The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

21 July 2025

Re: *Response to ESMA Call for Evidence on the retail investor journey*

Dear Sir/Madam:

The Investment Company Institute (ICI)[1] appreciates the opportunity to share our views on the European Securities and Markets Authority's (ESMA's) *Call for Evidence on the retail investor journey*.[2] ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Our members have significant experience and expertise in serving well over 125 million retail fund investors in jurisdictions around the world, including in the European Union (EU).[3] These investors rely on regulated funds, such as UCITS domiciled in the EU, to achieve important financial goals, including saving for retirement and education. The asset management industry supports the financial health and wellbeing of individual EU investors. The industry also contributes to broader economic growth by investing client assets in capital markets, providing a critical source of long-term funding for companies and projects.

Below please find our feedback on certain questions raised by ESMA.

Additionally, you may find our responses to recent European Commission calls for evidence and consultations on the Savings and Investments Union (SIU) helpful, as they relate to many of the questions raised by ESMA:

- call for evidence on the Single Market Strategy;[4]

[1] The Investment Company Institute (ICI) is the leading association representing the global asset management industry in service of individual investors. ICI members are located in Europe, North America and Asia and manage fund assets of $48.8 trillion, including UCITS, mutual funds, exchange-traded funds (ETFs), closed-end funds, unit investment trusts (UITs) and similar funds in these different jurisdictions. ICI has offices in Brussels, London, and Washington, DC.

[2] The Call for Evidence on the Retail Investment Journey is available at https://www.esma.europa.eu/document/call-evidence-retail-investor-journey-understanding-retail-participation-capital-markets.

[3] In the United States alone, our members serve over 125 million retail fund investors. See Holden, Schrass, and Bogdan, "Ownership of Mutual Funds and Shareholder Sentiment, 2024," *ICI Research Perspective* 30, no. 8 (October 2024); available at https://www.ici.org/system/files/2024-10/per30-08.pdf.

[4] The response is available at https://www.ici.org/system/files/2025-02/25-cl-response-european-commission-single-market-strategy.pdf.

- call for evidence on the Communication on European Savings and Investments Union;[5]
- targeted consultation on integration of EU capital markets;[6] and
- call for evidence on recommendations on savings and investments accounts.[7]

Question 1: What are the key reasons why many retail savers choose not to invest in capital markets and instead keep their savings in bank deposits?

A key reason many retail savers in the EU choose not to invest in capital markets and instead keep their savings in bank deposits is because they are not adequately empowered to engage in the capital markets with confidence. As a result, many individuals miss the opportunity for higher returns available through long-term investing in the capital markets.[8] Vibrant capital markets efficiently channel investment into businesses and, with long-term rates of return historically higher than bank accounts, are a compelling driver of household wealth creation. By reallocating some of their savings into capital markets investments, European citizens can enhance their savings over time. This shift would also meaningfully advance the goals of the SIU by deepening the role of capital markets in Europe's financial ecosystem.

The key elements that are critical to successfully empowering EU citizens and greater participation in the capital markets are (1) fostering an investment culture, and (2) establishing a streamlined and accessible vehicle that connects retail investors with a broad range of investment products to meet individuals' unique financial goals. EU citizens that have both the knowledge and the tools will feel empowered to engage in the capital markets and will be much more likely to take action to invest in their financial futures.

<u>Fostering an investment culture with enhanced financial literacy</u>

Policymakers can play an important role in supporting retail investor participation in the capital markets by joining together in articulating that the SIU's primary objective is to

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[5] The response is available at https://www.ici.org/system/files/2025-03/25-cl-response-european-savings-investments-union.pdf.

[6] The response is available at https://www.ici.org/system/files/2025-06/25-cl-siu-targeted-consultation.pdf.

[7] The response is available at https://www.ici.org/system/files/2025-07/25-cl-savings-investment-accounts-recommendations.pdf.

[8] For example, the Noyer Report observes that a financial portfolio reflecting the average French saver's holdings significantly underperformed the main European and global indices over the ten-year period between 2013 and 2023. See "Developing European Capital Markets to Finance the Future: Proposals for a Savings and Investments Union," Christian Noyer, Honorary Governor, Banque de France (April 2024), Figure 23, p. 30, ("Noyer Report"); available at https://www.ebf.eu/wp-content/uploads/2024/05/EN-Report-Developing-European-capital-markets.pdf.

empower retail investors, foster financial literacy, and create a resilient investment culture that recognises the role of risk in generating meaningful long-term outcomes. This is foundational to building public trust and for the broader European capital markets ecosystem.

Building this trust depends on avoiding any doubt that the financial empowerment of European households is a first-order priority. While the greater depth and liquidity that enhanced retail participation will bring to EU capital markets will inevitably benefit companies seeking to scale, in turn driving strategic priorities across defence, climate, and digital transition, it must be made clear that citizens' wealth is not sought for this purpose. Investors must know that their account has been designed to help them as individuals, not subsidise the cost of capital for domestic companies or state spending needs.

Building public trust also demands a meaningful investment in financial literacy. By educating citizens about the opportunities and risks of capital markets, the EU can foster a generation of confident, informed investors. This knowledge supports an investment mindset that complements traditional savings and pensions, positioning capital markets as a core component of personal financial wellbeing. As this culture of investing takes root, the benefits will extend beyond households by stimulating economic growth through higher consumption, reducing reliance on social safety nets, and contributing to fiscal stability. Moreover, a broader base of private investors will also strengthen EU capital markets, boost competitiveness, and expand access to long-term financing for European businesses.

Establishing a streamlined and accessible vehicle

To complement the empowerment that comes with knowledge, the EU should provide retail investors with easy, frictionless access to the capital markets. ICI strongly supports the European Commission's current efforts to provide recommendations to Member States on the creation of a successful savings and investment account blueprint.[9] We believe this blueprint is a constructive first step toward the creation of a broadly accessible investment account structure that provides meaningful long-term growth opportunities to all European citizens regardless of their national domicile. Coordinated effort by Member States is essential to achieving these long-term objectives, and removing regulatory barriers becomes particularly important to ensure the usability and ability to scale up savings and investment accounts over time.

[9] See ICI's response to the European Commission's call for evidence on recommendations on savings and investment accounts (4 July 2025); available at https://www.ici.org/system/files/2025-07/25-cl-savings-investment-accounts-recommendations.pdf. See also, ICI Roadmap Towards a Successful Savings and Investment Union (March 2025); available at https://www.ici.org/system/files/2025-03/25-ppr-roadmap-towards-successful-siu.pdf.

Based on global examples, we can draw out the critical features the European Commission should consider incorporating into its recommendations for the account blueprint to ensure Member States can promote retail investors' access to capital markets:

- ***Choice and Flexibility:*** Facilitate a broad range of investment options within the account, ensuring freedom of choice to meet individual financial goals without geographic or policy-driven restrictions.
- ***Digital Access:*** Ensure a seamless digital experience for the account set-up and management, supported by provider choice, simplified advice and comparison tools, cross-border portability, and investor education and guidance.
- ***Simple Tax Structure and Clear Incentives:*** Agree on a simple, efficient, and accessible tax structure for the account that minimizes administrative burdens for account holders.
- ***Workplace Integration:*** Consider the introduction of automatic enrolment through employers, leveraging payroll deductions to build a culture of investing and habits that support financial wellbeing and the uptake of the account.
- ***Long-Term Focus:*** Promote long-term investing with programs and incentives for the account that discourage short-term withdrawals.

Question 2a: To what extent do retail investors find investment products too complex or difficult to understand?

