PRESS RELEASE

The EU Supervisor falls short of advising a complete ban on commissions for "retail" investment advisors

Brussels, 4 May 2020 - On 1 April 2020, the European Securities and Markets Authority (ESMA) published its advice on "inducements"[1] (and on the disclosure of costs and charges) under "MiFID II", one of the main EU investor protection directives up for review this year, pushing the issue off into the future by encouraging the European Commission (EC) to further deepen its assessment of the "inducements".

BETTER FINANCE would have hoped that ESMA had conducted its own investigations into the huge detriment caused by inducements, in particular in light of the overwhelming evidence that low-cost investment products such as - for example - index ETFs are simply not promoted or sold by commission-based "advisors". Estimates indicate that in the European Union (EU) individual investors only hold a roughly 10% share of the ETF market compared to nearly 50% in the US. BETTER FINANCE has repeatedly drawn attention to the devastating impact of these conflicts of interest on the selection of investment funds and "units" by intermediaries and the damage this inflicts on the performances of long-term and pension savings.[2]

In addition, MiFID II rules on "inducements" de facto exempt "closed architecture" or "vertically integrated" providers of retail financial products, since they are not compensated through commissions but mostly sell, and provide advice on, in-house products, regardless of whether these are the best-suited to their clients' needs. Since such practices do not involve commissions or other inducements (other incentives are at work here), "closed architecture" networks are not subject to any of the MiFID II rules on inducements. Repeated warnings about this major conflict of interest by BETTER FINANCE had so far fallen on deaf ears.

BETTER FINANCE is therefore happy that ESMA does now share this concern in its advice and, notes that "*it could be made clear that firms, even if operating in closed-architecture models, should assess their products against third-party products and should provide details in the suitability report of any cheaper and less complex alternatives*".

In order to adapt a ban on "inducements" to "closed architecture" networks, ESMA puts forward three options:

- The first option of *"[investing] in financial education to make retail investors aware and conscious of the importance of independent fee-based advice*" does not address the fact that incentives for stakeholders to invest time and money in such an education are lacking.
- The second option of *"[providing] details in the suitability report of any cheaper and less complex alternatives"* definitely has merit but would need to be very clearly disclosed in writing and easily accessible in all pre-contractual information.
- The third option of imposing the inducement criterion of "quality enhancement" on "closed architecture" networks would only have a very limited impact in our view, as it is very difficult

[1] "Inducements" is the unclear legal term used in EU Law to designate advantages (essentially commissions) paid by providers to distributors for the sale of certain of their investment products.
[2] BETTER FINANCE Research Report "Pension Savings – The Real Return", 2019 Edition

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to assess. The more important - and easier to assess - requirement for allowing inducements in MiFID II (that they do "*not impair compliance with the firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients*") is once again overlooked by the European supervisor (as it is by most national ones). Otherwise, how come EU citizens are still sold (and "advised") index funds that are six to ten times more expensive than their ETF equivalents, despite numerous complaints from savers associations for more than a decade?

For Guillaume Prache, Managing Director of BETTER FINANCE, "*EU Investor Protection Law relies on a damaging confusion between advice and sale: "inducements" (mostly sales commissions) have never compensated any advice, they are compensating only the sale of specific products: no sale of such products means no compensation, whether it is an "advised" sale or not*."

BETTER FINANCE asks for a full ban on inducements, not only for investment products within the MIFID II scope (mainly investment funds, which represent only about 8% of the financial savings of households), but for all other "retail" investment products such as "IBIPs" (insurance-based investment products) and personal pension products, which taken together are five times larger. There already is massive regulatory arbitrage because of this serious and damaging inconsistency in EU investor protection rules.

If industry lobbies once again prove too powerful for EU Authorities to make a full ban on inducements happen - even though authorities in the UK and in the Netherlands were able to achieve this - we ask, at the very least, that:

a. the existing specific bans in MIFID II are extended to all substitutable investment products to ensure consistent investor protection across all "retail" investment products and end regulatory arbitrage, by extending the existing ban on inducements for independent advisors and for portfolio management also to IBIPs and personal pensions (therefore amending the Insurance Distribution Directive): ESMA does indeed agree that similar investment products should have the same inducement rules;
b. the existing ban is extended to "execution only" transactions where, by definition, there is no "advice" to be compensated, like it was done by Canada: there is no ground for maintaining commissions for such transactions;
c. current barriers to independent advice are removed (independent advisors must be able to easily access "clean chare classes" of funds and not be charged, by depositaries or fund platforms, the maximum entry fees (which are not required by - and for - the fund managers).

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