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EU financial market governance and the retail investor: reflections at an inflection point

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EU FINANCIAL MARKET GOVERNANCE AND THE RETAIL INVESTOR: REFLECTIONS AT AN INFLECTION POINT

1. Introduction: EU Financial Market Governance at an Inflection Point

An Inflection Point

The onset of the Global Financial Crisis reached its tenth anniversary in autumn 2018, prompting reflections on the turbulent reform period which followed.[1] EU financial market governance,[2] in common with most major systems of financial market governance internationally, experienced swingeing reform in the wake of the crisis and a subsequent period of calm might have been expected.[3] By early 2018, the final pillar measure of the EU's reform agenda, the behemoth Markets in Financial Instruments Directive II/Markets in Financial Instruments Regulation (MiFID II/MiFIR) had come into force on 3 January 2018, to some fanfare; [4] the new institutions which the crisis had brought forth (the three European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB) of the European System of Financial Supervision (ESFS), all established in 2011; and Banking Union's Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM), which commenced full operations in 2014 and 2016 respectively) were becoming normalized;[5] and the EU was well launched on a review of the different reforms.[6] Also by 2018, EU financial market governance, at the heart of which is the massive 'single rulebook,' was settling into maturity and acquiring the technocratic capacity to respond to environmental conditions, in a more evolutionary

[1] See, eg, the *Financial Times'* 2018 retrospective: https://www.ft.com/creditcrisis.

[2] The term financial market governance is used here to capture the superstructure of rules, supervisory arrangements, and institutional structures which govern the EU financial market.

[3] A massive and wide-ranging literature considers the redrawing of EU financial market governance after the Global Financial Crisis. See eg: C Burns, J Clifton, and L Quaglia, 'Explaining Policy Change in the EU: financial reform after the crisis' (2018) 25 *Journal of European Public Policy* 728; D Howarth and L Quaglia, 'Banking Union as Holy Grail: rebuilding the single market in financial services, stabilizing Europe's banks and 'completing' Economic and Monetary Union' (2013) 51 *Journal of Common Market Studies* 103; E Ferran, 'Crisis-driven Regulatory Reform: where in the world is the EU going?' in E Ferran, N Moloney, J Hill, and JC Coffee, *The Regulatory Aftermath of the Global Financial Crisis* (CUP, 2011), 1; and N Moloney, 'EU Financial Market Regulation after the Global Financial Crisis: 'more Europe' or more risks?' (2010) 47 *Common Market Law Review* 1317.

[4] Directive 2014/65/EU [2014] OJ L173/349 and Regulation (EU) No 600/2014 [2014] OJ L173/84.

[5] See eg N Moloney, *The Age of ESMA. Governing EU Financial Markets* (Hart Publishing, 2018); P Weismann, *European Agencies and Risk Governance in EU Financial Markets Law* (Routledge, 2015); L Cuocolo and V Miscia, The Gentle Revolution of European Banking Regulation: models and perspectives in supervision, BAFFI Centre Research Paper Series No 2014-164, available via http://ssrn.com/abstract=2539641; and T Tuominen, 'The European Banking Union: a shift in the internal market paradigm' (2017) 54 *Common Market Law Review* 1359 and the special edition of the *European Business Organisation Law Review* on Banking Union ((2015) 16(3)).

[6] Commission, Follow-up to the Call for Evidence – EU Regulatory Framework for Financial Services (COM(2017)736) (2017).

manner than the earlier punctuated, disruptive manner associated with the crisis era.[7] Nonetheless, three potentially disruptive agents could be identified: the Capital Markets Union (CMU) agenda; the ESA Reform Proposal; and the withdrawal of the UK from the EU.

The CMU agenda was adopted in 2015[8] and is due for completion by 2019.[9] It is designed to strengthen market-based funding (or funding through market-based mechanisms, such as securities issuances, rather than through bank loan funding); provide new and wider sources of funding; and strengthen household access to finance.[10] CMU is only the most recent of a series of EU initiatives which have, over time, sought to support the development of a single EU capital market. Whether or not CMU can deepen capital market funding in the EU financial system - which remains broadly bank-based[11] - is highly contested.[12] Among the many uncertainties are the impact of deep-seated political preferences which remains sceptical of market-based funding[13] as well as the scale of the disruption to the EU capital market which may follow from the withdrawal of the UK.[14] But it is clear that CMU is bringing with it an extensive reform programme.[15] The CMU agenda is primarily regulatory, but institutional reform is also on the EU's financial market agenda. The September 2017

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[7] As is discussed further by this author in N Moloney, 'EU Financial Governance after Brexit: the rise of technocracy and the absorption of the UK's withdrawal' in K Alexander, C Barnard, E Ferran, and N Moloney, *Brexit and Financial Services. Law and Policy* (Hart Publishing, 2018), 61.

[8] Commission, Action Plan on Building a Capital Markets Union (COM(2015)468) (2015).

[9] Progress is regularly monitored (eg, Commission, Completing the Capital Markets Union by 2019 – time to accelerate delivery (COM(2018)114) (2018)).

[10] eg Commission, Mid-Term Review of the Capital Markets Union Action Plan (COM(2017)292) (2017).

[11] Commission, European Financial Stability and Integration Review 2018 (SWD(2018)165) (2018), 21 and 26-27.

[12] CMU has re-ignited longstanding debates on whether EU financial market governance can drive market change. See eg J Gordon and K Judge, The Origins of a Capital Markets in the United States, ECGI Law Working Paper No 395/2018, available at https://papers.ssrn.com/abstract=3154676; N Moloney, 'Capital Markets Union: "ever closer union" for the EU financial system?' (2016) 41 *European Law Review* 307; and WG Ringe, 'Capital Markets Union for Europe – A Political Message to the UK' (2015) 9 *Law and Financial Markets Review* 5

[13] See L Quaglia, D Howarth, and M Liebe, 'The Political Economy of European Capital Markets Union' (2016) 54 *Journal of Capital Market Studies* 185.

[14] The ECB is sanguine, suggesting that alternative funding sources are likely to emerge (ECB, Financial Stability in Europe, May 2017, 28-30) and that financial stability is unlikely to be threatened (ECB, Financial Stability in Europe, May 2018, 22-23).

[15] Its flagship measures are the 2017 Securitization Regulation (Regulation (EU) No 2017/2402 [2017] OJ L347/35) and related reforms, directed to promoting securitization and in particular 'safe, transparent and standardized' (STS) securitizations; and the 2017 Prospectus Regulation (Regulation (EU) No 2017/1129 [2017] OJ L168/12), designed to refine the regime which governs issuers' prospectus disclosures. A host of other reforms are in train, including in relation to easier stock market access for small and medium sized enterprises (SMEs); the private placement markets; covered bonds; facilitating the cross-border distribution of investment funds; crowdfunding; fintech; and sustainable finance. See P Schammo, 'Market Building and the Capital Markets Union: Addressing Information Barriers in the SME Funding Marker (2017) 14 *European Company and Financial Law Review* 271; and V Bavoso, Capital Markets, Debt Finance and the EU Capital Market: A Law and Finance Critique, ECMI Working Paper No 5, available at https://papers.ssrn.com/abstract=3053783

ESA Reform Proposal, which followed the 2017 ESA Review,[16] covers all three ESAs but may lead to the ESA for financial markets (the European Securities and Markets Authority, ESMA) becoming materially more influential on EU financial market governance.[17] Among the Proposal's major reforms are that ESMA would be conferred with additional direct supervisory powers over certain regulated actors; its funding basis reformed to incorporate an industry component; and the powers of ESMA's decision-making Board of Supervisors - currently dominated by national financial market supervisors or national competent authorities (NCAs) - diluted by the location in a new 'Executive Board' (composed of officials appointed by the Parliament and Council) of a series of powers currently exercised by the Board of Supervisors and regarded as vulnerable to conflict of interests, notably ESMA's powers to proceed against or impose decisions on NCAs. The ESA Reform Proposal is proving highly contested politically and the final form in which the reforms will (if at all, given the 2019 European Parliament elections) be adopted by the co-legislators can only be guessed.[18] But it is not unreasonable to predict that ESMA is likely to emerge as a strengthened technocratic actor in EU financial market governance.[19] Finally, the withdrawal of the UK from the EU may have disruptive effects on EU financial market governance. It is unlikely that the UK withdrawal will have major implications for EU financial market regulatory governance; the direction of travel as regards regulatory reform has recently been set by the more interventionist coalition of 'market-shaping' Member States and not by the UK; and technocratic actors like ESMA and the ECB can be expected to have significant purchase on how the single rulebook develops.[20] The withdrawal of the UK - traditionally resistant to institutional centralization - may, however, accelerate the process of institutional reform.[21]

The Retail Market Implications

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[16] Commission, Consultation on the Operations of the European Supervisory Authorities (2017).

[17] COM(2017)536.

[18] At the time of writing, there was evidence of material political contestation, particularly as regards the funding and direct supervision reforms, and the Council had not reached political agreement although the Austrian Council Presidency (July-December 2018) had included the Proposal among its priority files. See eg F Maxwell, 'Brussels Standoff over Markets Regulator', *Politico*, 30 January 2018 and A Carrier, 'Member States to Continue Discussions over Controversial ESAs Review Proposal,' *Norton Rose Fulbright, Financial services: regulation tomorrow* (24 May 2018).

[19] See further Moloney, n 5.

[20] See, from a legal perspective, N Moloney, 'Bending to Uniformity: EU Financial Regulation With and Without the UK' (2017) 40 *Fordham International Law Review* (2017) 1335 and, from a political economy perspective, D Howarth and L Quaglia, 'Brexit and the Single European Financial Market' (2017) 55 *Journal of Common Market Studies* 149.

[21] See further E Ferran, 'Regulatory Parity in Post-Brexit UK-EU Financial Regulation: EU Norms, International Financial Standards, or a Hybrid Model' in Alexander et al, n 7, 1; N Moloney, 'Brexit and Financial Services: (yet) another re-ordering of institutional governance for the EU financial system' (2018) 55 *Common Market Law Review* 175; and J Armour, 'Brexit and Financial Services' (2017) 33 (Supp 1) *Oxford Review of Economic Policy* S54.

With all this activity in the EU financial market policy space, why focus on the perhaps less salient retail market agenda, which produces little of the political, institutional, and market pyrotechnics associated the CMU, ESA reform, and Brexit agendas? The answer lies in the reality that any moment of change or disruption which has the potential to generate new thinking on EU retail market governance - or the rules, supervisory arrangements, and institutional structures deployed to govern investment by household/consumer investors (here, retail investors)[22] in market instruments[23] - is welcome. Despite repeated cycles of scandal and reform,[24] retail market governance continues to seek an answer to one of the most intractable questions in modern financial governance: how, and to what extent, can households or individual consumers be encouraged to save for the long term through market-based instruments[25] and, at the same time, be protected, to an optimal degree, from abuses and/or from decision-making failures? The difficulties are many[26] and have been well-rehearsed, nationally,[27] regionally,[28] and internationally.[29] But the central policy/governance task is reasonably clear. First, retail investors face multiple forms of market failure deriving from the agency costs and risks they are exposed to when investing and

[22] Characterizing the 'retail investor' can be challenging given the different traits associated with such investors. The spectrum of characterization can range from vulnerable consumer of investment products required for welfare needs, to informed financial citizen taking on welfare provision responsibilities from the state, to empowered capital supplier to the capital markets. See, eg, D Kingsford Smith and O Dixon, 'The Consumer Interest and the Financial Markets' in N Moloney, E Ferran, and J Payne (eds), *The Oxford Handbook of Financial Regulation* (OUP, 2015), 695 and N Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime: consumers or investors' (2012) 13 *European Business Organisation Law Review* 169. For the purposes of this analysis, the term 'retail investor' is used to denote a non-professional investor investing discretionary funds in market-based instruments, whether for welfare or accumulation purposes.

[23] This discussion is concerned with market investments and not with other consumer finance saving products, such as pension or insurance products.

[24] Two of the more recent EU scandals relate to the mis-selling of complex Contracts for Differences (CfDs) from Cyprus-based online firms (see ESMA, Statement, European Parliament Committee on Petitions, 17 July 2017 and ESMA Executive Director Ross, Speech on 'Regulatory and Supervisory Developments, the challenges ahead – a European perspective,' 20 October 2016); and to the mis-selling of subordinated debt in Slovenian banks that were subsequently subject to 'bail-in' procedures, leading to serious losses for retail investors (see Better Finance, A Major Enforcement Issue: the mis-selling of financial products, Briefing Paper, April 2017).

[25] Financial markets allow households to smooth consumption over lifetimes, providing the means to accumulate and de-cumulate assets (eg, K Dynan, 'Changing Household Financial Opportunities and Economic Security' (2009) 23 *Journal of Economic Perspectives* 49).

[26] On the repeated attempts to grapple with retail market risks in the US see D Langevoort, *Selling Hope, Selling Risk. Corporations, Wall Street and the Dilemmas of Investor Protection* (OUP, 2016) and, from an EU perspective, N Moloney, *How to Protect Investors. Lessons from the EU and the UK* (CUP, 2010).

[27] On Australia's post crisis retail market reform efforts see J Hill, 'Why did Australia Fare so well in the Global Financial Crisis' in Ferran et al, n 3; and on the US response see L Kennedy, P McCoy, and E Bernstein, 'The Consumer Financial Protection Bureau' (2012) 97 *Cornell Law Review* 1141.

[28] The EU provides the most advanced example of regional coordination as regards retail market protection.

[29] Most notably through FinCoNet, the recently established (2013) international standard setting body for consumer financial market regulators. See http://www.finconet.org. The increased participation of consumers/households in financial markets has been identified as shaping transnational financial law: A Riles, New Approaches to Financial Regulation, Cornell Law School Research Paper No 15-03, available via https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2524384, 7-8.

when relying on financial intermediaries (whether investment advisers, asset managers, brokers, investment funds, or other forms of intermediaries). Chief among these are those flowing from severe information asymmetries[30] and related conflict of interest risks.[31] Second, they face the risks which flow from the now well-documented behavioural challenges which attend market investment.[32] These challenges not only disrupt optimal investor decision-making but also, given the behavioural features of the supply side, deepen agency costs and risks.[33] These different costs and risks can lead to significant welfare losses, not least among them sub-optimal market participation levels and related impaired ability to save for the long-term through market investments - at a time when governments globally are withdrawing from welfare provision.[34]

But it is not easy to address these risks and to support retail investors in an optimal manner. The task of protecting and encouraging (to whatever extent) retail investors is a notoriously difficult one, which is not made easier by the tendency of retail market governance to impose transaction costs on capital formation: the 'sweet spot' between investor protection and not obstructing capital formation is difficult to hit.[35] And yet, the 'protecting and encouraging' job should be a relatively uncontested and straightforward one. As Donald Langevoort puts it, 'some public commitment to fight marketplaces abuses is necessary to offset fear of exploitation and instil investor confidence.'[36] And as John Campbell has argued, enhancing retail investor confidence and willingness to participate in the financial markets is an appropriate concern for retail market policy, given the societal welfare costs which non- or sub-optimal participation in the markets can generate for households as governments withdraw from welfare provision.[37]

EU retail market governance, mirroring efforts at national level, has long sought to use harmonized regulation as a means of promoting retail investor confidence and of encouraging retail market access through protective regulation. But since the 2008 financial crisis, the EU has turbo-

[30] S Choi, 'A Framework for the Regulation of Securities Market Intermediaries' (2004) 1 *Berkeley Business Law Journal* 45.

[31] From the extensive financial economics literature on structural conflict of interest risks in intermediation see, eg, R Inderst and M Ottaviani, 'How (not) to pay for advice: A framework for consumer financial protection' (2012) 105 *Journal of Financial Economics* 393

[32] On behavioural risks and regulatory design challenges see E Avgouleas, 'The Global Financial Crisis, Behavioural Finance, and Financial Regulation: In Search of a New Orthodoxy' (2009) 9 *Journal of Corporate Law Studies* 23.

[33] For an analysis of these two main classes of failures and deficiencies see J Campbell, H Jackson, B Madrian, and P Tufano, 'The Regulation of Consumer Financial Products: An Introductory Essay with Four Case Studies' (2011) 25 *Journal of Economic Perspectives* 91.

[34] On the costs non-participation can levy in terms of household welfare see J Campbell, 'Household Finance' (2006) 61 *Journal of Finance* 1553.

[35] Langevoort, n 26, 3 and 131.

[36] Ibid, 3.

[37] J Campbell, Restoring Rational Choice: The Challenge of Consumer Protection Regulation, NBER Paper WP 22025 (2016), available at http://www.nber.org/papers/w22025.

charged its previously somewhat lack-lustre retail investor protection agenda. In the last ten years or so, the regulatory environment has been significantly changed, retail market supervision has come on the reform agenda, the relevant institutional governance structures have been re-organized, and the animating principles and philosophies underpinning EU retail market governance have shifted. 2018 marks an important way point, with the pivotal 2014 MiFID II/MiFIR and the 2014 Packaged Retail and Insurance-Based Investment Products (PRIIPs) Regulation[38] – the two pillars of the new retail market regulatory governance regime – coming into force in January 2018. Given the welfare implications of intervention in this area and the manifold difficulties, assessment is needed.

