

The Consumer Voice in Europe

THE CASE FOR BANNING COMMISSIONS IN FINANCIAL ADVICE



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Why it matters to consumers

Consumers rely on financial advice when taking important financial decisions, such as saving for their retirement, taking out a life insurance policy or when investing money for a rainy day. When taking such decisions, consumers should be able to rely on impartial, competent and trustworthy advice, assisting them in carefully considering the options available.

Summary

In June 2018, BEUC launched its [campaign](#) on *The Price of Bad Advice* which includes a website with over forty mis-selling scandals across fifteen European countries. Our web-map shows that consumers in Europe are too frequently exposed to poor financial advice, often with devastating results for the people involved. The mis-selling cases on our website demonstrate that financial advisers frequently give advice that is not in the consumer's interest, provide inadequate information to consumers, or sell expensive products to consumers that do not deliver what was promised.

At a time when consumers are forced to take more difficult decisions about their personal finances, urgent reforms remain necessary at EU level to ensure that advice to consumers is trustworthy and fair. Commission-based financial advice, where financial advisers are remunerated by product manufacturers for recommending a specific financial product to consumers, puts a conflict of interest at the heart of the client relationship, often leading to biased advice to the detriment of consumers. To ensure that advice to consumers is tailored to their needs, the payment of commissions for advice on retail investment products and complex financial products should be banned in the EU.

In this paper, we set out the case for a ban on commissions, building on our previous [position paper](#) on *The Price of Bad Advice*. We evaluate the impact of the recent bans in the Netherlands and the United Kingdom, where advisers are no longer allowed to accept conflicted remuneration from product manufacturers. The evidence shows that a commission ban would reduce conflicts of interest for advisers, encourage the distribution of more cost-effective investment products to consumers, while increasing competition between product manufacturers to the benefit of consumers. In addition, we address some of the concerns that an 'advice gap' may have emerged in countries which have implemented bans. Finally, we map efforts to date by financial regulators worldwide to ban commissions.

1. Banning commissions in financial advice

Today, consumers face a nearly insurmountable task when trying to choose the right investment product, life insurance or pension product. A high degree of product complexity and the variety of products available on the market mean that consumers find it difficult to make the right choice. For this reason, many turn to financial advisers for help.

When taking such important financial decisions, consumers should be able to rely on impartial, competent and trustworthy advice, assisting them in carefully considering the different options available. Unfortunately, misaligned incentives in the financial advice market often unduly influence the investment options offered to consumers. While advisers should have the best interest of clients at heart, commissions paid by product manufacturers (such as the producers of investment funds, life insurance policies, or pension products) give rise to conflicts of interest, undermining the ability of advisers to provide unbiased investment recommendations.



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Commissions can account for a very large proportion of the revenue for financial intermediaries advising on investment and insurance products. For instance, according to a survey carried out by the Swedish financial supervisor Finansinspektionen, insurance intermediaries in Sweden can derive up to 99% of their total revenues from the commissions paid to them by product manufacturers.¹ Often, the commissions paid by product manufacturers consist of one part that is paid out in the form of a lump sum (also known as the 'upfront commission'), and another part that is paid out on a staggered basis over the course of the life of the product (also known as the 'trailing commission'). Commissions have been a central driver behind many recent mis-selling scandals across financial services. The payment of commissions to advisers means that:

- **Advisers are more incentivised to sell products, rather than offer suitable advice to the consumer.** Mystery shopping exercises carried out by supervisors and our members show that the investment recommendations offered to clients are often not in line with the consumer's investment profile.² Our [web-map](#) of mis-selling scandals demonstrates the continuing inadequacy of financial advice in Europe.
- **Products are recommended to clients not based on their merits, but instead based on those which generate the highest commission for the adviser.** A study commissioned by the UK's Financial Services Authority in 2009, as part of its Retail Distribution Review, found that in the past, competition in the UK retail investment market was primarily driven by product providers offering higher

¹ Finansinspektion, 'A necessary step for a better savings market', https://www.fi.se/contentassets/2e823e1569864e69b8e9b052352cf2ed/battre_sparandemarknad_engny.pdf, p.9.

² Please refer to our [position paper](#) on 'The Price of Bad Advice' (p. 4-5) and our [web-map](#) for relevant case studies of mis-selling scandals.

commission rates to advisers in order to recommend their products to end investors.³

- **Financial advisers are encouraged to distribute higher-cost investment products to consumers, that allow for a higher commission to the adviser.** For instance, research by the European Insurance and Occupational Pensions Authority (EIOPA) shows how insurers receive over €5 billion on a yearly basis from investment fund managers, in turn steering EU consumers towards more expensive life insurance products in the process.⁴ [Research](#) by our member the Norwegian Consumer Council shows that commissions lead to conflicts of interest and make investments more expensive for the average consumer in Norway.
- **The products recommended by financial advisers may also be limited to those that attract a commission.** As a result, lower-cost investment products that do not attract a commission or attract lower commissions may fail to gain market share (see our case study below on [‘The sale of Exchange-Traded Funds to retail investors in Europe’](#)).

In recent years, in response to a series of mis-selling scandals in their countries, several governments have implemented bans on the payment of third-party commissions to financial advisers. Recognising the limits of disclosure in tackling conflicts of interests, the UK and the Netherlands banned third-party commissions in 2013. In these countries, advisers can no longer be remunerated by product providers and must instead charge a separate fee for the cost of advice to the consumer. Since the implementation of these bans, reviews carried out by the Dutch and UK governments demonstrate the profound impact that bans have had in ending product bias. This has, in turn, promoted the distribution of more cost-effective and simpler products to consumers (see [Section 3](#) of this paper). Several other countries worldwide have also implemented commission bans in order to mitigate against conflicts of interest (see the [Annex](#) for an overview).

CASE STUDY: THE SALE OF EXCHANGE-TRADED FUNDS TO RETAIL INVESTORS IN EUROPE

An Exchange-Traded Fund (also known as an ‘ETF’) is an investment fund that holds a mix of assets such as stocks, commodities, or bonds. Most ETFs are investment funds that follow a ‘passive’ investment strategy, where the fund seeks to replicate the performance of an underlying index. For example, if an ETF tracks the FTSE-100, the fund invests in all of the company stocks listed on the FTSE-100 stock exchange. ETFs mostly follow a ‘passive’ strategy and do not require security selection or extensive research by fund managers, and so fees are typically considerably lower than for actively managed funds. Due to the lower fees, ETFs generally do not pay commissions for distribution, reducing their attractiveness for intermediaries distributing products to retail investors.

