BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

PRESS RELEASE

Recent "Unofficial" Reports Paid for by Investment Industry Players Push Misleading Findings and Conclusions in Defence of Kickbacks

BETTER FINANCE finds that commission-based distribution models cost individual investors up to 15% of their investments in sales commissions and generate conflicts of interest which severely hurt their performance.

3 February 2022 – One of the main objectives of the European Commission's "*EU Strategy for Retail Investors*" is to "*ensure bias-free advice*" for individual investors. It is meeting with considerable resistance from many players of the financial industry, as evidenced by a recent report and the ongoing "smoke and mirrors" campaign to counter the EC's efforts. It befits BETTER FINANCE then, through its own independent research, to clearly demonstrate how the commission-based distribution model is damaging net returns for individual investors.

The reports have been discreetly circulated to public authorities as part of a large lobbying campaign by several industry associations in the four largest EU economies, to pre-empt EU policymakers from putting a proposal to ensure bias-free advice on the table. Surprise, surprise, no organisations representing independent advisors or other anti-kickback investment firms were included or even surveyed.

This recent industry-sponsored report bears severe weaknesses indeed:

A report that looked only at 9% of retail financial savings | It covers only about 9% of EU households' financial savings, excluding the largest retail investment product category, i.e., life insurance and pensions (34% of financial savings). The report omits to highlight that in many Member States retail funds are mostly marketed via insurance- or pension-based vehicles.

Confusing sales commissions with "payments for advice" | This report and other industry campaigns argue that "inducements" (commissions paid by providers of investment products to distributors) are payments remunerating "advice". This is quite far from the truth: they are **sales** commissions, or kickbacks, as evidenced by the egregious fact that "execution only" investments (i.e., sold without any "advice") nevertheless bear the same commissions as "advised" ones. Vice versa, an "advisor" who will advise a product but not sell it to the client will get zero commissions.

Omitting any analysis of the selection bias induced by the sales commissions | The main effect of this sales model is that distributors will promote, push and select investment products for which they get commissions, and the higher the better. For example, our evidence report proves that cheaper "clean share" classes of funds and low-cost index funds are almost never offered or sold on the main French retail funds market.

A fortiori omitting an analysis on the damaging impact of this conflict of interest on the net returns for individual investors | Using the same example (62% of the French retail fund market), the funds offered and sold by the distributors badly underperformed the "clean share" class funds and the index funds, and, by an even larger margin, their investment universe.

Omitting the issue of high and opaque sales commissions | The sales commission model tends to promote products with higher costs, those that embed high sales commissions (for example, the

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average ongoing annual cost for equity retail funds in the main French market, excluding entry fees, is reaching 2.88%).

In fact, the cheapest investment funds in Europe were sold in those countries (UK and NL) where inducements have been banned since 2012 and 2014 respectively and where investors have become "*more cost-sensitive and better informed*".[1]

Unfounded claims of an advice gap for the less wealthy | The report states that *"where inducements have been banned, no investment advice is provided to retail investors with assets under €100,000"* and that *"the inducements ban has shrunk the access to investment advice for mass retail clients"*.

There is no evidence to support the claim that less wealthy investors do not have access to investment advice. On the contrary, in the United Kingdom, following the inducements ban, an additional 1 million UK consumers accessed advice in 2020 compared to 2017. The "advice gap" for the less wealthy also failed to materialise in the Netherlands, where data from the supervisory authority (AFM) indicates a 43% increase in the use of independent financial advisors between 2014 (when the ban became effective) and the end of 2020.

Guillaume Prache, Managing Director of BETTER FINANCE, adds: *"What's more is that sales commissions are much higher than they seem. For example, a recent report from a Public Authority found that asset-based sales commissions were on average about 0,70% annually for the French personal pensions. However, these commissions are charged every year as long as the product is held by the pension savers, i.e., typically for 20 years or more. In reality, consequently, the average sales commission soar to 15% or more of pension savers' contributions, and that's without even counting other sales commissions like entry fees."*

Policy recommendations towards bias-free advice | At a minimum, the European Commission should endorse the priority recommendations issued by its own "High Level Forum on the Capital markets Union" in 2020:

- End the massive regulatory arbitrage by extending the MiFID provisions on conflicts of interests (regarding independent advice and portfolio management) – which mostly just apply to investment funds sold without wrappers - to all other (and much larger) categories of packaged retail investment products (such as insurance- and pension-based savings) by harmonising the provisions of the EU rules for other retail investment products.
- Put an end to the shocking "inducements" charged on "execution only" transactions.

The recent EC proposal to ban payments for retail listed securities order flows is hopefully a good sign that it now intends to walk the talk towards ensuring "*bias-free advice*".

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See Overview Table and Infographic below:

[1] Already in 2018, the EC itself stated that the ban on inducements in the Netherlands and the UK caused a shift in investor behaviour: *"Generally, local investors have become more cost-sensitive and better informed about investment products"* - European Commission study on "Distribution systems of retail investment products across the European Union – Final Report", Page 118, https://ec.europa.eu/info/sites/default/files/180425-retail-investment-products-distribution-systems_en.pdf

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Serious Weaknesses of an Industry Report Defending the Kickback-based Distribution of Retail Investment Products and Opposing the EU Commission Proposal to Ensure Bias-free Advice

The report is paid for by that part of the industry that relies heavily on the commission-based distribution model, and …

… ignores the main part of retail investment savings (life-insurance & pensions).

… disguises sales commissions as "payments for advice".

… ignores the conflicts of interest generated by kickbacks & and their devastating impact on long-term returns.

… omits the issue of high & opaque sales commissions.

… doesn't mention the fact that the cheapest equity funds in Europe were sold in the Netherlands, where kickbacks are banned.

… makes misleading claims of limited access to advice for the less wealthy.

… presents general legal requirements as added value services provided specifically by commission-based advisors.

… misrepresents automated investment advice as non-regulated "client support".