FACTSHEET The price of bad advice

Why is financial advice so important?

Advice is something we seek for all sorts of important financial decisions in our life like getting a mortgage, or setting up an investment or pension plan. That's because these products are often highly complex, come in all shapes and sizes and are long-term which might have a huge impact on the consumer's financial health. It's absolutely essential that consumers are able to rely on this advice.

Unfortunately, the quality of advice consumers receive in finance varies enormously. Acting in the best interest of clients, a principle enshrined in many pieces of financial regulation, remains often dead letter. In most cases, financial 'advice' is nothing more than a commission-driven sales pitch trying to sell the consumer particular products which offer greater rewards for the salesman.

How bad is the problem?

We have put together a snapshot of the major mis-selling scandals resulting from bad advice over recent years in a website www.ThePriceofBadAdvice.eu. The result is based on investigations carried out by national authorities, press coverage and information provided by national consumer groups.

Although it isn't possible to provide the exact consumer detriment in every case, the figures we do have are mind-boggling. When we know this is only a snapshot because many cases might not be investigated or even have been unearthed, the chasm between consumer protection laws and reality for consumers becomes evident. The website only considers mass mis-selling scandals, not individual cases of mis-selling which can be just as destructive for people's lives .

Payment Protection Insurance mis-selling scandal in the UK

An estimated 12m consumers were affected. Payment Protection Insurance (PPI) was a product sold on the basis that it would cover repayments on loans when a customer fell ill, became unemployed, or was involved in an accident. It was sold alongside credit, including mortgages or credit cards by all the main UK banks since the 1990s.

However, PPI policies were frequently mis-sold to consumers who would never be able to claim it and many consumers were not even aware that they were sold the insurance. In 2011, the UK banking industry lost a legal challenge and banks were required to pay redress to consumers. The 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.

Mystery shopping in Germany

Between November 2014 and October 2015, the Federation of German Consumer Organisations, vzbv, evaluated personal investment and pension advice given by banks and others in the German market. They evaluated 835 existing consumer portfolios (containing 3,502 investment products). Their 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.

BEUC The European Consumer Organisation

Rue d'Arlon 80
B-1040 Brussels
Tel +32 (0)2 743 15 90
www.beuc.eu

How can you regulate something like advice?

At first glance, it might look difficult to regulate the content of a conversation happening over the phone or in person at a company's premises. However, bad advice can be tackled by looking at its sources.

Commissions and mis-selling fit like a hand in a glove: Commissions and sales incentives fuel mis-selling in that the 'advisor' has an incentive to sell the product that offers them the best incentive rather than one that is in the consumer's interest. Both the UK (2012) and the Netherlands (2013-14) took the decision to ban commissions in certain areas. After review, both countries concluded the bans had had a positive impact on the quality of advice and the bans would be maintained.

A patchwork of rules at EU level: There are many concepts or requirements of advice which exist such as clear, fair and not misleading communication to consumers or suitability and appropriate tests, but these are brought into sectoral legislation in a completely piecemeal approach, lacking consistency and even common definitions and terminology.

Weak enforcement of the rules: The weak application of financial consumer protection law is a real concern.[1] One of the fundamental protections in recently-adopted financial services legislation is a requirement for a personal recommendation to suit the consumer's needs. But both the EU watchdog ESMA and the Irish Central Bank found these requirements were not being taken seriously enough.[2,3]

There is another factor that explains mis-selling: the **complexity of financial products** in general. This will need to be tackled in the future if the quality of consumer advice is to substantially improve.

What does BEUC recommend?

We recommend the EU takes action to improve the quality of advice consumers receive.

- The EU should ban commissions on all investment and complex financial products.
- There should be greater transparency for retail financial services, especially, transparency of costs and charges for investments, pensions, and other long-term saving products.
- The terminology and definitions related to financial advice should be harmonised across all financial legislation.
- There should be an investigation into complementary services to financial advice, such as independent guidance, to help consumers make better choices in retail finance.
- There should be minimum professional requirements for those who provide financial advice to consumers.

[1] '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).
[2] '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).
[3] '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).

This factsheet is part of an activity which has received funding under an operating grant from the European Union's Consumer