The Consumer Voice in Europe

THE PRICE OF BAD ADVICE

BEUC position paper

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Why it matters to consumers

Consumer need to be able to rely on trustworthy financial advice when taking important life decisions, from saving to retirement to getting the right mortgage credit.

Summary

Many life-changing decisions in a consumers' life, from saving for retirement to getting the right mortgage or insurance product, rely on financial advice. On someone able and qualified to navigate you in the jungle of complex financial products and help you to choose the best product available or refrain you from buying a financial product at all.

Such financial advice should be a straightforward concept, available for all EU citizens who need it.

Unfortunately, the reality is often different. Financial "advice" today is, in most cases, nothing more than a commission-driven sales talk aimed at extracting maximal profit from consumers. Acting in the best interest of clients, that divine principle enshrined in many pieces of financial regulation, remains often dead letter. Recent case studies show that consumers have often been sold financial products that resulted in them losing their pension savings or getting them into unaffordable credit.

Our webmap[1] gives just a snapshot of blatant mis-selling cases in the area of retail finance, exposing the worst kind of misconduct by financial service providers. They should be considered together with the widely documented, bleak overall performance of the sector, rock-bottoming every consumer scorecard.

Overall, the financial life of consumers has become increasingly complicated. Deregulation broke the barriers between different sectors in finance enabling banks, insurers and asset managers to compete for similar services. Unfortunately, this hasn't led to competition on price and quality of retail financial products but rather to an arms race in boosting information asymmetries. Consumers ended up with an oversupply of overly complex and costly products, often not suitable for their needs.

Regulatory efforts to help steer consumers in the right direction have led to an ever-expanding, but very patchy rule-book of hardly enforceable conduct rules. **The regulation of financial advice is scattered along outdated, sectoral lines and risks becoming even more obsolete in a rapidly changing, fintech driven market place**.

Stronger measures to drive real market change, like banning commissions in some areas, have been blocked at EU level, despite positive experiences in a few member states.

With this paper we will outline the main flaws in regulating financial advice and propose an ambitious agenda to stop consumers from paying the price of bad advice.

[1] http://www.thepriceofbadadvice.eu/

1. Introduction

Today, consumers in the EU are not getting the advice they really need when looking for mortgages, insurance or seeking to better invest their savings. Especially in the retail investment area, the low quality of advice has been documented widely, both by our members and by public authorities.

Third-party commissions or in-house sales incentives tend to steer consumers towards overly complex and expensive retail investment products, often not suitable for their risk profile.

Regulators have been grappling for years with the concept of financial advice. Following a surge of mis-selling scandals in the early 2000s, the need for better regulating financial advice was widely acknowledged in many EU countries but also at EU level.

The difficulty in fundamentally aligning the interests of consumers with those providing financial advice is reflected by the numerous regulatory concepts which have emerged: initiatives have been taken to stimulate 'basic advice', 'simple advice', 'streamlined advice', 'tied advice' and (non)-independent advice.

These initiatives have come with countless rules supposedly to mitigate conflicts of interest, ranging from passive and active disclosure of commissions to organisational requirements requiring firms to internally address conflicting objectives.

In this paper, we will firstly address some principal flaws in the current approach of financial advice. We will point to its patchy nature with different rules scattered along outdated sectoral lines and we will demonstrate that the current rules entail such a level of ambiguity that practical enforcement is a daunting task. On top of this, fintech market developments are further challenging profoundly the current framework.

Secondly, we will describe some more ambitious reforms recently rolled out in both the Netherlands and the UK, which provide valuable lessons for future EU regulatory action. In these countries, third-party commissions have been banned for a wide range of financial services, substantially improving outcomes for consumers.

On a final note, we will give some policy recommendations to improve consumer's fate across the EU when looking for financial advice.

BEUC The European Consumer Organisation

2. Mis-selling cases: evidence

In our **webmap** we have made an overview of the most blatant mis-selling cases across the EU in the area of retail finance. Below we highlight two cases that are explicitly linked to the bad sales incentives that have driven so many recent mis-selling episodes.[2] Next to this, **mystery shopping exercises**, run both by our members and national authorities, provide further evidence of consumer detriment.