The need for review is more acute given the current inflection point. The CMU agenda is primarily concerned with the wholesale (professional) funding markets and regards the retail investor for the most part as a capital supplier - and not as a vulnerable consumer of welfare-related investments - as is clear from the Commission's pathfinder 2015 CMU Green Paper[39] which regarded the tendency of EU household investors to 'save' through deposits rather than to 'invest'[40] as an obstacle to CMU.[41] The Green Paper did, however, identify an effective level of investor protection as essential for CMU and acknowledged that stronger retail participation depended on trust.[42] The Commission's September 2015 CMU Action Plan had a similar tone: 'retail investors need to save more to meet their retirement needs', but also noted that 'better information and advice are preconditions if retail investors are to be *encouraged* [emphasis added] back into market-based financing.'[43] The subsequent March 2017 Consumer Financial Services Action Plan, which forms part of the CMU agenda, was concerned with consumer finance generally and paid only fleeting attention to the investment markets,[44] but by June 2017, in its CMU Mid Term Review, the Commission was calling for households to have 'more and better opportunities to invest for their future', warning that retail engagement with the capital markets was low, and committing to increasing the transparency and comparability of retail investment products.[45] Identifying an outflow of household funds from capital-market-based investments into deposits and currency, the Commission argued that this outflow meant that households were foregoing future consumption and hindering

[38] Regulation (EU) No 1286/2014 [2014] OJ L352/1, Articles 15-18.
[39] Commission, Green Paper. Building a Capital Markets Union (COM(2015)63) (2015).
[40] See, eg, ECB, The Eurosystem Household Financial and Consumption Survey, Results from the First Wave, Statistics Paper Series No 2 (2013) and Commission, 2016 European Financial Integration and Stability Report (SWD(2016)146)(2016), 48-49.
[41] CMU Green Paper, n 39, 19-20.
[42] Ibid, 5 and 19.
[43] 2015 CMU Action Plan, n 8, 18.
[44] Commission, Communication on Consumer Financial Services Action Plan: Better Products, More Choice (COM (2017) 139).
[45] CMU Mid-Term Review, n 10, 2 and 6-7.

economic growth.[46] The Commission' March 2018 CMU review similarly underlined the need to empower households to save for retirement and to inject more savings into capital markets.[47] The CMU agenda has thus repeatedly identified the two recurring and great challenges of retail market governance: how to protect and how to encourage? Whether CMU will have a stabilizing or destabilizing effect on the new system of retail market governance which has recently developed at EU-level therefore requires consideration. Further, the 2017 ESA Reform Proposal may lead to a significantly stronger ESMA. Does this empowering of technocracy within EU financial market governance pose risks to the retail market agenda, or might it instead lead to a more secure positioning of retail market interests within EU financial market governance? Finally, Brexit should not, on the face of it, have material implications for the EU retail financial market; retail markets are, as discussed later in this chapter, primarily local in nature. Nonetheless, might Brexit lead to a diversion of the EU from its current retail market agenda, with prejudicial effects?

Roadmap

This discussion accordingly assesses retail market governance in the EU after a period of significant change and at a moment when further change may be on the horizon.

It first suggests that the recent reform period has led to a material reconfiguration of retail market governance in four key ways. First, the animating concerns of EU retail market governance have changed. It has traditionally been concerned with the promotion of investor confidence, with empowering investors, and with ensuring choice. While it never went as far as the US in 'cheerleading' for market investments through the regulatory system,[48] the EU's posture towards market investment was, certainly until the financial crisis, facilitative.[49] It is now significantly more paternalistic in nature and distrustful of the investor's and the market's ability to support optimal choices: EU retail market governance increasingly appears to be directed to constructing 'safe spaces,' as it were, within which retail investors can operate. Second, it has become highly operationalized and concerned with process; the high-level principles which previously characterized much of the EU's regulatory intervention here have been thickened by a procedural approach to retail investor protection which drills deep into the business models and processes of retail market actors. At the same time, it is also becoming 'prudentialized' – to coin a cumbersome term. The techniques now familiar from stability-oriented prudential regulation and supervision, notably stress

[46] Commission, CMU Mid Term Review Economic Analysis (SWD(2017)22) (2017), 75.
[47] N 26, 3.
[48] As argued in the work of Donald Langevoort in the context of the US Securities and Exchange Commission (SEC). See, eg, D Langevoort, 'Managing the Expectations Gap in Investor Protection: The SEC and the Post-Enron Reform Agenda' (2003) 48 *Villanova Law Review* 1139.
[49] See further Moloney, n 22.

testing, risk modelling, and scenario planning, are now appearing in EU retail market governance, while EU prudential supervision, albeit primarily concerned with financial stability, is beginning to be used to achieve conduct-oriented, retail market outcomes. Third, and in a related development, retail market governance is becoming an increasingly technocratic concern given the strengthening influence of the ESAs and particularly of ESMA on EU retail market governance. Finally, retail market governance is becoming ever-more standardized, and the traditional autonomy which Member States have enjoyed in this area is decreasing. The chapter goes on to assess whether these developments are likely to lead to better outcomes in terms of encouragement and protection, before considering whether CMU, the ESA reform process and Brexit will have stabilizing or destabilizing effects.

Section two draws the contours of the post-crisis system of EU retail market governance and its main features are identified in section three. Section four examines whether the reforms have been productive, and whether further reforms are necessary. Section five considers the implications of the current inflection point for EU retail market governance. Section six concludes.

2. The New EU Retail Market Governance Regime: Coverage and Context

The retail markets were a latecomer to the massive financial market governance reform programme which the EU initiated in response to the 2008-2012 financial and euro area crises. The overwhelming political, institutional, and market preoccupation with the restoration of financial stability dominated the early stages of this reform period; the prominence of financial-stability-related reform in the G20 crisis-era reform agenda, which shaped the EU's response to the financial crisis, further embedded financial stability as the core preoccupation of the initial phase of the reforms. Later in the reform cycle, however, a retail market agenda emerged.[50]

As the crisis-era reform process began to unfold, EU retail market governance was primarily regulatory in orientation and covered two of the three main pillars of retail market governance: disclosure (primarily through the retail-oriented, short-form 'summary prospectus' required under the EU's prospectus regime which governed capital-raising by issuers of securities, and through the Markets in Financial Instruments Directive (MiFID) I disclosure rules on investment services and products;[51] and investment distribution (primarily through the MiFID I conduct rules for investment intermediation, which covered investment advice, broking, and asset management). It also contained a sophisticated fund regulation regime, based on the EU portfolio allocation, risk

[50] For discussion see the articles in the special edition of the *European Business Organization Law Review* 13(2)(2012) on 'Retail Financial Services After the Crisis – Legal and Economic Perspectives.'
[51] Markets in Financial Instruments Directive I (MiFID I) 2004/39/EC [2004] OJ L145/1 (since repealed).

management, and disclosure rules applied to the 'UCITS' fund, the EU's flagship, retail-oriented regulatory vehicle for investment funds.[52]

In the wake of the crisis-era reforms, EU retail market governance has now come to address the third major pillar of retail market governance, missing from the pre-crisis period - product governance.[53] EU retail market governance is also now supported institutionally by the technocratic ESAs which are bringing a supervisory dimension to EU retail market governance. Enforcement, a critical feature of ex-post retail market governance, remains a largely national competence, albeit that the enforcement powers which NCAs must be able to deploy are now harmonized to a significantly greater extent.

Regulatory and Supervisory Reform

Three major classes of reform can be identified from the recent reform period.

First, a new product governance regime has been put in place at EU-level. Since its coming into force in 2018, MiFID II/MiFIR requires investment firms to have in place product governance processes designed to ensure new and significantly-adapted financial instruments are: subject to an approval process, including stress testing; designed to meet the needs, characteristics, and objectives of a defined 'target market,' the risks to which are identified; and distributed through a distribution strategy consistent with the target market.[54] These novel firm-facing product governance requirements are amplified in detail through administrative rules in Commission Delegated Directive 2017/593 which specifies the nature of firms' product approval and review processes.[55] The new regime also extends to intervention by regulators. MiFID II/MiFIR confers on NCAs and on ESMA (as well as on the European Banking Authority (EBA)) exceptional powers to intervene to prohibit the sale of financial instruments, once specific conditions are met; these intervention powers are specified in great detail through administrative rules in Commission Delegated Regulation 2017/567.[56] Similar powers have been conferred on the third ESA, the European Insurance and Occupational Pensions Authority (EIOPA), under the 2014 PRIIPs Regulation. These general product-oriented rules and product intervention powers are supplemented by targeted product-related regulation of investment funds. Investment fund product regulation is a

[52] Directive 2009/65/EC [2009] OJ L302/32.
[53] Classically, retail market governance has three components: product governance, directed to precautionary, ex-ante intervention relating to how products are designed; distribution, directed to addressing risks, primarily conflict of interest risks, arising from the firm/client distribution relationship (marketing, sales, advice, trading, eg); and disclosure, directed to informing the retail investor.
[54] MiFID II, Articles 9(3), 16(3), and 24(2).
[55] Commission Delegated Directive (EU) 2017/593 [2017] OJ L87/500, Articles 9 and 10.
[56] Commission Delegated Regulation (EU) 2017/567 [2017] OJ L87/90, Articles 19-21.

very longstanding feature of EU retail market governance: the 'UCITS' regulatory fund vehicle is subject to immensely detailed EU portfolio allocation/eligible assets rules. But these have now been supplemented by the rules governing a new form of fund, the European Long-Term Investment Fund (ELTIF), governed by the European Long Term Investment Fund Regulation 2015.[57] The ELTIF Regulation sets out specific portfolio allocation rules designed to protect retail investors while easing their access to the illiquidity premium which the ELTIF provides, as ELTIF investments are locked up over the life of the fund; this premium is not available within the UCITS fund structure, which must provide for redemption on demand. The ELTIF Regulation also includes product governance rules akin to the MiFID II rules: the ELTIF fund manager must assess whether an ELTIF fund is suitable for marketing to retail investors, taking into account at least the life of the ELTIF and the intended investment strategy of the ELTIF.[58]

Second, the EU's longstanding distribution rules have been reformed. MiFID II/MiFIR, which covers a wide range of intermediation services (including investment advice, broking, and asset management) in relation to a wide array of financial instruments, builds on and strengthens the suite of authorization, conduct, and operational rules which applied to investment intermediaries under MiFID I. The MiFID I conduct rules included: an obligation on firms to act in the best interests of clients; disclosure requirements; conflict of interest rules; know-your-client/suitability requirements; and rules governing execution-only sales, order allocation, and best execution. These have been retained and strengthened in the MiFID II/MiFIR regime, but the most significant reforms relate to the new rules governing the management of conflicts of interest in the distribution process. MiFID II puts in place a new set of rules for 'independent investment advice,' which prohibit the payment of fees, commissions, and/or other monetary/non-monetary benefits; these rules also prescribe that a sufficiently diverse range of instruments must be considered by the firm in providing 'independent investment advice,' and that the range of instruments advised on cannot be limited to proprietary or similar financial instruments.[59] Further, MiFID II strengthens conflict of interest management in non-independent distribution arrangements (typically proprietary distribution chains through which firms advise on and sell their own products), by imposing new rules restricting when 'inducements' can be paid to distributors of investment products: any such payment must be designed to enhance the quality of the relevant service and not breach the investment firm's duty to act honestly, fairly, and professionally in accordance with the best interests of the client. MiFID II

[57] Regulation (EU) No 2015/760 [2015] OJ L123/98. The Regulation sets out high-level rules governing the type of long-term 'eligible assets' in which the fund can invest and related diversification and concentration requirements.
[58] Regulation 2015/760, Article 27.
[59] MiFID II, Article 24(4) and (7).

also imposes new remuneration rules which are designed to prevent client conflict of interests within all investment firms.[60] These different rules are amplified in detail by administrative rules governing the nature of independent investment advice (Commission Delegated Regulation 2017/565[61] and Commission Delegated Directive 2017/593) and when inducements may be permitted (Commission Delegated Directive 2017/593).

Finally, the longstanding EU disclosure regime which applies to investment services and financial instruments has been enhanced. This has been primarily achieved through the 2014 PRIIPS Regulation which puts in a place a new requirement (which came into force in 2018) for a short-form 'key information document' (KID) for certain 'packaged' investment products; the detailed KID requirements are set out in the administrative Commission Delegated Regulation 2017/563.[62] There have also been a number of ancillary refinements to retail market disclosure more generally, including in relation to the disclosures provided on services and financial instruments (under MiFID II[63]) and to the short form summary prospectus required under the reformed prospectus regime (under the 2017 Prospectus Regulation).

Institutional Reform

Institutionally, the major development as regards retail market governance relates to the 2011 establishment of the three ESAs as part of the ESFS. The ESAs have been conferred with a range of quasi rule-making powers (including to advise the Commission on administrative rules, propose administrative rules for Commission adoption, and adopt soft law) and supervisory convergence/coordinating powers. Each ESA has a 'consumer protection' mandate under Article 9 of their respective founding Regulations and specific related coordination tasks,[64] and ESMA is charged with a specific 'investor protection' mandate under Article 8 of its founding Regulation. Nonetheless, the ESAs are not consumer/retail investor financial protection authorities. They have been conferred with an array of powers to support rule-making and supervisory coordination/convergence for the single market in financial services generally, and have been primarily concerned, so far, with the

[60] MiFID II, Article 24(9) and (10).
[61] Commission Delegated Regulation (EU) No 2017/565 [2017] OJ L87/1.
[62] Commission Delegated Regulation (EU) No 2017/653 [2017] OJ L100/1
[63] These include MiFID II, Articles 24(2)-(5) (investment services/financial instruments disclosure); 23(2) and 24 (7)/(9) (conflicts of interest disclosure); and 25(6) (suitability statement). These requirements are amplified Commission Delegated Regulation 2017/565
[64] Under Article 9 of the founding Regulations of the three ESAs, they are to 'take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services,' including by means of data interrogation, the coordination of financial literacy initiatives, and the development of common training standards and disclosure rules. Article 9 also empowers the ESAs to issue warnings and contains the enabling power for market intervention, which has subsequently been enacted by the MiFID II/PRIIPs product intervention regime, discussed in section three.

wholesale markets. Nonetheless, they have come to exert a distinct technocratic influence on EU retail market governance, as discussed in section three.

Drivers and Context

The drivers of these different retail market reforms are not easy to unpick, particularly as the reforms do not together form a coherent package. The cornerstone 2014 MiFID II/MiFIR reforms were initiated by the scheduled review of MiFID I, but the review coincided with and was shaped by the crisis-era reform period; the precautionary approach MiFID II/MiFIR adopts to the retail markets, evident in the product governance regime and in the new distribution rules, reflects the crisis-era concern to contain losses and risks associated with the dominant financial stability agenda. The 2014 PRIIPS reform, by contrast, was well in train before the crisis-era reform period, was neglected in the early stages of the crisis as financial stability took over as the EU's priority, but benefited from the reform momentum associated with the crisis-era period. The 2015 ELTIF Regulation, to take another example, is not primarily a retail market governance measure; it forms part of the EU's wider efforts to strengthen the EU's funding capacity, which assumed importance as the crisis-era receded. It is therefore difficult to ascribe a particular political, institutional, or market context to the retail market reforms as a package, given their piecemeal nature and their straddling of different periods over the 2008-2014 crisis era reform process. It is possible nonetheless to make some observations on the forces which shaped the reforms.

The national political preferences which typically shape EU financial market governance[65] can be discerned in the retail market reforms, but the degree of contestation here has been significantly less than that associated with the stability-related elements of the EU's post-crisis financial governance settlement. To the extent political preferences have clashed in the Council in this area, this has typically reflected different forms of retail market organization across the EU. The MiFID II/MiFIR distribution reforms, for example, were something of a flashpoint in Council discussions, reflecting the concern in some Member States, notably France, to protect distribution arrangements based on proprietary networks, and to avoid the imposition on these arrangements of requirements directed to independent-advice-based channels, which are common only in the UK. Political contestation was, however, generally limited, reflecting the political consensus on the need to address persistent mis-selling failures and to respond to the socialization by the financial crisis of losses across taxpayers. Distinct national traditions and approaches seemed to have acted as a

[65] From the extensive literature see recently Burns et al, n 3.

laboratory from which the Member States could draw lessons and not as a source of major contestation.[66]

Institutional interests, the other dominant influence on EU financial market governance[67] have, however, left an imprint on the reforms, primarily in the form of the legacy left by inter-institutional friction between the Commission and the European Parliament. While both institutions have traditionally been supportive of EU-level retail market reform,[68] retail market governance became a location for material inter-institutional tensions, in relation to retail market administrative rule-making. In September 2016, the European Parliament, which holds veto powers over delegated rule-making by the Commission, vetoed, by an overwhelming majority,[69] the administrative rules for the PRIIPs Regulation KID.[70] The PRIIPs veto marked the first time the Commission and Parliament had not been able to come to an agreement in relation to a set of administrative rules, and notwithstanding the extensive technical preparatory work which had been carried out at ESA level, in this case by the three ESAs together. It is not entirely clear why this set of rules triggered this first-ever veto, although the relatively low salience of retail market regulation may have emboldened the Parliament to test its veto powers. The veto was based on the Parliament's sharp disagreement with the Commission on several technical elements of the KID rules, including as regards the different investment scenarios disclosed in the KID, and the design of the 'comprehension alert' which signals when a retail investor may find an investment difficult to understand. But the veto certainly underlines the Parliament's willingness to substitute its own view on retail market regulation design for the Commission's (and the technocratic ESAs', which support the administrative rule-making process). The veto also reflects the injection of industry interests into Parliament deliberations; it was associated with lobbying by the financial industry.[71] The PRIIPs inter-institutional imbroglio not

[66] This was particularly the case with the product governance reforms as several Member States had already experimented with different approaches to product governance in the early stages of the financial crisis. See further N Moloney, 'The Legacy Effects of the Financial Crisis on Regulatory Design in the EU' in Ferran et al n 3, 111.

