commission and other institutions that wish to discuss these matters and our recommendations further.



1. Capital Markets Union

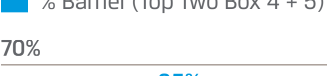
Main issues for the capital markets union (CMU) initiative are:

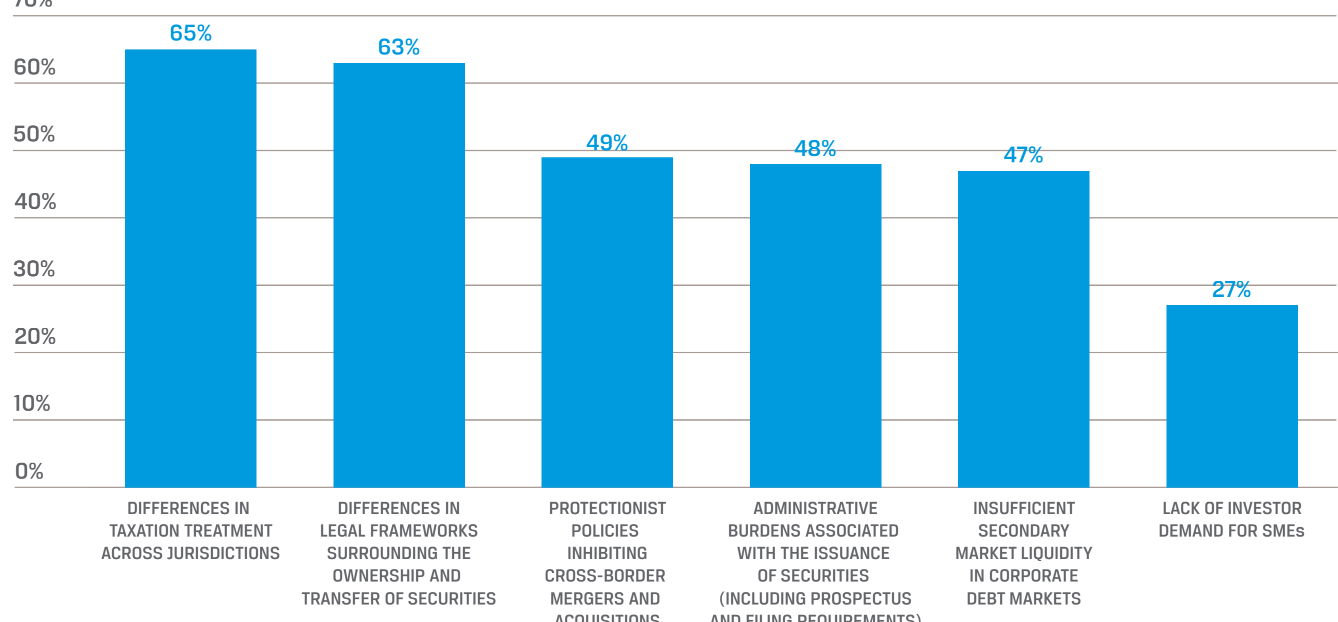
- market fragmentation and the rise of private markets;
- lack of alternatives to traditional bank financing;
- several obstacles that negatively affect small and midsize enterprise (SME) financing remain unaddressed;
- heterogeneity in taxation rules;
- wide diversity in regulations regarding ownership and transfer of securities across member states are not facilitating the cross distribution of transactions and investment vehicles; and
- securities lending practices for collateralisation considered excessive in certain circumstances, leading to illiquid and unstable financial markets.

Small and Midsize Enterprise Financing

The CMU Action Plan, which was launched first in September 2015 and reviewed in mid-2017, had the pivotal goal of boosting the European economy and stimulating investments by creating stronger capital markets and diversifying financing sources in the European Union, which was overly dependent on bank funding.

In 2015, CFA Institute conducted a CMU survey[1] to understand what our European members think about the need for more harmonised capital markets in the European Union. The survey focused on members' perception of what should be done to develop an EU capital market. The top-two barriers underlined by survey respondents included differences in taxation





Q: To what extent are each of the following a barrier to the development of EU capital markets?
Scale: Please rate each on a 1 to 5 scale, where 1 means it is not a barrier at all and 5 means it is a huge barrier.

SOURCE: CFA Institute (2015)

Figure 1. Barriers to the Development of EU Capital Markets

[1] "Capital Markets Union Survey Report," CFA Institute (April 2105), https://www.cfainstitute.org/-/media/documents/survey/capital-markets-union-survey-report-april-2015.ashx.

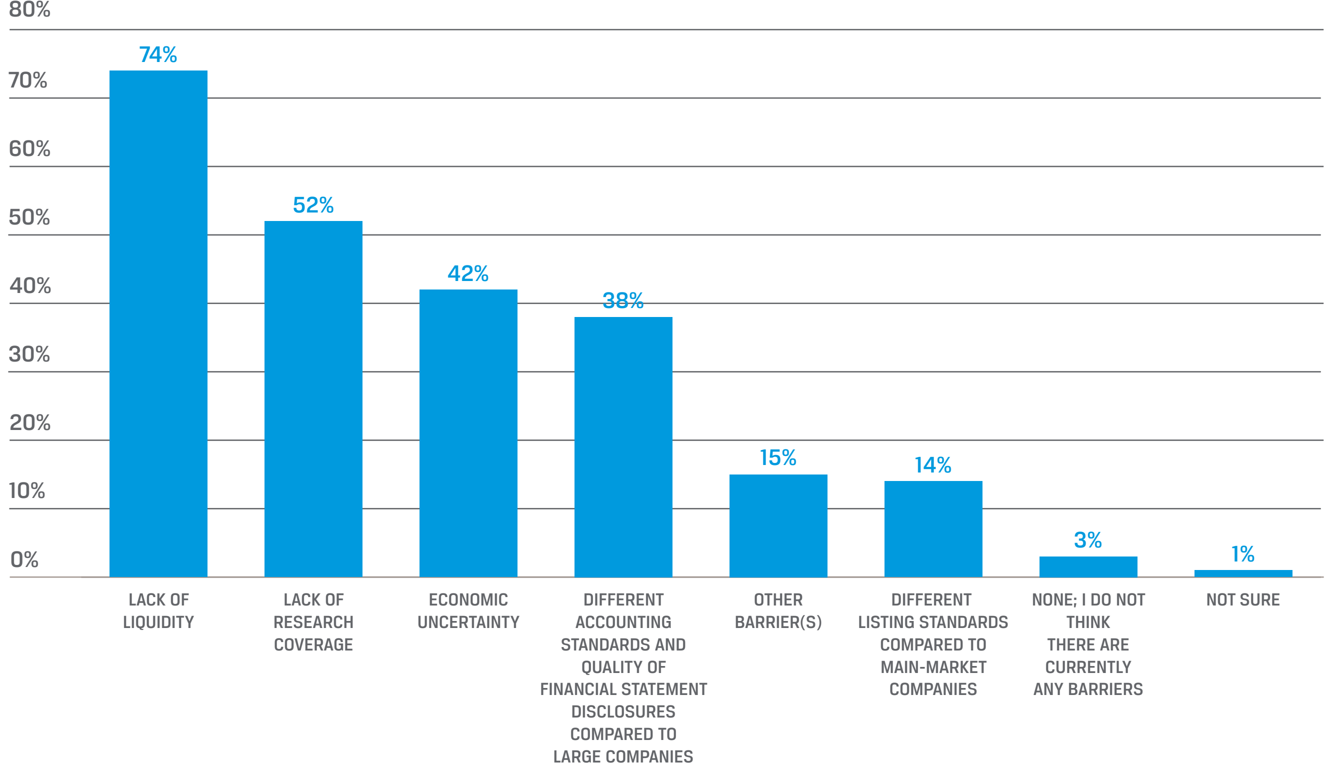


Figure 2. Barriers to investor interest in SMEs

treatment across jurisdictions and differences in national legal frameworks regarding ownership and the transfer of securities (Figure 1). Overall, our members called for greater standardisation of issuances and securities trading rules.

In 2013, CFA Institute published an SME report[2] on the issues that EU SMEs face when accessing funding. The report was based on the results of a survey that our members in the European Union completed early that year. According to the report, the main barriers affecting investor interest in SMEs at that time were lack of liquidity and of research coverage, economic uncertainty, different accounting standards, and the quality of financial statements (Figure 2).

Regarding measures that could encourage investors to invest more in European SMEs, members viewed granting further investment-driven tax reliefs, providing specific business and investor group schemes, and creating European social entrepreneurship funds for SMEs as possible solutions. CFA Institute believes that some of the aforementioned barriers are present in EU capital markets and continue to be major problems for SMEs. A case in point is research coverage that, according to the results of our recent survey on the Markets in Financial Instruments Directive (MiFID) II, seems to have declined for SMEs (Figure 3). This decrease in research might have an impact on SME financing because investors may be less incentivised to invest in small companies.

Because banking sector opportunities in Europe for SMEs are insufficient, alternative funding channels are needed from capital markets, such as private equity funds and alternative financial instruments. The development of disintermediated nonbanking finance is considered to be a priority for our societies. These private market mechanisms are robust in many developed countries and have led to significant advances in capital formation and economic growth.

[2] "Helping SMEs Access Funding Survey Report," CFA Institute (January 2013), https://www.cfainstitute.org/Survey/smes_poll_survey_report_28_jan.pdf.

United Kingdom

CFA Society United Kingdom stressed the importance of enhancing the possible nonbanking sources of financing and debt financing for SMEs. Some of our members also suggested that creating pooled investments into several SMEs would benefit investors from better risk diversification.

