The European Consumer Organisation

The Consumer Voice in Europe

BEUC RESPONSE: DISCUSSION PAPER ON AUTOMATION IN FINANCIAL ADVICE

Contact: Greg Van Elsen – financialservices@beuc.eu

BUREAU EUROPÉEN DES UNIONS DE CONSOMMATEURS AISBL | DER EUROPÄISCHE VERBRAUCHERVERBAND
Rue d'Arlon 80, B-1040 Brussels • Tel. +32 (0)2 743 15 90 • www.twitter.com/beuc • consumers@beuc.eu • www.beuc.eu
EC register for interest representatives: identification number 9505781573-45

Co-funded by the European Union

Ref: BEUC-X-2016-025 - 14/03/2016

Why it matters to consumers

Good and affordable financial advice is hard to find for consumers when taking important financial decisions. Digital technology is set to challenge the current advice models, which are overly costly and prone to sales pressure. Automated advice could help filling the void left by incumbents, but also brings new pitfalls for consumers.

General comment

BEUC welcomes the European Supervisory Authorities' early commitment to the topic of automated advice. In general the discussion paper presents a well-balanced overview of potential benefits and risks of this new trend in the distribution of financial services.

Digitalisation is set to profoundly change the way consumers will be managing personal finance. New distribution models, innovative products and services and changing consumer behaviour will challenge the current regulatory framework for retail financial services. Protecting consumers in this area will require new approaches.

Getting advice in financial services, in all its different forms, will be one of the areas where consumers could potentially benefit a lot from smart technology, if designed well.

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[1] and by public authorities[2]. 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.

In this perspective BEUC welcomes new entrants in this advice market, adding competitive pressure on more traditional intermediaries. **Automated advice models hold a promise of better delivering transparent & accessible & cost-effective advice to the mass market segment, which is unmet or badly served right now**. First assessments of such platforms, especially in the retail investment segment, seem to support this view[3].

[1] Test-Achats https://www.test-aankoop.be/action/pers%20informatie/persberichten/2014/mijn-bankier-adviseur-of-verkoper
VZBV http://www.vzbv.de/pressemitteilung/qualitaet-von-finanzberatungen-unzureichend

[2] FSMA http://moneytalk.knack.be/geld-en-beurs/fsma-banken-geven-slechte-informatie-en-advies/article-normal-578269.html
EC
http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/investment_advice_study_en.pdf

[3] Which? Money magazine article

Obviously, one of the key factors determining market outcomes will be the quality of the algorithm guiding consumers through the advice process. Regulatory oversight of the software involved is therefore crucial, as all the features of unsuitable "human" advice (e.g. a product bias toward unsuitable products because of commissions) can easily be mimicked by an algorithm. Regulatory attention should also go towards avoiding or mitigating the usual conflicts of interest which have perturbed classical advice models.

More broadly, automation in financial services distribution could further blur the boundaries between pure sales (execution-only) and regulated advice models, potentially leaving consumers much less protected than they would expect.

1. Do you agree with the assessment of the characteristics of automated financial advice tools presented in this Discussion Paper? If not, please explain why.

BEUC agrees with the assessment of characteristics as laid in the Discussion paper. This said, we would like to stress that:

- Fintech evolutions are blurring the boundaries between different distribution models at unprecedented pace. In that perspective it might prove very challenging to make a distinction between automated advice and price comparison websites. Comparison websites will deliver an increasingly "personalised" service too. Most importantly, consumers are likely not to make a distinction between using price comparison websites and platforms giving automated advice.

- Particularly in the non-life insurance area, we have witnessed the proliferation of many comparison websites. While these can be instrumental in stimulating price competition, we have observed conflicts of interest too, such as price comparison websites owned by insurance companies and questionable ranking methodologies. BEUC has identified previously some horizontal principles which could steer comparison websites towards better consumer outcomes[4].

- Similarly, it is hard for consumers to discern between services that provide legal advice and services that merely provide guidance. A well-designed on-line platform can easily give consumers the impression they are getting "full advice" while in practice this is not the case, which has major consequences for liability and redress mechanisms.

- The use of automated advice features is increasing in other Fintech segments, like peer-to-peer business lending, whereas over 40% of platforms offers auto-bidding/auto selection functionalities to lenders[5].

[4] http://www.beuc.eu/publications/2012-00536-01-e.pdf
[5] http://www.nesta.org.uk/publications/pushing-boundaries-2015-uk-alternative-finance-industry-report

3. Are you aware of examples of automated advice tools being used in the banking, insurance, and/or securities sectors? Please provide examples, giving details of their operating process.