- **Case 1: Payment Protection Insurance sold with loans**

Country: UK. Number of consumers affected: Estimated 12 million (2016). However, 64 million PPI policies were sold in total and the scale of mis-selling could be even higher. Consumer detriment: £24.2bn paid out in compensation (January 2016). Summary: In the United Kingdom, Payment Protection Insurance (PPI) was a product that was sold on the basis that it would protect a borrower's ability to repay loans. PPI was generally sold alongside credit, including mortgages, credit cards and other unsecured loans by all the main UK banks since the 1990s. However, there were significant problems with PPI in the United Kingdom. Any attention as to the suitability of the product for the consumer in question was often minimal, if it existed at all, and PPI policies were frequently mis-sold to consumers who would never be able to claim it. PPI policies were also not sought out by consumers, and there were many cases where consumers were not even aware that they were sold the insurance. Consumers were also often incorrectly led to believe that taking out the PPI was a condition in order to be granted the loan. In sales connected to loans, PPI policies were often promoted by commission-based sales people who were incentivised to sell the product, regardless of whether it was appropriate. In 2011, the UK banking industry lost a legal challenge against the UK regulator, and banks were required to pay redress to consumers. By January 2016, £24.2bn had been paid out to consumers. Total amounts set aside by banks for PPI redress now stands at £43.5 billion – around 4.5 times the cost of the London 2012 Olympics. In an effort to draw a line under the scandal, the Financial Conduct Authority set a final deadline for filing a PPI complaint of 29 August 2019.

[2] We would also like to refer to a study by Consumers International, which gives an excellent overview of how inappropriate sales incentives have driven mis-selling cases across the globe. *Risky business: The case for reform of sales incentives schemes in banks*. http://www.consumersinternational.org/media/1269/sales-incentive-report_riskybusiness_final2_151014.pdf

- **Case 2: Insurance-based investment products**

<u>Country</u>: Netherlands.

<u>Number of consumers affected</u>: Estimated 1 million, as many as 7 million of these products seem to have been sold.

<u>Consumer detriment</u>: Estimated €20-30 billion.

<u>Summary</u>: In 2006, a confidential report by the Dutch financial regulator into unit-linked insurance policies revealed that the policies sold by insurance firms were often complex, not transparent and that the fees charged to consumers were often excessive. A unit-linked insurance policy is a plan offered by insurance companies that integrates both life insurance (covering the risk of death) and investments (offering the opportunity for the investor to generate capital). These policies were very popular in the Netherlands in the 1990s and 2000s, with an estimated 7.2 million unit-linked policies sold to Dutch consumers. At the end of 2005, nearly €49.2 billion had been invested in these products.

However, an important part of the sum paid in was not invested, but covered the (administrative) costs, commissions and premiums. Often, it was unclear to the consumer how much was actually invested or what the costs of the products were. These policies were mostly sold by so-called 'independent advisors', who received attractive commissions from the insurance companies for "advising" on their products.

In 2008, the Dutch Ombudsman issued a recommendation to the Dutch life insurance sector to minimise the costs of these financial products and to compensate in cases where excessive costs were charged to consumers. This recommendation led to several Dutch insurers reaching resolution agreements with Dutch customer interest groups.

- **Mystery shopping exercises in the EU**

Checking firms' actual behaviour on the ground is often the most effective way to verify if rules are working in the interest of consumers. Unfortunately, mystery shopping exercises in the area of financial advice have often been utterly disheartening:

- In 2015, the **FSMA** (the Belgian financial market watchdog) conducted a mystery shopping exercise, showing that in **40% of cases the investment advice** given was not in line with the consumer profile.[3]

- In 2014, the Belgian consumer organisation **Test-Achats** also conducted a mystery shopping[4] at bank branches to check the quality of investment advice. They found that in most cases the information given to the client was insufficient and the identification of its investor profile was not properly carried out.
  Most strikingly, while mystery shoppers presented themselves with a very defensive, risk-averse profile (meaning he was best off with a savings or term account, or a government bond), half of all advisers nevertheless recommended a risky investment product, unsuitable to his needs. The advisors were often primarily focused on selling their products rather than considering the client's interest. The recommended investments then often proved more or less inadequate, with potential negative consequences for the client.