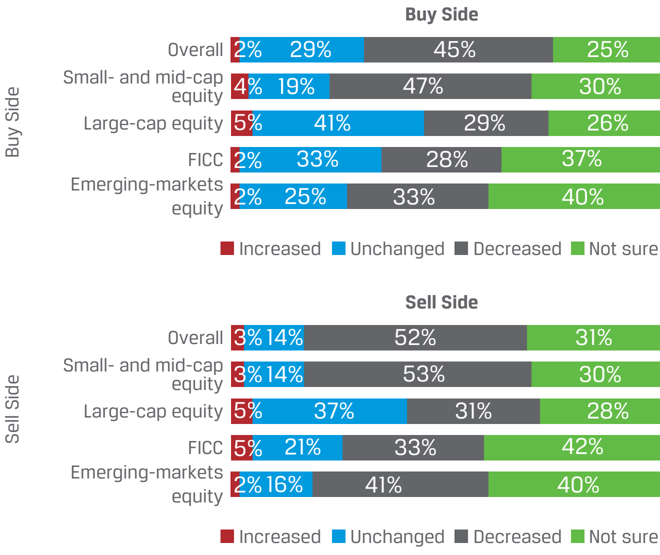
Netherlands

CFA Society VBA Netherlands believed that lending activity from the banking sector to SMEs has reduced in the recent years. Most small companies' financing sources, however, come from funding platforms that operate outside markets. Dedicated markets for such companies, such NPEX (i.e., the SMEs stock exchange based in The Hague), seem to be struggling to grow as they face excessive regulatory burden.

Spain

CFA Society Spain argued that a common legislation at the EU level for primary markets should be established to facilitate the issuing process for SMEs (e.g., through a single procedure for the adoption of a simplified prospectus for small firms) and to provide a single framework concerning information and data provided in terms of risk indicators, balance sheet presentation, and governance. The standardisation of issuance procedures also should include a third-country regime for firms operating in regions other than the European Union and should establish rules addressing specific issues regarding accounting issues on mark-to-market and capital consumption methods for pricing.

Question: Since the introduction of MiFID II, for the following asset classes, research coverage has [increased, remained unchanged, decreased, not sure].



SOURCE: MiFID II: One year on, CFA Institute (2019)

Figure 3. Research coverage since the introduction of MiFID II

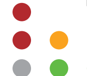
Making Public Markets More Attractive

The recent CFA Institute global study Capital Formation[3] clearly explains that public market participation in industrial markets has declined over the past 20 years (Figure 4). Data show that a trend in public company delisting in Europe has taken place in the past five years. The report on capital formation is part of an ongoing project in which we look at the evolution of private and public markets around the globe. The first part of the project was based mainly on inputs received from investment professionals and other CFA Institute members throughout the course of a series of workshops held in London, Abu Dhabi, Dubai, Hong Kong, New York, and Washington, DC. The second part of the report focusing on the continental market in the European Union is planned for release in fall 2019 (based on workshops to be held in France, Germany, Italy, Spain, Ireland, Sweden, and Luxembourg).

The first report suggested that the shift towards private markets might be caused by a combination of secular factors, such as the increased interest in investments related to intangible assets, and cyclical factors (e.g., low interest rate environment and higher volume of private capital). A distinctive issue occurring in the United Kingdom is the reluctance by retail investors to invest in active management activities. Excessive benchmarking of managers and the focus on fee reduction do not attract active management investments.

CFA Institute is particularly concerned about the trade-off certain regulators are willing to make between making public markets more easily accessible to issuers by reducing regulation, corporate governance

[3]Sviatoslav Rosov, "Capital Formation: The Evolving Role of Public and Private Markets," CFA Institute (2018), https://www.cfainstitute.org/-/media/documents/article/position-paper/capital-formation.ashx.



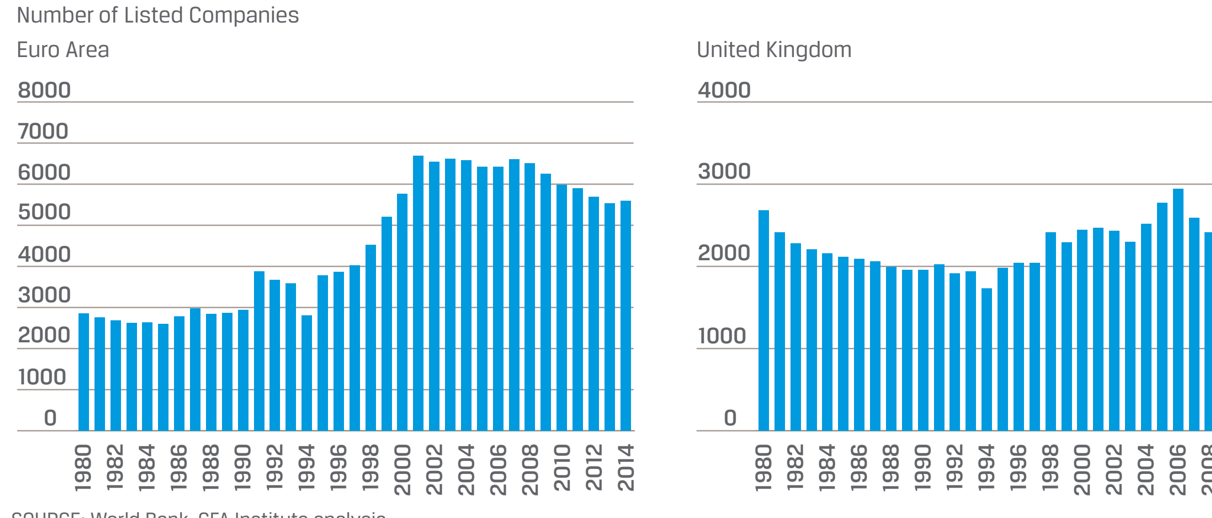


Figure 4. Public market participation

requirements, and audit oversight. We feel that protecting investors and market integrity must still be the prime consideration in the rush to add more public companies. Finally, it is not evident that many retail investors participate in IPOs and invest in new equity issues. Hence, policymakers should avoid introducing measures aimed at lowering disclosure requirements to stimulate companies to offer IPOs.[4]

We also highlight the alternative of enhancing the access of smaller investors to private market investments, especially the access of defined contribution funds to private markets. To do so, policymakers need to address the typical challenges that even sophisticated investors face when investing in private markets. These are information asymmetry, illiquidity, and long holding periods. Introducing measures that could minimise such obstacles could encourage retail investors to channel more of their savings into private markets.

This declining trend in public market participation has also been confirmed by our European members who have stressed the ongoing decline in IPO operations.

United Kingdom

UK investment professionals participating in a workshop on capital formation highlighted that the way in which the excessive benchmarking of managers and the goal of fee reduction combine to make it difficult to adopt active management strategies. UK members saw daily liquidity requirements in investment portfolios as an obstacle to managers' freedom to pursue innovative investment strategies, such as private market investments.

Poland

CFA Society Poland members remarked:

- Capital raised in the Polish market through IPOs has dramatically declined in the past 20 years. Warsaw Stock Exchange data confirm that a drastic fall in funds raised through initial offerings has taken place over the past seven to eight years. IPOs amounted to around 7 billion Polish złoty (PLN) on average in 2009, whereas they were less than PLN 500 million in 2018. In addition, 2017 was the first year since early 2000s during which the overall number of companies listed on the Polish stock exchange went down (by a significant percentage).
- Liquidity of equity markets is stable (on average, PLN 220 worth of transactions per year), but investors expect more from a thriving economy like Poland. The derivatives markets are not performing as expected (interest rates on this market are lower than the foreign exchange and cryptocurrencies markets).[5]

[4]See Sviatoslav Rosov, "Capital Formation: The Evolving Role of Public and Private Markets," CFA Institute (2018), https://www.cfainstitute.org/-/media/documents/article/position-paper/capital-formation.ashx.
[5]Konrad Krasuski, "Poland Plots Market Fix, Shuts Eyes to Elephant on Trading Floor," Bloomberg News (2 March 2019), https://www.bnnbloomberg.ca/poland-plots-market-fix-shuts-eyes-to-elephant-on-trading-floor-1.1222806.

Our Polish members stressed that the Polish capital market is not seen as the main source of financing for SMEs. Although EU legislative actions recently simplified access to capital markets, the process that Polish SMEs have to go through to obtain funding has become more complex since the beginning of the century. To be listed in the Warsaw Stock Exchange (GPW or New Connect), companies are required to submit detailed documentation, which is seen as a burden for SMEs in terms of time and costs. This is one of the primary reasons that access to Polish capital markets is far more problematic for SMEs in relation to other markets across the European Union.[6]

Cross-Border Retail Markets

As noted, differences in taxation and rules concerning ownership and transfer of securities are the main barriers identified by CFA Institute members. These factors hinder investors from purchasing cross-border products in the European Union. CFA Institute advocates that Fintech developments could facilitate cross-border investments and overcome the current challenges.

The rise of automated financial advice services, for instance, can favour additional cross-border transactions by reducing the cost of investment advice, facilitating access to products, and removing (or strongly reducing) physical and geographic barriers that are typical of human advice.

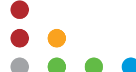
The roles of the European Supervisory Authorities (ESAs) in cross-border situations should be reinforced. European Securities and Markets Authority (ESMA) should have more powers to intervene when the issues concern cross-border transactions. ESMA should clarify differing local interpretations of applicable rules.