Retail investors in the EU vary in their financial goals, preferences, and levels of experience. To reflect this diversity, the range of investment products available to them must be equally broad offering accessible, easy-to-understand options for the general public, as well as more specialised products designed for investors with specific investment objectives or higher levels of financial sophistication.

Because of the varying levels of retail investor sophistication, it is not possible to make a general assumption—as a whole—about how complex or difficult products in the EU single market are to understand for EU retail investors. There may be some investors that refrain from investing because they find investment products too complex or difficult to understand. These investors may benefit from greater assistance in the investment process. However, there are others who may find the currently offered products straightforward and easy to understand, and may seek to further diversify their choices (e.g., via strategies that offer them greater access to private markets).

To empower all EU investors, particularly those that may be intimidated by the investment process, policymakers should address the current complexities surrounding financial advice in the European regulatory environment. Today, retail investors are often faced with a stark

reality: pay for comprehensive, often costly, financial advice or choose execution-only services with no guidance at all. This gap disproportionally affects less experienced investors and discourages broader participation in the capital markets. Introducing a simplified advice regime for investments would help retail investors make better informed decisions, bridging the divide between accessibility and appropriate advice.

Simplified advice would streamline retail investors' access to financial advisory services that target specific financial needs or goals (e.g., children's university education or first-time home buying). When paired with digital tools, simplified advice could effectively remove many of the barriers that currently hinder retail investor participation in the capital markets. For example, an online platform offering savings and investment accounts could present retail investors with a curated selection of diversified investment options based on their risk profile and financial goals at various stages of their lives. This model, inspired by digital advisory tools in other markets, would provide accessible, affordable guidance that encourages broader participation and inclusive access to investments and financial wellness.

The success of a simplified advice framework will require active participation from the asset management industry. Financial market participants can help retail investors navigate their choices through interactive tools, educational content, and transparent disclosures. By adopting these proven elements from global models, the Commission's blueprint on savings and investment accounts can become a trusted, accessible, and widely used model for savings vehicles that empower citizens to achieve their financial goals while strengthening Europe's capital markets over time.

Question 3: Do past experiences with low or negative returns significantly affect retail investors' willingness to invest again?

Of the answer choices offered, our response most closely aligns with: "No, past experiences with poor returns are not a major factor in investor decisions."

Since 2008 (i.e., the Great Recession), ICI has conducted extensive research on the behaviour of US households that is closely aligned with the focus of this question. Our findings, which we elaborate on below and explain further in Appendix A, show that periods of low or negative returns do not significantly affect US retail investors' willingness to invest again, either in the short run, or in the longer run. It is important to note that many of these insights are drawn from the context of the US defined contribution (DC) retirement system, where investment is largely tied to long-term retirement goals. This may differ from the experience of EU retail investors, particularly those who are investing outside of a DC framework, without the benefit of automatic, long-horizon saving structures. Nonetheless, the US experience may offer useful reference points for understanding investment sentiment more broadly.

In the United States, participation in an employer-based DC pension is an important means by which households invest in financial markets. Participants in these retirement plans are investing towards a long-term goal (i.e., retirement) with each paycheck. Therefore, any erosion in an investor's willingness to invest could have a meaningful impact for such individual's pension resources and retirement outcome.

Findings from multiple ICI surveys regarding individuals' management of DC plan accounts during market downturns demonstrate that investors respond to shocks in a measured and disciplined way.[10] Specifically, we have observed that investors generally do not exit the markets en masse after significant negative market events, and they avoid changing long-term strategies or allocations irrationally, even during periods of volatility. These studies also find that investors overwhelmingly do not want the government to take away retirees' ability to make decisions about retirement assets and income.

Further support for these findings comes from the Financial Industry Regulatory Authority (FINRA) Investor Education Foundation.[11] Examining new investor motivations during 2020, the year COVID-19 hit the United States, FINRA's key takeaway was: "In a year when pandemic gripped the world, beginning and experienced retail investors flocked to the stock market."[12] The study found that among new investors entering financial markets in 2020:[13]

- About one-in-six new investors said they primarily started investing because they could do so with small amounts.

- About one-in-five essentially indicated they wanted to take advantage of the low stock prices, about equally split between those agreeing that they primarily started investing

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[10] See series of ICI reports, "US Household Views on Retirement Saving;" available at https://www.ici.org/research/retirement/us-views, and "Defined Contribution Plan Participants' Activities;" available at https://www.ici.org/research/retirement/dc-plan-activities.

[11] The FINRA Investor Education Foundation was established in 2003 by the Financial Industry Regulatory Authority (FINRA) to provide educational programs and research that help consumers achieve their financial goals and that protect them in a complex and dynamic world (see https://www.finrafoundation.org/about-us).

[12] See Lush, Fontes, Zhu, Valdes, and Mottola, "Investing 2020: New Accounts and the People Who Opened Them," *Consumer Insights: Money & Investing* (February 2021), Chicago, IL: NORC at the University of Chicago, and Washington, DC: FINRA Investor Education Foundation; available at https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

[13] See Figure 8 in Lush, Fontes, Zhu, Valdes, and Mottola, "Investing 2020: New Accounts and the People Who Opened Them," *Consumer Insights: Money & Investing* (February 2021), Chicago, IL: NORC at the University of Chicago, and Washington, DC: FINRA Investor Education Foundation; available at https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

because of "dips in the market [which make investing cheaper]" versus those who "didn't want to miss out.

These findings suggest that many retail investors, remain engaged, forward-looking, and motivated to invest, even in the face of volatility. These insights may be informative as ESMA considers the relationship between past returns and investor willingness to re-enter or stay in the market.

For additional research findings, please see Appendix A, which addresses investor behaviours, and individuals' willingness to invest following meaningful market corrections.

Question 5a: Have you identified a lack of trust in investment service providers as a factor influencing retail investors' reluctance to invest?

Of the answer choices offered, our response most closely aligns with: "A contributing factor, but not the main issue."

While trust in financial service providers is important, research suggests that a lack of trust is not the primary reason retail investors choose not to invest. Instead, trust plays a more significant role in how investors prefer to interact with the market once they choose to participate

For example, Fisch and Seligman (2022) studied trust, financial literacy, degree of financial market participation, types of accounts held, preferences related to advice, and attitudes towards financial markets and advisors.[14] With respect to financial market participation, they found that participation increased along with trust in all types of people.[15] However results also showed no distinct impact for the degree of trust specifically in financial advisors.[16] Notably, increased trust in advisors was correlated with an increase in preferences for delegating financial decisions to advisors. Further, when considering whether a human- or robo-type of

[14] See Fisch and Seligman, "Trust, financial literacy, and financial market participation," *Journal of Pension Economics & Finance* 21, no. 4 (October 2022): 634–664; available at https://doi.org/10.1017/S1474747221000226.

[15] This result for the average type of person was consistent with results using the general trust in people question found in either the General Social Survey or World Values Survey (e.g., see https://gssdataexplorer.norc.org/variables/441/vshow).

[16] See Table 3 in Fisch and Seligman, "Trust, financial literacy, and financial market participation," *Journal of Pension Economics & Finance* 21, no. 4 (October 2022): 634–664; available at https://doi.org/10.1017/S1474747221000226.

delegation was preferred, preferences for a human advisor increased along with trust in financial advisors.

Question 6: Do retail investors feel they have adequate access to investment advice and relevant information when they encounter difficulties in understanding investment products? If not, what forms of support would be most helpful?

Both (1) the range of investment products and (2) the range of financial sophistication among retail investors are quite broad. As a result, it is difficult to gauge—on whole—how complex or difficult to understand EU retail investors feel investment products are, and how this impacts their investment behaviour. However, it is clear that investors refrain from investing when they find investment products too complex or difficult to understand. These investors need help in navigating the investment process in order to overcome this hurdle.