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[3] 'Le 'très mauvais" bulletin du secteur bancaire', *Knack,* 12 June 2015, http://trends.levif.be/economie/banque-et-finance/le-tres-mauvais-bulletin-du-secteur-bancaire/article-normal-400249.html, (accessed 18 May 2018).

[4] 'Mon banquier, ce pietre conseiller', *Test Achats*, 6 May 2014, https://www.test-achats.be/argent/comptes-epargne/news/mon-banquier-ce-pietre-conseiller, (accessed 18 May 2018).

- In a similar mystery shopping exercise[5] carried out in 2010 by the Italian consumer organisation **Altroconsumo**, more than 70% of the recommendations given to clients were deemed unsuitable.

- In 2017, **DECO**[6], the Portuguese Association for Consumer Protection, conducted a mystery shopping exercise, visiting 20 branches of the major 5 banks in Portugal. The mystery shoppers requested advice based on two different scenarios, one scenario based on a low level of capital to invest, and one with a higher amount. The main conclusions from the mystery shopping exercise was that the advice given to potential clients was often inadequate considering the age and the objectives of the potential investor, and that there was a lack of understanding by the staff members about the investment options that were available.

- Between November 2014 and October 2015, the Federation of German Consumer Organisations, **VZBV**[7]**,** evaluated personal investment and pension advice given by banks and other financial distributors to the German market:

  a) For the purposes of this assessment, VZBV evaluated 835 existing consumer portfolios (containing 3,502 investment products). VZBV's analysis showed that 45% of these contracts were inappropriate for the investor, and that more cost-efficient and flexible alternatives would have been more suitable for the investor;

  b) VZBV also assessed 362 new contract offers extended to German consumers and assessed that 95% of these contractual offers did not address the needs and interest of consumers. The recommended products were either often too expensive, too inflexible, or too risky.

- In 2015, the German consumer organisation **Stiftung Warentest**[8] assessed the quality of financial advice at banks in Germany through a mystery shopping test. Following the conclusion of the shopping test, Stiftung Warentest found that only 3 out of 23 of the banks it tested advised their mystery shoppers well. Most of the banks – including some of the major banks in Germany – only performed satisfactorily in the test, offering products that did not suit the profile of the investor.

[5] 'Investimenti: cosa consigliano le banche', *Altroconsumo*, 1 November 2010, https://www.altroconsumo.it/soldi/conti-correnti/news/investimenti-cosa-consigliano-le-banche-il-video-con-telecamera-nascosta-soldi-diritti-115, (accessed 18 May 2018).

[6] 'Senhor bancário, onde devo aplicar o meu dinheiro?', *DECO*, 17 August 2017, https://www.deco.proteste.pt/investe/senhor-bancario-onde-devo-aplicar-o-meu-dinheiro-s5155494.htm, (accessed 18 May 2018).

[7] 'Erhalten Verbraucher bedarfsgerechte Anlageprodukte?', *Marktwachter Finanzen*, 12 November 2016, https://ssl.marktwaechter.de/finanzen/marktbeobachtung/erhalten-verbraucher-bedarfsgerechte-anlageprodukte, (accessed 18 May 2018).

[8] 'Anla-geberatung: Nur 3 von 23 Banken beraten gut', *Stifting Warentest*, 19 January 2016, https://www.test.de/Anlageberatung-Nur-3-von-23-Banken-beraten-gut-4964413-0/, (accessed 18 May 2018).

3. Promoting financial advice: key challenges

3.1. A patchy framework for financial consumer protection

Consumer financial protection has been upgraded substantially over the last decade in the EU. A surge of disclosure and conduct of business requirements (conduct rules) has been set out in numerous laws, separately dealing with investments, insurances, mortgages, credit and payment accounts.

Such a sectoral approach has obvious limits, as financial firms typically offer a wide range of (substitutable) products, which opens the door for regulatory arbitrage. On top of this, horizontal issues like financial advice or cross-selling are tackled in an inconsistent manner in EU legislation.

