Brussels, 28 November 2022

<u>Subject</u>: Upcoming Retail Investment Strategy: debunking the "advice gap"

Dear Vice-President Dombrovskis,

Dear Commissioners McGuinness and Reynders,

We are writing to you on behalf of BETTER FINANCE, BEUC and Finance Watch, as the principal civil society organisations working on financial consumer protection at the European level, to encourage you to continue with an ambitious approach with regards to the Retail Investment Strategy and the stated goal of creating bias-free advice.

<u>Inducements harm consumers:</u>

As you know, the inducements-based sale of financial products generates significant conflicts of interest, which are harming consumers on a massive scale.[1] It is therefore the reason why we would like to insist on the importance of banning this practice in the European Union.

Naturally, the debate around a ban on inducements turns the attention to the examples of such bans that have already been established, namely in the Netherlands and in the United Kingdom. We fully agree that these examples serve well to assess the possible effects of a ban on inducements in the EU and have therefore fielded them in the past.

As evidenced, for example, by a recent report commissioned by the European Commission[2], in these two European countries where inducements were banned, retail investors now have lower investment costs and better value for money. And we note with satisfaction, that this seems to be generally accepted now.

In most of the EU, inducement-based sales of financial products are the norm. Advice driven by inducements is not advice at all but merely a sales pitch, often resulting in a product being offered to a customer not because it provides value for money for the customer but because the sale of the product provides monetary benefits for the seller. Thus, the status quo effectively leaves EU consumers without independent advice as it stands. For example, BaFin (the German Federal Financial Supervisory Authority) lists only 17 independent advisors being registered in Germany, meaning that real financial advice is functionally unavailable to most consumers there.[3] Establishing a system of independent advice would only reduce this gap by making genuine advice available in the first place.

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[1] For more, see the Price of Bad Advice website: www.thepriceofbadadvice.eu as well as Misselling of Financial Products in the EU - Briefing Paper 2017 - BETTER FINANCE and EVIDENCE PAPER ON THE DETRIMENTAL EFFECTS OF "INDUCEMENTS" (betterfinance.eu) (2022).

[2] European Commission (2022), Disclosure, inducements, and suitability rules for retail investors, P. 294.

[3] https://portal.mvp.bafin.de/database/HABInfo/?locale=en_GB

The advice gap has been misrepresented:

Unfortunately, however, the introduction of the inducement ban in the UK and the Netherlands has been accompanied by a false narrative that the ban has resulted in an **"advice gap"**. As this argument goes, following the ban of inducements in the United Kingdom through the Retail Distribution Review (RDR), an increasing number of

consumers have become unwilling and/or unable to access financial advice because they could not, or would not, pay for financial advice directly – which, supposedly, has harmed their financial prospects.

This narrative is not correct, and we would like to clarify the matter in this letter.

The UK's Financial Conduct Authority (FCA) established the term "advice gap," to describe consumers who may have needed financial advice in a given year but didn't take any – regardless of the reason(s)[4]. With respect to this, the FCA also studied and reported the reasons. The most common reasons for not taking advice were that the consumer did not want or need advice, did not consider the possibility, or made a deliberate choice to make independent decisions.

Amongst the responses regarding advice, the most common reason quoted to avoid advice was a lack of trust in the quality of advice (11%) and a lack of trust in financial advisors themselves (9%),[5] both of which are likely a lingering result of previous mis-selling under the inducement system. Even reasons such as "I didn't get around to taking advice yet" (10%) ranked above any mention of cost in consumer responses (which only 9% fielded).

The FCA also found that trust in financial advisors was higher among those consumers taking financial advice in the years following the RDR than their peers which reflects the increased professionalism in financial advice.[6] The fact is that trust is a larger issue against taking advice than cost. This means that behaviourally, consumers should be more inclined to seek advice when it is trustworthy and is transparently priced than in the current, opposite situation.

Furthermore, the advice gap is sometimes also presented as a simple pricing-out issue for less affluent consumers. However, these concerns do not stand up to scrutiny. In an inducements-based system, consumers already pay for advice, even if these payments are hidden from them.

Correspondingly, there is very little evidence for the pricing-out problem existing other than anecdotally. In fact, financial advice for small investment volumes (below £10,000) is not just available to consumers but also the norm.[7]

Underperformance is endemic:

Finally, it is necessary to stress that the current inducement-based system leads to consumers being sold underperforming products. A current study by ESMA showed that the cost of retail products is systematically higher than equivalent products are for institutional investors, while a study on the French unit-linked market shows that inducements double the price of products.[8] In the ESMA study, the cost of a 10-year investment of EUR 10000 would have been more than 35% more expensive for a consumer than the same would have been for an Industry actor.[9]

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[4] FAMR (2016) Final Report, P. 6.
[5] FAMR (2017), Baseline Report, P. 10.
[6] FAMR (2016), Final Report, P. 23.
[7] FAMR (2017), Baseline Report, P. 19.
[8] Data from GoodValueforMoney.eu commissioned by FAIDER, a BETTER FINANCE member organisation from France – 2021 figures.
[9] ESMA (2022), Performance and Costs of EU Retail Investment Products, P.11.

We hope the information we provide above regarding the context of the advice gap debate will be helpful for your considerations. We must seize the opportunity presented to us by the Retail Investment Strategy review to improve the situation of consumers in the retail investment market.

We are of course at the disposal of your services; in case they would like to discuss any of the issues mentioned above or receive any further details on it.

Yours sincerely,

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Monique Goyens
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