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RIPE FOR CHANGE

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Each European market has its particularities, and Italy is no exception. Recently, the record demand from retail investors for Italian government bonds hit the headlines – suggesting a kind of 'investment patriotism' as a pattern 'tipicamente Italiano'. The most recent offering from BTP Valore has been another successful retail government bond issue, the last one being the BTP Italia in March 2023. **Christophe F. Grosset, European Sales Director at Spectrum Markets** has an intimate knowledge of the country and its capital market. He says that this narrative entirely misses the point when trying to understand where Italy's investment culture is heading.

Christophe, what is the background of the most recent retail BTP[1] rally for Italian government bonds?

According to the Dipartimento del Tesoro[2], the country's medium and long-term refinancing needs will be between €300bn and €320bn[3]. At the same time, the European Central Bank (ECB) has started to reduce its asset purchase programme[4] which will result in declining demand from the ECB for European government bonds, including BTPs. Consequently, the Treasury will try to compensate for as much of this supra-institutional demand as possible.

So, there is nothing unusual about a finance agency tapping the domestic retail sector?

You may always discuss the numbers but yes, it's absolutely normal. Germany offered their Bundesschatzbriefe[5] to retail clients for more than 40 years before they were phased out in 2012. The reason why they were phased out had nothing do with political or ethical discussions, the exercise had just become too expensive in the face of ever-decreasing demand in an era of ultra-low rates. In an attempt to diversify its funding base, Italy is now issuing bonds with inflation-adjusted coupons plus a loyalty bonus for held-to-maturity securities, in times marked by high inflation and fears of recession. In 2022, some 75 percent of the €21bn, Italy raised via the issuance of inflation-linked BTPs, was contributed by retail investors. From their perspective, buying a BTP with an attractive yield, is a simple calculation. It is true that Italians have always been assiduous savers and if they invest, they have a clear preference for secure assets. However, the historical bias of Italian retail demand towards government debt has evolved into a more generalised appetite for bonds, including structured ones. It was not until interest rates vanished as a result of the financial crisis that a broader asset management industry began to develop. Meanwhile, the Italian retail investor, as with retail investors elsewhere in Europe, has become much more sophisticated. Then again, that doesn't mean there are no areas with leeway to make up for.

Which would these be?

I'm thinking of execution infrastructures or classic distribution channels. It's no secret that there is a lack of competition in terms of trading venues, which has created issues that are detrimental to the Italian capital market as whole. Still, there is only one stock exchange with complex listing rules and sluggish procedures across market segments, thus having become unattractive for companies. It is an undisputed fact that competition among operators of trading venues generates a number of benefits for companies looking for funding as well as investors, including retail investors – such as a reduction of transaction costs or increased innovation. Plus, the Italian example proves the argument wrong that competition among venues would only lead to liquidity fragmentation with negative effects on price formation. It shows, on the contrary, that as an exchange you cannot attract trading interest and concentrate liquidity just because you have a monopoly. Instead, unless you simplify and accelerate processes from listing to trading for a broad universe of companies and investors, demand will decrease. As demand decreases, stock prices of established companies will go down. As they do, those companies may consider a delisting and moving to somewhere else. This, in turn, weighs on the market's reputation as a listing hub and so on.

Coming back to the Italian retail sector – what would you think is a fair description of the market's particularities?