Currently, retail investors face a choice between comprehensive, often costly, financial advice and execution-only services with no guidance. This gap discourages participation, particularly among less experienced investors. Introducing a simplified advice regime—both for the investment account and more broadly across Europe—would help retail investors make informed decisions without the cost or complexity of full-service advice.

Simplified advice would streamline retail investors' accessibility to financial advisory services that target specific financial needs or goals (e.g., children's university education or first-time home buying). When paired with digital tools, simplified advice can effectively remove many of the barriers that currently hinder retail investor participation in the capital markets. Digital innovations can help with the distribution and calibration of advice to peoples' needs at relatively low cost. For example, an online platform offering the savings and investment accounts could present retail investors with a curated selection of diversified investment options based on their risk tolerance and financial goals. This model, inspired by digital advisory tools in other markets, would provide accessible, affordable guidance that encourages broader participation and inclusive access to investments and financial wellness.

The success of a simplified advice framework will also require active participation from the asset management industry. Financial market participants can help retail investors navigate their choices through interactive tools, educational content, and transparent disclosures. By adopting these proven elements from global models, the Commission's blueprint for savings and investment accounts can become a trusted, accessible, and widely used model for savings vehicles that empowers citizens to achieve their financial goals while strengthening Europe's capital markets over time.

Question 8a: To what extent does a lack of financial education or investment knowledge contribute to retail investors' reluctance to invest in capital markets?

Of the answer choices offered, our response most closely aligns with: "A contributing factor, but not the main issue."

Financial literacy is an important factor in retail investors' comfort in participating in capital markets, and a lack of understanding among potential investors can hamper their engagement. Experience in certain other jurisdictions, such as the United States, has shown that an effective way to foster comfort in investment decisions is through incentivized incremental exposure to investment in capital markets.

Deciding whether to invest one's money also requires deciding how to do so, which can be daunting for those unfamiliar with the capital markets and impact their decision to invest. For example, O'Donoghue and Rabin (1999) examine decision making in a model where a person must do an activity exactly one time – as with an initial decision to invest in capital markets – and find "naive people procrastinate."[17] In a later paper, these same authors find that (i) providing a person additional options can induce procrastination, and (ii) a person may procrastinate more when pursuing more important goals.[18]

The related dynamic of loss aversion—a bias whereby, following a decision, the psychological pain of losing something is greater than the pleasure of gaining something of equal value (i.e., people tend to be more motivated to avoid losses than to acquire equivalent gains) is also well established and can also impact a person's decision to invest. However, while loss aversion can cause people to fail to make decisions otherwise in their best interests, tools or incentives can be used to improve their decision making. For example, while Tversky and Kahneman (1991) find: (i) "losses and disadvantages have greater impact on preferences than gains and advantages,"[19] they note as well that (ii) changes in a decision maker's reference point can change their decision. For example, loss aversion may impede a person's decision to enrol in an investment program due to the risk of losing money upon joining the program. Conversely, if the person is defaulted into the program, loss aversion motivates the person not to exit the program ('opt out') due to the risk of losing money by exiting. In either case, the person's

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[17] See O'Donoghue and Rabin, "Doing It Now or Later," *American Economic Review* 89, no. 1 (March 1999): 103–124; available at https://doi.org/10.1257/aer.89.1.103.

[18] See O'Donoghue and Rabin, "Choice and Procrastination," *The Quarterly Journal of Economics* 116, no. 1 (February 2001): 121–160; available at https://doi.org/10.1162/003355301556365.

[19] See Tversky and Kahneman, "Loss Aversion in Riskless Choice: A Reference-Dependent Model," *The Quarterly Journal of Economics* 106, no. 4 (November 1991): 1,039–1,061; available at https://doi.org/10.2307/2937956.

decision is weighed in terms of possible bad outcomes, but in the first situation the person is less likely to participate in the program.[20]

In related work, Thaler and Sunstein (2009) document several cases in which a shift in the reference point—the default framing of the decision—changes behaviour.[21] These findings support our recommendation for the EU to establish a streamlined and accessible savings and investment vehicle (see our response to Question 1).

The financial literacy literature also contains several noteworthy empirical findings. For example, Bernheim and Garrett (2003) find that financial education in a narrow context (employer-based retirement programs) leads to greater saving outside of that context as well.[22] In addition, Seligman and Bose (2012) find that financial literacy programs are associated with a higher probability of: (1) capital market participation, (2) ownership of risky assets outside of the plan, and (3) higher net wealth in retirement.[23] Finally, Fisch and Seligman (2022) find evidence that receptivity to broader financial market participation increases with financial literacy, further supporting the benefits of financial education.[24]

In our view, loss aversion and naiveite are real barriers that impact retail investment in the European Union, but ones that can be overcome with thoughtfully implemented, targeted measures. A streamlined framework for introducing people to capital market investing designed to consciously account for decision framing biases, coupled with educational resources and options to change the degree and manner of participation over time, are key to engagement—especially for those with lesser trust and financial literacy.

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[20] In the United States, this framing effect has led to the increased adoption of auto-enrolment across employer-based retirement programs, and related legislation (2006 Pension Protection Act) supporting increased participation in plans through "automatic contribution arrangements." See: https://www.congress.gov/109/plaws/publ280/PLAW-109publ280.pdf, at section 902.

[21] See Thaler and Sunstein, *Nudge*, New York, NY: Penguin Books (2009), ISBN:014311526X.

[22] See Bernheim and Garrett, "The effects of financial education in the workplace: evidence from a survey of households," *Journal of Public Economics* 87, no. 7−8 (August 2003): 1,487−1,519; available at https://doi.org/10.1016/S0047-2727(01)00184-0.

[23] See Seligman and Bose, "Learning by doing: Active employer sponsored retirement savings plan participation and household wealth accumulation," *The Quarterly Review of Economics and Finance* 52, no. 2 (May 2012): 162−172; available at https://doi.org/10.1016/j.qref.2012.02.002.

[24] See Figure 5 (lower panel) and related text in Fisch and Seligman, "Trust, financial literacy, and financial market participation," *Journal of Pension Economics & Finance* 21, no. 4 (October 2022): 634–664; available at https://doi.org/10.1017/S1474747221000226.

Question 13: What measures—whether market-driven or policy-driven—could help improve retail investor participation in capital markets?

In our view, retail investor participation in the capital markets could be improved significantly through the successful empowerment of EU citizens. The key elements that are critical to such empowerment are (1) fostering an investment culture, and (2) the establishment of a streamlined and accessible vehicle that connects retail investors with a broad range of investment products to meet individuals' unique financial goals. As we noted earlier, establishing a flexible and easy to use vehicle can help develop an investment culture.

Fostering an investment culture with enhancing financial literacy

Enhanced financial literacy and a more resilient, risk-tolerant investment culture are needed in order to empower the EU citizenry. Policymakers can play an important role in achieving this by clearly and uniformly supporting retail investor participation in the capital markets and by joining together in articulating that the SIU's primary objective is to empower retail investors, foster financial literacy, and create a resilient investment culture that recognises the role of risk in generating meaningful long-term outcomes. This is foundational to building public trust among those who currently do not participate in the broader European capital markets ecosystem.

The financial empowerment of European households should be a first-order priority. While enhanced retail participation will improve EU companies' and governments' access to capital, this is generally a secondary concern (at best) for investors. For example, Lusardi, Michaud, and Mitchell (2017) find that investments in financial literacy are a function of expected benefits.[25] It follows that investors must expect their account will help them as individuals and not just lower the cost of capital for domestic companies or help bolster state spending.