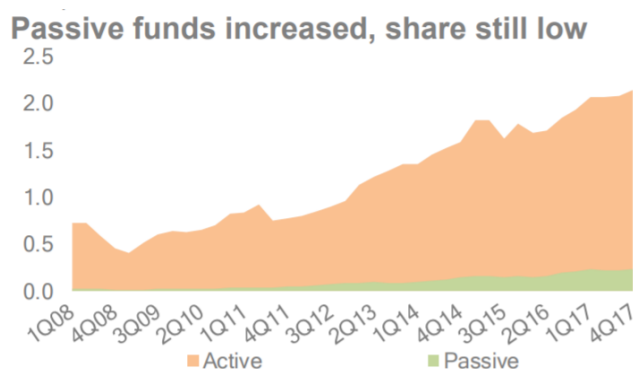
In 2018, the European Commission published a Retail Distribution Study investigating how investment products are distributed to retail investors in 15 European countries.⁵ The study shows that ETFs are easily accessible to well-educated retail investors when investing on their own on an online investment platform or through a robo-adviser. However, for less sophisticated retail investors who rely on human-based advice through banks or insurers,

³ Oxera, ‘Retail Distribution Review proposals: Impact on market structure and competition’, <https://www.oxera.com/wp-content/uploads/2018/03/RDR-proposals-June-2009-1.pdf>, p. 21.

⁴ EIOPA, ‘Thematic Review on monetary incentives and remuneration between providers of asset management services and insurance undertakings’, https://eiopa.europa.eu/Publications/Reports/16.%20EIOPA-BoS-17-064-Report_Thematic%20review%20on%20monetary%20incentives%20and%20remuneration.pdf.

⁵ European Commission, ‘Study on the distribution systems of retail investment products’, https://ec.europa.eu/info/publications/180425-retail-investment-products-distribution-systems_en.

the study found that ETFs are rarely offered to retail investors. As commissions are one of the main drivers influencing investment advice, ETFs have been neglected by advisers unwilling to market low-fee products. The study estimates that as a result, **retail investors only hold about 10% to 15% of total ETF assets in Europe.** A study conducted by the French Supervisory Authority (AMF) similarly finds that ETFs are generally not marketed to retail investors, estimating that ETFs accounted for only 4% of collective investment assets in France.⁶ ESMA estimates⁷ that passive investment management accounts for only 10% of the overall EU equity market, with passive investment funds particularly negligible in certain countries (including Belgium, Italy and France):



The commission ban in the UK has resulted in a shift towards passive investment strategies, such as ETFs. In the UK, the market share of passive funds grew significantly following the entry into force of the ban in 2013 (see more in [Section 3.1](#)). Investment research firm Morningstar estimates that index fund assets grew in the UK from 6.9% to 13.5% of industry assets between 2012 and 2016.⁸



According to a mystery shopping exercise carried out as part of the European Commission’s Retail Distribution Study⁹, independent financial advisers (IFAs) in the UK were recommending ETFs to their clients, as they are no longer incentivised to seek commissions. The study found that 20% of the assets actively offered by IFAs to retail investors in the UK included ETFs, with the remainder of assets divided between a variety

⁶ French AMF, ‘Risk and Trend Mapping No 17’, https://www.amf-france.org/en_US/Publications/Lettres-et-cahiers/Risques-et-tendances/Archives.html?docId=workspace%3A%2F%2FspacesStore%2Fc384ec29-a8f0-44d3-97bf-4013e7f17114, p. 81.

⁷ ESMA, ‘Performance and costs of retail investment products in the EU’, https://www.esma.europa.eu/sites/default/files/library/esma50-165-731-asr-performance_and_costs_of_retail_investments_products_in_the_eu.pdf, p.25

⁸ Morningstar, ‘CSA Consultation Paper 81-408; Consultation on the option of discontinuing embedded commissions’, <http://video.morningstar.com/ca/CommentLetter-ENG.pdf>, p. 3-4.

⁹ European Commission, ‘Study on the distribution systems of retail investment products’, https://ec.europa.eu/info/publications/180425-retail-investment-products-distribution-systems_en.

of mixed funds, bonds, equities, and pension products. In the Netherlands, passive funds also witnessed increased sales following the entry into force of the commission ban (see [Section 3.2](#)).

That financial advisers neglect lower-cost investment funds (such as ETFs) works to the detriment of the average retail investor, as studies show that the level of fees of an investment fund is critical to fund return over time. For instance, in 2018, the FCA carried out a study into the asset management sector in the UK. The study found that there is “**no clear relationship between price and performance** – the most expensive funds do not appear to perform better than other funds before or after costs.”¹⁰ On the contrary, the FCA found that there is “some evidence of **a negative relationship between net returns and charges**.”¹¹ In 2019, ESMA published a study showing that the performance of investment funds is significantly impacted by fees, with charges on average reducing gross returns by 25% for investors.¹² ESMA’s study also found that passive funds consistently outperformed actively managed funds, once charges were taken into account. A study by our member the Norwegian Consumer Council similarly found that actively managed investment funds offered to retail investors in the Norwegian market only rarely outperformed their cheaper passive alternatives.¹³

A ban on commissions would accelerate inflows into lower-cost passively managed funds, as well as into lower-cost active investment funds. The purpose of a commission ban would not be to displace active fund managers, or to favour passive investment funds over active investment management. However, a commission ban would level the playing field by eliminating the current incentive to recommend the most expensive products. It will also encourage advisers to exercise more discretion (including related to costs) when making investment recommendations.

2. MiFID II: Missed opportunity at the EU level

The EU considered a general ban on commissions during the revision of the Markets in Financial Instruments Directive (MiFID II). MiFID II is a key piece of investor protection legislation that sets harmonised conduct of business regulations for investment firms offering advice to investors. Unfortunately, due to strong opposition by the financial services sector, MiFID II ultimately only banned commissions where ‘independent advice’ is provided to consumers. Under MiFID II, firms that provide investment advice on an independent basis are not allowed to receive commissions when making investment recommendations. However, in cases where non-independent advice is given to a consumer, advisers are still permitted to receive commissions as long as they:

¹⁰ FCA, ‘Asset Management Market Study – Interim Report’, <https://www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf>, p.15.

¹¹ FCA, ‘Asset Management Market Study – Final Report’, <https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf>, p. 4.