In general, improved supervisory convergence would facilitate cross-border operations and better preserve investor protection and market integrity. The final agreement on the review of the three ESAs, which was reached at the end of the current EU mandate, represents a step forward to achieve these objectives. CFA Institute, however, believes that more direct supervisory powers should have been granted to the three ESAs, and especially to ESMA to successfully realise the goal of a CMU in the European Union. ESMA should be the single supervisory authority for capital markets in the European Union. The initial European Commission proposal on the ESAs review, launched in 2017, went in the right direction by granting more intervention and supervisory powers. The final legislation, however, does not include many of the proposed provisions on the harmonisation of supervisory role. CFA Institute argues that the area in which ESMA should have supervisory powers is cross-border investment funds. Direct supervision of cross-border investment funds by ESMA would reduce obstacles to fund distribution, such as reducing or alleviating duplicative or inconsistent national requirements that could lead to obstacles in the investment chain.

Enhanced harmonisation of regulation and supervision across EU markets is viewed as the main solution to cross-border and national hindrances in some regional markets in the European Union, such as Central and Eastern Europe (CEE). A CFA Institute survey on capital markets in the CEE region conducted in 2018 clearly reveals that this is the best regulatory approach to increase capital markets activity in the CEE financial market. This centralisation clearly comes at some expense of local regulator control. Yet, it is the most likely approach for achieving a more consistent, high-functioning, EU-wide marketplace that will be much more competitive in attracting global investment.

In 2013, CFA Institute published the global study "Restricting Sales Inducements,"[7] which analysed the measures put in place by policymakers around the globe with the objective of ensuring high-quality financial advice for investors. The paper also offered recommendations for regulators to prevent the risk of mis-selling of financial products. The document found that markets banning commissions might boost new platforms to offer low-cost and low-service investment options to clients (Figure 5). This situation could give rise to the practice of providing inappropriate

[6] "Report of the Management Board on the Activity of the Parent Entity and the Giełda Papierów Wartościowych w Warszawie Group in 2018," GPW (2018), https://www.gpw.pl/pub/GPW/files/PDF/raporty/R2018/skonsen/Management_Board_report_on_the_a.pdf.
[7] "Restricting Sales Inducements," CFA Institute (December 2013), https://www.cfainstitute.org/-/media/documents/article/position-paper/restricting-sales-inducements-availability-quality-of-financial-advice.ashx.



If commission payments by product producers are banned completely, what consequences, if any, do you see occurring as a result?

	Total	Americas	APAC	EMEA
Distributors will stop offering particular products altogether, so product choice will diminish.	30%	25%	42%	33%
Retail clients will refuse to pay fees for advice.	16%	10%	21%	32%
Small retail clients will not be able to afford advice.	29%	24%	43%	37%
Distributors will continue to offer advice, but will shrink the product offerings to those they continue to receive fees on.	46%	47%	42%	43%
Distributors will continue to offer advice, but will offer only "in-house" products (products from their own financial group).	38%	38%	32%	45%
Banks will stop offering advice altogether, and will steer client money into deposits.	12%	8%	23%	15%
Small distributors will go out of business, reducing distribution channel choice and reducing product and service choice.	25%	19%	35%	35%
Other	12%	13%	10%	11%
None-I don't see any consequences of a complete ban of commission payments by product producers.	12%	15%	5%	4%
No opinion	6%	6%	4%	7%
Unweighted Sample Size	513	157	91	265

Source: CFA Institute (2013)

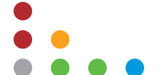
Figure 5. Consequences of markets banning commissions

investment service to retail clients without any form of control. This is a key problem in the European Union because the existing redress mechanisms (i.e., not all member states have compensatory collective redress instruments) are too complicated to be activated in case of cross-border activities. We advocate the establishment of a specific organisation or a unit in the ESMA structure that would replace national competent authorities in handling collective redress for cross-border cases.

With the new MiFID II rules on inducements, introducing bans for independent advice and portfolio management, there is a growing concern over unintended negative consequences on investment research coverage and quality, which should be monitored over the next few years as the effects of MiFID II start forming more clearly. We are concerned that this new model for investment research could lead to poorer-quality research, less coverage of small issuers, fewer public companies, and what is essentially a reduced service quality being offered to retail clients (Figure 6). Conversely, retail investors appreciate the fact that the marketplace seems to be more transparent as a result of the new rules. Indeed, according to the 2016 CFA Institute study (based on a survey produced by the research firm Edelman Berland),[8] retail investors consider the full disclosure of fees and other costs to be the most important feature in their relationship with investment firms.

As part of the CFA Institute Future of Finance initiative,[9] we published the report "Investment Firm of the Future," which explains what strategies firms are likely to develop and what approach they

[8]"From Trust to Loyalty: What Investors Want," CFA Institute (2016), https://www.cfainstitute.org/-/media/documents/survey/from-trust-to-loyalty.ashx.
[9]To find out more about the Future of Finance initiative, visit https://www.cfainstitute.org/en/research/future-finance.



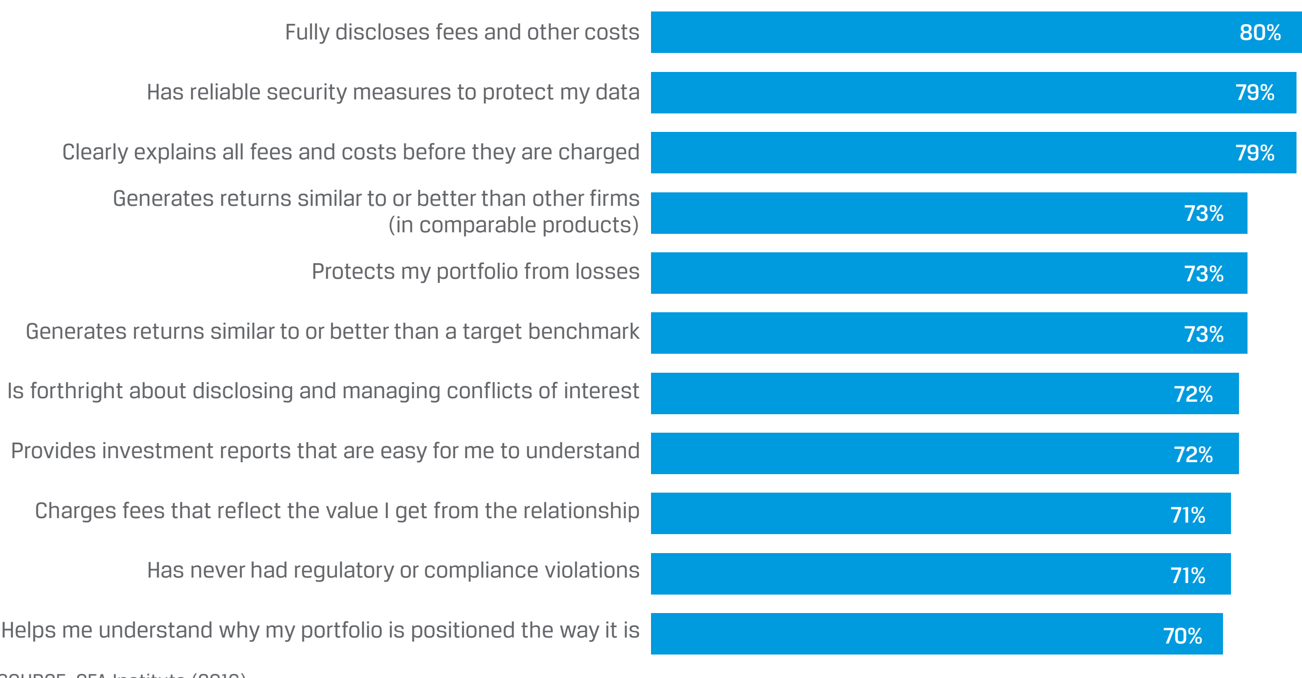
What matters to retail investors?

- 5 of 11 "essential" attributes relate to transparency and open communication
- Performance standards and data security are also highly rated

How important are the following attributes when it comes to working with an Investment Firm?

[Retail investors; % "important" (9,8,7)]

Top-Tier Attributes (70%+ rate important)

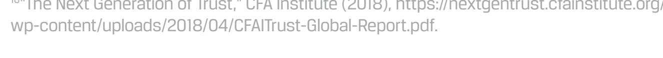


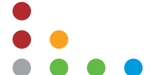
SOURCE: CFA Institute (2016)

Figure 6. What matters to retail investors

should take to better manage risks and achieve their objectives in light of possible disruptive scenarios. The research suggests that future organisations should ensure maximum transparency regarding their fiduciary responsibility, have better and quicker communications with their clients, and develop a more efficient framework for measuring client perceptions of value and outcomes.

The 2018 CFA Institute survey report "The Next Generation of Trust"[10] assessed the gaps between investor expectations and satisfaction regarding specific actions that investment firms could take to restore trust (Figure 7). The widest gaps for retail investors concerned disclosures, specifically about fees, charges, and management of conflicts of interest. Overall, institutional investors' expectations on industry's actions to build trust were higher than for retail investors; but at the same time, the gap between expectations and satisfaction is lower. The most important factor for institutional investors is reliability about securities measures protecting investors' data, and the widest gap was related to the time the organisation spends trying to understand investor priorities, the liability structure, and political dynamics with different stakeholders.


[10] "The Next Generation of Trust," CFA Institute (2018), https://nextgentrust.cfainstitute.org/wp-content/uploads/2018/04/CFAITrust-Global-Report.pdf.