Building a culture of investing requires investment in financial literacy. Providing financial education is not enough, however; people need to be motivated to engage this education. For example, Davis, Richardson, and Seligman (2023) find that overconfidence causes people who would benefit a great deal from financial education to believe it unneeded.[26] It is this population, however, for whom education would be of great potential benefit. Notably and

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[25] See Lusardi, Michaud, and Mitchell, "Optimal Financial Knowledge and Wealth Inequality," *Journal of Political Economy* 125, no. 2 (April 2017): 431–477; available at https://doi.org/10.1086/690950.

[26] These authors define overconfidence by comparing self-assessed financial acumen with an actual score from a graded financial literacy instrument. See Davis, Richardson, and Seligman, "Assessing the relative need and demand for financial education programs," *Financial Services Review* 31 (2/3) (Summer−Fall 2023): 133–150; available at https://doi.org/10.61190/fsr.v31i2/3.

related to this finding, various studies of the introduction of basic, foundational, financial education in US high schools have found such financial education to be beneficial.[27]

Given this literature, we believe that a two-stage design to financial education is likely beneficial for building a culture of investing in the EU. In the first stage an early introduction to personal finance during school years would be best designed to address early lifecycle goals. Later as saving and investing become more important, educational offerings would be more narrowly targeted to address investors' objectives.

A culture of investing offers benefits that extend beyond individuals' objectives. Greater participation in capital markets organizes more capital to the purpose of improved economic growth, increased wealth, consumption, reduce reliance on social safety nets, and contributes to fiscal stability by way of an expanded tax base.

Establishing a streamlined and accessible vehicle

To complement the empowerment that comes with knowledge, the EU should provide retail investors with easy, frictionless access to the capital markets. ICI strongly supports the European Commission's current efforts to provide recommendations to Member States on the creation of a successful savings and investment account blueprint. We believe this blueprint is a constructive first step toward creation of a broadly accessible investment account structure that provides meaningful long-term growth. Coordinated effort by Member States is essential to achieving these long-term objectives, and removing regulatory barriers becomes particularly important to ensure the usability and ability to scale up savings and investment accounts over time.

Based on global examples, we can draw out the critical features the European Commission should consider incorporating into its recommendations for the account blueprint to ensure Member States can promote retail investors' access to capital markets:

- ***Choice and Flexibility:*** Facilitate a broad range of investment options within the account, ensuring freedom of choice to meet individual financial goals without geographic or policy-driven restrictions.

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[27] See Stoddard and Urban, "The Effects of State-Mandated Financial Education on College Financing Behaviors," *Journal of Money, Credit and Banking* 52, no. 4 (June 2020): 747–776; available at https://doi.org/10.1111/jmcb.12624. See also, Urban, Schmeiser, Collins, and Brown, "The effects of high school personal financial education policies on financial behavior," *Economics of Education Review* 78 (October 2020); available at https://doi.org/10.1016/j.econedurev.2018.03.006. And, see Collins, "The impacts of mandatory financial education: evidence from a randomized field study," *Journal of Economic Behavior & Organization* 95 (November 2013): 146–158; available at https://doi.org/10.1016/j.jebo.2012.08.011.

- ***Digital Access:*** Ensure a seamless digital experience for account set-up and management, supported by provider choice, simplified advice and comparison tools, cross-border portability, and investor education and guidance.
- ***Simple Tax Structure and Clear Incentives:*** Agree on a simple, efficient, and accessible tax structure for the account that minimizes administrative burdens for account holders.
- ***Workplace Integration:*** Consider the introduction of automatic enrolment through employers, leveraging payroll deductions to build a culture of investing and habits that support financial wellbeing and the uptake of the account.
- ***Long-Term Focus:*** Promote long-term investing with programs and incentives for the account that discourage short-term withdrawals.

Question 14a: Do you believe that young investors are more attracted to speculative and volatile markets (e.g., cryptocurrencies) rather than traditional investments (e.g. investment funds)? If yes, what are the main reasons for this?

Of the answer choices offered, our response most closely aligns with just one option: "The expectation of higher returns."

While we recognize that the behaviour of investors in the EU may differ, we have seen evidence in the United States suggesting that younger investors are more attracted to speculative investments (such as cryptocurrency). Across all studies we reviewed, younger investors are disproportionately represented in retail crypto investments. Further, investors exhibit higher responsiveness to crypto price movements, highlighting the asset's likely appeal as both a speculative vehicle and possibly an inflation hedge.

More specifically, recent literature and data sources find that:

- Crypto investors are disproportionately younger and male,[28] with higher perceived return expectations and greater risk tolerance than non-crypto investors,[29] and that,

[28] For example, see Weber, Candia, Coibion, and Gorodnichenko, "Do You Even Crypto, Bro? Cryptocurrencies in Household Finance," NBER Working Paper No. 31284 (May 2023), Cambridge, MA: National Bureau of Economic Research; available at https://doi.org/10.3386/w31284. See also, Faverio, Dawson, and Sidoti, "Majority of Americans Aren't Confident in the Safety and Reliability of Cryptocurrency," *Pew Research Center Short Reads* (October 2024); available at: https://www.pewresearch.org/short-reads/2024/10/24/majority-of-americans-arent-confident-in-the-safety-and-reliability-of-cryptocurrency/, which finds that crypto ownership is concentrated among US adults under 50, with disproportionately higher participation by men and among Black, Hispanic, and Asian populations.

[29] See Weber, Candia, Coibion, and Gorodnichenko, "Do You Even Crypto, Bro? Cryptocurrencies in Household Finance," NBER Working Paper No. 31284 (May 2023), Cambridge, MA: National Bureau of Economic Research; available at https://doi.org/10.3386/w31284.

"among individuals holding crypto, those who expect higher inflation also expect higher crypto returns, consistent with cryptocurrencies serving as an inflation hedge."

- Studies using large scale transactions data from bank accounts and credit cards,[30] document crypto market participation across all income levels, finding that crypto ownership has surged along with speculative retail interest during bull-market runs and wealth shocks such as those resulting from COVID-19 stimulus checks.[31]

- With respect to trading behaviours and beliefs,[32] the same retail investors who exhibit "contrarian" trading behaviour in stocks and gold (i.e. they are more incline to buy when prices dip, and sell after prices increase), instead exhibit "momentum" trading behaviours with their crypto-currency holdings (i.e. purchasing after observing a price increase, and holding assets through dips), suggesting that a separate set of distinct beliefs for crypto-assets might influence retail investor demand for crypto.[33]

- Additional evidence included in a 2022 FINRA report finds that, in terms of investor motivation, 31 percent of new crypto investors in 2022 primarily chose to invest in crypto because of a "friend suggestion." The FINRA report adds that this is consistent with "a social element to cryptocurrency investing not evident in equities or bond investing."[34]

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[30] See Aiello, Baker, Balyuk, Di Maggio, Johnson, and Kotter, "Who Invests in Crypto? Wealth, Financial Constraints, and Risk Attitudes," SSRN Working Paper 4281330 (November 2023); available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4281330; Aiello, Baker, Balyuk, Di Maggio, Johnson, and Kotter, "The Effects of Cryptocurrency Wealth on Household Consumption," SSRN Working Paper 4455756 (April 2025); available at https://doi.org/10.2139/ssrn.4455756; and JPMorgan Chase Institute, "The Dynamics and Demographics of U.S. Household Crypto-Asset Use," (2022); available at https://www.jpmorganchase.com/institute/all-topics/financial-health-wealth-creation/dynamics-demographics-us-household-crypto-asset-cryptocurrency-use.

