Derville Rowland: Unity creates strength

Remarks by Ms Derville Rowland, Deputy Governor of the Central Bank of Ireland, at the 37th International Investment Funds Association Conference, Dublin, 9 October 2024.

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Introduction

Thank you to the International Investment Funds Association and Irish Funds for the invitation to speak to you this morning. Whether by design or fortune, the timing of this event - bringing together fund sector representatives from around the world - is fitting. After all, this event is taking place during World Investor Week. World Investor Week is an annual initiative by IOSCO, which focuses on providing education and information initiatives to retail investors to raise awareness about the importance of investor education and protection. This year's campaign themes are focused on actions to prevent frauds and scams, technology and digital finance and providing accessible and understandable information about the basics of investing.

Much like the work of the International Investment Funds Association, IOSCO's mission is centred around investor protection and promoting investor confidence in the integrity of financial markets. This is increasingly important when we consider the scale of the asset management sector globally. Worldwide regulated open-end fund assets stood at over $69 trillion US Dollars at the end of the first quarter of 2024.[1] In our respective roles as firms, representative associations, regulatory bodies and public policy makers, we have a duty to ensure that all investors, whether small or large, sophisticated or not, have fair and informed access to the investment market.

When we look back to the roots of investment funds and the history of how the sector has developed, we can see the value proposition they bring to investors. Not least because funds can offer access to investment opportunities in a diversified and risk appropriate manner. The first investment fund, thought to have been created in the 18th Century, was named for and established on the basis that '*unity creates strength*'.[2] This theme is as relevant today as it was then.

Given it is World Investor Week, I will focus my remarks on the needs and challenges facing retail investors and what actions we can take to support them. I will discuss the significant changes that we have seen in the retail investment market in recent years. Most importantly, I will outline the actions we need to take to respond to these challenges, to ensure that the sector continues to operate in serving the evolving needs of investors and maintains the mantra that *unity creates strength*.

The changing face of retail investments

We have seen a significant reshaping of the financial sector since the global financial crisis, with capital markets and retail investment changing significantly. While capital markets retain a central role the economy, the ways in which markets and products are accessed has changed considerable. Digitisation has transformed how we all engage with financial service and has reshaped the market for retail investments. This has made the retail investment market more accessible for investors, bringing benefits for firms and investors alike. However, it has also introduced new risks and considerations for the sector. We must consider and keep pace with the evolving manner in which retail investments are marketed, how information is disclosed and how products are being sold. We must also be mindful of the competition from accessible but unregulated products and the threats from increasingly sophisticated frauds and scams.

Existing firms will face increased competition from challenger firms, there will be a need to innovate quickly and invest heavily in order to meet the increased expectations from consumers. Equally, regulators need to be ready to respond quickly, to anticipate, as well as support innovation so that the benefits can be harnessed in a proportionate and risk-cognisant manner. Innovation is leading to new types of financial products and services being available to retail investors. However, we know that there is still more to be done to both grow and embed an 'investment culture'. As I have spoken about on previous occasions, there is more to be done to encourage retail consumers to move towards investing rather than holding their savings in bank deposits. In a European context, figures show that at the end of 2023, the EU27 share of global equity market capitalisation stood at just 11% compared to 45% for the US. Moreover, this share declined considerably over the past 15 years.[3] Other statistics, such as on public listings, also paint a similar picture, where the EU share of global Initial Public Offerings (IPOs) from 2015-2020 by value was 15%, less than half the US figure of 32%.

The funds sector has an important role to play in supporting the *Savings and Investment Union* in Europe. But more broadly, the sector globally has a role in providing opportunities for retail investors to participate in capital markets. If designed correctly, and sold appropriately, there are many benefits for investors having access to investments through diversified, pooled, collective investment funds. On an individual investor basis, the benefits include allowing investors to:

1. increase their investment opportunity set;
2. improve the risk/return profile of their portfolio (including cost control); and
3. entrust oversight of their investments to a professional investment manager.

Significantly, in terms of facilitating better outcomes for investors, an investment fund allows an investor to participate in a diversified portfolio of holdings with a view to mitigating concentration risk. We are reminded once more *unity creates strength*.

On a broader, system level basis, the sector has an important role to play in reducing the reliance on the banking sector. I have spoken about this on previous occasions so will not dwell on it today.[4] However, traditional forms of finance, including bank funding, imposes certain costs and can lead to fragilities where an economy is overly dependent on it.

On a sectoral basis, we know that the funds sector has generally demonstrated high levels of resilience, even during periods of stress such as the COVID market shock. Nevertheless, we of course must be mindful that an expanding and more interconnected financial sector may pose risks that need to be managed.

We must also be alert to the risks from frauds and scams. We are all aware of the emergence of increasingly sophisticated scams targeting retail investors. In Ireland, the Gardaí recorded that fraud incidents increased by 95% between 2019 and 2022, with the investment fraud element increasing by 358% during that period.[5] This is a risk to each customer but also an issue of trust and confidence. Conscious of this growing risk the Central Bank has recently announced that the first theme of our new innovation sandbox programme will be '*combatting financial crime*'. We will be looking at what technological solutions can help to deliver positive outcomes for consumers and firms in this area. We are equally conscious that the solutions to this issue do not lie solely within the financial sector. This is why we have been engaging with a number of large tech firms since the start of the year, including Google, encouraging them to do more to ensure they are not facilitating consumer harm. I am pleased that progress has been made in this regard and welcome Google's announcement that they will introduce a verification process for financial services advertisers. An effective financial services verification policy is a key disruptive tool in the fight against online financial scams.

How do we respond to these challenges?