Retail Investor Expectations

	Importance	Satisfaction	Gap
Fully discloses fees and other costs	84%	48%	-36
Has reliable security measures to protect my data	84%	55%	-29
Is forthright about disclosing and managing conflicts of interest	80%	43%	-37
Provides investment reports that are easy for me to understand	80%	51%	-29
Generates returns similar to or better than a target benchmark	78%	44%	-34
Charges fees that reflect the value I get from the relationship	74%	41%	-33
Employs Investment professionals with credentials from respected Industry organizations	73%	51%	-22

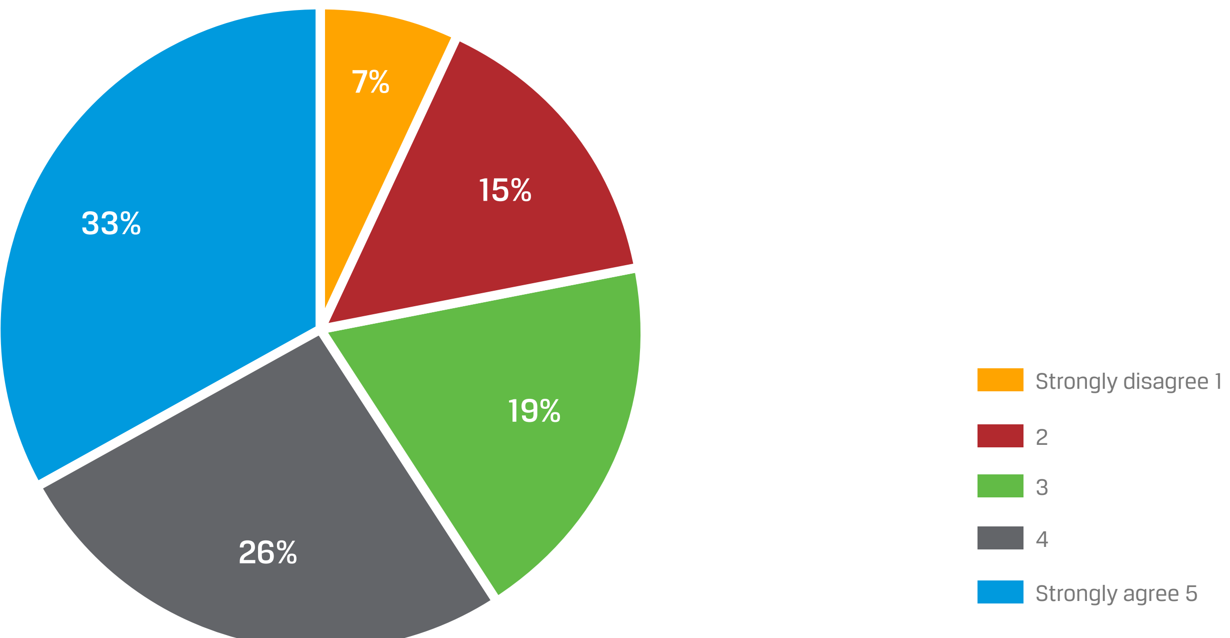
Institutional Investor Expectations

	Importance	Satisfaction	Gap
Has reliable security measures to protect my data	82%	74%	-8
Fully discloses fees and other costs	79%	71%	-8
Acts In an ethical manner In all our Interactions	79%	73%	-6
Takes time to understand my organization's priorities, liability structure, and political dynamics with different stakeholders	79%	70%	-9
Generates returns similar to or better than a target benchmark	78%	70%	-8
Employs Investment professionals with credentials from respected Industry organizations	78%	70%	-8
Sets fee arrangements so our financial interests are aligned	73%	69%	-4

SOURCE: CFA Institute (2018)

Figure 7. Gaps between investor expectations and satisfaction

An EU policy development that has been positively received by the industry has been the recent adoption of the new directive on cross-border distribution of investment funds. This new legislative text is a first step towards the reduction of impediments to the cross-border distribution of funds, and it is expected to make cross-border distribution less costly. Clearer rules for premarketing and marketing of funds and an enhanced consumer protection framework ought to render cross-border funds more attractive for investors. Greater transparency on costs and charges, however, and perhaps a standardisation on the capping of fees charges could further foster participation of retail investors in cross-border capital markets.



Q: To what extent do you agree or disagree that the introduction of a standardised European pension product is necessary to strengthen the single market in pension provision?
Scale: Strongly disagree 1 2 3 4 5 Strongly agree (chart excludes no opinion)

SOURCE: CFA Institute (2015)

Figure 8. Support for a Pan-European Personal Pension Product (PEPP)

Slovenia

CFA Society Slovenia remarked that the small amount of cross-border trading activity of financial products in their local market likely is the result of differences in regulatory requirements for the offering and licensing of investment products across the European Union. In fact, these requirements are much lighter in some member states than in others, such as Slovenia, and many see such divergences as regulatory dumping.

Poland

CFA Society Poland raised a similar issue. Our Polish members saw the differences in the implementation of EU law as a major problem. Directives are often implemented by national parliaments in a restrictive fashion. National competent authorities seem to have too much discretion in the transposition of EU laws into national laws. Having a different regulatory approach in the future, and using more regulations than directives as a legislative instrument, could provide solutions to this issue.

Pan-European Personal Pension Product

Another instrument to support the development of EU capital markets is the Pan-European Personal Pension Product (PEPP). CFA Institute welcomes the adoption of a PEPP regulation that is expected to enter into force later this year. An EU pan-European product would represent another investment option in addition to what is currently provided for consumers in existing national frameworks. We recognise that differing tax regimes and regulatory requirements in the European Union are the main barrier to the portability of these products

across barriers. We therefore advocate that uniformity in tax rules would be a prerequisite to the success of this instrument and that the opening of compartments would be the best way to mitigate such a barrier.

In the aforementioned 2015 CFA Institute survey on CMU, we also asked whether the introduction of a standardised European pension product would be necessary to strengthen the single market in pension provision (Figure 8). Some 59% of EU CFA Institute members surveyed agreed or strongly agreed on the benefits of the introduction of this type of instrument. A high level of agreement was found, especially in Italy and Spain (with more than 80% of responses in favour of a PEPP).

In 2015, CFA Institute partnered with Mercer to publish a report[11] looking at the principles necessary to build an ideal retirement system. The key points are as follows:

- Individuals who do not wish to make decisions need cost-effective and attractive default arrangements, both before and after retirement.
- The overall costs, including administration and investment, of each pension arrangement should be disclosed with some competition present within the system to encourage fair pricing.
- The retirement system must have some flexibility as individuals live in a range of personal and financial circumstances. This flexibility includes recognizing that retirement will occur at different ages and in different ways across the population.
- The benefits provided from the system during retirement should have an income focus but also should permit some capital payments or withdrawals during retirement, without adversely affecting overall adequacy.
- Contributions (or accrued benefits) at the required minimum level must have immediate vesting and portability. Such accrued benefits should be accessible only under certain conditions, such as retirement, death, or permanent disablement.
- Governments should provide taxation support to the funded pension system in an equitable and sustainable way, thereby providing incentives for voluntary savings and compensating individuals for the lack of access to their pension savings.

Systemic Risks Stemming from the Asset Management Sector

CFA Institute is pleased to provide some comments on the future EU agenda on the prevention of systemic risks in the asset management sector. In our Shadow Banking Report, published in 2015, we identified the following:

- Credit flowing amongst nonbanking entities, and between these entities and banks, increases the interconnectedness of the whole financial system. This, in turn, could increment potential sources of counterparty risks.
- One propagative channel of counterparty risk is the vast amount of collateral securities used to finance transactions because more business could be unable to meet margin calls and may default as a result of an increase of interconnectedness in the market.
- Use of derivatives and therefore the resulting impact of synthetic leverage could be another source of potential systemic risk in situations of liquidity shocks combined with poor risk management practices.
- Such concerns could ultimately cause an underprovision of credit, with risks of illiquidity and lack of stability in financial markets.
- The opacity in the nonbanking sector derives from a lack of trade reporting and an inability to capture data relating to credit pools and flaws.
- Corporate disclosures by banks and other financial institutions as regards their markets-based activities and exposures are limited. More transparency is required to enable investors and regulators to constantly monitor credit flows and market developments to timely detect possible systemic risks.

The Systemic Risk Council (SRC),[12] which is an advisory body supported by CFA Institute, wrote a statement letter to G–20 leaders in early 2017 and demanded the maintenance of minimal international standards

[11] "An Ideal Retirement System," Mercer and CFA Institute (March 2015), https://www.cfainstitute.org/-/media/documents/support/future-finance/an-ideal-retirement-system.ashx.

[12] The Systemic Risk Council is a private sector, nonpartisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues relating to global systemic risk, with a particular focus on the United States and Europe.

in global financial reform measures. The SRC also recommended higher common equity requirements for banking groups to lower the probability of defaults and called for the establishment of an effective regime to resolve financial intermediaries' crises without taxpayers' solvency support. The completion of the Banking Union Framework in the European Union, with the inclusion of a common European deposit insurance scheme, would be fundamental to tackle systematic risks in the banking system.

CFA Institute also wrote a letter to the Financial Stability Board in response to the consultative document https://www.fsb.org/wp-content/uploads/FSB-Policy-Recommendations-on-Asset-Management-Structural-Vulnerabilities.pdf, which gives a series of recommendations to address structural vulnerabilities in the investment management sector. We shared concerns about potential systemic risks emerging from asset management activities to the financial system. We are particularly focused on practices and products such as the proliferation of exchange-traded funds, the role and vulnerability of central clearing counterparties to systemic shocks, and whether such repositories of huge OTC derivatives exposures have adequate reserves and tools in the event of market disruptions. Many regulatory and industry actions have been taken in recent years, but new threats and systemic themes arise constantly as markets and products evolve. We encourage the current protective measures not be relaxed but rather maintained and evolved to address emerging systemic threats.[13]

With regard to those shadow banking activities that represent a risk to stability, in a policy statement[14] issued to G–20 leaders in 2017, the SRC stressed that the regulatory regime remains underdeveloped. Banking-type intermediaries should be required to materially reduce their exposure to liquidity risk. The recommendation for regulators is to adopt a systemwide view through which they can ensure the resilience of all intermediaries and market activities that are considered to be materially relevant to the resilience of the system as a whole.