In general, conduct rules are a range of principles which should govern the activities of financial firms in protecting the interest of consumers. In EU financial services law, they consist of provisions dealing inter alia with:

- Clear, fair and not misleading communication to consumers;
- Know your client provisions;
- Cross-selling practices;
- Suitability and appropriateness tests;
- Creditworthiness checks;
- Conflicts of interests;
- Client classification & categorisation;
- Financial advice;
- Complaints handling;
- …

Unfortunately, these conduct rules have been brought into sectoral legislation in a completely piecemeal approach, lacking consistency and even common definitions and terminology.

Below we highlight some blatant inconsistencies in EU financial consumer protection, many of which we already identified in the Commissions' Call for Evidence in 2015.[9]

[9] Farid Aliyev, 'EU Regulatory Framework for Financial Services: BEUC's Response to the Commission's Call for Evidence', 2016, *BEUC,* http://www.beuc.eu/publications/beuc-x-2016-0_call_for_evidence_fs_regulatory_framework_beuc_response.pdf, (accessed 18 May 2018).

- **Example 1: MIFID II vs the Insurance Distribution Directive (IDD)**

Following the adoption of MiFID I, which set out stronger investor protection rules for investment intermediaries, banks and insurers started repacking investment products as life insurance products or as structured products in order to be able to avoid these rules, adding layers of complexity and costs for the client in the process. Efforts by industry to structure products in a way, not to meet economic needs or investor preferences, but merely to avoid certain legislation, is a clear instance of regulatory arbitrage.[10]

A prime example is the growth of the market for unit-linked insurance products, which has led to mis-selling episodes[11] in countries including the Netherlands, Poland, Italy and Luxemburg.

With the adoption of IDD, legislators sought to close that regulatory loophole and aimed to closely align the investor protection provisions of IDD with the MiFID framework, which had been renewed in the meantime with the adoption of MiFID II. Unfortunately, this effort delivered only partially as divergences between IDD and MiFID II remain and even risk increasing regulatory arbitrage in the future. Some examples include:

- **Independent advice**: while MiFID II has set-up a regime whereby firms can provide 'independent advice', along with a strict prohibition of commissions, IDD has failed to include such a regime.

- **Inducements:** while MiFID II in principle bans all commissions but provides (too broad) exceptions to this rule, IDD turns around this logic: firms can still receive commissions, if these 'do not have a detrimental impact' on the quality of the service.

- **Disclosure of commissions:** while firms under MiFID II will need to disclose the nature and the amount of commissions to consumers, IDD only requires disclosure of the nature of the commissions.

Such divergences, which could have a major impact on consumers, cannot be explained by a different chosen policy approach between MiFID II and IDD, but rather "seem to be the result of lobbying or lack of agreement to apply rules as strict as the MiFID II rules to insurers"[12].

- **Example 2: Responsible lending: divergences between the Mortgage and Consumer Credit Directive**

Taking out credit is an important financial decision for consumers, which deserves proper guidance. Mis-selling cases in, for instance, the area of mortgage credit had grave consequences both on consumers and the wider financial system, as was shown in the build-up of the 2008 crisis. More recently, foreign exchange mortgage loans in many European countries have caused major detriment to consumers.

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10 Veerle Colaert, 'MiFID II in relation to other investor protection regulation: Picking up the crumbs of a piecemeal approach', 28 March 2017, http://www.academia.edu/32119298/MiFID_II_in_relation_to_other-investor-protection_regulation_Picking_up_the_crumbs_of_a_piecemeal_approach, (accessed 18 May 2018).

11 'EIOPA Fifth Consumer Trends Report', *EIOPA,* 16 December 2016, https://eiopa.europa.eu/Publications/Reports/06.0._EIOPA-BoS-16-239%20-%20EIOPA%20Fifth%20Consumer%20Trends%20report%20-%20Clean%20after%20BoS.pdf, (accessed 18 May 2018), p. 13.