[67] See eg R Epstein and M Rhodes, 'The Political Dynamics behind Europe's new Banking Union' (2016) 39 *West European Politics* 415 and N Moloney, *EU Securities and Financial Markets Regulation,* (OUP, 2014, 3 edition), 892-893.

[68] The European Parliament has long been a consistent supporter of retail market reforms. Over 2017-2018, eg, its powerful ECON (economic and monetary affairs) committee commissioned a series of reports on mis-selling in the retail markets (including K Alexander, Marketing, Sale and Distribution. Mis-selling of Financial Products (2018) (PE 618.996) and P-H Conac, Subordinated Debt and Self Placement. Mis-selling of Financial Products (2018) (PE 618 994)).

[69] The final vote was 561 votes to 9, with 75 abstentions: European Parliament, Press Release, Parliament Demands Better Protection for Small Investors.

[70] European Parliament, Objection to a Delegated Act: key information documents for packaged retail and insurance-based investment products, 14 September 2016 (P8_TA(2016)0347).

[71] Better Finance, Press Release, 30 August 2016.

only led to the ESAs' technical expertise as regards retail markets risks being over-ridden;[72] it also, given the significant delays which the veto and the subsequent redrafting of the administrative rules generated, led to a postponement of the implementation of the PRIIPs Regulation and its KID protections by one year to 2018.[73]

3. The New Retail Market Regime: Paternalism, Proceduralization, Technocracy, and Standardization

Paternalism and Distrust

EU retail market governance has always been primarily expressed through harmonized protective rules: harmonized regulation is the main vehicle for EU retail market intervention. These rules serve the driving imperative of EU financial market regulation generally - the removal of barriers to cross-border trade and the reduction of related transaction costs. But this is a secondary purpose here, given the still nascent quality of the cross-border retail market. The harmonization of retail market protective rules has long served a different and more transformative purpose: it has sought to build investor confidence, through law, in the cross-border investment services market, certainly, but also in the investment process generally, and has accordingly sought to encourage as well as to protect.

While 'protecting and encouraging' functions have always been evident in the EU's retail market regulatory regime, the balance between the two has evolved over the time. Over the first great reforming period of EU financial market regulation, the liberalizing 1999-2004 Financial Services Action Plan period, retail investor protection rules were harmonized and enhanced across the EU, most notably through the new, protective firm-facing conduct regime for investment intermediation set out in MiFID I 2004. But investor-facing disclosure requirements, investor choice, and investor empowerment were also totems of this period: retail investors were to be empowered, through EU regulation, to exercise choice, and the construction of an EU retail investment culture became a policy objective. For example, execution-only investment (investment without investment advice) was subject to only minimal regulatory requirements under MiFID I, and the proliferation of investment funds was promoted through the UCITS fund regime. Reflecting this facilitative orientation, harmonized EU regulation avoided drilling deeply into firms' business models and incentive structures and into industry structure.[74] Overall, EU regulatory governance 'trusted' the

[72] The Commission's agreement, following the veto, to change certain of the KID rules was not subsequently supported by the ESAs, who advised the Commission that the changes could lead to retail investors being misled: Joint ESA Letter to the Commission, 22 December 2016 (ESAs 2016 81)).

[73] A Mooney, 'Industry frustrated by EU retail regulation saga,' *Financial Times, Fund Management Supplement*, 9 January 2017.

[74] MiFID I did not, eg, address the deep-seated incentive risks generated by the dominant form of payment for investment advice, commissions, across the EU.

market, as it were. The crisis-era changed this posture to one that is significantly more paternalistic, interventionist, and distrustful of the markets.

Paternalism and the Investment Advice Market

In the early stages of the crisis-era reform period, it became clear that the EU's posture was shifting towards a more interventionist and distrustful stance. The MiFID II conflict of interest rules, for example, intervene directly in the structure of the investment advice industry, imposing restrictions on 'independent' investment advice and limiting the extent to which commission payments (inducements) can be made to investment advisers. More standardized and generic forms of advice delivery, better attuned to the needs of retail investors with straightforward investment needs, are predicted to develop in the wake of these reforms.[75] The MiFID II distribution rules seek to proactively shape the investment advice sector in other ways. The MiFID II execution-only regime, for example, reduces the space within which execution-only trades (without investment advice) can take place: structured UCITS investments and instruments which embed derivatives or incorporate structures which make it difficult to understand the risk involved are excluded from execution-only trades, while margin lending services relating to execution-only trading (which can lead to losses ratcheting) are prohibited.[76]

A similarly directive approach to advice and distribution emerges from the ELTIF regime. While, on the face of it, the ELTIF leans to a facilitative, empowering form of retail market intervention as it eases access by retail investors to riskier long-term investment funds by allowing them access to an illiquidity premium, it also seeks to shape the retail investment environment. The ELTIF manager, where it sells the ELTIF fund directly, and other distributors of the ELTIF fund, must apply a suitability test and, in addition, ensure that, in certain circumstances, a retail investor investing in the product not invest more than 10% of the investor's financial instrument portfolio in ELTIFs. [77]

Paternalism and Product Governance

This change in posture is most apparent in relation to the new product governance rules. The legislative MiFID II product governance rules heralded a significantly more precautionary approach to the retail markets on their adoption in 2014, but the administrative rules subsequently adopted in

[75] ESMA Executive Directive Ross, Speech on 'Regulatory and Supervisory Developments, the challenges ahead – a European perspective,' 20 October 2016. This has been the experience in the UK following similar reforms under the 'Retail Distribution Review' and where there is policy support for the development of such low-cost channels: HM Treasury and FCA, Financial Advice Markets Review. Final Report (2016).
[76] MiFID II, Article 25(4).
[77] ELTIF Regulation, Articles 28 and 30.

2017 underline the extent to which EU retail market regulation has become concerned with shaping the environment in which retail investor decisions are made.

The immensely detailed administrative product governance rules, which apply to 'manufacturers'[78] of a very wide range of financial instruments, including 'plain vanilla' bonds as well as complex packaged products, require, for example: that the target market for a financial instrument is identified at a 'sufficiently granular level' for each financial instrument and must specify the type(s) of client for whose needs, characteristics, and objectives the product is compatible; that a scenario analysis must be undertaken which assesses the risk of poor outcomes and when they may occur, in relation to a series of identified and potentially detrimental events; and that the financial instrument be assessed to determine whether it meets the needs, characteristics, and objectives of the identified target market, including in relation to its risk/reward profile and the business model implications for the firm.[79] The target market analysis extends to distribution, with manufacturers required to review whether the instrument is being distributed to its target market, or instead reaching clients for whose needs, objectives and characteristics it is not compatible.[80] Similar themes emerge, if in a more muted manner, from the 2015 ELTIF regime, which requires the ELTIF manager to engage in an internal assessment process, which must include analysis of the life of the fund and its intended investment strategy, before deciding it is suitable to market to retail investors.[81]

Product governance regulation of this form is new to EU retail market regulation and operates as a form of ex-ante filtering process. It does not require the pre-screening/authorization of investment products by NCAs. Instead, it requires firms to follow a process designed to minimize the risk of products which do not meet investor needs being marketed to them - and also to minimize the risks of regulatory devices such as distribution rules (for example, suitability requirements) and disclosure requirements (for example, short-form product disclosures) failing further down the line. It is a muscular form of intervention which goes beyond protecting retail investors from the classic market failures associated with agency/distribution relationships, and which seeks instead to shape the investment environment by directing only those products which meet the 'needs, characteristics, and objectives' of the relevant targeted group to the retail investor.

[78] The rules apply to investment firms which 'manufacture' financial instruments, encompassing the creation, development, issuance, and/or design of financial instruments: Commission Delegated Directive 2017/593, Article 9. Somewhat lighter rules apply to distributors of financial instruments.
[79] Commission Delegated Directive 2017/593, Article 9.
[80] Commission Delegated Directive 2017/593, Article 9.
[81] ELTIF Regulation, Article 27.

It is concerned with steering the retail investor towards optimal outcomes, and not only with reducing the risks of market failure.

Paternalism and Product Intervention

The new product intervention regime has a similar hue, albeit it is primarily directed to emergency/last resort intervention, although the powers can also apply on a precautionary basis.

Under MiFIR,[82] NCAs must be empowered to prohibit or restrict, in or from the Member State, the marketing, distribution or sale of certain financial instruments or structured deposits (or such products with certain specified features), or a type of financial activity or practice. These powers may be deployed on a precautionary basis by NCAs, before the product has been marketed, distributed or sold, where the necessary conditions are met.[83] A series of trigger conditions apply, which, from the retail investor protection perspective,[84] include the threshold requirement that the product or activity/practice gives rise to 'significant investor protection concerns.'[85] Immensely detailed administrative rules govern the related 'factors and criteria' which the NCA must take into consideration before deciding 'significant investor protection concerns' arise and proceeding to prohibit or restrict a product (or activity/practice). The existence of such 'significant investor protection concerns' can be determined, however, based on only one (or more) of the factors/criteria.[86] The conferral of these powers, which are new to most Member States,[87] provides powerful evidence of the EU's more interventionist approach to the retail markets and its concern to shape the investment environment. It also provides an indication of the type of product features which the EU regards as potentially troublesome and, by implication, of the type of investment 'safe space' which may be under construction by the EU. The factors/criteria which can ground a restriction/prohibition of a product, and which are indicative of the type of 'safe space' sought, include the complexity of the product; the size of potential detriment; the type of client engaged, including their skill and ability, economic situation, financial objectives, and whether the product has

[82] A similar suite of powers apply in relation to investment-linked insurance products under the PRIIPs Regulation: Articles 16-18 (covering NCAs and, at EU level, EIOPA).
[83] MiFIR, Article 42(2).
[84] MiFIR, Article 42. The power is also designed to cover threats to the orderly functioning and integrity of markets or to financial stability.
[85] In addition, the NCA must establish that the risks are not adequately addressed by other EU regulatory requirements and that the issue would not be better addressed by improved supervision or enforcement; act in a proportionate manner, taking into account a series of identified factors; consult with and notify (at least one month before) other NCAs (and notify ESMA/EBA which are empowered to adopt an opinion on the action; where the NCA takes action contrary to an ESMA/EBA opinion it must make a public notification of its reasons); and ensure that the action is not discriminatory: MiFIR, Article 42(2)-(4) and Article 43. Provision is made for expedited action by NCAs.
[86] Commission Delegated Regulation 2017/567, Article 21.
[87] A number of Member States, including the UK, Belgium, and the Netherlands, introduced product intervention powers at an early stage of the financial crisis: Moloney, n 66.

been sold outside its target market; the degree of transparency of the product; the product's components; disparity in the expected risk/return profile; liquidity risks; the degree of innovation; and selling practices.[88] NCAs are required only to consider whether these factors/criteria are relevant to the assessment of 'significant investor protection concerns', and to apply them if they are. Nonetheless, the factors and criteria amount to a formidable check list of product and distribution features which could expose retail investors to risk and are indicative of the type of investment space which the EU regards as posing risks.

Perhaps the most significant indication of the EU's change of posture and adoption of a more distrustful, paternalistic, and interventionist approach comes from the related empowerment of the three ESAs, albeit that their product intervention powers are only available where an NCA has not taken (adequate) action to address the threat, and only apply on a temporary basis (three-month renewable) (NCAs may act on a permanent basis). Any empowerment of the ESAs to take direct supervisory action raises the prospect of political and institutional contestation, given the related leakage of control from either the Member States or the EU institutions. It also raises legal difficulties as, under the *Meroni* doctrine,[89] EU agencies cannot take discretionary action unless such action is subject to appropriate conditions set by the legislature.[90] Nonetheless, EBA and ESMA have been empowered under MiFIR with product intervention powers (subject to failure by an NCA to act), albeit that more stringent threshold conditions apply than do to NCAs, given the political, institutional, and legal complexities.[91] The ESAs can be expected to be wary of exercising these new powers given their novelty and the political sensitivities. The ESAs' new powers are not, however, 'paper tigers,' as became clear from ESMA's 2018 deployment of these powers, shortly after MiFIR came into force in January 2018.

In June 2017 ESMA gave its first indication that it would exercise its new MiFIR powers, in relation to the pan-EU outbreak of mis-selling of complex CfDs and similar products during 2015–

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[88] Commission Delegated Regulation 2017/567, Article 21.

[89] Case 9-56 *Meroni v High Authority* (ECLI:EU:C:1958:7).

[90] The *Meroni* doctrine continues to frame the ESAs' powers despite the more liberal approach adopted by the CJEU in the *Short Selling* ruling (in which the CJEU accepted that general conditions were sufficient to provide the required degree of conditionality: *United Kingdom v European Parliament and Council* ECLI:EU: C: 2018:18). See P Craig, *UK, EU and Global Administrative Law* (CUP, 2015) 532-544; CF Bergstrom, 'Shaping the New System for Delegation of Powers to EU Agencies: United Kingdom v European Parliament and Council (Short Selling)' (2015) 52 *Common Market Law Review* 219; and E Howell, 'The European Court of Justice: Selling us Short' (2014) 11 *European Company and Financial Law Review* 454

[91] eg, while an NCA can take action 'if it is satisfied on reasonable grounds' that the threshold conditions are met, the powers only activate for ESMA and EBA where the conditions 'are met'. In addition, a stricter proportionality test applies in that the ESAs must ensure that the action does not have a detrimental effect on the efficiency of financial markets or on investors that is disproportionate to the benefits, and the ESAs must ensure that a risk of regulatory arbitrage is not created: MiFIR, Article 40 (ESMA) and 41 (EBA). The later EIOPA empowerment is in PRIIP Regulation, Article 16.

17,[92] once MiFIR came into force in January 2018.[93] ESMA confirmed its appetite for intervention over December 2017 and January 2018, but took a cautious approach, engaging first in a Call for Evidence on the proposed intervention.[94] The ESMA Board of Supervisors subsequently decided to adopt its first ever MiFIR product intervention measures in March 2018. The path-breaking measures (which were closely based on the proposals trailed in ESMA's January 2018 Call for Evidence and which were subsequently formally adopted by the Board as regulatory acts (Decisions) of general application in May 2018) imposed a series of temporary restrictions on the marketing in the EU of CfDs to retail investors, and imposed a temporary prohibition on the marketing of binary options to retail investors.[95] This intervention by ESMA represents a major staging post in the development of EU retail market governance and a vivid illustration of the more paternalistic approach to retail market investment which now frames EU retail market governance.

Paternalism and Disclosure

Similar inferences of a more paternalistic approach can be drawn from the PRIIPs disclosure regime – the most prominent of the crisis-era reforms to retail market disclosure. The new standardized KID, now required since 2018 for a wide range of packaged investment products under the PRIIPs regime, must, for example, include a comprehension alert for certain more complex products; a description of the retail investor to whom the product is intended to be marketed; an indication of maximum losses; a summary risk indicator; and four different performance scenarios addressing how the product might perform in a stressed, unfavourable, moderate, and favourable scenario.[96] The overall effect can be expected to highlight risks, and may as a result lead to a contraction in the distribution of riskier products, particularly as the requirement to highlight risks in an accessible and prominent manner might act as a disincentive for firms to develop such products for retail distribution. The ELTIF Regulation's disclosure regime has a similarly interventionist hue. It requires that where an ELTIF marketed to retail investors exceeds ten years (or a ten year 'lock-up' of the

[92] Over 2015–17, aggressive online marketing by certain Cypriot investment firms of CfDs to retail investors led to investor losses, a swathe of complaints, and to concerns across affected NCAs and within ESMA.
[93] ESMA, Product Intervention, General Statement, 30 June 2017 (ESMA35-36-885).
[94] ESMA, Statement on Preparatory Work in relation to CfDs and Binary Options offered to Retail Clients, 15 December 2017 (ESMA71-99-910); and ESMA, Call for Evidence on Potential Product Intervention Measures (ESMA35-43-904) (2018).
[95] ESMA, Additional Information on the Agreed Product Intervention Measures relating to Contracts for Differences and Binary Options, 27 March 2018 (ESMA35-43-1000). The two related Decisions were formally adopted by the Board on 22 May 2018: ESMA Decision (EU) 2018/795 (the prohibition on binary options) and ESMA Decision (EU) 2018/796 (the restrictions on CfDs). They were to be applied from 2 July (binary options) and 1 August (CfDs).
[96] Commission Delegated Regulation 2017/653, Articles 1-3. Very detailed Annexes on the granular content of the disclosures and how they are to be constructed accompany the Regulation.

investors' funds), it must be accompanied by a clear written alert that it may not be suitable for retail investors that are unable to sustain such a long-term and illiquid commitment.[97] It remains to be seen whether this form of disclosure, which adopts a much more assertive approach in risk disclosures, will be any more successful than previous models. But certainly, it represents a significantly more interventionist and market-distrustful approach.

Paternalism as a Recurring Theme

Paternalism can also be traced in the more interventionist, precautionary approach the EU has taken to how firms should respond to potential risks and threats to retail investors. For example, the MiFID II product governance regime specifies the 'appropriate action' which Member States must ensure is taken by firms on the occurring of certain 'crucial events' that would affect the risk/return profile of a financial instrument. These include the provision of information to investors, but also, and more intrusively, halting future issuances, changing the financial instrument, and reconsidering distribution channels/terminating distribution relationships.[98] Similarly, the new regulatory regime is more prescriptive and directive in defining when a firm cannot act. Under the new MiFID II independent investment advice regime, for example, firms are prevented from advising clients where their business models do not allow the required assessment as to whether they are 'independent' within the terms of MiFID II to be made.[99] The space for creative compliance by firms is accordingly being narrowed.