[31] See Divakaruni and Zimmerman, "Uncovering Retail Trading in Bitcoin: The Impact of COVID-19 Stimulus Checks," SSRN Working Paper 3888393 (July 2021); available at https://doi.org/10.2139/ssrn.3888393.

[32] See Kogan, Makarov, Niessner, and Schoar, "Are Cryptos Different? Evidence from Retail Trading," SSRN Working Paper 4289513 (January 2024); available at https://doi.org/10.2139/ssrn.4289513.

[33] Kogan et al. (2024) speculate that "retail investors have a model of cryptocurrency prices in which positive returns increase the likelihood of future widespread adoption, which in turn leads them to update their price expectations in the direction of the price change," noting as well that, "These dynamics are absent in traditional assets, where wider adoption has already happened." See Kogan, Makarov, Niessner, and Schoar, "Are Cryptos Different? Evidence from Retail Trading," SSRN Working Paper 4289513 (January 2024); available at https://doi.org/10.2139/ssrn.4289513.

[34] See Figure 3 and page 4 in Fontes, Meagher, Mulford, Bloomfield, Ganem, Valdes, and Mottola, "New Investors 2022: Entering the Market in Novel and Traditional Ways," *Consumer Insights: Money & Investing* (April 2023), Chicago, IL: NORC at the University of Chicago, and Washington, DC: FINRA Investor

Question 15a: MiFID II disclosure requirements aim to provide transparency and support informed investment decisions. In practice, do you believe these disclosures are helping retail investors engage with capital markets, or are there aspects—such as volume, complexity of content, lack of comparability, or format—that may reduce their effectiveness?

Certain aspects of the existing MiFID II disclosure requirements can hinder, rather than support, retail investor engagement in the capital markets. In particular, some requirements may confuse investors, impair decision making, or reduce comparability between products. As EU policymakers consider revisions to MiFID, especially in the context of the Retail Investment Strategy and the Savings and Investments Union, we encourage the adoption of meaningful changes that result in providing investors with decision-useful information. A few key areas for improvement are outlined below.

Costs and Charges Disclosure

Cost transparency is essential to informed investment decisions. An investor must understand the charges she or he will incur with respect to a particular product. We believe the following three principles should guide the disclosure of costs to retail investors: (1) costs should be presented in a manner that is clear and easy to understand, (2) costs should not misrepresent expenses, and (3) costs should be comparable among funds or other investment products.

To help implement these principles within the context of MiFID II disclosures, we recommend replacing the current patchwork of cost categories spread across MiFID II, UCITS, PRIIPs, and IDD with a unified, consistent categorization used across all investor disclosures. The lack of alignment in terminology and cost classifications across these regimes creates confusion for investors and makes it difficult to compare products or fully understand the charges they may incur.

Under our proposed framework, costs would be allocated to one of six clearly defined categories, with a clear split between distribution and management costs:

- One-off charges – costs for the initial provision of the investment service(s) or product(s) and its/their termination, split into entry costs and exit costs.
- Ongoing management charges – costs paid during the life of the investment service(s) or product(s) that are related to management activities (e.g., portfolio management).

Education Foundation; available at https://www.finrafoundation.org/sites/finrafoundation/files/New-Investors-2022-Entering-The-Market-In-Novel-and-Traditional-Ways.pdf.

- Ongoing distribution charges – costs paid during the life of the investment service(s) or product(s) to intermediaries and third parties, such as commissions and other distribution related fees, including fees paid to intra-group entities for the distribution of in-house products or closely linked third-party products.
- Transaction costs – costs related to transactions performed in the course of the provision of an investment service or incurred as a result of the acquisition or disposal of investments.
- Ancillary service costs – costs related to ancillary services not included in the above categories.
- Incidental costs, including performance fees.

Further, with respect to transaction costs, we strongly urge policymakers to reconsider the calculation and disclosure of transaction costs, and specifically to remove the requirement to include *implicit transaction costs* in the transaction cost calculation. The requirement to disclose implicit transaction costs, which has been in place in the EU for several years, has proven to be complex, difficult to implement, and prone to misleading results. Use of the required slippage methodology for calculating implicit costs has led to negative or overly inflated transaction costs, and such calculations are unreliable when estimating future costs. This is because they are largely dependent on trading styles and strategies and, for some instruments (e.g. derivatives), the availability and reliability of intra-day trading. In sum, it provides investors with information that has little or no value and is potentially incomprehensible and/or misleading.

Information Overload

European investors are provided with, or have made available to them, a myriad of different documents when subscribing to an investment fund. These documents either stem from EU level disclosure requirements (e.g., MiFID II, UCITS, PRIIPs and IDD) or Member State level disclosure requirements (e.g., country supplements for prospectuses, supplementary investor disclosures etc.).[35] There is a risk that retail investors may be overloaded with information, which could result in investor confusion or turning investors away from consuming valuable information about their investment services and products. We recommend that further steps be taken to develop a harmonised pan-EU disclosure regime for UCITS to eliminate Member State

[35] See ESMA's Report on Marketing requirements and marketing communications under the Regulation on cross-border distribution of funds for an example of Member State level requirements; available at https://www.esma.europa.eu/sites/default/files/library/esma_34-45-1219_-_report_on_national_rules_governing_marketing.pdf.

level supplementary investor disclosures. Building on the approach adopted for the PRIIPS KID and for marketing communications in the cross-border distribution of funds package, a pan-EU disclosure regime would (1) provide more consistent information to investors regardless of their location in the EU, and (2) promote harmonized cross-border selling of UCITS, including through digital channels.

Question 16a: Do retail investors find the PRIIPs KID helpful in understanding investment products? If not, are there alternative ways to protect retail investors that could be considered, while not increasing the volume of required disclosures.

We have found that the PRIIPs KID disclosure framework contains elements that are overly complex, misleading, and/or confusing, and thus, ultimately unhelpful to investors. We recommend the following three revisions to the content of PRIIPs KID to provide information that we believe is vital for investors to make informed decisions:

1. ***Permit the inclusion of past performance information*** – either in the body of the document or through layering in digital disclosure.[36] The future performance scenarios that are currently required are frequently not only difficult to calculate, but potentially misleading. While past performance is no guarantee of future results, being able to compare performance of similar investments over past periods provides investors with information that is useful in their evaluation and selection of an investment product.

2. ***Remove the requirement to calculate and disclose implicit transaction costs and require firms to narratively disclose transactions costs, rather than calculating a number***. Implicit costs are not only difficult to calculate, but also misleading, and therefore should not be included in any transaction cost calculation. If the recommendation to eliminate the inclusion of implicit transaction costs is not adopted, at a minimum, policymakers should introduce flexibility in the calculation of transactions costs to: (i) ensure investors are provided with decision-useful and comparable information; and (ii) address practical challenges and suitability issues arising from the application of the slippage cost methodology,[37] to assets that do not trade continuously or have a clearly identifiable spreads (e.g., due to illiquidity or OTC trading). Introducing flexibility in the way that anti-dilution effects are taken into

[36] For instance, breaking down each (or some) section(s) of a document into layers – the first layer containing general/key information while the second layer contains descriptive/additional information and links to external sources.

[37] "Slippage cost" is calculated using the difference between the arrival and execution price of a trade to capture the market impact and delay cost components of implicit transaction.

account can avoid potentially misleading negative calculated transaction costs from being disclosed to investors.