¹² ESMA, ‘ESMA Report finds investment product performance highly impacted by charges’, <https://www.esma.europa.eu/press-news/esma-news/esma-report-finds-investment-product-performance-highly-impacted-charges>

¹³ Finansportalen, ‘Indeksfond Eller Aktive Fond – Hva er Best?’, <https://www.finansportalen.no/andre-valg/artikler/indeksfond-eller-aktive-fond-hva-er-best/>

- Are designed so as to **enhance the quality of the service provided** (the so-called 'quality enhancement test'¹⁴)
- Do not impair the firm's duty to **act honestly, fairly and professionally** towards the client in accordance with their best interest
- The commissions are **disclosed**

Some suggest that commission disclosure would discourage advisers from recommending products with unacceptably high commission rates, or that disclosure would allow consumers to choose less costly advice. However, in practice, consumers find it difficult to understand how commissions may affect the independence of advice, and consumers may not have the required knowledge to sufficiently adjust for the disclosed conflict of interest. For instance, a survey of by the Central Bank of Ireland of consumers who recently sought financial advice shows that a **majority of respondents were completely unaware of any ongoing commission payment** to financial advisers.¹⁵ The survey also found that **39% of respondents believed that financial services laws require financial advisers to be paid the same level of commission** for the sale of all products (even though this is not the case).

A study in the Netherlands found that **commission transparency had limited impact on the decision-making behaviour of consumers**: "obtaining information is one step; converting that information into understanding and action, which is what transparency ultimately involves, is another."¹⁶ The Dutch Ministry of Finance argues that: "Remuneration transparency is an important first step. However, it appears that even if consumers are informed, they do not always act upon this information by shopping around for less costly and more unbiased advice."¹⁷

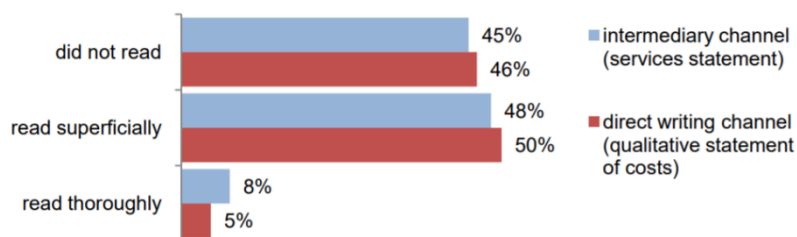
¹⁴ Official Journal of the European Union, Article 11(2)a of the Delegated Directive 2017/593 supplementing MiFID II, <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32017L0593>. Under MiFID II, non-independent advisers are permitted to continue receiving commissions as long as the inducement enhances the quality of the service for the client. A commission is considered to enhance the quality of the service if the inducement (a) allows access to a wider range of suitable investment products (including from third parties); (b) allows ongoing 'advice' or a 'service' to the client (e.g. on the continuing suitability of the products, and/or optimal asset allocation); (c) is paired with an added value tool (e.g. such as objective information tools helping the relevant client to take investment decisions). For the distribution of insurance-based investment products (for instance, life insurance policies with an investment component), even slightly different rules apply. For instance, while under MiFID II, financial advisers have to disclose the nature and the amount of the commission paid, the IDD only requires financial advisers to disclose the nature of the commission (but not the amount).

¹⁵ Central Bank of Ireland, 'Consumer understanding of Commission Payments', <https://www.centralbank.ie/docs/default-source/publications/consumer-protection-research/consumer-understanding-of-commission-payments--november-2017.pdf?sfvrsn=2>.

¹⁶ SEO, 'Evaluation of commission rules for complex products', http://www.seo.nl/uploads/media/2010-44_Evaluation_of_commission_rules_for_complex_products.pdf, p. iii.

¹⁷ Quoted in 'Towards a fairer deal for consumers and the financial industry', <https://sven-giegold.de/wp-content/uploads/2012/09/Towards-a-fairer-deal-engl-version.pdf>.

Figure 4-3: A minority of consumers read through the information about costs and services thoroughly



Source: SEO/TNS Nipo 2010

In 2010, research carried out for the Dutch government found that consumers who purchased complex investment products **rarely carefully considered the 'services statement' provided to them during the financial advice process.** The 'services statement' included detailed information about the level of remuneration paid to the financial adviser. According to a survey carried out as part of this study, **only a small number of consumers thoroughly read the document.**


Prior to the commission ban in the UK, the FCA introduced a disclosure regime in an effort to assist consumers in their decision-making when seeking financial advice. Firms were required to disclose the maximum commission they received for a product, as well as the market average for a range of products in the form of an 'initial disclosure document'. In 2007, a study commissioned by the UK's FCA, found no **consistent evidence that commission disclosure led to decreases in commission rates.** In fact, the study found evidence that **commission rates actually increased** following enhanced disclosure **for 8 out of the 11 product categories** covered by the disclosure requirement.¹⁸

¹⁸ CRA International, 'An Empirical Investigation into the Effects of the Menu', http://www.fsa.gov.uk/pubs/other/CRAreport_menu.pdf, p. 28. "Table 5 shows that there is no consistent evidence that mean commission rates fell following the implementation of the menu. In fact, of the 11 product categories the menu covers, there were increases in mean commission rates in 8 categories"

Fundamentally, disclosure also does nothing to address the structural and systemic problems that conflicts of interest have created in the first place, hurting investors and the market itself.

The quality enhancement test may require non-independent distributors to provide a wider range of suitable financial instruments, including from third party product providers with no close links to the investment adviser. However, distributors are still incentivised to select instruments that offer a commission, excluding the distribution of lower-commission products, or products (such as ETFs) that do not pay a commission.

Finally, a ban on commissions is a more targeted and simpler measure compared to imposing complex conduct rules and disclosure rules on market participants in order to limit the inherent conflicts of interest at the heart of the financial advice process. If the market structure is such as to give the right incentive, then appropriate behaviour by advisers should naturally follow, and regulatory oversight of that behaviour can be reduced. However, if the market structure and incentives are set incorrectly, then regulation which imposes behaviour which conflicts with the commercial interest of participants is likely to enjoy limited success.