A distrust of financial intermediation and markets and a related more interventionist and paternalistic approach can also be traced in how the scope of the regulatory regime has widened. The imprints of specific episodes of retail investor detriment are evident on MiFID II, for example, underlining the extent to which local mis-selling episodes are now being met by an EU response. One of the most striking examples relates to 'self-placement' by banks of their securities through their proprietary networks, which led to a major mis-selling in scandal in Spain as banks sold complex securities to depositors and shareholders in order to shore up their balance sheets over the crisis.[100] The risk to retail investors from self-placement has now been addressed by the inclusion of self-placement as an in-scope service within MiFID II, as well as by specific MiFID II rules governing how self-placements are to be carried out, including conflict of interest and disclosure requirements.[101]

[97] ELTIF Regulation, Article 28.
[98] Commission Delegated Directive 2017/593, Article 9(15).
[99] Commission Delegated Regulation 2017/565, Article 53.
[100] Better Finance, n 24, 12-13.
[101] Commission Delegated Regulation 2017/565, Article 41.

Overall, the crisis-era reforms introduced by MiFID II, the PRIIPS Regulation, and the ELTIF Regulation signal a more distrustful approach to the retail markets and a more muscular and paternalistic approach to retail market governance. This approach leans more to protection than to encouragement. Nonetheless, by seeking to construct an investment environment which is better shaped to the needs of retail investors and more responsive to risks, it may come to build greater trust and confidence in the investment process.

Proceduralization and Prudentialization

Proceduralization

This new muscularity is also evident in the proceduralization of EU retail market regulatory governance, which is increasingly taking the form of an operating manual for firms.

The MiFID II product governance rules provide a useful example. The administrative rules are closely focused on internal firm processes, the design of which is not left to firm discretion.[102] The main requirement of these rules is that procedures and measures are put in place by firms, but the outcomes which these procedures and measures must achieve, and the functions they must carry out, are prescribed in great detail. The required conflicts of interest assessment, for example, must ensure conflicts of interests are assessed each time a financial instrument is manufactured, and the assessment must cover whether clients may be adversely affected by an exposure opposite to the one previously held by the firm, or an exposure opposite to the one the firm wants to hold after the sale of the product.[103] The most striking example of process-related regulation comes from the 'target market' rules for product manufacturers, which require that the firm identify 'at a sufficiently granular level' the potential target market for the financial instrument and the type(s) of client for whose needs, characteristics, and objectives the financial instrument is compatible; where the manufacturer constructs instruments which are distributed through other firms (and thus has only a limited data base on the investors targeted), it must deploy its theoretical knowledge and past experience.[104] As part of this process, the 'negative' target market (those investors for whom the product is not compatible) must be identified; the risk/reward profile of the instrument must be assessed as being consistent with the target market, as must whether the instrument's design is driven by features that benefit the client, and not by a business model that depends on poor client outcomes; and the charging structure must be compatible with the needs and objectives of the

[102] Commission Delegated Regulation 2017/593.
[103] Commission Delegated Regulation 2017/593, Article 9(3).
[104] Commission Delegated Regulation 2017/593, Article 9(9).

target market, and appropriately transparent to that target market.[105] Detailed requirements govern firms' ongoing review of financial instruments.[106] These include that financial instruments must be reviewed on a regular basis to take into account any event that could materially affect the potential risk to the target market, and to ensure the instrument remains consistent with its target market and is being appropriately distributed to the target market; and that the review process must assess whether the instrument has functioned as intended, including by identifying 'crucial events' that would affect the potential risk/return expectation of the financial instrument. The detailed process requirements on product governance extend to staffing and to how effective board oversight is to be secured. Relevant staff involved in the manufacturing of financial instruments are required to possess the necessary expertise to understand the characteristics and risks of the financial instruments in question,[107] while the firm's internal compliance function must monitor the development and periodic review of the firm's product governance arrangements to detect any risk of compliance failures.[108] Further, the management body (board) is required to define, approve, and oversee product governance arrangements[109] and must have effective control over the firm's product governance process, and related compliance reports provided to the board must systematically include information on financial instruments manufactured by the firm and their distribution strategy.[110] These product governance rules have been further thickened and subject to proceduralization by ESMA's 2017 Product Governance Guidelines, which drill deep into the 'target market' process. The detailed Guidelines, which are supported by practical case studies, are designed to standardize procedures and act as a basis for firms' processes,[111] but also to ensure that firms do not overly rely on automation but apply qualitative criteria appropriately.[112] The MiFID II product governance administrative rules and ESMA Guidelines deploy process-related regulation to a significantly greater extent than previously in EU retail market regulation. By contrast with MiFID I which, by and large, was based on high-level, fiduciary-style conduct principles, the product governance rules are directed to an outcome (ensuring that products are designed for and

[105] Commission Delegated Regulation 2017/593, Article 9(9), (11), and (12).
[106] Commission Delegated Regulation 2017/593, Articles 9(14)-(15).
[107] Commission Delegated Regulation 2017/593, Article 9(5).
[108] Commission Delegated Regulation 2017/593, Article 9(7).
[109] MiFID II, Article 9(3).
[110] Commission Delegated Regulation 2017/593, Article 9(6).
[111] ESMA, Guidelines on MiFID II Product Governance Requirements (2017) (ESMA35-43-620), 14. The requirements are in part designed to have 'positive effects' on firms' productivity and efficiency: at 10.
[112] Ibid, 33.

distributed to an appropriate target market) and to the construction of firm processes that support that outcome.[113]

A similar theme emerges from the distribution sphere. For example, while the characteristics of ‘independent investment advice’ are established by high-level requirements under MiFID II, the administrative rules on ‘independent investment advice’ specify in detail the process which firms must engage in when the selecting the portfolio of financial instruments in relation to which they present themselves as providing independent investment advice. The process as prescribed must ensure that the number and variety of financial instruments in the portfolio is proportionate to the scope of investment advice services offered and adequately representative of financial instruments available on the market; consider whether the quantity of financial instruments issued by the firm or entities closely linked to it is proportionate to the total amount of instruments considered; and include criteria for selecting instruments that consider all relevant aspects, including risks, costs, and complexity, as well as the characteristics of the firm’s clients.[114] These rules are also directed to business model risks: where such an assessment process is not possible due to the business model of the firm or the type of service provided, the firm cannot present itself as ‘independent’. Similarly, where independent advice is provided only in relation to certain forms of investments (such as ‘green’ or ethical investments), the firm must ensure that its service is appropriate for each new client on the basis that its business model matches the client’s needs and objectives and the range of financial instruments suitable for the client.’[115]

The new proceduralization also applies to areas which were already subject to some degree of process regulation under MiFID I. The MiFID I suitability/know-your-client requirement, for example, had been subject to a degree of process regulation as regards the different client features which had to be assessed before a firm could make the suitability assessment of a client which was required in certain circumstances by MiFID I (and continues to be required under MiFID II). The suitability/know-your-client requirement has now been proceduralized to a much greater extent under MiFID II. For example, firms must now take reasonable steps to ensure that information collected about clients is reliable, including ensuring that all tools, such as risk assessment profiling tools, are fit-for-purpose and appropriately designed; ensuring questions used in the suitability process are likely to be understood by clients; and taking steps to ensure the consistency of client information. Firms must also have, and be able to demonstrate, adequate policies and procedures to

[113] The outcome-focused orientation is made explicit in ESMA’s Guidelines, which note that new rules should improve the compatibility between investment products and the needs and characteristics of clients, and consequently improve the quality of products: ibid, 9.
[114] Commission Delegated Regulation 2017/565, Article 53.
[115] Commission Delegated Regulation 2017/565, Article 53.

ensure they understand the nature, features, and risks of any services/instruments selected for their clients and they can assess whether equivalent services/instruments could meet a client's needs.[116] Automated process are expressly highlighted and the need for firm judgment emphasised; the responsibility to undertake a suitability assessment is specified as resting with the firm and cannot be reduced by reliance on electronic systems.[117]

Proceduralization is a recurring theme across the MiFID II distribution regime. The new rules on underwriting or placing securities, for example, require that systems, controls, and procedures be in place to manage conflicts of interests in relation to possible under- or over-pricing, that an allocation policy be established, and that the final allocation to each investment client be clearly justified and recorded.[118] Similarly, remuneration arrangements are now subject to new process controls in the form of a requirement to define and implement remuneration policies and practices designed to ensure client interests are not impaired by remuneration practices.[119] Further, the new inducements regime, which specifies when an inducement is permitted (in that it is designed to enhance the quality of the services to the client), requires firms to evidence quality enhancement by recording how the inducement provides quality enhancement.[120] A related new process, based on research payment accounts, for unbundling the provision by third parties, such as brokers, of investment research to asset managers is now required as part of the MiFID II inducements regime.[121]

ESMA soft law has brought an additional layer of proceduralization to the MiFID II distribution rules. The key ESMA intervention in relation to distribution is its lengthy 'Q&A' on MiFID II/MiFIR investor protection topics.[122] ESMA Q&As do not have the same status as ESMA Guidelines: for example, they are not policed through a 'comply or explain' mechanism (NCAs must comply with Guidelines or explain their non-compliance), and are reactive, being driven by stakekolder questions received by ESMA (Guidelines are proactively adopted by ESMA). Nonetheless, as an authoritative guide to common supervisory thinking across the EU, ESMA Q&As have the colour of ESMA Guidelines and similar potential to shape market behaviour.[123] And here again, in the MiFID II/MiFIR Investor Protection Q&A, process requirements are being used to achieve outcomes. In relation to

[116] Commission Delegated Regulation 2017/565, Article 54(7) and (9).
[117] Commission Delegated Regulation 2017/565, Article 54(1).
[118] Commission Delegated Regulation 2017/565, Articles 38-40 and 43.
[119] Commission Delegated Regulation 2017/565, Article 27.
[120] Commission Delegated Directive 2017/593, Article 11.
[121] Commission Delegated Directive 2017/593, Article 13.
[122] ESMA, Questions and Answers on MiFID II and MiFIR Investor Protection Topics, 15 April 2017 (ESMA35-43-349) (regularly updated).
[123] The Q & A is designed to promote common supervisory approaches and practices in the application of MiFID II/MiFIR (ibid, 10). On the 'hardening' quality of ESMA soft law see Moloney, n 5.

securities offering allocations to investors, for example, ESMA's Q&A covers what the allocation record should include and how the allocation justification should be approached, including, for example, that 'particular care' be taken in recording the allocation decision for those receiving a final allocation in the top 20% of the total allocation.[124] To take another example, in relation to the MiFID II suitability assessment, the Q&A provides case studies for how firms should proceed where a client wishes to proceed with an investment which the firm has deemed not to be suitable.[125]

Prudentialization

One of the most striking changes to EU retail market governance concerns the extent to which it has begun to embrace the highly interventionist and forward-looking tools associated with financial-stability-oriented prudential supervision, notably stress-testing and the imposition of capital requirements.

This development has, in an indication of the growing importance of technocracy to EU retail market governance, been driven by EBA, which has hitherto not been closely concerned with retail market matters given its banking market mandate and its primary focus on prudential matters. EBA has, however, come to focus on conduct risk - a risk which is closely tied to retail market risk as it incorporates mis-selling risks - as a threat to financial stability, reflecting an international trend.[126] In particular, EBA's Guidelines on the 'Supervisory Review and Evaluation Process' (SREP) (which is required, under the Capital Requirements Directive IV(CRD IV)/Capital Requirements Regulation (CRR), to be undertaken annually by all NCAs of firms within the scope of CRD IV/CRR, primarily banks and more complex investment firms) require NCAs to consider a firm's exposure to conduct risk, including in relation to poorly designed distribution channels, conflict of interest in the conduct of business, and product mis-selling.[127] Indicators of conduct risk include sanctions and complaints made against the firm. Capital requirements and other forms of supervisory remediation can follow from an SREP assessment of conduct risk; retail market mis-selling, could, accordingly, lead to additional, costly capital requirements for a bank.

In a similar development, in advising the Commission on the relevant administrative rules, EBA included conduct (misconduct) risk among the different risks against which banks must place

[124] N 122, at 39-40. These requirements are designed to prevent retail investors being discriminated against in favour of an investment firm's large clients when it comes to allocating securities in an offering.
[125] Ibid, at 24-26.
[126] Reflected in the recent focus by the Financial Stability Board on conduct risks and their relationship to systemic risk and financial stability. See recently FSB, Stocktake of Efforts to Strengthen Governance Frameworks to Mitigate Misconduct Risks (2017) and FSB, Reducing Misconduct Risks in the Financial Sector, Progress Report to G20 Leaders (2017).
[127] EBA, Guidelines on the Revised Common Procedures and Methodologies for the SREP (2014), paras 253-257 (aspects of the Guidelines have since been revised but the conduct regime remains in place).

capital for operational risk.[128] The management of operational risk is still a novelty for firms and for regulators, making EBA's decision to include conduct risk within operational risk a significant indicator of the growing 'prudentialization' of conduct risk. Under the new rules on the management of operational risks, operational risk events and losses now include those arising from 'misconduct events,' where wilful or negligent; firms must have in place an ongoing process to identify, assess, measure, monitor, and report on operational risks, including misconduct events; and firms must take balance sheet provisions against probable operational risk losses, including those arising from misconduct events (and allocate related capital).[129]

Conduct risk is also beginning to be incorporated within EU bank stress tests. The 2016 stress test of 51 major EU banks, which was coordinated through EBA, required consideration of the impact of conduct risk on bank capital[130] and accounted for some €71 billion of related capital requirements being imposed on EU banks; the stress test found that conduct risk was the major driver of operational risk within EU banks.[131] The 2018 stress test will also include conduct risk.[132]

Stress-testing-oriented retail market governance can also be found elsewhere. The MiFID II product governance regime, for example, requires that a 'scenario analysis' must be undertaken by firms of financial instruments, and that this assess the risk of poor outcomes and consider a series of potentially adverse events, including a market deterioration, the materialization of counterparty risk, the instrument failing to be commercially viable or, conversely, demand being higher than expected, placing a strain on firm resources.[133] The PRIIPS Regulation also incorporates stress testing, requiring that the KID contain four scenarios (stressed, unfavourable, moderate, and favourable) which explain how the product would perform in each of them.[134]

Technocratic Retail Market Governance and ESMA

The extent to which EU retail market governance has become more paternalistic and distrustful of the market is mainly a function of the inter-institutional legislative process and the legislative rules

[128] EBA, Final Draft Regulatory Technical Standard on Specification of Assessment Methodology under which National Competent Authorities can Permit Institutions to use Advanced Measurement Approaches for Operational Risk (EBA/RTS/2015/02) (2015) (adopted by the Commission as C(2018) 1446, 14 March 2018).

[129] March 2018 Commission Operational Risk RTS, ibid, Articles 3, 7, and 22. Following EBA's approach, a 'misconduct event' is an operational risk event arising from wilful or negligent misconduct, including the inappropriate supply of financial services.

[130] EBA, EU Wide Stress Test, Methodological Note (2016), chapter 5.

[131] EBA, Results of the 2016 EU-Wide Stress Test, 18.

[132] For this exercise, EBA has defined conduct risk as the current or prospective risk of losses to an institution arising from an inappropriate supply of financial services, including cases of willful or negligent misconduct: EBA, 2018 EU-Wide Stress Test – Draft Methodological Note (2017), 94.

[133] Commission Delegated Directive 2017/593, Article 9(10).

[134] Commission Delegation Regulation 2017/653, Article 3(3) (the methodology is set out in detail in Annex V to the Regulation).

adopted in MiFID II/MiFIR and the PRIIPs regime. The proceduralization and prudentialization of these rules, however, can be strongly associated with ESMA, whose technocratic influence on EU retail market governance is increasing. ESMA's powers take two broad forms: quasi-regulatory; and supervisory coordination/convergence based. ESMA is not a consumer/retail market agency, although it is charged with an objective of 'enhancing consumer protection'; the task of fostering investor protection; and a series of specific consumer/investor protection-oriented responsibilities.[135] Like the other ESAs, its primary function is to support the single rulebook and facilitate supervisory convergence and coordination. Established in 2011, ESMA's early years saw it pre-occupied with the vast array of risk-focused administrative rules and related soft law required to amplify and clarify the single rulebook. More recently, however, and as the demands of crisis-era rule-making have receded, ESMA has begun to strengthen its capacity in relation to the retail markets and to bring a related technocratic quality to EU retail market governance.

Technocracy and Regulation

With respect to quasi-rule-making, ESMA has been a decisive influence on the new generation of retail market administrative rules. ESMA's technical advice to the Commission on the MiFID II administrative rules on distribution and product governance, for example, was largely followed by the Commission.[136] ESMA is also thickening the new administrative rulebook by means of a raft of soft law, including its 2017 Product Governance Guidelines and its MiFID II/MiFIR Q & A on investor protection.