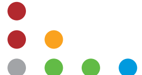
The SRC has also grown increasingly concerned about the potential systemic risks that could be caused by central clearing counterparties (CCPs). The impact of regulatory measures taken since the 2007–08 crisis both in the United States (Dodd-Frank) and in the European Union (EMIR) to improve market stability, risk management, and transparency in derivatives markets have also resulted in making these global intermediary institutions potentially systemic by nature while not addressing the concerns related to their resolution in cases of stress to their own stability. In March 2019 the SRC responded to the Financial Stability Board's (FSB) late-2018 discussion paper on the resolution of distressed CCPs.[15] Commenting that the discussion paper "is as welcome as it is overdue," given that many of today's CCPs are "super systemic" and therefore too important to fail, the SRC emphasizes that the resolution of CCPs is "one of the biggest gaps in the post-crisis regime for financial stability."

CFA Institute Recommendations

- In line with CMU objectives, focus policies on incentives and products that will encourage long-term investments by savers (whether through private or public markets), for the benefit of SMEs looking for attractive capital-raising solutions. Alignment of interest is key to successful capital markets.
- To alleviate the concerns around potential unintended consequences of MiFID II, focus policies on the mechanisms that could be necessary to ensure an efficient market for independent research is gradually established, with enough coverage and quality throughout the economic spectrum (including SMEs).

[13]See our 2016 comment letter to the Secretariat of the Financial Stability Board: https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20160921.ashx.
[14]"To the Finance Ministers, Governors, Chief Financial Regulators, and Legislative Committee Leaders of the G–20 Countries," Systemic Risk Council (2017), http://4atmuz3ab8k0glu2m35oem99-wpengine.netdna-ssl.com/wp-content/uploads/2017/02/Systemic-Risk-Council-Policy-Statement-to-G20-Leaders.pdf.
[15]The Systemic Risk Council (18 March 2019), https://4atmuz3ab8k0glu2m35oem99-wpengine.netdna-ssl.com/wp-content/uploads/2019/03/New-CCP_Resolution_-_SRC_-_March18__2019.pdf.

- Monitor the impact of regulatory measures on smaller firms with fewer economic resources and lower capacity to adapt. One solution may be to segregate and nurture such firms on a venture exchange that signals lighter touch regulation.
- Continue to set a clear focus on investor protection, by enhancing standardised disclosure requirements.
- Consider the appropriate mechanism required to grant the European Securities and Markets Authority more direct supervisory powers over practices and rules pertaining to cross-border distribution of investment funds. This could help reduce the current obstacles to the passporting of relevant products to investors across the Union.



2. Fintech

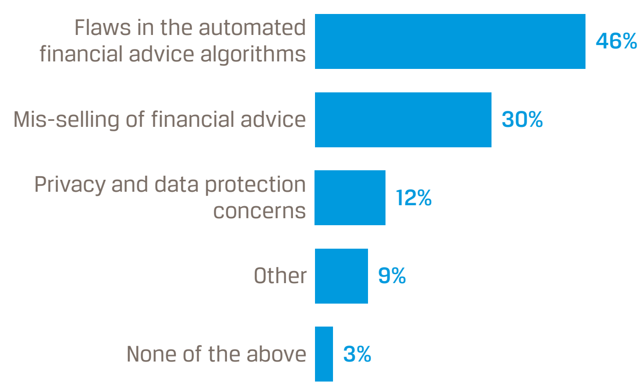
Main issues for fintech are

- increased likelihood of flows resulting from automated financial advice, creating behavioural biases in clients; and
- lack of regulation for crypto assets, leading to market manipulation and inefficiency.

As noted, digitalisation and financial technologies can help the development of cross-border investments in the European Union. In 2016, CFA Institute conducted a Fintech survey.[16] We collected our global members' views on the need to introduce regulatory measures for the better promotion of the safety and soundness of markets and the standardisation of rules. Innovation is expected to disrupt the investment management sector through several channels, some of which are positive and some negative. Our members believe that financial advice tools could have a negative impact on the quality of the services offered to clients, given that more cases of mis-selling financial services could occur. The biggest risk perceived by CFA Institute members, however, is the probability of flaws emerging from the use of automated financial advice tools (Figure 9). This would cause behavioural biases in clients because such tools might not properly consider account investor objectives and constraints.

Moreover, the development of financial technologies raises the issue of the future level of trust in the industry as a result of the different behaviours and services that firms offer their clients.[17] According to the 2018 CFA Institute survey entitled "The Next Generation of Trust,"[18] trust in financial services is still low (although it has experienced a slight increase relative to the previous years),

Biggest risk introduced from automated financial advice tools*



Question: What do you consider to be the biggest risk, if any, that could be introduced from automated financial advice tools?

* Excludes not sure

SOURCE: CFA Institute (2016)

Figure 9. Risks from financial advice tools

but technology is the most trusted industry by a wide margin. This represents an opportunity for the financial services community to attract those investors who have lost trust in the industry. Trust in technology is especially high for institutional investors (85% of trust compared with 64% trust level from end investors). The survey also found that trust in financial services varies by age: People between 25 and 34 years of age have a higher level of trust in the industry than do older investors.

Crowdfunding and peer-to-peer lending are becoming increasingly popular. Regulations should attempt to strike the right balance between accessibility and investor protection for these new ways of financing. This trade-off should be addressed in the regulatory initiatives adopted at the EU level. CFA Institute supports the creation of a framework on crowdfunding because this would facilitate SME access to capital markets. We are pleased that a new legislative procedure for the establishment of a pan-European framework for crowdfunding platforms is being negotiated, with ESMA in charge of their authorisation and supervision.

[16] "Fintech Survey Report," CFA Institute (April 2016), https://www.cfainstitute.org/Survey/fintech_survey.PDF.

[17] See the CFA Institute report "Investment Firm of the Future" (September 2018), https://www.cfainstitute.org/-/media/documents/survey/investment-firm-of-the-future.ashx, and "Future State of the Investment Profession" (April 2017), https://www.cfainstitute.org/-/media/documents/survey/future-state-of-investment-profession.ashx, which examine the state of the investment industry and its possible evolution based on various potential scenarios.

[18] "The Next Generation of Trust," CFA Institute (2018), https://nextgentrust.cfainstitute.org/wp-content/uploads/2018/04/CFAITrust-Global-Report.pdf.

We are also interested in understanding how technology developments like distributed ledger (e.g., blockchain) could change front-to-back operations as well as clearing and settlement in asset management and financial transactions more generally. The incumbent model that has developed over the years and is based on a chain of service and outsource providers may be upended by a simplification of contractual relationships and a further automation of trade processing between the asset manager and the custodian, depositary, valuation agent, and transfer agent. Such a development could transform how outsourcing risk is considered and managed. It could also have implications for the costs and charges structure of investment products for end investors. It could finally facilitate the cross-distribution of investment products by making it easier, quicker, and safer for investors to effect their investment decisions. We are, however, noticing a slow uptake of the distributed ledger technology across the operational chain (asset managers, banks, and service providers), which could be down to the difficulty of establishing a recognised and freely accessible industry standard. We are also cognizant of the radical changes to back office and middle office operations this evolution could entail.

Our local societies in the European Union also commented on other issues related to the rise of fintechs.

Spain

CFA Society Spain called for a common regulatory field in the European Union to allow companies conducting the same type of activities in Europe to comply with the same requirements and not to have advantages or disadvantages in regard to other countries.

Italy

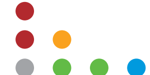
CFA Society Italy expressed concern about widespread manipulation in the crypto-assets market. This ongoing situation harms small retail investors and favours speculators who aim to profit from price movements. Crypto assets and trading platforms should be better regulated to ensure investor protection. Better regulation and supervision can be obtained by granting powers to a European authority, such as ESMA, or by creating a new ad hoc agency that would be responsible for the supervision of fintech developments.

Greece

CFA Society Greece stressed that the creation of innovation hubs in each member state would be useful to reduce the gap between the information needed for start-ups and the available information channels. Through these hubs, member states would be able to help innovative companies and boost financial innovation. These centres would represent the contact point for SMEs and would enable them to ask regulators questions, clarify doubts, and receive guidance on the development of innovative instruments and the environment in which SMEs want to be active. These innovation hubs would allow authorities to closely follow fintech developments in their local market and quickly support virtuous SMEs with the publication of guidelines on the correct compliance with regulatory requirements put in place.

CFA Institute Recommendations

- Introduce a European framework for crowdfunding and peer-to-peer lending, setting equivalent requirements for firms conducting similar types of activities across borders in the European Union.
- Facilitate and support the creation of innovation think tanks and advisory boards to serve as resources and intermediaries for start-ups looking to use financial technology for capital raising.
- Evaluate the need to regulate crypto assets and further the discussion as to whether they constitute financial instruments and if they do, under what circumstances.



3. Sustainable Finance

Main issues for sustainable finance are

- lack of agreed-on definition for environmental, social, and governance (ESG) issues and related to issuer disclosure;
- dissimilar training for investors on how to consider ESG factors;
- lack of quality and comparability of ESG data;
- the voice of minority shareholders promoting ESG strategic decisions for companies sometimes insufficiently heard; and
- variable regulatory or legislative approaches for dealing with integration of ESG issues in investment analysis and decisions.