"Regulatory policy has given little attention to issues of market structure and the nature and effectiveness of competition, instead developing detailed and often prescriptive rules governing market conduct, with substantial cost and limited success. **Regulation should focus on the establishment of market structures which provide appropriate incentives, rather than the fruitless attempt to control behaviour in the face of inappropriate commercial incentives.**"

Professor John Kay, Economics Fellow at Oxford University

3. The case for independent advice

3.1 Retail Distribution Review in the United Kingdom

In 2013, following an in-depth Retail Distribution Review (RDR) in the UK, the FCA banned commissions. As of 1 January 2013, intermediaries can no longer receive commissions on retail investment products offered by product providers, and advisers can only be paid for their services by charging a separate fee to the client. Following the RDR, firms providing advice on retail investment markets need to explain whether their services are 'independent' or 'restricted'. Independent advice should be free from any bias or restriction and based on an assessment of the whole of market. Where firms restrict the scope of their advice to only certain products or providers, they must disclose this to the consumer and clearly explain the nature of the restriction. The RDR also introduced stricter professional requirements on financial advisers.

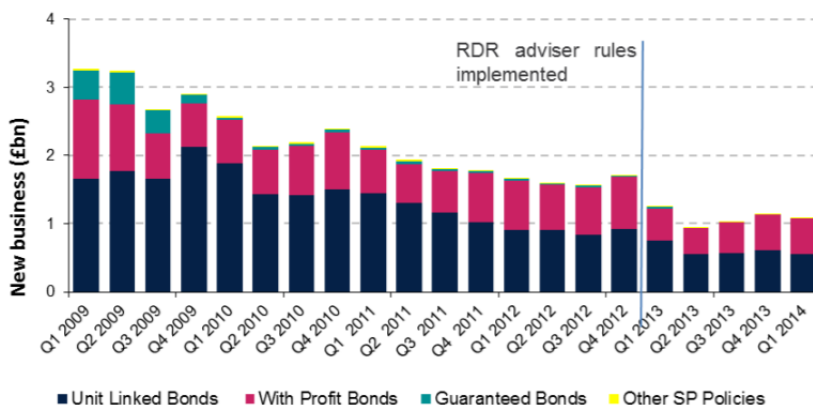
The commission ban reduced conflicts of interests for advisers

In 2014, a study commissioned by the FCA¹⁹ found that the ban **reduced conflicts of interests** for advisers and significantly **reduced product bias**. This was evident from a **decline in the sale of products which attracted high commissions pre-RDR**, and an

¹⁹ Europe Economics, 'Retail Distribution Review – Post-implementation Review', <https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf>.

increase in the sale of those products which attracted lower or no commissions before the entry into force of RDR. For instance, following the entry into force of the commission ban, there was a significant decline in the sale of investment bonds (which used to attract high commissions up to 7.5% of the initial invested amount):

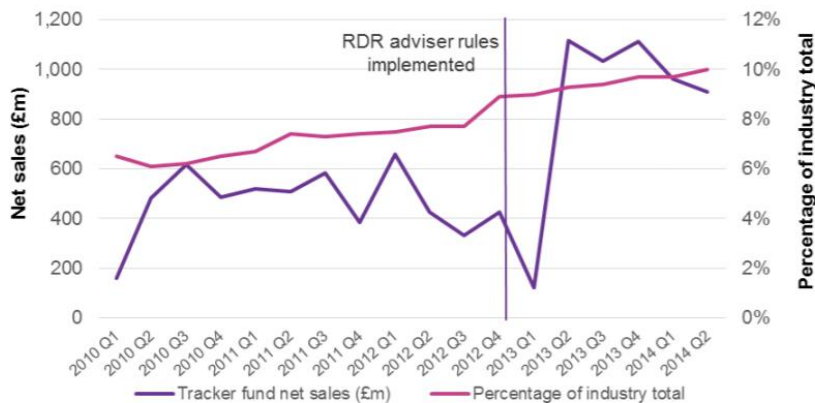
Table 6.3: Decline in investment bonds



Source: Association of British Insurers (2014). Note data refer to ABI members only.

There was also **a move towards lower-cost products** (which did not used to attract high commissions pre-RDR), with advisers increasingly recommending such products to consumers. For instance, the sales of tracker funds increased dramatically post-RDR, from approximately £400m in 2012 to £1,000m at the beginning of 2013 (RDR entered into force in Q1 2013). Tracker funds are low-cost investment products that typically have lower costs compared to actively managed investment funds (see also our case study on [The sale of Exchange-Traded Funds to retail investors in Europe](#)).

Figure 6.3: Tracker fund net sales and percentage of total funds under management

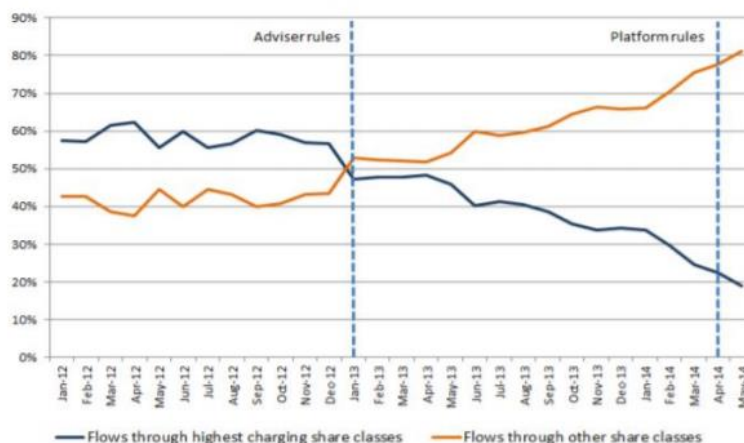


Source: IMA.

Tracker funds, or low-cost investment funds, **attracted an inflow of investment following the commission ban**, as advisers recommended products based on their merit, not for the commission they could attract.

The UK FAMR also found evidence of a decline in the sale of investment products sold from highest charging share-classes. In January 2012, **60 per cent of all gross retail flows** was through highest charging share classes. As of May 2014, two and a half years after the entry into force of the UK ban, this proportion fell to **20 percent**.

Figure 6.2: Gross retail flows through highest-charging class shares and other shares



The study concluded that the ban on third-party commissions appeared to have reduced product bias, and that **product manufacturers who sold lower or no-commission products prior to the RDR are now “competing on a more equal basis.”** The study finally also concluded that “consumers who are receiving full advice now are more likely to be receiving better advice due to advisers being better qualified and the reduction in product bias.”

The commission ban increased competition between product manufacturers and lowered prices for consumers

The study also found that “with the removal of provider commissions, advisers are **exercising price pressure on providers.**” For instance, the study showed “an increase in price pressure (e.g. in the form of more protracted negotiations [between advisers and product manufacturers]).” Advisers are increasingly searching for the most cost-effective product for their client, rather than searching for the product that attracts the highest commission for themselves. The study concluded that “charges for retail investment products have been falling post-RDR, **driven by increased pressure on providers from advisers and platforms as a result of the RDR.**” Removing financial incentives to favour one product over another encourages advisers to focus on the quality of the investment product, of which cost can be one important indicator.