ESMA's influence on rule-making now extends beyond the administrative rulebook to upstream policy developments, in relation to which it is coming to shape how Commission retail market policy develops. It has, for example, brought its technocratic expertize and a retail market orientation to bear on the Commission's fintech strategy,[137] including by constructing a data-set on national regulatory experiences with crowdfunding and making related recommendations,[138] and, with the other two ESAs, by assessing the challenges posed by automated financial advice ('robo-advice').[139] It similarly sought to shape the early stages of the proposed pan-European Personal

[135] Respectively, ESMA Regulation, Article 1(5) (among a series of other Article 1(5) objectives); Article 8 (among a series of Article 8 tasks); and Article 9 (see n 64 above on Article 9).
[136] ESMA's technical advice on the MiFID II product governance, intervention, and distribution rules (ESMA/2014/1569, December 2014) can be compared against the texts as finally proposed by the Commission. In relation to the product governance and inducement rules, for example, the texts are almost the same, save for some re-ordering.
[137] eg ESMA, Response to the Commission Consultation Paper on Fintech: a more competitive and innovative financial sector (ESMA50-158-457) (2017).
[138] ESMA, Opinion. Investment-based Crowdfunding (ESMA/2014/1378) (2014).
[139] ESMA, EBA, and EIOPA, Report on Automation in Financial Advice (2016).

Pension Product (PEPP),[140] calling for the development process to draw on experience with disclosure and distribution tools in the retail investment area.[141] ESMA is also seeking to shape legislative change upstream on its own initiative where it identifies weaknesses in the legislative framework. It has, for example, called for the MiFIR product intervention powers to extend to the fund management companies that are currently outside the reach of these powers,[142] and identified inconsistencies in the cross-sector application of the EU retail market rulebook, including in relation to persistent divergences in the treatment of UCITS managers (which sit outside MiFID II).[143]

Technocracy and Supervisory Convergence/Supervision

ESMA's primary mechanism so far for shaping retail market governance has been its quasi-regulatory powers. Its supervisory tools, however, are likely to be more influential over time.

As outlined above in this section three, ESMA has already exercised its MiFIR product intervention powers, in a clear signal of some determination to deploy these powers in the retail markets when the applicable conditions are met. And notwithstanding their novel and exceptional nature, ESMA's first exercise of its product intervention powers augurs well. ESMA's justification for acting underlines the acuteness and cross-border nature of the risk required before it will take product intervention action. For example, ESMA highlighted that very high losses were associated with the products which were restricted, reporting that 74–89 per cent of retail investor accounts were typically losing money on these investments, and that these highly complex investments had become available and were marketed across several jurisdictions – having previously been marketed only to niche client sectors – and were raising concerns across a 'large number of NCAs'.[144] ESMA's intervention also suggests a purposeful commitment to taking action to prevent retail detriment where deemed necessary, notwithstanding the political and market sensitivities associated with these powers.[145] Further, the two ESMA Decisions which impose the restrictions on the relevant investment products were based on extensive data assessment;[146] reflected a concern for

[140] A pathfinder consultation was carried out by the Commission in 2016 (Consultation on a Potential EU Personal Pension Framework (2016)) and a proposal followed in June 2017 (COM(2017)343).
[141] ESMA, Response to the Commission Consultation on a Potential EU Personal Pension Framework (ESMA/2016/1573) (2016).
[142] ESMA, Opinion, Impact of the Exclusion of Fund Management Companies from the Scope of the MiFIR Intervention Powers (ESMA50-1215332076-23) (2017).
[143] ESMA, Response to the Commission Green Paper on Retail Financial Services (ESMA/2016/648) (2016).
[144] March 2018 Agreed Product Intervention Measures, n 95, 2.
[145] ESMA acted in the face of considerable industry resistance. One of the Europe's largest online trading platforms set up a web platform from which customers could protest against the reforms; this generated some 14,600 responses: H Murphy, 'Europe Market Watchdog Hits Retail Trading Platforms with Tough New Rules', *Financial Times*, 27 March 2018.
[146] Clear from the very extensive discussion of the justifications for the measures in the recitals to the two formal Decisions (n 95).

proportionality;[147] and were signalled well in advance to the industry, which was also given time to prepare for the restrictions.[148]

The product intervention power is, nonetheless, a blunt instrument and is unlikely to be frequently deployed given the market, legal, and institutional/political risks. ESMA's fast-evolving supervisory convergence/coordination activities, however, are showing signs of exerting material operational influence on how NCAs engage with the practical, day-to-day business of retail market supervision. Recent indications suggest that ESMA is beginning to oversee national supervisory approaches more closely, particularly by means of its peer review powers.[149] The 2016 ESMA peer review of NCAs' supervisory practices in relation to the MiFID I suitability requirements, one of the first major ESMA peer reviews in the retail investor protection area, is instructive. While ESMA found, overall, that there were examples of good supervisory practices, it also reported on weaknesses and called for stronger supervisory oversight of firm compliance and for a related allocation of national supervisory resources; ESMA also highlighted the need for improvements in relation to enforcement and communications with stakeholders.[150] The tone of the review was assertive: ESMA found 'a lack of a proactive and focused supervisory approach' in some areas;[151] an over-focus on the distribution of complex products and insufficient attention to supervision of advice in relation to less complex products; a need for NCAs to better adapt their supervisory practices according to the complexity of the product in question; that four NCAs had not sufficiently supervised the suitability regime over the review period; and, in general, that a greater emphasis should be placed on enforcement. The review is also notable for the granular quality of the recommendations made by ESMA, including that NCAs review telephone records, review sales scripts, and simulate the client experience when assessing the quality of suitability practices; consider using thematic reviews and mystery shopping supervisory techniques; communicate more frequently with firms, including through 'Dear CEO' letters; and make greater use of non-pecuniary

[147] ESMA did not, eg, include warrants and 'turbo-certificates' in the CfD restrictions despite their similarities to the CfD products which were restricted, although it noted that it would closely monitor such products (March 2018 Agreed Product Intervention Measures, n 95, 4–5), and placed a complete prohibition on binary options only.

[148] The January 2018 Call for Evidence set out in detail a series of potential restrictions on CfD sales (including leverage limits and triggers requiring a firm to close out a retail investor's position to avoid losses exceeding the original investment) and a full prohibition on binary options. These were subsequently agreed by the Board in March 2018 and formally adopted in May 2018 but did not apply until July and August 2018, respectively. ESMA also produced an explanatory Q&A (ESMA35-36-1262)

[149] Set out in ESMA Regulation, Article 30. ESMA recently revised its Peer Review Methodology in a manner which suggests a commitment to robust and intrusive peer review: ESMA, Peer Review Methodology, July 2018 (ESMA42-111-4661).

[150] ESMA, MiFID Suitability Requirements. Peer Review Report (ESMA/2016/584) (2016).

[151] At 18.

sanctions. ESMA's peer review powers are still developing and it remains to be seen how NCAs will respond to this assertive approach, given that supervision remains a closely-guarded national competence and that ESMA's powers in this area are soft in nature, being limited to recommendations and 'name and shame' style techniques.[152] Nonetheless, this peer review marks something of a staging post in the evolution of ESMA's role in retail market governance. This trend has been sustained. ESMA's subsequent 2017 peer review on NCAs' supervision of the MiFID I requirement that disclosure be 'fair, clear and not misleading'[153] adopted a similarly operational and interventionist tone, noting, for example, that the adoption of a 'risk-based' approach to supervision (which was raised by some NCAs to explain supervisory deficiencies) should be able to accommodate action where potential breaches of MiFID I were signalled; warning that supervisory deficiencies in one Member State could leak into other national markets; and finding, despite progress being made, identified NCAs were still displaying deficiencies

Peer review aside, the retail markets became a priority for ESMA's supervisory convergence agenda generally in 2017, with ESMA's 2017 Supervisory Convergence Work Programme highlighting retail investor protection and ESMA's determination to ensure that EU retail investors received the same level of protection across the EU, independently of the location of the firm.[154] Practical action has followed. For example, ESMA pursued a multifaceted supervisory convergence response, following the 2015–17 outbreak of aggressive marketing of complex CfDs to retail investors across the EU from Cypriot-based firms. While this culminated in ESMA's adoption of the product intervention measures previously discussed, it also included the establishment of an ESMA CfD Task Force and a Joint Group of NCAs to facilitate NCA coordination; ESMA's support of the Cypriot NCA in intensifying its supervisory and enforcement activities; and investor warnings and directions to the industry.[155] Bouts of pan-EU mis-selling have repeatedly bedevilled the EU retail market, but the 2015–17 CfD saga marked the first time there was an operationalized and coordinated EU-level response to a live retail market crisis.

[152] The sensitivity of the peer review process is clear from the Spanish regulator, the CNMV, adding a public response to the peer review, disagreeing with some of its findings.

[153] The report is a follow-up to the earlier peer review and concentrates on those Member States that were previously found not to be fully applying certain criteria identified as essential for effectively ensuring the application of MiFID I rules: ESMA, Follow-up Report to the Peer Review on MiFID Conduct of Business Rules Relating to Fair, Clear and not Misleading Information (ESMA42-113-627) (2017).

[154] ESMA, Supervisory Convergence. Work Programme 2017 (ESMA42-397158525-448) (2017), 4.

[155] ESMA, Statement, European Parliament Committee on Petitions, 17 July 2017; and ESMA Executive Director Ross, Speech on 'Regulatory and supervisory developments, the challenges ahead – a European perspective', 20 October 2016. On foot of recommendations from its newly constituted CfD Task Force, ESMA also re-issued and updated its Q&A on CfDs, which is designed to promote common supervisory practices in this area and give guidance to the market (ESMA, Questions and Answers Relating to the Provision of CFDs and other Speculative Products to Retail Investors under MiFID) (ESMA35-36-794) (2017), and also issued two related warnings to investors.

ESMA's intensifying supervisory convergence activities also include its ad hoc interventions in response to retail market developments, such as the recommendations it has issued to the investment fund industry on 'closet indexing' practices (where an asset manager charges a fee for active management but is in practice following an index), following stakeholder concern and an investigation by ESMA, and its ongoing review of such practices.[156] ESMA is also showing an appetite for addressing 'upstream' potentially problematic market behaviours, as evidenced by its repeated warnings on the responsibilities of banks and investment firms when selling complex, higher-risk 'bail-in' securities, at a time when banks were increasing their issuance of these instruments to meet the requirements of the EU's bank recovery and resolution regime.[157] Finally,[158] ESMA is building a significant data-set on EU retail market risks and trends, which has the potential to fill a material gap in the EU's financial market data-set: the retail markets tend to get only sporadic attention in the major annual reports on the EU financial market produced by the Commission (primarily the 'European Financial Stability and Integration Review') and the ECB ('Financial Integration in Europe'). The retail markets were not covered to any material extent initially in ESMA's regular reports on 'Trends, Risks and Vulnerabilities' in the EU market, but this is changing, with recent reports building in coverage of retail market trends,[159] as well as of charges and pricing practices and their impact on investor returns.[160] ESMA has also begun to collect data relevant to the retail markets, notably the complaints data it collects through a regular survey of NCAs, and which it uses to support its retail market activities. Beyond these own-initiative activities, the Commission is increasingly calling on ESMA to provide retail market analysis, for example mandating ESMA, in the context of the CMU agenda, to provide regular reports on the cost and performance of retail investment products.[161]

Cross-sector technocratic influence

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[156] ESMA, Statement, Supervisory Work on Potential Closet Index Tracking (ESMA/2016/165) (2016). ESMA subsequently hosted a workshop for NCAs to promote supervisory convergence in relation to NCA supervision of closet indexing practices (27 June 2018).

[157] ESMA, Statement, MiFID Practices for Firms Selling Financial Instruments subject to the BRRD Resolution Regime (ESMA/2016/902) (2016); and ESMA, Statement, Potential Risks Associated with Investing in Contingent Convertible Instruments (ESMA/2014/944) (2014).

[158] ESMA also engages directly with the retail investor constituency, primarily through investor warnings on live risks which have covered, eg, online investments, CfDs, and recently bitcoin/initial coin offerings (see, eg, Joint ESA Warning on Virtual Currencies, 12 February 2018 and ESMA Alerts Investors to the High Risks of ICOs, 13 November 2017 (ESMA50-157-829)).

[159] See, eg, the first report of 2018, which covered retail investor returns and sentiment, as well as retail investor complaints data: ESMA, Report on Trends, Risks and Vulnerabilities, No 1 (2018).

[160] See, eg, the study of the impact of charges on mutual fund returns in ESMA, Report on Trends, Risks and Vulnerabilities, No 2 (2017).

[161] Commission, Request to the European Supervisory Authorities to Report on the Cost and Past Performance of the Main Categories of Retail Investment, Insurance and Pension Products, 13 October 2017 (Ref.Ares(2017)5008790).

The increasingly technocratic quality of EU retail market governance is predominantly a function of ESMA's activities. But EU retail market regulation, while predominantly based on the MiFID II/PRIIPs/UCITS axis, also engages other consumer finance measures (such as the insurance distribution rules which apply under the Insurance Distribution Directive and capture the distribution of unit-linked (investment-based) insurance products[162]), given the cross-sector nature of retail investment market risks and as investment products can cross the traditional investment, banking, and insurance silos into which EU financial regulation is segmented.[163] Accordingly, retail market issues can leak across from ESMA into the mandates of the other two ESAs, notably in relation to deposit-related investments (EBA) and unit-linked (investment-based) insurance products (EIOPA), as is reflected in the mandates often given by the co-legislators to the three ESAs to cooperate on investment-related initiatives.[164]

EBA and EIOPA are following a similar trajectory to ESMA, increasingly engaging with retail market risks (where relevant), particularly EBA. While ESMA is the dominant influence on retail market administrative rules and soft law, EBA, as outlined previously in this section three, is increasingly adopting a retail-market-oriented perspective in its supervisory and stress testing work on operational and conduct risk in banks, and is also building a significant data capacity on retail market investment.[165] In addition, all three ESAs have adopted a series of joint Guidelines in areas where the cross-sector synergies are strong, notably in relation to complaints management,[166] and where a cross-sector response to investment product design and distribution risks is warranted.[167]

Standardization

Standardization and the Single Rulebook

Finally, standardization is becoming a defining feature of EU retail market governance, as regards regulatory but also supervisory governance.

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[162] Directive 2016/97 [2016] OJ L26/19.
[163] For discussion see V Colaert, 'European Banking, Securities and Insurance Law: Cutting though Sectoral Lines' (2015) 52 *Common Market Law Review* 1579.
[164] Notably the PRIIPs administrative rules, which were developed by the three ESAs.
[165] Including through its regular 'Consumer Trends' reports which cover structured (investment-based) deposits.
[166] ESA Joint Committee, Final Report on Guidelines for Complaints-Handling for the securities (ESMA) and banking (EBA) sectors (JC 2014 43) (2014).
[167] A good example is provided by the ESAs' 2014 Statement on self-placement by banks, investment firms, and insurance companies of their securities with their depositors, retail clients, and policy holders: ESA Joint Committee, Placement of Financial Instruments with Depositors, Retail Investors, and Policy Holders (JC 2014 62) (2014). The ESAs have also collaborated in relation to automation in financial advice generally: ESMA, EBA, EIOPA, Joint Committee Discussion Paper on Automation in Financial Advice (JC 2015 080) (2015).

Retail market regulation has become highly standardized. EU regulation in this area traditionally allowed Member States significant autonomy, reflecting the very limited extent to which retail investors operate cross-border as well as the distinct local market features which shape retail activity (as noted in section four ahead). This changed over the crisis-era. The interventionist, procedural, and technocratic features of the new EU retail market governance regime would have inevitably increased the degree of harmonization, but a deliberate, purposeful commitment to a more standard approach to retail market intervention can also be identified. While the Commission has long favoured more intensive harmonization, across the Member States there was little resistance to the detailed mandates given for administrative rule-making across the MiFID II/MiFIR/PRIIPs legislative measures, although MiFID II contains express safeguards for Member States wishing to 'gold-plate' certain rules (or to apply additional rules).[168] The European Parliament has also been a strong supporter of retail market standardization; its concern that the new PRIIPs administrative rules were not sufficiently standardized in relation to the PRIIPs 'comprehension alert' was among the reasons for its September 2016 veto. At the ESA-level, the commitment to standardization is clear. ESMA's 2017 Product Governance Guidelines, for example, are designed to support a common, uniform, and consistent application of MiFID II and to reduce related regulatory/supervisory arbitrage risks.[169]

By way of example, the administrative rules which amplify the MiFID II distribution regime, the MiFID II/PRIIPs disclosure regime, and the MiFID II/MiFIR product governance regime are immensely detailed, bringing a new level of granularity to EU retail market regulation. The new MiFID II inducements regime, for example, specifies with a significant degree of prescription the types of inducement which are permitted, while the related rules governing which 'minor non-monetary benefits' are permitted to be paid to a firm when providing independent investment advice are also highly prescriptive.[170] Similarly, the MiFID II/MiFIR product intervention regime governing when NCAs and the ESAs can intervene to prohibit the marketing of products is highly prescriptive, setting out in detail the different factors and criteria which must be assessed before an ESA/NCA decision to deploy the intervention power can be made.[171] In addition, much of the new administrative rulebook for the retail markets is contained in administrative Regulations,[172] reducing

[168] In relation to the MiFID II Article 24 conduct rules (MiIFID II, Article 24(12)) and Article 16 client asset safeguarding requirements (Article 16(11))
[169] 2017 ESMA Product Governance Guidelines, n 114, 6.
[170] Commission Delegated Directive 2017/593, Articles 11 and 12.
[171] Commission Delegated Regulation 2017/567, Articles 19-22.
[172] Commission Delegated Regulation 2017/593 (distribution), Commission Delegated Regulation 2017/567 (product intervention), and Commission Delegated Regulation 2017/653 (PRIIPs disclosure).

further Member State discretion; only the product governance rules and those on inducements are contained in administrative Directives.