CFA Institute has been constantly monitoring key developments and debates, which are occurring at the EU and global level. These developments concern the role and application of ESG information in the investment management process. An increased consideration of ESG factors in investment management practices can improve the fundamental analysis that financial professionals conduct and the investment decisions they make.

One feature emerging from our 2017 Global ESG Survey[19] was the difference in training provided by firms on how to consider material ESG issues. The most common sources investment professionals use include third-party research, internal research by portfolio managers and their team, and management communication of material issues. Only 43% of the surveyed members in the Europe, Middle East, and Africa (EMEA) region, however, said that employees at their firm receive training on how to consider ESG issues.

There is no best way to integrate ESG factors and handle the integration of these criteria. Laws should not be too prescriptive in the way this integration can occur, given that ESG factor can be executed in several ways. The recent CFA Institute/Principles of Responsible Investment (PRI) report entitled "ESG Integration in Europe, the Middle East, and Africa: Markets, Practices, and Data"[20] shows that many techniques are used by practitioners in Europe regarding the ESG-integrated investment process. Although many practitioners view ESG as negative screening, they also view it as best-in-class screening. Others focus on impact investing when they refer to ESG integration. Asset owners and asset managers must incorporate material ESG elements in their investment choices. This report was built on a series of workshops with financial professionals working in the EMEA region. Regarding the input provided by EU investors, a large amount of information came from financial professionals based in France, Germany, the Netherlands, and the United Kingdom.

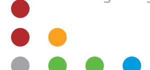
France

In France, investors identified corporate governance as the most relevant ESG issue to be integrated in the investment decision process. Nevertheless, environmental issues will be playing a more important role in the near term. Because these issues are expected to be at the top of the factors that investors need to integrate in the investment process, the E criteria are those that will likely affect equities and corporate bonds. Climate demand and risk management are the two main drivers of ESG integration, but at the same time, supply is inadequate. The main barrier to this integration is represented by limited education and a lack of understanding of ESG issues.

Germany

The impact of ESG issues on the prices of equities and bond yields in Germany is considered to be lower than in other EMEA markets. Like French professionals, however, investors in Germany believe that ESG issues will affect equity and debt markets by 2022, and the level of ESG integration likely will grow in the near future. Risk management and client demand are again viewed as the top drivers for ESG integration, whereas the lack of comparable data is the primary obstacle for firms to consider ESG factor in the investment process.

[19] "Environmental, Social, and Governance (ESG) Survey," CFA Institute (2017), https://www.cfainstitute.org/-/media/documents/survey/esg-survey-report-2017.ashx.
[20] "ESG Integration in Europe, the Middle East, and Africa: Markets, Practices, and Data," CFA Institute and PRI (2019), https://www.cfainstitute.org/-/media/documents/survey/esg-integration-in-emea.ashx.



Netherlands

The Netherlands has a higher level of ESG integration in relation to other European markets. Consideration of ESG criteria and impact investing is expected to grow in the future. Corporate governance issues are viewed as the most important factors in the investment process. As in the German market, the top drivers for ESG investment are risk management and client demand, whereas the shortage of historical data for comparison of ESG investments represents a barrier to further ESG integration in the Dutch market.

United Kingdom

Despite the fact that the United Kingdom is one of the most advanced countries in regard to ESG integration, UK investors indicated that corporate governance criteria are much more integrated than E and S factors in investment analysis and decisions. These latter factors, however, are expected to be systematically incorporated much more in the investment process. Risk management is the main factor driving ESG integration in capital markets, whereas the lack of comparable and historical data represents the main barrier to integration.

The EMEA report also included the following findings on ESG integration practices:

- Equities have medium levels of qualitative integration and low levels of quantitative integration.
- Fixed income has low levels of qualitative and quantitative integration.
- Sovereign debt markets have low levels of qualitative and quantitative integration.
- The sophistication levels of quantitative integration by equity investors and fixed-income investors are similar.

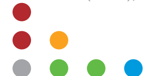
Comparing these results with the 2018 CFA Institute/ PRI report "ESG Integration in the Americas," which focused on inputs from investment professionals working in the United States, Canada, and Brazil, it is possible to identify some differences in terms of the level of integration as well as the drivers and barriers to integration. Respondents in these three countries believe that the ESG integration level is quite low: The report found that less than 20% of portfolio managers and analysts systematically include ESG issues in their investment analysis, and less than 10% adjust their models to include material ESG factors. Drivers are similar to those in the EMEA region: Risk management and client demand (plus the impact of positive regulation in Brazil) are the primary elements favouring greater ESG integration, whereas barriers include the lack of comparable data; a limited understand of ESG issues; and concerns about negative returns, tracking error, and underperforming benchmarks.

Overall, European market participants seem to share the importance of ESG integration in the decision-making process. The 2018 CFA Institute survey, "The Evolving Future of Fiduciary Duty in an ESG World,"[21] indicates that European investment professionals feel responsible for considering ESG factors in their analyses and decision. Of the institutional investors surveyed based in the European Union, 85% agree or strongly agree that it is appropriate to consider ESG factors when making investment decisions. An overwhelming majority of surveyed investors in the Netherlands (96%), France (88%), and Spain (88%) agree on the importance of considering ESG factors in the decision-making process.

Amongst other questions, we also asked our EU members whether the consideration of ESG factors ought to be mandatory and whether it should be an integral part of the fiduciary duty that investment professionals owe to their clients (Figure 10). In spite of an overall pushback by our members to this proposition, surveyed investors in some member states were less sceptical than in others. For example, our members in the Netherlands were in favour of such a proposal (57% are in agreement), whereas respondents from Spain were the least supportive (34%).

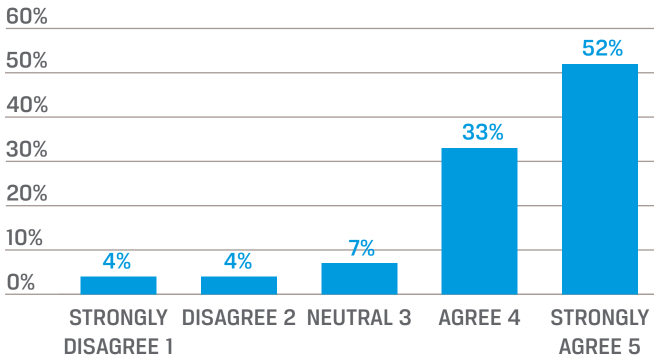
Issuers should disclose material ESG risks and opportunities to allow investors to make the best possible investment decision. As noted, however, we believe that an overly prescriptive approach would not work best for financial firms and their clients. Many ways of analysing and disclosing material ESG information are possible, and investment professionals use different methods depending on the firm size,

[21] Sviatoslav Rosov, "The Evolving Future of Fiduciary Duty in an ESG World," CFA Institute (2018), https://www.cfainstitute.org/-/media/documents/survey/esg-survey-2018.ashx.



To what extent do you agree or disagree that is appropriate for institutional investors to take ESG factors into account when making investment decisions

% of Total Responses



SOURCE: CFA Institute (2018)

Figure 10. Consideration of ESG factors

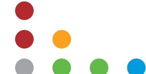
expertise, and regulatory environment in which they operate. Hence, a future EU classification framework for sustainable activities (taxonomy) should be as broad and flexible as possible in order to account for the numerous ESG integration policies and procedures as well as the best practices emerging from various jurisdictions. This concern is also shared by some of our European societies. For instance, our French Society has highlighted the narrowness of the Action Plan on Sustainable Finance, launched by the European Commission last year. CFA Institute agrees that the Action Plan only focuses on environmental and climate change factors while ignoring social and governance criteria that should have been considered in the commission paper. The final report of the High-Level Group on Sustainable Finance, published in 2018, stresses the importance of incorporating ESG factors in investment decision making. The report also recommends specific actions that would better align the governance and leadership of firms with a long-term outlook. The current executive and governing bodies of many European firms are not appropriately composed for achieving long-term goals and do not take adequate risks and opportunities into account.

Looking at the EU disclosure framework on sustainable finance, CFA Institute advocates a forward-looking "business model" with disclosure requirements that would facilitate the assessment of business models viability, sustainability of finance, and other wider ESG factors. Currently, many companies provide good information about the business models they use. Investors need to know whether their business models are robust and understand their management's vision and transition road map. Thus, disclosure rules imposed on management to explain where their business models will be in the short- and medium-term future (say, five years' time) would provide important information to investors, who would have more detailed data to make their investment decisions. In addition, these rules would provide a holistic picture of how management could react in the event of emerging risks with its strategy. A description of future business models could, for example, address the following sectors:

1. How centralised utilities relying on fossil fuel energy generation address distributed renewable energy grid systems (virtual power plants)
2. How auto parts manufacturers will cope with a faster transition to electric cars, which requires different and fewer parts in the manufacturing process
3. How the bricks-and-mortar retail sector will adapt to online sales, which are projected to increase drastically in the future
4. How the packaging industry would be affected by a tighter regulatory environment around plastic usage
5. How universities will cope with more uptake of online specialised and vocational courses compared with attending a university to get a degree

Spain

CFA Society Spain called for the standardisation of ESG criteria to be considered, especially if investment firms and professionals will be mandated to take such factors into account. Standardisation is necessary for clients to compare products and services offered and to evaluate the levels of ESG consideration taken by their investment managers and advisers. CFA Institute supports any effort to enhance the quality, consistency, and comparability of ESG information needed for investors to make informed decisions.



Italy

CFA Society Italy noted that companies enjoy too much flexibility in the way material nonfinancial information is disclosed in the annual reports of Italian listed companies. The "comply-or-explain" approach is too permissive because it allows firms to avoid publishing important material information as long as they can explain the reason.