12 Veerle Colaert, 'MiFID II in relation to other investor protection regulation: Picking up the crumbs of a piecemeal approach', 2017, http://www.academia.edu/32119298/MiFID_II_in_relation_to_other_investor_protection_regulation_Picking_up_the_crumbs_of_a_piecemeal_approach, (accessed 18 May 2018).

The Mortgage Credit Directive (MCD) has therefore put forward strong provisions ensuring more **responsible lending** practices: consumers can only get a mortgage loan if they can afford it.

Unfortunately, the Consumer Credit Directive (CCD) does not address this issue of irresponsible lending. Although there is a basic obligation to assess creditworthiness, the means by which this is done is largely left to the bank and the directive still does not oblige lenders to grant credit only to those borrowers who are likely to repay it.

The MCD has also set out provisions to ensure that any payments received by an intermediary should be product neutral, to avoid biased recommendations. The CCD does not contain such provisions.

- **Example 3: Cross-selling**

One horizontal issue in the area of retail finance relates to cross-selling practices, particularly tying, which is widespread across EU Member States. With tying, consumers are locked in by a provider by obliging them e.g. to buy an insurance of the same firm offering a mortgage credit. These practices limit competition and consumer choice and make it often impossible for the consumer to decide whether he is going to benefit financially or not.

All the legislative texts on retail financial services adopted following the EC consultation in 2010 contain provisions related to tying and bundling. Although all of these texts (MiFID II, MCD, PAD and IDD) recognise the harmful impact of tying on competition and consumers, none of them have actually introduced a ban on the practice.

In general, firms are only required to inform the consumer about whether the service can be purchased separately and provide the price of individual items included in the package.

Only the Mortgage Credit Directive instructs Member States to allow bundling (selling multiple goods in a package[13]) and prohibit tying practices, but this general provision has been considerably weakened by a Member State option allowing all kinds of tying justified on the grounds of providing additional security to the creditor in the event of default.

3.2. Weak enforcement

The weak application of financial consumer protection law in practice is a very stark concern and has been documented already by the EC's only expert group dedicated to financial services users, the FSUG.[14]

Below we summarise our main concerns related to the poor application of EU financial services law:

- **Suitability charade**: the most fundamental provision of the investor protection acquis is that any personal recommendation made (e.g. to buy fund X) suits the needs of that consumer, (in terms of e.g. risk profile, time horizon etc). A peer review carried by EU watchdog ESMA uncovered that those MiFID I suitability provisions are hardly enforced at the national level[15].

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[13] See BEUC position paper on different types of cross-selling: http://www.beuc.eu/publications/beuc-x-2015-027_fal_response_to_consultation_of_the.pdf

[14] 'For better supervision and enforcement in retail finance', *Financial Services User Group,* October 2016, https://ec.europa.eu/info/sites/info/files/file_import/1610-supervision-enforcement-retail-finance_en_0.pdf, (accessed 18 May 2018).

[15] 'MiFID Suitability Requirements Peer Review Report,' *European Securities and Markets Authority,* 7 April 2016, https://www.esma.europa.eu/sites/default/files/library/2016-584_suitability_peer_review_-_final_report.pdf, (accessed 18 May 2018).

More recently, the Irish Central Bank[16] warned that companies are not taking up their suitability responsibilities seriously.

- **Enforce the unenforceable**: while current provisions are not being put into practice, new and more complex conduct of business rules stemming from MiFID II and IDD will kick in.

  New rules on, for instance, product governance stipulate that firms will need to establish a target market (by defining the types of consumers for whom the product is suitable) for every product, which should be a good thing. However, more detailed provisions enable firms to sell outside that target market in "limited circumstances". Furthermore, a negative target market (type of consumers who should never be sold a particular product) needs to be established, but also here exceptions are granted.

  The question here is how such provisions can be put in practice effectively and, more importantly, how supervisors can check if firms are playing by those very detailed rules.

- **National competent authorities alert:** there are no minimum standards for checking compliance with the ever-expanding rulebook for the different EU member states. While some countries have established dedicated authorities to do so, others have not. Consumer protection rules are also often side-lined by prudential considerations.