Standardization and supervision

While standardization is primarily a function of regulatory governance, there are some indications, primarily from ESMA's peer review and other supervisory convergence activities, of a technocratic concern to bring more consistency to NCAs' supervisory practices in the retail markets. This is most marked in the banking sphere, however, where a standardized approach to supervision is mandated under the CRD IV/CRR 'SREP,' including with respect to bank stress tests. The SREP and bank stress tests are directed to securing bank stability. Nonetheless, the way these exercises, which are increasingly being standardized by means of EBA action, address conduct/misconduct risk has material implications for retail market outcomes as specific and costly supervisory remediations can be demanded by NCAs under the SREP and following stress tests. For example, for the EBA-coordinated 2018 pan-EU bank stress test, all bank projections given to NCAs on banks' conduct risks were to be supported by all available evidence, banks were to be asked by NCAs to provide evidence regarding issues widespread in the industry which could be of relevance, and NCAs were, over the stress test, to consider the impact of similar issues in banks' peer groups.[173]

4. Evaluation

Paternalism and Distrust: Monitoring the Safe Space

EU retail market governance is accordingly pivoting to a more paternalistic and distrustful posture, and seeking to shape the investment environment for retail investors. A 'safe space' or 'regulatory sandbox' might be under construction,[174] in which the retail investor can, with a degree of security, learn how to save through the markets in a more risk-controlled (but not risk-free) environment. But any significant change, such as this, to retail market governance brings risks. These range from, if protection is over-weighted, increased industry transaction costs (which may lead to reduced retail participation) to, if encouragement is over-weighted, sub-optimal incentivization through the regulatory system of retail investors (who may take on risks they are not equipped to manage). Tensions between libertarian and paternalistic visions of market operation are acute in the retail market area, reflecting the scale of the costs which regulation can impose on capital formation and the welfare losses which regulatory failure can generate. Nonetheless, experimentation and change,

[173] EBA, 2018 Stress Test – Draft Methodological Note (2017), 99.
[174] Famously, the UK Financial Conduct Authority has developed a 'regulatory sandbox' regime to facilitate qualifying fintech companies in accessing the consumer markets under controlled conditions and with limited liability. The Dutch AFM also operates a sandbox.

in the form of a more distrustful and paternalistic approach to the retail markets at EU level, and the construction of a 'sandbox/safe space' of sorts, should be given the benefit of the doubt.

The policy need for effective intervention is pressing. EU households remain reluctant to save for the long term through market investments, notwithstanding the potential for accumulation, income smoothing, and diversification. While household financial wealth across the EU has increased consistently since 2012, this increase has been driven mainly by deposits and by investments in insurance and pension products. Equity holdings have increased (marginally) since 2012, but holdings in debt securities, investment funds, and financial derivatives/employee share options have remained largely flat.[175] EU household financial assets are predominantly composed of insurance and pension assets (39.7%) and currency and deposits (30%); equity and investment fund assets represent 24.8% and debt securities 2.3%.[176] Similarly, a recent 'eurobarometer' report, based on survey evidence, reported that 76% of respondents had a bank account and 44% a savings account, but only 9% and 6% respectively owned shares/bonds or investment funds.[177] Non-participation accordingly represents a major policy challenge: how to shift EU households' allocation preference from deposits, which represent a stable, liquid, and guarantee-backed form of household financial allocation, to capital-market-based investments, which may bring higher returns and better support long-term welfare needs, but which may also carry greater transaction and information costs and risks? There are a multitude of drivers for households' portfolio allocations and of non-participation, including lack of trust in/access to intermediation structures, levels of discretionary income, poor financial literacy, limited access to portfolio diversification opportunities, and the biases which obstruct optimal allocation - and the extent to which these different drivers shape household choices is contested.[178] Further, not all of these drivers are susceptible to regulation. Nonetheless, it not unreasonable to base EU retail market policy in part on the premise that, given the need for long-term welfare provision, EU retail market governance should facilitate and support retail investor access to the markets, without imposing risks on the retail market which it not able to bear. But intervention requires careful regulatory design, as is clear from the persistence in the EU of mis-selling and of failures to consider retail investor outcomes.[179]

[175] 2017 CMU Mid Term Review Economic Analysis, n 10, 73.
[176] 2018 European Financial Stability and Integration Report, n 11, 58. Similarly, ECB, Household Sector Report Quarter 4 2017, May 2018, reporting on currency and deposits, and life insurance and pension schemes representing the majority share of euro area household financial investments (at 16).
[177] Commission, Special Eurobarometer 446, Financial Products and Services July 2016, 4.
[178] From a survey of the vast literature from a policy perspective see 2017 CMU Mid Term Review Economic Analysis, n 46, 64-67.
[179] See, eg, the 2018 ECON Committee reports on mis-selling at n 68 and ESMA's analysis of the 2015-2017 CfD mis-selling scandal in its two May 2018 product intervention Decisions (n 95).

The regulatory tools available, however, are not easy to deploy (disclosure, for example, as has been well documented, is of limited use in this area[180]), and newer tools, notably behavioural nudges, are in an early stage of development.[181] The regulatory perimeter can be fluid (fintech is currently posing particular challenges for retail investor protection, notably in relation to crowdfunding) and difficult to fix, involving complex trade-offs between risk and autonomy. Further, regulation here must carry significant weight, which it may be unable to bear, as retail investors, labouring under severe informational and behavioural constraints are ill-equipped to act as market monitors or to bring competitive pressure to bear. Regulators can accordingly be wary of creating regulatory incentives for retail participation, particularly in market sectors where they have not previously been active, given the risk of poor outcomes and the difficulties in marking out an appropriate 'retail space.'[182]

And even where solutions can be found, retail investor interests can be trumped by the still dominant financial stability imperative. For example, distinct and competing institutional preferences can be identified at present in relation to EU retail investment in complex bank securities. The Single Supervisory Mechanism, which supervises Banking Union's banks and has incentives to promote bank resolvability and, where necessary, the imposition of losses on retail investor holders of bank securities, appears to regard retail investors as 'responsible financial citizens,' capable of bearing losses. [183] The ESAs, by contrast, have repeatedly raised the risks which bank resolution generates for household investors in bank securities,[184] as has the European Parliament.[185] Similarly, political attention comes and goes but, for the most part, the retail markets only acquire salience, and resources are only provided, in the wake of major episodes of mis-selling

[180] From an extensive literature see G Howells, 'The Potential and Limits of Consumer Empowerment by Information' (2005) 32 *Journal of Law and Society* 349 and H Garten, 'The Consumerization of Financial Regulation' (1999) 77 *Washington University Law Quarterly* 287.
[181] For an example of nudges being used in UK financial regulation see Financial Advice Working Group, Rules of Thumb and Nudges: Improving the Financial Well-being of UK Consumers. A Report Prepared for HM Treasury and the Financial Conduct Authority (2017).
[182] The UK FCA, eg, has incorporated into its recent review of UK fund-raising markets an assessment of whether, and if so how, regulation can be used to create incentives for retail investors to access debt markets more easily, given low levels of debt market participation and the potential which debt securities have as high-quality retail market investments, but has recognized the risks and challenges: FCA, Review of the Effectiveness of Primary Markets: the UK Primary Market Landscape, Discussion Paper 17/2 (2017), 36-38.
[183] SSM Chairperson Nouy, Speech on 'Adjusting to New Realities – Bank Resolution and Supervision in Europe', 6 April 2016, in the context of the reality of consumer losses following bank resolution.
[184] eg ESMA and EBA, Statement of the EBA and ESMA on the Treatment of Retail Holdings of Debt Financial Instruments subject to the Bank Recovery and Resolution Directive, 30 May 2018 (ESMA71-99-991).
[185] European Parliament, Resolution on Banking Union – Annual Report (2016) (P8_TA-PROV(2017)0041), 15 February 2017.

or scandal which stir the usually diffuse and quiescent retail investor body.[186] And this political salience can be short-lived as a well-resourced industry responds to reforms – whether by working around reforms or calling for deregulation.

Given the difficulties, new thinking on how the EU protects and encourages retail investors is to be welcomed. And some experimentation, in the form of the embrace of a more intrusive form of intervention, directed to shaping the retail investment environment, is worth trying. Certainly, the evidence of limited participation and persistent mis-selling suggests that the pre-crisis approach to retail market governance, which was based on retail investor empowerment, is not a sustainable regulatory strategy.[187]

But there are dangers here. Experimentation requires review against outcomes, and it also requires metrics for assessing outcomes. And the EU regime suffers from a critical weakness in this regard. EU retail market governance has developed in a piece-meal manner and has never articulated the outcomes sought. Firm behaviour is regulated to ever higher degrees, but the nature of the retail market outcomes sought is typically not made express, beyond bromides concerning protection and confidence. EU retail market governance clearly now seeks a 'safer' investment environment, but it is not clear what this looks like. The relevant questions range from the macro (including, what level of household participation is optimal? what level of investor detriment is within the risk tolerance of the EU/NCAs and how is this monitored? and how can investors' trust in retail market governance be assessed?); to the structural (including, which forms of distribution structure are to be privileged, and how is this to be assessed? should retail investors be encouraged by product governance, distribution, and disclosure strategies to initially experiment with diversified instruments (classically index-funds) or guaranteed bonds, before graduating to riskier investments, whether shares or complex investments? and how much risk is 'enough'?). To take one example, the new MiFID II/MiFIR product governance rules, which suggest that a less detailed target market assessment can be completed by a product manufacturer for a 'simple' UCITS than for a structured product, might suggest a nudge towards retail investment in simple UCITS products, but such an outcome is implicit, not express.

[186] For an analysis of how the financial crisis led to civil society exerting more influence on financial consumer protection see L Kastner, 'Much ado about nothing?' Transnational Civil Society, Consumer Protection and Financial Regulatory Reform' (2014) 21 *Review of International Political Economy* 1313.

[187] As was examined in an important strand of the literature prior to the financial crisis. See, eg, G Pearson, 'Reconceiving Regulation: Financial Literacy' (2008) 8 *Macquarie Law Journal* 45 and T Williams, 'Empowerment of Whom and for What? Financial Literacy Education and the New Regulation of Consumer Financial Services' (2007) 29 *Law & Policy* 226.

None of these questions are easy to answer. Nonetheless, some form of outcome identification, and related metrics for assessing progress, are necessary if the success of the EU's new approach is to be monitored, the new regime calibrated, and any unintended consequences avoided or managed.[188] Means for assessing financial market intervention are, however, notoriously difficult to construct in a way that delivers meaningful results.[189] There are some examples available, to be sure. The UK Financial Conduct Authority, for example, establishes a series of consumer market 'outcome indicators,' against which it measures its performance and which allow it to direct resources and monitor progress.[190] Further, NCAs are adopting increasingly intrusive supervisory approaches in their retail markets, and evidence on their experience could inform the outcome development process at EU-level.[191] But some attempt to establish what success looks like is necessary given the novelty of the new regime and the high stakes in terms of household welfare.

Proceduralization and Prudentialization: If not 'What' – then 'How To'

If the new EU retail market governance regime is ambiguous about the specific outcomes it seeks, it is intrusive in dictating to firms how they interact with the retail markets. As outlined in section three, EU regulatory governance for the retail markets is increasingly taking the form of an intrusive 'how to' manual, which includes supporting supervisory techniques more familiar from the prudential sphere, even if the 'what' sought by intervention is not indicated in a granular manner. Here again, the new proceduralization and prudentialization of EU retail market governance deserves the benefit of the doubt.

Regulatory governance for financial markets has long recognized that it must grapple with the design of internal firm processes and the incentives they create,[192] and a related proceduralization of regulatory requirements has long been associated with EU financial market regulation, particularly as regards risk reduction. But proceduralization is novel in the retail sphere; high-level conduct principles previously tended to characterize much of EU retail market regulation.

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[188] On the importance of metrics see L Willis, 'Performance-Based Consumer Law' (2015) 82 *University of Chicago Law Review* 1309.

[189] The difficulties of cost benefit analysis, eg, have been identified as including a dependence on causal inferences, problematic data, and contestable assumptions and modelling: J Coates, 'Cost Benefit Analysis of Financial Regulation: Case Studies and Implications' (2015) 124 *Yale Law Journal* 882.

[190] FCA, Annual Report 2017-2018 (2018), 15.

[191] The Dutch AFM, eg, has banned certain investment products from retail marketing given the 'disproportionate level of risk of losses' for the average investor (AFM, Annual Report 2016, Intense Supervision in a Changed Playing Field (2016), 8) while the French AMF has signalled a more intrusive approach to the marketing of highly speculative products, involving the banning of such marketing: AMF, A Major Investor Protection Milestone: the AMF sets specifics for its ban on the advertising of the riskiest products, 10 January 2017.

[192] J Black, 'Regulatory Styles and Supervisory Strategies' in N Moloney, E Ferran, and J Payne (eds), *The Oxford Handbook of Financial Regulation* (OUP, 2015), 217.

The new EU-level proceduralization of retail market regulation, however, holds the promise of reducing the risks to retail investors from internal firm culture and from incentive weaknesses; of embedding greater technical capacity within firms in relation to the identification of retail market risks and desired outcomes; and of more data-informed action by firms. Procedures are only as good as the individuals overseeing and operating them, and of the data on which they depend. But the greater prescription of how firms approach their engagement with the retail markets should reduce firms' incentives to mis-sell and lead to a stronger cultural focus on the achievement of good retail outcomes. Proceduralization also implies closer supervisory/NCA engagement with internal firm processes. This can be expected to lead to stronger enforcement in the longer-term and in the shorter-term implies a much closer relationship between the firm and the supervisor.

The prudentialization trend also has promise. Requiring firms to use the internal risk management tools usually associated with, and familiar from, the banking sphere, such as product stress testing, should reduce the risk of mis-selling, but should also have the effect of concentrating firms' attention on how retail market detriment can arise. The most potential lies with the recent deployment of prudential supervisory strategies to address conduct risk, and the inclusion of conduct/misconduct risk among the risks against which financial institutions are supervised, stress-tested, and required to provide capital. This interlinking of prudential supervision and conduct risk brings the weight of stability-oriented prudential supervision to bear on retail market risks by internalizing within firms, through capital charges, the costs of a poor retail culture, and by generating strong, cost-based incentives for firms to focus on retail market outcomes.

Technocratic Governance: ESMA as a Retail Market Champion

The injection of technocracy also augurs well for a strengthening of EU retail market governance, particularly as regards regulatory governance. ESMA has now built a significant technical capacity in relation to retail market rule-making; in gathering and interrogating empirical evidence on the retail markets; and in 'horizon-scanning' for emerging retail risks, notably in relation to financial innovation. It is well-equipped accordingly to identify weaknesses in, the unintended consequences of, and required remediations to the new EU retail market regulatory regime. Hitherto, although the Commission had begun to make some headway, particularly in relation to behavioural and empirical research,[193] evidence-based regulatory design and finessing has been a weak point in EU retail

[193] For an early example see Decision Technology, Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective (2010) (for the Commission). More recent examples include the extensive empirical research the Commission contracted relating to the PRIIPS KID (London Economics and Ipsos, Consumer Testing Study of the Possible New Format and Content for Retail Disclosures of Packaged Retail and Insurance-based Investment Products (2015) (MARKT2014/060/G)) and the examination it contracted into

market governance. The ECB, the EU powerhouse in relation to data collection and interrogation, has shown little interest in the retail markets, while the European Systemic Risk Board, charged with monitoring the EU market for risks, does not have a retail mandate and focuses only sporadically on retail issues and then with an eye to systemic risk implications.[194] ESMA looks well-equipped, however, to strengthen the EU's empirical and related regulatory design capacity as regards the retail markets.

ESMA is also strengthening the retail market agenda within EU financial market policy generally. It has already proved to be robust in protecting retail interests during the development of administrative rules.[195] ESMA is also proving wary of the empowering and capital-supply agendas which can be associated with the CMU project, highlighting the importance of balancing encouragement with protection; ESMA Chairman Maijoor has warned that the strong preference of European households for deposit-based savings will not be shifted unless households gain or regain confidence in the capital markets, and that an enhancement of investor protection is crucial if households are to feel comfortable with the risk/reward balance offered by capital markets.[196]

There are, however, limits to ESMA's ability to strengthen EU retail market governance. ESMA does not have a mandate across all forms of substitutable investment product, the treatment of which can vary depending on the regulatory 'silo' in which the product sits. Most notably, insurance-related investment products come within the purview of EIOPA, and the related EU insurance distribution rules which apply diverge from, and are lighter than, the MiFID II distribution rules. Even within the securities/financial market 'silo' within which ESMA sits, there are persistent divergences in treatment across the EU retail rulebook, including in relation to cost disclosures under the MiFID II, PRIIPs, and UCITS framework.[197] And while the three ESAs, through their Joint Committee, seek to adopt convergence measures which are consistent across their different sectoral

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distribution structures (Deloitte Luxembourg, Distribution Systems of Retail Investment Products across the European Union (2018)).

[194] See, eg, ESRB, Systemic Risk due to Retailisation (2012). More recently, however, it has started to publish assessments with a distinct retail market focus (eg, ESRB, Study by C Célérier and B Vallée, Catering to Investors through Product Complexity, ESRB Working Paper 14/2016 (2016)).

[195] During the development of ESMA's technical advice to the Commission on the MiFID II product governance administrative rules, eg, the industry called for a less intrusive approach, including by means of excluding 'plain' shares and bonds from the product governance requirements, a call which was rejected by ESMA given the importance of these asset classes for retail investors and the need to ensure such investments were appropriately targeted, particularly as they are not covered by the PRIIPs disclosure rules: ESMA/2014/1569, 53-54.