We provide specific recommendations concerning corporate governance reforms in the European Union in the next section.

Corporate Governance

Over time, markets have shown that a good corporate governance can positively affect the company's results. CFA Institute believes that the best and most effective corporate governance structures are those that rely on active and prudent shareholder engagement. Our manual "The Corporate Governance of Listed Companies"[22] explains that there is indeed a direct correlation between active participation and a good corporate governance system.

Although many institutional shareholders have recently been more actively engaged in corporate decision making, the level of shareholder engagement remains low. The lack of formal rules governing the interaction of boards and shareholders in many jurisdictions may be the main cause. Information technology, however, facilitates new ways of engagement for shareholders, enabling them to communicate with their board by email or other forms of electronic communications.

Company boards and executives should focus more attention on the risk of shareholder short-termism affecting the company's long-term vision, value creation plans, and investment into innovative projects. Recent trends have shown that monetary and fiscal policy can also play a role, alongside executive incentivisation programmes, in driving the preference for share buy-backs over investment-focused capital expenditures.

In 2016, CFA Institute published the report "Corporate Governance Policy in the European Union,"[23] coauthored by George Dallas, International Corporate Governance Network, and David Pitt-Watson, London Business School. This report was prepared on the basis of three half-day workshops, held in London and Brussels, with investors and governance professionals having responsibility for governance oversight. The recommendations included in the report remained unaddressed by EU institutions. We call on the European Commission to develop a guidance statement for company boards and institutional investors. This statement should focus on the issues large-investment managers face with diversified holdings, multiple mandates, and different investment strategies. We are concerned about the protection of minority shareholder rights, especially those exercised in controlled companies. More protection for this category of shareholders can be better guaranteed with three actions:

1. Better promote board accountability to minority shareholders, for example, through a major role in setting robust independence standards, and the hiring and firing practice of the board members as well as a major push for a stronger board diversity.
2. Press for more rights related to material-related party transactions votes.
3. Fail to promote the practice of differential ownership rights and dual-class shares because these reduce open accountability. Dual-class shares can lead to poorer corporate governance standards in the industry. We advocate the "one-share, one-vote" principle as the best and fairest approach contributing to better corporate governance practices.[24]

EU Institutions should collaborate with market participants to solve the problems of cross-border voting. We do not ask to extend rights but only to make practical those rights that have already been granted, such as through the timing of general

[22] "The Corporate Governance of Listed Companies," CFA Institute (2018), https://www.cfainstitute.org/-/media/documents/article/position-paper/corporate-governance-of-listed-companies-3rd-edition.ashx.

[23] George Dallas and David Pitt-Watson, "Corporate Governance Policy in the European Union," CFA Institute (August 2016), https://www.cfainstitute.org/-/media/documents/article/position-paper/corp-gov-policy-in-european-union-through-investor-lens.ashx.

[24] Read the CFA Institute report "Dual-Class Shares: The Good, the Bad, and the Ugly: A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific" (August 2018), https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx.

meetings and the flow of information to shareholders about meetings and their agenda. Nondomestic shareholders need to receive such information on a timely basis and should be given more flexibility, for example, through the possibility to submit votes electronically by proxy. It is crucial to ensure that all shareholders be able to vote in an informed way and that all votes cast by shareholders should be formally counted and confirmable to the voting shareholder.

Our EU societies also highlight specific issues relating to the corporate governance practices in their local market.

Germany

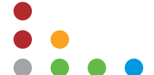
CFA Society Germany remarked that shareholder engagement is currently undermined by thresholds that are too high for shareholders to be more active in a company's choices. For instance, 5% of shareholders (or €500,000 of capital participation) in Germany are needed to request for a resolution in an annual general meeting, and 20% are required to call for an extraordinary general meeting. The current rules do not favour minority shareholders' participation in company decisions, especially in the German context, where companies typically have a concentrated ownership structure.

Netherlands

CFA Society VBA Netherlands stressed that the main corporate governance debate is now focused on the need to further reduce the remuneration of top management of listed companies and financial institutions. A new proposal focuses on the requirement for top managers of failed financial organisations to pay back their bonuses and the bulk of their salaries if the firm is bailed out by the government. Our CFA Society VBA Netherlands members are particularly concerned that the national law would deviate too much from the European standards. This situation could potentially transform the country into a pariah for international firms looking for new locations.

CFA Institute Recommendations

- Through our Corporate Governance Manual, we continue to advocate strong standards for how investors should include governance issues in the investment analysis and decision-making process.
- We encourage promotion of greater board accountability to minority shareholders and discourage the practice of differential ownership rights and dual-class shares.
- We support the work done by the European Commission's Technical Expert Group and its technical report on EU taxonomy. CFA Institute believes some degree of standardisation will be necessary for the emergence of meaningful, sustainable finance products and services. Given the quick pace of changes observed in technology, research, and the economy at large, we recommend that such taxonomy also permit enough flexibility to adapt to the changes over time while retaining its focus on core sustainability objectives.



4. Value for Money

Main issues for retail investors are these:

- There remains insufficient understanding of how investment products are sold and the fees paid by retail investors or how the investments are performing and the value being received by such investors.
- Exclusion of the presentation of past performance information in the packaged retail investment and insurance products (PRIIPs) key information document (KID) does not enable investors to have all the useful information to make their decisions.
- PRIIPs' regulation regarding its scope of application remains unclear, which may lead to a conservative approach by financial institutions on the type of products to offer to retail investors.

There is one main issue for institutional investors:

- MiFID II rules may have a potential unexpected negative impact on the quality and coverage of research.

Recently, CFA Society United Kingdom published the paper "Value for Money: A Framework for Assessment,"[25] which focuses on the area of value for money in the investment management sector. A clear value-for-money assessment is key for investors to gauge the benefits and costs of investment decisions. The paper suggests that a regulatory framework should consider three main elements: costs and charges, risks and return, and service and quality. Investors should evaluate not only costs but also the investment returns and other service benefits. Returns and benefits must then be compared with the charges paid. The assessment of these elements varies from client to client.

Typically, when assessing the value of investments, clients focus on three aspects: whether the investment would generate an attractive, risk-appropriate return over a time span that is compatible with the investment horizon of the investor and is net of costs but inclusive of perceived service benefits received.

The value of independence, governance, and high-quality administration is also important because clients cannot compare the value for money offered by different asset managers only on the basis of returns and costs of investments. Service and quality provided by managers are also valuable, and such a value delivered to the investor must be clearly acceptable and measurable.

CFA Society United Kingdom has called for a consistent and harmonised regulatory framework for value-for-money assessment. Such a framework would allow investment managers and clients to have a common understanding of the value of an investment. This framework should not be too prescriptive but quite flexible. At the same time, however, regulators should attempt to harmonise the requirements across sectors.

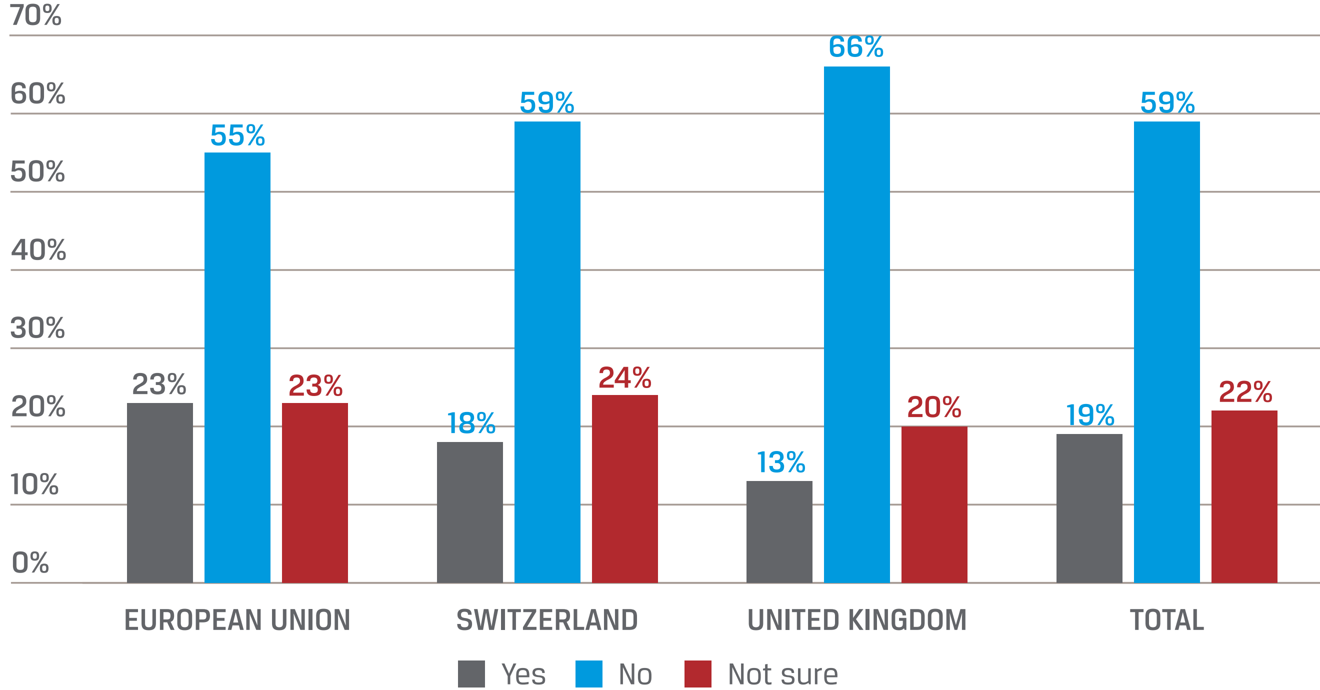
The CFA Institute's "Investment Firm of the Future"[26] report observed that investment firms tend to give precedence to short-term financial results of the businesses they are considering over a long-term value-adding strategy. This creates a misalignment of interest and agency issue between the investment firm (whose compensation structure is related to short-term factors) and the end investors themselves, whose interest may rather be in incentivising long-term strategic goals for businesses.