While they do not present the same calculation challenges as implicit transaction costs, explicit transaction costs are also difficult to calculate accurately and reliably. A narrative disclosure of transactions costs, rather than calculating a number to be included in cost disclosure, would provide investors with much more meaningful disclosure that puts these costs into context. For example, if a particular fund has a more active trading strategy, the disclosure can note the higher frequency turnover costs, explaining that investors should view this in the context of net returns, rather than merely impacting any one set of costs.

3. ***Eliminate the use of "summary" risk score measures from investor disclosures.*** Summary risk disclosures suffer from inconsistencies across time and asset classes, along with failure to represent the higher expected returns that ought to compensate higher risk investments in a competitive market. We describe our rationale and associated research in Appendix B.

Together, ineffective risk ratings and the suppression of historic returns have a detrimental impact on ESMA's objectives and investors looking for value in financial markets.

We additionally recommend the following with respect to the manner of PRIIPs disclosure:

<u>E-delivery</u>

Current PRIIPs rules require investor consent, and other conditions to be satisfied, before a PRIIPs KID can be provided to an investor using a durable medium other than paper (e.g., e-delivery). Digital disclosures have the potential to foster greater investor engagement and understanding, including through interactive features such as layering, tailoring, and personalization. We therefore recommend making e-delivery the default for disclosures without explicit consent and subject to limited condition, as was done with the MiFID Quick Fix and the PEPP KID. Other digital features of the PEPP KID, such as the use of QR codes linking to electronic versions of disclosures should also be applied to the PRIIPs KID.

<u>Delivery form</u>

Current rules require PRIIPs KIDs to be produced on document-based templates. Disclosures in document form, even when produced electronically (e.g., PDF) are not conducive to all digital devices (e.g., mobile phones). Information may be challenging or inconvenient to access or read, which may deter investors from "consuming" important information. We recommend that the EIOPA's proposed approach for the PEPP KID– which enables the presentation of information to be adapted for online disclosures and permits the layering of information – be applied to the PRIIPs KID.

EIOPA's layering approach includes breaking down a document into layers – the first layer containing general/key information and the second layer containing descriptive/additional information and links to external sources. We therefore recommend the following specific reforms to the PRIIPs KID:

- Enabling the presentation and order of content of disclosures to be adapted to the durable medium used, including website, mobile application, audio or video.
- Permitting the layering of information when disclosures are provided in an electronic format.
- Increasing the parameters regarding the maximum overall length of disclosures when printed to five sides of A4-sized paper, to enable layered information presented on digital disclosures to be included in a single printed document.

Question 18: Do retail investors find the costs and charges disclosures helpful in understanding the costs of investing? If not, are there alternative ways to protect retail investors that could be considered while not increasing the volume of required disclosures?

Costs and Charges Disclosure

At the forefront of the decision-useful information that is necessary for an investor to make an informed decision, is information about the costs and charges an investor will incur with respect to a particular product. We believe the following three principles should guide the disclosure of costs to retail investors: (1) costs should be presented in a manner that is clear and easy to understand, (2) costs should not misrepresent expenses, and (3) costs should be comparable among funds or other investment products.

One way to protect retail investors without increasing the volume of required disclosures would be by replacing the patchwork of cost categories in existing disclosures with a unified categorization that is used across all investor disclosures and clearly splits out distribution and management costs.[38]

Differences in the categorization of costs and the terminology used in MiFID II, UCITS, PRIIPs and IDD disclosures create challenges for investors who wish to understand and effectively use cost information to make investment decisions. We recommend replacing the patchwork of cost categories in product level disclosures (e.g., PRIIPS KID) and distributor level disclosures

[38] For a more detailed explanation of our proposal, see ICI Response to ESMA Call for Evidence on the European Commission Mandate on Certain Aspects relating to Retail Investor Protection (24 December 2021), at Question 2; available at https://www.ici.org/system/files/2022-01/34000a.pdf.

(e.g., MiFID ex-ante disclosures) with a unified categorization that is used across all investor disclosures. Under our proposed framework, costs would be allocated to one of the following six categories:

- One-off charges – costs for the initial provision of the investment service(s) or product(s) and its/their termination, split into entry costs and exit costs.
- Ongoing management charges – costs paid during the life of the investment service(s) or product(s) that are related to management activities (e.g., portfolio management).
- Ongoing distribution charges – costs paid during the life of the investment service(s) or product(s) to intermediaries and third parties, such as commissions and other distribution related fees, including fees paid to intra-group entities for the distribution of in-house products or closely linked third-party products.
- Transaction costs – costs related to transactions performed in the course of the provision of an investment service or incurred as a result of the acquisition or disposal of investments.
- Ancillary service costs – costs related to ancillary services not included in the above categories.
- Incidental costs, including performance fees.

Further, with respect to transaction costs, we strongly urge policymakers to reconsider the calculation and disclosure of transaction costs, and specifically to remove the requirement to include *implicit transaction costs* in the transaction cost calculation. The requirement to disclose implicit transaction costs, which has been in place in the EU for several years, has proven to be complex, difficult to implement, and prone to misleading results. Use of the required slippage methodology for calculating implicit costs has led to negative or overly inflated transaction costs, and such calculations are unreliable when estimating future costs. This is because they are largely dependent on trading styles and strategies and, for some instruments (e.g. derivatives), the availability and reliability of intra-day trading data. In sum, it provides investors with information that has little or no value and is potentially incomprehensible and/or misleading.

Question 21a: Do retail investors find the information on every 10% depreciation of leveraged instruments, or the portfolio value in case of portfolio management, helpful in keeping track of their investments?

Of the answer choices offered, our response most closely aligns with: “No, this information may arrive at a moment of temporary market stress, triggering impulse-driven investment decisions at the wrong time.”

Generally, there is concern that focusing on short-term fluctuations is distracting and may be damaging when investing towards long-term financial goals. This is particularly true if investors regard such notices as prompts, or calls to action, as in the language offered in ESMA's answer choice above, "triggering impulse-driven investment decisions." We further note that the answer choice suggesting that a benchmark be provided, would not remediate this concern.

Question 34: For firms and trade associations: Have firms observed cases where clients struggle to express their sustainability preferences in a meaningful way? How have these issues been addressed to help retail investors?

In practice, the three criteria constituting the "sustainability preferences" under MiFID do not align with retail investors' actual sustainability preferences. For the current criteria to be effective, retail investors would need to have a sophisticated understanding of the regulatory parameters of PAIs, "sustainable investments" as defined by the SFDR, and Taxonomy alignment.

The narrow approach in defining sustainability preferences in MiFID currently constrains the universe of ESG- and sustainability-related investment products available to investors, running counter to the EU's objective of facilitating a broader range of retail products that appeal to EU investors. These criteria have also been challenging to apply due to significant data limitations and a lack of consistency and clarity among financial market participants and supervisors.

Changes to MiFID's suitability approach with respect to sustainability-related investment products should wait for the SFDR review to be fully completed, in order to ensure full compatibility between the regimes. With respect to SFDR and MiFID, policymakers should avoid novel concepts when developing a fund categorisation system within SFDR, and likewise when considering suitability. Steering investors toward certain financial products or creating a hierarchy among products will ultimately impede investors' choice. Market (e.g., advisors and distributors) and consumer testing should be conducted to inform the development of a categorisation system and sustainability preferences.

Additionally, the MiFID sustainability preferences and suitability requirements should accommodate products that may fall outside of any SFDR categorisation system. The use of voluntary categories should be a distinguishing factor among funds that elect to align with the categories, and not a limiting factor that could deter retail investors from accessing a diversity of sustainable investing strategies that meet their preferences.