[196] ESMA Chairman Maijoor, Speech on 'Safeguarding Investors is key to ensuring the Capital Market Union's Success,' 17 November 2016.

[197] The difficulties caused by legislative divergences have been repeatedly raised by ESMA, including in the context of CMU: ESMA, Response to the Commission Green Paper on Retail Financial Services (ESMA/2016/648) (2016).

silos, different legislative rules can combine to make it impossible for a common approach to be taken.[198]

There also dangers from the ever-increasing influence of ESMA, particularly as regards its supervisory coordination/convergence activities. A degree of supervisory convergence and consistency is necessary to promote best practices and to avoid arbitrage risks in the EU retail market. But safety valves against the EU regime acting as an obstructive clamp are also necessary. Retail markets display considerable structural difference across the EU, with retail investor preferences and distribution structures often differing sharply, as noted ahead in this section. The Commission, in its 2017 ESA Consultation, similarly acknowledged that consumer financial protection (generally) was a shared competence between the EU and its Member States,[199] while the NCAs which are coordinated through ESMA are typically concerned to protect their autonomy and flexibility as regards retail market intervention. There are, however, encouraging signs. ESMA's refined Peer Review Methodology, adopted in July 2018, highlights the importance of accommodating different supervisory approaches which respond to local market features,[200] while ESMA also appears sensitive to NCAs' concerns to retain autonomy. [201]

Whatever the merits of ESMA action, questions arise as to the appropriateness of legitimation. ESMA's increasing reach over regulatory governance, its growing influence on supervisory practices, and its direct product intervention powers demand that its legitimation arrangements are secure. Thus far, ESMA is working within a relatively secure legitimation framework that includes the constitutive rules that structure its discretion - under the ESMA Regulation but also under relevant EU legislation, such as the detailed MiFIR rules governing its product intervention powers - as well as its multiple accountability-oriented legitimating mechanisms, including those provided by its NCA-dominated Board of Supervisors, administrative and judicial review, its budgetary oversight arrangements, and institutional accountability to the Council and European Parliament.[202] But if ESMA's powers increase, close attention will be needed to its legitimation arrangements. This all the more the case as, while the European Court of Justice has shown some appetite for allowing national courts significant room to manoeuvre as regards their judicial review of technocratic decisions made by national regulatory authorities under EU

[198] The three ESAs were unable to adopt joint Guidelines on cross-selling practices, despite being charged to do so under MiFID II, because of divergences in the underlying securities, banking, and insurance legislation: ESMA, EBA, and EIOPA, Letter to Commission Hill, Cross Selling of Financial Products, 26 January 2016.
[199] 2017 ESA Consultation, n 16, 8.
[200] 2018 Peer Review Methodology, n 149, 3.
[201] ESMA Chair Maijoor has underlined, eg, that ESMA consciously took a 'cautious approach' to its closet indexing review, relying heavily on NCAs who were closest to domestic markets: ESMA Chair Maijoor, 'Keynote Speech,' 16 November 2017.
[202] See further Moloney, n 5.

regulatory measures,[203] there are some indications that it is less inclined to inquire into ESMA's financial market decision-making,[204] implying that other forms of legitimation must be robust.

Standardizing Retail Market Governance: Risks to Flexibility

Standardization could also prove problematic as there is still little evidence of a real 'EU retail market'. Households in the EU rarely, if ever, invest in cross-border investment products, and distribution channels vary across national markets and are usually contained within national markets.[205] A 2016 Commission 'eurobarometer' on financial products and services, based on survey evidence, similarly found that none of its respondents had purchased shares or an investment cross-border.[206] Retail investment is a local process and reflects domestic idiosyncrasies.

The main impact of EU retail market governance is accordingly on domestic markets, but these markets diverge, often sharply. There is significant variation in the size of household financial asset portfolios across the EU (as a proportion of GDP).[207] Investment patterns vary widely, reflecting the cocktail of factors, including local distribution structures, path-dependent product preferences, taxation and welfare systems, and cultural biases which shape investment across the EU. In relation to equity holdings, for example, the largest proportional holdings by households are in Estonia, Bulgaria, and Lithuania; but when it comes to investment funds, the largest household holdings are in Luxembourg, Belgium, and Spain.[208] There is also significant heterogeneity on the supply side.

[203] In the *Opta* ruling (Case C-28/15 *Koninklijke and others v ACM* (ECLI:EU:C:2016:692)), and in the context of a pricing regulation decision made by the Dutch telecoms regulator, the European Court of Justice allowed national courts significant latitude to review/over-rule technical decisions made by national regulatory authorities under the EU's regulatory regime for the EU telecommunications market (under Framework Directive 2002/21/EC [2002] OJ L108/33, which governs fixed and mobile telephone services), including as regards the proportionality of decision-making - although it also ruled that a national court could not require a national regulatory authority to demonstrate that the decision in question actually attained the objectives of the Framework Directive.

[204] In the *Short Selling* ruling (n 90), where the constitutional validity of ESMA's direct intervention powers as regards short selling were under review, the ECJ did not review a specific exercise by ESMA of these powers (which have yet to be exercised) but, given the importance the Court ascribed to expert, technical agency action in this area, it seems more likely than not that the Court will show some deference towards ESMA's expert judgement. On the approach of the CJEU to administrative discretion generally see J Mendes, 'Bounded Discretion in EU Law: a limited judicial paradigm in a changing EU' (2017) 80 *Modern Law Review* 443 and J Mendes, 'Discretion, Care and Public Interests in the EU Administration: probing the limits of law' (2016) 53 *Common Market Law Review* 419.

[205] From the many relevant studies see 2018 Report on Distribution Systems of Retail Investment Products Across the EU, n 193.

[206] Commission, Special Eurobarometer 446, Financial Products and Services July 2016. 7.

[207] Household financial asset portfolios are largest in the Netherlands, Denmark, the UK and Belgium representing over 300% of GDP: 2016 European Financial Stability and Integration Report, n 40, 48-49.

[208] CMU Mid Term Review Economic Analysis, n 46, 73.

Industry cost structures, competitive conditions, distribution arrangements, and taxation burdens vary across the EU, shaping how firms interact with retail investors.[209]

The increasing standardization of retail market governance across the EU by EU measures could accordingly hinder NCAs' ability to secure good retail market outcomes geared to national market features, to manage local risks, and to use regulatory and supervisory incentives to respond to local drivers of household portfolio allocation. It could also stifle experimentation and innovation, and so limit the potential of national systems to act as laboratories in which potential EU-level solutions can be developed and tested; the MiFID II distribution and product governance reforms, for example, were informed by earlier reforms trialled in the UK and the Netherlands.

Nonetheless, it is difficult to argue against the current levels of regulatory standardization. It is a functional reality, for a start, and there is little political or institutional contestation of the current drive to standardize rules. Further, EU-level retail market regulation brings economies of scale, allows the sharing of regulatory experience, and brings the EU's growing empirical capacity to bear on retail market regulation. The standardization trend is also being tempered by the proportionality mechanisms increasingly being used to calibrate EU rules to particular market situations. For example, the MiFID II mandate for administrative conduct rules required that the nature of different services, products, and clients be taken into account in the development of the regime,[210] and a concern for proportionality can be traced in the related administrative rulebook; the product governance rules, for example, are to apply in a way which takes into account the nature of the instrument, service, and target market concerned.[211] Proportionality is also a feature of EMSA's related soft law, including of ESMA's 2017 Product Governance Guidelines. While there was some market concern that the 'target market' assessment for 'plain vanilla' bonds might require as granular an assessment as more complex products,[212] the Guidelines make clear that the intensity of a firm's target market assessment should be calibrated to the features of the particular product. [213]

Supervisory standardization poses greater risks. Supervisory jurisdiction over the retail markets currently rests at national level with NCAs, albeit that supervision is coordinated through ESMA by means of its different supervisory convergence activities. The need for greater convergence in NCAs' supervisory practices is incontrovertible given the risks to the nascent cross-border retail

[209] Ibid, 79 and 2018 Report on Distribution Systems of Retail Investment Products Across the EU, n 193.
[210] MiFID II, Articles 24(13) and 25(8).
[211] Commission Delegated Directive 2017/593, Article 9(1),
[212] International Capital Market Association (ICMA), Response to ESMA Product Governance Guidelines, 4 January 2017. ICMA sought an exemption from the product governance rules for professional market distributions of bonds, which was rejected by ESMA as being in breach of MIFID II.
[213] ESMA Product Governance Guidelines, n 114, 8, and 35-36 and Case Study 1 and 5.

market from supervisory failures, but also given the risks to domestic retail investors from poor national supervisory practices and, more positively, given the benefits of supervisory learning and experience sharing in an area which is challenging for supervisors.[214] Creeping convergence could, however, come to place excessive pressure on national discretion. Nonetheless, there are few signs, so far, that ESMA is encroaching into national supervisory autonomy to prejudicial effect. Its 2018 product intervention action, for example, appears to have enjoyed strong NCA support, while its peer reviews, although robust, are not designed to impose particular supervisory approaches.[215]

5. The Impact of the Inflection Point

There are, therefore, grounds for optimism, but the implications of the inflection point outlined at the outset of this discussion fall to be considered.

The CMU Agenda

Chief among the forces that may bear on the EU's new retail market governance regime is the CMU agenda. At first sight, the CMU agenda jars with the new EU retail market governance regime and its privileging of protection. CMU can be associated with assertive support for stronger retail investor engagement with market-based savings and it characterizes the retail investor as a capital supplier. But there was little in the Commission's pathfinder 2015 CMU Green Paper that suggested a policy sensitivity to the dangers posed by attempts to 'cheerlead' for market investments; to the serious behavioural challenges faced by retail investors; and to the entrenched structural market features that can lead to poor retail investor outcomes. As far as reforms went, cursory reference was made in the Green Paper to the benefits of financial literacy, to the value of standardized products, and to potential enhancements to the powers of the ESAs.[216] The response from the traditional supporters of retail investors in the EU was, not unexpectedly, cool.[217] The subsequent September 2015 CMU Action Plan maintained the commitment to 'fostering' retail investment.[218] It placed considerable weight on the ability of market mechanisms to encourage retail investment and on the competence

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[214] During the Commission's wide-ranging 2015-2016 'stock-take' of EU financial regulation, consumer finance stakeholders generally raised concerns as to incomplete or uneven enforcement at national level and that national supervisors were not always equipped to engage in effective supervision: Commission, Call for Evidence. EU Regulatory Framework for Financial Services. Staff Working Document (SWD(2016)359) (2016), 65.

[215] See further Moloney, n 5.

[216] 2015 CMU Green Paper, n 39, 19-20.

[217] The European Parliament supported the need to foster the flow of household savings to the market, but warned of the need for adequate safeguards (European Parliament, Resolution on Building a Capital Markets Union, B8-0655/2015, 1 July 2015, para 44), while 'Better Finance for All' (now Better Finance), the EU's major retail investor lobbying group, was hostile: Better Finance For All, Briefing Paper. An EU Capital Market Union for Growth, Jobs and Citizens (2015).

[218] 2015 CMU Action Plan, n 8, 18.

of empowered investors. Similarly, it suggested that restoring the trust of retail investors was primarily the responsibility of the finance industry, although regulation and supervisors could 'help to establish the rules of the game.'[219] The related CMU 'actions' adopted by the Commission were to increase choice and competition for retail investors, to help them get a better deal, and to support saving for retirement. The CMU Action Plan's related reform agenda for the retail markets was, however, more articulated than that presented earlier by the CMU Green Paper. In addition to committing the Commission to the adoption of a specific Green Paper on Retail Financial Services (this was adopted in 2015 and was followed by the March 2017 Consumer Financial Service Action Plan[220]) and to examining the case for a European Personal Pension Product (the PEPP), its main component was empirical. The Commission committed to undertaking three major reviews: a review into the performance of long-term retail and pension products; a review of the new disclosure landscape; and a comprehensive assessment of the market for retail investment products, including distribution channels and investment advice, to identify ways to improve the policy framework so that retail investors could access 'suitable' products on cost-effective and fair terms, and to address fintech.[221] By the Commission's subsequent June 2017 Mid-Term Review of the CMU agenda, enthusiasm for the retail investor as capital supplier seemed to have waned. The Commission made the usual reference to the limited engagement by EU retail investors with capital markets, despite their being among the highest savers in the world, and to the value of market investments in addressing the challenges posed by ageing populations and low interest rates.[222] But although the Commission argued that access to attractive investment propositions on competitive and transparent terms was necessary, the related actions were limited to progress on the PEPP initiative and a gearing up of the different retail market reviews promised. By the March 2018 review of progress on the CMU agenda, while the Commission noted that CMU should provide savers with 'more and innovative investment opportunities', the Commission's main focus was on accelerating progress on the main wholesale market measures, although it did prioritise its FinTech Action Plan[223] which, it argued, would enable innovation but not compromise investor protection.[224]

[219] Ibid, 18.
[220] Commission, Green Paper on Retail Financial Services. Better Products, More Choice and Greater Opportunities for Consumers and Businesses (COM(2015)630) (2015) and Commission, Consumer Financial Services Action Plan: Better Products More Choice (COM(2017)139) (2017). Both are primarily concerned with the consumer finance market, not with retail investment.
[221] 2015 CMU Action Plan, n 8, 18.
[222] N 10, 4.
[223] Commission, FinTech Action Plan: For a more competitive and innovative European financial sector (COM(2018)(109) (2018)).
[224] N 9, 2.

Accordingly, while the CMU policy rhetoric suggests something of a pivot away from the currently distrustful posture of EU retail market governance, in practice there are few real indications of a destabilizing policy shift from current EU retail market governance arrangements. The CMU agenda is certainly leading to a host of reforms, which may ultimately increase choice for retail investors, but these are primarily concerned with the wholesale markets. [225] Most of the retail-oriented reforms are either concerned with consumer finance generally (of which the keystone measure is the 2017 PEPP Proposal[226]); fintech specifically, but with a retail market dimension (the 2018 Crowdfunding Proposal[227]); or retail market data collection (for example, the ESAs have been charged with reporting on the cost and past performance of the main categories of retail investment, insurance, and pension products, while a major study was completed for the Commission in 2018 on retail investment distribution systems[228]). Of these initiatives, the 2018 Crowdfunding Proposal has the most immediate relevance for retail market investment, but it is somewhat peripheral. The proposed new regime for regulating crowdfunding is designed to operate as a voluntary 'opt in' measure for crowdfunding platforms seeking access to an 'EU' label and to EU-level authorisation (by ESMA), is not designed to replace national regimes, is at a very early stage of its legislative passage, and its future beyond the 2019 European Parliament elections may be uncertain. But whatever its fate, the Proposal has a protective quality which has resonances with the current design of EU retail market governance, using mechanisms beyond disclosure to protect investors accessing investments through such 'EU labelled' crowdfunding platforms.[229]

There may, however, be prejudicial effects, albeit at the fringes, from the deregulatory aspects of the CMU agenda, which sit uneasily with the current concern of EU retail market governance to shape the retail investment environment. The 2017 Prospectus Regulation, a key component of CMU's funding-related reforms, has deregulated, at least to some extent, the disclosure which small and medium-sized enterprises (SMEs) are required to file, and so may increase risks to the retail market, albeit that EU retail investors do not invest directly in equities to a significant extent. To take another example, the Commission's CMU-related FinTech Action Plan, which is in part directed to fostering consumer access to financial services,[230] while clearly sensitive

[225] CMU's cornerstone Prospectus Regulation and Securitization Regulation (and ancillary reforms) were adopted by the co-legislators in 2017, but a host of other proposals and initiatives are in train (n 15).
[226] COM(2017)343.
[227] COM(2018)113.
[228] 2018 Report on Distribution Systems of Retail Investment Products Across the EU, n 193.
[229] Including organisational requirements, competence standards, conflicts of interest rules, client asset protection requirements, outsourcing rules, disclosure requirements (including that a Key Investment Information Sheet (KIIS) be provided for investors), marketing requirements, due diligence requirements relating to hosted firms seeking capital, and access to data obligations.
[230] N 223, 2, noting that fintech can provide better access to finance and improve financial inclusion.

to retail market risks,[231] may lead to the construction of an overly facilitative specialist regime for fintech financial services providers.[232] The Commission has also raised the prospect of an EU-level 'sandbox' for fintech firms,[233] notwithstanding the unease in some supervisory quarters relating to sandboxes. But there is also evidence that the ESAs, now embedded within EU retail market governance, are bringing a countering empirical capacity, as well as challenge and friction, to the CMU agenda. ESMA has, for example, been cautious in relation to the fintech agenda, developing a data-set on developments;[234] warning of the risks of crowdfunding, collecting data on national approaches, and calling for an EU-level approach;[235] adopting warnings on certain fintech practices;[236] and, more generally, identifying the retail markets risks from fintech and calling for a measured approach.[237]

But while it is not proving to be destabilizing, the CMU agenda offers little in terms of addressing one of the most material design risks in the current retail market governance regime – the failure to establish metrics against which its success can be measured. Nonetheless, there are some welcome data-related elements. The development of the CMU agenda has strengthened the Commission's data-set on the EU retail market.[238] Further, the two major CMU-driven reviews currently underway (into retail market distribution systems; and into the performance of long-term investment products) should generate a badly-needed and overdue data-set on structural weaknesses in the EU retail market. Both may also lead to a more empirically-informed and outcome-based approach to the retail markets. The CMU agenda is in addition reinforcing the role of the ESAs, both formally, by linking the adoption of the 2017 ESA Reform Proposal to the CMU

[231] The Action Plan highlights the need for a high level of consumer protection as regards fintech (ibid, 3).
[232] The Action Plan calls on the ESAs to map current national authorization approaches for innovative fintech business models (and whether the opportunities for proportionate and flexible approaches provided for in EU financial legislation are being used), to adopt soft law as appropriate, and to advise the Commission where adaptations to EU financial law are needed: ibid, 7.
[233] The Action Plan acknowledges the unease in some quarters regarding regulatory sandboxes (which were pioneered by the UK FCA and allow certain fintech firms to provide services under a limited authorization), but commits the Commission to exploring their use further, including through best practice recommendations: ibid, 9.
[234] Primarily through the work of the ESA Joint Committee which has reviewed developments relating to Big Data and automated advice: eg ESMA, EBA, EIOPA, Joint Committee Discussion Paper on the use of Big Data by Financial Institutions (JC 2016 86) (2016) and Report on Automation in Financial Advice (2016).
[235] ESMA, Opinion, Investment-based Crowdfunding (ESMA/2014/1378) (2014). ESMA also regularly engages in information-gathering on how NCAs are responding to crowdfunding.
[236] Including on bitcoin (jointly with EBA and EIOPA, 12 February 2018) and initial coin offerings (13 February 2017).
[237] ESMA, Response to the Commission Consultation Paper on Fintech(ESMA50-158-457) (2017) and ESMA Chair Maijoor, Speech on 'A Measured Approach to Fintech,' 27 February 2018.
[238] The series of 'staff working documents' which accompany the major CMU policy documents contain a wealth of data on the retail markets.

agenda,[239] and informally, by creating opportunities for the ESAs to strengthen their position as regards retail market governance. In their responses to the 2017 CMU Green Paper on Retail Financial Services, for example, EBA and ESMA took the opportunity to identify weaknesses in their retail mandates, notably in relation to inconsistencies in the legislation which supports EU retail market governance.[240] ESMA has also used the CMU agenda to strengthen its position as a major advocate for retail investor interests in the EU, warning that while the CMU agenda should be used to increase retail participation, an enhanced level of protection was necessary.[241] Overall, however, CMU is unlikely to have major consequences for the current design of EU retail market governance.