- **No EU oversight:** the European Supervisory Authorities (ESAs), erected in the aftermath of the financial crisis, lack sufficient means and a clear mandate to raise consumer protection standards effectively across the EU.
  National authorities still govern those agencies supposed to control them, which weighs down on the ESAs effectiveness in protecting consumers.

  BEUC has, together with other civil society organisations working on finance, called for giving the ESAs the necessary muscle to make sure rules are enforced effectively across the EU.[17]

3.3. Beware of the robots

On-line investment platforms are heavily promoted to consumers and we expect a substantial uptake in the upcoming years. BEUC welcomes new entrants in the advice market, for which the incumbents are not delivering to consumers. Automated advice models should deliver more transparent, more accessible, and more cost-effective advice to the mass market.

In our first assessment[18] we noted that such platforms could give value to some consumers, by providing easier access to low-cost investment funds.

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[16] 'Review of suitability requirements finds many investment firms fail to meet the required standard', *Central Bank of Ireland*, 29 August 2017, https://centralbank.ie/news/article/review-of-suitability-requirements-investment-firms, (accessed 18 May 2018).

[17] 'Proposal for the EU financial supervisory reform – open letter', *BEUC, Better Finance, Finance Watch, AGE Platform Europe, EIFN, Families Europe,* 27 November 2017, http://www.beuc.eu/publications/beuc-x-2017-139_fal_proposal_for_the_eu_financial_supervisory_reform_open_letter.pdf, (accessed 18 May 2018).

[18] Greg Van Elsen, 'Discussion Paper on Automation in Financial Advice', *BEUC*, 14 March 2016, http://www.beuc.eu/publications/beuc-x-2016-025_gve_automation_in_financial_advice.pdf, (accessed 18 May 2018).

However, we have also noted that there are substantial challenges in this new market which, if not mitigated, could lead to serious detriment:

- **Blurring boundaries between advice and execution-only services:** as a consumer it will be increasingly hard to see the difference between 'regulated advice' and mere guidance on an on-line platform, whereby the consumer shoulders the full responsibility for making the right choice.

- **Cost transparency is not achieved**: a study[19] from our UK member the Financial Services Consumer Panel found that only 1 in 15 consumers was able to calculate the correct amount of fees on a €1,000 investment. A study commissioned by the European Commission into the distribution of retail investment products found that robo-advisors fees were often difficult to find on their webpages and/or displayed in a complex way, making it difficult for the average retail investors to understand the fees that they would be charged.[20]

- **No rules for the "online questionnaire**": there should be rules on how a platform should deal with conflicting answers in the on-line questionnaire which assesses the risk profile of the consumers.

- **Black-box algorithms:** the importance of the algorithm that guides consumers cannot be understated. If this is not properly calibrated, there is a serious risk of systematic mis-selling, which cannot be mitigated through human interaction.

Overall, automated advice could help giving consumers access to more tailored and personalised advice. However, there is a **thin line between targeted sales & marketing and providing real advice with the corresponding regulatory protections** (e.g. professional requirements and liability of the adviser).

4. Best practices across the EU: commission ban in the UK and the Netherlands

4.1. Missed opportunities at EU level

The impact of third-party commissions on the quality of investment advice is arguably the thorniest of regulatory challenges in this area.

BEUC has consistently argued that commissions are one of the main reasons for conflicts of interest among financial advisors. They prevent intermediaries from advising their clients as to the product which best suits them. Instead, commissions trigger advice on products bearing the highest profit for the salesperson, not those which respond best to the consumer's needs.

Unfortunately, with MiFID II, EU legislators missed the opportunity to ban such commissions at EU level, in the wake of tremendous industry pressure.

[19] 'Online investment and advice services – the consumer experience', *Financial Services Consumer Panel*, https://www.fs-cp.org.uk/sites/default/files/final_panel_position_paper_online_investment_and_advice_services.pdf, (accessed 18 May 2018).

[20] 'Distribution systems of retail investment products across the European Union: Summary', *European Commission,* 2018, https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems-summary_en.pdf, (accessed 18 May 2018).