Markets in Financial Instruments Directive II

CFA Institute supports the objectives of greater transparency and enhanced investor protection, which the MiFIR/MiFID II framework attempts to achieve. MiFID II introduced new rules on the unbundling of investment research, aiming to increase transparency and competition in the

[25] "Value for Money: A Framework for Assessment," CFA Society United Kingdom (November 2018), https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/3-research-and-position-papers/value-for-money--a-framework-for-assessment.pdf.
[26] "Investment Firm of the Future," CFA Institute (September 2018), https://www.cfainstitute.org/-/media/documents/survey/investment-firm-of-the-future.ashx.

Question: Overall, do you believe MiFID II reforms are delivering better outcomes for end-investors?



SOURCE: CFA Institute (2019)

Figure 11. Impact of MiFID II reforms

investment management sector. We recently conducted a European survey[27] on the first outcomes of the new reform to gauge its initial impact on CFA Institute European members (mainly portfolio managers and research, investment, or quantitative analysts). The report shows a mixed reaction: Research budgets seem to have reduced, leading to a perceived reduction in research quality and coverage. Nonetheless, competition in the research marketplace appears to have increased.

The main findings of the report reveal the following:

- The new reform has affected research providers: The majority of the buy-side respondents have been sourcing less research since the implementation of the directive (3 January 2018).
- Research budget have shrunk: The bigger the asset management firm, the larger the percentage of research budget cut down.
- The quality of research appears to have remained unchanged for buy-side professionals, whereas sell-side respondents report a decrease. In particular, research quality seems to be worsened for small- and mid-cap stocks.
- Respondents also believe that research coverage has deteriorated. The majority of sell-side professionals surveyed report a decrease.
- The research marketplace is more competitive than before the implementation of MiFID II: 39% of respondents said that an increase in competition has taken place.

Although the directive has a noble purpose, survey results demonstrate that some unintended consequences may emerge (Figure 11). Overall, a clear majority of European members surveyed (all industry practitioners) feel that the new rules are delivering negative outcomes for end investors. Our members' opinions represent only their perceptions of the impact of the directive, which has not been

[27] "MiFID II: One Year On," CFA Institute (2019), https://www.cfainstitute.org/-/media/documents/survey/cfa-mifid-II-survey-report.ashx.

fully implemented in all EU member states. It is worth noting that the survey did not analyse the reaction to MiFID II of asset owners, pension fund managers, and other institutional investors, whose perspective on the benefits of MiFID II may differ.

CFA Institute remains of the view that policymakers should always be mindful of the potential operational complexity when introducing new regulatory frameworks. As such, the implementation of MiFID II has proved to be a significant challenge for most investment firms in terms of both actual costs and operational changes. We recommend monitoring over time the effects on the barriers to entry in the investment industry to measure the risk of concentration and consolidation.

Our European societies also expressed the following concerns.

France

CFA Society France highlighted that the new reform has given rise to information asymmetry between small and large market players and to a price war on investment research and an overall lower level of research quality and coverage. In addition, the new rules may have led to a greater imbalance between large- and small-asset managers as large-asset managers may have rationalised their broker list, undermining the small- and mid-cap brokers.

Netherlands

CFA Society VBA Netherlands remarked that the price of investment research went down in 2018 compared with the previous year's price. The new rules seem to have squeezed broker margins. The feeling in the Netherlands, however, is that brokers still finance their research expenses through their trading revenues; thus, they have not been as affected by the new approach.

Romania

CFA Society Romania argued that market concentration is now greater. This has been caused by the new scope of application regarding sanctions introduced by MiFID II because penalties are larger and can affect an entire group (and not only the entity that operates under the directive rules) as a result of some large players' decision to exit the market because of low revenue streams from capital market activities.

Slovenia

CFA Society Slovenia members recalled that the MiFID II legislation is yet to be fully implemented in their country. Our Slovenian members underlined that only one brokerage firm currently operates in the local market, whereas a few years ago five firms were active.

Spain

CFA Society Spain feels that the scope of application concerning the unbundling rules is not clear. Uncertainties have manifested about when and how the rules apply, since they might also cover collective investment schemes (CIS). Our Spanish members are concerned about possible tax implications, particularly on the value-added tax treatment: Exemptions were granted for CIS and discretionary portfolio management. Such differences may have an impact on how research is supplied or purchased by market players.

United Kingdom

CFA Society United Kingdom recently published a new MiFID II report,[28] which was built on a series of interviews with UK stakeholders. The report underlines the potential unintended impact of the rules on sell-side research, especially for SMEs, which issue both equity and fixed-income securities. Interviewees fear that the directive might favour large global firms and create more consolidation of both buy- and sell-side sectors. Nevertheless, these are preliminary observations, and it is too early to judge whether the new rules on unbundling of payments for investment research would cause a declining trend in sell-side research, in its coverage, or in its quality. In addition, the majority of interviewees supported the ultimate aim of the MiFID II framework and were confident that the objectives of the directive will be met over the long term.

The MiFID II report also looked at product governance areas. UK-surveyed firms stated that changes to their product governance process were minimal and generally they support the aim of the new rules. Many

[28] "MiFID II: One Year On," CFA Society United Kingdom (April 2019), https://www.cfauk.org/-/media/files/pdf/pdf/9-media-centre/mifid-ii-one-year-on.pdf.

signalled a relevant increase in the administrative burden to implement these new measures. The majority of respondents also raised the need for more ESMA guidance in some areas. Regarding the benefits of the new rules for the client, the survey did not show a clear result. Nonetheless, MiFID has certainly improved transparency on product fees and could encourage better value-for-money relationships between the investment professionals and the clients.

Investor Protection

On 1 January 2018, the PRIIPs Regulation entered into force in the European Union. Since then, concerns relating to the scope of application of the new regulation and the information included in the KID have arisen.

Uncertainties regarding which financial instruments are covered under the regulation could negatively affect the liquidity amount of secondary markets. In fact, it is not clear whether the scope of the application also includes products such as corporate bonds and floating-rate bonds. This lack of certainty could cause a reduction in the availability of these products. Providers could take a conservative approach and decide not to offer corporate bonds to retail investors to avoid the risk of failing to abide by the PRIIPs Regulation.

CFA Institute believes that it is necessary to disclose past performance information in the KID when this is available. Doing so would provide useful additional information for all investors. It is important, however, that the information provided be standardised and presented in a way that would clearly, effectively, and accurately inform prospective investors for the decisions they make regarding potential investments. We believe that the risk of not including such information would lead investors to attempt to get it from other sources. In this case, data would not be standardised, comparable, and disclosed in a fair and full manner.

CFA Institute developed the Global Investment Performance Standards (GIPS®),[29] which serve as voluntary standards for the calculation and presentation of investment performance based on the ethical principles of full disclosure and fair representation of investment performance results. If used for the presentation of the actual performance history in the KID, GIPS® would enable investors to compare and better understand the products they are purchasing.

Simulated performance can be included, but it should be clearly presented separately and distinctly from actual information. Linking performance of simulated or model portfolios with actual performance is a practice that violates the CFA Institute GIPS®. Performance composites should include only actual assets managed by the firm. Simulated information and results can be provided if they are clearly labelled as "supplementary information."

Further considerations have been made by some of our European societies.

France

CFA Society France underlined that the PRIIPs Regulation has given rise to some incoherence in the calculation of costs and charges in regard to the rules set out under MiFID II. Our French members also raised the issue of difficult adaptation of the PRIIPs rules to the specifics of the French insurance market. In fact, multioption insurance contracts seem not to fit in the PRIIPs category, even though they represent the largest portion of assets under management. Multioption insurance contracts offer investments both in general and diversified funds, which are managed by the insurer, and the option to invest in unit-linked products.

Spain

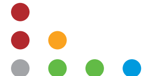
CFA Society Spain argued that the PRIIPs Regulation should not apply to Undertakings for Collective Investments in Transferable Securities (UCITS) funds because the methodology would not work best for these funds and could lead to inconsistent or illogical results. The main impact for investors would be an excess of information that could create confusion. The latter also would result from a lack of standardisation in the calculation and presentation of costs and charges. Because the application of PRIIPs for UCITS has been postponed, EU institutions should better assess, and perhaps reconsider, whether the PRIIPs Regulation should apply to UCITS.

[29] Global Investment Performance Standards (GIPS®), CFA Institute (2010), https://www.cfainstitute.org/ethics/codes/gips-code.

CFA Institute is in the process of setting up a task force to focus on the issues of the current PRIIPs Regulation and more broadly on value for money in the investment management sector.

CFA Institute Recommendations

- Enhance the consistency of definitions and rules pertaining to reporting requirements on costs, charges, risks, and returns across the various relevant regulatory frameworks (e.g., MiFID, AIFMD, PRIIPs).
- For investors to be in a better position to judge if costs and charges they pay are fair and reasonable, focus policies on the quality and meaningfulness of the information received by investors rather than the quantity of metrics.
- Have a closer look at the potential unintended impact of MiFID II rules and the cost/benefit to the industry, competition, and investor choice regarding the unbundling of investment research cost provisions.
- Clarify the scope of application of the PRIIPs Regulation. Permit the introduction of information on past performance in the KID, as the only true and simple measure of investment managers' actual performance.



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