“Taken altogether, post-RDR there has **been a shift in the dynamics of competition**, with providers no longer competing via commission for advisers to sell their products. Instead, **providers now compete, at least partly on price, for business from platforms and from advisers.**”

Findings from the Retail Distribution Review Post- Implementation Review

In 2018, the UK's Financial Conduct Authority carried out its Financial Advice Market Review (FAMR), concluding that: **"Given the strong arguments against a commission-based system, such as the lack of transparency and distortion of incentives, FAMR does not believe there is a case to consider, and is therefore not recommending a return to commission-based financial advice."**²⁰

3.2 'Provisieverbod' in the Netherlands

Following several high-profile mis-selling cases, the Dutch government implemented a series of reforms to tackle problems in the financial advice market. In 2009, the government implemented a cap on commissions, limiting how much commission a financial intermediary could receive. Deciding that this proved insufficient to mitigate against conflicts of interests, a ban was finally implemented in 2013 for a range of financial services products, including insurance, mortgages, complex savings products, and investment funds. In January 2014, the ban was extended to all other forms of retail investment products.²¹ At the end of 2014, the Dutch Authority for Financial Markets (AFM) drew its first lessons from the inducement ban, witnessing that the ban had led to an increased sensitivity of distributors to product quality:

*"Previously, [distributors] were keen to negotiate the most favorable distribution inducement, or retrocession. Indeed, the biggest distributors typically could extract higher inducements from asset managers than their smaller competitors. Since the inducement ban, necessarily distributors are trying to optimize their revenues in other ways. They are now **focusing more on their customers**, experimenting to find that mix of service concepts that **best serves their customers' needs**. Part and parcel of this new strategy are efficient as well as high quality investment funds. As we hear from the industry, **this has fundamentally changed the discussions between asset managers and distributors.**"*²²

The ban also increased competition between product manufacturers, according to the Dutch AFM. The increased sensitivity of distributors to product quality following the commission ban drove competition in the Dutch market, in turn leading to lower prices for consumers:

*"Another impression is that with the introduction of the inducement ban, **competition between product manufacturers has increased**. This can be seen in the fact that some manufacturers have **started to reduce prices**, especially in the passive product segment. A number of manufacturers have reduced their prices by roughly 50%."*

Intermediaries in the Netherlands are offering a larger variety of investment products to consumers:

*"We increasingly see that distributors in the Netherlands are choosing to offer passive funds to clients. Our impression is that distributors find it easier to offer passive products to clients, because for the first time, **passive and active funds are competing with each other on equal terms**. Prior to the [commission ban], this was not the case, because **active funds secured distribution through commission fees, whereas***

²⁰ FAMR

²¹ Cover Magazine, 'Banning protection commissions ` the Netherlands experience', <https://www.covermagazine.co.uk/cover/feature/2333037/banning-protection-commissions-the-netherlands-experience>.

²² Speech by Theodor Kockelhoren, Board member of the Netherlands Authority for Financial Markets (AFM), at a conference of the European Money and Finance Forum SUERF in Madrid in 2014, <https://www.afm.nl/en/nieuws/2014/nov/speech-tk-ban-inducements>.

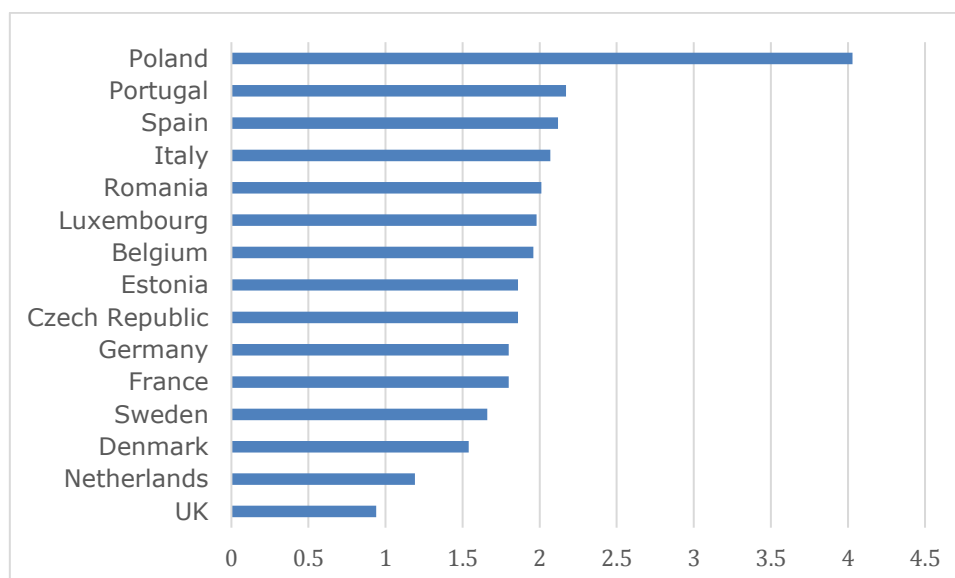
passive funds generally did not pay commission fees to distributors. *The share of passive funds held by retail investors has as a result increased considerably, from 8% in 2011 to 16% in 2014. Our impression is that as a result of such developments, **the costs for investors are also decreasing...***²³

In 2018, the Dutch government carried out a full review of the commission ban. The review found that the ban on commissions was effective and that the quality of advice had improved following its entry into force. In a letter²⁴ to the Dutch Parliament, Finance Minister Wopke Hoekstra wrote that the steering towards specific products and/or providers due to inducements ended following the ban, and that the quality of advice improved. Following the review, the Dutch government firmly committed to maintaining the ban in place.

3.3 European Commission Retail Distribution Study

A study carried out on behalf of the European Commission also shows that retail investors in countries with a commission ban in place have access to investment products with the lowest ongoing charges. The study assessed how retail investment products are sold to consumers across 15 European countries, including the UK and the Netherlands. The study found that fees vary significantly between EU Member States, and that costs can in certain cases remain prohibitively high for retail investors. For instance, in Poland, the average ongoing charge for **investing into an equity fund is about four times higher** compared to the investment funds offered to retail investors in the UK and the Netherlands. Indeed, among the Member States in scope of the study, distributors in the Netherlands and the UK appeared to present the lowest ongoing charges for all types of funds.