Instead, new requirements closely link such commissions to 'service improvements' for people seeking investment advice. But even these modest changes have been watered down further in the implementing phase[21]. It remains to be seen what the concrete effect of the so called "quality enhancing test" will be.

In similar vein, the IDD did not ban commissions, but specified they should not be "detrimental to the service of the consumers". Again here, efforts by EIOPA to give those new rules some flesh to the bone, by specifying which kind of commissions carry greater risks[22], were diluted in the end.

The UK and the Netherlands, which have been frontrunners in this policy debate, have witnessed that enhanced disclosure of commissions did not substantially change the poor state of financial advice and proceeded with a ban of commissions in some areas. Below we discuss briefly its positive effect on their national markets.

4.2. Ban on commissions in the Netherlands

Following a major mis-selling scandal with insurance-linked investment products, the Netherlands gradually strengthened its conduct rules to mitigate the blatant conflicts of interests in financial advice.

The "*Woekerpolis*" scandal in the Netherlands found insurers guilty of profiteering by mis-selling up to seven million investment-linked policies, dating back to 1995 – many of which were sold on the basis of poor advice that failed to disclose the high fees these policies incurred.
As merely disclosing conflicts of interest (the approach still followed by MiFID II and IDD) did not drive real change in firms' behaviour, the Netherlands decided to ban commissions for:

- Mortgages and complex investment product in the Netherlands (2013);
- All retail investment products (2014).

This measure came together with an upgrade of the professional requirements for persons giving financial advice, which has helped in driving change as well. In 2018, the first ban on commissions (for mortgages and complex products) was formally evaluated by the Dutch authorities[23]. Its main findings can be summarised as follows:

- The **ban on commission was effective** and the push of specific products through commissions has completely stopped.
- **Product simplification**: as financial products are not constructed anymore to generate a commission stream, they have become more simple and easy to understand.
- **The quality of the advice delivered to consumers went up substantially**. Although this is not only related to the ban on commissions, and a combination of increased supervision, stricter professional competence requirements and the increasing use of the advisory software are important factors in increasing the quality of advice.

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21 Johannes Kleis, 'EU Regulator waters down financial markets rules after industry pressure', *BEUC*, 6 May 2015, http://www.beuc.eu/publications/beuc-web-2015-002_mifid.pdf, (accessed 18 May 2018).

22 'Technical Advice on possible delegated acts concerning the Insurance Distribution Directive', *EIOPA*, 1 February 2017, https://eiopa.europa.eu/Publications/Consultations/EIOPA%20Technical%20Advice%20on%20the%20IDD.pdf, (accessed 18 May 2018).

23 'Evaluatie provisieverbod, *Tweede Kamer,* 14 February 2018, https://www.tweedekamer.nl/kamerstukken/brieven_regering/detail?id=2018Z00927&did=2018D01944, (accessed 22 May 2018).

- There is **no issue with availability of advice**, although some consumers struggle to differentiate the different kind of services. Intermediaries need to better explain and show the additional value of their advice service. Only 2% of consumers considers the advice cost as a barrier for taking out advice.

- 80% of consumers for mortgages still take out advice, for life insurance it is 60%.

In the light of the positive developments listed above, the Netherlands has firmly decided to maintain the ban on commissions.

4.3. Ban on commissions in the UK

In 2012, the Retail Distribution Review (RDR) proposed several measures to improve the quality of financial intermediation in the UK. One important recommendation has been to remove the bias in financial advice by banning commissions for retail investment products. The RDR thus marks the transition of the UK market to a fee-based system of financial advice. This change came together with much stronger professional requirements for advisers.

In 2016, the UK ban was formally evaluated as part of the Financial Advice Market Review (FAMR)[24]. The FAMR concluded that the Retail Distribution Review "reduced commission bias in the market, ensuring that consumers can have confidence in the impartiality of their advisers, increased transparency regarding charging structures, and increased professionalism in the industry."

While some challenges remain, the main outcomes of the ban were similar to the experience in the Netherlands:

- **Reduction in product bias:** increase in distribution of lower-cost and simpler products;

- More **diversification of business models**, including online distribution;

- More consumers are **buying investment products without advice**, as they can now better judge the additional value of it.