At the Central bank of Ireland, core to informing our approach to respond to these challenges, is to take a broader perspective. We must consider the views of retail investors and how the asset management sector is working for them. Our experience has shown us the importance of listening to these views and using insights from retail investors to inform our annual risk assessment. They also inform our understand of what should be done to mitigate these risks.

As such, tomorrow we will be publishing findings from our most recent consumer research which looked at the experience of retail investors interacting with investment firms, their views of the sector and the issues they have faced. We undertook this research along with a mystery shopping exercise. Both of which informed a thematic review which looked at the use of marketing and advertising by investment firms. We will also be publishing the findings from this review tomorrow.

The insights from the research are of real value. Investors are telling us that they still find engaging with the sector challenging in some ways. They highlight disclosures and the provision of information as a challenge for them, saying that while benefits about products are often explained in plain language and illustrated using graphs and visuals, important disclosures and regulatory information (including risks, warnings and fees) tend to use language that is more technical, and text based. This view is similar to what we saw in previous supervisory work by the Central Bank which looked at fees and charges. That found there is more that could be done by firms in providing clarity and detail on the fees charged to retail investors.

The research also shows that investments are now more accessible, mainly through digital channels. Nevertheless, retail investors with very limited experience continue to have a number of preconceptions about investing which may adversely affect engagement levels. This includes a sense that getting involved with investments is only for those who have a high level of knowledge and keep abreast of the market on a regular basis.

The research provides valuable perspectives to understand the challenges that investors are dealing with. It tells us that while a firm may be meeting all its obligations in providing prescribed information to investors, there are real questions on the clarity and usefulness of some of this information. Firms need to consider if they providing information in a way that helps investors to make decisions. Does the information require an established knowledge base or is it accessible to someone who has never invested before? If the information is a challenge or difficult to understand at the outset, does that instil confidence with investors or is it more likely to attract them to products with a simple message but less regulatory protections. Firms that consider and act on what investors are telling them and make changes that support and inform retail investors will be acting in an investor centric way. A strong investor culture, based on establishing trust and confidence with investors could be what sets a firm apart in an increasingly digital investment environment.

A prevailing theme is also the impact of different fee arrangements for retail investors as compared with the more favourable terms offered to institutional investors. Of course, there can be underpinning reasons for this, such as economies of scale and so on. Notwithstanding this, a firm which has strong investor centric culture, will be challenging themselves on such fee arrangements to assess whether they are justifiable and appropriate.

Building an effective culture for retail investors

Understanding and addressing these challenges will require action across the board by firms, industry representatives, policy makers and regulators. Without action to address these issues, we risk increasing disengagement from retail investors with traditional capital markets. We know that the trust of investors is hard earned, and easily lost. As we seek to encourage greater retail participation in capital markets it will be important that all of us play our role in supporting that trust. Before I conclude, I would like to spend a few minutes discussing the challenge of how to navigate the changing and evolving environment in a way that maintains and builds trust to the extent that new retail investors may be attracted to engage and invest.

As you might expect, for regulators and public policy makers, this is primarily about better investor outcomes, ensuring their interests are upheld, and client assets are protected. High quality regulation plays a vital role in supporting well-functioning markets. It ensures that investors are protected and that risks to financial stability are identified and mitigated. Our interventions are intended to:

- Promote and safeguard the integrity of the funds sector and maintain confidence in the financial system more generally; and
- Identify and mitigate systemic risks which may arise.

High quality regulation plays a vital role in supporting well-functioning capital markets. There is a direct link between effective regulation and ultimately better investor outcomes. Regulatory intervention should:

- support innovation and product development to meet the changing needs of investors and the broader evolution of the global financial sector; and

- be appropriately calibrated in order to achieve the right outcomes without being unduly onerous on market participants. Ultimately, any inefficiencies that may be created will be borne either by the end investors or users of the financial service.

At the start of my remarks today, I noted the similarity of purpose that both the International Investment Funds Association and IOSCO have in terms of investor protection and promoting investor confidence. So too there is a similarity of purpose on ensuring regulatory alignment and consistency on a global basis. Again, this is an area where *unity creates strength*.

At the Central Bank of Ireland, and personally as an elected member of IOSCO's Board, we support international efforts to set global standards and drive consistency of regulatory outcomes. This World Investor Week, it is useful to remind ourselves of IOSCO's key role here. IOSCO is the leading international policy forum for securities regulators and the global standard setter for financial markets regulation. It develops, implements and promotes adherence to internationally recognized standards for financial markets regulation and works closely with other international organizations on the global regulatory reform agenda. But regulatory bodies and policy makers cannot do this work allow. Nor would it lead to efficient regulatory outcomes if we were to attempt to tackle every issue or topic.

Industry associations and representative bodies, such as the International Investment Funds Association, have a key role to play in supporting collaboration and encouraging the development of best practice across jurisdictions. Of course, different countries and regions will have their own characteristics and may require some tailoring of approach as a result. Nevertheless, we should strive for consistency of outcomes for investors. This will become ever more important as technology continues to reduce barriers that would otherwise prevent cross border activity.

That founding concept which underpinned the first investment fund, that *unity creates strength*, is as relevant for investors and firms today as it was then. If we are all mutually aligned, informed and empowered, then that can only lead to better outcomes for retail investors, capital markets and the financial sector overall.

Thank you.

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[1] *Worldwide Regulated Open-End Fund Assets And Flows, Q1 2024* (PDF 202.72KB), International Investment Funds Association Worldwide.

[2] *The Origins of Mutual Funds* (2004) by K. Keert Rouwenhorst, Yale School of Management.

[3] ESMA, 2024.

[4] For example, see *Private Assets: A changing European landscape* - remarks by Deputy Governor Derville Rowland at the Irish Funds, 10th Annual UK Symposium.

[5] *Report*, Houses of the Oireachtas, 1 June 2023.