The study found that in the UK and the Netherlands, individual investors were systematically redirected by their banks and insurers to independent financial advisors and distributors presenting the lowest ongoing charges for all types of funds. The median ongoing charges for equity funds in the Netherlands (1.10%) and the United Kingdom (0.94%) are the lowest among the countries in scope:



²³ Speech by AFM member to Dutch Association of Insurers (translated by BEUC). Theodor Kockelhoren, 'Eerste indrukken van het provisieverbod: 'so far so good', <https://www.afm.nl/~/profmedia/files/lezingen/2014/speech-tk-provisieverbod.pdf>.

²⁴ Rijksoverheid, 'Kamerbrief evaluatie provisieverbod', <https://www.rijksoverheid.nl/documenten/kamerstukken/2018/01/23/kamerbrief-evaluatie-provisieverbod>.

4. Advice Gap?

Opponents of a commission ban say that consumers will not want to pay for advice, that the costs of advice will be too high, or that those without the resources or low incomes will be left with little to no access to advice, leading to a so-called 'advice gap'. However, the UK and Dutch evaluations show that the vast majority of consumers continue to be able to access advice, if they judge the costs and value of advice to be worth it.

Despite some concerns about a so-called advice gap, regulators and policymakers have not considered a return to commission-based financial advice, which would erode important consumer safeguards. **A majority of respondents who provided input to the UK's Financial Advice Market Review (FAMR) agreed that the "post-RDR adviser approach to charging produced good outcomes for consumers, and there was not a case for a return to the pre-RDR rules on charging structures."** While a small number of respondents to the FAMR called for a return to commission-based financial advice, "these were outweighed by the opposing view."²⁵

The vast majority of consumers in the UK and in NL continue to access advice

The UK and Dutch evaluations demonstrate that the vast majority of consumers are willing to explicitly pay for financial advice, if they judge it to be worth its price. An FCA study in the wake of RDR concluded that "there is little evidence that the availability of advice has reduced significantly, with the majority of advisers still willing and able to take on more clients." Similarly, the study found very little evidence that explicit adviser charges "led to significant numbers of consumers no longer being willing to pay for advice." Moreover, the study identified no concerns among advisers "of customers unwilling to continue to receive advice due to cost."²⁶

A survey carried out as part of the UK's Financial Advice Market Review (FAMR) found that the main reason for not taking advice "was not having a need for it, or deciding to make decisions on their own, rather than any explicit issues with accessibility." Indeed, evidence as part of the FAMR found that of consumers seeking financial advice, only 9% were concerned that they would not be able to afford to pay the adviser's charges, and only 0.5% said that they were unable to find an adviser willing or able to offer them advice. Similarly, in the Netherlands, consumers are willing to pay for advice – with consumer research showing that only 2% considered costs as a barrier for taking out advice on a mortgage or a life insurance policy.²⁷

While there was an initial decline in adviser numbers in the UK following the commission ban (in part driven by higher professional standards for financial advisers introduced as part of the RDR, as well as other factors), there is evidence that the advice market is increasingly delivering the services needed by consumers. In 2019, the FCA published data²⁸ showing that:

²⁵ FCA, 'Financial Advice Market Review – Final Report', <https://www.fca.org.uk/publication/corporate/famr-final-report.pdf>.

²⁶ Europe Economics, 'Retail Distribution Review: post-Implementation Review', <https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf>.

²⁷ CentERdata, 'Consumentenonderzoek in het kader van de evaluatie van het provisieverbod', <https://www.tweedekamer.nl/downloads/document?id=d5ae9a58-85ba-41b5-ac23-88aaf0f87b04&title=Consumenten%20en%20financieel%20advies.%20Consumentenonderzoek%20in%20het%20kader%20van%20de%20evaluatie%20van%20het%20provisieverbod.pdf>, p. 51.

²⁸ FCA, 'Evaluation of RDR and the FAMR – Call for input', <https://www.fca.org.uk/publication/call-for-input/call-for-input-evaluation-rdr-famr.pdf>, section 4.5.

- The reported **number of adviser staff at financial advisers' firms increased by 3% from 2016 to 2017**, reaching 26,311 staff members. The number of **intermediary firms increased from 4,970 in 2016 to 5,049** in 2017. With the number of firms steadily increasing in recent years by 10% since 2013.
- UK **financial advisers' revenue and profits have been increasing**, despite a fall in the revenue that they receive from commissions (firms in the UK continue to receive trail commissions for advice given to consumers prior to the RDR).
- There has been a statistically significant increase in the number of people taking regulated financial advice since 2017, with **an additional 1.3m people taking advice**. There was also **an increase in the use of guidance services, and automated-advice services**, to help with financial planning decisions.

UK and Dutch consumers are better able to judge the cost and value of advice, and decide whether to take it or not

The UK and Dutch evaluations reveal that by separating the cost of advice from the product, consumers are now better able to judge the cost of advice and make an informed decision whether to take it or not. In the past, it was not always clear to consumers that they were paying for advice, as the costs of advice were bundled with the cost of the investment product. Prior to the RDR, many consumers erroneously believed that advice was free of charge and did not understand the impact that commissions could have on their investment returns. According to research by Deloitte, **87 per cent of consumers assumed that advice was free prior to the RDR**, with the adviser incurring the cost of advice.²⁹

Advice can be expensive and is not always a cost-effective or appropriate option for consumers, particularly those seeking help in relation to smaller amounts of money, or with simpler needs (for instance, those with a smaller amount of money to invest or those saving for a rainy day fund). Clear pricing also creates the possibility for consumers to influence the supply of advisory services. If advice, as it looks today, is perceived by consumers to be too expensive for the value that it provides, there is an opportunity for other more cost-efficient models of advisory services to emerge, including new and more cost-effective digital solutions such as robo-advice. Our member Which? has called for the FCA to "focus on making it easier for industry to create new ways to give advice, without reducing consumer protection, as this should reduce costs significantly."³⁰ As part of the FAMR, the FCA has announced a series of steps to make advice more affordable and accessible for consumers.

UK consumers refrain from using professional advice because of a 'trust gap'

Consumer trust in the financial services industry was severely shaken in the wake of several mis-selling scandals in the UK, and it is clear that a history of issues in the financial sector and lack of trust continues to deter consumers from engaging with financial advice. The UK's FAMR identified a continuing lack of trust as one of the main barriers preventing consumers from seeking financial advice. Research carried out by our member Citizens Advice as part of the FAMR found that there is still a common misconception among consumers that "advisers might take commission," and that advice is not truly independent.³¹ The FAMR concludes that "it seems likely that it will take longer for

²⁹ Deloitte, 'Bridging the advice gap: delivering investment products in a post-RDR world', <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fs-rdr-bridging-the-advice-gap.pdf>.