We have to distinguish between market structure and the behavioural patterns of investors. As far as the former is concerned, it has to be noted that in Italy, banks and financial advisors dominate the distribution of securities. While this alone is not a uniquely Italian feature, there are the still very high levels of concentration. In terms of structured retail product sales, for example, Italy ranks among the top three European markets after France and Germany. In contrast to the exchange-based distribution of these products in Germany, however, in Italy the distribution via banks and financial advisors dominates. A report[6] by the European Securities and Markets Authority published last year found that Italy has the highest fees for equity and structured retail products in Europe with the majority of the costs being attributable to the distribution network. Then again, there are different developments that have begun to change, if not disrupt established distribution channels. One is that there was a low interest rate environment for a very long time – which paved the way for distributors of products other than those that the retail market has been accustomed to - simply for yield considerations. On the other hand, technological and regulatory progress has given birth to entirely new players with Spectrum Markets being one such example. Through our plug and play infrastructure, Italian distributors can very easily connect and thus facilitate trading and investment in structured retail products for their clients. This is important because having their trades executed in a fully regulated, fully transparent and highly liquid environment including lots of innovative product and trading features is opening up new options for Italian securitised derivatives investors. New players who focus on new generations of investors have ramped up their sales efforts in Italy, too. Over time, this is building a new ecosystem which does not just bring about new instruments, trading opportunities and information services but which also entails new fee distribution models.

Which leads us to the behavioural patterns – is there any such thing as a typical Italian retail investor profile?

As you may know, the preference for fixed income products is often said to be a typical attribute of Italian retail investors. I would differentiate this and repeat what I had mentioned earlier, that is, if this has been a typical pattern, then it has been a supply-driven one. What's more, this bias cannot just be blamed on to the sovereign as a traditional payer of comfortable coupons but it's also attributable to the distribution infrastructure we've discussed. In other words, the question of whether there is any form of advice taken by the investor also plays an important role.

Can you please explain this in more detail?

Overall, demand for financial advice has room for growth. According to a recent Consob[7] report, 26% of Italian retail investors say they make use of it. It's worth noticing that the main reasons cited by the majority of respondents to the Consob report for going without advice are that they deem advice unnecessary when investing small amounts or in simple instruments or that advice is simply too expensive. In contrast, reliance on what is called 'informal advice' – following the recommendations from relatives, friends and colleagues – was relevant for almost half of the interviewees. In line with the relatively low demand for advice there is limited knowledge about the characteristics of advice as an investment service, i.e., who is allowed to provide it, what the mandatory elements are, what distinguishes independent advice from non-independent advice and so on. Consequently, there is little willingness among investors to pay for a service the content and benefits of which they do not fully understand. Then again, you see changes in the typical investor profile emerging in more recent years with higher participation rates and higher levels of self-efficacy – ultimately resulting in investing becoming less reserved to high net worth individuals and more open to a broader retail community.

That doesn't sound so much different from other European countries…

Exactly, taking all these factors into account, there aren't that many differences. The developments since the aftermath of the great financial crisis of 2008/09 show a relative synchronism in investor behaviour across many European countries. Low and ultra-low interest rates impelled savers to become investors and investors to become increasingly cost-aware and to start leaving a beaten path. Yet, it wasn't until after the introduction of MiFID II[8] and until a major technological leap that investors were able to access and actively participate in capital markets on fair terms.

What we've seen, again across most of Europe, is that a wide range of instruments and asset classes became available very quickly, and that retail investors have been given access to it much faster than they have been given access to the necessary education. However, the past two decades have taught investors to realise increased self-responsibility for their financial well-being. Which is why the Italian retail investor, like retail investors elsewhere in Europe, has advanced significantly and exhibits a higher level of sophistication. A changing market structure in Italy ensures that growing demand from these investors will be met with adequate product and execution supply.

Thank you very much!

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[1] Buoni Poliennali del Tesoro
[2] Department of the Treasury
[3] https://www.dt.mef.gov.it/it/news/2022/calendario_linee_guida_2023.html
[4] https://www.ecb.europa.eu/press/pr/date/2023/html/ecb.pr230202~1a4ecbe398.en.html
[5] Bundesschatzbriefe (not to be confused with Bundesschatzanweisungen) were publicly issued bonds by the Federal Republic of Germany
[6] https://www.esma.europa.eu/sites/default/files/library/esma_50-165-1677_asr_performance_and_costs_of_eu_retail_investment_products.pdf
[7] *Commissione Nazionale per le Società e la Borsa,* national competent authority responsible for regulating the Italian financial markets
[8] Directive 2014/65/EU, the "Markets in Financial Instruments Directive"

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