In this context, the UK has also decided to maintain the ban on commissions.

4.4. Lessons learned from UK and NL

A study commissioned by the European Commission published in 2018 found that the ban on commissions in the UK and the Netherlands had a substantial impact on the national investment landscape in these countries. The ban led to a shift in investor behaviour from "obtaining advice through banks and insurers to retail investors either taking investment decisions on their own through on-line investment platforms or obtaining advice through IFAs." The study found that, generally, local investors in these countries became "more cost-sensitive and better informed about investment products."[25]

Overall, the respective evaluations in both countries make it clear that banning commissions is an essential step to reduce conflicts of interest in some areas of retail finance.

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[24] 'Financial Advice Market Review', *Financial Conduct Authority,* 21 December 2015, https://www.fca.org.uk/firms/financial-advice-market-review-famr, (accessed 22 May 2018).

[25] 'Distribution systems of retail investment products across the European Union: Summary', *European Commission,* 2018, https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems-summary_en.pdf, (accessed 18 May 2018).

We acknowledge that going from a commission-based system to a fee-based regime, whereby consumers see explicitly the price they are paying for financial advice, requires a mentality shift from all parties involved. But we are strongly convinced that a commission ban has the following effects:

- Mis-selling incentives for firms are mitigated profoundly, as they are no longer financially driven to sell a particular product to touch commissions.

- Consumers are finally aware of the price they are paying for advice and can make an informed choice whether to take it or not.

- Financial advice providers need to explain more clearly the added value of their service, which incentivizes them to really act in the best interest of their clients, raises the quality of advice and spurs innovative services.

The evaluations also indicate that consumers are willing to explicitly pay for financial advice, if they judge it is worth the price. Industry allegations over the danger of a so-called advice gap seem not to materialise in practice.

Obviously, we should keep in mind that banning commissions is not the silver bullet that solves all problems in retail finance. Other measures such as more product intervention and the adoption of simple and standardised products remain equally important, especially for lower to middle-income consumers. But banning commissions is an essential building block in letting consumers stop paying the price for bad advice.

5. Policy recommendations

Improving consumers' fate when receiving financial advice is fundamental towards restoring trust in retail financial services.

In this paper we have set out that the current regulatory approach is not set to restore that trust in any near future. The rulebook is scattered along outdated sectoral lines, full of inconsistencies and not future-proof with digitalisation in mind. Enforcement of the detailed rules is hardly happening on the ground, while more straightforward rules such as introducing a ban on commissions have been blocked at EU level.

In order to fix the flawed regime for regulating financial advice across the EU, we propose the following measures to be investigated and considered by EU legislators:

- **Harmonisation of conduct rules across all different financial sectors through an omnibus legislation, providing;**

    - **a common set of definitions and terminology;**

    - **minimum conduct rules dealing inter alia with conflicts of interests, provision of advice, suitability of financial products, marketing rules, etc.**
    - **minimum professional requirements for intermediaries providing financial advice.**

- **A ban on commissions for all investment products and complex financial products;**

- **For all other types of financial services (e.g. for mortgage credit and consumer credit), a limitation of commission-based remuneration to a product neutral model, whereby monetary incentives from third-parties are equal and transparent;**

- **An investigation into complementary services to financial advice, such as independent guidance[26], to help consumers make better choices in retail finance;**

- **Greater price transparency for retail financial services, especially, transparency of costs and charges for investments, pensions, and other long-term saving products.**

In the shorter term, the changes brought about by MiFID II and IDD should be tested swiftly by the Joint Committee of the European Supervisory Authorities (ESAs). Therefore, we ask EU legislators to:

- **Check the implementation and enforcement of MiFID II and IDD, in particular, the revised framework concerning commissions, including an analysis of best practices;**

- **Hold a comprehensive mystery shopping exercise across all member states, coordinated by the ESAs, on the quality of financial advice.**

END

[26] 'Financial guidance – FSUG Recommendations', *Financial Services User Group*, November 2016, https://ec.europa.eu/info/sites/info/files/1611-fsug-financial-guidance_en.pdf, (accessed 22 May 2018).

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