³⁰ Which?, 'Should I get financial advice?', <https://conversation.which.co.uk/money/fca-ifas-financial-advice-pensions-mortgages-investments/>.

³¹ Citizens Advice, 'The Affordable Advice Gap', [https://www.citizensadvice.org.uk/Global/CitizensAdvice/Debt%20and%20Money%20Publications/AffordableAdviceGap%20\(5\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Debt%20and%20Money%20Publications/AffordableAdviceGap%20(5).pdf).

awareness of the changes introduced by the RDR to lead to higher levels of confidence in the industry.”

Consumers place ‘trust’ and ‘independence’ as important factors when dealing with their financial advisers, above and beyond the mere affordability of advice. Research by Citizens Advice shows that ‘trust’ (cited by 57%) and ‘independence’ (cited by 44%) in a financial adviser were the most important factors when seeking financial advice, with the affordability of advice only the third most important factor (by 28% of respondents). A survey carried out by the Central Bank of Ireland similarly found that **73% believed it was important for financial advisers to describe him- or herself as independent**, with **63% stating that they would prefer to choose an independent adviser**.³²

5. Conclusion

Improving advice for consumers when investing in capital markets is fundamental towards restoring trust in retail financial services. In this paper, we demonstrated that the current regulatory approach is not set to restore that trust in any near future without a real change in policy. The European Commission’s Mid-term Review of the Capital Markets Union Action Plan³³ acknowledged the need to increase the engagement of retail investors in capital markets and to ensure access to more cost-effective investment opportunities. This paper demonstrates that a commission ban would reduce conflicts of interests and encourage the distribution of more cost-effective investment products to consumers, while increasing competition between product manufacturers to the benefit of consumers.

In an ideal advice market, competition would create a downward pressure on the costs for end-consumers. However, today’s commission-based model works in the opposite direction, steering advice and distribution in favour of higher-cost investment products. This is a highly predictable outcome of a business model where the revenues of a financial adviser depend on recommending the most expensive products. Unlike in a competitive market, expensive and poor performing products are not eliminated, but continue to be sold with a wide margin. Financial advice today is too frequently influenced by the size of commissions paid by product manufacturers, instead of the needs of the consumer.

In order to remedy this, BEUC calls for:

- A **ban on commissions** for all retail investment products and complex financial products.
- For all other types of financial services (e.g. mortgage credit and consumer credit), a **limitation of commission-based remuneration to a product neutral model**, whereby monetary incentives are linked to the long-term performance of the financial product for the consumer and the consumers’ satisfaction levels.
- An **investigation into complementary services to financial advice**, such as independent guidance³⁴ to help consumers make better choices in retail finance.

³² Central Bank of Ireland, ‘Consumer understanding of commission payments’, <https://www.centralbank.ie/docs/default-source/publications/consumer-protection-research/consumer-understanding-of-commission-payments---november-2017.pdf?sfvrsn=2>.

³³ European Commission, ‘Communication of the Mid-Term Review of the Capital Markets Union Action Plan’, https://ec.europa.eu/info/sites/info/files/communication-cmu-mid-term-review-june2017_en.pdf, p. 17.

³⁴ BEUC, ‘Financial guidance: the missing tool!’, <https://www.beuc.eu/blog/financial-guidance-the-missing-tool/>

ANNEX: REGULATORY REFORMS WORLDWIDE IN RESPONSE TO CONFLICTED REMUNERATION

United Kingdom:

In June 2006, the UK Financial Services Authority (FSA, which became the Financial Conduct Authority in 2013) initiated the Retail Distribution Review – an in-depth review into the retail distribution of investment products. It identified a number of long-running problems affecting the quality of financial advice and consumer outcomes, as well as a lack of confidence and trust in the UK investment market. Following the review, the FSA recommended a ban on commissions for advised investment sales to retail investors. As of 1 January 2013, intermediaries can no longer receive commissions on retail investment products offered by product providers, and advisers can only be paid for their services by charging a separate fee to the retail clients. In 2016, the UK carried out a review of the commission ban and firmly committed to maintain the ban in place.

Netherlands:

Following a number of high-profile mis-selling cases in the Netherlands, the Dutch government implemented a series of reforms in order to tackle problems in the financial advice market for Dutch consumers. In 2009, the Dutch government implemented a cap on commissions, limiting how much commission a financial intermediary could receive for certain financial products. Finally, a ban was implemented in January 2013 for a range of financial services products, including insurance, mortgages, complex saving products, and investment funds. In January 2014, the ban was also extended to all other forms of retail investment products.³⁵ The Dutch government committed to maintaining its ban in place following an evaluation that was carried out in 2018.

Ireland:

In 2017, the Central Bank of Ireland carried out a survey on ‘*Consumer understanding of commission payments*’ in 2017, which revealed that 73% of consumers believe it is important for a financial adviser to describe himself as independent. With 63% of respondents stating a preference for choosing a financial adviser who described himself or herself as independent. In November 2017, the Central Bank of Ireland published a consultation paper on proposals to enhance the protections for consumers when seeking financial advice from financial intermediaries. Under the proposed rules, financial intermediaries would no longer be permitted to accept certain types of commission and inducements.

Under the proposed rules from the central bank, intermediaries would no longer be allowed to accept any inducements that could give rise to a potential conflict of interest. Inducements to be included under the ban include those that are: linked to targets based on sales volumes; the size of the mortgage loan; soft commissions; and those which could exert a bias on which product brokers recommend to their clients because those products offer a higher rate of commission. Financial intermediaries will be prevented from making any recommendations if the advisers accept different levels of inducements for the range of products that they offer. The Central Bank of Ireland is currently taking stock of responses to its consultation and is in the process of finalising its new measures on inducements.³⁶

³⁵ Cover Magazine, ‘Banning protection commissions – the Netherlands experience’, <https://www.covermagazine.co.uk/cover/feature/2333037/banning-protection-commissions-the-netherlands-experience/>.

³⁶ The Irish Times, ‘Fiona Reddan: Financial advisers slow to display fees and commission rates’, <https://www.irishtimes.com/business/personal-finance/fiona-reddan-financial-advisers-slow-to-display-fees-and-commission-rates-1.3791572>.