Next to comparison websites in the non-life insurance area, the most notable new players offering automated advice are in the retail investment area. Wealth Horizon, Nutmeg and Money on Toast (UK) and Prittle (NL[6]) have a similar modus operandi: through a pre-defined set of questions, platforms assess a consumer's investment goals, time horizon and risk appetite. On the basis of that outcome they will suggest an optimal mix between different asset classes for the consumer, often involving cost-effective Exchange Traded Funds (ETFs).

6. Do you consider the potential benefits to consumer to be accurately described?

BEUC agrees with the potential benefits described in the discussion paper. We would especially like to stress the potential of lowering costs for consumers which in turn can:

- Deliver better returns to retail investors, taking into account the huge impact of costs and charges on profitability.
- Unlock access to affordable investment advice for mass market consumers who are comfortable with purchasing financial services on-line. Research from Which? showed that there is a clear discrepancy between what people are willing to pay for advice and the likely cost of giving traditional advice[7].

An additional positive feature of automated advice is that such platforms are designed to ensure a user-friendly experience, providing all necessary information in a clear and timely fashion. Such **transparency**, **especially on costs,** would provide a welcome change for the often opaque and complex charging structures in more traditional set-ups.

From a behavioural point of view, consumers could also act more rationally when making financial choices in a digital environment, being not exposed to often sales-driven human pressure.

9. Have you observed any of these benefits? If so, please provide examples and describe the kind of benefit accrued.

The first assessments of automated advice in retail investment provide clear evidence that these models are substantially cheaper than traditional advice models. According to research from Which?, total annual costs of these platforms range from 0,5% and 1.6% of funds invested. Compared with levies charged by traditional independent financial advisors (typically 3% upfront + 0,5% annual fees + 1% ongoing advice), it is clear that there is a lot of potential for cutting costs.

[6] http://www.consumentenbond.nl/financieel-adviseur/robotbelegger-pritle

[7] For investing a £60.000 pot, the average amount people say they'd willing to pay is around £260, but is more likely to cost around £1.450 – excluding fund charges (Which? Money Magazine, February 2016). Costs using an automated tool (excluding fund charges) would amount on average to £586.

14. Do you agree with the description of potential risks identified? If not explain, why?

BEUC broadly agrees with the description of the potential risks identified. We would like to point to the importance of the algorithm that guides consumers. If this is not properly calibrated, there is a serious risk of systematic mis-selling, which cannot be mitigated through human interaction.

Next to this, we feel that the privacy risks associated with automated advice are a bit narrowly described. In this perspective we would like to flag the possibility that the algorithm takes into account other data gathered elsewhere, besides what the consumer actively inputs.

Overall, there is an absolute need for automated advice models to respect EU data protection law, in particular the rules on "purpose limitation" (data must not be used for purposes which are incompatible with the original purpose that justified the initial data collection) and data minimisation (intermediaries should not ask for more data than is necessary for the provision of the service). Consumers also need to be well informed and receive transparent information on how their data is used and processed.

On a final note, we would like to point to the cross-border potential of on line automated advice in the longer run and the specific risks this entails. According to recent research on alternative finance platforms[8] (covering e.g. peer-to-peer lending and equity crowdfunding) more than half of the platforms surveyed reported cross-border inflows. Weak or absent regulatory regimes in one member state could therefore increasingly cause detriment in other member states.

24. Are there any other comments you would like to convey on the topic of automation in financial advice?

As laid out above, BEUC embraces the potential of automated advice tools for bringing more cost-effective, accessible and transparent investment advice or guidance to consumers, if they are designed well.

We believe the potential of automated financial advice is especially large for internet-savvy consumers who have a minimum level of financial education. Appropriate measures should be taken to prevent over-confident consumers from taking bad decisions using automated online tools. Using proper risk warnings, or prompts steering consumers to double-check the suitability of products him/herself (especially in non-advised sales) should therefore be investigated further.

Finally, we would like to underline that a majority of consumers will not be relying on these automated advice tools, even in the years to come. ESAs must remember that traditional financial advice in general is of poor quality. Quite strikingly, the development of automated financial advice in retail investment seems to emerge first in member states where serious measures to fix traditional advice markets have been taken. Upgrading investor protection by banning third-party commissions[9] is probably one of the best ways to stimulate the development of more consumer-centric advice models in retail investment.

---

[8] http://www.nesta.org.uk/publications/pushing-boundaries-2015-uk-alternative-finance-industry-report

[9] As in the UK and NL.

This publication is part of an activity which has received funding under an operating grant from the European Union's Consumer Programme (2014-2020).

The content of this publication represents the views of the author only and it is his/her sole responsibility; it cannot be considered to reflect the views of the European Commission and/or the Consumers, Health, Agriculture and Food Executive Agency or any other body of the European Union. The European Commission and the Agency do not accept any responsibility for use that may be made of the information it contains.