The 2017 ESA Reform Proposal

Since their establishment in 2011, the ESAs, while not dedicated retail market authorities, have come to provide something of an institutional buttress for securing the promotion of retail investor interests in the EU. This is particularly the case with ESMA which, through its quasi-rule-making, supervisory convergence, data collection, and direct product intervention powers, is proving to be an increasingly assertive supporter of retail investor interests. Over time, a gradual intensification of its retail market activities could have been expected, particularly given ESMA's institutional incentives for prioritizing retail matters; the European Parliament, a key institutional stakeholder for ESMA, has long been supportive of greater EU-level support for retail investors. The 2017 ESA Reform Proposal, however, has intervened and may lead to a change in ESMA's posture.

The Proposal, if adopted (and this is far from certain), does not contain much in the way of specific retail market powers for ESMA, reflecting the local nature of retail market risks and supervision, and NCAs' concern to retain supervisory autonomy in this area. Earlier, the 2017 ESA Consultation had exposed the different interests which institutional reform in relation to retail market governance generates. While there was retail investor/consumer stakeholder support for a stronger ESMA retail investor protection mandate, and concern as to a perceived lack of ESMA action in this area, public authorities/NCAs and the industry did not support any extension of the ESAs'/ESMA's powers in this area, although there was some support for the ESAs/ESMA taking a more proactive role in financial literacy and in relation to financial innovation. The Commission, while supportive of strengthening the ESAs' role in financial consumer protection, was cautious,

[239] 2018 Commission CMU Review, n 9, 5.
[240] EBA, Response to the Commission Green Paper on Retail Financial Services, 21 March 2016.
[241] ESMA Chairman Maijoor, Speech on 'How can we improve outcomes for investors in investment funds?' 16 November. Similarly, ESMA Executive Director Verena Ross has suggested that while investment opportunities and capital market investment will have to become a key element of a retail investor's portfolio, providing comfort that the rules of the game are clear and fair will be one of the main challenges of CMU: Speech on 'Regulatory and Supervisory Developments, the challenges ahead – a European perspective, 20 October 2016.

careful to note that consumer protection was a shared competence between the EU and its Member States.[242]

The 2017 ESA Proposal reflects this wary approach. If adopted it would add 'consumer protection' to the list of tasks set out for ESMA in Article 8 of its founding Regulation; while a largely semantic reform (ESMA is already charged with the task of fostering investor protection under Article 8 and has consumer protection as a general objective under Article 1(5)),[243] it would underline the importance of the retail investor interest. The Proposal also suggests a strengthening of ESMA's Article 9 investor-protection-oriented list of specific tasks.[244] If adopted, this reform would require ESMA, under Article 9, to engage in thematic reviews of market conduct, and to build a common understanding of market practices and to develop retail risk indicators for the timely identification of potential causes of consumer and investor harm. The Proposal further suggests a useful governance reform which reflects the reality that not all NCAs have express consumer protection mandates, making retail-oriented action more difficult: authorities responsible for consumer protection would be represented on ESMA's Financial Innovation Standing Committee, and the Board of Supervisors' composition rules would be required to allow an NCA, where it did not have responsibility for the enforcement of consumer protection rules, to invite a (non-voting) representative of the relevant national consumer protection authority. Retail/consumer stakeholders have been hostile to the limited set of reforms, suggesting, in a joint submission, that the Commission had missed an 'historic opportunity' to propose an ambitious reform, warning that the ESAs were insufficiently focused on consumer protection and highlighting the persistence of mis-selling, underlining the risks arising from the sectoral/silo-based nature of the three ESAs, and calling for the establishment of a dedicated, specialist EU Financial Consumer Protection Agency.[245]

The retail-oriented proposed reforms to ESMA are certainly limited and are unlikely of themselves to lead to a change in ESMA's current posture as regards the retail markets. The Proposal's other reforms, however, may, if adopted, prove to be a distraction that diverts ESMA from retail market concerns. If adopted, the Proposal would confer on ESMA a series of new direct supervisory powers which are almost entirely concerned with the professional markets;[246] while these powers are limited, they may lead to ESMA's institutional culture and attention being diverted

[242] 2017 ESA Consultation, n 16, 8.
[243] 2017 ESA Proposal, n 17, ESMA Regulation, art 8(1)(f).
[244] On Article 9 see n 64.
[245] BEUC, Better Finance, Finance Watch, Age Platform Europe, European Financial Inclusion Network and COFACE Families Europe, Open Letter on the Proposal for the EU Financial Supervisory Reform, 27 November 2017.
[246] Including over certain investment funds, benchmarks, data services providers and prospectuses. Currently ESMA has supervisory jurisdiction only over rating agencies and trade repositories.

away from the retail markets (ESMA may also, under related reforms, be conferred with direct supervisory powers over Central Clearing Counterparties (CCPs), market infrastructures of immense systemic significance, that could have a similar effect). ESMA's ability to proceed against NCAs and to undertake peer reviews would also be strengthened if the Proposal was adopted (by means of the removal of certain decision-making powers from the ESMA Board of Supervisors to a new bureaucratic Executive Board). This could inject a degree of distrust and antagonism into the pivotal NCA/ESMA relationship and make it more difficult for ESMA to drive good retail market supervisory practices.

The most likely outcome, given the degree of contestation the Proposal is provoking and Member States' sensitivity to any EU-level centralisation of supervisory power over financial markets,[247] is that ESMA will emerge as somewhat but not radically strengthened, and will continue to have incentives to focus on the retail markets. This modest outcome has attractions given that retail investment remains a local activity and there are dangers to standardization of rules and, in particular, of supervisory practices.

Brexit

Finally, the implications of Brexit fall to be considered, and here a prediction of limited change can be made relatively confidently even though the nature of the UK/EU financial services relationship after the UK withdrawal remains unclear. [248]

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[247] Council working group review started in October 2017. An initial late 2017 ECOFIN discussion on the Proposal noted 'a variety of views' on the level of ambition of the reforms and that initial work would focus on 'targeted adjustments' to address shortcomings: ECOFIN Council Conclusions, 7 November 2017 (Council Document 13932/17). A 'bumpy decision-making process' was predicted at an early stage of the negotiations (F Demarigny and K Lannoo, Navigating the Minefield of the ESA Review, ECMI Commentary No 49, February 2018), while ESMA Chair Maijoor noted Member States' wariness: Speech on 'CMU, Brexit and ESA Review – where to next? 20 March 2018.

[248] At the time of writing, the final shape of any EU/UK agreement as regards financial services access was not clear. Prime Minister May's March 2018 'Mansion House' speech called for a bespoke access arrangement based on a 'collaborative, objective framework that is reciprocal, mutually agreed, and permanent and therefore reliable for business', and on the EU and UK's maintaining the same 'regulatory outcomes' over time: Speech on 'Our future economic partnership with the European Union,' 2 March 2018. The UK industry had earlier been pressing for such a bespoke approach, setting out how it might work in practice (eg UK Finance, Supporting Europe's Economies and Citizens: A modern approach to financial services in an EU-UK Trade Agreement (2017) and International Regulatory Strategy Group, A New Basis for Access to EU/UK Financial Services Post Brexit (2017)). Similarly, a leading parliamentary report earlier called on the UK Government to either secure substantial changes to the EU's current third country/equivalence regime, or (the preferred option) ensure access through a bespoke free trade agreement incorporating mutual recognition mechanisms (House of Lords, EU Committee, 11th Report of Session 2017–2019, Brexit: The Future of Financial Regulation and Supervision (2018)). Subsequently, in its July 2018 White Paper on the future EU/UK relationship, the UK government indicated that 'new economic and regulatory arrangements for financial services' that would provide regulatory flexibility but preserve the mutual benefits of integrated markets and protect financial stability, outside the EU's passporting arrangements, would be sought: HM Government, The

In terms of market effects, while any serious rupture in the pipeline of financial services from the UK to the EU-27 could have destabilizing effects,[249] these are likely to be limited to the wholesale markets, as retail markets are organised on national lines and are not cross-border in nature. This is not to say that households may not be affected; a major dislocation in the EU financial market following from an abrupt rupture between the UK and the EU would not leave retail investors unscathed, but the direct consequences are likely to be limited. Certain consumer finance products, notably insurance contracts, may be at risk as UK providers will need to be re-authorised in an EU Member State in order to continue to meet their contractual obligations to service contracts,[250] but contract continuity risks of this type are less acute in the retail investment market.

Brexit is also unlikely to bring disruptive change to how EU retail market governance is designed. The UK has had a major influence on the design of retail market regulation as one of EU's path-finding innovators in this area,[251] but the retail market rulebook is now extensive, while major retail market regulators, such as the Dutch AFM, are likely to continue to shape how the rulebook is designed.

Future Relationship Between the United Kingdom and the European Union, Cm 9593, July 2018, 28-32. The White Paper argued that the EU's current third country arrangements were not sufficient to deal with the degree of interconnection between the UK and EU-27 financial markets and called for an access regime based on the regulatory autonomy of both parties and on an 'expanded' equivalence regime.

The EU position has, from the outset, been that its current third country access rules, which are based on the UK's rule remaining equivalent to the EU regime, will apply. The March 2018 European Council negotiating guidelines did not expressly reference financial services but underlined that any future trade agreement in services must be consistent with the UK's being a third country and operate on the basis of host state (EU) rules, and that any future framework must safeguard financial stability in the EU and respect its regulatory and supervisory arrangements: European Council (Art 50) Guidelines of 23 March 2018. The European Parliament similarly declared that the EU's third country regime must govern financial services access: European Parliament, Resolution of 14 March 2018 on the Framework of the future EU–UK Relationship (P8_TA-PROV(2018)0069). Commissioner Vice-President Dombrovskis has also emphasised that bespoke access arrangements for financial services will not be acceptable and that EU's third country regime will apply: Speech, 24 April 2018. This position was reflected in a number of interventions by the EU's chief negotiator Michel Barnier over 2017 and 2018, including Speech, 26 April 2018, querying why the third country regime, which he asserted worked well for the US, would not work for the City of London, and emphasising that the third country/equivalence regime would apply. Reaction to the July 2018 White Paper was, at the time of writing, reported to be cool.

[249] As has been extensively considered in the burgeoning policy and scholarly literature on Brexit and financial services. See, eg, Alexander et al, n 7 and Armour, n 21. Thus far, the European Central Bank is proving sanguine (ECB, Financial Stability Review, May 2018, 22-23), although the Bank of England is more pessimistic (Bank of England, Financial Stability Report, June 2018).

[250] The problem of 'contract continuity' has been well-flagged since the June 2016 referendum and highlighted by the three ESAs: eg, ESA Joint Committee, Risks and Vulnerabilities in the EU Financial Sector, April 2018 (JC 2018 07), 11-12. EIOPA has adopted an opinion advising on contract continuity as regards insurance contracts, in relation to which the risks are most acute: EIOPA, Opinion on Service Continuity in Insurance in Light of the Withdrawal of the United Kingdom from the European Union, 21 December 2017 (EIOPA-BoS-17/389),

[251] The UK was a pioneer as regards the commission prohibitions and product governance powers which were ultimately adopted in MiFID II/MiFID.

6. Conclusion

The inflection point that can be identified in EU financial market governance at present is not likely to have a major influence on EU retail market governance, which has, since the financial crisis period, become more interventionist, procedural, prudential, and technocratic. While this change to the design of EU retail market governance is not without risks, it marks a new approach which augurs well for the retail market. This new approach is primarily directed to reshaping the processes through which firms engage with the retail market and to minimizing the risks to retail investors. This predominantly protective and distrustful approach should bring also encouragement, and related participation, benefits if it succeeds in creating a 'safer space' for retail investors.

There are, of course, gaps. EU retail market governance is not a complete system, being based primarily based on ex-ante regulatory and supervisory measures. Ex-post enforcement, both public and private, remains a national competence and thus dependent on national procedural and institutional contexts, while the relationship between private parties' enforcement rights (including contractual rights) and public enforcement of the EU's rulebook, is still being worked out. [252]

Further, a more radical approach to ex-ante retail market governance could be imagined, based on providing regulatory and supervisory incentives for new, low-cost distribution systems and for 'safe', 'simple' investment products. MiFID II has made significant progress in relation to the management of conflicts of interests in the distribution process, but it is not designed to support access to simple, low-cost advice services; such services may instead become a casualty of the costs associated with the MiFID II reforms. The lack of low-cost advice channels for supporting retail investors with the most basic of investment needs has, however, been repeatedly identified as an obstruction to EU retail market participation.[253] The CMU commitment to reviewing the nature of the EU distribution market is welcome. But it is not easy to dictate by regulatory/supervisory fiat the availability of low-cost advice channels.[254] Ultimately, the development of such channels will depend on whether a business case can be found by the industry; fintech and its support of automated advice delivery may hold the most promise in this regard. The role of EU retail market governance, and in particular of the ESAs, should be supportive here, directed to: ensuring that the

[252] See O Cherednychenko, 'Cooperative or Competitive? Private Regulators and Public Supervisors in the Post-Crisis European Financial Services Landscape' (2016) 35 *Policy and Society* 103.

[253] See, eg European Parliament, Resolution of 22 November 2016 on the Green Paper on Retail Financial Services (P8_TA-PROV(2016)0434) (2016), paras 24 and 25 and Commission, Report, CMU Workshop on Fostering Retail Investment in Capital Markets, Brussels 7 February 2017.

[254] The UK has struggled with a series of reforms and innovations and has recently sought to support industry-led developments in its Financial Advice Markets Review: HM Treasury and FCA, Financial Advice Market Review. Final Report (2016) and HM Treasury and FCA, Financial Advice Market Review. Baseline Report (2017).

relevant EU rules, including the new MiFID II product governance rules on distribution, are applied and supervised in a manner that encourages new industry thinking; and collating and communicating national experiences with the support of low-cost advice channels. Similar observations can be made in relation to the potential development of 'simple' investment products. The siren calls for 'simple' products have been getting louder in the EU. The European Parliament has called for 'simple, safe, and standardised products' and supported a 'broader offer of standardised retail investment products',[255] while the CMU policy trail includes references to 'suitable' products. The Commission's June 2017 proposal for the 'PEPP' pension product may herald further product-design-related reforms. But regulatory engineering here is fraught with danger. Metrics are difficult to establish – for example, 'simple' is not a proxy for good investor outcomes; the complexity of a product may well be linked to stronger diversification and risk management. Products which are designed to be low cost can struggle to gain industry traction, particularly if distribution and related mis-selling risks are high. Regulatory labels for 'simple' products can lead to moral hazard risks. The new MiFID II product governance rules, however, hold great promise as a means for focusing firms' attention on the product design and targeting process; their appropriate supervision and enforcement is likely to prove more fruitful in terms of products being more closely related to investor needs than new adventures in regulatory design.

The conclusion of this analysis of EU retail market governance after a period of intense reform is accordingly positive. The recent reform period has seen the emergence of regulatory, supervisory, and institutional arrangements that have the potential to drive stronger retail investor outcomes and that should not be weakened by the current inflection point. The absence of outcomes and metrics against which the success of the new regime can be assessed remains a difficulty, but the current developmental trajectory suggest that the EU's retail market regime is likely to become more data informed and sophisticated over time.

[255] 2016 European Parliament Green Paper on Retail Financial Services Resolution, n 253, paras 13 and 24.