Australia:

In 2013, a ban on commissions entered into force as part of Australia's Future of Financial Advice (FoFA) reforms. The reforms banned commissions paid by product manufacturers to financial advisers when they give personal advice to retail clients. Advisers will instead be required to negotiate fees for advice directly with clients, and will only be allowed to charge an ongoing fee if the client receives an ongoing service. A number of products were excluded from the scope of the ban on conflicted remunerations to financial advisers, including certain life insurance and general insurance products. In 2018, the Royal Commission into Misconduct in Financial Services recommended for a review to be carried out to assess whether the ban should also be applied for such insurance products, or at the very least if the commissions for such products should be capped.³⁷ The Australian government also announced that it would carry out a review on the effectiveness of FoFA reforms, including the ban on commissions, by the end of 2022.³⁸

South Africa:

Following a number of mis-selling scandals, the South African government banned financial advisers from receiving any form of commissions payments for selling investment products. Under the new rules, intermediaries are prohibited from earning any form of remuneration in respect of investment products other than the advice fees agreed with the customer, similar to the reforms that were introduced in the United Kingdom under the FSA's Retail Distribution Review. The rules were implemented on 1 January 2017.³⁹ A number of exceptions will apply to investment products that are marketed to the low-income market. The regulator is currently consulting with industry in order to identify what types of investment products will be exempted from the regulation. As part of this consultation, the South African regulator is considering potential commission limits for investment products marketed to the low-income market.⁴⁰

India:

In October 2018, the Indian Securities and Exchange Board (Sebi) banned the payment of upfront commissions by mutual funds to distributors. Sebi argues that a ban on up-front commissions would "bring transparency in expenses, reduce portfolio churning and mis-selling in mutual fund schemes."⁴¹ Sebi decided to introduce the ban on up-front commissions following concerns that distributors were frequently moving customers from one fund scheme to another, in an attempt to seek the upfront commission: "Sebi has observed that such excessive commissions offered to distributors lead to migration of distributors from one asset management company to another and compel them to sell mutual fund schemes to customers merely with an intention to earn better commissions, without really assessing the customer's risk appetite."⁴² In India, fund houses frequently paid upfront commissions to distributors at rates as high as 6.5%, on top of the trail

³⁷ Australian Government, 'Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry', <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>, 185-186.

³⁸ Australian Government, 'Restoring trust in Australia's financial system', <https://static.treasury.gov.au/uploads/sites/1/2019/02/FSRC-Government-Response-1.pdf>.

³⁹ South Africa Financial Services Board, 'Retail Distribution Review 2014', <https://www.fsca.co.za/Regulatory%20Frameworks/Documents%20for%20Consultation/FSB%20Retail%20Distribution%20Review%202014.pdf>, p. 52.

⁴⁰ South Africa Financial Sector Conduct Authority, 'Retail Distribution Review', <https://www.fsca.co.za/Regulatory%20Frameworks/Temp/RDR%20status%20update%20-%20Proposal%20TT%20-%20December%202018.pdf>

⁴¹ Securities and Exchange Board of India, 'Total Expense Ratio (TER) and Performance Disclosure for Mutual Funds', https://www.sebi.gov.in/legal/circulars/oct-2018/total-expense-ratio-ter-and-performance-disclosure-for-mutual-funds_40766.html.

⁴² LiveMint, 'Sebi plans to cap mutual fund commissions to curb mis-selling', <https://www.livemint.com/Money/Q0qOWL8GkqIbBnCT5Vq6RN/Sebi-plans-to-cap-mutual-fund-commissions-to-curb-missellin.html>.

commissions that are paid on an annual basis to fund distributors. Under the new rules, mutual funds are no longer allowed to pay upfront commissions, however mutual funds remain permitted to pay trail commissions to fund distributors. Sebi also observed that a wide difference in commissions led to harmful competition among asset management companies and attracted distributors to only sell a certain set of mutual funds.

Sweden:

In 2015, the Swedish government established an inquiry in order to assess how MiFID II should be incorporated into Swedish law.⁴³ In February 2016, the Swedish Financial Supervisory Authority (*Finansinspektionen*) published a [report](#) as part of this inquiry, recommending to the Swedish government a full ban on the payment of commissions for financial advice. In issuing its report, *Finansinspektionen* wrote that advisers and intermediaries face “strong incentives to recommend products that generate the highest commission and not those that best suit the needs of the customer.”⁴⁴ *Finansinspektionen* also concluded in its report that a ban on commissions would lead to “simplified advisory services and an increased range of lower-fee products” for Swedish consumers. In 2016, despite *Finansinspektionen*’s recommendation, the Swedish government opted not to introduce a general ban on third-party commissions for financial advice.⁴⁵

Canada:

In 2017, the Canadian Securities Administrators (CSA) issued a consultation paper on banning embedded commissions, due to concerns related to conflicts of interest, limiting investor awareness of dealer compensation, and distorting incentives for dealers. The CSA argued that embedded commissions incentivises dealers to recommend funds that best compensate themselves, rather than those that are best for the client. The CSA cited evidence that commissions led to fund underperformance and higher retail prices for investment funds “due to a competition between investment fund managers to offer attractive commissions to secure distribution.”⁴⁶ According to the CSA, mutual fund fees in Canada are consistently among the highest in the world. Following heavy industry lobbying against the proposals, the CSA opted not to include a general ban on the payment of commissions.⁴⁷ The CSA did adopt prohibitions that would ban the payment of commissions to dealers who do not make a suitability determination, such as execution-only platforms.

⁴³ FT Adviser, ‘Sweden to ban adviser commission in line with MiFID II’, <https://www.ftadviser.com/2015/02/05/ifa-industry/sweden-to-ban-adviser-commission-in-line-with-mifid-ii-OUKKUtcbaFM4HgZsJdsckN/article.html>.

⁴⁴ Finansinspektion, ‘A necessary step for a better savings market’, https://www.fi.se/contentassets/2e823e1569864e69b8e9b052352cf2ed/battre_sparandemarknad_engny.pdf, p.3.

⁴⁵ Swedish Ministry of Finance, ‘Consumer protection in the field of financial advice should be strengthened’, <https://www.regeringen.se/pressmeddelanden/2016/05/konsumentskyddet-vid-finansiell-radgivning-ska-starkas/>.

⁴⁶ CSA, ‘Consultation on the option of discontinuing embedded commissions’, https://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20170110_81-408_consultation-discontinuing-embedded-commissions.htm.

⁴⁷ CSA, ‘Status Report on Consultation on Embedded Commissions and Next Steps’, https://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20180621_81-330-status-report.htm.

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