If calibrated correctly, product categories and suitability assessments that are easy to understand could potentially facilitate retail investors' ability to navigate the existing landscape of sustainability-related investment products. Consideration should be given to current market

practices, international frameworks, classification regimes of other jurisdictions (e.g., UK SDR) and the broad range of sustainability-related investment strategies that align with consumer interests, to ensure that the MiFID approach to sustainability preferences captures the current breadth of available products (e.g., impact, SRI, exclusion, etc.) and allows for future innovation. Regulatory alignment across distribution and disclosure obligations is critical to the EU's investor protection and retail investment objectives.

* * * *

We appreciate your consideration of our comments. If you have any questions or would like to discuss our comments further, please contact me at tracey.wingate@ici.org or Eva Mykolenko at emykolenko@ici.org.

Sincerely,

/s/ Tracey Wingate

Tracey Wingate
Head of Global Affairs
Investment Company Institute

APPENDIX A: Supplemental Information for Question 3

This appendix addresses investor behaviours, and individuals' willingness to invest following meaningful market corrections. While the data here focus on outcomes for US investors, we believe they can be informative regarding EU investors, due to the similarity in the levels of economic development, and goals of citizens within the two jurisdictions, broadly speaking.

Over a 17-year period of surveys on this topic we have consistently found that periods of low or negative returns do not significantly affect US retail investors' willingness to invest again, either in the short run, or in the longer run. For example, beginning in the aftermath of the Financial Crisis but while still in the Great Recession, results from ICI's 2009 DC plan recordkeeper survey,[39] covering nearly 24 million DC plan accounts, indicated that:

> (1) DC plan participants did not tap into their accounts following the large slide in market valuation in the fourth quarter of 2008. Notably, only 2.6 percent of DC plan participants took withdrawals in the first three quarters of 2009. Participant loan activity in 2009 was in line with historical experience of prior years as well.
>
> (2) Participants continued saving in their plans. In fact, only 5 percent stopped contributing over the first three quarters of 2009.
>
> (3) As well, most maintained the asset allocations of their ongoing contributions and their total account over the first three quarters of 2009. About one in 10 changed the asset allocation of their account balances, and a similarly small fraction changed the asset allocation of their contributions.

In addition, analysis of related household surveys conducted in 2008 and 2009,[40] found that:

> (4) Households with DC accounts mostly agreed that these plans helped them think of the long term and made it easier for them to save.

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[39] See Holden, Sabelhaus, and Reid, "Enduring Confidence in the 401(k) System: Investor Attitudes and Actions" (January 2010), Washington, DC: Investment Company Institute; available at https://www.ici.org/system/files/attachments/ppr_10_ret_saving.pdf.

[40] See Holden, Sabelhaus, and Reid, "Enduring Confidence in the 401(k) System: Investor Attitudes and Actions" (January 2010), Washington, DC: Investment Company Institute; available at https://www.ici.org/system/files/attachments/ppr_10_ret_saving.pdf. The survey sampled respondents to be representative of the US population.

(5) Households intuitively appreciated the benefit of cost-averaging their purchases of financial assets. Saving paycheck-by-paycheck made nearly six out of 10 households less worried about the stock market.

Indeed, despite the stock market downturn that began in late 2007 and continued through early 2009, households—whether they owned DC plan account balances or not—were generally confident in these investment plans' ability to help individuals meet their long term (retirement) goals. Further:

(6) Among those expressing an opinion of DC plans in 2009, 91 percent were favourable.

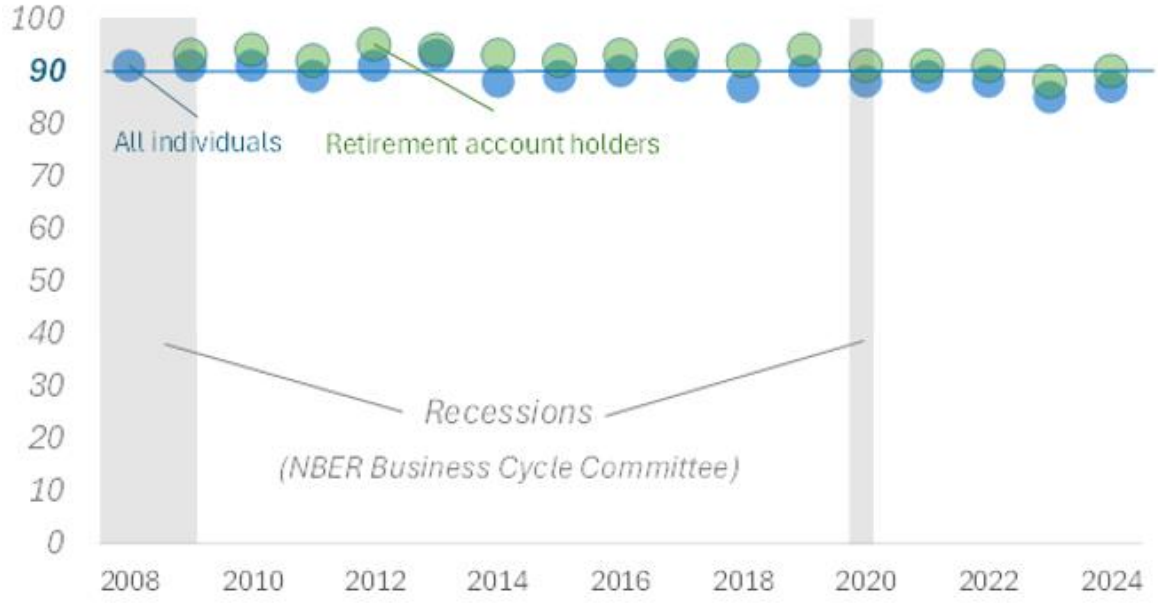
(7) Finaly, DC-owning individuals appreciated the opportunity to make asset allocation decisions, including in retirement. In fact, 96 percent of all US households indicated they did not want the government to take away retirees' ability to make decisions about retirement assets and income.

Importantly, in the years since 2009, sentiments related to DC plans are consistently and broadly favourable. Indeed, these views have remained stable for the better part of two decades (17 years), including through the COVID-19 pandemic (Figure A.1).[41] Importantly, these accounts are viewed favourably not only among retirement account holders but also across all US individuals, more broadly.

[41] See Holden, Schrass, Bogdan, and Seligman, "American Views on Defined Contribution Plan Saving, 2024," *ICI Research Report* (January 2025); available at https://www.ici.org/system/files/2025-01/25-rpt-am-views-dc-plans.pdf.

Figure A.1: Opinions of DC plan accounts are consistently favourable over time, among all individuals, as well as retirement account holders.

Among those expressing an opinion, percentage with a favourable opinion



Note: Retirement account holders are US adults with DC plan accounts or IRAs at the time of the survey.
Sources: Investment Company Institute survey results (available at https://www.ici.org/research/retirement/us-views) and National Bureau of Economic Research "US Business Cycle Expansions and Contractions" (available at https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions)

APPENDIX B: Supplemental Information for Question 16a

This appendix addresses elements of the PRIIPs KID related to the disclosure of investment risk and returns. As ICI has noted in several comments to regulators in the past, we are concerned with disclosures that attempt to simplify (summarize) risk, while often further stripping any risk assessment from the context of expected returns.

To understand how summary risk disclosures suffer from inconsistencies across time and asset classes, along with failure to represent the higher expected returns that ought to compensate higher risk investments in a competitive market, consider two challenges for risk rating based on a volatility measure over a limited time period (Figure B.1).

First, if only a measure of the volatility of returns, "σ," is reported, investors cannot assess any merit from accepting additional risk. Because an individual cannot decide which investments best meet their goals absent information on returns, investors should readily be made aware of historic returns, not just the volatility of those returns. This is fundamental to both casual portfolio investment decisions and to more formal analysis using models like CAPM and associated measures like the Sharpe Ratio.[42]

Second, the shorter the data-sample time window for calculating any measure of volatility, the more likely that different asset classes fluctuate between being relatively lower- or higher-risk when compared on the basis solely of such a summary risk rating.[43]

(1) Figure B.1 considers three investments, *a*, *b*, and *b'*. If only risk (σ) is reported rather than both expected return and risk{E(*r*), σ} for the three investments, then *a* looks like the best choice because it is the least risky and, failing to consider returns, *b'* is indistinguishable from *b* (having the same higher risk than *a*). Looking solely at risk, an investor will rate both *b* and *b'* the same (and as more risky than *a*). However, this assessment overlooks the fact that *b'* has a higher expected return than *b* and should not be judged equal. Investment *b* is inferior to both *a* (as *b* has higher risk, but the same expected return), and to *b'* (as *b* has the same risk, but lower expected returns). Thus, focusing on a summary risk measure at the exclusion of expected returns distorts investors' perceptions of the investments.

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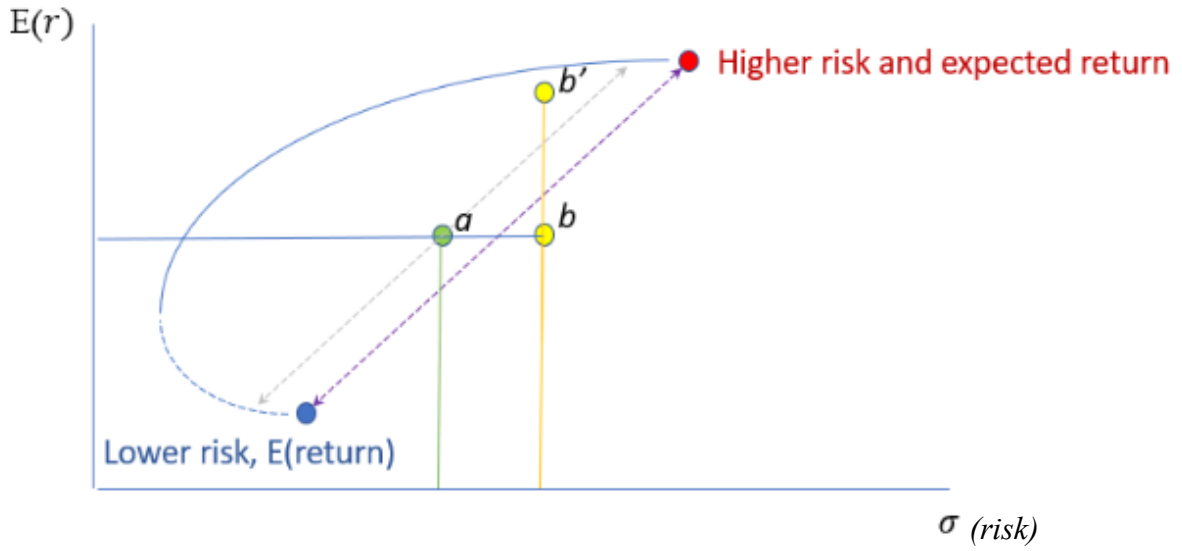
[42] For an overview of both the Capital Asset Pricing Model (CAPM) and the related Sharpe Ratio, see Figures 1 – 3 and related discussion in Perold, "The Capital Asset Pricing Model," *Journal of Economic Perspectives* 18, no. 3 (Summer 2004): 3–24; available at https://doi.org/10.1257/0895330042162340.

[43] In the past we have commented on problems related to (3) lagged changes for summary risk ratings, and (4) affording investment companies' discretion over their risk ratings. We will summarise these after covering (1) and (2).

In terms of impacts for capital markets' ability to allocate risk and resources efficiently, in lieu of information on returns, investment opportunity *b'* is likely to be starved of capital relative to *a*, potentially limiting growth stemming from higher risk, higher return investments. In terms of personal outcomes, EU citizens are less likely to benefit from broader capital market access in ways noted within the recent Noyer Report.[44]

Figure B.1: Putting risk ratings in the Capital Asset Pricing Model (CAPM) framework highlights two challenges for risk rating schemas over limited time periods.



Source: Investment Company Institute example

(2) The shorter the sample window for calculating the risk measure "σ," the more likely investments *a* and *b* switch positions. This is because they are relatively close together on this one dimension (risk) and could move across thresholds for risk categories. Related to this, in a recent set of comments to the UK's Financial Conduct Authority (FCA), ICI documented failures in ordinal stability across asset classes in Canadian risk measures over a relatively brief four-year time period (2021−2025).[45] We note that the Canadian data window for the risk rating calculation is relatively long (10 years) when compared with other designs (many are five years), and that the Canadian scale for ratings (1−5) is relatively low. Because longer

[44] See "Developing European Capital Markets to Finance the Future: Proposals for a Savings and Investments Union," Christian Noyer, Honorary Governor, Banque de France (April 2024), Figure 23, p. 30, ("Noyer Report"); available at https://www.ebf.eu/wp-content/uploads/2024/05/EN-Report-Developing-European-capital-markets.pdf.

[45] See "Additional Background Research" beginning at page 15 in ICI's letter to Financial Conduct Authority, *RE: Response to CP24/30 – A new product information framework for Consumer Composite Investments* (March 2025); available at https://www.ici.org/system/files/2025-03/25-cl-response-cci-consultation.pdf.

data windows and a lower number of thresholds within a scale both lend stability to reported risk ratings, our findings for Canada should be more concerning than otherwise.

We noted other concerns with risk ratings to the FCA, mostly to do with (3) lags in changes of reported risk ratings when compared to market cycles and corrections, and (4) the problem associated with offering a fund (UCITS or otherwise) discretion over the ratings report. Related to (3) we note that data windows generate lags such that declines in ratings are more likely to induce investment near the top of a market cycle while increases in the ratings after following negative market corrections are more likely to inhibit constructive investment. Given these pro-cyclical characteristics, investors trading in accordance with risk ratings will be more likely to buy at higher prices and sell at lower prices. It follows that ratings additionally make fiscal and monetary stabilisation policies following financial shocks more expensive and less effective, placing burdens on investors, taxpayers, and broader standards of living over longer periods of time.

As a result of the data work carried out for ICI's FCA submission,[46] we strongly discourage use of any summary risk rating requirement. Here, we further emphasize the damage such ratings can do to investor trust in regulators and markets over time. Getting to (4), discretion, we find this likely makes trust problems worse, not better. One reasonably hopes that discretion might improve the representative accuracy of a rating. However, a rating system that does not track the rule for calculations on the specifically assigned scale can further mislead investors and reduce their trust in the rating system. This risk exists whether the fund endeavours to keep a rating higher or lower than any related raw score represented accurately on a scale. Further, confusion may occur where some firms adhere strictly to the scale, while other firms attempt to employ discretion judiciously. Investors may trade across very similar products based merely on these discretionary differences, enduring higher trading costs than would otherwise be deemed prudent. As well, when reflecting on their experience, investors may be more prone to wasting additional resources in seeking remedies for harms, real or imagined, when UCITS managers are each independently acting in good faith based on a ratings scheme that includes an element of discretion.

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[46] See ICI's letter to Financial Conduct Authority, *RE: Response to CP24/30 – A new product information framework for Consumer Composite Investments* (March 2025); available at https://www.ici.org/system/files/2025-03/25-cl-response-cci-consultation.pdf.